

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT

20050000341-01

TO: Department of Market Regulation
NASD

RE: BRUT, LLC, Respondent,
Broker-Dealer
CRD No. 7270

Pursuant to Rule 9216 of the NASD Code of Procedure, BRUT, LLC ("BRUT" or the "firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against BRUT alleging violations based on the same factual findings.

BRUT understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Market Regulation and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs, pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against BRUT; and
3. If accepted:
 - a. this AWC will become part of BRUT's permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against BRUT;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about BRUT's disciplinary record;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. BRUT may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any allegation in this AWC or create the impression that the AWC is without factual basis. Nothing in this

provision affects BRUT's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

BRUT also understands that its experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

BRUT has been a member of NASD since October 29, 1976 and its registration remains effective. BRUT has the following relevant disciplinary history:

- On April 23, 2004, an AWC became final pursuant to which BRUT was fined \$5,000 for violating SEC Rule 11Ac1-5 by publishing a report regarding the execution of orders in National Market System securities in which the firm incorrectly classified some of its orders.
- On January 16, 2004, an AWC became final pursuant to which BRUT was fined \$5,000 for violating NASD Marketplace Rule 6330, NASD Conduct Rule 3320 and SEC Rule 11Ac1-1 by failing to honor its published quotation for securities in which the firm was a market maker.

I.

WAIVER OF PROCEDURAL RIGHTS

BRUT specifically and voluntarily waives the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against BRUT;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, BRUT specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

BRUT further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

II.

ACCEPTANCE AND CONSENT

The staff of NASD's Department of Market Regulation ("staff") has conducted examinations and investigations of BRUT regarding the firm's monthly reports on order execution produced pursuant to SEC Rule 11Ac1-5 [now Rule 605 under Regulation NMS] ("execution reports"). In connection with these investigations and examinations, the staff reviewed BRUT's supervisory systems and written supervisory procedures regarding SEC Rule 11Ac1-5. The staff has also conducted Trading and Market Maker Surveillance Examinations ("TMMS Exams") and several other reviews of BRUT in the following areas: Order Audit Trail System ("OATS") reporting, trade throughs, locking and crossing markets, the publication and honoring of quotations, and related supervision.¹

- A. BRUT hereby accepts and consents, without admitting or denying the allegations or findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NASD:

(1) Execution Reports (SEC Rule 11Ac1-5/Rule 605 of Regulation NMS)

BRUT published monthly execution reports beginning with a report for October 2001. The execution reports published by BRUT from that initial time period until July 2005 contained reporting errors stemming from two flaws in the firm's calculation of reported data relating to reserve size orders and partial executions.

BRUT provided subscribers the ability to enter orders that included a "reserve size component." BRUT's treatment of reserve size orders did not include the full size of each such order in its execution reports. Instead, after each portion of a reserve size order was executed, the newly displayed portion of the original order was counted as another order on

¹ This matter thus includes two main components, conduct relating to SEC Rule 11Ac1-5/Regulation NMS Rule 605 and supervision thereof (the "execution reports" component), and conduct relating to the regulatory areas of TMMS Exams, OATS, trade throughs, locking and crossing, the publication and honoring of quotations and supervision thereof (the "quality of markets" component). The execution reports component includes review 20050006299. The quality of markets component encompasses the following reviews: 20042000126, 20042000232, 20042000237, 20050000341, 20050000521, 20050000776, 20050002077, 20050002141, 20050009835, 20050009862, 20050017847, 20050018122, 20050022356, 20050024203, 20050024648 and 20060039442.

BRUT's execution reports. The incorrect treatment of reserve size orders impacted BRUT's reported order size, reduced the order execution time, and increased the number of covered orders.

In 2005, BRUT also experienced other problems with its monthly reporting of the firm's order execution statistics. First, the publications of reports for January, April and July 2005 were late. In addition, BRUT determined that its January 2005 report was incomplete as originally published. Finally, the firm's staff identified a duplication of data for its October 2005 report.

