

OMB APPROVAL

OMB Number: 3235-0045
 Estimated average burden
 hours per response: 38

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of 9

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

File No. * SR - 2011 - * 058

Amendment No. (req. for Amendments *) 2

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



Exhibit 3 Sent As Paper Document



Description

Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *).

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 * Racquel Last Name * Russell

Title * Assistant General Counsel

E-mail * racquel.russell@finra.org

Telephone * (202) 728-8363 Fax (202) 728-8264

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 06/04/2012

By Alan Lawhead

(Name *)

Vice President and Director - Appellate Group



(Title *)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Alan Lawhead, alan.lawhead@finra.org

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information (required)

[Add](#) [Remove](#) [View](#)

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 (required)

[Add](#) [Remove](#) [View](#)

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

[Add](#) [Remove](#) [View](#)

Exhibit Sent As Paper Document

☐

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

[Add](#) [Remove](#) [View](#)

Exhibit Sent As Paper Document

☐

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

[Add](#) [Remove](#) [View](#)

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

[Add](#) [Remove](#) [View](#)

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

[Add](#) [Remove](#) [View](#)

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.

On October 6, 2011, FINRA filed with the Securities and Exchange Commission (“SEC” or “Commission”) SR-FINRA-2011-058, a proposed rule change to amend FINRA Rule 6433 (Minimum Quotation Size Requirements for OTC Equity Securities).¹ The proposed rule change to amend the minimum quotation sizes for OTC Equity Securities is intended to, among other things, simplify the tier structure, facilitate the display of customer limit orders under new FINRA Rule 6460 (Display of Customer Limit Orders), and expand the scope of the rule.

The SEC published the proposed rule change in the Federal Register for notice and comment on October 20, 2011, and the SEC received seven comment letters from four parties on the proposed rule change. FINRA responded to comments on December 23, 2011.² On January 24, 2012, the SEC issued a Proceedings Order³ and received one comment letter in response to the Proceedings Order.⁴ FINRA filed Amendment No. 1 to the proposed rule change on April 16, 2012, to modify the proposed tiers in response to the comments received and to propose that the rule change be implemented as a one-year pilot to allow FINRA and the Commission to review the effects of the proposed rule change.⁵ The SEC received two comment letters on the Revised Proposal.⁶

FINRA is filing this Amendment No. 2 to the proposed rule change to (i) address the comments submitted by Knight and OTC Markets on the Revised Proposal; (ii) outline the steps FINRA will take to review and assess the effects of the proposed rule change during the pilot period, including the data FINRA will provide to the SEC to allow it to assess the effects of the

¹ See Securities Exchange Act Release No. 65568 (October 14, 2011), 76 FR 65307 (October 20, 2011) (Notice of Filing of File No. SR-FINRA-2011-058) (“Original Proposal”).

² On December 23, 2011, FINRA responded to comment letters received by the SEC as of that date. See Letter to Elizabeth M. Murphy, Secretary, Commission, from Stephanie M. Dumont, Senior Vice President and Director of Capital Markets Policy, FINRA (“FINRA Response Letter”).

³ See Securities Exchange Act Release No. 66168 (January 17, 2012), 77 FR 3515 (January 24, 2012) (Order Instituting Proceedings to Determine Whether to Disapprove File No. SR-FINRA-2011-058) (“Proceedings Order”).

⁴ Letter to Elizabeth M. Murphy, Secretary, Commission, from Daniel Zinn, General Counsel, OTC Markets Group, Inc., dated February 14, 2012.

⁵ See Securities Exchange Act Release No. 66819 (April 17, 2012), 77 FR 23770 (April 20, 2012) (Notice of Filing of Amendment No. 1 to File No. SR-FINRA-2011-058) (“Revised Proposal”).

⁶ Letters to Elizabeth M. Murphy, Secretary, Commission, from Michael T. Corrao, Managing Director, Knight Capital Group, Inc., dated May 7, 2012 (“Knight”) and Daniel Zinn, General Counsel, OTC Markets Group, Inc., dated May 7, 2012 (“OTC Markets”).

proposed rule change; and (iii) clarify certain issues in the Original Proposal and the Revised Proposal.

