

September 23, 2009

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

**Re: Comments to Securities Exchange Act Release No. 60515
File No. SR-FINRA-2009-054**

Dear Ms. Murphy,

Pink OTC Markets Inc. ("Pink OTC") respectfully submits the following comments on the proposal by the Financial Industry Regulatory Authority, Inc. ("FINRA") to adopt new FINRA Rules 6434 (Minimum Pricing Increment for OTC Equity Securities), 6437 (Prohibition from Locking or Crossing Quotations in OTC Equity Securities), 6450 (Restrictions on Access Fees) and 6460 (Display of Customer Limit Orders) (collectively, the "Current Proposal").

We support FINRA's attempts to improve the quality of OTC markets. However, we believe the Current Proposal is flawed and will negatively impact market quality in its current form. While some parts of the Current Proposal merit serious consideration, we urge the Securities and Exchange Commission (the "Commission") to require changes to the Current Proposal before approving its adoption.

We believe it is a mistake to introduce hidden access fees into the market for OTC equity securities due to their known adverse effects on investors and market quality. Accordingly, hidden access fees should be dropped from the Current Proposal. We also believe that the other elements of the Current Proposal need to be modified by (i) extending the protections for locked and crossed markets, (ii) making the minimum quotation increments for OTC equity securities priced at less than one dollar meaningful, (iii) requiring the display of prices for customer limit orders, but permitting broker-dealers to exercise discretion in the display of size to avoid adverse market impact, and (iv) clarifying order handling requirements when orders are submitted at less than the minimum quote size.

Pink OTC is the leading provider of financial information and technology services for the OTC securities markets. Among other things, Pink OTC operates Pink Quote, an electronic inter-dealer quotation system for OTC equity securities for market makers and other broker-dealers registered with FINRA that is the largest non-exclusive Securities Information Processor ("SIP") for OTC equity securities.

Background

The Current Proposal is based on two erroneous assumptions: First, the Current Proposal assumes that market conditions for OTC equity securities are the same as market conditions for exchange listed securities. This assumption leads to the false conclusion that rules governing the exchange listed markets will protect investors adequately in the OTC markets. Second, the Current Proposal adopts the false assumption that facilitating the access fee-based maker-taker model will promote the development of agency trading. This assumption leads to the fallacy that permitting hidden access fees by all market participants effectively promotes fair competition between broker-dealers that rely primarily on agency trading and firms that use principal trading models to satisfy customer orders in the OTC equity securities marketplace.

The facts run counter to the assumptions on which the Current Proposal is based. First, the market for OTC equity securities is vastly different than the market for NMS stocks. The OTC market is characterized by lower trading volumes, and less natural liquidity, as well as a preponderance of smaller issuers when compared to the NMS market. The large issuer securities traded in the OTC market are ADRs and foreign ordinary shares of non-U.S. issuers listed on non-U.S. stock exchanges that depend on cross border arbitrageurs to create U.S.\$ liquidity in these cross-listed securities. Investors in the OTC market are largely self directed in their investment decisions and self directed retail orders can individually and in aggregate have significant market impact to the trading price of an OTC equity security. Second, the primary advantage of agency trading for investors is that it allows them to differentiate the cost of trading services from the prices paid for securities. This promotes competition by allowing ready price comparisons among service providers. Hidden access fees defeat this advantage, rendering it more difficult for investors to compare costs. In the relatively inactive OTC market, the result will be less, rather than more, competition among different broker-dealer models for providing execution service to investors. There is no good reason to introduce opacity into the OTC equity market. Unlike the market for NMS stocks, in the OTC market, industry participants have not charged tariffs for competitors to access their liquidity.

Pink OTC is agnostic regarding broker-dealer business models as our Pink Quote inter-dealer quotation system allows the display of quotes and routing of trade messages by market makers, agency brokers and ATSS. It is worth noting that NASDAQ during most of its existence was a market maker system that was not available for direct participation by agency brokers or ATSS.

We believe that the principal model is successful in the OTC market because it has provided investors the highest quality service when trading OTC equity securities. In our experience, market quality is poor where OTC equity securities are quoted entirely on an agency basis. Under Exchange Act Rule 15c2-11, when a broker-dealer is not able to obtain adequate current public information regarding the issuer of an OTC equity security, the broker-dealer can only accept unsolicited agency orders from customers. The stocks quoted under this rule are characterized by wider spreads, less liquidity and

more volatility, as compared to other OTC equity securities with proprietary quotations by market makers.

