July 8, 2013

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Email: rule-comments@sec.gov

Re: Regulation Systems Compliance and Integrity – Proposed rule and form; proposed rule amendment; File No. S7-01-13

Ladies and Gentlemen,

Liquidnet, Inc. appreciates the opportunity to comment on the Securities and Exchange Commission's proposed Regulation Systems Compliance and Integrity (Regulation SCI).[1] Liquidnet supports the approach proposed by the Securities and Exchange Commission (the Commission), subject to the following comments, discussed in more detail below:

- Regulation SCI should apply equitably across market participants, including market makers, high-frequency trading firms and other broker-dealers.
- Certain defined terms should be further clarified consistent with the stated intent of the rule proposal.
- A security and controls framework for the industry should be established by a committee consisting of regulators, industry participants and security and controls experts.
- We suggest alternatives to the Commission's proposals relating to testing with customers.

Background on Liquidnet

Liquidnet provides a system used by institutional investors worldwide to negotiate block trades directly with other system participants. Institutions that use Liquidnet reduce their trading costs by avoiding the market impact costs that result when institutional block orders are exposed to high-frequency traders and other short-term traders in the market. Cost savings achieved by institutional investors using Liquidnet are passed on to the hundreds of millions of individual investors globally on whose behalf our clients trade, resulting in reduced trading costs and higher investment returns for these individual investors.

Analysis by Intelligent Financial Systems Limited (IFSL), a UK-based firm that specializes in execution cost analysis for European equities, demonstrates the value of Liquidnet for long-

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[1] Securities and Exchange Commission, "Regulation Systems Compliance and Integrity," Release No. 34-69077, File No. S7-01-13, March 8, 2013, http://www.sec.gov/rules/proposed/2013/34-69606.pdf (accessed July 5, 2013).

term investors. In its March 2013 report, IFSL computes that Liquidnet provides 106.64 basis points of savings on average relative to execution on an exchange market.[2] The report further shows that Liquidnet Europe's average execution size for March 2013 was €811,163, resulting in Liquidnet saving each side (the buyer and the seller) €8,650, or the equivalent of $11,089, on average, for each trade executed on Liquidnet.[3] These cost savings are passed on directly to the individual long-term investors that are the beneficiaries of the accounts managed by our institutional clients.

The savings of 106.64 basis points on each trade is particularly significant in relation to our commission, which is eight basis points or less for the major European jurisdictions.

Because Liquidnet is not an attributed market in the U.S., similar data for the U.S. is not available, but we can assume similar results because we provide similar functionality in the U.S. and Europe. Last week, Abel/Noser Solutions, a firm that provides broker-neutral pre-trade, real-time and post-trade tools to institutional investors, issued a press release announcing that Liquidnet ranked first for Best Global and Best North American Brokerage Firm. The press release further reports that Liquidnet ranked first for the second year in a row.[4]

In addition to reduced market impact, Liquidnet provides significant price improvement. In the U.S., Liquidnet provided price improvement of 96.58% for the first half of 2013, relative to the industry average of 10.17% over the same period.[5] This means that for the first half of 2013 Liquidnet provided a level of price improvement that was more than nine times greater than the industry average.

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Regulation SCI should apply equitably across market participants, including market makers, high-frequency trading firms and other broker-dealers

The objectives of Regulation SCI would be more readily achieved by applying Regulation SCI to market makers, high-frequency trading firms (HFT) and other broker-dealers. These firms arguably provide lower market impact costs savings and less price improvement than a system like Liquidnet. At the same time, the activities of these firms can present systemic risk to the market, as evidenced by the flash crash (May 6, 2010), the Knight Capital computer malfunction (August 1, 2012) and the hash crash (April 23, 2013). Accordingly, obligations imposed pursuant

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[2] Intelligent Financial Systems Limited, "LiquidMetrix Guide to European Dark Pools," March 2013. The summary page of the report is enclosed with this letter.
[3] Based on a conversion rate of USD/EUR = 1.282, as of July 5, 2013, http://www.bloomberg.com/markets/currencies/currency-converter/ (accessed July 5, 2013).
[4] "Abel/Noser Solutions Ranks World's Best Brokerage Firms," July 1, 2013, http://www.marketwatch.com/story/abelnoser-solutions-ranks-worlds-best-brokerage-firms-2013-07-01 (accessed July 5, 2013).
[5] Rule 605 data compiled by Thomson Transaction Analytics Reports. Data is for January through June of calendar year 2013.

to Regulation SCI should apply not only to exchanges and ATSs, but also to market makers, HFT firms and other broker-dealers that are participants of an exchange or ATS, taking into account the potential risks to the market that each type of participant presents.

Certain defined terms should be further clarified consistent with the stated intent of the rule proposal

We recommend further clarification of several of the defined terms, as follows:

- ***SCI systems.*** This term should be more specifically focused on those systems where the unavailability or malfunction of the system could reasonably be expected to result in significant harm or loss to participants of the system generally or impact the operation of fair and orderly markets. Further, while we believe that Regulation SCI should apply to different categories of trading firms, as a matter of equity, if the only trading entities to which Regulation SCI is to apply are exchanges and ATSs, the concept of SCI System should be limited to exchange and ATS systems operated by an SCI entity and should not include, for example, brokerage systems operated by an SCI entity.

- ***Material system changes.*** Consistent with the objectives of the rule proposal, this term should be more specifically targeted at systems changes that, if not properly implemented, could reasonably be expected to result in significant harm or loss to participants of a system generally or impact the operation of fair and orderly markets.

- ***Systems compliance issue.*** This term should similarly be focused on issues that could reasonably be expected to result in significant harm or loss to participants of a market generally or impact the operation of fair and orderly markets. For example, as presently drafted, a systems compliance issue could include an error in OATS reporting.

