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January 8, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington DC 20549-0609

Re: **File No. S7-23-03 Proposed Regulation SHO**
Release No. 34-48709 (Oct. 28, 2003), 68FT 62972 (Nov. 6, 2003)

Dear Mr. Katz:

Bernard L. Madoff Investment Securities L.L.C. (Madoff) is pleased to comment on the Securities and Exchange Commission's proposal regarding short sales, Regulation SHO. Madoff has been engaged in market making activities for over forty years as a registered market maker in Nasdaq for both Nasdaq and exchange-listed securities as well as a Designated Dealer on the National Stock Exchange (formerly the Cincinnati Stock Exchange). This has provided us with vast experience related to the operations of the National Market System (NMS) and in particular with SEC Rule 10a-1 and NASD Rule 3350.

Madoff makes regular and continuous two sided markets in over 600 of the most active NYSE listed securities (including the S&P 500) and over 200 of the most active Nasdaq NMS securities. In each of these securities, Madoff offers to our broker dealer and institutional clients liquidity guarantees for market and marketable limit orders. These guarantees are provided at the National Best Bid or Offer (NBBO) with opportunities for price improvement. In addition, we handle all types of non-marketable limit orders, where we provide our clients with both price protection and print protection.

Competition between markets has been the hallmark of our National Market System since its inception following the enactment of the 1975 Amendments. While Congress envisioned linkages among the various markets comprising the National Market System, advances in communications technology since its establishment have still not overcome many political obstacles. One of the residual effects has been fragmentation. To deal with this, market participants have developed their own trading systems that complement the less than perfect ITS system. This enables them to provide immediate liquidity at the prevailing NBBO or better to satisfy their clients' orders, thereby providing "best execution" not only with respect to price, but also with respect to timeliness. The ability of specialists and competing market makers to provide their clients a "better" execution has led to a market that is highly liquid, with extremely low execution costs, as defined by narrowing spreads and declining commission rates. It is critical that we preserve an environment that will allow this competitive spirit to continue. Customers have grown to expect that all of their orders, regardless of type, will be given such timely and competitively priced executions.

Request To Preserve Exemption to Passively Protect Customer Buy Orders

Every registered market maker and specialist today accepts and holds non-marketable limit orders for their clients. These orders are governed by the requirements of the SEC Order Handling Rules (OHR). Although these orders help define the NBBO when displayed, there are no assurances that they will receive an immediate execution from other competing market centers. That is most often left to the abilities of the market maker or specialist who, upon accepting such orders, must now provide competitive executions in the handling of those orders. While the order exposure requirements in the OHR provide a baseline for transparency (requiring the individual market maker or specialist to publicly represent the order), participants must also competitively decide on the necessary immediacy and liquidity to be applied to that order as demanded by the activity taking place elsewhere in the National Market System and reported to the Consolidated Tape.

This has long been accomplished by the competitively healthy practice known as **"print protection"**, whereby market makers and specialists can ensure that their clients' orders are protected and provided with a timely execution at a price equivalent to executions taking place anywhere in the National Market System. Providing such print protection is an integral part of every specialist and market makers' daily operations, and is a competitive necessity within the National Market System framework. Furthermore, from a purely regulatory and fiduciary perspective, the ability to provide effective print protection for such limit orders is often a critical factor in how a client defines and measures "best execution".

The enhanced liquidity necessary to provide such print protection to protect clients' limit orders against activity that takes place in other market centers comes directly from a specialist or market maker's willingness to assume proprietary risk. That is, he or she must be willing to respond to demands for liquidity out of its own inventory. The market maker or specialist accepts the risk necessary to assure satisfaction of the client's limit order irrespective of its inventory position.

The execution of a client's limit order should not be dependent on activity taking place solely on the market where their order resides. All trading activity in the National Market System should be considered. To strip market makers and specialists of the flexibility of providing a timely execution based on consolidated activity across all markets severely limits competition among market centers and can only serve to erode the concept of a truly "National" Market System.