We believe that the appropriate way to increase agency brokerage in the market for OTC equity securities is to incentivize and increase the transparency of available liquidity, so that the costs of providing principal trading services can be readily compared with agency services. We also believe that rules that encourage the display of market maker liquidity and limit order display also encourage the use of agency brokers to display orders and to access displayed liquidity. Meaningful quotation increments encourage market maker and limit order display by creating more liquidity at each price point. Encouraging investors to display limit orders, while permitting the exercise of broker discretion in the display of potentially market impacting orders, prevents trade throughs. Increased price transparency and rules that encourage limit order display provide appropriate incentives for investors to choose agency brokerage services. Investors can then make the right choices based on their individual needs. Hidden access fees render the costs of providing trading services less transparent, and therefore reduce investor protection.

In Exchange Act Release No. 52280, on August 17, 2005, the Commission published FINRA's first proposal, designated SR-NASD-2005-095, to adopt the rule against sub-penny quotations found in Regulation NMS.¹ This proposal was opposed by one ATS commenter, which pointed out that FINRA Rule 6540(c) required access fees to be included in displayed OTCBB[®] quotations.² Although there is no evidence that the ATS ever included an access fee in any OTCBB quotation, the ATS argued that since its fees were in sub-penny amounts, the proposed prohibition against sub-penny quotations effectively would prevent it from including access fees in its quotes.

FINRA responded to the ATS's comment by proposing to eliminate FINRA Rule 6540(c) altogether,³ which would have permitted ATSS to charge hidden access fees that were not included in its OTCBB quotes. However, the proposed rule would not have permitted ATSS to charge hidden access fees for quotes in other OTC equity securities. This practice would have run afoul of FINRA Rule 3320, which requires members to trade at the prices stated in their quotations. Pink OTC and numerous other industry participants strenuously objected to this proposal on the grounds that it would enable alternative trading systems ("ATSS"), to charge hidden fees that would be excessive and injure other market participants.⁴

¹ Accordingly, the original version of SR-NASD-2005-095 would have prohibited its members from displaying, ranking or accepting a bid, offer, order or indication of interest in any OTC equity security priced in an increment smaller than \$.01 if such bid, offer, order or indication of interest is priced equal to or greater than \$1.00 per share, or smaller than \$.0001, if such bid, offer, order or indication of interest is priced at less than \$1.00 per share.

² See Exchange Act Release No. 53024 (December 27, 2005).

³ *Id.*

⁴ See Letter from R. Cromwell Coulson, CEO of Pink Sheets LLC (the predecessor to Pink OTC Markets Inc.) to Nancy M. Morris, Secretary, Securities and Exchange Commission, re "Comments to Release No. 34-53024, File No. SR-NASD-2005-095," dated January 24, 2006.

In its third attempt to introduce hidden access fees to the market of OTC equity securities, FINRA proposed to allow ATSS to charge a limited amount of hidden access fees, while denying this privilege to other market participants.⁵ Amounts in excess of these limitations would have to be disclosed in quotations. Pink OTC and other industry participants opposed this proposal on a number of grounds,⁶ primarily because it would have created an unlevel playing field by granting privileged status to ATSS to impose hidden access fees, while denying this privilege to competing market makers. Pink OTC also argued that hidden access fees should not be permitted without rules prohibiting locked and crossed markets and that if hidden access fees were permitted for securities quoted on the OTCBB, the same rule should also apply to other markets for OTC equity securities.

The Current Proposal addresses some of the concerns expressed by our earlier comments. First, it allows industry participants to charge hidden access fees on all transactions in OTC equity securities, rather than limiting their application to OTCBB transactions. Second, all industry participants, including market makers, agency brokers as well as ATSS, would be permitted to charge hidden access fees. Third, it would require FINRA members to implement policies and procedures that reasonably avoid displaying quotations that lock or cross markets within the same interdealer quotation system.

Nonetheless, we continue to believe this is a bad proposal based on erroneous assumptions and flawed logic that will injure investors and adversely affect market quality.

Hidden Access Fees Should Not be Introduced Into the OTC Market

We continue to believe that hidden access fees should not be introduced into the market for OTC equity securities. They do more harm than good and fail the Commission goal of promoting fair competition between different types of market centers.”⁷

FINRA has mistakenly assumed that the way to increase the agency handling of customer orders in the OTC market is through hidden access fees. We disagree strongly that this is the appropriate way to encourage agency trading.

