



The Security Traders Association of New York, Inc.

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Marcia E. Asquith
Senior Vice President and Corporate Secretary
FINRA
1735 K Street NW
Washington, DC 20006-1506

Via e-mail to: pubcom@finra.org

Re: Regulatory Notice 11-43
Proposed Amendments to Rule 5210 Regarding Publication of Indications of Interest

Dear Ms. Asquith:

The Security Traders Association of New York, Inc.¹ ("STANY") respectfully submits this letter in response to the Financial Industry Regulatory Authority's ("FINRA's") request for comments on proposed amendments to FINRA Rule 5210 to require that member firms receive a customer order in a security before displaying a quotation or indication of interest ("IOI") in a way that purports to represent that the quotation or IOI originated with a customer and to require that a firm displaying a quotation or IOI that represents a customer order amend or terminate that display once the customer order is executed or cancelled.

As an industry organization of individuals employed in the securities markets, STANY does not represent a single business or business model, but rather we provide a forum for trading professionals representing institutions, broker-dealers, ATSS and trading centers to share their unique perspectives on issues facing the securities markets. Our members work together to promote their shared interest in efficient, liquid markets, and their concern for investor protection. We believe that competition is the best driver of innovation and market improvements. We appreciate and support the existence of various centers of liquidity- including registered exchanges, ATSS, market makers and other liquidity providers – the existence of which provide choices for investors and help to maintain the primacy of the US capital markets.

FINRA Regulatory Notice 11-43 ("the proposal") is of keen interest to our members. However, as can be expected given the diverse nature of STANY's membership, opinions differ on the merit and advisability of the proposed rule change.² The large majority of our members, including institutional traders, broker

¹ STANY is the voice of the trader in the New York metropolitan area and represents approximately 1,000 individuals who are engaged in the trading of securities. As such, we are uniquely qualified to discuss proposed rules and regulations affecting trading. STANY is the largest affiliate of the Security Traders Association ("STA"), a multinational professional association that is committed to being a leading advocate of policies and programs that foster investor trust, professional ethics and marketplace integrity and that support education of market participants, capital formation and marketplace innovation.

² A minority of STANY's members, specifically including those employed by exchanges, do not oppose the proposed definition of "natural IOIs." In general these members believe that actionable IOIs should be treated as orders and subject to public display requirements. The proposed requirement that an IOI not be deemed "natural" unless there is an order on the books of the firm originating the IOI would be one step closer to requiring natural IOIs to be subject to order display rules. However, even those

dealers and sell-side traders believe that it is unnecessary and potentially detrimental for FINRA to limit “natural IOIs” as proposed in section (d) of Rule 5210.01.

It should be noted that STANY and its members oppose fraudulent market activity and we appreciate FINRA’s interest in ensuring that information communicated through IOIs is accurate. However, we believe that the message in NASD Notice to Members 06-05 and FINRA Regulatory Notice 09-28³ is clear and that further elucidation is unnecessary. We believe that guidance, together with anti-fraud rules and self-policing are adequate protections against manipulative uses of IOIs.

Distinction between Indications of Interest and Orders

Indications of interest have played a legitimate and valuable role in the equity markets since trading began. IOIs by their nature can be vague and are intended to communicate or advertise customer or proprietary trading interest. They are especially valuable tools in that they offer institutional investors the ability to seek liquidity for larger orders without providing guarded and valuable information to the public, the release of which could adversely impact execution.

Among the specific requests for comment in the proposal, FINRA asks whether it should define the term “indication of interest.”⁴ In the Background & Discussion section of the proposal FINRA states that “Indications of interest, or IOIs, are *non-firm expressions of trading interest* that contain one or more of the following elements: security name, side, size, capacity and/or price.” (Emphasis added) We are satisfied that this definition, as well as the self-explanatory nature of the term, requires no further clarification.

The majority of the proposed amendments to Rule 5210 simply reiterate the long accepted proscription that IOIs shall not be published or circulated “unless the member believes that such indication of interest represents a bona fide interest in purchasing or selling such security.” In this regard, the language of proposed sections 5210 (c) and 5210.01 (c), simply restates what has already been understood and is nothing new. While STANY believes that these proposed changes to the Rule 5210 are unnecessary and redundant, we have no objection to these provisions. However, STANY and its members are concerned with the extension of the concept of bona fide interest proposed in Rule 5210.01(d) which would define and limit the use of the designation “natural” associated with some IOIs.

