

March 20, 2009

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, D.C. 20006-1506

Subject: Comments to Proposed FINRA Rule Addressing Best Execution

Dear Ms. Asquith,

Pink OTC Markets Inc. ("Pink OTC", formerly Pink Sheets LLC) respectfully submits the following comments in response to Regulatory Notice 08-80 issued by the Financial Industry Regulatory Authority ("FINRA"), formerly known as the National Association of Securities Dealers, Inc. ("NASD"). Pink OTC supports regulations that improve market quality and FINRA member firm obligations to obtain best execution of customer orders for OTC Equity Securities. For that reason, we oppose certain parts of the proposed revisions to NASD Rule 2320(g) (the "Three Quote Rule" or the "Rule"). We believe the key parts of the proposal are flawed and the change runs counter to the salutary requirement of best execution.

Pink OTC is the leading provider of pricing and financial information for the over-the-counter ("OTC") securities markets. Among other things, Pink OTC operates Pink Quote, a real-time Inter-Dealer Quotation System for OTC Equity Securities for market makers and other broker-dealers registered under the Securities Exchange Act of 1934.

Benefits of the Current Rule for Transparency of OTC Market Prices

The quotations submitted into Inter-Dealer Quotation Systems and their publication has fostered the development of a widely available national best bid or offer (NBBO) in the vast majority of OTC Equity Securities in which trades take place. This investor friendly market transparency in OTC Equity Securities is significantly different from the OTC bond market where there are more principle based best execution requirements. Much of the quote transparency available to investors in OTC Equity Securities is a result of the Three Quote Rule.

FINRA Regulatory Notice 08-80 proposes replacing the Three Quote Rule with Supplementary Material .06 to proposed FINRA Rule 5130. The proposed Supplementary Material would rely on member firms to develop written policies and procedures to determine the best inter-dealer market for OTC Equity Securities in situations where multiple published quotations are not available. The Supplementary

Material suggests that member firms should seek quotations from other broker-dealers, but are not required to do so. FINRA's stated reason for replacing the Three Quote Rule, which has served to protect the investing public for over two decades, is its belief that the current requirements can result in unnecessary delay in the execution of a customer's order.

The current Three Quote Rule contains an important electronic NBBO exception (Rule 2320 (g)(3)(A) or the "Electronic NBBO Exception") that speeds executions for investors. Under the Electronic NBBO Exception, Broker-dealers are not required to obtain three quotes where there is a NBBO of two or more firm priced quotations that are displayed on an Inter-Dealer Quotation System that permits quotation updates on a real-time basis. Pink Quote and the OTCBB[®] are the Inter-Dealer Quotation Systems that currently serve this function. Unfortunately, the proposed abandonment of the Three Quote Rule also eliminates the Electronic NBBO Exception. This has the effect of tossing the baby out with the bath water.

The broad dissemination of publicly available prices has transformed the market for OTC Equity Securities, vastly increasing price transparency since the adoption of the Three Quote Rule and the Electronic NBBO Exception. The Electronic NBBO Exception has led to important improvements in the speed and quality of order execution and it encourages dealers to submit quotations into Inter-Dealer Quotation Systems as they know that other member firms will have to either compete at that price or access their price. In turn, the prices generated by Inter-Dealer Quotation Systems are published in Bloomberg, Reuters and other public market information distributors as well as available in online brokerage customer trading applications. These prices are used by public investors to decide if they want to trade at the NBBO price, as well as determine the quality of executions received from their brokers. Investors that submit a market or marketable limit order in a market displaying an NBBO generally are expressing a desire to obtain an execution at the displayed NBBO price, an opportunity that exists only in transparent markets.

We therefore request that FINRA state, whether in the text of the Rule or the Supplementary Material, that member firms must execute customer orders at an equal or better price as displayed in any Inter-Dealer Quotation System that permits quotation updates on a real-time basis. The NBBO should be a minimum standard for all customer executions and conversely member firms that make their prices publicly accessible to all market participants by displaying firm quotes in an inter-dealer quotation system should be protected from having those prices ignored or traded through.

The Current Rule Promotes Straightforward Best Execution Compliance

The proposed Supplementary Material as proposed would abolish an effective and helpful regulatory guideline and introduces a level of subjectivity in an area where judgments are difficult to make. In the absence of actual quotations from willing buyers

and sellers, there are no known reliable indicators of value. Without the benefits of a bright-line rule, it will be impossible for the compliance department of a member firm to determine with any degree of certainty whether a particular method of determining best execution is correct or incorrect. The Supplementary Material will therefore increase the tensions between the compliance department and the trading desk. For similar reasons, regulatory examinations will become more difficult and time-consuming. Any marginally increased efficiency in executing customer orders resulting from the proposed rule change will be greatly outweighed by the increased risk of best execution violations by member firms, costly and time-intensive self-reviews by FINRA member firms, and the cost and difficulty for FINRA in determining whether best execution violations have occurred.

