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OFFICE OF THE SECRETARY

February 19, 2009

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

Re: NASDAQ's Proposal to Adopt a Modified Sponsored Access Rule (File No. SR-NASDAQ-2008-104)

Dear Ms. Murphy,

FTEN, Inc. ("FTEN")[1] appreciates the opportunity to provide feedback on Nasdaq's proposal to adopt a modified Sponsored Access rule (File No. SR-NASDAQ-2008-104) (the "Proposal").

With the increasing adoption of electronic algorithmic trading through Sponsored Access, the risk of a catastrophic error and its impact on Sponsoring Members[2] and the securities market as a whole becomes more and more ominous. The magnitude of potential systemic losses resulting from this type of error are much more significant than similar errors associated with trading styles of the past because of the enormous volumes traded at high-speeds across multiple Exchanges that are characteristic of this type of trading. Since Sponsored Participant[3] trading patterns are leveraged and sponsored by Sponsoring Members in a custodial relationship, Sponsoring Members are ultimately held accountable for any erroneous trades by Sponsored Participants and if the Sponsoring Members are unable to absorb resulting losses then the financial industry as a whole will suffer the consequences.

In today's increasingly cross-asset, multi-exchange, multi-broker environment, Exchange offered Sponsored Access risk systems fall short of fully mitigating systemic risk because they inherently lack a cross-market awareness. An Exchange Sponsored Access risk system has an order-level view only and as a result only knows about trading activity in its own environment. Its risk checks are unaware of other positions taken by a customer in other liquidity centers. Because of these blind spots, Exchange offered Sponsored Access risk systems cannot see the net impact of a trade across the market. If an algorithm makes a bad trade on multiple Exchanges, there is no way for each individual Exchange to detect the customer's overall exposure. Therefore, we believe it is imperative that Congress and regulators, together with the private sector, work together to encourage effective real-time, pre-trade, market-wide systemic risk solutions that help prevent such errors from occurring in the first place.

[1] As an independent third party solutions provider of mission critical financial technology applications, FTEN enables prime brokers, clearing firms, broker-dealers, hedge funds and proprietary trading groups to achieve greater access, speed and control through scalable, low-latency routing, real-time intra-day risk management, compliance, surveillance and market data services. On October 30, 2008, FTEN announced strategic minority investments in the company by Merrill Lynch, Goldman Sachs, J.P. Morgan, and Credit Suisse in connection with FTEN's initiatives to redefine global financial securities risk management (see http://www.wallstreetandtech.com/financial-risk-management/showArticle.jhtml?articleID=211800273). For more information on FTEN, see http://www.FTEN.com.

[2] The Proposal defines a "Sponsored Participant" as a firm or customer to whom a member firm (the "Sponsoring Member") provides access to Nasdaq.

[3] *Id.*

We respectfully request that the following suggestions be considered in connection with your review of the Proposal:

- The pressing need for effective market-wide systemic risk controls should serve as the principal backdrop for review of the Proposal and the realities of today's competitive securities markets should be taken into account when assessing the potential efficacy of the Proposal.

- Use of Sponsored Access systems that do not enable Sponsoring Members to comply with pre-trade oversight and compliance obligations should not be permitted; attempts to impose contractual arrangements between parties involved in Sponsored Access do not overcome the limitations of such systems and systems that do provide pre-trade risk protection would not benefit from these arrangements.

- Minimum criteria for Sponsored Access systems and opt-out / certification procedures for Sponsoring Members who desire to use private sector Sponsored Access systems rather than Exchange Sponsored Access systems should be established.

Each of the aforementioned suggestions is discussed further below.