- ***Responsible SCI personnel.*** It should be clarified that this refers to the relevant supervisory personnel for the system as designated by the firm.

A security and controls framework for the industry should be established by a committee consisting of regulators, industry participants and security and controls experts

Liquidnet agrees with the approach of requiring SCI entities to comply with security and controls standards. As an alternative to the specific standards referenced in the Regulation SCI proposal, we recommend that a working group consisting of regulators, industry participants (from exchanges, ATSs and broker-dealers) and security and controls experts be established to develop a security and controls framework for the industry. This framework should not dictate specific development, testing, implementation and support methodologies, but instead should identify the required elements for a comprehensive development, testing, implementation and support program.

Over the past number of years, firms in the technology and finance industries have implemented various approaches to improve the efficiency and reliability of the software development process, including methodologies such as scrum, context-driven testing, and test-driven development. It is important that firms can take advantage of the most current information and research to guide their development practices, including published books on software development practices, published proceedings of software development conferences, and online and print publications of non-profit organizations that are dedicated to advancing the practice of software development, including the Scrum Alliance, the Association for Software Testing (AST), the Institute of Electrical and Electronics Engineers (IEEE), and the Association for Computing Machinery (ACM).

Alternatives to the Commission's proposals relating to testing with customers

Liquidnet currently conducts testing with our buy-side customers on a bilateral basis, as agreed between Liquidnet and each customer. However, we are not in a position to mandate testing by our customers, as they are not under a legal obligation to participate in such testing. We would support an obligation for SCI entities to participate in testing as reasonably requested by a customer. We also would support an obligation for SCI entities that are members of an exchange, and all broker participants of an exchange, to participate in testing as reasonably required by an exchange.

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We appreciate the opportunity to comment on the proposed Regulation SCI.

Very truly yours,

Howard Meyerson
General Counsel

LiquidMetrix Guide to European Dark Pools – March 2013

Key Points

- This guide contains information on the following dark pools: BATS Europe Dark, BlockMatch™, Chi-Delta, Liquidnet, Nordic@Mid, POSIT, Turquoise Dark, UBS MTF.
- We analyse every trade executed on these venues comparing the price achieved to full depth lit liquidity on European trading venues.
- Based on this analysis we can quantify price improvement, EVBBO outliers and a range of other execution quality statistics for each dark pool.
- For each dark pool we also provide some general information such as market model used, stock coverage.

Overview

During March 2013 a total value of **EUR 32.64bn** was traded on the Dark Pools included in this guide.
Some brief statistics:
- Overall an average price improvement of **14.19 BPS** representing **EUR 46.33m** was achieved by dark pool participants compared to a strategy of sending aggressive orders to the best lit venue.
- Although all venues price off the midpoint of the primary market, well over **99%** of dark pool trades executed were also within consolidated EVBBO.

Trade sizes on some venues were of a size that meant the trades could not have been executed on any lit venue (% illiquid on lit).

	BATS Dark	BlockMatch	Chi-Delta	Liquidnet	Nordic@Mid	POSIT	Turquoise Dark	UBS MTF
% Illiquid on Lit	0.06%	0.32%	0.05%	70.80%	0.36%	18.89%	0.28%	0.06%
% inside EVBBO*	99.62%	99.98%	99.71%	99.98%	99.92%	99.73%	99.62%	99.70%
% outside EVBBO*	0.38%	0.02%	0.29%	0.02%	0.08%	0.27%	0.38%	0.30%
% at EBBO Mid*	52.94%	26.20%	55.36%	69.59%	76.23%	52.97%	48.04%	30.20%
Arbitrage v MTF	0.003 BPS	0.000 BPS	0.002 BPS	0.000 BPS	0.000 BPS	0.001 BPS	0.004 BPS	0.004 BPS
Avg Onbook Spread	8.42 BPS	8.99 BPS	8.83 BPS	213.28 BPS	16.13 BPS	36.60 BPS	10.70 BPS	7.48 BPS
Avg Improvement	4.21 BPS	4.49 BPS	4.41 BPS	106.64 BPS	8.07 BPS	18.30 BPS	5.35 BPS	3.74 BPS
Worst Case Spread Capture ***	30.41%	31.57%	32.38%	40.11%	42.38%	33.28%	24.99%	16.75%
Value Traded	€ 5,251 m	€ 3,245 m	€ 6,128m	€ 2,579 m	€82m	€ 4,245 m	€ 2,923 m	€ 8,186 m
No of trades	780,969	365,531	950,241	3,179	7,497	253,759	415,718	1,001,947
Avg Trade Size	€ 6,724	€ 8,878	€ 6,449	€811,163	€10,939	€ 16,729	€7,031	€ 8,170
Instruments Traded	1,289	1,325	1,307	720	210	1,393	1,336	1,505
(Avg p.d)	(853)	(651)	(902)	(86)	(65)	(621)	(865)	(959)
Eff Instruments	71.1	74.8	80.0	52.4	20.4	85.8	83.1	72.6
(Avg p.d)	(52.8)	(45.6)	(59.1)	(13.6)	(7.5)	(32.90)	(50.3)	(48.7)
Fees	0.15 BPS 0.05BPS (self cross)	n/a	0.30 BPS 0.15 BPS (non IOC/ FOK)	n/a	n/a	n/a	0.30 BPS	0.10 BPS
Cleared / Counterparty	Yes CCP=Multiple	No Bilateral	Yes CCP=Multiple	Bilateral/ CCP=SIXx-clear	CCP/ Bilateral	n/a n/a	Yes CCP=Multiple	Yes CCP=Multiple

*Based on value traded
** Based on midpoint reported trades only, not accounting for maker - taker fee/rebate.
*** For dark pools that include bid/offer matches, this statistic is not relevant, see Methodology.