Lime
Brokerage LLC
Member NYSE, Nasdaq, FINRA, NFA, SIPC

March 29, 2010

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

Re: Risk Management Controls for Brokers or Dealers with Market Access
Release 34-61379, File No.: S7-03-10

Dear Ms. Murphy:

Lime Brokerage LLC ("Lime"), appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC") proposed Rule 15c3-5, "Risk Management Controls for Brokers or Dealers with Market Access" ("Proposed Rule"). As an agency broker-dealer that provides electronic market access for various classes of market participants into Exchanges, ATSs and other Trading Centers, Lime addresses market access and risk management issues on a daily basis while conducting our business.

Lime appreciates the sweeping nature of the Proposal that attempts to address various known issues in the market access space regarding sponsored and unfiltered/naked access. Specifically, the potential for systemic risk posed by unregulated entities accessing the public markets directly and without any supervision is an issue too large to ignore, with estimates that naked access may account for somewhere between 10%[1] - 38%[2] of all US equity market trading activity, and most likely a much greater participation percentage for orders placed. As well, ambiguous regulatory requirements regarding appropriate supervisory controls that prima facie contradict current business practices need to be addressed.

Following are our considered responses to certain questions and issues that the were raised in the Proposed Rule[3]

a) *"The proposed rule would apply equally to brokers or dealers with market access, whether they are proprietary traders, conduct traditional brokerage services, or provide direct market access or sponsored access. Should the proposed rule apply to all types of market access similarly? Should market access arrangements be*

[1] March 26, 2010 comment letter on Release No. 34-61379; File No. S7-03-10 by Fortis Clearing
[2] January 14, 2010 Wall St. Journal article, "SEC Proposes Banning 'Naked Access'"
[3] Risk Management Controls for Brokers or Dealers with Market Access, Release No. 34-61379; File No. S7-03-10, www.sec.gov/rules/proposed/2010/34-61379.pdf

treated differently under the proposed rule depending on the type of market participants that are party to the arrangement? If a broker or dealer provides another broker or dealer with market access, should such an arrangement be treated differently under the proposed rule? In this situation, should the proposed rule permit an allocation of responsibilities for implementing the appropriate financial and regulatory risk management controls between those brokers or dealers? If so, to what extent, and on what basis?"

There are multiple factors that Lime believes are critical to consider when evaluating a market access arrangement which are stated outright, inferred or implied directly by the Proposed Rule:

1) ***What is a Market Access Provider***: A "Market Access Provider" ("MAP") is defined as a participant providing access to trading in securities on an exchange or ATS as a result of being a member or subscriber of the exchange or ATS ("Trading Center"). It does ***not*** specifically include the concept of an "infrastructure provider" ("IP"). The proposed MAP definition is intentionally broad, to include not only providers of direct market access or sponsored access services offered to customers of broker-dealers ("BD"), but also access to trading for the proprietary account of the BD and for traditional agency business. Therefore, a MAP is, by definition, always a broker-dealer, and always a member of the Trading Center being discussed.

2) ***What is being proposed by 15c3-5:*** Any BD with direct access to trading on a Trading Center should establish effective risk management controls over activity submitted to the Trading Center(s) of which they are a member, to protect against breaches of credit or capital limits, erroneous trades, violations of SEC or exchange trading rules, and other regulatory and/or SRO requirements. These controls should reduce risks associated with market access and thus enhance market integrity and investor protection. A BD with market access should ensure that the same types of controls are in place whenever it uses its unique position as a Trading Center member or subscriber to gain access to those markets.

3) ***The Proposed Rule does not specifically include the concept of an "infrastructure provider" ("IP").*** An IP is the entity that provides physical connectivity to the Trading Center. The IP can be internal to the sponsoring BD, part of an unrelated BD, or a third-party non-BD – usually a technology or network infrastructure firm. Market connectivity and optimum infrastructure design are of such a specialized nature that not every organization is best suited to house its own IP. It may be more compelling for a BD to outsource its connectivity and network infrastructure requirements to a specialist in the field. The role of the IP in assisting the MAP with its compliance and risk management obligations needs to be recognized, especially if the IP is another BD. The concept that "the risk management controls and supervisory procedures required by Proposed Rule 15c3-5 must be under the direct and exclusive control of the broker or dealer with market access" seems to be at odds with outsourcing the

operational implementation to a third party expert. The Proposed Rule should recognize that contractual obligations are sufficient to comply with the "exclusive control" provisions, otherwise third party-service providers could be viewed as non-compliant arrangements. However, under all circumstances the MAP would still be ultimately responsible from a legal and regulatory perspective for the services that the IP performs on its behalf.

