



Financial Industry Regulatory Authority

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Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. SR-FINRA-2008-055 – 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 NASD Rule 2315 (Recommendations to Customers in OTC Equity Securities) as FINRA Rule 2114, with certain modifications. The Commission received three comment letters in response to the proposal.¹

Among other things, the proposed rule change would require a Series 24 principal to conduct or supervise a review of current financial statements and current material business information before a member could recommend the purchase of an OTC Equity Security. Wachovia and SIFMA request that FINRA amend the proposal to permit the required review, or supervision thereof, alternatively to be conducted by a person qualified as a General Securities Sales Supervisor (Series 8 or 9/10) – a limited principal registration category for individuals who supervise securities sales activity.² FINRA agrees that a General Securities Sales Supervisor is properly qualified to conduct or oversee the review requirements of the rule, and FINRA therefore will amend the proposed rule change accordingly.

SIFMA also suggests that FINRA retain the current rule’s exemptions for a security with a worldwide average daily trading volume of at least \$100,000 during each of the six calendar months preceding a recommendation, as well as a convertible

¹ Letter from Wachovia Securities LLC to Florence E. Harmon dated December 9, 2008 LLC (“Wachovia”); letter from the Securities Industry and Financial Markets Association to Florence E. Harmon dated January 6, 2009 (“SIFMA”); and letter from the Financial Services Institute to Elizabeth Murphy dated January 6, 2009 (“FSI”).

² The Series 8 is the historical equivalent to the Series 9/10.

security, if the underlying security meets that same average daily trading volume levels. SIFMA argues that removing those current exemptions would require firms to conduct the required due diligence review on some large companies whose securities do not pose the risks that the rule intends to address.

As discussed in the rule filing, FINRA proposes to eliminate those exemptions out of concern that the advent of the Internet and the increased number of trading venues has rendered the trading volume threshold unreliable to screen out less risky securities. That significant investor protection concern is not dissipated by the fact that eliminating the exemptions may bring the securities of certain larger companies within the purview of the rule. Furthermore, FINRA notes that SIFMA's examples of large companies whose securities supposedly would be ensnared by the rule if the trading volume exemptions are eliminated – well-capitalized foreign companies whose American Depository Receipts trade over-the-counter – likely would qualify for another exemption that carves out securities of issuers that have at least \$50 million in total assets and \$10 million in shareholders equity. To the extent larger companies don't satisfy one of the remaining exemptions, FINRA believes the review required by the proposed rule is appropriate.

FSI criticizes for a variety of reasons the proposal to expand the scope of the current rule to cover all OTC Equity Securities, irrespective of whether they trade through a quotation medium. FSI asserts that such expansion will deny investors reasonable access to OTC Equity Securities by increasing barriers to entry into the OTC Equity marketplace. FSI further asserts that the proposal will impose delays on processing OTC Equity Security purchases, resulting in missed market opportunities for investors, and that the time to locate and review financial statements and current material business information will limit a broker's choice of stocks to recommend. FSI also contends that the proposal is overly burdensome and suggests its approval will lead FSI firms to no longer offer their clients the ability to engage in OTC Equity Securities transactions, thereby reducing competition and increasing investor costs.

FINRA strongly disagrees that its proposed amendment to include within the rule those OTC Equity Securities that do not trade through a quotation medium will have such deleterious effects on investors. On the contrary, FINRA believes investors will be better protected by the proposed rule change, as recommendations of those OTC Equity Securities that trade in the unlisted market, absent the due diligence required by the rule, pose substantial risk to investors that the rule seeks to redress.

In response to some of FSI's more specific criticisms, FINRA notes that the proposal – and the existing rule – applies only to recommendations and not to unsolicited purchases. As such, it in no way denies investors access to the OTC Equity Securities market. Moreover, there should be no processing delays of purchases in response to solicited orders – and therefore no missed price opportunities – as the required due diligence review must be conducted prior to recommending the purchase of an OTC Equity Security. As to the prospect of a member having fewer

Florence E. Harmon
February 13, 2009
Page 3

OTC Equity Securities stocks to recommend, FINRA believes that is a desirable outcome if the alternative is to allow a member to recommend these securities without confirming the existence – and reviewing the content – of basic company information that a broker ought to be familiar with before recommending most any security. Along the same lines, given the choice between recommending these securities with no basic due diligence review and having fewer brokers recommending such securities, FINRA believes investors and the marketplace are better off with the latter.

For many of the reasons set forth above, FINRA declines FSI's suggestion to exempt firms that generate less than 5% of their commission revenue from OTC Equity Security transactions and don't make a market in those securities. FINRA believes such an exemption would undermine the purpose of the rule by allowing a significant volume of OTC Equity Securities to escape the rule's review requirements with no countervailing interest to investors.

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FINRA believes that the foregoing responds to the material issues raised by the commenter to this rule filing. If you have any questions, please contact me at (202) 728-8451; email: philip.shaikun@finra.org. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,



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