I. <u>The Pressing Need For Effective Market-Wide Systemic Risk Controls Should Serve As The Principal Backdrop For Review Of The Proposal And The Realities Of Today's Competitive Securities Markets Should Be Taken Into Account When Assessing The Potential Efficacy Of The Proposal.</u>

We believe the Proposal should be analyzed within the context of the growing need for more effective market-wide systemic risk controls. In her first public speech after becoming Chairman of the Securities and Exchange Commission, Mary Schapiro stated, "The SEC should reduce systemic risk in markets…."[4] Christopher Dodd, the Chairman of the U.S. Senate Banking Committee,[5] and Barney Frank, the Chairman of the House Financial Services Committee,[6] both recently emphasized the need to overhaul financial regulations to better manage systemic risk. Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System, highlighted the need for a broader "field of vision" among regulators and supervisors in his speech at the Federal Reserve Bank of Kansas City's Annual Economic Symposium where he stated: "Under our current system of safety-and-soundness regulation, supervisors often focus on the financial conditions of individual institutions in isolation. An alternative approach, which has been called systemwide or macroprudential oversight, would broaden the mandate of regulators and supervisors to encompass consideration of potential systemic risks and weaknesses as well...[t]he Federal Reserve will continue to work with the Congress, other regulators, and <u>the private sector</u> to explore this and other strategies to increase financial stability."[7] *(emphasis added)* With this heightened focus on systemic risk, we believe the Proposal should be carefully structured and implemented to avoid

[4] http://www.InvestmentNews.com/apps/pbcs.dll/article?AID=2009902069994
[5] http://www.reuters.com/article/marketsNews/idUSWBT01057320090204
[6] http://online.wsj.com/article/SB123370729697045667.html
[7] http://www.federalreserve.gov/newsevents/speech/bernanke20080822a.htm

adversely impacting the availability of private sector Sponsored Access risk management solutions that can, in certain circumstances, provide more effective systemic risk management.[8]

The need for more effective market-wide systemic risk controls is exacerbated by the increasing growth in electronic and algorithmic trading. Electronic trading has grown to the point that it now represents approximately 50% of total U.S. Equities trading. A study by the Boston consultancy firm Aite Group found that algorithmic trading accounted for 35% of U.S. Equities trading volume in 2006 and is projected to account for 52.5% in 2010. Separately, Tabb Group's most recent U.S. Institutional Equity Trading study reported that electronic trading represented 27% of all U.S. Equities trading in 2005, 44% in 2006 and 51% in 2007. As a result of the "earthquake that shook the markets [in 2008]," electronic trading from January through October 2008 decreased to 44% but is expected to resume its growth curve.[9]

A Financial Times article entitled Algo Trading: The Dog That Bit Its Master reported that, "In the search for someone to blame for the problems gripping the world's financial system, there is one scapegoat that cannot answer back: the machines...For a decade, investment banks, traders and exchanges have been engaged in a technology arms race, in which the fastest computers net the biggest profits…Automated algorithmic trading programs now buy and sell millions of dollars of shares time-sliced into orders separated by thousandths of a second…"Innovation in certain cases leads to uncontrolled automation," concedes Andrew White, global head of trade and risk management at technology and information group, Reuters. In volatile markets, the risks can change rapidly and hugely within the day. "Many risk systems weren't able to keep up," he says…It is little wonder that many banks' risk and technology officers are feeling sore. Computerised trading technology is the dog that bit its master."[10] Without adequate risk management controls, the speed at which automated algorithmic trading occurs could serve as a catalyst for a potential collapse of our financial markets if an algorithmic program were to go awry. As noted in a Reuters article entitled Algo Trading Raises Stakes For Market Regulators, "Think of a rogue trader like Nick Leeson, whose $1.4 billion of losses caused the collapse of Barings Bank in 1995. Then imagine a character like him with automated programs that could send thousands of orders per second."[11]

In a recent industry luncheon speech entitled Maximizing Liquidity in the U.S. Equity Markets,[12] Erik R. Sirri, Director of the Division of Trading and Markets at the Securities and Exchange Commission, commented that, "we are fortunate in the U.S. to have such vigorous competition among markets." Director Sirri noted that among the key characteristics of the post-Regulation NMS equity market structure, the "distinguishing feature is its exceptionally strong competition among a variety of markets to attract order flow and trading volume." He went on to note that " [n]o single U.S. exchange executes more than one-half of the volume in its own listed stocks." Strong competition among Exchanges is essential to the successful operation, integrity and credibility of the U.S. markets. We believe it is important to acknowledge the status of Exchanges as competitors to one another when analyzing the potential efficacy

