Goldman, Sachs & Co. | One New York Plaza | New York, New York 10004
Tel: 212-902-1000

Goldman Sachs

March 30, 2010

Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Rule 15c3-5, Risk Management Controls for Brokers or Dealers with Market Access, File No. S7-03-10

Dear Ms. Murphy:

Goldman, Sachs & Co. ("GS&Co.") and Goldman Sachs Execution & Clearing, L.P. ("GSEC")[1] (collectively "Goldman Sachs") appreciate the opportunity to comment on the Securities and Exchange Commission's ("SEC's" or "Commission's") proposed new Rule 15c3-5 ("Proposed Rule") under the Securities Exchange Act of 1934 ("Exchange Act"). The Proposed Rule would impose new risk management requirements on any broker-dealer with access to trading directly on an exchange or alternative trading system ("ATS") or that provides a customer or other person with access to an exchange or ATS through the use of its market participant identifier or otherwise.[2] We share the Commission's interest in ensuring that the U.S. markets continue to be deep, liquid, efficient and systemically safe, and we agree that measures should be taken to reduce the risks to broker-dealers and the financial markets that could result from market access[3] over which appropriate financial and regulatory controls are not exercised.

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[1] GS&Co. is a global investment banking and brokerage firm that participates in the U.S. markets in a variety of capacities, including for its own account and as an executing broker, a clearing broker, and a prime broker for its customers. GSEC predominantly is an unsolicited agency broker that provides access to various market venues to professional clients, including institutions, broker-dealers, and hedge funds.

[2] Exchange Act Release No. 61379, 75 Fed. Reg. 4007 (Jan. 26, 2010) ("Proposing Release"). As discussed below, the Commission should clarify that the Proposed Rule would apply only to broker-dealers accessing an exchange or ATS directly or permitting a client to access such markets using such broker-dealer's participant identifier, and that the "or otherwise" language of the proposed definition of "market access" is not meant to extend the Proposed Rule, for example, to broker-dealers acting solely as service providers to persons accessing markets in ways other than through the use of such broker-dealer's participant identifier.

[3] As used in this letter, "market access" means arrangements under which a registered broker-dealer (i) accesses an exchange or ATS directly on its own behalf, (ii) allows a third party to access such markets using its participant identifier, or (iii) as the operator of an ATS, permits non-broker-dealer subscribers to access the ATS.

We commend the Commission for its continuing efforts to ensure that the regulatory framework keeps pace with market developments. We generally are supportive of the principle that appropriate market access controls are necessary, and, in particular, we support the Commission's policies and procedures approach in the Proposed Rule. As discussed below, however, the Commission should consider further some practical implications of the Proposed Rule, and clarify and modify certain aspects of the Proposed Rule to help ensure that risk management controls are reasonable and appropriately tailored to minimize risks without unnecessarily chilling innovations in trading and technology that may be beneficial to the markets.

Our comments below reflect three key points. First, in our view, there cannot be a "one-size-fits-all" solution to risk controls. Risk controls must be tailored to the particular nature of the market access, the arrangements between the market participants and the market venue, and the client's trading strategy. Second, the type of unfiltered access that we believe raises significant risk is access that is monitored neither by the sponsor of the access nor the market itself.[4] We believe that either the market access sponsor or the market venue itself, solely or in combination, can provide appropriate risk management controls. Third, any new rule relating to market access should supplement existing broker-dealer risk management controls and not result in a complete overhaul of existing programs and systems used by broker-dealers to conduct reasonable regulatory surveillance. Any new rule relating to market access controls should be targeted at those controls needed to manage risk more effectively at the gateway to the market. Not all controls lend themselves solely to pre-order entry blocks and sponsoring broker-dealers should be allowed to rely on a reasonable combination of pre-order blocks, intra-day monitoring, and surveillance to satisfy their obligations under the Proposed Rule.

I. Background

The complex nature of the various access arrangements used by today's market participants demonstrates the need for a more tailored approach to risk management, one that carefully balances the risks to be addressed, the likelihood that controls will address the risks, the feasibility of implementing the controls, and the impact that such controls will have on the markets and the investors that use them. While we support the Commission's goal of providing reasonable risk standards for market access,[5] in our view the Proposed Rule should be refined to better reflect the degree to which particular types of controls are reasonable or even feasible under different circumstances, taking into consideration the types of arrangements that exist among market venues, executing and clearing brokers, clients, and other market participants. Some of the more common arrangements are as follows:

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[4] A broker-dealer providing market access is the "sponsoring" broker-dealer, while a third party gaining access to an exchange or ATS is the "sponsored" entity.

