

Marcia E. Asquith
Senior Vice President and
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March 25, 2010

Via Email to rule-comments@sec.gov

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

**Re: Comment Letter on Securities Exchange Act Release No. 61379 –
Risk Management Controls for Brokers or Dealers with Market Access
(File No. S7-03-10)**

Dear Ms. Murphy:

FINRA staff¹ appreciates this opportunity to comment on the Securities and Exchange Commission's ("Commission") proposed rule change to adopt new Rule 15c3-5 under the Securities Exchange Act of 1934 ("Act"), as published in the *Federal Register* on January 26, 2010 (the "Proposal").² The Proposal would require brokers or dealers with access to trading directly on an exchange or alternative trading system ("ATS"), including those providing sponsored or direct market access to customers or other persons, to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of this business activity.

As an initial matter, FINRA agrees with the Commission that the substantial increase in the use of sponsored access and direct market access arrangements in recent years warrants careful attention to the issues these arrangements raise and that a comprehensive standard that applies across markets, rather than an exchange-by-exchange approach, is the appropriate manner for the Commission to address the risks associated with market access arrangements.

¹ The comments provided in this letter are solely those of FINRA staff; they have not been reviewed or endorsed by the FINRA Board of Governors. For ease of reference, this letter may use "we," "FINRA," and "FINRA staff" interchangeably, but these terms all refer only to FINRA staff.

² See Securities Exchange Act Release No. 61379 (January 19, 2010), 75 FR 4007 (January 26, 2010) (File No. S7-03-10).

The Proposal touches on a number of concerns that FINRA has provided guidance on in the past. Given its unique position, FINRA has not adopted a rule specifically addressing market access arrangements or establishing parameters governing those arrangements. Rather, FINRA has consistently taken the view that, under FINRA rules, a firm providing market access to a third party, including another broker-dealer, or otherwise allowing a third party to use the firm's market participant identifier ("MPID") is responsible for the trading conducted pursuant to that relationship. Thus, for example, under NASD Rules 3010 and 3012, as well as Incorporated NYSE Rule 342, a member must control, monitor and supervise all orders for which it is the broker of record, including orders entered by customers through market access arrangements with the member. Members providing market access to customers must also have controls and supervisory procedures in place that are reasonably designed to ensure compliance with applicable regulatory requirements.

As the Commission acknowledges in the Appendix to the Proposal, FINRA has issued guidance in the past regarding market access. In *Notice to Members* 98-66, FINRA stated that members were responsible for honoring all executions that resulted from the provision of market access and should perform appropriate due diligence of customers that were permitted market access through the firm. The *Notice* also noted that members providing market access should have adequate written procedures and controls that permit the member to effectively monitor and supervise order entry by customers. The *Notice* specified that the items that should be found in such procedures and controls include the entry of unauthorized orders or orders that exceed or attempt to exceed credit and other parameters, such as order size, that the member has established for a particular customer, as well as any activity by a customer that could be considered manipulative or an attempt to improperly affect the price of the security or related product. The *Notice* also noted that a signed agreement should be in place between the firm and its customer.

In 2004, FINRA published *Notice to Members* 04-66 reminding firms of their obligations under FINRA's supervision and quotation rules regarding orders entered under their MPIDs. In that *Notice*, FINRA stressed that firms are "ultimately responsible for all orders entered, whether entered by the firm or by a sponsored customer or non-member, even if such firm is using the services of a vendor to facilitate the entry of such orders." FINRA also noted that firms were required to have a supervisory system and written supervisory procedures in place to ensure that orders are not entered in error or in a manner inconsistent with FINRA Rules, and that such a system and procedures should include appropriate controls that include provisions to limit the use of systems to authorized persons, check for order accuracy, and prevent orders that exceed preset credit and order-size parameters.

The Proposal encapsulates many of the concepts that have informed FINRA's guidance regarding market access in the past. Further, the Proposal would effectively prohibit any "unfiltered" access to trading on an exchange or ATS where pre-trade controls are not applied. FINRA shares the Commission's concerns with such "unfiltered" access and believes appropriate controls to manage financial and regulatory risk are essential to ensure the integrity and orderliness of the markets, the protection of investors, and the financial soundness of broker-dealers. Mandating that controls be applied on a pre-trade basis will more effectively address the risks of such market access arrangements.