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[8] For example, Sponsored Access systems offered by Exchanges can provide order level pre-trade risk management by checking orders submitted to the specific Exchange against risk management criteria while Sponsored Access systems developed in-house by Sponsoring Members or licensed from third parties for use by Sponsoring Members can provide order level plus account level pre-trade risk management by checking orders submitted to all allowed Exchanges, non-Exchange liquidity destinations and across all asset classes against risk management criteria while taking into account daily beginning account position balances and real-time market-wide position management throughout the day.
[9] http://www.reuters.com/article/rbssFinancialServicesAndRealEstateNews/idUSN0228739120081203
[10] http://www.ft.com/cms/s/0/cd68eae2-f1e0-11dc-9b45-0000779fd2ac.html?nclick_check=1
[11] http://www.reuters.com/article/reutersEdge/idUSN2139129320070605
[12] http://www.sec.gov/news/speech/2008/spch050908ers.htm

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of the Proposal as well as the ability of other Exchange Sponsored Access systems[13] to deliver effective market-wide systemic risk management solutions. While Exchanges can develop the technical capabilities in their risk management systems to accept transaction data from their competitor Exchanges, it is unrealistic to expect that they will voluntarily share such information with one another given their status as competitors[14] and mandating the sharing of confidential information among competitive Exchanges would not reflect positively on the integrity and credibility of the U.S. markets when effective private sector alternatives (e.g., internally developed risk management systems and independent third party Sponsored Access risk management solutions) exist that provide integrated systemic risk management coverage across all Exchanges, liquidity destinations and asset classes.

The following comments detail suggested changes to the Proposal which we believe are necessary to ensure the continued availability of private sector Sponsored Access risk management solutions so that market participants are not limited to Exchange Sponsored Access solutions which only relate to a portion of the market and therefore are not as effective at managing systemic risk.

II. Use Of Sponsored Access Systems That Do Not Enable Sponsoring Members To Comply With Pre-Trade Oversight And Compliance Obligations Should Not Be Permitted; Attempts To Impose Contractual Arrangements Between Parties Involved In Sponsored Access Do Not Overcome The Limitations Of Such Systems And Systems That Do Provide Pre-Trade Risk Protection Would Not Benefit From These Arrangements.

In our discussions with clients and partners and as a participant on numerous financial industry association conference calls regarding the Proposal, there has been considerable dissatisfaction expressed regarding definitions used in the Proposal. In addition, complaints have been voiced regarding the Proposal's requirement that new forms of contractual arrangements be entered into between various parties – some of which are not subject to securities licensing requirements and with respect to which there is no precedent for statutory or regulatory jurisdiction. Rather than trying to create forced contractual arrangements, FTEN suggests that Sponsored Access systems that do not provide pre-trade risk management should no longer be authorized (in the chart copied below and attached as Exhibit A, such non pre-trade risk management systems are characterized as Category One Sponsored Access systems). This would still allow systems offered by Exchanges and systems developed in-house by Sponsoring Members and by third parties for use by Sponsoring Members that provide pre-trade risk management to continue to be used to provide Sponsored Access. If only Sponsored Access systems that provide pre-trade risk management, whether provided by Exchanges (Category Two Sponsored Access systems) or developed in-house by Sponsoring Members or provided by third-parties for use by Sponsoring Members (Category Three Sponsored Access systems), are authorized, then no new contractual arrangements will be required, existing relationships between parties involved in Sponsored Access will not need to be disturbed and the responsibility for compliance will properly remain with Sponsoring Members.

[13] For example, NYSE's Risk Management Gateway (File No. SR-NYSE-2008-101, see http://www.sec.gov/rules/sro/nysealtr/2009/34-59353.pdf).
[14] For example, despite introducing capabilities within Nasdaq's ACT Risk Management System to accept "drop copies" from competitive liquidity destinations, Nasdaq's efforts over the last two years to integrate non-Nasdaq trading data into the scope of ACT Risk Management have been largely unsuccessful - see www.nasdaqtrader.com/content/ProductsServices/Trading/ACTWorkstation/risk_factsheet.pdf).

