



September 30, 2021

VIA Email: [pubcom@finra.org](mailto:pubcom@finra.org)

Ms. Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
Financial Industry Regulatory Authority, Inc.  
1735 K Street, NW  
Washington, DC 20006-1506

**Re: Regulatory Notice 21-19, *Short Sales: FINRA Requests Comment on Short Interest Position Reporting Enhancements and Other Changes Related to Short Sale Reporting***

Dear Ms. Mitchell:

Provable Markets LLC (“PML” or the “Firm”)<sup>1</sup> appreciates the opportunity to comment on the proposal set forth by the Financial Industry Regulatory Authority, Inc. (“FINRA”) in Regulatory Notice 21-19 (“RN 21-19”) regarding Short Sales.

As noted in a previous letter to FINRA and the U.S. Securities and Exchange Commission (the “SEC”) regarding SB Swaps<sup>2</sup>, PML submits the following comments to the FINRA Staff (the “Staff”) from two perspectives. The first is in the direct interest of the Firm itself. As a future operator of an ATS platform, PML does not intend to engage in principal trading of borrowing and lending or transactions of short sales; however, once its Form NMA is approved by FINRA, and it is cleared by the SEC to operate its ATS, PML will be a platform for borrowers and lenders to meet, and we will support their short sale activity. Second, our comments are offered as an agnostic, but experienced firm in securities lending and short selling, and as such our comments are what PML believes to be in the best interest of *all* market participants.

Broadly speaking, PML is of the view that FINRA and the SEC have made major and successful steps in creating a more stable and rigorous framework for short selling to occur over the past two decades. More specifically, the Firm is of the opinion that current rules including, but not limited to, SEC Regulation SHO<sup>3</sup> and FINRA Rule 4560 (which this proposal would impact most greatly), have curtailed a lot of the “headline” activity that is often attributed to disruptive and volatile market events. The Firm explicitly applauds the efforts of both FINRA and the SEC in essentially ridding the market of what is deemed Naked Short Selling (“NSS”) that was a large contributor to the negative stigma around short selling leading into, during, and after the Financial Crisis of 2008 also known as the Global Financial Crisis (the

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<sup>1</sup> PML has filed a New Member Application (“Form NMA”) with FINRA to become a broker-dealer operating an alternative trading system (“ATS”) to bring greater transparency, liquidity, and access to the Securities Lending market, and to corresponding synthetic markets that offer derivative access to financing-related transactions.

<sup>2</sup> See, <https://www.sec.gov/comments/sr-finra-2021-008/srfinra2021008-8893543-241144.pdf>.

<sup>3</sup> See generally, <https://www.sec.gov/investor/pubs/regsho.htm>.

“GFC”). To wit, during the House Financial Services Committee’s hearings around GameStop (“GME”), the topic of NSS was frequently raised as a major component to the events surrounding GME’s volatility. PML believes that while the practice of NSS has certainly not been eradicated, through rule implementations and enforcement, the SEC and FINRA have significantly reduced the occurrence of this activity to a level where its impact to the broader market is de minimis.

PML supports the view that short selling plays an important role in properly functioning financial markets. We reaffirm comments made by the CFA Institute’s response to RN 21-19<sup>4</sup>, as well as in a prior comment letter to FINRA<sup>5</sup>, the latter of which states in relevant part:

*“Both in the U.S. domestic market and in Europe, we have recognized short selling as a legitimate investment activity and one that serves a number of useful purposes for the financial markets. Among these benefits are improvements to the markets’ price determination mechanisms, leading to more pricing efficiency, narrower bid-ask spreads, and greater market liquidity.”*

With that said, PML believes that when deciding on any changes to short selling rules, it is important to holistically analyze the process by which short selling occurs. PML believes, and will go on to note, that proper analysis of rules should take into consideration both the current process by which participants obtain and use locates, and the act of borrowing and loaning securities. Improvements in technology, new ways to transact and source liquidity (e.g., the Firm’s forthcoming ATS), and market structure developments such as the proposed launch of the National Securities Clearing Corporation’s (the “NSCC”) Securities Finance Transaction (“SFT”) Clearing Service are, in the view of the Firm, positive and beneficial new developments taking place that can help both FINRA and the SEC continue to support properly functioning and fair markets in an efficient and complementary manner with a pragmatic approach to rule changes.

