Engmann Options, Inc.

March 16, 2010

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

Re: Comment on File No. S7-03-10

Dear Ms. Murphy:

We have read and reviewed the SEC's Proposed Rule 15c3-5, *Risk Management Controls for Brokers or Dealers with Market Access*, released for comment on January 19, 2010. We commend the Commission for its efforts in working to establish a common regulatory structure regarding electronic access to the U.S. Securities Markets.

However, there are a number of issues that the proposed rule does not specifically cover or adequately clarify. These open issues leave open questions on how to comply with the proposed rule. Among these questions are:

- ***Would market makers and specialists be exempt from the proposed rule? There is seemingly no way for them to comply with a pre-trade approval since they are constantly streaming quotes to the market, yet the proposed rule does not specifically provide that exemption.***

  This is the only situation where we believe an exemption to the proposed rule would be appropriate. Market makers and specialists are traditionally direct members of exchanges and subject to specific regulation in carrying out their responsibilities. Their accounts are generally guaranteed by their clearing firms, who conduct real-time risk surveillance of the accounts.

- ***What is the impact of this rule regarding broker-dealer firms with their own exchange, Nasdaq or ATS MPID, but which clear their trades through a clearing broker in what are commonly referred to as "parent/child" relationships, correspondent clearing or QSR relationships? Will the broker-dealer with the executing MPID have the responsibility to comply with proposed Rule 15c3-5 or will that be the responsibility of the clearing broker or will it be a shared responsibility?***

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We think that requirements to the proposed rule should apply to the member broker-dealer who is executing directly with an exchange, Nasdaq or ATS. The executing broker with the MPID should be responsible for doing all pre-submission trade verification for risk and credit, market validation and, regulatory compliance. The clearing firm should sign a guarantee of the accounts and conduct real-time surveillance of all executed trades and have a robust review for risk management purposes.

- ***Can a broker-dealer with its own MPID and a Joint Back Office (JBO) arrangement with a clearing broker, use the JBO relationship to satisfy both the Executing Broker and Clearing Broker responsibilities described above?***

  JBO participants: 1) must be registered broker-dealers; 2) generally have their own execution MPIDs; and 3) have established an ownership interest in their clearing firm. We think that the combination of these three points makes it most appropriate for the JBO participant to be responsible for the pre-trade validations proposed in the rule. This would mean that the JBO participant would have the appropriate real-time risk management infrastructure necessary for complying with the rule.

  The clearing firm should sign a guarantee of the accounts and conduct real-time surveillance of all executed trades and a have robust review for risk management purposes.

- ***What is the status of Prime Broker and Institutional trading that is done away from the Prime Broker or Custody Agent? Is the executing broker required to comply with all of the requirements of the proposed Rule 15c3-5 or can the executing broker rely on the Prime Broker or Custody Agent to comply with the Credit and Capital control aspects of the rule?***

  Given the scope and purpose of the proposed rule we do not think that the current structure in which an executing broker relies on a free funds letter from the Prime Broker to be appropriate for any type of algo or computerized trading by the executing broker that does not have a manual input or review of order input. Traditionally most institutional orders were executed with a manual interface, but in the current environment large institutional orders are often broken up into smaller and smaller trades using VWAP (value weighted average price) type or other algorithms for execution and aggregation.

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Any executing broker using automated execution methods either should do the full pre-trade validation based on the customer, or be accumulating these trades as risk or risk less principal trades and validate the trades as proprietary transactions. The executing broker should have to conduct some kind of credit evaluation of each of its customers in any case.

Further, with regard to institutional trades, it seems somewhat incongruous to create an enhanced pre-trade validation requirement and not address the far greater settlement issues which can cause risk to the system. There are some estimates that about 70 percent of the equity trades executed in the U.S. have not confirmed the details of the trades by the end of the day. This is further exasperated by the trade-for-trade, counterparty-to-counterparty, three day delivery-versus-payment (DVP) process currently in use for the settlement of institutional trades. If the commission senses such substantial concern about risks in the execution of algo generated trades, it should have equal if not greater concern over the settlement of these institutional trades. We think that the Commission should include a regulatory push towards an institutional netting solution, if not in this rule then in another rule filing.

- ***Can the annual review of the broker-dealers market access business and CEO certification be combined with the required annual compliance audit and CEO certification that is already in place, or would this have to be a separate and distinct set of actions?***

  We would recommend that these reviews be combined as a component of the annual compliance review and CEO certification in order to lessen the burden of the rule on broker-dealers.

We would also like to provide our opinion on several of the questions posed by the Commission in the release.

- ***Would the controls imposed by the rule substantially increase latency?***

  As the Commission's own research indicates the implementation of the rule could add an additional latency of approximately 200 to 500 microseconds. The rule will shift competition to the broker-dealers whose systems can capture all order messages, review and validate the messages and submit orders to the market with the least amount of latency.

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This will likely lead to less competition and consolidate much of the current trade volumes with a few specialized broker-dealers and, greatly reduce the number of entry points into the markets. This consolidation in itself could add to greater overall latency.

- ***Would the proposed rule have any unintended consequences for the U.S. markets?***

  Given the many uncertainties that a rule of this scope presents to the U.S. markets and the broker-dealer community it is hard to believe that there would not be unintended consequences. For example, it is likely that exchanges will see an increase of High Frequency Firms apply for membership in order to obtain direct access. Given the cost of broker-dealer status, some HFT firms may merge to spread the cost of the regulatory overhead thus possible reducing competition. While these and other unintended events should not be enough to prevent implementation of the rule, we would suggest that the proposed rule, when implemented, be released as a one or two year pilot program in order to allow for adequate monitoring and subsequent fine tuning should issues arise.

- ***Would the proposed rule stifle or impact certain trading strategies that may add value to the market?***

  It is hard to imagine the proposal not having an impact on certain contingency, hedge or OCO (one cancels the other) strategies where one order is contingent on execution of the other or, other strategies that are dependent on speed to the market relating to external events that might impact the market. However, it is unclear as to the value of such strategies in maintaining narrower spreads or liquidity in the market and we recommend that such an analysis be conducted during a pilot period.

- ***Would the proposed rule limit price discovery mechanisms?***

  The actions of the Commission over the past fifteen years have done a lot to diminish the role of market makers and specialists in the price discovery process. These actions include: the approval and expansion of alternative trading systems; the approval of Rule NMS; the multi-listing of options; and the ever decreasing bid–offer spreads from eights, to sixteenths, to dimes, to nickels, to pennies and, to sub-pennies. These actions were taken to provide tighter spreads, more efficient pricing and greater liquidity to the market. All of which has been accomplished.

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Occurring coincidental to these actions was the rapid use of computer assisted trading, the development of new and ever more effective algorithms and ever faster execution speeds with decreasing levels of latency. By the commission's own estimates high frequency trading accounts for as much as 60 percent of U.S. equities volume. If there were a 10% reduction in this volume due to this rule, that would mean billions of shares removed from the market with each of those shares potentially being a point of price discovery.

The absence of these points of prices discovery are likely to mean wider bid-offer spreads and a reduction of liquidity in the market.

However, it is unclear that such a reduction in volume would occur under the proposed rule which is why we recommend the adoption of the pilot period for analysis.

We appreciate the opportunity afforded us to comment on proposed rule 15c3-5 *Risk Management Controls for Broker or Dealers with Market Access*. We feel that this rule is critical to the effectiveness the U.S. markets and should passed by the Commission, initially under a pilot program to assess any negative impacts on market quality.

Sincerely,

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