Sponsored Access Systemic Risk Management			
Pre-Trade Risk Management Checks	Category One: Direct Connections to Markets	Category Two: Exchange Sponsored Systems*	Category Three: Sponsoring Member / 3rd Party Systems**
Restricted Stock Lists	-	✔	✔
Manipulative Trading	-	✔	✔
Erroneous Trades	-	✔	✔
Margin Rules	-	O	✔
Available Capital	-	O	✔
Long Sales	-	O	✔
Short Sales / Locates (Reg. SHO)	-	O	✔
Post-Trade Accountability			
Legal Remedies	✔	✔	✔

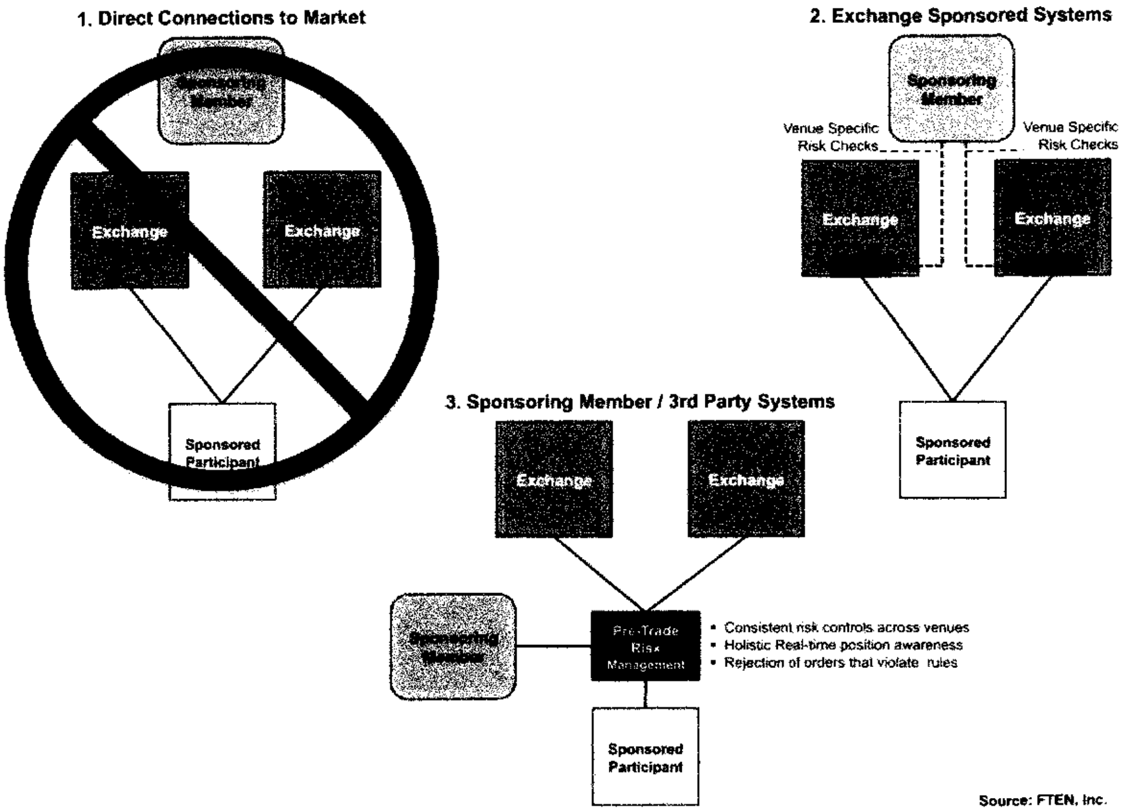
✔ Available
O Coverage limited to trading activity on specific Exchange
- Not Available

* Sponsored Access Systems offered by Exchanges can provide order level pre-trade risk management by checking orders submitted to the specific Exchange against risk management criteria.

** Sponsored Access Systems developed in-house by Sponsoring Members or licensed from 3rd parties for use by Sponsoring Members can provide order level plus account level pre-trade risk management by checking orders submitted to all allowed Exchanges and non-Exchange liquidity destinations against risk management criteria and taking into account daily beginning account position balances and real-time market-wide position management throughout the day.

Source: FTEN Inc.

