June 15, 2009

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

Re: File No. SR-NASDAQ-2008-104 (34-59275)

Dear Ms. Murphy:

Lek Securities Corporation ("LSC") appreciates the opportunity to comment on the captioned NASDAQ Stock Market, LLC ("Nasdaq ") proposed rule change regarding "Sponsored Access". LSC is best known for the ROX System, an electronic front-end to many market centers and a provider of clearing services to professional and institutional clients.

This comment focuses exclusively on the willingness of Nasdaq, the NYSE, ARCA and other exchanges and ECNs to permit direct access to their matching engines by *unregulated* entities, without orders first passing through credit and compliance checks of the sponsoring *regulated* member ("Unfiltered Access"). Unfiltered Access is a classic creator of systemic risk, with little or no offsetting benefit to investors. Accordingly, as explained in detail below, the Commission should ban Unfiltered Access and eliminate the need that makes it important: The competitive edge that sub-millisecond access to the exchanges creates for professional traders. The Commission can accomplish this by limiting the number of orders/cancellations that a single beneficial owner can send to an exchange in a single symbol on the same side of the market to one per second and require that all orders received within one second be considered received at the same time and be placed on parity.

Background

Professional traders often see arbitrage and other trading opportunities that give them a signal to trade against a displayed quote or post a bid or offer. Because there are many traders involved in the same or similar strategies there is competition to get to the exchange first, because the first person to accept the quote will trade and everyone else will miss the market. Also, because of time priority rules, the person displaying a bid or offer first will have his order fully satisfied before anyone else can trade at all. The latter phenomenon has been exacerbated due to the Commission's ban on sub-penny pricing. If the spread is only a penny wide, one cannot improve the quote, so the only thing that matters is who gets there first. Initially, getting to the market within a few seconds was fast enough, but as the exchanges improved their matching engines and communication facilities have become faster, latency is now measured in nanoseconds (one/millionth of a second). Customers are now demanding to have their computer systems placed in co-locations right next to the exchanges' matching engines and the length of the fiber optic cable connecting the two systems is significant even though the data travels at the speed of light, i.e. at 300,000,000 meters per second. The actual speed does not matter much. It's only important to be ahead of one's competitor. It reminds me of a joke an old friend once told me:

A Harvard grad and a guy from Brooklyn go camping. They are sitting by the fire when they spot a hungry bear 500 feet away. As the bear starts running towards them, the guy from Brooklyn starts putting on his running shoes. The Harvard grad looks at him and says: "It's hopeless we're doomed. The bear can run at 30 miles an hour. You and I can do 6 miles at best. Every hour the bear could gain 24 miles on us, or 126,720 feet. Each second, the bear can gain 35.2 feet on us. To gain 500 feet, the bear only needs 14.2 seconds". To which the Brooklyn guy replied: "What are you talking about? I don't need to outrun the bear! All I have to do is outrun *you*"!

The Risks

Of course none of these orders could be generated manually. They all come from computer systems that read market data and automatically generate orders, and the volume of orders is significant. We have seen customers that believe that being able to generate and cancel 1,000 orders per second is "unacceptably" slow. Of course, like all computer systems, from time to time, something goes wrong and the computer starts generating thousands of bad orders. We have seen it before, and we will see it again. Normally, these orders would be caught by the Sponsoring Firm's (or third party's) credit or compliance controls, but with Unfiltered Access there is nothing to prevent them from going through. The only question is what the damage is going to be? Will it be a few thousand dollars or enough to put the Sponsoring Firm into a SIPC liquidation and endanger the savings of thousands of innocent investors?

Similar problems can happen when compliance checks are bypassed. Unregulated entities have little incentive to abide by the rules. They are completely outside of the jurisdiction of the SROs and even the Commission would have to engage in costly enforcement actions to halt the violators. The sponsoring member could cut the customer off, but the same customer would likely soon appear somewhere else. Moreover, malice cannot be ruled out. As Sponsored Access grows, it's not difficult to imagine a customer that goes for the one-off "make or break" trade with the airplane ticket to Brazil in hand. Unfiltered Access might also inspire a terrorist organization to try to disrupt or manipulate our markets by shorting hundreds of millions of shares from an unknown foreign location.