[5] *See* Proposing Release at 69.

- Forms of Market Venue Access

  Consumers of market access arrangements may be either registered or unregistered entities and may or may not be members or subscribers of a market venue. The sponsored entity's access may be "unfiltered," *i.e.,* allowed to access the market directly, without its orders passing through the sponsoring broker-dealer's, a third-party vendor's or an exchange's risk management controls, or, conversely, subject to all of the regulatory checks imposed by broker-dealers when handling orders for their clients. A broker-dealer also may offer technology services to a client seeking to access the market using their own or someone else's participant identifier through the broker-dealer's service platform.

- Forms of Client-Broker-Dealer Arrangements

  Broker-dealers may have multiple arrangements with the same client, some of which involve use of a broker-dealer's participant identifier to access a market and others that only involve use of technology services to route orders using the client's own or another broker-dealer's participant identifier. A broker-dealer may act only as the executing broker, as the executing and clearing broker or only as a clearing broker, and, when clearing, may be doing so either on an omnibus or a fully-disclosed basis. The sponsored client also could be executing and/or clearing trades via multiple broker-dealers.

Additionally, we note that the Commission undoubtedly recognizes that the multi-faceted relationships among broker-dealers and other market participants represent a fundamental challenge to achieving comprehensive market access management. For example, even the most stringent financial controls (assuming they could practically be implemented) would not completely address the Commission's concerns about systemic risk. Unless a broker-dealer is the exclusive clearing and executing broker for a fully-disclosed client, it will not have a complete picture of the client's overall exposure in the various markets and the broker-dealer will not be able to prevent, limit, or mitigate the systemic risk presented by the client's trading activities. Accordingly, while advancing the cause of risk management, there is an inherent limitation on the overall likely efficacy of the Proposed Rule.

II. Discussion

Market access arrangements are not new phenomena. Market participants have used their executing, clearing, or prime broker's participant identifier for years to access the markets for a variety of reasons, including gaining access to exchanges of which they are not members, obtaining volume discounts available when multiple orders are aggregated, or reducing latencies through the use of superior technology. Indeed, the Commission recognizes the many potential benefits from various market access arrangements in the Proposing Release.[6]

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[6] *See* Proposing Release at 7.

As today's markets tend to be more open, non-discriminatory, and competitive, a wider array of participants have a need to access markets. In addition, technological advances have made automated, high speed access to multiple market venues a more standard practice. These developments have led to significantly higher trading volumes. The advent of more highly automated forms of trading and increased trading volumes has refocused the public's scrutiny on market access risk controls. While the speed and complexity of trading admittedly present elevated risk, they also offer numerous benefits to investors and the markets. High speed trading has enhanced the efficiency and liquidity of our markets by reducing latencies,[7] facilitating better and more transparent pricing of related instruments in different markets, and reducing transaction costs. Reduced latency and enhanced pricing transparency aid in the quality of executions received by investors. These benefits, which are infrequently cited in today's debates, should be taken into account when determining the reasonableness of controls. Controls that are too stringent could have the unintended consequence of causing unnecessary inefficiencies in the functioning of normal market processes.

As discussed more fully below, different types of market access may create different risks. Whether controls are "reasonably designed to manage the financial, regulatory, and other risks"[8] depends upon a number of factors, including the types of markets accessed, the client's relationship with the sponsoring broker-dealer and the client's trading strategy.

A. The Reasonableness of Controls Must Take into Consideration the Type of Market Access, the Scope of the Client-Broker-Dealer Arrangements, and the Nature of the Market Venue and Products Traded

We agree with the Commission that mandatory risk management controls are important for the safety of the markets and the financial system as a whole. However, rather than applying the same regulatory risk management and supervisory requirements to all types of market access relationships, products, and orders, sponsoring broker-dealers should have the flexibility to implement controls that are reasonable in light of a number of factors. Such factors could include, for example, the types of markets accessed (*e.g.*, high volume and highly liquid vs. lower volume and less automated), the sponsoring broker-dealer's relationship with the client (*e.g.*, clearing vs. executing only), and the client's trading strategy.