The illustration copied below and attached as Exhibit B highlights the distinction between Sponsored Access systems that enable Sponsoring Members to comply with their oversight and compliance obligations and those that do not. In the first figure entitled "1. Direct Connections to Market," the Sponsored Participant uses a Sponsored Access system that enables them to transact business directly with the Exchanges using a Market Participant Identifier (MPID) associated with the Sponsoring Member but does not provide the Sponsoring Member with the ability to ensure that the order flow complies with applicable rules and regulations. In the second figure entitled "2. Exchange Sponsored Systems," the Sponsored Participant uses a different Sponsored Access risk system at each Exchange with regard to business transacted directly with that Exchange using an MPID associated with the Sponsoring Member which provides the Sponsoring Member with the ability to ensure that the order flow submitted only to that Exchange complies with applicable rules and regulations. In the third figure entitled "3. Sponsoring Member / 3rd Party Systems," the Sponsored Participant uses a Sponsored Access system that enables them to transact business directly with all Exchanges using an MPID associated with the Sponsoring Member which provides the Sponsoring Member with the ability to ensure that the Sponsored Participant's order flow at all allowed Exchanges complies with applicable rules and regulations.



Despite the simplicity of the above illustration, it helps to capture the essence of the risk management issues surrounding Sponsored Access. Initially, Sponsored Participants requested Sponsored Access arrangements because they enjoyed the anonymity provided by trading under the auspices of a Sponsoring Member's market participant identifier. However, as electronic algorithmic trading has increased in popularity, hedge funds and other high-volume trading groups began to request Sponsored Access arrangements because they could get to the markets faster thereby enabling them to more effectively execute their trading strategies. The problem is that rather than making ongoing investments in software, hardware and communications facilities as necessary to provide solutions that enable Sponsored Participants to access markets with the speed their trading strategies require yet still provide Sponsoring Members with control, a number of Sponsoring Members have elected to use solutions like those outlined in the first figure entitled "1. Direct Connections to Market," that increase speeds to the market by, among other things, eliminating the ability of Sponsoring Members to control order flow[15].

[15] It should be noted that this need not but be an "either / or" situation; users of FTEN's VelocityXpress™ (VX™) Sponsored Access risk management trading gateway average less than one-fifth of a millisecond (0.2 milliseconds) round-trip in total additional processing time for (i) completion of pre-trade risk management by the Sponsoring Member, including both order level and account level pre-trade risk management tests, (ii) normalization of interactions between the Sponsored Participant

We suggest that the best way to effectively manage systemic risk is to authorize only Sponsored Access arrangements that provide Sponsoring Members with the ability to ensure compliance with securities rules and regulations. Rather than trying to address the shortcomings of Sponsored Access arrangements which fail to provide Sponsoring Members with such capabilities by mandating specific contract arrangements between parties,[16] some of which are not subject to securities licensing requirements and with respect to which there is no precedent for statutory or regulatory jurisdiction, we propose that only Sponsored Access systems (whether such systems are provided by Exchanges, internally developed or provided by third parties) that provide Sponsoring Members with the ability to ensure compliance be authorized. In this manner, existing relationships between parties need not be disturbed, the responsibility for compliance will properly remain with the Sponsoring Member and appropriate focus can be placed on specifying appropriate "minimum requirements" for Sponsored Access systems in order to provide effective market-wide systemic risk controls as more fully discussed below.

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and applicable Exchanges and (iii) normalization of interactions between the Sponsored Participant and the Sponsoring Member.

[16] An excellent summary of the shortcomings of a contract-based approach to Sponsored Access risk management is provided in the September 24, 2008 letter sent by Alistair Brown, Chief Executive Officer, of Lime Brokerage LLC ("Lime") to Florence Harmon, Acting Secretary of the Securities and Exchange Commission, (the "Lime Letter") in the context of relying on agreements between Sponsoring Members and Sponsored Participants to provide protection:

> Oversight by Contractual Agreement Falls Short of Direct Oversight
>
> NYSE Rule 123B [and Nasdaq Rule 4611] places the ultimate responsibility for compliance with the securities laws and rules on the sponsoring member, but it does not explain how the sponsoring member will satisfy these obligations in practice. Instead, NYSE Rule 123B [and Nasdaq Rule 4611] requires the sponsored participant to sign an agreement stating that it will comply with the securities laws. Such contracts only provide the sponsoring member with after-the-fact oversight via contractual remedies – and, only if the problem is discovered. It cannot provide the same level of supervision as real-time oversight of trading activities, as would be imposed if the trades were sent through the broker-dealers own system. Moreover, such an agreement does not provide the level of investor protection provided by a registered broker-dealer or associated person performing the trading activities. The sponsored participant and its authorized trader are performing functions that have historically been done only by registered personnel of a broker-dealer who satisfy numerous requirements designed to insure the integrity of the markets. The many prophylactic requirements include being free from a statutory disqualification, passing several examinations (including Series 7 and Series 55), being supervised in their trading activities, participating in Regulatory and Firm Elements of Continuing Education and an annual compliance interview or meeting, and being subject to limitations on personal securities transactions, including the purchase of new issues. If the requirements imposed on broker-dealer personnel are relevant and meaningful, there seems to be no justification for permitting non-registered persons to participate on an equal, indeed preferential, basis." (see www.sec.gov/comments/sr-nyse-2008-71/nyse200871-1.pdf)

We believe that permitting only Sponsored Access arrangements that provide Sponsoring Members with the ability to ensure compliance with securities rules (i.e., arrangements exemplified by Figure 2 above) would accomplish the market stability and compliance objectives advocated for in the Lime Letter without requiring the elimination of the Sponsored Access provisions of NYSE Rule 123B or Nasdaq Rule 4611 as proposed in the Lime Letter.

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III. Minimum Criteria For Sponsored Access Systems And Opt-Out / Certification Procedures For Sponsoring Members Who Desire To Use Private Sector Sponsored Access Systems Rather Than Exchange Systems Should Be Established.

We suggest that the Securities and Exchange Commission coordinate a dialogue among Exchanges, other regulators[17], financial securities industry organizations[18] and industry participants[19] to develop minimum requirements that all Exchange, in-house and third-party Sponsored Access systems must satisfy. Then, each Exchange should offer a procedure whereby Sponsoring Members can certify that they are using a Sponsored Access solution that satisfies these criteria if they want to opt-out of using the Sponsored Access solution offered by such Exchange. An analogous precedent exists in the opt-out provisions from ACT Risk Management which enable clearing firms to opt out of Nasdaq's ACT Risk Management System by submitting a letter indicating that they are using "another risk management tool of equal quality" (see SEC Release No. 34-47208; File No. SR-NASD 2002-157).

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FTEN appreciates the opportunity to provide feedback on NASDAQ's proposal to adopt a modified Sponsored Access rule (File No. SR-NASDAQ-2008-104). If you have any questions concerning these comments or would like to discuss this matter further, please feel free to contact FTEN through our General Counsel, M. Gary LaFever, at glafever@ften.com.

Sincerely,

Ted Myerson

Ted Myerson
President

cc: Mary Schapiro, Chairman, Securities Exchange Commission
Christopher Dodd, Chairman, U.S. Senate Banking Committee
Barney Frank, Chairman, House Financial Services Committee
Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System
Erik R. Sirri, Director, Division of Trading and Markets, Securities and Exchange Commission

[17] For example, the Board of Governors of the Federal Reserve System, the Financial Industry Regulatory Authority (FINRA) and the Commodity Futures Trading Commission (CFTC)

[18] For example, the Securities Industry and Financial Markets Association (SIFMA) and the Financial Information Forum (FIF).

[19] FTEN would be honored to share its perspectives as an independent, third party, non-trading entity and representative of the financial technology segment of the industry in such a working group.

Exhibit A

Sponsored Access Systemic Risk Management

Pre-Trade Risk Management Checks	Category One: Direct Connections to Markets	Category Two: Exchange Sponsored Systems*	Category Three: Sponsoring Member / 3rd Party Systems**
Restricted Stock Lists	-	✔	✔
Manipulative Trading	-	✔	✔
Erroneous Trades	-	✔	✔
Margin Rules	-	O	✔
Available Capital	-	O	✔
Long Sales	-	O	✔
Short Sales / Locates (Reg. SHO)	-	O	✔
Post-Trade Accountability			
Legal Remedies	✔	✔	✔