Response to Comment Letters

As noted above, the SEC received two comment letters in response to the Revised Proposal: one from Knight and one from OTC Markets. Knight supports the changes to the proposed tier sizes set forth in the Revised Proposal. Specifically, Knight states that the Revised Proposal “appears to strike an appropriate balance between displayed liquidity from retail limit orders and a tier size requirement for market makers.” Knight also supports the adoption of the proposed changes as a pilot – though it believes that a shorter period would be more appropriate.⁷ In addition, although Knight acknowledges that minimum quotation sizes are quite different from minimum tick sizes, it asks that the SEC study these two issues together in light of the directive set forth in the Jumpstart Our Business Startups Act (“JOBS Act”) that the Commission study minimum tick sizes (i.e., quoting securities in one-cent increments).⁸

OTC Markets, on the other hand, disagrees with the Revised Proposal and believes that the revised tiers would harm the markets due to reduced displayed liquidity. Based on the public comment file available to FINRA, the commenter appears to have formed its views based heavily on an internal analysis conducted of one day’s trading activity in October 2011 under the existing tiers, and a simple calculation of the change to the number of shares at the inside based on a comparison of the existing and proposed tier sizes, assuming that market makers’ quotations are always at the minimum quote sizes.⁹

OTC Markets also states that FINRA has not conducted a study of how the revised tiers will likely affect overall liquidity in the over-the-counter market. In fact, FINRA has conducted multiple analyses of relevant data in the context of this proposed rule change and the positive impact the proposed rule change will have on the display of customer limit orders, has discussed its findings in the previous filings and the FINRA Response Letter, and has concluded that the proposed rule change is consistent with the standards set forth in the Exchange Act. With

⁷ Knight suggests that the pilot extend for three or four months. OTC Markets requests a three-month pilot period.

⁸ See Pub. L. 112-106 § 106(b), Exchange Act § 11A(c)(6). OTC Markets also asks that the SEC study minimum quotation sizes at the same time that it conducts the minimum tick size study pursuant to the JOBS Act. FINRA believes the amendments to minimum quotation sizes should not be delayed given the potential benefits from increased limit order display for the market and investors. If minimum tick sizes were to change as a result of the JOBS Act study, FINRA would then consider whether additional changes are necessary for OTC Equity Securities.

⁹ See Letter to Elizabeth M. Murphy, Secretary, Commission, from Daniel Zinn, General Counsel, OTC Markets, dated May 7, 2012. OTC Markets asserts that, based on its internal evaluation, the tier size reductions in the Revised Proposal “may still lead to the loss of 50% or more of the proprietary liquidity in securities priced between \$.20 and \$1.00.”

respect to potential impact on liquidity, FINRA believes the ability to compare and contrast data under the existing tiers with data collected as part of a pilot program is the most effective manner in which to reach any accurate and meaningful conclusions on the impact of the new tier sizes on liquidity, or any other impact on the over-the-counter market. A review of one trading day with the existing tiers, or a comparison solely of dollar value ranges of the various minimum tier sizes, is not a sufficient basis upon which to reasonably predict the impact to liquidity.

FINRA is very cognizant of the concerns raised by commenters of the potential impact that changes to tier sizes may have on the over-the-counter market and on investors therein.¹⁰ In this regard, FINRA has worked closely with key over-the-counter liquidity providers, including Knight, among others, to revise the Original Proposal to best achieve a balance that would both facilitate the goal of providing for meaningful liquidity commitments by market makers and facilitate the display of competitively priced customer limit orders.¹¹ As acknowledged by Knight, FINRA believes the proposed rule change accomplishes these two primary goals and strikes the appropriate balance of potentially competing benefits and concerns. Moreover, and as described more fully below, FINRA will review the impact of the pilot on the over-the-counter market and will provide the Commission with data so that the Commission can also undertake an analysis of the impact the pilot has on the over-the-counter market.

¹⁰ In a previous comment letter submitted prior to the Revised Proposal being filed, which included FINRA's proposal that the proposed rule change be implemented initially on a pilot basis, Knight raised the issue of increased clearing costs that could potentially result "[i]f reduced quote size results in a more fragmented market." See Letter to Elizabeth M. Murphy, Secretary, Commission, from Michael T. Corrao, Managing Director, Knight Capital Group, Inc., dated January 13, 2012. Knight states that these costs could be even more burdensome for non-DTCC eligible securities. Although the comment rests on numerous assumptions that may, or may not, result from the proposed rule change, FINRA believes that non-DTCC eligible securities account for a very small percentage of securities that would be subject to the proposed rule. FINRA will, however, include this issue in those it monitors throughout the pilot period and notes that Knight's most recent comment letter states that Knight believes the Revised Proposal strikes the appropriate balance between potential costs and benefits.

