J.P.Morgan

April 26, 2010

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

Re: Exchange Act Release No. 61379; File No. S7-03-10; Risk Management Controls for Brokers or Dealers with Market Access

Dear Ms. Murphy:

J.P. Morgan Securities Inc.[1] ("**J.P. Morgan**") appreciates the opportunity to comment on the Securities and Exchange Commission's ("**Commission**") proposed rule regarding market access (the "**Proposal**"). The Proposal would require broker-dealers with market access to implement pre- and post-trade risk management controls and supervisory procedures reasonably designed to manage financial, regulatory and other risks of accessing markets directly. J.P. Morgan is fully supportive of the Commission's goal of mitigating the risk associated with market access in today's trading environment. We also support the Commission's approach of creating a uniform standard across markets.

To give our comments specific context, we focus on the particular risks presented by computer-generated order flow that is sent to an exchange or alternative trading system ("**ATS**") without human intervention, which we believe is the core concern of the Proposal. This type of automated trading presents two major risks:

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[1] J.P. Morgan is a leading global investment bank with one of the largest client bases in the world. We serve nearly 20,000 clients, including corporations, governments, states, municipalities, healthcare organizations, education institutions, banks and investors. Our clients operate in more than 100 countries. We offer a complete range of financial services to help clients achieve their goals. We provide strategic advice, lend money, raise capital, help manage risk, and extend liquidity, and hold global leadership positions in all of our major business lines. Across our business, our goal is to help clients succeed, contribute to orderly and well functioning markets and support global economic growth. One of the most important functions we serve is extending credit to companies to help them grow.

- an order could be sent to the market with incorrect parameters, such as a limit order with a price that is not reasonably related to the quoted price of a security at the time the order is sent or an order that exceeds pre-agreed price or size parameters; and

- an excessive number of orders could be sent to a trading center within an extremely short period of time, causing a market participant to accumulate a position that is larger than intended and that could, in an extreme scenario, cause a credit event with respect to the market participant or the market participant's clearing firm.

To achieve the goals of mitigating systemic risk while minimizing the impact of the Proposal on liquidity providers, J.P. Morgan believes the Commission should revise the Proposal to specifically identify the parties who should be responsible for risk management controls depending on the type of market access being used, allocate those responsibilities on a pre-trade and post-trade basis, and leverage the central role played by exchanges and ATSs. Moreover, because of current practice by certain broker-dealers offering low latency access without adequate pre- and post-trade controls, the Commission must establish minimum standards to prevent these broker-dealers from endangering the broader market.

Pre-Trade Controls

We agree with the Commission that pre-trade controls need to be applied to all orders sent under a broker-dealer's MPID to an exchange or ATS. In particular, pre-trade controls are essential for orders that go directly to an exchange or ATS – the "naked" form of sponsored access. However, we believe that the best place for those pre-trade controls to reside is at the exchange or ATS itself. Consequently the Commission should require every exchange and ATS[2] to develop pre-trade control systems that must be applied to monitor such naked sponsored access, unless the broker-dealer whose MPID is being used chooses to implement such pre-trade controls itself (either via its own infrastructure or through a vendor under its direct and exclusive control).[3]

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[2] The Commission should consider limiting this requirement to ATSs that meet certain minimum volume thresholds or that publicly display their orders.

[3] For other forms of market access, such as direct market access, J.P. Morgan believes that the Commission should clarify that the broker-dealer whose MPID is being used and through whose infrastructure the order flow is being routed should be responsible for applying the pre-trade controls.

Pre-trade controls at the exchange or ATS level would allow a sponsored participant to connect directly to a trading center without the degree of risk currently posed by "naked" access. The broker-dealer providing access should be able to work with the exchanges and ATSs to set stricter standards for its order flow if the broker-dealer so chooses.

Finally, the Commission should articulate a clear set of minimum standards for all forms of pre-trade controls, applicable equally to exchanges, ATSs, sponsoring broker-dealers or vendors, as a way to ensure that a baseline level of monitoring is conducted in a consistent manner.