It is worth noting that “grey market” securities, that is securities not quoted in inter-dealer quotation systems, are traded by means of telephone conversations among traders. This method has not changed substantially since the Three Quote Rule was originally promulgated in 1988. These are illiquid securities that trade infrequently. Accordingly, speed of execution is relatively less-important as an element of best execution. We believe that the delay in execution required to obtain three quotations is necessary to establish a market price for securities for purposes of best execution. We do not believe it is useful to change a rule that has served regulators and member firms well for two decades when there has not been any substantial change in the technology of the business.

Principle Based Regulation is May Not Be Appropriate

We think the proposed abolition of the Three Quote Rule may reflect a poorly considered preference for regulations based on principles, rather than rules. We think that both approaches are necessary in any sensible system of securities regulation.

Rules have the advantage of providing “bright-line” standards with which member firms must comply. Member firms know what they can and cannot do, and FINRA can more easily determine whether the rules have been violated. Principles-based systems, by contrast, provide more general principles for member firms to follow. FINRA must then evaluate each action a member firm takes to determine if it adheres to the appropriate general principles.

In theory, principles-based regulation ensures greater compliance with the principles the regulators are protecting. This advantage is counter-balanced by the practical difficulties inherent in any principles-based regulatory system. FINRA’s task, as well as the burden placed on compliance professionals, becomes much more arduous, as FINRA’s representatives or a firm’s compliance professionals must, in each case, evaluate the action taken by a registered person and determine whether it is in keeping with the regulatory principles. Moreover, member firms receive less guidance and as a

result often are uncertain how to comply or how an act will be interpreted according the principles.¹

We think there are situations where principles-based regulation makes sense. Suitability is an area where rules-based regulation is unlikely to protect investors from abuse because the spirit of the rule is more important than bright-line distinctions. In some aspects of best execution, principles-based regulation may be more likely to take account of customer preference in some situations. On the other hand, FINRA Regulatory Notice 08-80 provides a particularly salient example of a situation – determining market value in relatively illiquid OTC Equity Securities -- where principles-based regulation can lead to confusion, reductions in market and execution quality, and decreased compliance.²

The Three Quote Rule is based on the premise that market prices – the prices offered by willing buyers and sellers – are the best indication of the value of a security. The Rule therefore requires member firms to determine the existing market and helps member firms meet FINRA's best execution requirements. It mandates specific actions, obtaining three quotations from three dealers – thereby establishing a current market price – that must be taken before executing a customer order in a non-exchange listed security not otherwise exempted by the Rule. Where two quotations have been published in an Inter-Dealer Quotation System Inter-Dealer Quotation Systems that permits real-time updates, member firms and their customers can rely on the presence of a publicly available, transparent, ready market to determine best execution. The Three Quote Rule provides FINRA a clear basis for enforcement if a member firm does not comply with a standard that is readily understood within the industry. In this way, the Three Quote Rule minimizes non-compliance.

If the Three Quote Rule were to be replaced with the proposed Supplementary Material to FINRA Rule 5130, the Rule's clear compliance guideline would be substituted with a general principle. The premise would be that for OTC Equity Securities, market prices are not necessarily the best indication of the value of a security. Presumably some member firms would develop valuation algorithms to establish best execution. Others would attempt to obtain quotes, but it would not be clear whether one or two quotations, or perhaps in some cases, nine or ten, would be sufficient to establish best execution. Any set of procedures developed by a member firm would be subject to question, on the basis of twenty-twenty hindsight, that the procedures failed to establish value based on some other metric and therefore failed to achieve best execution. Compliance professionals would be in conflict with the trading desk over best execution, with traders insisting that their view should prevail as having more credibility in the market. FINRA examinations would be tedious affairs, and customer complaints would increase. The

¹ See John H. Walsh, *Institution-Based Financial Regulation: A Third Paradigm*, 49 Harv. Int'l L.J. 381 (2008). Mr. Walsh is the Associate Director and Chief Counsel in the SEC's Office of Compliance Inspections and Examinations.

² See generally David B. Bayless, *A Matter of Principles*, GC California, Winter 2007. Mr. Bayless is a partner in the San Francisco office of Covington & Burling and is a former head of the SEC's San Francisco office.

proposals in FINRA Regulatory Notice 08-80 may therefore inadvertently lead to more breaches of the duty of best execution.³

Systems and Mediums have Different Market Functions

The existing definitions to "Quotation Medium" and "Inter-Dealer Quotation System" in the existing Three Quote Rule are drawn directly from Rule 15c2-11 under the Securities Exchange Act of 1934. Rule 15c2-11 governs quotations published by broker-dealers in Quotation Mediums and in Inter-Dealer Quotation Mediums under federal securities laws.

