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SEC EXEMPTS LIQUIDNET FROM CERTAIN PROVISIONS OF REGULATION ATS

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19232] October 7, 2005 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 36-05 RE: SEC EXEMPTS LIQUIDNET FROM CERTAIN PROVISIONS OF REGULATION ATS The SEC has conditionally exempted Liquidnet from certain provisions of Regulation ATS, as recently amended in connection with the adoption of Regulation NMS.¹ The most significant aspects of the exemption are summarized below. In connection with the adoption of Regulation NMS, Regulation ATS' "Fair Access Rule" was amended to lower the fair access threshold from 20% of the average daily volume in a security to 5%.² In its exemption request, Liquidnet argued that it operates in a manner similar to a broker-dealer that operates a traditional block trading desk, which generally would not be subject to the Fair Access Rule. In addition, Liquidnet noted that it does not display quotations and does not maintain a "book" that is accessible by its membership. Liquidnet therefore requested an exemption from the Fair Access Rule that would permit it to apply its access standards in a manner that might be unfair or discriminatory, thereby preserving its ability to deny access to subscribers or potential subscribers whose trading strategies, in its view, could cause institutional customers to abandon the Liquidnet system. In granting the exemption, the Release notes that the order display and execution access requirement applies only to the best priced "orders" displayed to more than one person in an ATS. Liquidnet, however, does not display orders through its system to more than one person. Instead, Liquidnet surveys subscribers' order management systems, identifies potential contra- side interest, and provides an electronic platform through which subscribers may negotiate trades on an anonymous, one-to-one basis. The Release also notes that an unintended consequence of lowering the fair access threshold is that an ATS such as Liquidnet, whose business model depends on preserving subscribers' confidence that information about their trading interest will not leak outside the system, could lose the ability to deny access to those who would leak such information. ¹ Securities Exchange Act Release No. 52514 (September 27, 2005) ("Release"). The Release can be found on the SEC's website at <http://www.sec.gov/rules/exorders/34-52514.pdf>. ² The Fair Access Rule is designed to ensure that market participants have fair access to services offered by an ATS that has a significant percentage of a security's trading volume. The fair access threshold was lowered in connection with Regulation NMS to improve the fairness and efficiency of private linkages and facilitate the incorporation of large ATSs into the national market system. ² Finally, the Release notes that granting Liquidnet limited exemptive relief should accommodate a forum in which large institutional investors can negotiate trades in a manner that limits their market impact costs, yet should not impede the functioning of the national market system. In particular, since Liquidnet does not disseminate quotations,

applying the new 5% fair access threshold to Liquidnet would not further the SEC's primary policy goal in lowering the threshold, i.e., facilitating indirect access to the quotes of ATSS that are displaying them in the public quote stream. Ari Burstein Associate Counsel

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