¹¹ In the Original Proposal and in the FINRA Response Letter, FINRA previously described the significant benefits of the display of customer limit orders, which has been firmly established in the U.S. securities markets. See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) (Order Execution Obligations Adopting Release).

The financial markets as a whole should benefit from [limit order display] because the price discovery process will be enhanced, market transparency will be improved and price competition will be promoted. By their very nature, these benefits are broad-based and pervasive.

Securities Exchange Act Release No. 36310 (September 29, 1995), 60 FR 52792 (October 10, 1995) (Order Execution Obligations Proposing Release).

As noted above, in response to concerns raised by commenters regarding the interplay of differing market forces on liquidity and FINRA's continuing concerns regarding investor protection, price transparency, and market quality in the over-the-counter market, FINRA has amended the proposal to be implemented as a pilot. While commenters support the implementation of the rule as a pilot, they suggest reducing the term to a few months. FINRA does not believe that a three- or four-month period will provide sufficient time to gather data and to evaluate fully the impact of the proposed changes. However, in connection with FINRA's data provision to the SEC, which is described below, FINRA will regularly monitor the results of the pilot. If FINRA concludes there has been a significant negative impact (including on liquidity) on the over-the-counter market, FINRA will consider rescinding the pilot prior to the end of one year.

Other comments by OTC Markets on the Revised Proposal are, in substance, not germane to a consideration of the merits of this proposal. For example, OTC Markets suggests an amendment that would allow market makers to trade "in parity" with their customers if they were displaying a quotation prior to the receipt of a customer order priced equal to the market maker's quotation. Such trading would be contrary to FINRA's long-standing principle found in FINRA Rule 5320 (Prohibition Against Trading Ahead of Customer Orders), which ensures customer orders are executed in a fair manner by restricting members from trading ahead of customer orders.

Review and Assessment of the Proposed Rule Change During the Pilot Period

In the Revised Proposal, FINRA proposed that the new tiers be implemented for all OTC Equity Securities displayed on an inter-dealer quotation system on a pilot basis for a period of one year from the effective date. FINRA also committed to providing the Commission with data necessary to evaluate the impact of the pilot on the over-the-counter market.¹² Specifically, FINRA will provide the following data to the SEC aggregated daily by symbol for those securities that are subject to the pilot:¹³

1. The price of the first trade of each trading day executed at or after 9:30:00 a.m., based on execution time.
2. The price of the last trade of each trading day executed at or before 4:00:00 p.m., based on execution time.
3. Daily share volume.

¹² See Revised Proposal, supra note 5, at 23772.

¹³ FINRA will provide the listed data to the SEC for five random days from each month for a one-year period prior to the effective date of the pilot. Beginning no later than 90 days after the start of the pilot, FINRA will provide the SEC with the listed data for each day of the pilot period. The data for each month will be provided to the SEC within 20 business days of the beginning of the following month.

4. Daily dollar volume.
5. Number of limit orders from customers and in total.
6. Percentage of day the size of the BBO (i.e., best bid and offer on FINRA's OTCBB facility¹⁴ and OTC Link) equals minimum quote size.
7. Number of market makers actively quoting.
8. Number of executions from a limit order and number of limit orders at the BBO or better by tier size from a customer and in total.¹⁵
9. Liquidity/BBO metrics
 - a. Time-weighted quoted spread.
 - b. Effective spread.
 - c. Time-weighted quoted depth (number of shares) at the inside.
 - d. Time-weighted quoted depth (dollar value of shares) at the inside.

In addition to providing the SEC with the data listed above, FINRA also commits to providing the SEC with an assessment addressing the impact of the pilot, concerns raised by commenters during the rule filing process, and whether the pilot has resulted in the desired effects. The assessment will include FINRA's conclusions regarding the impact of the pilot on liquidity, and potentially other measures of market quality, of the stocks in each tier as well as whether the tier cutoffs or sizes should be revised in light of the impact of the pilot on the over-the-counter market. FINRA will provide the assessment to the SEC at least 60 days before the conclusion of the pilot.

