VIA Electronic Submission

Marcia Asquith

Office of the Corporate Secretary

FINRA

1735 K Street, NW

Washington, DC 20006-1506

Re: **Regulatory Notice 16-34; Display Facility for Quotations in OTC Equity Securities**

Dear Ms. Asquith:

OTC Markets Group Inc. [1] ("OTC Markets Group") respectfully submits to the Financial Industry Regulatory Authority, Inc. ("FINRA") the following comments on FINRA's proposal to provide a FINRA-sponsored interdealer quotation facility (the "ODF") for all OTC equity securities (the "ODF Proposal").

As the operator of OTC Link ATS, a Securities and Exchange Commission ("SEC") registered alternative trading system ("ATS") that is the primary interdealer quotation system for OTC equity securities, we have an in-depth understanding of how the ODF Proposal will impact OTC equity market participants. We have several areas of concern related to the proposal, which are best characterized as follows:

- The ODF would not be a viable system for trading OTC equity securities.
- The ODF Proposal's mandatory connection and testing requirement represents regulatory overreach and presents a conflict of interest.
- The ODF Proposal would impose unnecessary time, resource and monetary costs on FINRA member broker-dealers.
- The ODF market structure could confuse investors and facilitate fraud and other market abuses.

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[1] OTC Markets Group Inc. (OTCQX: OTCM) operates the OTCQX® Best Market, the OTCQB® Venture Market, and the Pink® Open Market for 10,000 U.S. and global securities. Through OTC Link® ATS, we connect a diverse network of broker-dealers that provide liquidity and execution services. We enable investors to easily trade through the broker of their choice and empower companies to improve the quality of information available for investors.
OTC Link ATS is operated by OTC Link LLC, member FINRA/SIPC and SEC registered ATS.

- The ODF is a solution in search of a problem that does not exist. OTC Link ATS is an 'SCI entity' subject to the SEC's Regulation Systems Compliance and Integrity ("Reg. SCI"), a comprehensive regulation of the technology systems of key market participants.

Each of these concerns is discussed in further detail below.

The ODF Would Not Be a Viable System

FINRA currently operates the OTC Bulletin Board ("OTCBB"), which the ODF Proposal notes has operated in the same quote-only form since its inception in 1990.[2] Since that time, OTC Link ATS has developed increased functionality, most notably the ability for subscribers to electronically send directed trade messages to one another for the purpose of negotiating and agreeing to trades. Due to the difference in system functionality, the OTCBB became so infrequently used that FINRA filed to cease its operation in 2014. FINRA noted at the time that the OTCBB was so little used that its closing would not negatively impact investors.[3]

In the ODF Proposal, FINRA states that it "envisions that the general functionality of the ODF system will be similar to the features currently offered by OTCBB." In other words, the ODF will be a quote-only system lacking electronic messaging functionality, which broker-dealers have already determined does not meet their needs. FINRA's proposed revisions to the rules governing the ODF would address the number of eligible securities and FINRA's ability to disseminate limited quote information, but not the ODF's core functionality issues. The ODF as proposed would still essentially be a system designed decades ago for telephone-based trading.

OTC Link ATS's broker-dealer subscribers, all of whom are FINRA members, already have the option of posting quotes in eligible securities on the OTCBB as an alternative or backup to OTC Link ATS, yet they choose not to do so. Renaming the OTCBB as the ODF, and allowing additional securities to be quoted, will not create a viable alternative or backup to the electronic markets operated by OTC Link ATS and Global OTC. Instead, the ODF Proposal would force FINRA member firms, already heavily

[2] ODF Proposal at page 4: "FINRA envisions that the general functionality of the ODF system will be similar to the features currently offered by OTCBB."

[3] *See* Securities Exchange Act Release No. 72575 (July 9, 2014), noting "less than twelve securities out of the 10,000 OTC equity securities are quoted solely on the OTCBB. Furthermore, based upon a sample of 20 days in 2013, the OTCBB only disseminated an average of 27 computed BBOs, which means that OTCBB BBO quotation information was available through Level 1 on less than 0.3% of the 10,000 OTC equity security symbols. Therefore, FINRA does not believe that the discontinuance of the OTCBB as an inter-dealer quotation system will have an appreciable impact on issuers, investors or member firms."

burdened by regulatory obligations, to spend more time, effort and money on a system that does not allow them to effectively carry on their business.

