

OMB APPROVAL

OMB Number: 3235-0045
Expires: August 31, 2011
Estimated average burden
hours per response.....38

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2009 - 054
Amendment No. 1

Proposed Rule Change by Financial Industry Regulatory Authority
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial ☐	Amendment ☒	Withdrawal ☐	Section 19(b)(2) ☒	Section 19(b)(3)(A) ☐	Section 19(b)(3)(B) ☐
			Rule		
Pilot ☐	Extension of Time Period for Commission Action ☐	Date Expires 	☐ 19b-4(f)(1) ☐ 19b-4(f)(2) ☐ 19b-4(f)(3)	☐ 19b-4(f)(4) ☐ 19b-4(f)(5) ☐ 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document
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Exhibit 3 Sent As Paper Document
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Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
Title
E-mail
Telephone Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date

By
(Name)

Senior Vice President and Director of Capital Markets
Policy

(Title)

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Stephanie Dumont,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) Amendment No. 1 to SR-FINRA-2009-054, a proposed rule change to adopt new FINRA Rules 6434 (Minimum Pricing Increment for OTC Equity Securities), 6437 (Prohibition from Locking or Crossing Quotations in OTC Equity Securities), 6450 (Restrictions on Access Fees) and 6460 (Display of Customer Limit Orders).

The text of the proposed rule change is attached as Exhibit 5 to this rule filing.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on April 16, 2009, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. In addition, the proposed rule change has been approved by the General Counsel of FINRA pursuant to delegated authority. No other action by FINRA is necessary for the filing of the proposed rule change as modified by Amendment No. 1.

FINRA will announce the implementation dates of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. In recognition of technological changes necessary to implement the proposals, the

¹ 15 U.S.C. 78s(b)(1).

implementation date of Phase one, as described herein, will be at least 120 but no more than 365 days from Commission approval and the implementation date of Phase two will be at least 90 days following the implementation of Phase one but no more than 365 days from Commission approval.

3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

Rule Filing History

On August 7, 2009, FINRA filed with the SEC SR-FINRA-2009-054, a proposed rule change to adopt new FINRA rules to extend certain Regulation NMS protections to quoting and trading in over-the-counter equity securities.² On August 26, 2009, the Commission published for comment the proposed rule change in the Federal Register and received twelve comment letters.³ Based on comments received, FINRA is filing this

² See Securities Exchange Act Release No. 60515 (August 17, 2009), 74 FR 43207 (August 26, 2009) (Notice of Filing File No. SR-FINRA-2009-054) (“Proposing Release”).

³ Letter from Ann L. Vlcek, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Elizabeth M. Murphy, Secretary, SEC, dated October 13, 2009 (“SIFMA”); Letter from Christopher Nagy, Managing Director Order Strategy, TD Ameritrade, Inc., to Elizabeth M. Murphy, Secretary, SEC, dated October 6, 2009 (“TD Ameritrade”); Letters from R. Cromwell Coulson, Chief Executive Officer, Pink OTC Markets Inc., to Elizabeth M. Murphy, Secretary, SEC, dated September 23, 2009 (“Pink1”) and January 6, 2010 (“Pink2”); Letter from Janet M. Kissane, Senior Vice President, Legal & Corporate Secretary, NYSE Euronext, to Nancy M. Morris, Secretary, SEC, dated September 23, 2009 (“ArcaEdge”); Letter from William Assatly, Sr. Vice President, Trading, Mercator Associates, to Elizabeth M. Murphy, Secretary, SEC, dated September 16, 2009 (“Mercator”); Letter from Leonard J. Amoruso, General Counsel, and Michael T. Carrao, Chief Compliance Officer, Knight Capital Group, Inc., to Elizabeth M. Murphy, Secretary, SEC, dated September 16, 2009 (“Knight”); Letter from Elaine M. Kaven, Chief Compliance Officer, StockCross Financial Services, Inc., to Florence H. Harmon, Deputy Secretary,

Amendment No. 1 to respond to the comments received and to propose amendments, where appropriate.

Proposal

As described in the Proposing Release, FINRA proposes to adopt rules to: (1) restrict sub-penny quoting; (2) restrict locked and crossed markets; (3) implement a cap on access fees; and (4) require the display of customer limit orders. FINRA believes that these Regulation NMS principles, if applied to over-the-counter equity securities ("OTC Equity Securities"),⁴ would enhance market quality and investor protections in this market.

Comments to the Proposed Rule Change

Restriction on Access Fees

Currently, FINRA Rule 6540(c), which applies only to the OTC Bulletin Board ("OTCBB") montage, requires that an alternative trading system ("ATS")⁵ and electronic communications network ("ECN")⁶ reflect non-subscriber access or post-transaction fees in their posted quote. Consistent with Regulation NMS, FINRA proposed to eliminate the OTCBB access fee display requirement and to, instead, implement a cap on access fees in

SEC, dated September 16, 2009 ("StockCross"); Letters from Kimberly Unger, Executive Director, Security Traders Association of New York, Inc., to Elizabeth M. Murphy, Secretary, SEC, dated September 14, 2009 ("STANY1") and September 16, 2009 ("STANY2"); Letter from Daniel Kanter, President, and Craig Carlino, Chief Compliance Officer, Monroe Securities, Inc., to Elizabeth M. Murphy, Secretary, SEC, dated September 16, 2009 ("Monroe"); and Letter from Anonymous dated September 1, 2009. (available at <http://www.sec.gov/comments/sr-finra-2009-054/finra2009054.shtml>).

⁴ "OTC Equity Security" means any non-exchange-listed security and certain exchange-listed securities that do not otherwise qualify for real-time trade reporting. See FINRA Rule 6420(d).

⁵ See Rule 300(a) of Regulation ATS under the Act.

all OTC Equity Securities, wherever displayed, that exceed or accumulate to more than the following limits:

- a. If the price of the quotation is \$1.00 or more, the fee or fees cannot exceed or accumulate to more than \$0.003 per share; or
- b. If the price of the quotation is less than \$1.00, the fee or fees cannot exceed or accumulate to more than 0.3% of the quotation price per share.

Also consistent with Regulation NMS, the proposal would explicitly permit market makers to charge access fees.

While some commenters generally expressed support for the proposal to impose a cap on access fees,⁷ most commenters opposed it.⁸ Several commenters expressed concern that the proposal would lead to a reduction in the transparency of over-the-counter (“OTC”) quotations by permitting market participants to charge an access fee without displaying it in the quoted price, making it difficult for investors to compare prices offered by different broker-dealers across different marketplaces.⁹ Commenters also expressed concern that an access fee cap (without a corresponding display requirement) would result in a shift in market structure that harms investors by leading to an increase in transaction costs.¹⁰ Some commenters also argued that the proposal would unfairly favor the ATS

⁶ See Rule 600(b)(23) of the Act (defining “electronic communications network”).

⁷ See ArcaEdge and TD Ameritrade.

⁸ See Knight, Mercator, Pink1, SIFMA, STANY2 and StockCross.

⁹ See e.g., Knight, Pink1 and SIFMA.

