citigroup
corporate and
investment banking

May 17, 2006

VIA EMAIL
Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Re: Nasdaq Filing Relating to Nasdaq Market Center (SR-NASDAQ-2006-001, as amended by Amendment No. 1), and Nasdaq Order Delivery Fee Proposal (SR-NASD-2006-048)

Dear Ms. Morris:

Citigroup Global Markets Inc. and its affiliate OnTrade, Inc.[1] (together, "Citigroup") is pleased to respond to the rule proposals by The Nasdaq Stock Market, Inc. ("Nasdaq") that, among other things, would 1) eliminate its order-delivery function and require participating Electronic Communication Networks ("ECNs") to accept only auto-executions (SR-NASDAQ-2006-001, as amended by Amendment No. 1, the "Auto-Execution Proposal"), and 2) would shift fees Nasdaq currently charges market participants in the Nasdaq Market Center onto order-delivery ECNs (SR-NASD-2006-048, the "Order Delivery Fee Proposal" and collectively with the Auto-Execution Proposal, the "Proposals"). Citigroup believes that the Proposals will hinder the ability of ECNs to operate within the Nasdaq Market Center, and therefore urges the Commission not to approve the Proposals until a truly viable alternative to the Nasdaq Market Center is established, as set out below.[2]

Both Proposals would provide strong disincentives for ECNs to participate in the Nasdaq Market Center. The Auto-Execution Proposal would force ECNs to accept auto-executions, which could cause a "race condition", resulting in duplicate executions. Because ECNs are not capitalized for principal trades, duplicate executions could cause economic hardship. Unlike market makers and block positioners, ECN's are typically agency-only entities. As such, ECNs

[1] On January 11, 2006, Citigroup acquired OnTrade, Inc. (formerly known as NexTrade ECN).

[2] We note that an earlier proposal (SR-NASD-2005-013, the "Access Fee Proposal"), which is still pending before the Commission, would prohibit ECNs from charging access fees. We urge the Commission to abrogate the Access Fee Proposal if Nasdaq does not withdraw or otherwise amend it to remove the access fee prohibition.

are not prepared to conduct this type of activity, and they should not have to bear this economic risk just by displaying a quote in the Nasdaq Market Center. Under the Order Delivery Proposal, Nasdaq will shift fees from those accessing liquidity at the Nasdaq Market Center to ECNs, increasing the ECNs' operating costs while incurring no increase in their own operating costs. For these reasons, we believe that the Proposals should not be approved until the NASD's Alternative Display Facility ("ADF") develops into a feasible alternative to the Nasdaq Market Center, as described below.

Contrary to the assertions made by Nasdaq in the Auto-Execution Proposal,[3] participation in the Nasdaq Market Center is, in effect, *not* voluntary for ECNs wishing to offer their customers liquidity from one of only two remaining significant liquidity pools. In claiming that participation in the Nasdaq Market Center is voluntary, Nasdaq has previously asserted that ECNs have the alternative of posting their orders within NASD's ADF.[4] This assertion is misleading. While Citigroup fully supports efforts to develop ADF, the unfortunate reality is that ADF is not currently a viable alternative to the Nasdaq Market Center. There are several reasons why this is the case, including, but not limited to, the following:

- *Burdensome connectivity costs* – Connectivity costs are higher for ADF participants because they have to connect to each ECN separately or through a third party extranet source, as compared to the Nasdaq Market Center where each participant is automatically connected to each other through a single connection to Supermontage.

- *No ability to quote in exchange-listed securities other than Nasdaq securities* – Regulation NMS has spurred each of the 11 market centers with a protected quote to consider trading securities that are listed on another market. For example, Nasdaq has set forth its plans to trade NYSE-listed securities as part of phase two of its exchange status plan. If the ADF is limited to trading only Nasdaq securities, participants will migrate to a market that will allow them to trade all securities in one place, thus limiting ADF's usefulness even more.

- *Economic Disincentives* – Unlike any other market center, ADF currently charges rates for quote updates, and does not have a general revenue sharing plan, ultimately making it more expensive for ECNs to operate at ADF.

- *No ability to display sub-penny quotes to four decimal places for securities priced less than $1.00*

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[3] "Nasdaq states that. . . participation in the [Nasdaq Market Center] system in whole or part is completely voluntary," Auto-Execution Proposal, p. 19596.