Consequently, FINRA supports the Proposal and believes it will serve as an effective and comprehensive way to ensure that firms providing customers with market access are held responsible for activity conducted pursuant to that access. FINRA supports the Proposal in broad measure and also offers three specific comments regarding the Proposal.

1. Broker-Dealers Sponsoring Other Broker-Dealers

One question posed by the Commission is whether an arrangement whereby a broker or dealer provides another broker or dealer with market access should be treated differently than one involving a non-broker-dealer. The Commission also asks whether the proposed rule should permit an allocation of responsibilities for implementing appropriate financial and regulatory risk management controls between those brokers or dealers. FINRA believes that sponsored firms that are themselves registered broker-dealers and are accessing a market through another broker-dealer have the same obligations that they would have if they were accessing the market directly, and as a result, both the sponsored firm and the sponsoring firm have regulatory obligations with respect to the trading conducted pursuant to these relationships. The fact that a sponsored firm has independent regulatory obligations should not alter the fact that the sponsoring firm is responsible for monitoring all trading conducted using its MPID. FINRA believes such obligations should continue to apply to both the sponsored and sponsoring firms under the SEC's Proposal.

2. Market Participant Identifiers

In the Proposal, the Commission asks whether separate identifiers for each person provided with market access should be required. FINRA strongly believes that, at a minimum, unique identifiers should be required any time a broker-dealer provides another broker-dealer with access to an exchange or ATS. Currently, for example, it is possible for a broker-dealer to have its own MPID (or multiple MPIDs) and to access a market center through a market access arrangement where its trading activity is identified with an MPID assigned to the sponsoring firm. In some instances, multiple customers (and/or the sponsoring firm itself) may be trading under the same MPID. Because it is impossible to identify, on an automated basis, precisely which firm is behind any given trading activity, requiring the use of unique identifiers, particularly if the customer is another broker-dealer, would enhance the ability of regulators to surveil for illicit trading activity on an automated basis. FINRA recommends that the Commission take steps (either directly or through mandates to the various self-regulatory organizations) to ensure that MPIDs are assigned uniformly and consistently across markets so that a broker-dealer cannot potentially mask trading activity either through the use of multiple identifiers or through trading activity conducted using another firm's MPID.

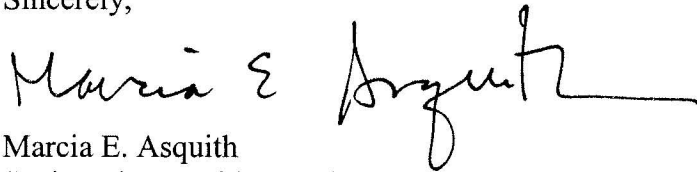
3. ATS Requirements

The Commission requests comment on whether ATSs, in their capacity as registered broker-dealers, should be required to implement appropriate risk management controls and supervisory procedures associated with non-broker-dealer subscribers' access to its ATS. FINRA believes that ATSs should be required to have controls in place for activity by any ATS subscribers that access them and that are not registered as broker-dealers.

The same regulatory and financial risks the Commission identifies throughout the Proposal in the context of direct market access and sponsored access are present when non-broker-dealers subscribe to ATSS. Because neither the Commission nor an SRO can impose risk management controls directly on these subscribers and because the ATSS themselves have regulatory obligations as registered broker-dealers and FINRA members, FINRA believes it is appropriate for the Commission to impose risk management obligations on these ATSS to the extent they permit non-registered entities to access the ATS.

For the reasons set forth above, FINRA supports the Proposal. Please contact Stephanie Dumont, Senior Vice President and Director of Capital Markets Policy, at (202) 728-8176 or Brant Brown, Associate General Counsel, at (202) 782-6927, if you have any questions or would like to discuss further.

Sincerely,

A handwritten signature in black ink, appearing to read "Marcia E. Asquith", followed by a long horizontal line extending to the right.

Marcia E. Asquith
Senior Vice President and
Corporate Secretary