¹⁰ See e.g., Mercator and Pink1.

business model, result in an increase in the incidence of locked and cross markets, and lead to an increase in gaming practices.¹¹

Commenters noted that the proposed access fee cap of 0.3% of the quotation price per share for securities priced under \$1.00 may result in the assessment of an undisclosed access fee that is greater than the price increment, which may provide an incentive for gaming activity and “access fee trading.”¹² One commenter presented a scenario that would result in “access fee trading” through crossing quotes across inter-dealer quotation systems.¹³ In the example, the inside market for a stock quoted on the OTCBB is \$.8999 x \$.90 (the relevant access fee cap under the original proposal would have been \$.0027 per share). Rather than take the offering at \$.90, the commenter states that a market maker could cross the market in the Pink Sheets by posting a bid of \$.9001. If the market maker’s bid is hit in the Pink Sheets, it will be able to buy the stock at \$.9001 and then immediately sell to the OTCBB bid at \$.8999. The commenter notes that, although the market maker sold the stock at a slight loss of \$.0002 per share, the access fee of \$.0027 per share provided an instant, virtually riskless profit.¹⁴ Accordingly, certain commenters argued that the appropriate access fee cap should never be greater than 30% of the relevant

¹¹ See e.g., Knight, Pink1 and SIFMA.

¹² See generally ArcaEdge, STANY2 and Pink1. As an example, Pink noted that, using the proposed formula, the access fee cap on a \$0.90 security would be \$0.0027 while the pricing increment would be \$0.0001.

¹³ See Knight.

¹⁴ See Knight.

pricing increment, which would ensure that the access fee is always lower than the relevant increment.¹⁵

FINRA has considered the comments opposing the elimination of the access fee display requirement in conjunction with the establishment of an access fee cap, and continues to believe that the proposal strikes the appropriate balance between addressing the practical difficulties of incorporating access fees in published quotes and the need to curtail potentially excessive undisclosed access fees. FINRA notes that similar concerns and debate were raised in the context of the adoption of Regulation NMS, to which the Commission concluded that a uniform fee limitation of \$0.003 per share is the fairest and most appropriate resolution of the access fee issue.¹⁶ FINRA believes that the same holds true in this context as well.

However, in light of the lower price points for securities in the OTC market, and in response to commenters' concerns regarding potential gaming activities, FINRA believes that an adjustment to the proposed access fee cap calculation method is appropriate. FINRA is proposing a revised method of calculating the access fee for securities priced under \$1.00 to ensure that the access fee is always less than the relevant quotation increment. FINRA is proposing that the cap on access fees for securities priced under \$1.00 would be the lesser of: (a) 0.3% of the published quotation price on a per share basis, or (b) 30% of the relevant minimum pricing increment applicable to the display of the quotation. The revised proposal would provide that:

¹⁵ See ArcaEdge, Pink1 and STANY2.

¹⁶ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (order adopting rules under Regulation NMS, SEC File No. S7-10-04).

A member shall not impose, nor permit to be imposed, non-subscriber access or post-transaction fees against its published quotation in any OTC Equity Security that exceeds or accumulates to more than:

- (a) \$0.003 per share, if the published quotation is priced equal to or greater than \$1.00; or
- (b) the lesser of 0.3% of the published quotation price on a per share basis or 30% of the minimum pricing increment under Rule 6434 relevant to the display of the quotation on a per share basis if the published quotation is less than \$1.00.

FINRA believes that this approach would ensure that a permissible access fee would always be smaller than the pricing increment (which would address concerns regarding gaming). If the security is priced at \$1.00 or more, the access fee cap would continue to be \$0.003 per share.

Sub-penny Restrictions

Currently there are no restrictions in place for quotations in subpenny increments in the OTC marketplace. Subpenny increments have been associated with certain market abuses, including stepping ahead of standing limit orders for an economically insignificant amount. Subpenny increments also have been associated with added difficulty for broker-dealers in meeting certain regulatory obligations by increasing the incidence of so-called “flickering” quotes. Thus, FINRA has proposed restrictions on the display of quotations and orders in sub-penny increments for OTC Equity Securities.

Specifically, FINRA proposed to prohibit members from displaying, ranking or accepting from others a bid, offer, order, or indication of interest in OTC Equity Securities in an increment smaller than:

- \$0.01 if the bid or offer, order, or indication of interest is priced \$1.00 or greater per share,
- \$0.0001 if the bid or offer, order, or indication of interest is priced below \$1.00 and equal to or greater than \$0.01 per share, and
- \$0.000001 if the bid or offer, order or indication of interest is priced less than \$0.01 per share.

Commenters generally favored a restriction on quoting in subpenny increments, though some argued for modifications to the increments proposed. Commenters also generally believed that the proposal should go further by prohibiting subpenny quotations in increments of more than four decimal places.¹⁷ Certain commenters also proposed specific alternative quotation increments for the OTC market.¹⁸

FINRA has considered commenters' concerns and is proposing a modification to the tiers originally proposed. Specifically, FINRA is proposing to reduce the minimum pricing increment from \$0.000001 to \$0.0001 for all securities priced under \$1.00. However, with respect to securities priced less than \$0.0001, members would be permitted to rank or accept (but not display) orders and indications of interest in an increment of \$0.000001 or greater so as not to effectively eliminate trading in such securities. For example, a member would be permitted to rank or accept an order of \$.000089, but would not be permitted to display the order at such increments. A member would not be permitted to rank or accept an order of \$.00059, because it has an increment of \$.00001 and is not priced less than \$.0001. The proposed exception to allow the ranking and

¹⁷ See ArcaEdge and Pink1.

¹⁸ See ArcaEdge and Pink1.

acceptance of orders in smaller increments for securities priced below \$.0001 per share is in recognition of the fact that some OTC Equity Securities trade at prices below \$.0001 and having a restriction on increments below that amount would in effect eliminate trading of those securities. The proposal for securities priced \$1.00 or greater would continue to be a penny. Therefore the revised proposal would provide that:

No member shall display, rank, or accept a bid or offer, an order, or an indication of interest in any OTC Equity Security priced in an increment:

- (1) Smaller than \$0.01 if that bid or offer, order or indication of interest is priced equal to or greater than \$1.00 per share; and
- (2) Smaller than \$0.0001 if that bid or offer, order or indication of interest is priced less than \$1.00 per share except, where an order or indication of interest is priced less than \$0.0001, a member may rank or accept (but not display) such order or indication of interest in an increment of \$0.000001 or greater.¹⁹

FINRA believes that most, if not all, systems cannot accommodate the display of pricing increments smaller than four decimal places and that increasing the minimum pricing increment to \$.0001 would further promote and solidify uniformity in the OTC market at these price levels.

¹⁹ FINRA also is clarifying that such orders priced less than \$.0001 are not required to be displayed pursuant to proposed Rule 6460 (Display of Customer Limit Orders).

Prohibition on Locking and Crossing Quotations

FINRA rules do not currently prohibit locking or crossing quotations in OTC Equity Securities. FINRA believes that locked and crossed markets can cause confusion among investors concerning the trading interest in a stock and, therefore, FINRA believes that restricting the practice of submitting locking or crossing quotations (and requiring reconciliation of locked/crossed quotes) will enhance the usefulness of quotation information for OTC Equity Securities. Thus, FINRA proposed requiring members to implement policies and procedures that reasonably avoid the display of, or engaging in a pattern or practice of displaying, locking or crossing quotations in any OTC Equity Security within the same inter-dealer quotation system.