4) ***The regulatory and membership status of the Market Access Recipient ("MAR" – the entity that is obtaining access via the MAP into the Trading Center), on the Trading Center(s) being accessed.*** The Proposed rule makes it abundantly clear that BDs are effectively prohibited from enabling the practice of "naked access" – direct market access by non-BDs directly into a Trading Center. If, however, the MAR is a BD, exactly which entity is responsible for which requirements (such as regulatory and risk) starts to become ambiguous. A BD that is not a Trading Center member should still be able to perform the necessary validations mandated by the MAP as long as day-to-day operational responsibility is clearly defined. However, ultimate accountability must always rest with the MAP, in whose name all of the MAR's activity is being done. This point is discussed further after item (5).

5) **What is the regulatory and membership status of the IP on the Trading Centers to which it provides connectivity services?** Is the IP related to the MAP BD, and if related how is it related? To the extent that an IP is directly part of a BD, its product and service offerings are subject to oversight by the SEC and possibly the SROs that the BD is a member of, or subject to their jurisdiction. To the extent that the IP is a BD, its role must be explicitly defined – that it is acting in a "service bureau" capacity, and not in its capacity as a BD at the Trading Center to which it is providing connectivity and infrastructure services.

The proposed rules should not apply to all classes and arrangements of market access similarly. Market access arrangements should be treated differently under the proposed rule depending on the types of participants that are party to the arrangement. Lime believes that it is essential that in each market access arrangement, that the three discrete roles are always identified, even if all parties are part of the same organization: the Market Access Provider, the Market Access Recipient, and the Infrastructure Provider. The responsibility and accountability need to be agreed upon by all parties, with ultimate accountability resting with the BDs, who in turn may assign the day-to-day implementation responsibility to a non-BD, as permitted by SEC and SRO rules and requirements.

It seems clear after reading both the Proposed Rule and the supplementary accompanying information, that the SEC's main motivation is to ensure that various financial, regulatory and other risks are appropriately addressed. As the SEC and the SROs that are discharged with overseeing the public markets have limited recourse to non-regulated entities, it is absolutely essential that a regulated broker-dealer is always directly accountable for the services that it provides both directly

through itself, and indirectly through the third party service providers that it uses. While responsibility may be delegated, accountability is not. A BD in its role as a MAP should be knowledgeable of the systems that it's MAR use to supervise, monitor and control the activity that is being done under the MAP's membership. Indeed, the MAP should incorporate some type of oversight review and monitoring of the MAR's control system into the MAP's supervisory procedures (this type of oversight review must also accommodate the software/system release cycle employed by the MAR, as any new system version can include significant changes which could impact the services performed). Jesse Lawrence, Director and Managing Counsel of Pershing LLC noted in a comment letter on this same rule[4], that the concept of allocating responsibility among different BDs is permissible under NYSE Rule 382 and FINRA Rule 3230, which "provide for an efficient mechanism to allocate responsibilities to those parties in the relationship best positioned to ensure compliance."

While there are many reasons for parties to enter into a market-access arrangement, one of the more complex motivations is for tiered Trading Center execution fee and rebate pricing. Certain Trading Centers provide improved execution rate pricing for participants that execute greater volume. For example, on Nasdaq on March 25, 2010 the rebate to add liquidity (based on average daily shares of liquidity per month for all U.S. equities) was $0.00295 per share if a participant adds greater than 95 million shares on the Nasdaq market daily. However, if less than 20 million shares are added daily then the rebate dropped to $0.00200 per share, a 32% decrease in direct Trading Center execution costs. This improvement in pricing is a strong incentive to firms that might otherwise be a MAP, to instead become a MAR and use a MAP that has greater combined Trading Center volume, and is thus eligible for improved pricing.