The Mitigating Factors Are Ineffective

Nasdaq suggests that the inherent risks of Unfiltered Access can be controlled by requiring that the there be a contractual agreement in place where the sponsored participant must promise to comply with the rules, allow access to his books, not allow anyone else access to his systems, and provide financial information to the sponsor and agree that the sponsoring member can cut him off at any time. The sponsored participant must also promise not to exceed his credit limit, not trade in unauthorized products and to have a system in place to catch errors. This is of course all fine, but we all know that computer errors happen, even if someone has a contract saying that they won't. Equally unimpressive is what Nasdaq expects from the sponsoring member: A written acknowledgement that the sponsor is economically liable for all of the sponsored participant's trades and liable to the regulators for the customer's rule violations. Neither of these "agreements" is worth much more than the paper that they are written on, because by definition the sponsoring member doesn't know about the orders until it's too late.

The best risk control lies in the simple fact that the sponsored participant generally won't want to lose his money, but as an unregulated entity there will be an incentive to trade with as little capital as possible. Another problem is that any control, including controls in the sponsored participant's own computer system, slow down the process and make it less likely that the trader will win the race to the market. Thus there is a perverse incentive to eliminate all checks and balances.

Unfiltered Access was originally only for large sophisticated customers with capital in the hundreds of millions, but with competition between member broker dealers heating up it's not difficult to imagine firms taking on smaller and smaller clients, with less and less sophistication. An unfortunate characteristic of the inherent risk of Unfiltered Access is that the potential damage a customer can cause does not decline with the capital and sophistication of the customer. Even a small customer can have a computer problem that has the potential to cause losses in the billions.

The credit controls that the exchanges have in place mitigate some of the risk, but they are not anywhere near sophisticated enough and could possibly be defeated. The exchanges will undoubtedly disagree with me, but they don't "put their money where their mouth is." Every single exchange contractually exonerates itself from all liability relating to the malfunctioning of their credit controls. If something goes wrong, it's the regulated and SIPC insured entity that is on the hook. The exchanges will wash their hands of it. Moreover none of the exchanges have any controls in place to detect and prevent illegal trading.

The Regulation of Credit Risk is Appropriate

Since the Great Depression customer leverage has been limited by Regulation T. Although some might argue that Reg. T has been too restrictive, it has prevented major credit losses by broker dealers in the United States for more than 75 years. I believe that the regulation preventing unwarranted risk taking by SIPC insured entities is appropriate, because as recent experience with the banks shows, the market tends to underestimate the cost of risk taking, until it's too late. The cost of sponsoring Unfiltered Access appears to be zero and therefore competitive forces have lead to imprudent behavior. This will continue unless it is halted by regulation. Unfiltered

Access creates a very small chance of a massive loss. Not surprisingly, many broker dealers look at it as an opportunity to make some "free" money. The likelihood of losses is remote. However, sooner or later something will go wrong and SIPC and the government will be left holding the bag. For this reason the Commission should ban Unfiltered Access to our markets by unregulated entities. The Commission must take a leadership role and put an end to this dangerous practice. Otherwise when something does go wrong – and it most certainly will – the regulators will look foolish. Unfiltered Access is irresponsible and unnecessary, particularly in light of the dubious benefit of sub-millisecond race to the exchanges' matching engines.

What the Commission should do – Slow down the Bear

The Commission must remove the benefit that traders gain by being able to route their orders directly to the exchanges without them first having to pass through rigorous credit and compliance checks. Rather than trying to regulate the race between the Harvard grad and the Brooklyn guy, the Commission should slow down the bear. This way everyone is on a level playing field and no one gets hurt. To accomplish this, the Commission should limit the number of orders/cancellations that a single beneficial owner can send to an exchange in a single symbol on the same side of the market to one per second and require that all orders received within one second be considered received at the same time and be placed on parity. One second is plenty of time for orders to pass though credit and compliance checks of regulated exchange members. The Commission has already limited the granularity of price priority by banning sub-penny pricing. The Commission should likewise limit the granularity of time priority by treating orders received within a single seconds as being received at the same time. This will eliminate the need for Unfiltered Access and create a more level playing field. The result will be less quote flicker and greater liquidity as more people will have an incentive to trade. Everyone will be able to reach the exchange on time. Not just the fastest of the fastest.

Respectfully submitted,

Samuel F. Lek
Chief Executive Officer