

FINANCIAL INFORMATION FORUM

212-422-8568

February 19, 2009

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

Re: File Number SR-NASDAQ-2008-104

Dear Ms. Murphy,

The Financial Information Forum (FIF)¹ would like to take this opportunity to provide feedback on File Number SR-NASDAQ-2008-104. The proposal to establish a well-defined set of rules governing sponsored access is a positive step towards addressing consistency in sponsored access requirements. Exchange members should assume responsibility for their customers' trading activity; however, based on feedback from FIF's broker dealer and vendor members, we would like to offer the following comments on implementation issues associated with the NASDAQ sponsored access proposal. We suggest the proposal be modified in order to:

- Clarify the definition of Sponsored Access
- Focus Sponsored Participant information requirements on credit determination
- Maintain the existing relationship between sponsoring members, sponsored participants and their service bureaus/3rd party providers
- Limit the required scope of sponsored access system functionality
- Align rule requirements with current surveillance report review practices

Each of the aforementioned topics is discussed below in more detail.

Clarify the Definition of Sponsored Access

Traditionally, sponsored access has meant using an exchange's infrastructure to allow sponsored participants with the ability to trade directly on an exchange using the sponsoring broker-dealers' name. The filing expands this definition to include situations in which the broker dealer's infrastructure is being used, commonly referred to as Direct Market Access or DMA. The implications of DMA falling under the sponsored access definition are worth further discussion in that currently DMA contracts are not based on agreements with an individual market center nor are there independent controls associated with a specific market center.

¹ FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the financial technology industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

Focus Sponsored Participant Information Requirements on Credit Determination

Sponsored access gives non-member firms the ability to immediately interact with markets without a human intermediary affiliated with a member firm. Proposals to further regulate Sponsored Access should seek to systematize the reviews that would otherwise take place, if the orders were being placed with a living intermediary. Proposals should not seek to create new requirements that would not apply if the orders had been given to member firm intermediaries outside of a sponsored access relationship. For example, the proposal's requirement that Sponsored Firms provide Sponsoring Member with access to its books and records promptly upon request. FIF members believe this is an overly-broad requirement without precedent that, if not changed, would likely impact dramatically the number of firms willing to be sponsored. There is no similar requirement for non-sponsored customers of member firms to provide access to their books and records upon request. It is difficult to imagine sponsored customers agreeing to such unbridled access. For sponsored participants that are broker dealers, it is unclear why the sponsoring broker should be reviewing this level of information when that function is already performed by the SRO of the sponsored broker-dealer.

Regardless of whether or not customers are sponsored, broker dealers function as credit intermediaries between the markets and their clients and as a matter of course are making determinations of the client's credit worthiness. FIF believes it is sensible, to the extent the member firm extends credit, for all customers, including sponsored customers, to provide member firms with current corporate and financial information necessary to accurately assess credit risk. Only information sufficient to make a credit determination should be required.

Maintain the Existing Relationship between Sponsoring Members, Sponsored Participants & Service Bureau/3rd Party Providers

Broker dealers should continue to be responsible for (1) having adequate risk management controls and (2) for having procedures reasonably designed to achieve compliance with applicable securities laws and regulations, irrespective of how sponsored access functionality is provisioned (i.e., in-house system, 3rd party vendors, service bureaus, or exchange systems). Requiring contractual arrangements between service bureaus and Sponsored Participants specifying that the Sponsored Participant must commit to the Service Bureau that it will comply with all applicable securities laws and rules and Exchange rules, provide books and records upon request to the Sponsoring Member, and perform various SRO functions such as maintaining its trading limits within the financial limits specified by the Sponsoring Member, and providing financial and other information to the Sponsoring Member runs counter to past guidance. That guidance explicitly states that the compliance obligation falls with the broker dealer and not with any 3rd party vendor that they use. There is no clear reason why service providers used for sponsored access should be treated any differently. It is also unclear what the contractual arrangements would be when the sponsored access provider is an exchange. Given that the broker dealer is ultimately responsible for trading done in their name, they should continue to do the due diligence on their 3rd party providers as they do today.

In order to best serve the broadest interests of the financial securities market, we believe it is important that broker dealers have the flexibility to select risk management solutions that work best for them and that regulation not favor any one risk management solution, be it an exchange or independent third party provider. An analogous precedent exists in the opt-out provision 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). We believe a similar system should be put in place with regard to sponsored access risk management solutions since broker dealers may prefer to develop in-house

technology or contract with third-party providers to integrate sponsored access risk management functionality across all exchanges / liquidity destinations. Requiring broker dealers to agree that their sponsored access system (3rd party or in-house) meet minimum functionality requirements would keep the onus on the broker dealer for ensuring appropriate risk controls when they give up their MPID for use in sponsored access arrangements.

Limit the Required Scope of Sponsored Access System Functionality

The filing identifies several compliance related validations that should be performed by sponsored access systems most of which are embedded in sponsored access systems today. However, incorporating functionality for trading halts and identifying manipulative behavior may not be appropriate for inclusion within the requirements of a sponsored access system.

While not a significant implementation effort, it is not clear why it is necessary for the sponsored access system to check for exchange halts when the exchange matching engine already performs this function. While broker dealer systems that internalize trades check for halts, this is often not part of systems where order flow is sent to exchanges.

Of much greater concern is the difficulty in complying with the requirement to prevent manipulative trading behavior. Sponsored access systems do not have access to a sponsored participant's entire position. Determination of manipulative behavior is based not only on data but also on judgment calls made after a full review of trading activity. Programming a sponsored access system based on subjective criteria with insufficient data is not likely to yield meaningful results. Even with respect to just the trades done on a sponsored access system, it is often only after the fact that patterns can be detected and reported. Identifying specific exception reports and/or algorithms for sponsored access systems to institute would be required in order for sponsored access systems to provide this kind of functionality.

We encourage Nasdaq and the other exchanges to work with the SEC in defining reasonable systematic controls that can be incorporated into sponsored access systems to address market manipulation if it is deemed necessary. Defining precise requirements and allowing sufficient implementation time will ensure that multiple service providers can meet the requirements. While we understand that it is not possible to identify every possible type of violation, establishing a set of reasonable policies and procedures for sponsoring brokers to adhere to would be useful in developing appropriate system functionality.

Align Rule Requirements with Current Surveillance Report Review Practices

The filing calls for sponsoring brokers to obtain a complete audit trail at the end of the trading day. This is not functionality that is part of all systems. While receiving immediate drop copies is done today in many cases, execution reports alone are not sufficient to create a full audit trail. Some reports are done at the end of the business day or in overnight processing and not available until the next business day. As noted earlier, often patterns can only be identified post-trade, therefore we recommend broadening the language to require review and surveillance within a reasonable time frame rather than a specific time within the trading day.

Additionally, these reports are reviewed by staff in a supervisory function (e.g., business risk managers) not necessarily compliance personnel as is stated in the filing. We suggest broadening the language used to describe which staff/roles are eligible to review surveillance reports.

Summary

FIF supports the filing's intent to establish a balanced and consistent approach to sponsored access risk management. We look forward to reviewing an amended filing that takes into consideration the feedback on implementation issues provided in this comment letter.

It is our understanding that the NASDAQ sponsored access rule will be the template used across the exchanges to define sponsored access system requirements. We stand ready to discuss the implementation issues associated with the NASDAQ sponsored access filing in order to ensure a consistent and efficient implementation of sponsored access rules across the national market system.

Sincerely,


Manisha Kimmel
Executive Director
Financial Information Forum