Commenters generally supported the adoption of a rule reasonably designed to prohibit locked and crossed markets, though commenters preferred that the prohibition apply across interdealer quotation systems.²⁰ One commenter expressed concern that the proposed rule takes a “fragmented” approach and should, instead, require members to canvas multiple venues for the purpose of avoiding locking/crossing the market in a similar manner as is currently required to meet best execution obligations.²¹

As FINRA stated in the Proposing Release, because there currently is no mandated consolidated quotation dissemination mechanism for OTC Equity Securities (as exists for NMS stocks), the proposed rule would only restrict locking and crossing quotations within inter-dealer quotation systems. FINRA continues to believe that, at the present time, the lock/cross rule can only reasonably be made to impose restrictions on locking and crossing

²⁰ See e.g., ArcaEdge, Pink1 and TD Ameritrade.

²¹ See Pink1.

quotations within, but not across, interdealer quotations systems due to the lack of a widely accessible, consolidated national best bid and offer for OTC Equity Securities. FINRA notes, however, that FINRA has proposed a rule that would require members to submit all quotation information in OTC Equity Securities to FINRA, and FINRA would, in turn, disseminate a best bid and offer as part of the Level 1 data feed entitlement.²² If this proposed quotation consolidation facility is approved, FINRA believes that it would then be reasonable to propose that members must avoid locking and crossing across interdealer quotation systems. Thus, FINRA does not believe that any amendments to the proposed rule addressing locked and crossed quotations are warranted at this time.

Limit Order Display

FINRA proposed requiring market makers displaying a priced quotation in a security to immediately display customer limit orders received where such order: (1) improves the price of the bid or offer displayed by the market maker, or (2) improves the size of its bid or offer by more than a de minimis amount where it is the best bid or offer in the interdealer quotation system where the market maker is quoting. Regulation NMS includes several exceptions from its limit order display requirements, which generally also would apply to the proposed limit order display rule for OTC Equity Securities.

Commenters generally supported a display requirement for limit orders but requested certain clarifications and modifications. For example, commenters request that the rule permit market makers to retain discretion as to the size displayed because small

²² See Securities Exchange Act Release No. 60999 (November 13, 2009), 74 FR 61183 (November 23, 2009). (Notice of Filing File No. SR-FINRA-2009-077; Proposed Rule Change to Restructure Quotation Collection and Dissemination for OTC Equity Securities).

orders are more likely to be executed than large ones.²³ Certain commenters also argued that market makers should not be required to display limit orders in thinly traded securities, but that these orders should be excepted for the same reason block orders are excepted (i.e., market impact).²⁴ One commenter expressed concern that requiring automatic display prevents market makers from exercising discretion to handle the order in the best possible manner, which will disadvantage retail customers.²⁵ One commenter believed that the proposal should be amended to require the display in an interdealer quotation system of all limit orders in OTC Equity Securities (unless immediately executed by the member or transmitted to another firm that would display such order in an interdealer quotation system) and should be expanded to include debt securities.²⁶ Commenters asserted that any automatic limit order display size requirement should be based on the current OTCBB tier sizes, and provide members with discretion above the size of the tier.²⁷ Commenters argued that the proposed definition of “block size” in the context of the exception to the display requirement still would require display of orders at sizes that may disadvantage the customer.²⁸ Therefore, these commenters believed that members should be required to display only a portion of the order equal to the minimum quote size.

²³ See Pink1 and STANY2.

²⁴ See Mercator, Pink1 and STANY2.

²⁵ See Pink1.

²⁶ See Pink2.

²⁷ See Pink1.

²⁸ See Knight and SIFMA.

FINRA appreciates the issues raised by commenters regarding the possible impact of limit order display on OTC Equity Securities in general and thinly traded OTC Equity Securities in particular. We confirm that the proposed limit order display rule would not require display of customer orders that would result in a violation of the tiers prescribed in FINRA Rule 6450 (Minimum Quotation Size Requirements For OTC Equity Securities).²⁹ FINRA is proposing a new exception for limit orders less than \$0.0001, consistent with the changes made to proposed FINRA Rule 6434 prohibiting the display of a bid or offer, order, or indication of interest in any OTC Equity Security priced less than \$0.0001 per share.³⁰ However, FINRA does not believe that any additional modifications to the proposed rule are appropriate, including with respect to comments that market makers should retain discretion over display of the size of a customer's limit order.

FINRA notes that, where the member believes that a customer would be best served by not displaying the full size of a limit order, the member is free to obtain the customer's consent to refrain from displaying such customer's order as is permitted by a proposed exception to the limit order display provision. FINRA is not persuaded that the suggested more volatile nature of OTC Equity Securities in general (or of any subset of especially thinly traded OTC Equity Securities) should permit a member independently to determine to withhold display of the full size of a customer limit order. Finally, FINRA does not agree that the proposed definition of "block size" should be modified. As stated

²⁹ If a member is already displaying a quotation at or above the minimum quotation size, then the displayed size must be increased to reflect the full size of any customer limit order (if the limit order size represents more than a de minimis amount).

³⁰ See supra note 19 and accompanying text.

in the Proposing Release, the proposed definition of “block size” is consistent with the existing large order size exception under IM-2110-2 (Trading Ahead of Customer Limit Order) and we believe it is appropriate that large orders be defined consistently across both rule sets.³¹ Furthermore, if a member believes that full display of a limit order that does not meet the definition of “block size” would disadvantage the customer, the member may obtain that customer’s consent to refrain from display of the full size. As stated in the Proposing Release, FINRA believes that extending limit order display requirements to OTC Equity Securities will improve transparency in the OTC equity market and will advance the goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution and disintermediation.

With respect to the recommendation that all customer limit orders in OTC Equity Securities be displayed, irrespective of whether the firm that receives the order is already quoting the security, FINRA continues to believe that the appropriate conditions for the trigger of an obligation to display a customer limit order is where a market maker is already displaying a priced quotation in an interdealer quotation system in the same security (unless an exception applies). Finally, the changes recommended by the commenter to expand the limit order display requirements to debt securities are outside the scope of the proposed changes that are part of this rule filing and therefore, FINRA is not responding to these recommendations specifically herein. FINRA will review and analyze

³¹ FINRA filed proposed rule change SR-FINRA-2009-090 to adopt NASD IM-2110-2 (Trading Ahead of Customer Limit Order) and NASD Rule 2111 (Trading Ahead of Customer Market Orders) with significant changes in the Consolidated FINRA Rulebook as new FINRA Rule 5320 (Prohibition Against Trading Ahead of Customer Orders). However, FINRA is not proposing changes to the definition of “large order.” See Securities Exchange Act Release No. 61168 (December 15,

these recommendations in the same manner in which it would consider any requests for rulemaking, and, based on such review and analysis, will determine whether further action on these recommendations is appropriate.

