



Electronic Transaction Clearing, Inc.

February 5, 2009

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

(sent via [rules-comments@sec.gov](mailto:rules-comments@sec.gov))

Re: File Number SR-NASDAQ-2008-104 – Proposed Rule Change to Adopt a Modified Sponsored Access Rule

Dear Ms. Murphy:

Electronic Transaction Clearing, Inc. ("ETC") as a member of The Nasdaq Stock Market LLC ("Nasdaq" or "Exchange") appreciates the opportunity to comment on the recent proposed rule change filed by Nasdaq with the Securities and Exchange Commission ("Commission") on December 30, 2008, subsequently amended on January 8, 2009, and published by the Commission for comment on January 22, 2009.

#### Overview

In its submission, Nasdaq cites the purpose for the proposed rule change as, "to ensure that member firms that are assuming responsibility for their customer's trading activity have effective financial and regulatory oversight of the Sponsored Participant, and that Nasdaq has access to all information necessary to provide effective exchange oversight."

In order to reach its stated objective, Nasdaq proposes to (a) redefine "Sponsored Access" to include two areas that have not been traditionally considered "sponsored access," and (b) to impose additional requirements on Sponsoring Member firms, Sponsored Participants, and non-member third parties and service bureaus.

It is our assertion that Nasdaq "Sponsored Access" rules, in their current form, in conjunction with existing securities law, already comply with Nasdaq's stated purpose of the proposed rule change. Given the increased requirements placed on the Sponsoring Member firms, Sponsored Participants, and non-member third parties and service bureaus, we believe Nasdaq should offer a rationale which warrants and supports the need for the additional requirements set forth in the proposal, or provide an explanation for why the existing rules are inadequate.

In its proposal, Nasdaq has submitted two new definitions for "Sponsored Access" which are ambiguous, and dependent upon the intended meaning and application, could have far reaching implications. In addition, the new definitions themselves are contradictory to the premise and concept behind sponsored access.

The proposed rules, as written, impose unnecessary and burdensome requirements on non-member service bureaus and third party access providers. They also subject Sponsoring Member firms to the unreasonable standards of **ensuring** the integrity of their sponsored participants, as well as **preventing** the submission of erroneous orders; in essence, ensuring an error-free environment. In addition, the proposed rules require that Sponsoring Member firms institute systems which, in effect, render the practice of "sponsoring" moot.

Based on its submission, it is not immediately clear to us what Nasdaq is attempting to accomplish with the proposed rules that it could not with its existing rules. However, many of the proposed requirements appear to be outside the purview of Nasdaq, in that they infringe on the duties and responsibilities that customarily fall on a member firm's Designated Examining Authority ("DEA").

#### **Discussion**

Traditionally, "Sponsored Access" was relegated to what Nasdaq refers to in this proposal as "Direct Sponsored Access" whereby a "Sponsored Participant enters orders directly into Nasdaq via a dedicated port provided by the Sponsoring Member." Insofar as "Sponsored Access" is limited to this definition in the proposed rules, we are in agreement. The very purpose of Sponsored Access had to do with providing non-member access directly to Nasdaq through means other than through the member firm's systems and technology; hence sponsorship. To the extent that a non-member's (Sponsored Participant's) trading activity circumvents the Sponsoring Member's systems and technology, we agree that it is reasonable for the Exchange to expect that the member firm employ adequate methods to monitor that activity, and require that the member firm accept responsibility for the trades of the Sponsored Participant, as if the activity was entered through the Sponsoring Member's systems.

To the extent, however, that trade activity is sent to Nasdaq through the member firm's systems and technology, in any capacity, the member firm has the ability to interact with such activity and apply varying risk management measures, or any other treatment it deems appropriate in fulfilling its regulatory, financial, and risk responsibilities. This, historically, has never been construed as Sponsored Access. In fact, with exception of how the client enters orders into the member firm's systems, this activity is the same as if the member firm had entered the orders itself. To now define that activity as "Sponsored Access" is misplaced and opens the door to broader ramifications. As an example, depending on how one interprets the definition as proposed, a member firm that offers online trading to its client base would be bound by this definition. Is Nasdaq, therefore, suggesting that those firms should obtain Sponsored Access Agreements from all of its online retail clients; and subject itself and its clients to all the "Sponsored Access" requirements of the proposed rule? Recent studies indicate that the number of online trading accounts is in the tens of millions. If the proposed definition of

Sponsored Access is interpreted this way, we believe it would be unreasonable and impractical to assign such a burdensome process to a member firm and its clients, especially given that, by Nasdaq's own definition, the trade activity is passing through the member firm's systems and is thus already being filtered and surveilled prior to submission to Nasdaq.

Further, service bureaus and third party providers provide the brokerage industry with tools to facilitate a myriad of functions; ranging from back office accounting to front end order entry. Many member firms elect to enter into agreements with service bureaus and third party providers for these tools in lieu of developing their own proprietary technologies. For all intents and purposes these service bureau and third party provided systems have been historically accepted throughout the securities industry as the member firm's "systems." Therefore, to now define this activity as sponsored access is misapplied, and such application is not consistent with the industry at large. We contend that Nasdaq should not differentiate or place additional requirements on member firms which utilize service bureau or third party provided systems versus those that utilize proprietary systems. The requirements of the Sponsored Access rules are simply inapplicable in this case.

However, to the extent that a client of a member firm enters into agreements with service bureaus or third party providers, separate and apart from the member firm, then we agree that in those cases the Sponsored Access requirements may apply. We believe that Nasdaq should amend and restate its definition in the proposed rule in order to make this clarification.