[4] "Indeed, many ECNs that once posted orders within Nasdaq have since elected to move voluntarily their activities to different trading venues not operated by Nasdaq, including.. .the NASD's Alternative Trading [sic] Facility ("ADF"). Indeed, the creation of the ADF was approved by the Commission specifically to provide such freedom to market participants." (Letter from Thomas Moran, Associate General Counsel, Nasdaq to Jonathan Katz, Secretary, Commission, dated August 5, 2005.)

- *Inadequate Order Protection* - The ADF does not provide an aggregate top-of-the-book quote that would be protected in accordance with the Order Protection Rule; individual ECNs are therefore disadvantaged because they are not part of an aggregate top-of-the book as they would be in any other market center.

Numerous commenters have also elaborated on the shortcomings of ADF.[5] The fact that ADF is not a voluntary alternative to the Nasdaq Market Center is further borne out by the disparity in daily trading volume on ADF versus the total daily trading volume of Nasdaq-quoted securities: "As reported on Bloomberg, daily volume on the ADF averages around fifteen million shares out of a total daily volume in Nasdaq-quoted securities of approximately 1.7 billion shares."[6]

The Commission itself has also recently indicated that ADF is not a viable alternative to the Nasdaq Market Center; referring to comments received in response to the Nasdaq application for registration as an exchange, the Commission noted in its conditional approval of the application:

> . . .[one] commenter believed that the Commission should withhold approval of Nasdaq's exchange registration until a viable NASD quotation display and trade reporting facility is in place because, without such a facility, market makers and electronic communications networks would essentially be mandated to become a member of the Nasdaq Exchange to meet their regulatory obligations. . .[another] commenter believed that Nasdaq's exchange application could not be reconciled with the requirements of the Exchange Act until after the NASD has in place operational facilities to permit OTC trading to continue to flourish in the U.S. The Commission agrees with these commenters. . .[7]

Citigroup stands ready to work with the NASD and the industry in efforts to improve ADF in order for it to become a viable alternative to the Nasdaq Market Center. However, for

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[5] See, e.g., Letter from Jon Kroeper, First Vice President, Instinet Corporation to Jonathan Katz, Secretary, Commission, dated July 1, 2002, responding to SR-NASD-2001-90 (NASD's proposed separation from Nasdaq and the establishment of ADF); Letter from William O'Brien, Senior Vice President and General Counsel, Brut, LLC to Annette Nazareth, Director of Market Regulation Division, Commission, dated August 5, 2002, responding to SR-NASD-2002-97 (order granting approval on a pilot basis to operation of ADF (the "ADF Proposal")); Letter from John Schaible, President, NexTrade Holdings, Inc., to Jonathan Katz, Secretary, Commission, dated August 20, 2002, responding to the ADF Proposal; Letter from Mark Shefts, President, Domestic Securities Inc., to Jonathan Katz, Secretary, Commission, dated August 21, 2002, responding to the ADF Proposal.

[6] Letter from representatives from Bloomberg Tradebook LLC, Bats Trading, Inc. Direct Edge ECN LLC, and Track ECN to Robert L.D. Colby, Esq., Acting Director, Division of Market Regulation, Commission, dated March 21, 2006, (pg. 5, ftnote 3).

[7] Commission, In the Matter of the Application of The Nasdaq Stock Market LLC for Registration as a National Securities Exchange, Release No. 34-53128, January 13, 2006, pgs. 57-58 (referring to comments from the Securities Industry Association and Instinet).

the time being, given ADF's shortcomings, participation in the Nasdaq Market Center is not voluntary in any meaningful sense. Both from the perspective of an ECN and a broker-dealer, Citigroup believes that the Proposals will reduce liquidity to the detriment of the market, and are directly inconsistent with the goal of increasing competition the Commission sought when promulgating Regulation NMS. We therefore believe that the Proposals should not be approved until a viable alternative to the Nasdaq Market Center is in place.

We appreciate the opportunity to respond to the Proposal. Please contact me at 212.723.4921 if you have any questions.

Sincerely,

CTR

C. Thomas Richardson
Managing Director

cc:

The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Cynthia A. Glassman, Commissioner
The Hon. Roel C. Campos, Commissioner
The Hon. Annette L. Nazareth, Commissioner
Robert L. D. Colby, Esq., Acting Director, Division of Market Regulation

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