As stated in the Proposing Release, because the proposed new rules provide for significant regulatory changes, FINRA plans to implement the requirements in two phases to minimize the impact on firms. Phase one would implement sub-penny quoting restrictions, an access fee cap and restrictions on locked and crossed markets. Phase two would implement customer limit order display requirements. FINRA will announce the implementation dates for the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date of Phase one will be at least 120 days but no more than 365 days from the date of Commission approval and Phase two will be at least 90 days following the implementation of Phase one, but no more than 365 days from the date of Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,³² which requires that FINRA rules must be designed to

³²

2009), 74 FR 68084 (December 22, 2009) (Notice of Filing File No. SR-FINRA-2009-090).
15 U.S.C. 78o-3(b)(6).

prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

FINRA further believes that the proposed rule change is consistent with the provisions of 15A(b)(11) of the Act,³³ which requires, among other things, that FINRA rules must govern the form and content of quotations relating to securities sold otherwise than on a national securities exchange and require that such rules relating to quotations shall be designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.

FINRA is proposing to: (1) restrict subpenny quoting; (2) restrict locked and crossed markets; (3) implement a cap on access fees; and (4) require the display of customer limit orders. FINRA believes that the proposed restrictions on sub-penny quoting will promote greater price transparency and consistency, reduce the potential harms associated with sub-penny quoting in OTC equity securities and improve the depth and liquidity of this market.

FINRA believes that locked and crossed markets can cause confusion among investors concerning trading interest in a stock and that restricting the practice of

³³ 15 U.S.C. 78o-3(b)(11).

submitting locking or crossing quotations will enhance the usefulness of quotation information in the over-the-counter market, facilitate more fair and orderly markets and support market efficiency.

Where wide disparities in access fees are permitted, the prices of quotations are less useful and accurate. Therefore, FINRA believes that a cap on access fees would improve the usefulness and accuracy of quotations and address the potential distortions caused by substantial, disparate fees. Finally, FINRA believes that applying limit order display requirements to OTC Equity Securities would improve transparency in the OTC equity market and advance the goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution and disintermediation.

FINRA believes that the proposed extension of the specified Regulation NMS protections to quoting and trading in OTC Equity Securities will prevent fraudulent and manipulative acts and practices in this market, promote just and equitable principles of trade, and protect investors and the public interest.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were solicited by the Commission in response to the publication of SR-FINRA-2009-054, which proposed new rules to: (1) restrict sub-penny quoting; (2) restrict locked and crossed markets; (3) implement a cap on

access fees; and (4) require the display of customer limit orders.³⁴ The Commission received twelve comment letters.³⁵ The comments are summarized above.

6. Extension of Time Period for Commission Action

FINRA has granted an extension of the time period for Commission action until March 12, 2010.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 4. Text of the proposed rule change marked to show additions to and deletions from the changes proposed by the original filing.

Exhibit 5. Text of the proposed rule change.

³⁴ See Proposing Release.

³⁵ See supra note 3.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2009-054)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 6434 (Minimum Pricing Increment for OTC Equity Securities), 6437 (Prohibition from Locking or Crossing Quotations in OTC Equity Securities), 6450 (Restrictions on Access Fees) and 6460 (Display of Customer Limit Orders)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 7, 2009, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) and amended on -----, the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing Amendment No. 1 to SR-FINRA-2009-054, a proposed rule change to adopt new FINRA Rules 6434 (Minimum Pricing Increment for OTC Equity Securities), 6437 (Prohibition from Locking or Crossing Quotations in OTC Equity Securities), 6450 (Restrictions on Access Fees) and 6460 (Display of Customer Limit Orders).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Rule Filing History

On August 7, 2009, FINRA filed with the SEC SR-FINRA-2009-054, a proposed rule change to adopt new FINRA rules to extend certain Regulation NMS protections to quoting and trading in over-the-counter equity securities.³ On August 26, 2009, the Commission published for comment the proposed rule change in the Federal Register and received twelve comment letters.⁴ Based on comments received, FINRA is filing this

³ See Securities Exchange Act Release No. 60515 (August 17, 2009), 74 FR 43207 (August 26, 2009) (Notice of Filing File No. SR-FINRA-2009-054) ("Proposing Release").

⁴ Letter from Ann L. Vlcek, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Elizabeth M. Murphy, Secretary, SEC, dated October 13, 2009 ("SIFMA"); Letter from Christopher Nagy, Managing Director Order Strategy, TD Ameritrade, Inc., to Elizabeth M. Murphy, Secretary, SEC, dated October 6, 2009 ("TD Ameritrade"); Letters from R. Cromwell Coulson, Chief Executive Officer, Pink OTC Markets Inc., to

Amendment No. 1 to respond to the comments received and to propose amendments, where appropriate.

Proposal

As described in the Proposing Release, FINRA proposes to adopt rules to: (1) restrict sub-penny quoting; (2) restrict locked and crossed markets; (3) implement a cap on access fees; and (4) require the display of customer limit orders. FINRA believes that these Regulation NMS principles, if applied to over-the-counter equity securities ("OTC Equity Securities"),⁵ would enhance market quality and investor protections in this market.

Comments to the Proposed Rule Change

Restriction on Access Fees

Elizabeth M. Murphy, Secretary, SEC, dated September 23, 2009 ("Pink1") and January 6, 2010 ("Pink2"); Letter from Janet M. Kissane, Senior Vice President, Legal & Corporate Secretary, NYSE Euronext, to Nancy M. Morris, Secretary, SEC, dated September 23, 2009 ("ArcaEdge"); Letter from William Assatly, Sr. Vice President, Trading, Mercator Associates, to Elizabeth M. Murphy, Secretary, SEC, dated September 16, 2009 ("Mercator"); Letter from Leonard J. Amoruso, General Counsel, and Michael T. Carrao, Chief Compliance Officer, Knight Capital Group, Inc., to Elizabeth M. Murphy, Secretary, SEC, dated September 16, 2009 ("Knight"); Letter from Elaine M. Kaven, Chief Compliance Officer, StockCross Financial Services, Inc., to Florence H. Harmon, Deputy Secretary, SEC, dated September 16, 2009 ("StockCross"); Letters from Kimberly Unger, Executive Director, Security Traders Association of New York, Inc., to Elizabeth M. Murphy, Secretary, SEC, dated September 14, 2009 ("STANY1") and September 16, 2009 ("STANY2"); Letter from Daniel Kanter, President, and Craig Carlino, Chief Compliance Officer, Monroe Securities, Inc., to Elizabeth M. Murphy, Secretary, SEC, dated September 16, 2009 ("Monroe"); and Letter from Anonymous dated September 1, 2009. (available at <http://www.sec.gov/comments/sr-finra-2009-054/finra2009054.shtml>).

⁵ "OTC Equity Security" means any non-exchange-listed security and certain exchange-listed securities that do not otherwise qualify for real-time trade reporting. See FINRA Rule 6420(d).

Currently, FINRA Rule 6540(c), which applies only to the OTC Bulletin Board (“OTCBB”) montage, requires that an alternative trading system (“ATS”)⁶ and electronic communications network (“ECN”)⁷ reflect non-subscriber access or post-transaction fees in their posted quote. Consistent with Regulation NMS, FINRA proposed to eliminate the OTCBB access fee display requirement and to, instead, implement a cap on access fees in all OTC Equity Securities, wherever displayed, that exceed or accumulate to more than the following limits:

- a. If the price of the quotation is \$1.00 or more, the fee or fees cannot exceed or accumulate to more than \$0.003 per share; or
- b. If the price of the quotation is less than \$1.00, the fee or fees cannot exceed or accumulate to more than 0.3% of the quotation price per share.