Applying these minimum pre-trade controls at the exchange or ATS level is not only an effective way to minimize the risks of "naked" access, it also would reduce opportunities for regulatory arbitrage caused by broker-dealers that apply few or no controls in an attempt to secure client business. In addition, a centralized approach would be cost efficient for the industry and would allow regulators to more efficiently monitor the application of controls operated at the trading center level, as opposed to being operated by hundreds of broker-dealers. Finally, this centralized approach is consistent with the regulatory approach taken with respect to trading halts and clearly erroneous trades.

Post-Trade Controls

J.P. Morgan believes that a clearing broker-dealer should be obligated to implement post-trade credit controls that enable it to monitor the order flow of its introducing broker-dealer clients, including those introducing broker-dealers that provide sponsored access to investors and execute away from the clearing broker-dealer. Such post-trade credit controls should:

- focus on the aggregate trading activity of each market participant;
- enable the clearing broker-dealer to monitor executions on a real-time basis; and
- provide the clearing broker-dealer with the ability to immediately terminate, in whole or in part, its obligation to clear for a particular introducing broker-dealer client if pre-agreed credit limits have been compromised.[4]

[4] Presumably this would require creation of an automated mechanism to terminate the execution connection associated with such order flow.

This is particularly important because clearing broker-dealers customarily enter into contractual arrangements (such as qualified special representative agreements) that require them to clear a trade as soon as the trade is executed at the trading center. The ability for a clearing firm to be able to reliably shut off an introducing broker-dealer client would help mitigate systemic risk by providing a mechanism for taking action, from a credit perspective, before activity spirals out of control. Finally, as with pre-trade controls, the Proposal should set minimum standards for the post-trade credit controls of clearing broker-dealers.

We note that the approach we suggest is already a "best practice" in the foreign exchange markets, which have operated on a sponsored access model for many years. In addition, similar controls and procedures, including pre-trade control systems provided by exchanges, are being implemented in the futures markets. For example, on April 9, 2010, the Chicago Mercantile Exchange ("**CME**") announced that it will require all member firms and their underlying customers to use pre-trade risk controls provided by the CME beginning on June 25, 2010.[5]

An allocation of responsibility as discussed above has been successful in preserving the main benefits of market access in these markets. In particular, where pre-trade controls are applied by trading centers:

- low latency is preserved and is uniform across market participants;
- market participants are able to access trading centers of which they are not a member or subscriber; and
- providers of market access are able to pass along competitive execution pricing due to their ability to aggregate activity and qualify for advantageous volume pricing tiers offered by trading centers.

In conclusion, J.P. Morgan believes that to best mitigate systemic risk the Proposal should be revised to take into account the different roles played by executing and clearing broker-dealers. Responsibility for risk controls should be allocated based on these roles. Providing for a clear allocation of responsibility with minimum standards, and leveraging the central role played by exchanges and

[5] CME Group Advisory Notice No. 10-153, Phased Introduction of Mandatory Globex Credit Controls (April 9, 2010), *available at* http://www.cmegroup.com/tools-information/lookups/advisories/clearing/Chadv10153.html

ATSs, would help avoid regulatory arbitrage, which ultimately will provide for greater market stability and integrity.[6]

We welcome the opportunity to meet with you to discuss our thoughts further and will contact you shortly to arrange such a meeting. Please do not hesitate to call Irene Halpin at 212-622-5341 if you have any questions regarding our comments.

Respectfully yours,

Richard Berliand

Richard D. Berliand
Managing Director and Head of Prime Services and Market Structure Group

J. Hogan

John J. Hogan
Managing Director and Chief Risk Officer, Investment Bank

cc: Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
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Robert W. Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets

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[6] We encourage the Commission to consider how the Proposal will or could interact with the recently-announced large trader reporting requirement, which was proposed on April 14, 2010.