Some errors may have resulted in certain execution quality statistics appearing to be better than was actually the case. Other errors may have resulted in other execution quality statistics appearing to be worse or better than was actually the case. The accuracy of BRUT's execution reports could be particularly important to market participants due to the percentage of Nasdaq volume executed on BRUT. For the time period October 2001 through July 2005, BRUT accounted for between 1.7 percent (in October 2001) and 13.9 percent (in April 2005) of the monthly trading volume on Nasdaq.

(2) Quality of Markets Reviews

(i) Firm Quotations

During the period April 29, 2004 through October 6, 2004, BRUT was a registered market maker in certain Exchange Traded Funds ("ETFs"). In 2920 specific instances, an order was presented to BRUT as a market maker at BRUT's published bid or published offer in an amount up to its published quotation size. BRUT failed to execute these orders upon presentment and thereby failed to honor its published quotation.

During the period January 1, 2005 through March 31, 2005, BRUT was a registered market maker in certain securities. In 23 specific instances, an order was presented to BRUT as a market maker at BRUT's published bid or published offer in an amount up to its published quotation size. BRUT failed to execute these orders upon presentment and thereby failed to honor its published quotation.

During the period April 1, 2005 through June 30, 2005, BRUT was a registered market maker in certain securities. In 274 specific instances, an order was presented to BRUT as a market maker at BRUT's published bid or published offer in an amount up to its published quotation size. BRUT failed to execute these orders upon presentment and thereby failed to honor its published quotation.

(ii) Two-Sided Quote Compliance

During the period April 1, 2003 through June 30, 2003, BRUT, an ITS/CAES market maker, failed to maintain a continuous two-sided quotation in the absence of an excused withdrawal or a functional excused withdrawal on 33 occasions.

During the period January 1, 2004 through September 30, 2004, BRUT, an ITS/CAES market maker, failed to maintain a continuous two-sided quotation in the absence of an excused withdrawal or a functional excused withdrawal on 40 occasions.

During the period April 1, 2005 through June 30, 2005, BRUT, an ITS/CAES market maker, failed to maintain a continuous two-sided quotation in the absence of an excused withdrawal or a functional excused withdrawal on 46 occasions.

(iii) Trade-Throughs

During the period April 1, 2004 through June 30, 2004, BRUT, an ITS/CAES Market Maker, purchased or sold an ITS/CAES security in 39 instances, whether in a principal capacity or as an agent, at a price that was lower than the bid or higher than the offer displayed from an ITS Participant Exchange or ITS/CAES Market Maker.

During the period April 1, 2005 through June 30, 2005, BRUT, an ITS/CAES Market Maker, purchased or sold an ITS/CAES security in 30 instances, whether in a principal capacity or as an agent, at a price that was lower than the bid or higher than the offer displayed from an ITS Participant Exchange or ITS/CAES Market Maker.

(iv) Locking/Crossing the Market

During the period March 17, 2004 through July 2, 2004, BRUT, an ITS/CAES market maker, without making reasonable efforts to avoid a locked or crossed market by executing transactions with all market makers whose quotations would be locked or crossed, entered a bid or asked quotation which caused a locked or crossed market condition to occur in 51 instances.

(v) OATS

Examinations and reviews of BRUT's compliance with OATS rules between October 2003 and June 2005 found several deficiencies in the firm's OATS reporting relating to certain systems issues. In the fourth quarter of 2003, the firm submitted over 300,000 reports that were rejected, but the firm did not repair 98 percent of the rejected orders. In the second quarter of 2004, over 2.1 million Route or Combined Order/Route Reports, or 100 percent of such reports submitted by the firm, contained inaccurate, incomplete or improperly formatted data such that the OATS system was unable to link the reports to related orders in