Also consistent with Regulation NMS, the proposal would explicitly permit market makers to charge access fees.

While some commenters generally expressed support for the proposal to impose a cap on access fees,⁸ most commenters opposed it.⁹ Several commenters expressed concern that the proposal would lead to a reduction in the transparency of over-the-counter (“OTC”) quotations by permitting market participants to charge an access fee without displaying it in the quoted price, making it difficult for investors to compare

⁶ See Rule 300(a) of Regulation ATS under the Act.

⁷ See Rule 600(b)(23) of the Act (defining “electronic communications network”).

⁸ See ArcaEdge and TD Ameritrade.

⁹ See Knight, Mercator, Pink1, SIFMA, STANY2 and StockCross.

prices offered by different broker-dealers across different marketplaces.¹⁰ Commenters also expressed concern that an access fee cap (without a corresponding display requirement) would result in a shift in market structure that harms investors by leading to an increase in transaction costs.¹¹ Some commenters also argued that the proposal would unfairly favor the ATS business model, result in an increase in the incidence of locked and cross markets, and lead to an increase in gaming practices.¹²

Commenters noted that the proposed access fee cap of 0.3% of the quotation price per share for securities priced under \$1.00 may result in the assessment of an undisclosed access fee that is greater than the price increment, which may provide an incentive for gaming activity and “access fee trading.”¹³ One commenter presented a scenario that would result in “access fee trading” through crossing quotes across inter-dealer quotation systems.¹⁴ In the example, the inside market for a stock quoted on the OTCBB is \$.8999 x \$.90 (the relevant access fee cap under the original proposal would have been \$.0027 per share). Rather than take the offering at \$.90, the commenter states that a market maker could cross the market in the Pink Sheets by posting a bid of \$.9001. If the market maker’s bid is hit in the Pink Sheets, it will be able to buy the stock at \$.9001 and then immediately sell to the OTCBB bid at \$.8999. The commenter notes that, although the

¹⁰ See e.g., Knight, Pink1 and SIFMA.

¹¹ See e.g., Mercator and Pink1.

¹² See e.g., Knight, Pink1 and SIFMA.

¹³ See generally ArcaEdge, STANY2 and Pink1. As an example, Pink noted that, using the proposed formula, the access fee cap on a \$.90 security would be \$.0027 while the pricing increment would be \$.0001.

¹⁴ See Knight.

market maker sold the stock at a slight loss of \$.0002 per share, the access fee of \$.0027 per share provided an instant, virtually riskless profit.¹⁵ Accordingly, certain commenters argued that the appropriate access fee cap should never be greater than 30% of the relevant pricing increment, which would ensure that the access fee is always lower than the relevant increment.¹⁶

FINRA has considered the comments opposing the elimination of the access fee display requirement in conjunction with the establishment of an access fee cap, and continues to believe that the proposal strikes the appropriate balance between addressing the practical difficulties of incorporating access fees in published quotes and the need to curtail potentially excessive undisclosed access fees. FINRA notes that similar concerns and debate were raised in the context of the adoption of Regulation NMS, to which the Commission concluded that a uniform fee limitation of \$.003 per share is the fairest and most appropriate resolution of the access fee issue.¹⁷ FINRA believes that the same holds true in this context as well.

However, in light of the lower price points for securities in the OTC market, and in response to commenters' concerns regarding potential gaming activities, FINRA believes that an adjustment to the proposed access fee cap calculation method is appropriate. FINRA is proposing a revised method of calculating the access fee for securities priced under \$1.00 to ensure that the access fee is always less than the relevant

¹⁵ See Knight.

¹⁶ See ArcaEdge, Pink1 and STANY2.

¹⁷ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (order adopting rules under Regulation NMS, SEC File No. S7-10-04).

quotation increment. FINRA is proposing that the cap on access fees for securities priced under \$1.00 would be the lesser of: (a) 0.3% of the published quotation price on a per share basis, or (b) 30% of the relevant minimum pricing increment applicable to the display of the quotation. The revised proposal would provide that:

A member shall not impose, nor permit to be imposed, non-subscriber access or post-transaction fees against its published quotation in any OTC Equity Security that exceeds or accumulates to more than:

- (a) \$0.003 per share, if the published quotation is priced equal to or greater than \$1.00; or
- (b) the lesser of 0.3% of the published quotation price on a per share basis or 30% of the minimum pricing increment under Rule 6434 relevant to the display of the quotation on a per share basis if the published quotation is less than \$1.00.

FINRA believes that this approach would ensure that a permissible access fee would always be smaller than the pricing increment (which would address concerns regarding gaming). If the security is priced at \$1.00 or more, the access fee cap would continue to be \$0.003 per share.

Sub-penny Restrictions

Currently there are no restrictions in place for quotations in subpenny increments in the OTC marketplace. Subpenny increments have been associated with certain market abuses, including stepping ahead of standing limit orders for an economically insignificant amount. Subpenny increments also have been associated with added difficulty for broker-dealers in meeting certain regulatory obligations by increasing the

incidence of so-called “flickering” quotes. Thus, FINRA has proposed restrictions on the display of quotations and orders in sub-penny increments for OTC Equity Securities.

Specifically, FINRA proposed to prohibit members from displaying, ranking or accepting from others a bid, offer, order, or indication of interest in OTC Equity Securities in an increment smaller than:

- \$0.01 if the bid or offer, order, or indication of interest is priced \$1.00 or greater per share,
- \$0.0001 if the bid or offer, order, or indication of interest is priced below \$1.00 and equal to or greater than \$0.01 per share, and
- \$0.000001 if the bid or offer, order or indication of interest is priced less than \$0.01 per share.

Commenters generally favored a restriction on quoting in subpenny increments, though some argued for modifications to the increments proposed. Commenters also generally believed that the proposal should go further by prohibiting subpenny quotations in increments of more than four decimal places.¹⁸ Certain commenters also proposed specific alternative quotation increments for the OTC market.¹⁹

FINRA has considered commenters’ concerns and is proposing a modification to the tiers originally proposed. Specifically, FINRA is proposing to reduce the minimum pricing increment from \$0.000001 to \$0.0001 for all securities priced under \$1.00. However, with respect to securities priced less than \$0.0001, members would be permitted to rank or accept (but not display) orders and indications of interest in an

¹⁸ See ArcaEdge and Pink1.

¹⁹ See ArcaEdge and Pink1.

increment of \$0.000001 or greater so as not to effectively eliminate trading in such securities. For example, a member would be permitted to rank or accept an order of \$.000089, but would not be permitted to display the order at such increments. A member would not be permitted to rank or accept an order of \$.00059, because it has an increment of \$.00001 and is not priced less than \$.0001. The proposed exception to allow the ranking and acceptance of orders in smaller increments for securities priced below \$.0001 per share is in recognition of the fact that some OTC Equity Securities trade at prices below \$.0001 and having a restriction on increments below that amount would in effect eliminate trading of those securities. The proposal for securities priced \$1.00 or greater would continue to be a penny. Therefore the revised proposal would provide that:

No member shall display, rank, or accept a bid or offer, an order, or an indication of interest in any OTC Equity Security priced in an increment:

- (1) Smaller than \$0.01 if that bid or offer, order or indication of interest is priced equal to or greater than \$1.00 per share; and
- (2) Smaller than \$0.0001 if that bid or offer, order or indication of interest is priced less than \$1.00 per share except, where an order or indication of interest is priced less than \$0.0001, a member may rank or accept (but not display) such order or indication of interest in an increment of \$0.000001 or greater.²⁰

FINRA believes that most, if not all, systems cannot accommodate the display of pricing increments smaller than four decimal places and that increasing the minimum

²⁰ FINRA also is clarifying that such orders priced less than \$.0001 are not required to be displayed pursuant to proposed Rule 6460 (Display of Customer Limit Orders).

pricing increment to \$0.0001 would further promote and solidify uniformity in the OTC market at these price levels.

