Racquel Russell
Assistant General Counsel
Regulatory Policy and Oversight

Direct: (202) 728-8363
Fax: (202) 728-8264

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Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-FINRA-2009-054-Amendment No. 1 — Response to Comments

Dear Ms. Murphy:

This letter responds to comments submitted to the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing, a proposed rule change to adopt 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.[1] The SEC published the Original Proposal for notice and comment on August 17, 2009 and received twelve comment letters. FINRA responded to these comments in Amendment No. 1.[2] The SEC published Amendment No. 1 for notice and comment on March 9, 2010 and received two comment letters, which are addressed below.[3]

FINRA notes that the comment letters received in response to Amendment No. 1 do not address the changes proposed in that amendment, but rather largely reiterate comments previously received and responded to regarding aspects of the Original Proposal. Thus, in addition to the below discussion, FINRA refers commenters to the Original Proposal and Amendment No. 1.

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1 *See* Securities Exchange Act Release No. 60515 (August 17, 2009), 74 FR 43207 (August 26, 2009) ("Original Proposal").

2 *See* Securities Exchange Act Release No. 61677 (March 9, 2010), 74 FR 12584 (March 16, 2010) ("Amendment No. 1").

3 Letter from R. Cromwell Coulson, Chief Executive Officer, Pink OTC Markets Inc., to Elizabeth M. Murphy, Secretary, SEC, dated April 9, 2010 ("Pink"); and Letter from Daniel Kanter, President, Monroe Securities, to Elizabeth M. Murphy, Secretary, SEC, dated April 6, 2010 ("Monroe").

Triggering Event for Limit Order Display

One commenter reiterated concern that the FINRA proposal does not require display of quotations in an interdealer quotation system ("IDQS") and is limited to customer limit orders where OTC Market Makers are already displaying quotes.[4] This commenter believes that FINRA should expand the rule's application to any member directly or indirectly displaying a priced quotation in an IDQS or electronic communications network.[5]

FINRA is not proposing an amendment to this proposed provision. As recognized by the SEC in applying limit order display obligations only to market makers and specialists, FINRA likewise believes that proposed Rule 6460 also should be limited to those members that are market makers.[6] Thus, as stated in Amendment No. 1, FINRA continues to believe that, at this time, the appropriate conditions for the trigger of an obligation to display a customer limit order is where an OTC Market Maker is already displaying a priced quotation in an IDQS in the same security (unless an exception applies). However, it should be noted that FINRA's determination not to expand the rule's application to non-market makers in no way changes or limits such members' best execution or other order handling obligations to these orders. In addition, while members are not required to display customer limit orders priced less than $0.0001, a member's customer order protection obligations under IM-2110-2 (Trading Ahead of Customer Limit Order) continue to apply.

Display of the Full Size of a Customer Limit Order

Commenters restated the view that members should not be required to display the full size of customer limit orders because this may reduce execution quality.[7] Pink argued that the limit order display requirement should be limited to display of half the size of the largest individual order above the tier size, but no more than five times tier size, unless the customer requests otherwise.[8] However, as stated in Amendment No. 1, FINRA continues to believe that the proposed formulation is preferable. FINRA believes that the default obligation should be the requirement to display the full size of

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4 *See* Pink.

5 *Id*.

6 Securities Exchange Act Release No. 36310 (September 29, 1995), 60 FR 52792 (October 10, 1995) (''LOD Proposing Release'') (stating that the Commission has considered and is building upon the special role played by market makers and specialists in discovering prices and providing liquidity to the securities markets).

7 *See* Monroe and Pink.

8 *See* Pink.

a customer's limit order, unless an exception applies or the customer requests otherwise.[9]

FINRA notes that the SEC received similar comments in response to its LOD Proposing Release. Specifically, commenters argued that "the [proposed limit order display rule] would eliminate their discretion to determine the best way in which to execute a customer's order."[10] The commenters further stated that "customers rely on the judgment of a market professional in choosing whether to display a limit order."[11] In response to these comments, the Commission stated that the rule "appropriately establishes a presumption that limit orders should be displayed, unless such orders are of block size, the customer requests that its order not be displayed, or one of the exceptions to the rule applies."[12] The Commission further determined that, "[t]he exception allowing a customer to request that its limit order not be displayed gives the customer ultimate control in determining whether to trust the display of the limit order to the discretion of a market professional, or to display the order either in full, or in part, to other potential market interest."[13] FINRA agrees with the Commission's determination and is proposing the same approach here.

Another commenter provided an example of an OTC Equity Security that trades at prices where the dollar minimum for the block sized order exception would be satisfied but the share volume minimum would not.[14] As stated in the Proposing Release and Amendment No. 1, the proposed definition of "block size" is consistent with the large-sized order exception under NASD 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. In addition, as stated above, we note that an OTC Market Maker may obtain the customer's consent to refrain from the display of a customer limit order.

Scope of the Locked and Crossed Markets Proposal

One commenter reiterated its argument that the locked and crossed markets prohibition should apply across IDQSs.[15] 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, IDQSs due to the lack of an

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9 *See* Amendment No. 1.