Regulatory Overreach and Conflict of Interest

Having established that the ODF would be equivalent to the OTCBB system that brokers have determined is obsolete, why would firms connect to and use the ODF? The answer is that FINRA, at the behest of the SEC, will use its regulatory authority to force its member firms to connect. The ODF Proposal states that the SEC "has urged FINRA, as the self-regulatory organization (SRO) with responsibility for the over-the-counter market, to operate a quotation facility . . ." The SEC has interceded in this area before, as FINRA ultimately withdrew its proposal to cease operation of the OTCBB "in light of SEC staff concerns."[4]

FINRA is the country's premier self-regulatory and enforcement organization, and its stated mission is "investor protection and market integrity."[5] FINRA is not, and should not be, a market operator. The ODF Proposal would institute FINRA rules that *require* FINRA member firms deemed "active market participants" to connect to the ODF and periodically test that connection. The ODF Proposal attempts to impose on OTC market makers obligations similar to those that were placed on exchange specialists in the 1980's, but without any of the corresponding benefits.[6]

Furthermore, the ODF, like the current OTCBB, would be operated by the Transparency Services group, a revenue generating arm of FINRA.[7] That means FINRA, acting at the direction of the SEC, would require by regulation that member firms connect to its revenue generating business.

An additional portion of FINRA's revenue generation comes from sales of OTCBB market data. As the ODF Proposal notes, under current rules market data is distributed in well under 100 OTCBB securities. This lack of data may threaten FINRA's revenue stream. The ODF Proposal would amend FINRA Rules 6530 and 6520 to allow more securities to be quoted and to allow for dissemination of market data in securities with

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[4] ODF Proposal at page 3.

[5] *See* FINRA's website at http://www.finra.org/about/what-we-do.

[6] *See* "Report of the Presidential Task Force on Market Mechanisms," (January, 1988) (Nicholas F. Brady, Chairman) at page 49: "Unlike shares on the NYSE, each NASDAQ stock is served by a number of market makers, none of which has either an express or implied commitment to maintain an orderly market."

[7] *See* FINRA 2015 Year in Review and Annual Financial Report at page 19, available at: https://www.finra.org/sites/default/files/2015_YIR_AFR.pdf.

only a single, one-sided priced quote. In short, the ODF Proposal would impose regulation that forces FINRA member firms to connect to an inadequate system while providing lower-quality data to the market.[8] This regulatory overreach raises significant conflict of interest concerns that need to be addressed.

Unnecessary Time, Resource and Monetary Costs

FINRA estimates that based on sample data, 23 firms, 22 of which are not currently connected to the OTCBB, would be considered "active market participants" and thus be forced to connect to the ODF. The ODF Proposal would impose a number of significant costs on these firms, including required investments in systems, personnel, legal and regulatory advice, and the internal resources required to code to and test with the ODF. Even in the event these firms never use the ODF, the added operational and regulatory costs would be an ongoing burden.

All the firms that would be deemed "active market participants" currently subscribe to OTC Link ATS for quoting and sending directed trade messages in OTC equity securities. In recent years, the number of firms participating in the OTC equity market has drastically declined and major market makers, such as Citigroup's Automated Trading Desk earlier this year, have exited the business. Many firms have cited narrowing margins, increasing regulatory requirements and costs, including time and personnel resources, as primary reasons for exiting the OTC market or folding outright. The substantial added regulatory costs mandated under the ODF Proposal would effectively raise overall costs for the FINRA member broker-dealers that provide the most liquidity in the OTC equity market.

The added costs and burdens will likely further reduce participation in the OTC equity market. Less participation by broker-dealers leads to less liquidity, less competition, increased volatility and less robust market data. All of the added costs and their downstream impacts will raise costs for investors and provide them less service, all to establish a trading system that lacks viable functionality and is unlikely to be used.

The ODF Market Structure is Flawed, Confusing and May Facilitate Fraud

The ODF Proposal would create a FINRA-operated quotation market for all OTC equity securities, without differentiating companies based on the amount, timeliness and sufficiency of the information they provide to the public. A company that provides limited or no information to the public would be able to claim that it qualifies for the

[8] ODF Proposal at page 6: "FINRA has recognized that if the OTCBB has limited participation, the disseminated quotations may not fully represent the most recent information about the value of that security. And as such, **OTCBB may provide information that is incomplete, potentially misleading investors who rely on it exclusively.** ***This proposal does not alleviate this concern.***" (emphasis added)

FINRA-operated ODF, and could tout its 'compliance' and 'regulatory status' to investors. The ODF will confuse investors, who may incorrectly believe that the FINRA ODF designation is a mark of company quality. That issue already exists with respect to the approximately 100 companies currently quoted[9] on the OTCBB, and that risk would be multiplied exponentially if the ODF were expanded to include all of the more than 9,600 publicly quoted OTC equity securities.

OTC Markets Group operates a tiered market system. Our OTCQX®, OTCQB® and Pink® markets give investors and other market participants a clear indication of whether a company is providing adequate current information as well as whether it meets tests regarding verification of officers and directors, SEC penny stock status and other quantitative standards.[10] Within the Pink market, we further categorize companies as current information, limited information and no information to provide additional clarity to investors. Our market designations incentivize disclosure, as companies seek to rise to the highest possible market level, and the clear differentiation between current, limited and non-reporting companies informs investors.