Prohibition on Locking and Crossing Quotations

FINRA rules do not currently prohibit locking or crossing quotations in OTC Equity Securities. FINRA believes that locked and crossed markets can cause confusion among investors concerning the trading interest in a stock and, therefore, FINRA believes that restricting the practice of submitting locking or crossing quotations (and requiring reconciliation of locked/crossed quotes) will enhance the usefulness of quotation information for OTC Equity Securities. Thus, FINRA proposed requiring members to implement policies and procedures that reasonably avoid the display of, or engaging in a pattern or practice of displaying, locking or crossing quotations in any OTC Equity Security within the same inter-dealer quotation system.

Commenters generally supported the adoption of a rule reasonably designed to prohibit locked and crossed markets, though commenters preferred that the prohibition apply across interdealer quotation systems.²¹ One commenter expressed concern that the proposed rule takes a “fragmented” approach and should, instead, require members to canvas multiple venues for the purpose of avoiding locking/crossing the market in a similar manner as is currently required to meet best execution obligations.²²

As FINRA stated in the Proposing Release, because there currently is no mandated consolidated quotation dissemination mechanism for OTC Equity Securities (as exists for NMS stocks), the proposed rule would only restrict locking and crossing

²¹ See e.g., ArcaEdge, Pink1 and TD Ameritrade.

²² See Pink1.

quotations within inter-dealer quotation systems. FINRA continues to believe that, at the present time, the lock/cross rule can only reasonably be made to impose restrictions on locking and crossing quotations within, but not across, interdealer quotations systems due to the lack of a widely accessible, consolidated national best bid and offer for OTC Equity Securities. FINRA notes, however, that FINRA has proposed a rule that would require members to submit all quotation information in OTC Equity Securities to FINRA, and FINRA would, in turn, disseminate a best bid and offer as part of the Level 1 data feed entitlement.²³ If this proposed quotation consolidation facility is approved, FINRA believes that it would then be reasonable to propose that members must avoid locking and crossing across interdealer quotation systems. Thus, FINRA does not believe that any amendments to the proposed rule addressing locked and crossed quotations are warranted at this time.

Limit Order Display

FINRA proposed requiring market makers displaying a priced quotation in a security to immediately display customer limit orders received where such order: (1) improves the price of the bid or offer displayed by the market maker, or (2) improves the size of its bid or offer by more than a de minimis amount where it is the best bid or offer in the interdealer quotation system where the market maker is quoting. Regulation NMS includes several exceptions from its limit order display requirements, which generally also would apply to the proposed limit order display rule for OTC Equity Securities.

²³ See Securities Exchange Act Release No. 60999 (November 13, 2009), 74 FR 61183 (November 23, 2009). (Notice of Filing File No. SR-FINRA-2009-077; Proposed Rule Change to Restructure Quotation Collection and Dissemination for OTC Equity Securities).

Commenters generally supported a display requirement for limit orders but requested certain clarifications and modifications. For example, commenters request that the rule permit market makers to retain discretion as to the size displayed because small orders are more likely to be executed than large ones.²⁴ Certain commenters also argued that market makers should not be required to display limit orders in thinly traded securities, but that these orders should be excepted for the same reason block orders are excepted (i.e., market impact).²⁵ One commenter expressed concern that requiring automatic display prevents market makers from exercising discretion to handle the order in the best possible manner, which will disadvantage retail customers.²⁶ One commenter believed that the proposal should be amended to require the display in an interdealer quotation system of all limit orders in OTC Equity Securities (unless immediately executed by the member or transmitted to another firm that would display such order in an interdealer quotation system) and should be expanded to include debt securities.²⁷ Commenters asserted that any automatic limit order display size requirement should be based on the current OTCBB tier sizes, and provide members with discretion above the size of the tier.²⁸ Commenters argued that the proposed definition of “block size” in the context of the exception to the display requirement still would require display of orders at

²⁴ See Pink1 and STANY2.

²⁵ See Mercator, Pink1 and STANY2.

²⁶ See Pink1.

²⁷ See Pink2.

²⁸ See Pink1.

sizes that may disadvantage the customer.²⁹ Therefore, these commenters believed that members should be required to display only a portion of the order equal to the minimum quote size.

FINRA appreciates the issues raised by commenters regarding the possible impact of limit order display on OTC Equity Securities in general and thinly traded OTC Equity Securities in particular. We confirm that the proposed limit order display rule would not require display of customer orders that would result in a violation of the tiers prescribed in FINRA Rule 6450 (Minimum Quotation Size Requirements For OTC Equity Securities).³⁰ FINRA is proposing a new exception for limit orders less than \$0.0001, consistent with the changes made to proposed FINRA Rule 6434 prohibiting the display of a bid or offer, order, or indication of interest in any OTC Equity Security priced less than \$0.0001 per share.³¹ However, FINRA does not believe that any additional modifications to the proposed rule are appropriate, including with respect to comments that market makers should retain discretion over display of the size of a customer's limit order.

FINRA notes that, where the member believes that a customer would be best served by not displaying the full size of a limit order, the member is free to obtain the customer's consent to refrain from displaying such customer's order as is permitted by a proposed exception to the limit order display provision. FINRA is not persuaded that the

²⁹ See Knight and SIFMA.

³⁰ If a member is already displaying a quotation at or above the minimum quotation size, then the displayed size must be increased to reflect the full size of any customer limit order (if the limit order size represents more than a de minimis amount).

³¹ See supra note 20 and accompanying text.

suggested more volatile nature of OTC Equity Securities in general (or of any subset of especially thinly traded OTC Equity Securities) should permit a member independently to determine to withhold display of the full size of a customer limit order. Finally, FINRA does not agree that the proposed definition of “block size” should be modified. As stated in the Proposing Release, the proposed definition of “block size” is consistent with the existing large order size exception under IM-2110-2 (Trading Ahead of Customer Limit Order) and we believe it is appropriate that large orders be defined consistently across both rule sets.³² Furthermore, if a member believes that full display of a limit order that does not meet the definition of “block size” would disadvantage the customer, the member may obtain that customer’s consent to refrain from display of the full size. As stated in the Proposing Release, FINRA believes that extending limit order display requirements to OTC Equity Securities will improve transparency in the OTC equity market and will advance the goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution and disintermediation.

