

**COPY**

Edward S. Knight  
Executive Vice President and General Counsel

November 14, 2001

Mr. Thomas Peterffy  
Chairman  
Timber Hill LLC  
1 Pickwick Plaza  
Greenwich, Connecticut 06830

**Re: IM 4613: Autoquoting Restriction**

Dear Mr. Peterffy:

This letter responds to your letter dated November 14, 2001, wherein you request confirmation that Timber Hill's automated quotation algorithm is consistent with NASD IM-4613, Nasdaq's policy prohibiting market makers from autoquoting, as that term is defined in IM 4613.

We understand the facts of your letter to be as follows:

Timber Hill is a technology-based market maker that, along with its affiliated companies, operates on over 40 exchanges and market centers in 16 countries worldwide. Timber Hill is registered with the Securities and Exchange Commission as a broker-dealer and is a member in good standing of the National Association of Securities Dealers, Chicago Board Options Exchange, American Stock Exchange, Philadelphia Stock Exchange, International Securities Exchange and Pacific Exchange. Timber Hill only engages in proprietary trading.

Timber Hill's affiliated company, Interactive Brokers LLC, is also a registered broker-dealer, and it engages exclusively in agency trading for customers. Interactive Brokers currently operates as a Nasdaq Order Entry Firm, and Timber Hill routes its orders to Nasdaq through Interactive Brokers.

On most exchanges and electronic communications networks ("ECNs") Timber Hill ordinarily generates its markets in a fully automated fashion through electronic systems that do not require any physical entry (such as a manual entry to these systems). Timber Hill's trading volume in Nasdaq securities on Nasdaq and through various ECNs is approximately 10 million shares per day.

Timber Hill's quotes are determined by a proprietary trading system that calculates and disseminates bids and offers bracketing the "most probable price" for the products Timber Hill trades based on several factors, such as the last sale, bids, offers and sizes, where available, on stocks, futures and options on which Timber Hill receives this information, and certain statistically derived relationships among these factors. These prices are then modified by Timber Hill's system's tendency to hedge exposure in the most cost efficient manner. Timber Hill's systems do not employ techniques that track changes to the inside market for the purpose of generating quotes to keep Timber Hill's prevailing quote away from the inside market.

Timber Hill's systems currently provide substantial liquidity in Nasdaq securities at ECNs, as illustrated by the fact that, on a recent randomly selected sample day's trading, Timber Hill was on at least one side of the inside market in the 280 Nasdaq issues that Timber Hill trades approximately 10.98% of the time. Timber Hill believes that as a Nasdaq market maker it could quote similarly on SuperSOES.

Timber Hill indicates that of the 280 Nasdaq issues it currently trades, it will select 20 stocks to begin quoting, and then expand that list. Timber Hill will select the initial 20 stocks after discussion with Nasdaq's technology staff and will expand that list in a manner that is consistent with Nasdaq's determination that a further increase in the number of stocks will not have a material adverse impact on Nasdaq's systems capacity.

Timber Hill notes that NASD IM-4613 sets out a general prohibition of autoquoting that Nasdaq deems necessary to offset the negative impact on the capacity and operation of Nasdaq by certain autoquote techniques that generate quotes to keep a market maker's quote away from the best market. Timber Hill further notes that since its system does not employ such techniques, Timber Hill does not believe that the express purpose of the Autoquote Policy would be applicable to Timber Hill's systems, and accordingly, Timber Hill seeks guidance with respect to the applicability of the policy. In particular, Timber Hill requests that before it employs its automated systems as a Nasdaq market maker, that Nasdaq confirm that its use (without any manual entries to the system) will not be deemed inconsistent with, or violative of the Nasdaq "Autoquote Policy" set out in NASD IM-4613.

### Response

NASD IM-4613 states that, with certain exceptions, Nasdaq market makers are prohibited from using systems that effect automated quote updates or track inside quotations in Nasdaq. The purpose of this restriction is to "offset the negative impact on the capacity and operation of Nasdaq of certain autoquote techniques that track changes to the inside quotation in Nasdaq and automatically react by generating another quote to keep the market maker's quote away from the best market." As your letter notes, Timber Hill's autoquote system does not employ techniques that track changes to the inside quotation in Nasdaq for the purpose of generating another quote to keep Timber Hill's prevailing quote away from the best market.

Therefore, on the basis of your representations and the facts presented, Nasdaq's Office of the General Counsel is of the belief that it would be consistent with NASD IM-4613 for Timber Hill, as a Nasdaq market maker, to quote automatically in the manner described in your letter as stated above, subject to the following conditions:

- (1) Timber Hill will trade as a Nasdaq market maker exclusively on a proprietary basis;
- (2) Timber Hill's automatic quoting algorithm is based on several factors, such as the last sale, bids, offers and sizes, where available, on stocks, futures and options on which Timber Hill receives this information, and certain statistically derived relationships among these factors;
- (3) Timber Hill's systems do not employ techniques that track quote changes to the inside market for the purpose of generating quotes to keep Timber Hill's prevailing quote away from the inside market;
- (4) Timber Hill is an established provider of proprietary liquidity in Nasdaq securities, currently through ECNs, as indicated by Timber Hill's presence at the inside on at least one side in excess of 10 percent of the time on a recent sample day;
- (5) Timber Hill will phase in its trading as a Nasdaq market maker starting with 20 Nasdaq securities that it will select in coordination with Nasdaq staff and will expand that number in a manner designed to help ensure that Timber Hill's quoting activity does not have a material adverse impact on Nasdaq's systems capacity; and
- (6) Timber Hill will quote in a manner consistent with the autoquoting restrictions set forth in Amendment 12 to the Nasdaq/UTP Plan, a copy of which is attached.

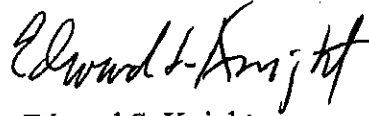
The foregoing interpretive relief is based solely on your representations and the facts that you have presented to the staff as well as Nasdaq's belief that providing Timber Hill with this interpretation will enhance market liquidity and serve the public interest. This interpretation is strictly limited to the application of NASD IM- 4613. In the event that any material change occurs with respect to any of those facts or representations as they relate to NASD IM-4613 you should immediately inform Nasdaq staff.

This interpretive relief is subject to modification or revocation if at any time Nasdaq determines that such action is necessary or appropriate in furtherance of applicable laws or NASD or Nasdaq rules. Moreover, this interpretation may be revoked or modified, if Nasdaq determines that Timber Hill's automated quotation practices are having a material adverse impact on Nasdaq's systems capacity.

The opinions expressed herein are staff opinions only and have not been reviewed or endorsed by the Board of Directors of Nasdaq or NASD Regulation, or the Board of Governors of the NASD. This letter responds only to the issues that you have raised, based on the facts as described, and does not address any other rule or interpretation of the NASD or Nasdaq, or other regulatory or legal issues.

If you have any questions, please feel free to call me at 202-728-8212.

Sincerely,



Edward S. Knight

Attachment