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MEMORANDUM

August 5, 2010

To: File No. S7-02-10
File No. S7-27-09
File No.: S7-03-10

From: Saurabh Shah
Office of Commissioner Troy A. Paredes

Re: Concept Release on Equity Market Structure
Regulation of Non-Public Trading Interest
Risk Management Controls for Broker-Dealers with Market Access

On July 21, 2010, Commissioner Troy A. Paredes, and Saurabh Shah, Counsel to the Commissioner, met with Bill Yancey, President and CEO, Penson Financial Services, Carl Gilmore, Senior Vice President, Penson Financial Services, and Dave Franasiak and Joel Oswald, both of Williams and Jensen, PLLC.

The participants discussed generally developments in equities market structure and the Commission's proposed rulemakings concerning the regulation of non-public trading interest and risk management controls for broker-dealers with market access. Mr. Yancey provided the attached presentation.



PENSON WORLDWIDE, INC. (NASDAQ: PNSN)

BUILDING THE BEST CLEARING AND EXECUTION SERVICES FIRM IN THE WORLD

when vision meets opportunity

Washington Update
July 21, 2010



Our History

- Penson Financial Services founded in 1995
 - Clearing broker based in Dallas
- Penson Canada and UK acquired in 2000
 - Clearing brokers based in Montreal and London
- Nexa Technologies acquired in 2004
- Initial Public Offering in May 2006
 - Raised \$110 million in equity capital
- Penson GHCO acquired in February 2007
 - FCM based in Chicago
- Penson Asia launched in 2007
 - Offices in Hong Kong and Tokyo
- Penson Australia launched in 2009
 - Clearing broker based in Sydney



Penson Today

- Headquartered in Dallas, Texas
- US Offices in New York, Chicago, Irvine
- International Offices in Montreal, Toronto, London, Hong Kong, Tokyo and Sydney
- More than \$300 million in equity capital
- More than \$300 in annual revenue
- More than eleven hundred team members
- Four hundred correspondents serving more than one million retail and institutional clients worldwide.

PENSON® WORLDWIDE





What We Do

- Clearing and Execution
 - Multi-asset class platform
 - Equities – Options
 - Futures – Foreign exchange
- Custody and Financing Services
 - Investment of excess customer funds
 - Margin lending
 - Stock lending services
 - Money market funds
- Technology Platforms
 - Trade entry
 - Routing and execution
 - Market data

Market Leading Positions

- Clearing Broker
 - #2 in the U.S.
 - #2 in Canada
 - #2 in the U.K.
 - #3 in Australia
- Futures Commission Merchant
 - #7 largest independent in the U.S.
- Significant Scale (FY09 Volume)
 - 347 MM option contracts
 - 291 MM equity / option tickets
 - 107 MM futures contracts

Note: Rankings based on number of correspondents



Fast Growing Correspondents

Category	Representative Correspondent	Key Characteristics
Online		<ul style="list-style-type: none"> • High transaction volume • Rapid account growth • Cutting edge customers • Technology driven
Options		
Futures	HTG Capital Partners, LLC	
Direct Market Access	<i>Lightspeed</i>	
Professional Trader		
Institutional		



2010 Best Online Broker Survey (Penson correspondents named)

- 8 of 22 Top Online Brokers
- 5 – *Best for Options Traders*
- 4 – *Best for Frequent Traders*
- 2 – *Best for International Traders*

Penson's unique service offering provides differentiation within industry



Independent Provider

- Unlike most competitors, Penson is unaffiliated with a large financial institution, and thus does not compete with its clients
- Products focused on client needs
- Independent status is a key selling point for potential clients facing laborious conversions due to ongoing industry consolidation

Integrated Solutions

- Integrated across asset classes: futures, options, equities and currencies
- Flexible end-to-end solutions for securities processing allows Penson to tailor service offering to specific client needs
- Technology and data products complete service offering

International Presence

- Global reach provides Penson the opportunity to capitalize on international growth trends
- Operations based in U.S., Canada, U.K., Hong Kong and Tokyo
- Services domestic and international clients across more than 40 markets worldwide

The Broadridge Transaction



On June 30th, Penson acquired the Ridge Clearing Business

- \$50-60 MM in expected revenues
- Approximately \$600 MM in expected customer balances
- Approximately 100 correspondents
- Penson became No. 2 based on 400 correspondents
- Penson gained scale in core operations



Securities Processing to Be Outsourced to Broadridge

- Replaces separate systems at US, UK & Canadian equity-option subsidiaries
- Saves Penson +20% from current spend rate
- Broadridge gains scale in core operations





Market Structure Overview

The US equities market is efficient and is widely regarded as the best in the world!

Spreads are reduced, execution costs are down, and liquidity is up

The investing community (especially the retail investor) has benefitted from industry competition and the evolving market structure.