With respect to the recommendation that all customer limit orders in OTC Equity Securities be displayed, irrespective of whether the firm that receives the order is already quoting the security, FINRA continues to believe that the appropriate conditions for the trigger of an obligation to display a customer limit order is where a market maker is

³² FINRA filed proposed rule change SR-FINRA-2009-090 to adopt NASD IM-2110-2 (Trading Ahead of Customer Limit Order) and NASD Rule 2111 (Trading Ahead of Customer Market Orders) with significant changes in the Consolidated FINRA Rulebook as new FINRA Rule 5320 (Prohibition Against Trading Ahead of Customer Orders). However, FINRA is not proposing changes to the definition of “large order.” See Securities Exchange Act Release No. 61168 (December 15, 2009), 74 FR 68084 (December 22, 2009) (Notice of Filing File No. SR-FINRA-2009-090).

already displaying a priced quotation in an interdealer quotation system in the same security (unless an exception applies). Finally, the changes recommended by the commenter to expand the limit order display requirements to debt securities are outside the scope of the proposed changes that are part of this rule filing and therefore, FINRA is not responding to these recommendations specifically herein. FINRA will review and analyze these recommendations in the same manner in which it would consider any requests for rulemaking, and, based on such review and analysis, will determine whether further action on these recommendations is appropriate.

As stated in the Proposing Release, because the proposed new rules provide for significant regulatory changes, FINRA plans to implement the requirements in two phases to minimize the impact on firms. Phase one would implement sub-penny quoting restrictions, an access fee cap and restrictions on locked and crossed markets. Phase two would implement customer limit order display requirements. FINRA will announce the implementation dates for the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date of Phase one will be at least 120 days but no more than 365 days from the date of Commission approval and Phase two will be at least 90 days following the implementation of Phase one, but no more than 365 days from the date of Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,³³ which requires that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable

³³ 15 U.S.C. 78o-3(b)(6).

principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

FINRA further believes that the proposed rule change is consistent with the provisions of 15A(b)(11) of the Act,³⁴ which requires, among other things, that FINRA rules must govern the form and content of quotations relating to securities sold otherwise than on a national securities exchange and require that such rules relating to quotations shall be designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.

FINRA is proposing to: (1) restrict subpenny quoting; (2) restrict locked and crossed markets; (3) implement a cap on access fees; and (4) require the display of customer limit orders. FINRA believes that the proposed restrictions on sub-penny quoting will promote greater price transparency and consistency, reduce the potential harms associated with sub-penny quoting in OTC equity securities and improve the depth and liquidity of this market.

FINRA believes that locked and crossed markets can cause confusion among investors concerning trading interest in a stock and that restricting the practice of submitting locking or crossing quotations will enhance the usefulness of quotation

³⁴ 15 U.S.C. 78o-3(b)(11).

information in the over-the-counter market, facilitate more fair and orderly markets and support market efficiency.

Where wide disparities in access fees are permitted, the prices of quotations are less useful and accurate. Therefore, FINRA believes that a cap on access fees would improve the usefulness and accuracy of quotations and address the potential distortions caused by substantial, disparate fees. Finally, FINRA believes that applying limit order display requirements to OTC Equity Securities would improve transparency in the OTC equity market and advance the goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution and disintermediation.

FINRA believes that the proposed extension of the specified Regulation NMS protections to quoting and trading in OTC Equity Securities will prevent fraudulent and manipulative acts and practices in this market, promote just and equitable principles of trade, and protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were solicited by the Commission in response to the publication of SR-FINRA-2009-054, which proposed new rules to: (1) restrict sub-penny quoting; (2) restrict locked and crossed markets; (3) implement a cap

on access fees; and (4) require the display of customer limit orders.³⁵ The Commission received twelve comment letters.³⁶ The comments are summarized above.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2009-054 on the subject line.

Paper Comments:

³⁵ See Proposing Release.

³⁶ See supra note 4.

- Send paper comments in triplicate to Florence E. Harmon, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2009-054. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-054 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁷

Florence E. Harmon

Deputy Secretary

³⁷ 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Below is the text of the proposed rule change with the changes proposed in the initial filing shown as though approved. New language proposed in this amendment is underlined; proposed deletions are in brackets.

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Text of Proposed Changes to FINRA Rules

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6000. QUOTATION AND TRANSACTION REPORTING FACILITIES

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6400. QUOTING AND TRADING IN OTC EQUITY SECURITIES

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6434. Minimum Pricing Increment for OTC Equity Securities

(a) No Change.

(b) No member shall display, rank, or accept a bid or offer, an order, or an indication of interest in any OTC Equity Security priced in an increment smaller than \$0.0001 if that bid or offer, order or indication of interest is priced [equal to or greater than \$0.01 per share and] less than \$1.00 per share except, where an order or indication of interest is priced less than \$0.0001, a member may rank or accept (but not display) such order or indication of interest in an increment of \$0.000001 or greater.

[(c) No member shall display, rank, or accept a bid or offer, an order, or an indication of interest in any OTC Equity Security priced in an increment smaller than \$0.000001 if that bid or offer, order or indication of interest is priced less than \$0.01 per share.]

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6450. Restrictions on Access Fees

A member shall not impose, nor permit to be imposed, non-subscriber access or post-transaction fees against its published quotation in any OTC Equity Security that exceed or accumulate to more than:

(a) \$0.003 per share, if the published quotation is priced equal to or greater than \$1.00; or

(b) the lesser of 0.3% of the published quotation price on a per share basis[,] or 30% of the minimum pricing increment under Rule 6434 relevant to the display of the quotation on a per share basis if the published quotation is less than \$1.00.

6460. Display of Customer Limit Orders

(a) No Change.

(b) The requirements in paragraph (a) of this Rule shall not apply to any customer limit order:

(1) through (7) No Change.

(8) That is priced less than \$0.0001 per share.

(c) through (d) No Change.

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EXHIBIT 5

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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Text of Proposed Changes to NASD Rule 2320

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2300. TRANSACTIONS WITH CUSTOMERS

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2320. BEST EXECUTION AND INTERPOSITIONING

(a) through (e) No Change.

(f)(1) No Change.

(2) Members that display priced quotations on a real-time basis for a non-exchange-listed security in two or more quotation mediums that permit quotation updates on a real-time basis must display the same priced quotations for the security in each medium, except with respect to a priced quotation that represents a customer limit order displayed on an electronic communications network in conformance with the exception to FINRA Rule 6460 provided in paragraph (b)(5) of that rule.

(3) through (5) No Change.

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Text of Proposed Changes to FINRA Rules

6000. QUOTATION AND TRANSACTION REPORTING FACILITIES

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6400. QUOTING AND TRADING IN OTC EQUITY SECURITIES

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6430. OTC Equity Quotation Requirements

6431. Recording of Quotation Information

(a) through (f) No Change.

[6440] 6432. Compliance with the Information Requirements of SEA Rule 15c2-11

(a) through (d) No Change.

[6450] 6433. Minimum Quotation Size Requirements For OTC Equity Securities

No Change to rule text.

6434. Minimum Pricing Increment for OTC Equity Securities

(a) No member shall display, rank, or accept a bid or offer, an order, or an indication of interest in any OTC Equity Security priced in an increment smaller than \$0.01 if that bid or offer, order or indication of interest is priced equal to or greater than \$1.00 per share.

(b) No member shall display, rank, or accept a bid or offer, an order, or an indication of interest in any OTC Equity Security priced in an increment smaller than \$0.0001 if that bid or offer, order or indication of interest is priced less than \$1.00 per share except, where an order or indication of interest is priced less than \$0.0001, a member may rank or accept (but not display) such order or indication of interest in an increment of \$0.000001 or greater.