Under the "Contractual Provisions" section in its rule filing, Nasdaq proposes to require that "a Sponsoring Member that provides Third Party Sponsored Access must execute and maintain agreements with each service bureau or other entity that facilitates such Third Party Sponsored Access providing that such entity will execute and maintain agreements with each Sponsored Participant containing the commitments below for the benefit of the Sponsoring Member." As referenced above, we contend that in the case where the member firm is utilizing service bureau and or third party provided systems, these systems should be considered a part of the member firm's "system." Setting that aside for a moment, it is important to note that most service bureaus and third party providers are purely non broker dealer technology companies. To require that these firms execute and maintain individual agreements with each of the Sponsored Participants of a member firm is not only unduly burdensome and redundant, but would be of no meaning or consequence given the fact that these firms do not fall under the jurisdiction of the Exchange nor any other securities industry regulatory body. In those cases where the service bureaus or third party providers are members of Nasdaq, they are already bound by the rules of the Exchange, including the Sponsored Access rules, thus invalidating any further need for sponsorship agreements between the two member firms.

Under the "Financial Controls" section of its rule filing, Nasdaq rightfully establishes the premise that "each Sponsoring Member shall establish **adequate procedures and controls** that permit it to **effectively monitor and control** the Sponsored Access to systemically limit the Sponsoring Member's financial exposure." [emphasis added]. However, the statement is immediately followed by language which states that the Sponsoring Member shall "**Prevent** each Sponsored Participant . . . from "entering orders that in aggregate exceed appropriate pre-set credit

thresholds . . . from trading products that the Sponsored Participant or Sponsoring Member is restricted from trading . . . from submitting erroneous orders." These requirements, of necessity, presuppose that a client's orders are in some way passing through the member firm's systems. As stated above, in cases where client orders pass through the member firm's systems it is not Sponsored Access. Given that the member firm has the ability to perform pre-trade risk management, there would be no additional inherent risk to Nasdaq than if the member firm had entered its clients orders itself. Therefore, to the extent that member firms have systems in place to "prevent" the submission of orders to Nasdaq, there is no need to deem this activity as Sponsored Access.

True Sponsored Access, on the other hand, on a pre-trade basis circumvents the member firm's systems and technology, and is by definition incongruous with the concept of "prevention." But what is important to note is, that it is not, however, incongruous with the concept of establishing adequate procedures and systems to effectively monitor and control the activities of Sponsored Participants. Member firms not only have the ability to monitor and control their client's trade activity in an effective way, mainly on a post-trade basis, but many have been doing so since the implementation of exchange sponsorship.

Also, while we would agree that it is reasonable and proper for Sponsoring Members to assume responsibility for the trades of their Sponsored Participants, it is not reasonable for Nasdaq to expect that a member firm can **ensure** that Sponsored Participants orders are always error free, or in compliance with all Regulatory Requirements. In the "Regulatory Control" section of the rule filing, member firms are expected to do just that.. While member firms can **ensure** that they will have adequate systems and procedures in place to monitor for any violations of applicable Regulatory Requirements, they cannot ensure, or guarantee the conduct, behavior or integrity of their clients, nor even ensure that they will catch all violations in all instances. For example, while a member firm has the ability to know whether a client is in violation of Regulation Sho on a post trade basis, it may not always know if a client is privy to certain information and engaged in insider trading. How then can a member firm be held accountable for **ensuring** that its clients are in compliance with all Regulatory Requirements? We doubt that neither the Exchange nor the Commission itself could offer similar assurances. A member firm can only ensure that it will have adequate procedures and controls to effectively monitor and control the activity of its Sponsored Participants.

Finally, it is our contention that portions of the proposed rules, though perhaps well intended, fall outside of the purview of Nasdaq. Specifically, as it pertains to sections B and E of the "Contractual Provisions" section, wherein Nasdaq is purporting to require the manner and form by which a member firm is to conduct its due diligence on, and oversight of its clients. While Nasdaq obviously maintains regulatory oversight of its member firms as it relates to the member firm's trading activity on the Exchange, that oversight does not generally extend to the trading activity occurring on other exchanges, nor does that oversight generally extend to the non exchange regulatory responsibilities of its member firms. In contrast this oversight does extend to the member firm's DEAs. Nasdaq elected not to serve as a DEA, but preferred instead to relegate this responsibility to other Self Regulatory Organizations that maintain DEA status. These DEAs, which bear this responsibility, have rules, in conjunction with existing securities

laws that adequately and effectively address a much broader scope of requirements, in light of the totality of a member firm's business operations, which cover, amongst other things what financial information or books and records are needed from clients. Therefore, these sections address issues that are already regulated by the member firm's DEAs, and as such are outside of the purview of Nasdaq and we believe should be removed from the submission.

### **Conclusion**

In summary, we support the process of amending and adding rules when necessary in order to protect the market place and the securities industry at large. However, it is imperative that rules be adequately and appropriately written such that the future application thereof is unambiguous and consistent with that which supports increased competition, increased efficiencies, and better protection for the Exchange, its member firms, and the trading public. We believe that sponsorship is a practice that has been good for adding efficiencies and liquidity to the market place. As stated above, it is our contention that the existing rules in connection with Sponsored Access have been sufficient, and already encompass the purpose stated in this rule filing. Nevertheless, to whatever extent Nasdaq may have encountered abuses as a result of inadequacies with the existing rules, we believe it should propose new language that addresses those inadequacies without imposing the onerous and burdensome requirements proposed in this rule filing, or rendering the entire sponsorship process moot.

We respectfully request that the Commission consider the above arguments and deny Nasdaq's rule filing in its current form.

Sincerely,



Harvey Cloyd  
Chief Executive Officer