It is clear from the proposal that FINRA recognizes the value of IOIs and, wisely, does not suggest that IOIs be prohibited or their use restricted. FINRA has however, expressed some concern with the manipulative use of IOIs. If, as we believe, the intention of the proposed changes to Rule 5210 is to stop manipulation or false advertising, the rule is overly broad. FINRA has previously made clear the prohibition against non-truthful, inaccurate and misleading IOIs. If this is indeed the issue, then enforcement actions can and should be taken against those believed to be misusing IOIs.

who wish to see actionable IOIs to be subject to display requirements, recognize the need for a block exception. See, Letter from Janet M. Kissane, Senior Vice President- Legal & Compliance Secretary, NYSE Euronext to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission in response to File S7-27-09 (February 22, 210) at p 4.

³ NASD Notice to Members 06-50 (Sept. 2006) and FINRA Regulatory Notice 09-28 (May 2009) make it clear that “IOIs must be truthful, accurate and not-misleading” and that submission of a non-truthful, inaccurate and misleading IOI would be considered conduct inconsistent with high standards of commercial honor and just and equitable principals of trade and could violate the anti-fraud provisions of the federal securities laws. It is also clear that FINRA has the ability to enforce its anti-fraud provisions and bring enforcement actions against any firm found to have issued untruthful, inaccurate and misleading IOIs.

⁴ Regulatory Notice 11-43 at p. 3

The proposed restriction or definition of “natural IOI” defeats the purpose of an IOI and would limit their effectiveness as a tool for institutional traders.

While we do not believe that it is necessary for FINRA to define “indications of interest,” we think it may be detrimental for FINRA to define “natural” in connection with IOIs.” The use of the term “natural” in connection with an IOI is generally understood to represent interest in buying or selling a security that originated with a customer. In the absence of a codified definition of “natural”, FINRA has affirmed that a natural IOI may be considered to solely refer to interest a firm represents on an agency basis, or refer not only to agency interest but also proprietary interest in certain specific contexts (e.g., proprietary interest that was established as the result of the facilitation of a customer order or the execution of a customer order on a riskless principal basis).⁵

Assuming that a customer has a bona fide interest in trading as represented by an IOI, there is nothing inherently fraudulent or misleading in expressing that interest through an IOI designated as “natural”, regardless of whether the customer has expressed that interest to his or her broker through a booked order. STANY is concerned that limiting the use of the identifier “natural” to instances in which customer origination equates to an in-hand order, does not accurately reflect the way in which IOIs are used and will materially change the nature of “natural IOIs.”

Not all indications of interest that originate with or purport to represent a bona fide trading interest on the part of a customer do so with an order in hand. Likewise, not having an order in hand does not necessarily make the interest any less bona fide and does not make labeling that interest as “natural” (or customer driven) misleading, inaccurate or false. Institutional customers may and often do direct brokers to ascertain interest without placing a firm order. For example, an institutional customer may wish to work his or her order through more than one broker dealer, asking each to look for natural contra-side order flow prior to placing a firm order. The simultaneous sourcing of liquidity and contra-side interest through multiple venues is a common practice among some institutions seeking the highest quality executions. Likewise, an IOI does not need to have all of the elements of an order. Such an IOI may not be automatically executable or actionable, but may represent a bona fide interest on the part of a customer to purchase or sell such security. For example, it is not uncommon for an institutional trader looking to buy a large block of stock to ask a broker dealer to show him “anything that comes in to sell.” In these scenarios, the broker dealer has a customer who has a bona fide interest in purchasing a security, but has not yet placed a firm order. Under what we understand to be common practice, these types of IOIs would be marked “natural”, although some broker-dealers qualify these types of IOIs with notations that they represent “in touch with” IOIs.

If a “natural IOI” is defined as requiring the issuing firm to have an order on its books, rather than dealing with a customer driven indication of interest, the executing broker will be required to handle the order as an order.

We are also concerned that the limitations contemplated by proposed Rule 5210.01 (d) could have negative unintended consequences upon the options and derivatives markets. Rules regulating options traders provide that an options desk cannot send an “anticipatory hedge” into the market if they have “full terms of a [customer] order” in hand. The requirement that “natural IOIs” be predicated upon a customer order being in hand could, depending upon how defined, place additional burdens upon hedging activity.