[6470] 6435. Withdrawal of Quotations in an OTC Equity Security in Compliance with SEC Regulation M

(a) through (b) No Change.

6437. Prohibition from Locking or Crossing Quotations in OTC Equity Securities

(a) Members must implement policies and procedures that reasonably avoid displaying, or engaging in a pattern or practice of displaying, locking or crossing quotations in any OTC Equity Security.

(b) For purposes of this Rule, the following definitions shall apply:

(1) The term “crossing quotation” shall mean the display of a bid for an OTC Equity Security at a price that is higher than the displayed price of an offer for such OTC Equity Security in the same inter-dealer quotation system, or the display of an offer for an OTC Equity Security at a price that is lower than the displayed price of a bid for such OTC Equity Security in the same inter-dealer quotation system.

(2) The term “locking quotation” shall mean the display of a bid for an OTC Equity Security at a price that equals the displayed price of an offer for such OTC Equity Security in the same inter-dealer quotation system, or the display of an offer for an OTC Equity Security at a price that equals the displayed price of a bid for such OTC Equity Security in the same inter-dealer quotation system.

[6460] 6440. Trading and Quotation Halt in OTC Equity Securities

(a) through (c) No Change.

• • • Supplementary Material: -----

.01 FINRA may impose a trading and quotation halt in an OTC Equity Security pursuant to Rule [6460] 6440(a)(3) where FINRA determines, in its discretion, based on the facts and circumstances of the particular event, that halting trading in the security is the appropriate mechanism to protect investors and ensure a fair and orderly marketplace. As

a general matter, FINRA does not favor imposing a trading and quotation halt in an OTC Equity Security and will exercise this authority in very limited circumstances.

.02 In determining whether to impose a trading halt under Rule [6460] 6440(a)(3), FINRA will consider several factors in making its determination, including but not limited to: (1) the material nature of the event; (2) the material facts surrounding the event are undisputed and not in conflict; (3) the event has caused widespread confusion in the trading of the security; (4) there has been a material negative effect on the market for the subject security; (5) the potential exists for a major disruption to the marketplace; (6) there is significant uncertainty in the settlement and clearance process for the security; and/or (7) such other factors as FINRA deems relevant in making its determination. FINRA may review all or some of these factors as it determines appropriate.

6450. Restrictions on Access Fees

A member shall not impose, nor permit to be imposed, non-subscriber access or post-transaction fees against its published quotation in any OTC Equity Security that exceed or accumulate to more than:

(a) \$0.003 per share, if the published quotation is priced equal to or greater than \$1.00; or

(b) the lesser of 0.3% of the published quotation price on a per share basis or 30% of the minimum pricing increment under Rule 6434 relevant to the display of the quotation on a per share basis if the published quotation is less than \$1.00.

6460. Display of Customer Limit Orders

(a) Each OTC Market Maker displaying a priced quotation in any OTC Equity Security in an inter-dealer quotation system shall publish immediately a bid or offer that reflects:

(1) The price and the full size of each customer limit order held by the OTC Market Maker that is at a price that would improve the bid or offer of such OTC Market Maker in such security; and

(2) The full size of each customer limit order held by the OTC Market Maker that:

(A) Is priced equal to the bid or offer of such OTC Market Maker for such security;

(B) Is priced equal to the best bid or best offer of the inter-dealer quotation system in which the OTC Market Maker is quoting; and

(C) Represents more than a de minimis change in relation to the size associated with the OTC Market Maker's bid or offer.

(b) The requirements in paragraph (a) of this Rule shall not apply to any customer limit order:

(1) That is executed upon receipt of the order.

(2) That is placed by a customer who expressly requests, either at the time that the order is placed or prior thereto pursuant to an individually negotiated agreement with respect to such customer's orders, that the order not be displayed.

(3) That is an odd-lot order.

(4) That is a block size order, unless a customer placing such order requests that the order be displayed.

(5) That is delivered immediately upon receipt to a national securities exchange or an electronic communications network that widely disseminates such order and that complies with paragraph (c) below with respect to that order.

(6) That is delivered immediately upon receipt to another OTC Market Maker that complies with the requirements of this Rule with respect to that order.

(7) That is an all-or-none order.

(8) That is priced less than \$0.0001 per share.

(c) The electronic communications network:

(1) Provides to a national securities exchange, national securities association or inter-dealer quotation system the prices and sizes of the orders at the highest buy price and the lowest sell price for such security entered in, and widely disseminated by, the electronic communications network; and

(2) Provides, to any broker or dealer, the ability to effect a transaction with a priced order widely disseminated by the electronic communications network entered therein by an OTC market maker that is:

(A) Equivalent to the ability of any broker or dealer to effect a transaction with an OTC market maker pursuant to the rules of the applicable national securities exchange, national securities association or inter-dealer quotation system to which the electronic communications network supplies such bids and offers; and

(B) At the price of the highest priced buy order or lowest priced sell order, or better, for the lesser of the cumulative size of such priced orders entered therein by OTC market makers at such price, or the size of the execution sought by the broker or dealer, for such security.

(d) Definitions.

For purposes of this Rule, the following definitions shall apply:

(1) Best bid and best offer mean the highest priced bid and the lowest priced offer.

(2) Block size with respect to an order means it is of at least 10,000 shares and has a market value of at least \$100,000.

(3) Customer limit order means an order to buy or sell an OTC Equity Security at a specified price that is not for the account of either a broker or dealer; provided, however, that the term customer limit order shall include an order transmitted by a broker or dealer on behalf of a customer.

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6500. OTC BULLETIN BOARD® SERVICE

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6540. Requirements Applicable to Market Makers

(a) Market-maker participation in the OTCBB is voluntary and open to any FINRA member firm that satisfies the financial/operational requirements applicable to member firms engaged in over-the-counter market making; subscribes to the service designated by FINRA that permits OTCBB quotations; and demonstrates compliance with (or qualifies for an exception or exemption from) SEA Rule 15c2-11 at the time of

initiating (or resuming) the quotation of any OTCBB-eligible security in the Service.

Rule 6432 [6440] sets forth the procedure for demonstrating compliance with SEA Rule 15c2-11.

(b) No Change.

(c) [A participating ATS or ECN shall reflect non-subscriber access or post-transaction fees in the ATS's or ECN's posted quote in the OTC Bulletin Board montage.]

[(d)] OTCBB-eligible securities that meet the frequency-of-quotation requirement for the so called "piggyback" exception in SEA Rule 15c2-11(f)(3)(i) are identified in the Service as "active" securities. A member can commence market making in any active security by registering as a market maker through the service designated by FINRA that permits OTCBB quotations. In all other instances, a member must follow the procedure contained in this Rule to become qualified as a market maker in a particular OTCBB-eligible security.

(1) Permissible Quotation Entries

(A) No Change.

(B) A priced bid and/or offer entered into the Service for a domestic equity security must be firm up to the minimum quotation size specified in Rule 6433[6450]. This firmness requirement applies only during normal business hours, i.e., 9:30 a.m. to 4:00 p.m. Eastern Time.

(C) No Change.

(2) through (5) No Change.

[(e)] (d) Compliance with Market Maker Requirements

Failure of a member or a person associated with a member to comply with this Rule may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2010.

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