In light of the foregoing, PML offers the following granular comments in response to RN 21-19:

### **I. Publication of Short Interest for Exchange-Listed Securities**

PML is largely in favor of FINRA publicly disseminating short interest data for exchange-listed securities in addition to the unlisted equity data it currently produces. Generally speaking, the Firm believes that when at all possible, data held in the hands of regulators should not require a “cost for entry” to industry participants. The Firm is interested in understanding better the reason for the current method by which FINRA “provides the reported short interest position information to the applicable listing exchange for processing and publication”<sup>6</sup>, in order to properly assess whether or not this may result in increased costs for the exchange or others if shifted to the proposed reporting mechanism. As FINRA notes in RN 21-19, “some exchanges currently charge fees for access to or licensing for short interest data on their listed securities, and this revenue could be reduced if the data is freely available on the FINRA website. The

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<sup>4</sup> See, CFA Comment Letter submitted on 7-28-2021 at pg. 5: <https://www.cfainstitute.org/-/media/documents/comment-letter/2020-2024/20210927.ashx>.

<sup>5</sup> See generally, CFA Institute Comment Letter to the SEC on File No. S7-08-09, Amendments to Regulation SHO [www.cfainstitute.org/-/media/documents/comment-letter/2005-2009/20090821.ashx](https://www.cfainstitute.org/-/media/documents/comment-letter/2005-2009/20090821.ashx).

<sup>6</sup> RN 21-19 at pg. 3 <https://www.finra.org/sites/default/files/2021-06/Regulatory-Notice-21-19.pdf>.

decrease in revenue could potentially be passed on in the form of increases in other fees for other market participants.” As the Firm understands it, FINRA provides the short interest data at no cost to applicable listing exchanges, who in turn provide the data for a fee to subscribers to their data feeds. If the Firm is accurately interpreting the genesis of the market data at issue, it is difficult to see how the exchanges could reasonably argue for passing on reductions in revenue to market participants under this proposal. To the extent it is made objectively apparent that exchanges are passing on costs as a result of FINRA making market data free to the public, PML would be supportive of a structure whereby exchanges that lose access to charging for market data need to explicitly state the increase to their operational overhead rather than access to opportunistic sources of income.

In summary, PML believes that by FINRA providing market data in a freely accessible and consolidated manner, it will have the effect of removing unnecessary costs and confusion relative to the current data dissemination process, and that it is ultimately the spirit of fairness for market participants large and small.

## **II. Content of Short Interest Data**

While PML supports the change described in Section I. above, it appreciates FINRA’s thoughtfulness in considering potentially helpful new data to disseminate, which we will comment on further in this letter. However, the Firm would be remiss if it did not point out concerns it has regarding the current content classified as “days to cover”. Whether or not FINRA carries forth on the proposal for all equities (listed and unlisted), the Firm requests that FINRA review the value and benefit of continuing to provide a “days to cover” calculation. PML believes this calculation does not often provide valuable context to corporate events (e.g., earnings, tenders, dividends) of an underlying equity that would help explain what would appear to be an irregular spike in the “days to cover” data. We believe this can result in potentially misinformed or misguided transactions in response. For example, during the trading window of a given corporate action, whether it be a merger or tender offer, it is not uncommon for shares to experience significant increases in volume. There have been countless studies on this very topic, with one such example concluding the following:

*“The public announcement [of a corporate action] changes traders’ beliefs and induces them to engage in a new round of trade. It is assumed that traders are diversely informed and differ in the precision of their private prior information; they therefore respond differently to the announcement, and this leads to positive volume”.*<sup>7</sup>

If short interest prior to the event and post announcement remained unchanged, the volume increase in the calculation would result in a significant reduction in the perceived days to cover output. Conversely, if short interest were to increase in the lead up to the culmination of such an event (e.g., a secondary offering), this could also significantly distort the view of market participants looking at this data without reference to the cause of the increase. In both instances, a potentially misguided conclusion may be drawn that a stock is “over-shortened”, or at risk of a short squeeze.