The Rule 15c2-11 definitions are as follows:

An "Inter-Dealer Quotation System" shall mean any system of general circulation to brokers or dealers which regularly disseminates quotations of identified brokers or dealers.

"Quotation Medium" shall mean any "interdealer quotation system" or any publication or electronic communications network or other device which is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

The proposed alterations to these definitions in other parts of FINRA Regulatory Notice 08-80 would diverge from Rule 15c2-11, suggesting they have a meaning different from the Rule. No reason is given in the Regulatory Notice for these changes, and we doubt that these changes reflect anything more than aesthetic considerations. Subtle alterations to these definitions can only cause confusion and counter-productive mischief. If there is some reason to make these changes, FINRA should explain them carefully in a Regulatory Notice. Otherwise, the definitions existing in the current Three Quote Rule should be reinstated.

Generally speaking, an Inter-Dealer Quotation System is a system that is widely available to all broker-dealers and identifies the source of quotations. The function provided the marketplace is that if a broker-dealer is willing to trade with any other broker-dealer by making their quotes accessible, and conversely if a broker-dealer desires to set a price other broker-dealers must compete against or access, they publish their quotation prices in an Inter-Dealer Quotation System.

A Quotation Medium is a much broader description which can cover anywhere a quote could possibly be published, including closed systems that are not widely accessible by competing broker-dealers. Quotation mediums have an important function, as closed or partially closed networks such as ECN's, ATS, Dark Pools, Web Sites, and other platforms where a broker-dealer may get a better execution for their order by showing

³ See *id.*, noting "if the goal is to prevent certain behavior, it is better to have a specific rule that addresses the particular conduct that puts everyone in the industry on notice. This will actually lead to a decrease in the conduct that the regulator is aiming to prevent."

interest to a select group without alerting the whole market. Since Quotation Mediums are not readily available to other broker-dealers the Electronic NBBO Exception rightfully is limited to Inter-Dealer Quotation Systems. Any Quotation Medium can easily publish the quotes that they want to make widely accessible in an Inter-Dealer Quotation System.

Conversely, the requiring of broker-dealers to look for quotations in Quotation Mediums under the Section (f)(2)(A) of the Proposed Rule is not workable and Inter-Dealer Quotation System should be substituted with the definition from SEC Rule 15c2-11 used in Section (f)(2)(B).

Multiple Quotation Rule

Proposed Rule 6480 is overly restrictive of broker-dealer activities in attempting to locate liquidity for clients. The rule should use the definition of Inter-Dealer Quotation System as there are many situations when a firm may want to use a system that could be described as a Quotation Medium to discretely facilitate a trade without having to publish that same price publicly in an Inter-Dealer Quotation System.

Conclusion

Pink OTC has generally advocated modifications in existing regulations to accommodate changing markets and technological progress. But, we do not believe that markets and the investing public benefit from regulatory changes for the sake of change. This is one of those rare occasions where we believe that existing rules, which are working well, should be left alone. We think the changes proposed by FINRA Regulatory Notice 08-80 provide no obvious benefit to FINRA, members firms or the investing public, while risking confusion and harm to the market for OTC Equity Securities.

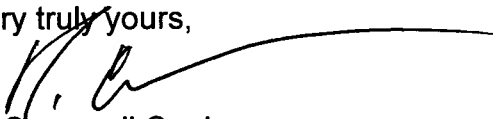
The Three Quote Rule, in its current formulation, properly reflects the significant technological changes in the market for OTC Equity Securities over the last two decades. Inter-Dealer Quotation Systems currently provide robust, transparent, ready markets in many OTC Equity Securities. The Rule has facilitated the formation of NBBOs in many securities, which are made available in robust Inter-Dealer Quotation Systems and widely disseminated to the investing public, and permitted the introduction of sophisticated order handling rules. At the same time, the Rule takes account of the fact that much of the market in OTC Equity Securities has not changed over the twenty years since its adoption.

Exchanging the clear standard embodied by the Three Quote Rule for the principles-based approach of Supplementary Material to FINRA Rule 5130 may undermine member firms' attempts to meet their best execution obligations while unnecessarily taxing the compliance resources of member firms and FINRA. The Rule reflects the reality that market prices are the best way to determine value and establishes a practical, easy to understand, regulatory standard. Ambiguous "principles-based"

regulations in this area, while well-intended, would lead to confusion, customer complaints and a negative impact on the execution of customer orders.

Thank you for the opportunity to comment upon the proposals set forth in FINRA Regulatory Notice 08-80. Please call if you have any questions or require any additional information.

Very truly yours,

A handwritten signature in black ink, appearing to read 'R. Coulson', with a long, sweeping horizontal line extending to the right.

R. Cromwell Coulson
Chief Executive Officer