As noted earlier, the primary advantage of agency trading over principal trading is that it facilitates ready comparisons of the costs of providing trading services among service providers. Hidden access fees defeat this advantage, rendering it more difficult for investors to compare costs. We believe this market inefficiency is disguised in the

⁵ See Securities Exchange Act Release No. 34-55717, SR-NASD-2007-029 (May 11, 2007).

⁶ See Letter from R. Cromwell Coulson, CEO of Pink Sheets LLC to Ms. Nancy M. Morris, Secretary, Securities and Exchange Commission re “Comments to SEC Release 34-55717, File No. SR-NASD-2007-029,” dated May 31, 2007.

⁷ See Securities Exchange Act Release No. 34-60684; File No.S7-21-09 “The Commission generally has sought to interpret its rules in such a way that they promote fair competition between manual and automated markets.”

market for NMS stocks by the high trading volumes in that market. In contrast, the OTC market is much more inactive and illiquid. As a result, there will be less, rather than more, competition among different broker-dealer models for providing execution service to investors.

The disadvantage of hidden access fees to investors was recognized by the Commission in its initial proposal to adopt Regulation NMS, where the Commission forcibly pointed out that hidden access fees have the effect of not reliably indicating the true prices actually available to investors. As a result, it is difficult for investors to compare prices offered by different broker-dealers across different marketplaces.⁸ Limiting the amount of hidden access fees reduces this injury to market quality, but does not eliminate it. We believe this injury will be particularly pronounced in the market for OTC equity securities due to its lower volumes and there being less natural liquidity. As a result, FINRA should be required to demonstrate that the benefits of introducing hidden access fees to the market for OTC equity securities are greater than the recognized harm hidden access fees cause to investor confidence and market quality.

Moreover, hidden access fees and liquidity rebates offered by ATSS encourage gaming through locked and crossed markets as market participants use these devices to obtain rebates or avoid the payment of hidden access fees. Gaming activity is especially incentivized when the hidden access fees are larger than the minimum quote increment. Market participants have little incentive to lock or cross markets where hidden access fees are not permitted, and as a result, markets without hidden access fees have lower compliance costs. It is inevitable that transactions costs to investors must be greater in a market that permits hidden access fees to cover these additional compliance costs.

We disagree with the notion that the ATS business model requires hidden access fees because an ATS is in an “agency” business. Broker-dealers have charged agency commissions to their customers for decades; however, they historically have not been able to charge commissions to persons who access the quotes resulting from agency orders, but are not their customers. There is nothing inherent in an agency commission business model that requires or justifies the use of hidden access fees.

We believe the hidden access fees permitted under Regulation NMS reflected the Commission’s recognition of an historical fact of life. At the time of its adoption, registered stock exchanges and some ATS business models charged hidden fees to access their liquidity. We do not believe the Commission would have permitted hidden access fees in Regulation NMS if it had been drawing on a clean slate. In several releases prior to the adoption of Regulation NMS, the Commission suggested that it would be appropriate for self-regulatory organizations to ban hidden access fees, virtually inviting rule proposals that prohibit the practice.⁹ Among other things, the Commission expressed concern that market participants were using some ATS systems

⁸ See Securities Exchange Act Release No. 34-49325 (February 27, 2004), at 61.

⁹ See, e.g., Regulation of Exchanges and Alternative Trading Systems, Securities Exchange Act Release 34-39884, File No. S7-12-98 (April 17, 1998), at 43.

to obtain the rebate paid for by hidden access fees, rather than expressing a preference for the service offered by such ATS systems.

Finally, if all market participants charge hidden access fees that are limited to some certain amount, as under Regulation NMS and the Current Proposal, the practice amounts to a zero sum game. However, the game is not free. The charges must somehow be billed and collected by market participants. As described in our earlier comment letters, Pink OTC is prepared to implement a billing service to accommodate this need for the accounting of hidden access fees. Nonetheless, the fact remains that additional transaction costs will be incurred by market participants to deal with hidden access fees, which will inevitably end up being passed through to investors.

We believe that it would be better for FINRA to adopt rules that encourage greater transparency of all trading costs, which will encourage the development of agency models that can demonstrate superior service at lower costs, as compared to their principal trading competitors.