## **III. Proprietary and Customer Account Categorization**

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<sup>7</sup> Oliver Kim and Robert E. Verrecchia, Trading Volume and Price Reactions to Public Announcements, “Autumn” 1991, <https://faculty.fuqua.duke.edu/~qc2/BA532/1991%20JAR%20Kim%20and%20Verrecchia.pdf>.

PML is in favor of pragmatic, and not overly burdensome, reporting. However, PML believes any time rule proposals are being considered, that the lens in which they are being viewed expands to comparative rules and seeks parallelism. The Firm is unaware of any reporting requirements on the long side for firms to provide the market. If FINRA were to proceed, PML would be interested in learning more why they believe there is not a need for harmonious and/or parallel reporting requirements on the long side. This applies to both cross agency (e.g., Swap regulations between FINRA, the SEC, and the CFTC), within the same product category (e.g. Equities), and across different strategies.

Specific to this part of the proposal, the added benefit of requiring firms to segregate the total reportable short interest into proprietary and customer accounts appears superficial at best from a public point of view. There may be an argument to be made by providing this granularity to dispel more cynical views of the practice of short selling overall. However, PML fears this may create more ire than providing relief, by giving the most negative views on the practice more direct targets. In addition, PML believes that short selling serves many purposes and takes many forms. From our perspective, delineating between proprietary (i.e., broker-dealer) and customer (i.e., non broker-dealer customers) short positions will provide little additional insight as to FINRA's oversight of short sales.

To the extent FINRA moves forward with requiring designation of the type of market participant holding a short interest position, PML would seek to ensure that this would not create any regulatory arbitrage that could also provide incomplete market data. While FINRA addresses one such example in RN 21-19 as it pertains to arranged financing, PML is supportive of future responses and potential rule implementation to further define "proprietary short selling". While the Firm believes that participants required to report such information would likely do so in good faith, it also feels FINRA would benefit from ensuring participants do not have reason to view certain data as non-proprietary trading positions and, as a result, avoid reporting them - either intentionally or unintentionally.

In light of the foregoing, PML would welcome further detail from FINRA as to what it believes the benefits of this increased transparency will provide with respect to its regulatory oversight responsibilities.

#### **IV. Account-level Position Information**

Under the current structure of FINRA short selling rules in conjunction with SEC Regulation SHO, PML believes FINRA has successfully implemented rules and obligations of member firms to generally avoid the potential impacts of abusive behavior for short selling. As such, the Firm believes the balance is currently in place for firms to be responsible for their own compliance and surveillance of Regulation SHO and short sale rules.

In reality, both FINRA and the SEC have the effective ability to both inquire and obtain information that may result in the highlighting and proper enforcement of violations. PML would encourage at the very least, additional fact finding to see whether or not account-level position reporting would net an overall benefit in cost and effectiveness for the market. PML can foresee a scenario whereby this reduces the urgency and diligence by which member firms responsible for monitoring such activity would assume that providing this data to FINRA and the SEC gives them an unofficial form of no action relief from

their obligations, with the self-regulatory organizations (“SROs”) superseding them with all available information. More bluntly and practically, the Firm sees immediate concerns that would come with implementing such rules:

- Reporting at this level would likely create highly burdensome technology costs for firms to comply with. This could create a disadvantage for start-up firms with less financial resources to meet obligations in both an efficient and timely manner. While PML believes that this would naturally be a boon for technology vendors who support firms that do not have the internal infrastructure or capital to build this, it would still come at some cost.
- This would also raise concerns around cybersecurity for clients who are more sensitive to the proprietary nature of their positions and “edge”. Once again, this could adversely affect smaller firms with less capabilities on providing their clients comfort with how information is transmitted. Vendors will also likely be involved here, adding an additional layer of cybersecurity risk. PML, along with its technology arm Provable Labs BV (“PLA”), focuses on employing where possible advanced cryptographic techniques that ensure data transmitted remains fully encrypted. While the Firm selfishly sees an opportunity to use such technology to allay the aforementioned concerns if this rule were put in place, it is not under the illusion that all firms collecting and providing such data would or should choose to use the type of technology PLA uses. Should there be a breach in the process, participants could be harmfully exposed, creating both reputational and nominal risk to the parties disseminating this data.
- Lastly, we envision the potential for this to drive trading interest overseas, or to alternative markets that are out of scope for such reporting. More specifically, as it pertains to the latter, the Firm adds more detailed comments in response to reporting of synthetic short positions in Section V. below.