These tiered market center execution rates already are a barrier to fair market access as the direct trading costs for firms below the volume tier thresholds present a potentially insurmountable cost barrier. Registered BDs that are acting as MAR's in order to achieve better execution rates under this scenario are already providing a level of oversight relating to the client and the orders being submitted into the marketplace. Under the Proposed rule, the MAR's orders would need to be validated a second time by the MAP, which would put the MAR at yet another disadvantage due to the increase in latency resulting from the second level of order validation checks by the MAP - who may not be in a position to know relevant details about the ultimate client submitting any given order.

As presently written, the Rule Proposal states that the financial and regulatory risk management controls and supervisory procedures shall be under the direct and exclusive control of the MAP. Therefore, MARs are faced with two sub-optimal choices. First, face adverse Trading Center execution rates by not aggregating flow

[4] Jesse Lawrence, Director and Managing Counsel, Pershing LLC, in a letter to the SEC 3/24/2010, http://www.sec.gov/comments/s7-03-10/s70310-24.pdf

and thus become their own Market Access Provider to avoid the additional latency. Second, as an alternative, the MAR could permit the MAP to add a validation layer, with the resulting adverse latency impact. We do not believe it was the SEC's intent to force BDs to make these tradeoffs, nor to create a potentially dramatic increase in Trading Center memberships so that only MAPs that are Trading Center Members can trade directly on the Trading Center.

Again, as per Mr. Lawrence, an effective rule would ""provide for an efficient mechanism to allocate responsibilities to those parties in the relationship best positioned to ensure compliance.". At certain times the MAP might be the optimum party, and at certain times it might be the MAR. However, prior to the initiation of a MAR/MAP relationship, the compliance, supervisory, and other requirements should be explicitly defined and allocated among the regulated BDs. As well, the role of the IP with assisting either party with its obligations should be adressed, within the confines that the IP can never be given ultimate accountability – that in the end must rest with the registered BDs.

The Proposed Rule should make it abundantly clear that in all cases appropriate and required validation checks must be performed. It should also be made clear that the BDs involved may delegate operational responsibility amongst themselves in accordance with a clearly defined plan of allocation of duties. Therefore, the risk management controls and supervisory procedures required by the Proposed Rule should not require that they are under the direct and exclusive control of the BD with market access when both the MAP and MAR are regulated BD entities. As stated above, in this scenario the SEC should view the supervisory system that the MAP and MAR together have compiled, which may also include certain services being provided by an IP, if so allocated by one of the registered BDs party to the market access agreement. In all circumstances responsibility and accountability must be clearly defined, with accountability ending at the BD level

b) *"Should the proposed rule apply equally to trading in all securities?*"

Yes. For all the reasons discussed in item (a), above. Good business practice and clearly defined operational organization suggest that it would be appropriate to have identical requirements no matter what the underlying asset. A lack of clearly defined supervisory controls combined with a lack of accountability back to a regulated entity is not an appropriate method to maintain market integrity, regardless of the securities being transacted

c) *"Are pre-trade controls the preferred method for adequately mitigating all the risks associated with market access?"*

Real-time pre-trade, order-placement controls are certainly a critical component to mitigate many of the risks associated with market access. While they are not the only essential ingredient, they are probably the most critical one. In the world of high frequency trading, order cancellation rates well beyond 90% are the norm. Looking

solely at post-trade execution activity is insufficient as certain validations are required to be done at the time of order placement, and are completely unrelated to whether an order actually receives an execution. Looking solely at the executed trades provides false comfort that adequate order-entry control procedures are in place, such as the locate requirements of Regulation SHO. Boundary price controls, if mandated, are obviously only able to be performed at the pre-trade level. If the SEC deems boundary price validation to be a mandatory requirement, then it should rest with the Trading Center to which the order is routed for execution to perform this validation, again, on a pre-trade basis. Trading Centers are in the best position to apply a consistent set of criteria to all orders.

d) *"Should the method for managing risk be particular to the specific risk?"*

The method for managing risk should be determined by the specific risk. Certain risks are best mitigated by the MAR who should have the most complete information on the "background" of the orders being submitted into the Trading Center. Another set of requirements that can only rest with the MAR are the order marking requirements of SEC Regulation SHO, Rules 200(c) and 200(g)(1). For long sales, SEC Rule 200(c) states that "A person shall be deemed to own securities only to the extent that he has a net long position in such securities." This validation ***cannot*** be performed by any party that does not have a complete ***real-time*** view of the customer's activity at other Trading Centers. If this obligation was assigned by the MAR to the Trading Center's "risk management gateway", for example, the Trading Center would not be aware of the end customer's order and trading activity at other Trading Centers. Similarly a MAP cannot have a holistic of view of an end-client's activity if they have no direct relationship with the end client.

