

April 21, 2010

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

Re: File Number S7-02-10

Dear Ms. Murphy:

We are submitting this letter to the Securities and Exchange Commission (“SEC”) in response to your request for public comment on the Concept Release on Equity Market Structure<sup>1</sup> (“**Concept Release**”). ESP Technologies Corporation (“ESP”) is a post-trade technologies provider to buy-side institutions. We help money managers obtain best settlement as an element of best execution. ESP’s technologies improve the efficiency of the clearance and settlement system in accordance with Section 17A of the Securities and Exchange Act of 1934 (“**Exchange Act**”).

ESP, through its broker-dealer subsidiary, specializes in providing efficient post-trade processing services to money managers including allocation aggregation, fail management, and commission management services. ESP’s aggregation technology has demonstrated a 30% or more reduction in the number of custodial deliveries. This efficiency translates into significant cost savings for institutional investors. Transactions are cleared under fully disclosed arrangements with ESP’s broker-dealer partners.

The SEC’s Concept Release requested public comment on questions relating to the structure of the current equities market. This letter posits that money managers should include clearance and settlement costs as an important factor in their best execution analysis in order to enable institutional investors to (i) reduce their inflated clearance and settlement costs by aggregating fragmented trades; (ii) diversify their clearing counterparty risk; and (iii) obtain greater transparency into their transaction costs.

#### Impact of Current Market Structure on Money Managers and Institutional Investors

Institutional investors use money managers to advise them on long-term investment decisions. Money managers also buy and sell these securities on their behalf, and instruct executing brokers to deliver the resulting positions to the institutional investors’ custodial accounts. Examples of typical institutional investors include pension plans and insurance companies that provide capital on a long-term basis to listed companies and accept the risks associated with such ownership. The SEC has specifically requested comment on the fairness and performance of the current market structure from such institutional investors.<sup>2</sup>

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<sup>1</sup> Exchange Act Release No. 34-61358 (January 14, 2010) (“Concept Release”).

<sup>2</sup> Id. at text preceding Footnote 52.

We believe that greater market center competition within the current market structure provides institutional investors with better priced executions at lower costs. Greater market center competition, however, has resulted in and increase in clearance and settlement costs money managers fragment orders. These costs are often deducted by the custodian from the institutional investor's account. Money managers should instead be encouraged to (i) include settlement costs as an important factor in their best execution and transaction cost analysis, and (ii) adopt post-trade technologies that reduce settlement costs associated with fragmented trading.

Money managers generally send orders to multiple market centers in order to obtain best execution for their customers. Market competition has created a complicated structure in which money managers can access a web of brokers and markets and use them in any combination. The variety of execution tools available to money managers is a positive development as it allows them to negotiate the lowest execution rates possible.

The SEC must keep in mind that money managers must always fragment their orders across trading centers (i.e., broker internalization, dark pools, ATSS, etc.) in order to manage counterparty risk and information leakage. Even if there is a single execution platform, money managers will continue to fragment orders across market participants in order to achieve these other goals. This fragmentation will continue to cause the ongoing debate about market competition versus order interaction.

#### Inclusion of Post-Trade Costs in Best Execution and Transaction Cost Analysis

In guidance issued to investment company boards, the SEC noted that, as a part of best execution, the investment adviser has an obligation to “execute securities transactions for clients in such a manner that the client’s total costs or proceeds for each transaction is most favorable under the circumstances.”<sup>3</sup> The SEC cited its prior soft dollar interpretations as authority for this statement.

In its most recent soft dollar interpretation, the SEC adopted a temporal standard for brokerage that “begins when the money manager communicates with the broker-dealer for the purpose of transmitting an order for execution and ends when funds or securities are delivered or credited to the advised account or the account of the holder’s agent.”<sup>4</sup> Section 28(e) of the Exchange Act also includes functions related to the clearance, settlement and custody of securities transactions within the definition of “eligible brokerage”.

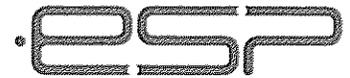
We believe that the SEC’s definition of brokerage as contained in the soft dollar releases should be applied by money managers in their best execution and transaction cost analysis. Specifically, the money manager should endeavor to reduce all costs and charges accrued during the SEC’s temporal definition of brokerage, such that the institutional investor pays the lowest aggregate amount possible per transaction.

Today, most money managers perform their best execution analysis by measuring the investor funds used to pay for the execution of transactions. We believe that the best execution analysis should include

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<sup>3</sup> Exchange Act Release No. 34-58264 at text preceding footnote 37 Quoting text from 1986 Release. (July 30, 2008).