## **V. Synthetic Short Positions**

While PML holds varying levels of conviction to proposals throughout RN 21-19, it is specifically concerned about the potential for many unintended consequences due to the high amount of complexity that encompasses synthetic (i.e., derivative) positions. The Firm believes that there is a higher likelihood for confusion and double reporting if FINRA instituted a reporting requirement that captures synthetic short positions, creating another area of ambiguity whereby participants misinterpret, or are simply misled about, the actual short interest around a specific security.

PML does not deny the growth of synthetic trading has created very real concerns for the market, with the events related to Archegos being a prime example. In fact, independent studies have surmised that “synthetic” Prime Brokerage (i.e., Swaps) has exceeded physical Prime Brokerage in terms of revenue and gross balances in the past few years<sup>8</sup>. Coupled with a notable rise in option open interest, we firmly believe FINRA is right to consider how this may impact overall short positioning. However, as noted in the opening of our letter, and as we will detail in the proposed remedies section, it is the view of PML that harmonization between FINRA and the SEC focusing on the process to enact and settle a short sale will

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<sup>8</sup> Josh Galper, Headline: “Synthetic prime brokerage revenue now bigger than physical financing revenue for the first time”, (Premium article), <https://finadium.com/synthetic-prime-brokerage-revenue-now-bigger-than-physical-financing-revenue-for-the-first-time-premium>.

provide the most accurate and appropriate information for both the market and regulators to assess what true short selling activity is taking place.

As it pertains to synthetic trading, given the complexities of option deltas, and how Swaps structurally are hedged, we believe once again there is too much ambiguity and complexity to properly rely on reporting to assess what the true short exposure is in the market. In an attempt to provide real world context to the prior statement, PML presents the following examples for FINRA's review:

- FINRA describes the situation wherein a market participant enacts the “sale of a call option and purchase of a put option with the same expiration date and strike price”<sup>9</sup> to express “equivalent exposure to the price of a stock as a short sale.”<sup>10</sup> This transaction is commonly performed in conjunction with the simultaneous purchase of a delta neutral amount of equity, resulting in what is known in the market as a “Conversion” (or “Converter”) with the contra referred to as a “Reversal” (or “Reverser”). As with any trade, there must be a buyer and seller, so PML assumes the countra to this trade (i.e., the Reverser) provides offsetting economic exposure. The resulting net exposure to the underlying equity upon this transaction is initially neutral. In order to obtain the “equivalent exposure,”<sup>11</sup> the Conversion buyer must sell out the equity *long*.

In one scenario of this trade structure, the Reverser would be selling its shares short to the Converter. The short sale would fall under applicable short sale rules, and be reported as such. In the event the Converter were to sell out its equity (leaving it with the aforementioned synthetic exposure), under the proposed rules, the result would be duplicative reporting of short exposure in the underlying security. The short sale tied to the Reversal would be reported, as would the synthetic exposure post sale of the underlying equity. This would provide the market with the perception that twice the amount of shares are currently expressing short exposure.

In an alternative instance of this scenario, the Reversal seller would be a long holder looking to synthetically lend out its shares via this structure. Once again, upon initial trade, economically nothing has fundamentally changed in the market until the Converter sells the purchased stock long. In this case, the resulting information on short exposure *would* in fact indicate that there is new short exposure in the market.

The problem in the two scenarios above is that they produce dramatically different, and potentially incorrect, perceptions of short exposure. To add further complexity, every firm uses different calculations for the net delta exposure their options positions create. PML cannot conceive of an efficient means by which reporting would be dynamic enough, while also using a standard methodology whereby accurate reporting can occur. In the second scenario wherein the Reverser is selling long, FINRA would also need to collect additional reporting of other related options in the same underlying security to ensure the net equivalent of a given participant's portfolio. It is the view of PML that the only conceivable path in this case would involve securing net exposures at the clearing level from the Options Clearing Corporation (the “OCC”) of listed options for all given issues. While this may provide some further insight, it would, in the view of

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<sup>9</sup> RN 21-19 at pg. 9, <https://www.finra.org/sites/default/files/2021-06/Regulatory-Notice-21-19.pdf>.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

PML, be ambiguous at best, as the OCC would not have complete data as to how participants have or have not hedged those exposures. It is furthermore the view of the Firm that this would create significant additional direct and indirect costs to compile and report.

