March 26, 2010

Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 10529

Re: <u>Risk Management Controls for Brokers and Dealers with Market Access (File No. S7-03-10)</u>

Dear Ms. Murphy:

Direct Edge Holdings, LLC[1] ("Direct Edge") appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC's") proposed Rule 15c3-5, which would require brokers or dealers with access to trading directly on an exchange or alternative trading system ("ATS") to implement risk management controls and supervisory procedures designed to manage the financial, regulatory and other risks arising from such access.[2] Proposed Rule 15c3-5 would require that brokers or dealers with access to trading securities directly on an exchange or ATS put in place risk management controls and supervisory procedures that are designed to limit the financial exposure of the broker-dealer that could arise as a result of such market access, and ensure compliance with all regulatory requirements that are applicable in connection with market access.

The purpose of this letter is to request that the Commission specifically recognize that there are circumstances in which such risk controls may be duplicative, and therefore unnecessary – specifically, in the case of exchange order routing broker-dealers. In this regard, we ask that the Commission acknowledge that the financial and regulatory risk controls proposed in Rule 15c3-5 should not apply to order flow that is directed by an exchange facility to an away market by way of an exchange affiliated routing broker. Such an interpretation would be consistent with the goals of the proposal, i.e., ensuring that all orders pass through effective automated, pre-trade risk controls prior to entry on an exchange or ATS.[3] We believe that all orders initially entered on exchanges should be subject to pre-trade risk filters, but once an order is on an exchange, any subsequent order routing by that exchange should not require additional risk management screening by the exchange order router.

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1 Direct Edge currently operates the third-largest stock market for the trading of U.S. equity securities, behind only NYSE Euronext and NASDAQ OMX. In addition, Direct Edge was approved by the SEC to convert its EDGA and EDGX trading platforms to two new stock exchanges. More information about Direct Edge is available at http://www.directedge.com.

2 SEC Release No. 61379, 75 FR 4007 (Jan. 26, 2010).

3 Id. at 4008 ("The Commission, however, is particularly concerned about the quality of broker-dealer risk controls . . . where the customer order flow does not pass through the broker-dealer's systems prior to entry on an exchange or ATS"); Id. at 4013 ("...[P]re-trade controls should protect investors by blocking orders that do not comply with such controls from being routed to a securities market"); Id. at 4014 ("These ... controls would therefore prevent orders from being sent to the securities markets, if such orders fail to meet certain conditions").

Direct Edge, 545 Washington Boulevard, 6th Fl., Jersey City, NJ 07310 Tel 201.942.8220 Fax 201.557.8019 www.directedge.com

As discussed in greater detail below, the function of an exchange routing broker is fundamentally different from the role of other broker-dealers accessing trading centers. An exchange routing broker is merely a conduit that communicates information on behalf of an exchange for the benefit of an exchange member. Exchange routing facilities are also subject to extensive SEC oversight and the function is within the scope of the exchange's responsibility as an SRO. As such, the risks associated with order flow routed by an exchange routing broker are already subject to the risk management obligations and processes of both the members of the exchange and the exchange itself. Imposing a layer of risk management controls on the exchange order router would be superfluous and unnecessarily burdensome without any added benefits.

The Special Role of Exchange Routing Brokers

Exchange routing brokers offer the limited but important exchange function of providing an intermarket linkage between trading centers. Some exchanges use their own affiliated broker-dealers to route orders and some exchanges contract with a broker-dealer to provide the routing service. In either case, an exchange routing broker is simply an extension of the exchange function and a mechanism to route the order to an away trading center.

When an order is entered on the exchange, the exchange's algorithm for matching orders determines which orders may be matched for execution, which orders must be posted in the book, and which orders must be routed away. In this regard, it is the exchange that makes all order routing determinations in accordance with exchange rules. The routing broker has no authority to reject or change the terms of other orders that it receives from the exchange. The routing broker is merely a conduit between the exchange and an away trading center.