Locked and Crossed Markets Policies Should Cover the Entire Market

Because hidden access fees create incentives to lock or cross markets to obtain rebates or avoid the payment of hidden access fees, the Current Proposal would require broker-dealers to implement policies and procedures that reasonably avoid locked and crossed quotations within the same inter-dealer quotation system. We think this prohibition needs to be amended to cover all inter-dealer quotation systems that operate in the OTC market.

The Current Proposal justifies this limited rule against locked and crossed markets on the grounds that there is not currently a mandated consolidated quotation dissemination mechanism for OTC equity securities.¹⁰ This appears to be an attempt by FINRA to create a problem that does not exist to justify a forthcoming proposal to require all broker-dealers to provide their quotes to a FINRA SIP.¹¹

Pink OTC already provides non-exclusive SIP services to the OTC market and, in particular, consolidated prices in dually quoted securities on our OTC Dealer application and via market data vendors. Pink OTC Requirements and Guidelines for quote vendors states: "Vendors must consolidate the inside quote for securities that are dually quoted on the Pink Sheets and the OTCBB. The consolidated quote should be the best quote across Pink Sheets (including OTCQX) and OTCBB. The inside should clearly identify the source of the quote, i.e., Pink Sheets marketplace or OTCBB."¹² All of the significant order management systems used by OTC broker-dealers and major quote

¹⁰ See Current Proposal, n. 9.

¹¹ See OTCBB Sale Announcement "FINRA is proposing to shift its role from operating the OTCBB to acting as the consolidator and disseminator of all quotation and trade information for unlisted equity securities—non-listed, publicly traded equity securities." At <http://www.finra.org/Industry/Compliance/MarketTransparency/P119958>

¹² See Requirements and Guidelines <http://pinksheets.com/content/doc/ps/quotedisplay.pdf>

vendors use Pink OTC's non-exclusive SIP services to provide consolidated quotations for dually quoted securities in the OTC market.

The number of broker-dealers using the OTCBB quotation system and number of individual quotations has been declining in the face of competition from the product, service and price superiority of Pink OTC products¹³. We believe this aspect of the Current Proposal represents an attempt to justify the expense and burden of a FINRA mandated SIP for OTC quotations and a regulatory taking of quotation data from a private competitor that has offered a better product at a lower cost. The private market facilitates broker-dealer best execution obligations by providing non-exclusive SIP services to the market for OTC equity securities that are freely chosen by broker-dealers and ATS. There is no need for FINRA to step in and create an anti-competitive monopoly when the private market is already providing such services. FINRA is only required to "promote" orderly procedures for collecting, distributing, and publishing quotations,¹⁴ not to be the sole provider by operating a system their members are required to use.

FINRA is well aware that the duty of best execution requires a broker-dealer to use "reasonable diligence to ascertain the best inter-dealer market for a security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions."¹⁵ This duty of best execution may require a broker-dealer to canvass several market venues that are reasonably available to obtain the best possible price for a customer order. It is worth noting that this duty of best execution has historically included a duty to canvass quotations that are not included within a "mandated consolidated quotation dissemination system" for NMS securities, as well as OTC equity securities.

We believe the duty to avoid locked and crossed quotations should be co-extensive with the duty of best execution. A broker-dealer that is required to canvass a quotation venue to ascertain the best inter-dealer market for a security should also be obligated not to publish a quotation that locks a market that includes that venue.

Quote Increments Must Be Meaningful

We believe that the willingness of investors to display liquidity is one of the most important tools that FINRA can use to make the services of agency brokerage more attractive to investors. When liquidity is visible, investors are more willing to use an agent to access it. Meaningful quote increments are a key element of attracting more limit order display from investors and proprietary liquidity display by market makers. The usefulness of meaningful quote increments in limit order display has strong academic

¹³ See Position Graphs <http://otcbb.com/dynamic/tradingdata/position/position.htm>

¹⁴ See Exchange Act 15A(b)11

¹⁵ See NASD Notice to Members 01-22 (April 2001), at 202. See also, NASD Rule 2320(a).

support¹⁶, and meaningful increments have been proven to be non-detrimental to investors in the OTC market¹⁷.

We support restrictions on sub-penny pricing for all of the reasons stated in the Current Proposal. When increments are too small, there is an incentive for market participants to step ahead of limit orders for an economically insignificant amount and “flickering” quotes make it difficult for broker-dealers to meet their regulatory obligations and reduce investor confidence in the market.