Certain validations are best performed by the Trading Center to which the order is routed for execution such as real-time boundary price validation, so that the validations are performed fairly and consistently, just prior to the order being entered into a matching engine. There is no "one-size-fits-all" approach – the complete set of validations to be performed, who is responsible for operationally completing the validations, and who is ultimately accountable from a legal and regulatory perspective for ensuring that the validations are completed, should be determined by the regulatory and membership status amongst the MAP, MAR, and the IP, and the written allocation plan of regulatory accountability between the MAP and the MAR. In the absence of such specific plan of regulatory allocation, the MAP would be liable for all aspects of trading activity submitted under its' membership(s). However, the SEC should recognize the concept of allocating responsibility, as per NYSE rule 382, so that responsibilities can be allocated to the party best able to enforce them, regardless of Trading Center membership status.

Following are two different risk categories, addressing two concerns that the SEC raised in the Supplementary Information to the Proposed Rule.

1) ***The proposed rule would require broker-dealers to establish an appropriate credit threshold for each customer, should the criteria for determining the appropriate threshold be explicitly listed in the proposed rule?*** The party best able to determine the credit threshold for the customer is the BD that has the direct relationship with the customer, and thus has the corresponding "know your customer" obligations. Customer credit risk is best managed by the BD that directly knows and interacts with the customer.

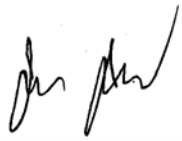
2) ***Is there a common understanding among market participants regarding the timeframe used to prevent the entry of erroneous orders?*** Erroneous orders are a complex topic as there is no definitive source of what an erroneous order is, there is only a definition, at the Trading Center level, of what an erroneous ***execution*** is. The difference between the two is critical. To prevent an erroneous execution from occurring, it should be incumbent on the Trading Center Operator to which the order is routed for execution, to have final control over price boundary validation, which is an implied obligation in Regulation NMS. However, it should be incumbent upon the BD that routes the order to the Trading Center, to determine if an order is valid, exclusive of Trading Center price boundary validation. The BD receiving the order is in the best position to determine what is an appropriate order for a specific customer given the receiving BD's know-your-customer requirements. Items that the entering BD would factor into its order validation process would be the customer's credit limit, intended trading strategy, investment objective, and other relevant criteria. A day-trader with a $100,000 in equity would have different order validation criteria applied than an institutional investment manager with a demonstrated $1 billion in assets under management.

e) *"Broker-dealers would have the flexibility to seek out risk management technology developed by third parties, but the Commission expects that the third parties would be independent of customers provided with market access."*

It is important that the SEC contemplate the scenario of customers "selling" their risk management systems to Market Access Providers. We assume that the intent of the Proposed Rule is not to permit the customer to "sell" its risk management system to its MAP, so that the MAP would then use it to monitor the customer's activity. If a MAP is using a customer's provided monitoring and control system, the MAP must be able to demonstrate that the acquired system has had customer access to its controls disabled, and that the equipment performs all required validations. The Rule should be explicit that all monitoring and control systems for the MAP and the MAR need to be evaluated for effectiveness in monitoring, controlling and supervising the applicable financial and regulatory risks discussed in Proposed Rule 15c3-5(c), and that extra scrutiny is required when systems have been acquired either directly or indirectly from customers or their affiliates.

Again, Lime Brokerage appreciates the opportunity to comment on the Proposed Rule. Should you desire to discuss the points raised further, we are available to do so at your convenience. Thank you for your consideration of our views on this important matter.

Regards,



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Lime Brokerage LLC

cc: Mary Schapiro, SEC
Richard Ketchum, FINRA
Also submitted electronically via comments on SR Release 34-61379, File No. S7-03-10