Given the special and limited role of an exchange order router, it would be difficult if not impossible for the exchange routing broker to ensure on a pre-trade basis that the member firm (or the sponsored client of the member firm) had complied with all of the financial and regulatory requirements that proposed Rule 15c3-5 requires. In contrast, the member firm responsible for the order at the point of market access is in the best position to monitor for the financial and regulatory risk of such orders. Once the order has been received by the exchange, the application of the Rule 15c3-5 risk management controls would simply be inconsistent with the role of an exchange order router.

No Gaps in Risk Management Controls for Order Flow Handled by Exchange Routing Brokers

An exception from proposed Rule 15c3-5 for exchange routing brokers is warranted because there are extensive risk management controls already in place for orders routed away by exchanges. First, all market participants accessing an exchange are subject to existing risk management requirements of the various trading centers. Of course, in the future, these market participants will be subject to the financial and regulatory risk controls of Rule 15c3-5. The order flow from these market participants – whether from an exchange member or sponsored client – will pass through necessary pre-trade risk controls mandated by the SEC's proposal before the order enters the exchange.

Second, once an order has been entered on an exchange, the order is subject to the real-time and post-trade surveillance of the exchange that monitors orders on the exchange and those orders routed to away market centers. Any potential erroneous trades or violations of trading rules are investigated by the exchange's regulatory staff. Furthermore, the U.S. stock exchanges have recently adopted, at the urging of the Commission, uniform rules respecting breaking stock trades that are considered "clearly erroneous."[4] This uniform approach to breaking stock trades will greatly enhance the management of erroneous transactions at the exchange level.

As well, it is important to note that the SEC approves the conditions under which exchanges match orders and route orders to away trading centers. Necessarily, the routing function of the exchange is narrowly confined to those instances in which the exchange is approved in its rules to route to another destination.[5] Where the exchange routing broker is a facility of the exchange, the exchange is required to file with the Commission rule changes and fees relating to the broker's routing function.[6] We believe that this order flow -- limited to those instances when an exchange is approved to route away -- does not raise the same concerns discussed by the SEC in its proposal. The SEC's proposal is largely designed to ensure risk management controls are in place for firms that handle orders with a much wider array of strategies and tactics, such as orders generated by the algorithms of proprietary trading firms. An exchange routing broker does not fit this profile.

Finally, exchange's are subject to extensive oversight pursuant to the SEC's Automation Review Policy ("ARP"). Under ARP, exchanges must perform rigorous quality assurance testing of exchange software to help ensure that orders will be matched and routed away in accordance with exchange rules. This quality assurance testing greatly reduces the risk of erroneous orders.

Conclusion

We ask that the Commission address the special role of exchange routing brokers and craft a narrow exception to the proposed risk management controls for this limited function. Excepting exchange routing brokers will not create any risk management gaps because every order entered on an exchange will be subject to proposed Rule 15c3-5 market access controls and the exchange's real-time and post-trade surveillance. It would be duplicative for an exchange routing

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[4] EDGA Exchange Rule 11.13; EDGX Exchange Rule 11.13; The NYSE Amex, NYSE Arca, New York Stock Exchange, National Stock Exchange, International Stock Exchange, Chicago Stock Exchange, NASDAQ Stock Market, NASDAQ OMX BX, Chicago Board Options Exchange, and BATS Exchange all filed similar rule changes on October 2, 2009 that were published in the Federal Register on October 9, 2009.

[5] See, e.g., SEC Release No. 61698, 75 F.R. 13151 at 13165 (March 18, 2010).

[6] Id.

broker to also provide a pre-trade risk management filter for the orders leaving an exchange for an away market.

Direct Edge is ready to be of service as the Commission embarks on this process and thanks the Commission in advance for the consideration of these comments.

Sincerely,

Eric W. Hess
General Counsel

cc: Hon. Mary L. Schapiro, Chairman
Hon. Luis A. Aguilar, Commissioner
Hon. Kathleen L. Casey, Commissioner
Hon. Troy A. Paredes, Commissioner
Hon. Elisse B. Walter, Commissioner
Robert W. Cook, Director of Trading and Markets
James Brigagliano, Deputy Director of Trading and Markets