The Current Proposal would adopt the same restrictions on sub-penny quoting currently found in Regulation NMS. However, we believe the insignificant increments used by Regulation NMS for stocks quoted at prices less than one dollar per share¹⁸ are too small to accomplish these beneficial objectives, harm investors who display limit orders and will thus diminish the willingness of investors to display limit orders.

FINRA acknowledges the importance of meaningful increments in a quote from the Commission in the Current Proposal: “As the SEC stated in the proposing release for Regulation NMS and in the Regulation NMS Adopting Release, potential harms associated with sub-penny quoting include an increase in the incidence of market participants stepping ahead of standing limit orders for an economically insignificant amount and added difficulty for broker-dealers to meet certain of their regulatory obligations by increasing the incidence of so-called “flickering” quotes.”

This predicate is inconsistent with Current Proposal’s creating one thousand price points between ninety nine cents (\$0.99) and a dollar (\$1.00). Such insignificant increments fail the definition of “meaningful”. We do not believe that much thought was given to stocks quoted at less than one dollar when Regulation NMS was adopted. At the time, very few NMS stocks were quoted at prices less than one dollar per share, and even in this difficult market environment, sub-dollar quotations remain relatively rare. In contrast, in the market for OTC equity securities, the majority of stocks are quoted at prices less than one dollar.

The Current Proposal actually departs from Regulation NMS in some cases. For stocks quoted at prices less than one penny, the Current Proposal would establish even more insignificant increments of \$.00001, a category not found in Regulation NMS. So, it would be appropriate to consider carefully whether or not the quotation increments contained in Regulation NMS are appropriate in the market for OTC equity securities. We strongly believe that these proposed extra-insignificant increments of \$.00001 will have the unintended consequence of facilitating fraudulent distributions by OTCBB and

¹⁶ See, William G. Christie “A Minimum Increment Solution” Traders Magazine, (October 2003) <http://www.tradersmagazine.com/issues/20031031/1743-1.html>

¹⁷ See Bollen, N., and W. Christie “Market Microstructure of the Pink Sheets” (July 17, 2007 Version).

¹⁸ Rule 612 under the Exchange Act establishes increments of \$.0001 for quotations priced at less than one dollar.

Pink Sheets issuer that conduct “dump and dilute” schemes by continuously issuing and selling shares at lower and lower per share prices¹⁹.

Other international markets that have listings of smaller issuers establish larger increment sizes for lower priced stocks. For example, on the Australian Stock Exchange, the minimum increment for stocks priced between one and ten cents is one-tenth of a cent (\$.001), for stocks priced between ten cents and two dollars, one-half of a cent (\$.005).²⁰ On the TSX Venture Exchange division of TSX Markets in Toronto, Canada, securities traded at less than fifty cents per share are quoted in minimum increments of half a cent (\$.005).²¹

There is no logical reason for a stock quoted in penny increments at one dollar to suddenly be quoted in hundredth of a penny increments at 99 cents so there are one thousand (1,000) price points. We believe that appropriate increments for stocks quoted below a dollar should be as follows:

- For quote prices at or below \$1 but above \$.50, a quote tick size of 0.01
- For quote prices at or below \$.50 but above \$.10, a quote tick size of 0.005
- For quote prices at or below \$.10 but above \$0.005 a quote tick size of 0.0005
- For quote prices at or below \$0.005 a quote tick size of 0.0001

We believe these meaningful increments are necessary to attract more investor limit orders and prevent stepping in front of customer limit orders for economically trivial amounts. However, it would be worthwhile to set these meaningful increments as a temporary rule, which could be revisited at a prescribed later time with a view to making further adjustments to increment sizes in the light of experience and analysis by the Commission’s Office of Economic Analysis as necessary to protect investors.

Access Fee Amounts for Stocks Quoted at Prices Less Than One Dollar Should be Reduced

In the event that the Commission approves the introduction of hidden access fees in the market for OTC equity securities, the amount of hidden access fees permitted for stocks quoted at prices at less than one dollar needs to be reduced. If access fees are greater than the quote increment they are by definition not de minimis and thus raise significant comparability issues.²²

¹⁹ These types of issuers often engage in a reverse split to disenfranchise existing shareholders and then start the printing presses again.