1. Pre-Trade and Intraday Monitoring Controls

The Proposed Rule would require that controls be reasonably designed to prevent entry by the sponsoring broker-dealer of certain types of orders. In our view, not all controls can reasonably be applied before an order is transmitted to an exchange or ATS. Moreover, not all controls should be applied pre-order, even if it were feasible to do so, because of the potential for market disruption and the negative impact on liquidity. We believe that the Commission should

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[7] The Commission recognized that latency itself can be a source of problems for investors and the markets when it mandated fast markets in the context of Regulation NMS. *See* Exchange Act Release No. 51808, 70 Fed. Reg. 37496 (Jun. 29, 2005) (adopting Regulation NMS).

[8] *See* Proposing Release at 35.

distinguish between the types of situations that reasonably lend themselves to pre-order blocks and those that would more appropriately be addressed through "next-trade" (*i.e.,* stopping entry or execution of an order following an event triggered by execution of a previous order) or rolling intra-day and threshold controls.

Based on our experience, the following are examples of automated pre-order controls that could reasonably function as pre-order blocks:

- Authorizations – A control to block unauthorized accounts, passwords, and user identifications.

- Restricted list – A control reasonably designed to block entry of orders involving securities that the sponsoring broker-dealer or client is restricted from trading.

- Unauthorized instruments – A control reasonably designed to block entry of orders where the sponsoring broker-dealer or client is not authorized to trade a specific product, such as options.

- "Penalty box" short sales – A control reasonably designed to block entry of orders that would violate SEC Rule 204T's requirement to close out fail-to-deliver positions.

- Order size and price – Controls reasonably designed to block orders that exceed appropriate size and price parameters, *e.g.*, per order average daily volume checks, per order notional value checks, and per order shares/contracts checks, as well as controls reasonably designed to indicate possible duplicate orders.

Reasonably designed risk management controls also would include other intra-day and post-close monitoring. For example, effective risk management controls should include controls designed to monitor trading patterns for potential regulatory violations. Therefore, the Commission should clarify that a sponsoring broker-dealer may satisfy its obligations under the Proposed Rule through risk management controls that include a reasonable combination of pre-trade, intra-day, and end-of-day controls.

2. Controlling for Financial Risks

More difficult logistical and policy issues, however, arise in connection with the proposed requirement for pre-order credit or capital thresholds.[9] We agree that a broker-dealer offering market access to a client should be required to establish appropriate credit thresholds for the client and also should set appropriate capital thresholds for its own proprietary trading.[10] We

[9] *See* Proposed Rule 15c3-5(c)(1)(i).

[10] *See* Proposing Release at 25.

also agree that an aggregate exposure threshold should be required for each account and, where appropriate, for specific industry sectors and/or securities.[11]

As an alternative to pre-order blocks for credit or capital thresholds, we suggest that the controls required to monitor capital, credit, and exposure thresholds be applied either on a rolling intra-day or post-close basis. Depending on the amount of information reasonably available to the sponsoring broker-dealer, thresholds could, as an initial matter, be monitored on the basis of trades executed. For example, once the threshold is reached, as determined by executed orders, an aspect of the sponsoring broker-dealer's controls could automatically block the routing of additional orders to the market that would increase the client's exposure and also cancel any open orders on the market unless those orders, if executed, would reduce the client's exposure.

3. Any New Rulemaking Should Preserve the Distinction Between New Control Obligations and Existing Regulatory Frameworks Broker-Dealers Employ to Conduct Reasonable Surveillance

In our view, the risk management controls required by the Proposed Rule are intended to target vulnerabilities that may exist at the gateways to market venues and exchanges. Thus, in many respects, these controls are distinct from the surveillance framework that broker-dealers have traditionally relied upon to identify irregular activity and prevent regulatory infractions. In this regard, we believe that the Commission should clarify that the Proposed Rule is not intended to require broker-dealers to overhaul or replace their existing surveillance programs and that many types of regulatory risk controls could be addressed through these more traditional forms of surveillance. Traditional surveillance can be used to monitor for patterns or trading that may be more difficult to isolate and block on a pre-order or intraday basis. For example, a client's attempt to engage in manipulation by marking the close may only become apparent after reviewing several days of trading activity at or around the close. Specifically, we ask the Commission to clarify that broker-dealers may rely upon their existing surveillance programs to satisfy the requirements of the Proposed Rule.