⁵ Some of our members believe that it would be appropriate for FINRA to specifically limit the term “natural” to those IOIs in which the broker dealer has received from a customer an order *or* a bona fide indication of interest in the purchase or sale of the security. Others believe that it is important to retain the use of the term “natural” for certain principal orders- those in which the broker dealers is acting as a riskless principal or in which the IOI represents an existing position established as the result of the facilitation of a customer order (i.e., swap) in which the principal order is a position closing trade that does not create a competing order. Either way, the proposed suggestion of requiring “natural IOIs” to represent an in-hand order is seen as unnecessarily limiting.

We also note that unlike rules proposed by the SEC regarding the treatment of IOIs, FINRA's proposal does not include or mention the need for exceptions relating to block sized orders. As the Commission mentioned in its proposal on the Regulation of Non-Public Trading Interest⁶ such an exception is necessary to permit block crossing networks and other trading venues to offer ways for institutional investors to find contra-side trading interest without affecting price swings.

Both self-policing and enforcement are sufficient to prevent and/or punish any manipulative or fraudulent uses of IOIs.

It should not be inferred from STANY's objection to the language in Rule 5210.01 (d) that STANY supports manipulative or fraudulent uses of "natural IOIs." On the contrary, were IOIs not such valuable tools for institutional traders interested in high quality, natural, contra-side liquidity; we would not be as concerned about their continued viability.

FINRA has made it clear that communication of untruthful, inaccurate or misleading information in an IOI, including labeling non-natural IOIs as "natural", would be considered conduct inconsistent with high standards of commercial honor and just and equitable principals of trade and a violation of FINRA Rule 2010, as well as possibly a violation of FINRA Rules 5210, 2020, NASD Rule 2210 and the anti-fraud provisions of the federal securities laws.

In addition to the anti-fraud remedies available to FINRA, we believe that the process of finding liquidity through IOIs is largely self-regulating. The less reliable the information in IOIs broadcast by firms themselves or through vendors, the less useful they are to those seeking to execute orders. Brokers who are not accurate in their advertising or who employ excuses that give the impression that they are using IOIs inappropriately soon find themselves in the "penalty box"; with institutional traders formulating negative opinions and disengaging from further dealings. The institutional traders, with whom STANY spoke, consider it part of their duty to ferret out those within the trading community who do not live up to their "advertisements." These misguided participants either clean up their acts quickly or lose the interaction with contra-side order flow.

Since FINRA fined firms for inaccurate advertising of trade volumes in 2008 and issued Regulatory Notice in 2009, our members as well as other institutional traders with whom we spoke, report that they have not encountered problems with misleading or falsely advertised IOIs. It is our understanding that FINRA Member Firms have utilized the guidance provided by both Notice to Members 06-50 and Regulatory Notice 09-28 and have policies and procedures in place to instruct traders on which IOIs may be marked "natural." Additionally, we understand that firms advise their customers in writing of their IOI policies. Institutional traders have reported that FINRA's proscription, together with self-policing; have been effective in reducing inaccurate labeling of IOIs to the point where they are considered to be a non-issue.

Therefore, we question what FINRA means when it asks, "Does the application of the new labeling requirements to both IOIs and quotations adequately cover the situations on which concerns regarding inaccurate labeling arise?" STANY is not aware of any systemic problems regarding mislabeled or misleading IOIs. Although FINRA notes that it remains concerned that firms are disseminating misleading IOIs, the proposal does not mention any specific behavior or basis for this concern. If such misrepresentations are indeed occurring, we would suggest that the appropriate response would be for FINRA to exercise its enforcement authority to ascertain violators and bring enforcement actions against those errant individuals or firms.

⁶ Securities Exchange Act Release No. 34-60997, File No. S7-27-09

Conclusion

STANY believes that it is important to preserve the function of traditional, non-actionable IOIs, which provide a much needed means for market participants to communicate trading interest that is still subject to negotiation. We do not believe that any additional definition or clarification to FINRA's recognized guidance on the issue of IOIs is necessary at this time.

While IOIs are a useful way to source block liquidity, we recognize that they can be used by broker dealers to draw out information about block order flow that institutions are reluctant to divulge. However, we do not believe that additional regulation is needed to address the occasional inappropriate use of IOIs. Misconduct is self-regulating and punishment for intentional offenders is already part of FINRA's enforcement tools. We recommend that any perceived issues with errant behavior be dealt with through enforcement and not through additional regulation which would negatively impact institutional traders' choices and flexibility in satisfying their best execution obligations.

STANY appreciates the opportunity to submit these comments on FINRA's proposed amendments to Rule 5210. If you have any questions or comments concerning the thoughts expressed in our letter, please do not hesitate to contact us.

Respectfully submitted,

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