²⁰ See Australian Stock Exchange, Market Reform Project Communication, Minimum Price Steps (March 7, 2005) http://www.asx.com.au/about/pdf/Market_Reform_070305.pdf

²¹ See TSX Markets, Notice to Issuers re Revision of Trading Rules – Minimum Quotation Increments (March 24, 2003) <http://www.tmx.com/en/pdf/Mar24-03-TradingRules.pdf>

²² See Securities Exchange Act Release No. 34-43084; File No. S7-16-00 “ECN access fees that were de minimus in size would not raise significant comparability issues.”

The Current Proposal would adopt the access fee limitations of Regulation NMS. Therefore, for stocks quoted at prices less than one dollar, the Current Proposal would limit any access fee to 0.3% of the quotation price per share.

As with the insignificant increments below a dollar, we doubt that much thought was given in the adoption of Regulation NMS to the appropriate limits on hidden access fees for stocks quoted at prices less than one dollar. For a stock quoted at prices equal to or greater than one dollar, the amount of any access fee cannot exceed the applicable quoting increment. So, for a stock quoted at one dollar, the increment is \$.01 and the access fee limit is \$.003. On the other hand, for stocks quoted at less than one dollar, the .3% limitation may exceed the quote increment. This means that for a stock quoted at \$.90, the quote increment would be \$.0001, while the hidden access fee limit would be \$.0027. Such a relatively high hidden access fee would not be trivial and opens the door to access fee-driven gaming.

The high percentage hidden access fee for stocks quoted at prices less than one dollar in the Current Proposal provides ATSS with an incentive to offer higher percentage rebates, and for market makers to offer payments for order flow, on such stocks. Experience tells us that high percentage rebates and payments for order flow cause market participants to send orders to an ATS or market maker, not due to a superior service offering or superior executions, but to obtain a rebate or order flow payment. The access fee limitations of Regulation NMS were designed to preclude this perverse incentive so that orders are sent to market centers to obtain best execution.

We believe that the appropriate limitation for hidden access fees is 30% of the relevant quote increment. This is the best way to express the Regulation NMS access fee limitation for NMS stocks quoted at prices greater than one dollar, and we believe was the intended result for lower priced stocks. Accordingly, if the increment is \$.01, the appropriate access fee limitation should be \$.003, if \$.001, the access fee limitation should be \$.0003, if \$.0001, \$.00003, and so forth.

Limit Order Display

The Current Proposal grafts the limit order display rule of Regulation NMS onto the market for OTC equity securities, but leaves behind the other protections offered to limit orders. Among other things, the Current Proposal does not include a trade through rule.

It is worth noting that a limit order display rule for listed stocks was a prominent feature of the Order Handling Rules adopted by the Commission in 1996,²³ many years before the adoption of Regulation NMS. When first adopted, it was hoped that the rule would encourage investors to submit priced orders, thereby limiting the need for intervention by market makers. Unfortunately, the limit order display rule did not fulfill these expectations.

²³ See Securities Exchange Act Release No. 37619A (September 6, 1996).

Investors that submitted priced orders with larger sizes governed by the Order Handling Rules generally failed to obtain good executions. Instead, their displayed orders were frequently “traded around” by professional traders and other market participants. For these reasons, Regulation NMS also included a trade through rule, which requires a market center to sweep the market for better-priced orders before executing an inferior priced order on its book. We believe that the trade through rule of Regulation NMS has also failed to induce sophisticated investors to submit market impacting orders for display in the national market system, instead preferring the anonymity offered by “dark pools.”

The risk that an order will be traded around is especially likely if a stock is thinly traded, which is the case for many OTC equity securities. It is worth noting that, unlike the market for NMS stocks, a relatively small retail order can have a market impact. While institutional and professional traders have many tools such as non-displayed orders, icebergs, automated algorithms and dark pools, retail order flow depends on the skill and discretion of the executing broker-dealer to handle the order in the best possible manner. Automatic limit order display of full order size removes that service and leaves the retail limit orders to be stepped ahead and traded around by the professional trading community.

We also doubt that a NMS type trade through rule is practical in the market for OTC equity securities due to the different liquidity requirements of institutional investors. However this is not an issue as the majority of order flow goes through market makers and ATS that currently provide inside price protection to retail orders.