SuperMontage. In the first quarter of 2005, the firm submitted over 2.8 million reports that were rejected, but the firm did not timely repair 35 percent of the rejected orders. Between February and September 2005, the firm submitted over 143 million late reports to OATS. For much of 2005, the firm failed to submit Combined Order/Route or Combined Order/Execution reports. In the second quarter of 2005, over 1.1 million Route Reports, or 28 percent of such reports submitted by the firm, contained inaccurate, incomplete or improperly formatted data such that the OATS system was unable to link the reports to related orders submitted to OATS by other firms. Finally, samples of OATS reports submitted by BRUT for the firm's 2005 TMMS Exam indicated that for trade dates January 25 and 26, 2005 there were certain orders that were not submitted, duplicative reports, and reported capacity errors.

(3) Supervision

BRUT failed to adequately supervise the production of order execution reports described above. With regard to those order execution reports, BRUT failed to timely implement regulatory guidance that the firm had received from both the SEC and NASD staff as to the handling of reserve size orders, resulting in the publication of erroneous reports. BRUT also failed to adequately supervise the timely publication of order execution reports and accurate statistics and data.

At times between April 1, 2003 through June 30, 2005, BRUT's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to the applicable rules of NASD concerning OATS, firm quotes, the maintenance of continuous two-sided markets, trade throughs, and locked/crossed markets.

Finally, in connection with the publication of order execution reports, OATS and the "tick test" for short sales, although BRUT's written supervisory procedures were adequate, the firm failed to provide documentation to demonstrate that supervisory reviews were actually conducted.

(4) Retention of Records

In responding to certain inquiries made during the course of the staff's review, BRUT discovered and reported to the staff that certain emails created before November 2004 had not been retained in accordance with SEC Rule 17a-4.

Conclusion

The conduct described above constitutes violations of SEC Rule 11 Ac1-1 (now Rule 602 under Regulation NMS); SEC Rule 11 Ac1-5 (now Rule 605 under Regulation NMS); SEC Rule 17a-4; NASD Marketplace Rules Rule 4613(b), 5220(e), 5262, 5263(c)(1)(A), 6955(a); and NASD Conduct Rules 2110, 3010 and 3320.

The staff acknowledges that during the course of its review, BRUT independently undertook a comprehensive review of all of its order types for compliance with SEC Rule 11Ac1-5. The sanctions set forth below reflect the credit that BRUT has been given for such action.

B. BRUT also consents to the imposition, at a maximum, of the following sanctions:

A censure, a fine of \$2.2 million and an undertaking to revise the firm's written supervisory procedures with respect to the areas described in paragraph II.A.(3) above. Within 30 business days of acceptance of this AWC by the NAC, a registered principal of the Respondent firm shall submit to the **COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850**, a signed, dated letter, providing the following information: (1) a reference to this matter; (2) a representation that the firm has revised its written supervisory procedures to address the deficiencies described in paragraph II.A.(3) above; and (3) the date on which such revised written supervisory procedures were implemented.

The sanctions imposed herein shall be effective on a date set by NASD staff.

III.

OTHER MATTERS

- A. BRUT understands that BRUT may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. BRUT understands that BRUT may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.
- B. BRUT agrees to pay any monetary sanctions imposed on BRUT upon notice that this AWC has been accepted and that such payments are due and payable and has attached an Election of Payment form showing the method by which BRUT proposes to pay any fine imposed.
- C. BRUT specifically and voluntarily waives any right to claim that BRUT is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

BRUT certifies that BRUT has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce BRUT to submit it.

JUNE 28, 2006
Date

Respondent
BRUT, LLC

By: Brian K. Hyndman
Name: Brian K. Hyndman
Title: Vice Pres.

Reviewed by:

Mary M. Dumbauld
Counsel for Respondent

Accepted by NASD:

7/25/06
Date

Thomas R. Gira
Thomas R. Gira
Executive Vice President and Deputy
Department of Market Regulation
Signed on behalf of the Director of
ODA, by delegated authority