STANY
The Security Traders Association of New York, Inc.

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Via email: pubcom@finra.org

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street
NW Washington, DC 20006-1506

Re: Regulatory Notice 16-34

Dear Ms. Asquith

The Security Traders Association of New York, Inc. ("STANY")[1] respectfully submits this letter in response to Financial Industry Regulatory Authority's ("FINRA") request for comments on a Proposal Relating to its Inter-Dealer Quotation System for OTC Equity Securities ("the Proposal.") For reasons discussed below, STANY opposes the creation of the proposed quotation system.

The proposed system does not provide a viable solution for sustaining trading in OTC equities.

FINRA has proposed the operation of a "quotation facility that is capable of serving as an alternative in the event of system disturbances or technological failure in another interdealer quotation system." However, the order display facility ("ODF") proposed by FINRA would not serve merely as a backup. Instead, it would accept quotes on a real time basis continuously. Thus, the ODF amounts to an alternative venue in competition with existing systems.

[1] STANY is the voice of the trader in the New York metropolitan area and represents approximately 750 individuals who are engaged in the trading of securities. STANY is one of the largest affiliates 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. As an industry organization of individuals employed in the securities markets, STANY does not represent a single business or business model, but rather provides a forum for trading professionals representing institutions, broker-dealers, ATSs, and trading centers to share their unique perspectives on issues facing the securities markets.

Significantly, the ODF will not support real time messaging and, thus, cannot serve as an effective backup system in today's marketplace since most firms have automated their OTC Equity Securities systems using messaging systems.

A quotation system without messaging will essentially be worthless. Before 2008, 90% of the volume in OTC equity securities was in US securities. Currently, 80% of the volume is in foreign securities which have delisted from, or chosen not to list on, the U.S. exchanges in response to Sarbanes-Oxley and the additional cost and regulatory burdens of exchange listing. These securities, due to the continual updating of foreign exchange rates, are executed electronically and require a messaging system as well as a quotation system. The industry has become accustomed to the negotiation of transactions in OTC equity securities through directed trade messages, and a quotation system alone is inadequate. ODF itself would be a single point of failure that will not eliminate the possibility of a market-wide trading halt.

Even in the event of a market-wide halt, trading of OTC equity securities accounts for .5 of 1% of daily dollar volume traded on US markets. This further underscores that the potential benefits of an alternative quotation system does not justify the costs associated with building, connecting to, and testing (on a semi-annual basis by the 23 FINRA member firms that currently quote an average of 500 or more OTC equity securities per month, known as "active market participants") the ODF.

Moreover, there is no need for the ODF, as dealers have no obligation to quote at all times in the OTC market.

<u>The proposed system is anti-competitive and unfairly weighted toward a regulator.</u>

Under the Proposal, there will be no charge for firms to submit quotes into the proposed system. Since FINRA will incur costs to develop, operate and maintain the ODF, it likely that the system will be subsidized by trading fees charged to all industry participants. The unintended consequence will be that fees, currently paid by firms to FINRA for other purposes, will be used to support the regulator's quotation facility, which will compete unfairly with private solutions.

This anti-competitive approach will be amplified by requiring active market participants to test with the facility, whether or not they use it. FINRA is essentially using its regulatory authority to require member firms to not only buy into their new system, but also expend resources and time to test their system. Effectively, FINRA is offering a private market solution operated by a commercial division of a regulator. As with any system operated by a regulator, conflicts of interest will arise and firms may feel obliged to use the system in the belief, real or imagined, that using it will curry favor with their regulator.

As FINRA notes, 22 of the 23 active market participants are not currently connected to the OTCBB system. These firms would incur connectivity and testing costs, as well as internal development costs if FINRA's ODF is instituted as proposed. We are concerned that firms will pass some or all of these costs on to investors, or in the alternative, reduce the average number of symbols quoted per day from the 500 symbols to avoid active market participant status. Either response will harm the overall market and investors.

Private competitors have not emerged for trading platforms in the market for OTC Equity Securities primarily because brokerage firms operating in this space have seen declining profits. In recent years, many brokerage firms have left the business, due in part to increased regulatory costs. There just aren't enough potential profits to encourage more competition. This also indicates that the market will not support another trading platform, so that any business that is attracted to the ODF will simply drain resources from private enterprise in favor of a regulatory solution. This will necessarily inhibit innovation. Similar to its operation of the OTCBB, FINRA will not have any incentive to innovate the ODF since it will not generate any direct revenues from it, assuming that revenue generation is an appropriate regulatory goal for FINRA.

<u>FINRA's proposed expansion of the OTCBB will create additional problems with potentially serious unintended consequences.</u>

FINRA intends to expand the universe of securities traded on the ODF to include all OTC Equity Securities. At present, OTCBB is limited to trading securities of SEC reporting issuers. However, FINRA has no plans for vetting the securities that are quoted or requiring that they satisfy any disclosure mandate. Experience tells us that fraudsters will use FINRA's operation of the ODF to make false claims about the validity of the securities traded there. And, experience also tells us that investors are easily confused into thinking that an inter-dealer quotation system operated by a regulator is the equivalent of an exchange.

International securities are not registered under the Exchange Act and cannot trade on national securities exchanges. Many of these securities are OTC Equity Securities that trade on OTC Link. Having an SRO operate a system that trades unregistered securities disregards the mandate of the Exchange Act, so FINRA, as an SRO should not operate a trading system on which unregistered foreign securities can trade.

<u>Summary</u>

FINRA plans to expand its current OTCBB system, require firms to use and periodically test it, and pay for it entirely through regulatory fees, all of which provides it with anti-competitive advantages over private firms operating inter-dealer quotation systems in the market for OTC Equity Securities.

As detailed above, our position is that the proposed ODF will not serve the primary goal as a sufficient back-up as it does not support messaging. The additional fees and costs inherent to implementing such a system far outweigh any benefits due to the minimal impact of OTC activity in comparison to the overall US markets. Finally, we maintain that there are numerous unintended consequences and potential conflicts of interest of FINRA operating a quotation facility in direct competition with private industry over which it has regulatory responsibility.

Respectfully submitted,

Kimberly Unger
CEO & Executive Director