<sup>4</sup> Exchange Act Release No. 34-54165 at text preceding Footnote 123 (July 18, 2006).



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the costs to investors associated with clearance and settlement of their transactions as well. These costs include custodial or prime broker charges for settling transactions as well as any fees associated with fails and counterparty risk. Money managers should focus on reducing clearance and settlement costs in order to reduce their clients' aggregate costs per transaction. This goal can be achieved by using post-trade technology that aggregates and thereby reduces an institutional investors' clearance and settlement costs.

Money managers that fragment orders across market centers to provide their customers with the best price may unwittingly cost those customers money through inflated clearance and settlement charges. A money manager may break up a large order across multiple brokers and markets to (i) prevent information leakage and market impact; (ii) access different pools of capital and liquidity; (iii) diversify risk; (iv) obtain research and other services; and (v) obtain superior pricing. Each market center or broker that receives a portion of this fragmented order must deliver the execution to the beneficial owner's custodian, so that an order fragmented across five markets will result in five separate deliveries resulting in five times the clearance and settlement costs that would otherwise apply. One article estimated that custodians charge from \$10 to \$25 for each settlement.<sup>5</sup> This means that the investor may have saved money by executing with multiple brokers but will pay \$125, rather than \$25, to settle the transaction. This increased transaction cost should clearly be a factor in the best execution analysis.

Money managers using aggregation technology can obtain the best price through market competition while avoiding the costs of fragmentation by reducing the settlement costs associated with multiple custodial deliveries. On a post-trade basis, the institutional investor saves money by consolidating or aggregating fragmented executions into one settlement delivery. Using the example above, the settlement cost paid by the institutional investor is reduced from \$125 to \$25. The institutional investor receives the best execution, which includes best settlement, by obtaining the best execution price available across market centers, and aggregating allocations to result in the settlement costs of a single execution.

We believe that the money managers must include the cost of clearance and settlement in their best execution and transaction cost analysis. When possible, money managers should employ aggregation technology to reduce the overall transaction costs paid by institutional investors.

### Managing Counterparty Risk in Today's Market Structure

In addition to the settlement cost savings, ESP's post-trade technology also provides money managers with the ability to manage their counterparty and fail risk. Unlike other aggregation solutions, we allow money managers to control their clearing counterparty risk by routing transactions to a broker-dealer in ESP's network with whom they choose to clear and settle. This capability provides money managers with information about the post-trade processes previously unavailable, including such as fail and commission management tools.

Money managers naturally fragment orders across brokers, and thus market venues, as a method of diversifying counterparty risk. Following the collapse of Lehman Brothers, it is increasingly more important for money managers to diversify the counterparty risk for their institutional investors. This

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<sup>5</sup> Chris Kentouris, *The Net Net of Institutional Netting: Does it Matter?*, Securities Industry News (October 26, 2009).

concern is heightened by lack of clarity around the question of whether delivery versus payment or receipt versus payment (“DVP/RVP”) accounts are protected under SIPA remains unanswered.

Under the current market structure, institutional transactions clear and settle using DVP/RVP. The institutional investor is exposed to market risk against the clearing firm until the DVP/RVP settles on T+3. However, we have found that some money managers believe their transactions are guaranteed after midnight of T+1 through the NSCC’s CNS system.

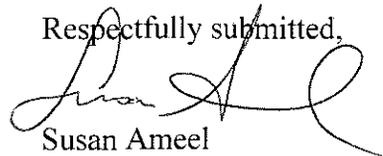
We have worked with money managers to address their concerns by developing technology that saves them money and allows them to manage their counterparty risk directly across clearing brokers. This approach is more effective than relying on pre-trade diversification of order flow among executing brokers. As a broker-dealer, we have the expertise to manage the other post-trade brokerage services.

We have developed an innovative technology which improves the efficiency of the clearance and settlement system. We do not believe that the SEC should allow monopolies to perform these broker-dealer functions. Their monopoly strength can subsidize the creation of a service that effectively destroys free enterprise and innovative products as our own.

We believe the current market structure provides money managers with the ability to obtain the best prices for their customers across market centers and thereby mitigate counterparty risk. We believe that best settlement is integral to the transaction cost analysis and should constitute an import and factor in a money manager’s furtherance of their best execution obligations.

Please do not hesitate to contact me if you have any questions regarding this letter.

Respectfully submitted,



Susan Ameel