- A second example wherein PML believes ambiguity will arise, is related to borrowing for hedge positions to support bona fide customer positioning and swap trading. PML assumes that swaps would also fall under a reportable synthetic position given their “equivalent exposure”<sup>12</sup>. A feasible scenario could involve Hedge Fund A (“HFA”) seeking to pay returns (i.e., go synthetically short) via swap with a member firm on a specific security (e.g., AAPL). The firm providing swap exposure would then likely do so as a hedged position, and thus sell short the AAPL stock. Under the proposal in RN 21-19, short interest in AAPL would be reported twice (i.e., once synthetically, and once on the hedge), thus creating the perception that the economic exposure to AAPL is twice what it actually is.
- Market participants employing long / short strategies may often seek to gain exposure for numerous reasons (e.g., risk reduction, transaction costs) in a single name through the use of exchange-traded funds (“ETFs”). If HFA were to synthetically short an ETF with 10 components, and simultaneously take a long position in nine of the 10 underlying equities, the result would be a net short position in the unhedged security. However, from a reporting perspective, this would appear to show a short position in the overall ETF. The same analysis can be performed in reverse, creating an effect of a short in all 10 names, despite an economic exposure 90% lower.

While PML believes that synthetic exposures have played a significant and increasing role in the market, it remains wary that there is a feasible answer to properly identify what is truly a synthetic short, and what may be misconstrued as such, and therefore create more confusion rather than less for the market.

## **VI. TSO and Public Float**

PML is supportive of FINRA disseminating short interest total shares outstanding (“TSO”) and/or public float information to the market. The Firm believes this statistical information is objective and not open to misinterpretation, and thus would at worst be neutral data to provide participants (in contrast to the Firm’s points made regarding “days to cover” data in Section II. above). Notwithstanding the foregoing, PML would appreciate FINRA articulating its rationale for seeking to extract this information from a third-party data source.

PML would like to reaffirm that not all data is relevant in a vacuum. For example, a company may file a shelf registration for the sale of additional securities via a Form S-3. It is highly probable that participants will increase short activity in anticipation of a sale of stock by the company, and that there will be increased volume brought on by the publicity of such an event<sup>13</sup>. Without context, the perception would show a spike in short interest relative to the size of the float. If the issuance of securities is imminent, this could result in a subsequent one day drop between the period when the new shares *settle*, and the newly available data is provided to investors. In this scenario, any reactionary transactions to the statistical change can create unintended trading decisions that can be harmful to investors, despite efforts by FINRA

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<sup>12</sup> *Id.*

<sup>13</sup> *Supra* note 8.

to make the market structure stronger. PML believes there is a benefit to market participants for FINRA and the SEC to explore ways in which corporate events published via EDGAR can be tagged to note there may be corporate events related to the equity that could distort the accuracy of the data. PML believes this could be based on a defined system of characteristics (e.g., upcoming dividend, shelf registration, spin-off). As such, PML is generally supportive of providing TSO and public float information, and where possible adding valuable context.

## **VII. Frequency and Timing of Short Interest Position Reporting and Data Dissemination**

PML is generally supportive of increasing the frequency of short interest reporting to a weekly standard, while also of the view that processing time can and should be reduced to provide more accurate information. Reducing this reporting further to daily frequency may potentially create confusion due to the potential volatility of such metrics day over day. Weekly reporting provides, in our view, enough data for participants to use, while encompassing windows that are often relevant. In fact, PML and its team have frequently discussed the fact that the current bi-weekly product does not capture highly impactful events such as monthly option expiry.