10 *See* LOD Proposing Release.

11 *Id*.

12 *Id*.

13 *Id*.

14 *See* Monroe.

15 *See* Pink.

SRO-sponsored widely accessible, consolidated national best bid and offer for OTC equity securities. While the commenter is correct that a broker-dealer's duty of best execution may require it to canvass several market venues to obtain the best possible price for a customer, that obligation is separate and apart from the real-time obligations of a member firm in posting quotations. As FINRA noted in Amendment No. 1, 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.[16] 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 IDQSs.

Access Fee Restrictions

One commenter argued that FINRA should not permit members to charge undisclosed access fees.[17] This commenter asserted that the proposal "favors certain agency models to the detriment of the OTC market."[18] FINRA disagrees. As we have stated previously, the SEC determined that a uniform fee limitation of $0.003 per share (if the published quotation is priced equal to or greater than $1.00) is the fairest and most appropriate resolution of the access fee issue and FINRA agrees that such course is most appropriate for OTC Equity Securities as well.[19]

Thus, FINRA believes the proposal permits a landscape where market forces can drive the adoption of various business models in the OTC market. As stated in the Original Proposal, a uniform fee limitation promotes equal regulation of different types of trading centers, where previously some had been permitted to charge fees and some had not.[20] FINRA therefore believes it is appropriate to implement a rule to

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16 *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).

17 *See* Pink.

18 *Id*.

19 In light of the lower price points for securities in the OTC market, FINRA amended the proposal to provide an alternative for quotations priced less than $1.00 per share. In such cases, the access fee cannot exceed or accumulate to more that the lesser of 0.3% of the published quotation price on a per share basis or 30% of the minimum pricing increment under proposed Rule 6434 relevant to the display of the quotation on a per share basis. *See* Amendment No. 1. *See also* 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).

20 Pink commented that FINRA has discouraged electronic communications networks from trading on a riskless principal basis with non-subscriber broker-dealers to earn their access fee, but that this should be permitted. While it is not clear what is meant by this comment, if the assertion is that members should engage in a principal transaction at one price (*i.e.*, that factors in an access fee) and then sell to (or buy from) another party at another price, such a

ensure that such fees do not accumulate to more than the prescribed limitation proposed.

Other Comments

Pink stated that FINRA's determination not to incorporate certain Pink recommendations (and to so state in our response letter) was "disrespectful to [FINRA's] congressionally mandated responsibilities" in connection with the notice and comment process. Pink states that "Congress intended that agencies treat comments seriously and provide thoughtful reasons for rejecting them."[21]

As an initial matter, the commenter misperceives the comment process. As a matter of statute, there are no legal obligations on the part of a self-regulatory organization with respect to comment letters submitted in response to filings published by the Commission in the *Federal Register*. Notwithstanding the requirements of statute, FINRA is deeply committed to the comment process because it is a highly valuable discipline in determining the appropriate scope and detail of all proposed rulemaking; consequently we accord to all comments a level of consideration commensurate with our view of their importance in the rulemaking process. We believe that our responses to date in respect of comments received pertaining to this filing demonstrate the degree to which FINRA highly values the views of the investing public, the firms we regulate, and others regarding the proposal. As is the case with many rule filings, FINRA filed an amendment providing requested clarifications and incorporating certain changes in line with certain commenters' suggestions. Our treatment of comments in this rule filing is contrary to Pink's suggestion that we have acted disrespectfully or irresponsibly in respect of this rule filing.

Moreover, Pink's view that its comments must be met with "thoughtful reasons for rejecting them" inures to the commenter a level of deference that neither exists at law or in common sense. As a regulator, FINRA's proposals should be anchored in its statutory responsibilities and FINRA must promulgate rules in accordance with statutory standards. Provided we meet those standards, our rulemaking proposals should be accorded deference. Because commenters are free to propound endless competing formulations or counter proposals that seek only to nullify the regulators' proposal in whole or part, the rulemaking process would be frustrated if each comment was accorded the same weight as the proposal itself. That noted, FINRA may, and in this case did, determine that certain suggested approaches from the comment letters better refined the rule proposal and warranted an amendment to the proposal. In sum,

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transaction is not a "riskless principal" transaction because each "leg" is executed at two different prices. *See e.g.*, FINRA Rule 6282(e)(1)(C)(ii). FINRA neither encourages nor discourages the capacity in which firms trade; however, FINRA does require that trades are properly reported and that capacity is accurately reflected on trade reports and the books and records of the firm.

21 *See* Pink.

FINRA has put forth its proposed rule, which it believes is consistent with the Exchange Act, and responded to relevant comments.

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FINRA believes that the foregoing responds to the material issues raised in the comment letters to Amendment No. 1 to this rule filing. If you have any questions, please feel free to contact me at (202) 728-8363.

Sincerely,

Racquel L. Russell
Assistant General Counsel
Regulatory Policy and Oversight