B. The Sponsoring Broker-Dealer Should be Responsible for Risk Controls

We agree with the Commission that risk management controls should be under the control of the broker-dealer sponsoring such access. In light of continued regulatory focus on the role of clearing broker-dealers in monitoring the activity of their introducing firms, however, the Commission should acknowledge that, under the Proposed Rule, clearing broker-dealers and others have no responsibility for maintaining market access risk controls for order flow for which they do not provide "market access." Further, as discussed more fully below, a market access sponsor may satisfy its responsibility by using its own risk management infrastructure or by relying upon a set of controls provided by a third party vendor or an exchange. In either instance, the market access sponsor must have timely notification of exceptions and the ability to respond.

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[11] *See* Proposing Release at 26.

1. Reasonable Controls Can be Satisfied through a Third-party Vendor, including an Exchange

Broker-dealers should be permitted to rely on third-party risk management systems, including an exchange as a third-party vendor, provided such systems are under the control of a broker-dealer subject to the Proposed Rule. Specifically, a sponsoring broker-dealer should be able to rely not only on its own risk management infrastructure, but also on the systems of an exchange or other third-party, provided the broker-dealer either has the ability to monitor the trades in real-time or receive immediate notification of the trades and, in either case, to react promptly. We also agree that the third-party vendor should not be a market access participant or be affiliated with such a participant. We request, however, that the Commission clarify that the sponsoring broker-dealer be permitted to rely on a representation from the third party regarding its affiliations and market access.

2. Certain Controls should be Exclusively Controlled by the Market Venue

We believe that exchanges or ATSs are best positioned to observe certain market-wide developments and are best suited to police risk controls related to such developments. For example, controls with respect to trading halts can more effectively be implemented by exchanges or ATSs than by a sponsoring broker-dealer. In such cases, the market venue should be responsible for compliance with the Proposed Rule. Accordingly, we ask the Commission to reconsider whether a market venue should be responsible for employing risk controls under the Proposed Rule since that market venue likely has better access to relevant information and can act more quickly to impose necessary blocks or other controls.

C. The Annual CEO Certification Requirements in the Proposed Rule are Reasonable.

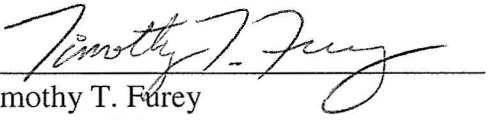
Finally, Goldman Sachs agrees with the annual assessment and CEO certification requirements required by the Proposed Rule. We request that the Commission clarify the circumstances under which a certifying CEO or other officer of a broker-dealer with market access may reasonably rely on certifications of others within or outside of the organization.

III. Conclusion

For the reasons and subject to the suggestions discussed above, we support the Commission's efforts to require that broker-dealers with access to exchanges and ATSs (or that operate ATSs that permit non-broker-dealer subscribers) implement reasonable and appropriate risk management controls and supervisory systems to help ensure that the U.S. markets continue to function safely and efficiently. We appreciate the opportunity to comment on the Proposed Rule and look forward to working with the Commission on this important issue. We would be pleased to discuss our comments and recommendations with Commission staff in more detail. Please feel free to contact the undersigned with any questions.

Sincerely,

J. Ronald Morgan
Managing Director
Goldman, Sachs & Co.



Timothy T. Furey
Managing Director
Goldman Sachs Execution & Clearing, L.P.

cc: Mary L. Schapiro, Chairman, SEC
Kathleen L. Casey, Commissioner, SEC
Louis A. Aguilar, Commissioner, SEC
Troy A. Paredes, Commission, SEC
Elise B. Walter, Commissioner, SEC
Robert W. Cook, SEC Division of Trading and Markets
James A. Brigagliano, Deputy Director, SEC Division of Trading and Markets
David S. Shillman, Associate Director, SEC Division of Trading and Markets