For these reasons, while we generally support the objectives of a limit order display rule, we believe there is more risk of harm to investors than benefit under current market conditions if there is automatic size display. If the Commission determines to approve the Current Proposal’s limit order display rule, we believe certain amendments are required to protect investors.

First, a market maker should be required to display only the price of an order, but have discretion over the display of size. This is already the market practice, which would seem to eliminate the need to impose this as a regulation. It is much more likely that a smaller order will receive an execution than a larger order in many circumstances, so that investors will benefit from the exercise of market maker discretion. It is possible that many limit orders will be submitted at the same price point. If all orders at the same price point must be displayed simultaneously, the result may be that all of them will be traded around and none of them receive an execution, particularly when the market for a security is thinly-traded, while smaller amounts may receive an execution.

If the Commission determines that broker-dealers should be required to display amounts greater than the tier size, at a minimum, the broker should have discretion with at least 50% of the aggregate order size and not be required to display size that is more than ten (10x) times the tier size with respect to any order or aggregate of orders at that

price level.²⁴ Rules that result in the increase of displayed liquidity have the effect of encouraging agency orders to access displayed liquidity. On the other hand, investors will not display liquidity if their orders are consistently traded around by other orders. Broker-dealer discretion is required to encourage the display of limit orders.

Second, limit orders for less than the minimum quotation size for OTC equity securities should not be required to be displayed. Minimum quotation sizes are an important element of market quality in the market for OTC equity securities that should not be undermined by a limit order display rule.

Encourage Display of Market Maker Proprietary Liquidity

We believe that it is important to incentivize increased liquidity display by market makers by giving them priority over subsequently received customer limit orders of liquidity they have publicly displayed in an inter-dealer quotation system.²⁵ While the Current Proposal does not include this change, we believe it will create more publicly displayed liquidity and assist fair competition between market makers and agency brokers.

Timing of Implementation

FINRA has proposed implementing quote increments, lock and cross restrictions and hidden access fees first, with limit order display to be implemented thereafter. We believe that hidden access fees should not be implemented at the present time, but we believe that if hidden access fees are approved, they should be implemented last. The other three proposals, as adjusted, will have the greatest effect on improving OTC market structure, increase the competition between market makers and agency brokers, and are easiest to implement. Access fees on the other hand, will require broker-dealers to devote substantial time and resources to modify correspondent agreements and develop accounting systems to track, reconcile and bill access fees with their customers, correspondents and competitors.

Conclusion

“Given the importance of the securities markets to the American economy, we cannot permit our desire for facilities innovation to result in the elimination of the desirable features of the current trading system without confidence that its successor will be superior and the transition orderly and in investor interests.”²⁶

²⁴ See FINRA Rule 6450. Minimum Quotation Size Requirements for OTC Equity Securities

²⁵ See Pink OTC Comments on FINRA Regulatory Notice 09-15 (Market and Limit Order Protection) <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticcomments/p118975.pdf>

²⁶ See THE NATIONAL MARKET SYSTEM: AN UPDATE

Address by Harold M. Williams, Chairman, Securities and Exchange Commission
http://www.sechistorical.org/collection/papers/1970/1979_1130_WilliamsMarket.pdf

We believe it is a mistake to introduce hidden access fees into the market for OTC equity securities. Broker-dealers currently trade directly with each other in the wholesale OTC market without imposing additional fees on competitors. No existing business model depends on them and they are not needed to increase the amount of agency trading in the market. There are well known adverse effects to investors and market quality that are greater than any benefit that may be derived from their implementation. However, if the Commission permits hidden access fees, they should be capped at 30% of the relevant quote increment, rather than the .03% of quotation size suggested in the Current Proposal.

Prohibitions on locked and crossed markets are essential in a market that permits hidden access fees, and should be co-extensive with a broker-dealer's duty to provide best execution, rather than limited to each interdealer quotation system.

Quotation increments should be meaningful and the thus for stocks quoted at prices less than one dollar should be greater than proposed to avoid the risk of "flickering" quotes and stepping ahead of limit orders for economically insignificant amounts.

To protect investors that submit limit orders from "trading around," broker-dealer should have some discretion to limit the amount of an order size, or combination of orders, that is displayed at any price point. Market makers should not be required to display limit orders that are less than the minimum quotation size requirements for OTC equity securities because minimum quotation sizes are an important aspect of market quality.

Thank you very much, and please call me if you have any questions.

Very truly yours,

R. Cromwell Coulson
Chief Executive Officer