¹⁴ As set forth in FINRA rule filing SR-FINRA-2011-019, FINRA will rename its OTCBB facility as the Non-NMS Quotation Service (NNQS) and will announce further details about the transition over the coming months. At present, the anticipated implementation date of the name change will be no later than December 31, 2012. See Securities Exchange Act Release No. 66244 (January 26, 2012), 77 FR 5069 (February 1, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2012-003) (Proposed Rule Change to Delay the Implementation Date of SR-FINRA-2011-019). The OTCBB data to be provided herein refers to the BBO displayed on the FINRA OTCBB or, if subsequent to the implementation of the name change, the FINRA NNQS facility.

¹⁵ This data will be provided to the SEC using OATS execution data.

Clarification of Other Issues

FINRA is also filing this Amendment No. 2 in part to clarify certain statements in the Original Proposal and the Revised Proposal.

In the Original Proposal, FINRA noted that the proposed rule change would result in the display of a larger number of customer limit orders in lower-priced securities. In particular, FINRA highlighted the improvement in those securities priced between \$0.51 and \$1.00/share that would be achieved with the proposed tier sizes. FINRA would like to clarify that the sample FINRA referred to in the following statement referred only to securities in that tier size (i.e., those priced between \$0.51 and \$1.00/share): “Based upon a review of a sample of Order Audit Trail System data submitted over the past year in OTC Equity Securities, only approximately 50% of customer limit orders in the sample met the current Rule’s thresholds and would have been eligible to be displayed.”

Although, based on the sample data FINRA has analyzed, the improved display of customer limit orders is most dramatic for securities in that tier, FINRA also found that, in the aggregate, a material increase in the number of displayable customer limit orders would be achieved with the new tier sizes. Specifically, FINRA looked at a random sample of 32 trading days between May and December 2011 and found that the number of customer limit orders at or above the minimum tier size increased from approximately 85% of customer limit orders being at or above the minimum size to be eligible for display under the current tiers to 96% of customer limit orders being eligible for display under the tiers proposed in the Revised Proposal.¹⁶

Although improvements in the display of customer limit orders is an extremely important goal to enhance investor protection, it is not the sole benefit that could result from the proposed rule change.¹⁷ For example, FINRA also believes that the proposed changes to the tier sizes may lead to increased competition among market makers with the potential to enhance liquidity and reduce spreads in many OTC Equity Securities.¹⁸ However, as noted above in response to

¹⁶ FINRA notes that, in performing these calculations and arriving at the described results, it relied on OATS data for each of the 32 days randomly selected. FINRA calculated the percentage of customer limit orders at or above the minimum tier size by using all limit orders reported to OATS as being received by a FINRA member, including those received from other FINRA members. FINRA excluded all proprietary orders originated by a member from its calculations.

¹⁷ As also noted in previous submissions, the revised tiers simplify the existing Rule by reducing the number of minimum quotation tiers from nine tiers to six tiers and make more uniform the minimum capital commitment required across tiers.

¹⁸ In a letter submitted prior to the filing of the Revised Proposal, Knight queried how FINRA could evaluate a rule filing’s burden on competition under Section 15A(b)(9) of the Securities Exchange Act. See Letter to Elizabeth M. Murphy, Secretary, Commission, from Michael T. Corrao, Managing Director, Knight Capital Group, Inc., dated January 13, 2012. The Act does not require that FINRA rules impose no economic

commenters concerns regarding a potential decline in liquidity, FINRA believes the ability to compare data under the existing tiers with data collected as part of a pilot program is the most effective manner in which to reach such conclusions (both positive or negative) on the impact of the new tier sizes.¹⁹

Finally, there was an inconsistency in the implementation date language in the Original Proposal (no later than 180 days from SEC approval) and in Amendment No. 1 (120 days from SEC approval). FINRA is clarifying that the correct implementation date period is as stated in the Original Proposal, no later than 180 days from SEC approval, and will be no sooner than 120 days from SEC approval.

burden on competition, but rather that any such burden be necessary and appropriate to further the purposes of the Act. See 15 U.S.C. 78o-3(b)(9). As noted, it is FINRA's view that the proposed changes in the tier sizes do not constitute an undue burden on competition that is not in furtherance of the purposes of the Act and may, in fact, promote competition by lowering many of the minimum share requirements. In addition, FINRA notes that Knight's most recent comment letter states that Knight believes the Revised Proposal strikes the appropriate balance between potential costs and benefits.

¹⁹ FINRA notes that several of the data points listed above to be provided to the SEC will aid in determining the effect the pilot has on spreads and market-maker competition.