The ODF proposal would move investor protection backwards. For example, FINRA proposes that the ODF will indicate whether an issuer is timely reporting, delinquent, or non-reporting, using publicly available information. That approach does little to mitigate the problems discussed above. The ODF would include all OTC equity securities, not just those that are SEC reporting. It is unclear whether FINRA would review company reporting just at the SEC level, or if other types of timely reporting, such as foreign issuers reporting in accordance with Exchange Act Rule 12g3-2(b), would be evaluated and considered.

OTC Markets Group clearly discloses and explains a number of acceptable reporting standards, including SEC Reporting, Bank Reporting, International Reporting and Alternative Reporting.[11] Without specific disclosure standards and a process for monitoring compliance, FINRA's proposed disclosure of timely reporting will only add to the confusion. Similarly, regardless of how FINRA determines an issuer's reporting status, leaving all issuers classified as quoted on ODF limit investors insight into, or understanding of, an issuer's disclosure status.

[9] Data as of November 14, 2016.

[10] An overview of OTCQX qualifications is available at http://www.otcmarkets.com/services/companies/otcqx-us/qualifications, and of OTCQB standards at: http://www.otcmarkets.com/services/companies/otcqb/requirements.

[11] An overview of OTCQX and OTCQB reporting standards is available at: http://www.otcmarkets.com/learn/otc-company-reporting.

The ODF is Not Needed

This letter highlights the heavy costs and limited benefits of establishing the ODF. FINRA's stated purpose for the ODF is to develop an alternative to OTC Link ATS for quoting OTC equity securities, in the event that OTC Link ATS suffers a system related issue. The ODF Proposal cites two prior OTC Link ATS systems issues, one each from 2013 and 2014, as evidence that the ODF is needed. In each instance, FINRA chose to impose a trading halt in OTC equity securities, and importantly the systems issues were resolved and the halts lifted before market close on both days. On subsequent industry-wide calls, the FINRA member broker-dealers directly impacted by FINRA's trading halts expressed that they were able to complete their trading by market close, and that they preferred temporary halts to the prospect of a mandated alternative quoting system and its associated costs.

Much has changed in the past few years. In November 2014, the SEC adopted Reg. SCI, a comprehensive regulation of the technology systems of key market participants. OTC Link ATS was deemed an "SCI entity" subject to Reg. SCI, which became applicable to SCI entities in November 2015. This new regulation has caused OTC Link ATS and other SCI entities to implement policies, develop procedures, and have personnel in place to monitor, prevent and mitigate systems issues. OTC Link ATS has not experienced similar systems issues since 2014, and FINRA has not imposed a market-wide halt on OTC equity securities during that time. Regulation SCI is a giant expansion of regulatory obligations on ATSs, SROs and exchanges. With the SEC having recently imposed this new regulation to ensure that "systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability and promote the maintenance of fair and orderly markets," the ODF is an unnecessary, costly additional obligation on the industry.

The ODF Proposal also fails to address FINRA's OTC Reporting Facility (ORF), which would continue to be a single point of failure that could impact the availability of OTC equity securities trading. Broker-dealers are required to report all trades in OTC equity securities to FINRA's ORF, and its unavailability due to systems issues or otherwise would necessarily shut down the entire market.

In the event that FINRA is concerned about the long-term or permanent unavailability of OTC Link ATS, we would be happy to discuss ways of recreating the OTC Link ATS system, including putting the OTC Link ATS source code into a repository accessible by FINRA and other market participants, as is the practice with certain software as a service models.

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Conclusion

We understand and appreciate FINRA's desire to provide the best possible markets for investors in OTC equity securities. We work diligently toward the same goal. The ODF Proposal, however would use regulatory authority to create a system with limited, display-only functionality that would not present a viable alternative to existing interdealer quotation systems. The ODF would create an inherent conflict of interest, with FINRA to mandate and regulate a for profit system. The potential for the ODF to produce flawed, potentially misleading market data, and impose greater costs on industry participants, may further reduce the number of liquidity providing market participants and increase investor costs.

For all of the reasons set forth above, the ODF Proposal overreaches in its regulatory scope and imposes too much cost with little to no benefit, and therefore should not move forward.

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We appreciate the opportunity to comment on the ODF Proposal, and look forward to further discussions with FINRA about the issues raised in this letter as well as more viable, longer-term potential solutions.

Please contact me at (212) 896-4413 or dan@otcmarkets.com with any questions.

Very truly yours,

Daniel Zinn

General Counsel

OTC Markets Group Inc.