## **VIII. Conclusion**

As PML noted in the introduction and throughout this comment letter, the Firm believes that to truly get an accurate reflection of short sale activity, the market would benefit from FINRA and the SEC applying their respective areas of authority to add more focus on the process that is taken to enact short sales - namely, the locate process and the subsequent delivery of shares to settle short sales through the Securities Lending (“SL”) process. SL, both for cash borrows and synthetic exposure, has undergone tremendous change over the past two decades. The Firm welcomes FINRA taking a deep dive into the current SL rules and regulations to see where and if there needs to be additional rules and remedies to make the market structure stronger and fair for all participants. We also note that there have been many developments made on the technological side by leading infrastructure players, including the growth of the OCC Stock Loan and Hedge Program, and the impending NSCC SFT Service for Centrally Cleared SL transactions. The SFT Service will mirror the success of Fixed Income Clearing Corporation’s (“FICC”) Sponsored Repo Service, which has over 2,000 participants, and has significantly broadened access and improved market structure in the Fixed Income Repo markets. We believe that while considering its proposed rules relative to RN 21-19, FINRA, other SROs with applicable authority, and / or the SEC should take into account these NSCC and FICC developments when instituting new rules applicable to short interest position reporting. The Firm believes that it can utilize its partnership with the NSCC, and that certain items in the Securities Lending Market Structure can serve to work in concert with FINRA’s regulatory developments to better serve the market as it relates to short selling overall.

The process for a non-exempt party to short stock requires that one party acquire a locate under Regulation SHO. PML believes this area in particular can assist in reducing the amount of fails to deliver in the market, by employing newer technology and encouraging those providing locates to use more dynamic systems and logic when providing “good” locates. Under the current rules as prescribed in Section 203 of Regulation SHO, a broker-dealer must have “reasonable grounds”<sup>14</sup> to believe it can make delivery of securities on settlement date. Furthermore, the rules allow a broker-dealer to make this

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<sup>14</sup> See generally, <https://www.sec.gov/rules/final/34-50103.htm>.



assessment with a list that “is no more than 24 hours old”<sup>15</sup> in its analysis for providing a locate. The rule does not require further details as to what constitutes reasonable grounds, and as a result, locates can be provided that may not be relevant when taking into account market dynamics within the 24-hour window. Using GME as an example, on many days of high volatility, it is presumed that significant amounts of locates were provided that did not take into account the stock had traded multiples of its historical average daily volume (“ADV”) and had experienced high volatility. A broker-dealer using a list that complies with the 24-hour window could “reasonably” provide a locate despite what is likely higher shorting and a higher likelihood of delivery being logically more difficult on settlement date due to the increase in volume and volatility. PML believes that technology improvements can reasonably allow for stricter requirements than 24-hour old data. This would allow for providers of assets that populate those lists to timelier update the assets they have and, should they choose, pull back their available shares during bouts of increased volume, volatility, or both. Additionally, “reasonable grounds” subjectivity, in the view of PML, can be enhanced by adding language to have broker-dealers providing locates take into account market events (e.g., notable ADV increases) when providing locates from data received before such events occurred. PML would also encourage a more centralized system for obtaining locates whereby end-users can interact directly with long holders and other sources of potential borrows directly to avoid what the Firm deems the waterfall effect of the current system (i.e., information leakage leading to higher prices).

Beyond the locate process, settlement activity is largely related to actual borrows and loans (or netting where applicable) that settle such trades. As stated previously, PML believes that the most accurate source of short interest and short sentiment is derived when a short is covered with an actual borrow. Under the current reporting regimes, this information is non-public. With non-purpose borrow rules in place, the likelihood of inaccurate data would be reduced, and borrow and loan activity should represent the closest figure to the actual physical shorts in the market (coupled with fail data).

PML would support FINRA and the SEC exploring methods of reporting for this activity that are not overly burdensome, and also provide the market with information and transparency currently unavailable to most, or available at a significant cost. The current system that supports SL has the relevant data, and as noted, developments such as the NSCC’s SFT Service are further providing more modern methods for this process to occur and provide useful supported data for all participants.

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<sup>15</sup> *Id.*

Thank you very much for your consideration. If you have any questions about the information provided herein, or require additional information or documentation, please feel free to contact the undersigned at (908) 377-4837 or [matt@provablemarkets.com](mailto:matt@provablemarkets.com).

Sincerely,



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