Historically, this flexibility has long been available to market makers and specialists by virtue of exemptive provisions under both SEC Rule 10a-1 and NASD 3350. This has allowed such participants to sell short out of their inventory at a price that would otherwise be prohibited under the various short sale rules. It is critical to note that these are "passive" exemptions, invoked only in response to a customer's "buy" order, and even then only in response to similar priced activity in the National Market System. It is these exemptions that allow market makers and specialists to provide their rightful and beneficial role in the marketplace – to provide liquidity when demanded and maintain fair and orderly markets.

In order for registered market makers and specialists to continue effectively in these roles and to provide competitive and fiduciary services for their clients' orders, Regulation SHO would need to provide similar "passive" short sale exemptions.

The following represents several specific examples of situations in which registered market makers and specialists would need to avail themselves of an exemption from Regulation SHO based on specific price related activity in the NMS. In each of these instances the registered market maker or specialist is assumed to have a flat position in the security in question and is in possession of previously non-marketable limit orders delivered to them by their clients in their market making or specialist capacity:

Example 1

NBBO in KO: 50 x 50.01

a) Customer enters order to buy 1,000 KO @ 50.
b) Market maker represents customer order in its NASDAQ Intermarket quote.
c) Trading activity is reported @ 50 in NYSE and the NMS

Based on the activity in the primary market and the related activity in the NMS, the customer could be entitled to a fill on his limit order. In order to give the customer an execution the market maker would need to sell short 1,000 shares as principal, at a price equal to the bid. This would require an exemption from the proposed Rule SHO

Example 2

NBBO in INTC: 30 x 30.01

a) Customer enters an order to buy 11,000 INTC @ 30.
b) The order is a block as defined by the OHR, and the market maker is not required to represent it in his quote but chooses to represent 5,000 shares in his NASDAQ quote in order to protect the customer.
c) Market maker buys 5,000 @ 30 through SuperMontage.

The customer is entitled to a minimum of 5,000 shares @ 30 as per Manning. The market maker feels he owes his customer additional shares @ 30 based on activity reported on the consolidated tape. This would require an exemption from the proposed Rule SHO.

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Example 3

NBBO in MRK: 45 x 45.01

a) Customer A enters an order to buy 500 shares @ 44.99
b) Specialist is representing this specific order in its NSX quote.
c) Customer B enters an order to buy 1000 shares @ 44.98
d) Specialist is not representing this order in its quote, as provided by the Order Handling Rule, but is obligated to protect it as a fiduciary.
e) A print for 3,000 shares @ 44.98 is reported on the NYSE (the primary market)

Current ITS rules would only provide a "potential" execution for Customer A's order by the NYSE specialist as provided for in the ITS Plan's "Trade Through Rule". This is a cumbersome process that may not result in an execution at all, let alone a "timely" one. The execution of Customer B's order would be solely the responsibility of the NSX specialist who may wish to provide a competitive execution of Customer B's order @ 44.98. The NSX specialist could not meet his fiduciary and competitive responsibilities to either Customer A or Customer B without an exemption from the proposed Rule SHO.

In all of the above examples, registered market makers and specialists were engaging in bona fide competitive market making activity in order to provide "best execution" to their customers' orders. The executions sought under our proposed "passive" exemption would have resulted in enhanced pricing and liquidity along with the speed and certainty that have become the benchmarks of our competitive National Market System. The requested limited exemptions for the short sale activity that were highlighted in these examples were driven by specific types of trading activity as defined by a truly transparent NMS. The market maker and specialist short sale activity was not prompted by any specific intention to drive the market for these securities down, but rather to passively respond on behalf of their customers, to related price discovery activity taking place in the marketplace. Market makers and specialists must be allowed to have these limited exemptions if they are to be able to continue to contribute to the strength and vitality of our National Market System.

We would be happy to discuss any of our comments with the Commission.

Sincerely yours,

Bernard L. Madoff

Peter B. Madoff

cc: William H. Donaldson
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