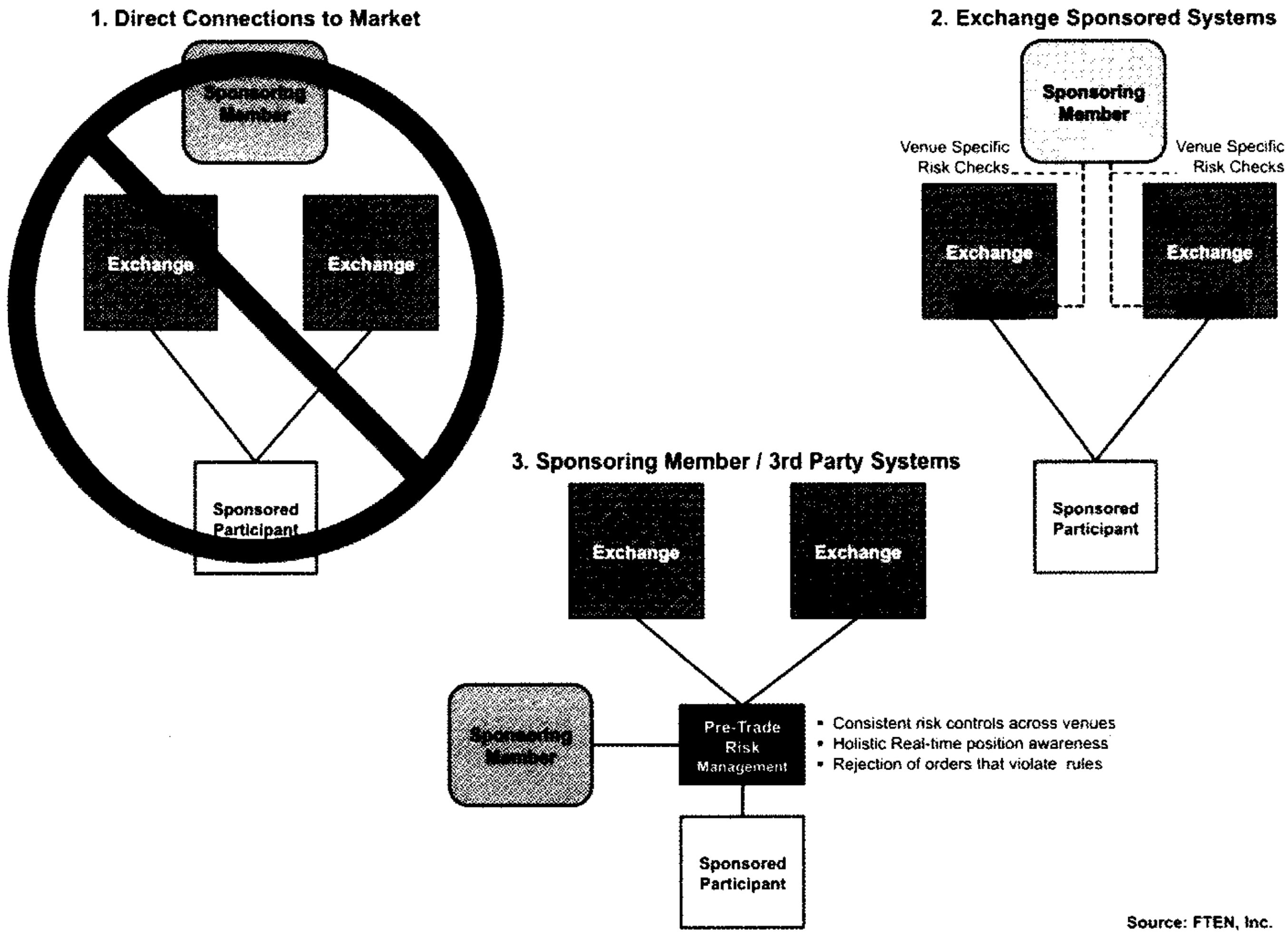
✔ **Available**
O **Coverage limited to trading activity on specific Exchange**
\- **Not Available**

*** Sponsored Access Systems offered by Exchanges can provide order level pre-trade risk management by checking orders submitted to the specific Exchange against risk management criteria.**

**** Sponsored Access Systems developed in-house by Sponsoring Members or licensed from 3rd parties for use by Sponsoring Members can provide order level plus account level pre-trade risk management by checking orders submitted to all allowed Exchanges and non-Exchange liquidity destinations against risk management criteria and taking into account daily beginning account position balances and real-time market-wide position management throughout the day.**

Source: FTEN, Inc

Exhibit B



Source: FTEN, Inc.