Current market structure:

1. Short Selling, Pre-borrow, & Hard Locates

- Rule 204 of Regulation SHO had the desired effect of reducing fails in the marketplace.
- 99.9% of trades do not fail. (*GAO statistic)

2. "Dark Pools" & Reg. ATS:

- Non-displayed liquidity has always existed. (Not held orders)
- "Dark Pools" - technological evolution of classic market structure that created benefits to institutional and retail trading alike.
- "Trade-At Protection," or a reduction to the Reg. ATS Fair Access threshold, would **not** be in the best interest of investors.

3. High-Frequency Trading & Exchange Co-location

- Additional trading obligations should be attached to the privilege of co-location and special rebates offered by exchanges.

4. Sponsored Access / DMA

- "Naked" sponsored access introduces the potential for significant systemic risk due to the lack of appropriate risk controls.

5. Flash Trading & IOIs

- Penson believes that actionable IOIs and so called "flash orders" should be treated as quotes and subject to the applicable rules and regulations.



July 2010 – Two Key Issues

- High Frequency Trading (HFT)
 - Co-location
- Sponsored Market Access
 - New Rule Making Considerations



What is High-Frequency Trading (HFT)?

Overview

- In general, it is accepted that HFT refers to trading strategies that have a holding period that range from minutes to fractions of a second.
- **“High frequency” strategies have replaced the liquidity traditionally supplied by “specialists” and “market makers”**
 - Co-location, Sponsored Access, direct exchange data feeds should be available to all members to insure fair and equal access
- **Automation of manual procedures has driven efficiency gains**
 - Shift to algorithmic trading for execution of agency orders
 - Use of the ATS construct within the broker-dealer has allowed for the automation of internal crossing opportunities before going to the marketplace, previously a manual function
- **A very robust private network has developed, greatly increasing connectivity and access to liquidity**
 - As part of the Reg. NMS inter-market sweep, exchanges are also now connected to both displayed and non-displayed liquidity pools

CONCLUSION: While all of this change has not been without its challenges, it has been accompanied by a decline in both implicit and explicit trading costs, benefiting both retail and institutional investors



HFT – Co-location

Co-location

- In order to reduce latency, HFT market participants physically place their equipment at the exchange or ATS' data centers as near the data sources as possible.

Penson believes that all firms should have equal access to participate in co-location arrangements, including the use lower latency data, or greater bandwidth consumption, and should not have affirmative or negative obligations solely as a result of such arrangements.

- Co-location is the logical in this electronic age
- By establishing a co-location facility that is accessible to all, the exchanges are leveling the playing field creating constructive competition.
- The Futures Industry Association Principal Traders Group, which includes high-frequency traders, recently filed a comment letter in support of the US Commodity Futures Trading Commission's proposed co-location rule, which requires exchanges to provide fair and equal access to exchange trading engines



What is Sponsored Access?

Sponsored Access is the practice of a member, or non-member, using the exchange membership of another broker-dealer.

Three Types of Sponsored Access:

1. Member Sponsoring Member (regulated entities- i.e. Broker Dealers)

- Provides Sponsoring Member with the ability to aggregate transaction/share volumes for aggregation purposes, resulting in lower execution costs for Sponsoring Participant and its clients.

2. Naked Sponsored Access (un-regulated participant access)

- Allows the *Sponsored Participant* the ability to transact directly with the exchanges using a Market Participant's Identifier (MPID) associated with the *Sponsoring Member*.
- The Sponsoring Member does not have the risk monitoring sufficient to ensure that the order flow complies with appropriate risk thresholds and regulatory checks

3. Sponsoring Member / 3rd Party Systems

- Sponsored Participant uses a 3rd party system which enables the Participant to access and transact directly with an exchange using the Sponsoring Member's MPID.
- The implementation of controls via the 3rd Party System provides the Sponsoring Member the ability to ensure the Sponsored Participant's order flow complies with applicable risk thresholds and regulatory compliance.

Penson believes that Naked Sponsored Access introduces the potential for significant systemic risks due to the lack of appropriate pre/intra/post trade controls.

Penson Sponsored Access



Penson is a non-conflicted provider of sponsored access
(no proprietary interests) for the purpose of achieving most favorable pricing.

New rulemaking considerations:

- **Regulated Entity (BD) exemption** – Sponsoring Member should not be responsible for pre-trade risk controls for a member firm accessing the market through the Sponsoring Member.
 - Regulated firms are already subject to internal and regulatory risk requirements.
- **Clearing Firm exemption** – A clearing broker providing sponsored access to member firms should not be responsible for pre-trade risk controls.
 - Clearing firms are already responsible for the transactions executed by their correspondent brokers. Provision of sponsored access by a clearing broker does not increase systemic risk.
- **Exchange Risk controls** – the exchanges and other execution venues should be required to institute risk controls at the execution point.
 - Risk controls at the execution venue will ensure a level playing field for all participants, while risk controls at the order entry point will make risk a competitive issue.



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