

OTC Markets

March 22, 2011

VIA Electronic Mail

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

Re: File Number SR-FINRA-2011-008; Release No. 34-63960

Dear Ms. Murphy,

OTC Markets Group Inc.,¹ (“OTC Markets Group”) respectfully submits the following comments on the proposal by the Financial Industry Regulatory Authority, Inc. (“FINRA”) to amend Rule 6450 by adding Supplementary Material .01 (the “rate-setting rule”). Rule 6450 permits FINRA’s members to charge access fees against their published quotations for OTC equity securities in interdealer quotation systems. The rate-setting rule would require FINRA’s members to disclose on their websites the amount of such access fees at least three (3) business days in advance of imposing them.

OTC Markets Group fully supports the intent of FINRA’s proposed rate-setting rule. We view the proposal as a well-intended attempt to increase market transparency in a particularly critical area, since access fees directly impact the execution costs ultimately paid by investors to purchase OTC equity securities. To satisfy their best execution responsibilities, members firms must have a clear understanding of the price they are paying to purchase securities on behalf of their customers.

Unfortunately, FINRA’s proposed rate-setting rule is flawed in two crucial respects, which run counter to its salutary goals. First, a member’s website is not the best place to publish access fee information. Second, the proposed rule introduces rigidity into the pricing of OTC equity securities, which has anti-competitive effects.

¹ OTC Markets Group Inc., a financial information and technology services company, operates an electronic quotation and trading system in the United States OTC securities market. It offers OTC Dealer, a subscription based software-as-a-service application that enables broker-dealers to post quotes and communicate with other broker dealers on its OTC Link interdealer quotation and messaging system; and OTCQuote.com for OTC agency traders, institutional investors, and compliance officers who require access to real-time OTC trade and market data.

Access Fees Should Be Disclosed Where the Accessed Quotations Are Published

As a starting place, we are not aware of any rules or statutes that require a broker-dealer to disclose its fee schedules for any service publicly, and in particular, the various ways that discounts can be obtained to any of its fees. Some broker-dealers publish fee schedules for some services because they believe this disclosure provides them with a competitive advantage. But many do not. Those that do publish fee schedules generally do not disclose the amount of discounting or the circumstances under which discounting might be available. So, the proposed rule is a significant expansion of FINRA's previous rulemaking, moving from setting guidelines for maximum permissible service charges to dictating the terms under which members are allowed to negotiate discounts for services.

Since broker-dealers have been regulated under federal securities laws for almost eighty years, it seems odd that the rules have never before required this disclosure. It is true that until 1975, the New York Stock Exchange required its members to charge fixed commissions, which mooted the need for disclosure. But, fixed commissions never existed in the over-the-counter markets. It is now widely held that fixed commissions were anti-competitive and resulted in higher transactions costs and lower service for investors. We believe the reason why broker-dealers have not been required to publish their fees, or the discounts available, is because this sort of disclosure produces inflexible fee structures, which is a move in the direction of fixed commission practices known to be harmful to the markets and the investing public.

In general, the websites of FINRA's member firms are designed to provide information to customers. As a result, the complexity and amount of material displayed varies widely. International bulge-bracket firms target a wide audience and their websites may describe thousands of products. The execution of OTC equity securities often plays a very minor role in the business of such firms, which is reflected in the prominence such activities are afforded on their websites. The websites of these larger firms generally are managed internally and changes to the presentation occur frequently. Smaller firms are likely to have much less complex websites and often outsource management of their websites to external providers. Website changes are relatively costly and cumbersome for smaller firms. As a result, they rarely change the information contained on their websites.

Since the websites of FINRA's members are targeted to customers (and potential customers), it is unusual to find information in such websites that is intended to be viewed by competitors. Access fee information would therefore be an anomaly, since an access fee is a charge imposed on a competitor. Since this is information disclosed

to competitors, some firms may find the information difficult to locate. Moreover, we would expect that a firm would move the location of this information from time to time, without notice. Smaller firms, on the other hand, generally would avoid making changes, since that would impose an extraordinary cost on the firm. This fact of life would cause a severe loss of pricing transparency and flexibility, which are the primary attributes that permit a smaller firm to compete with its much larger and more bureaucratic competitors. The rate-setting rule would therefore have the unintended effect of making it more difficult for smaller firms to compete with their larger competitors.

Moreover, the rate-setting rule, as proposed, is impractical. There are over 100 broker-dealers publishing quotations for OTC equity securities. The proposed rate-setting rule would require broker-dealers to monitor over 100 competitor's websites each day for changes to access fee schedules. The result is both inefficient to implement and an unreasonable burden, especially for smaller broker-dealers.

For these reasons, OTC Markets Group believes that the best place to display access fee information is within the interdealer quotation system where priced quotes are published in OTC equity securities. This is the place where competitive firms typically provide pricing information to each other. The manner of display is determined by the operator of the interdealer quotation system, which prevents FINRA member firms from making the information difficult to locate since its location is beyond their control. Moreover, the information displayed through an interdealer quotation system can be updated and changed frequently in the same way that quotations are frequently updated, but those changes will be immediately disclosed to any FINRA member interested in interacting with a priced quote. This will eliminate the need for a three-day lag time, thereby freeing smaller firms to compete effectively with larger firms through their more flexible pricing procedures. It is well established economic principle that the more dynamic the nature of pricing changes, the more efficient and competitive the marketplace.

OTC Link is the interdealer quotation system operated by OTC Markets Group to facilitate the publication of quotations by FINRA member firms in OTC equity securities. OTC Link has created an additional field in its quotation montage to display an access fee rate associated with a FINRA member firm's displayed quotation for each quoted stock. The new field, called Quote Access Payment ("QAP"), will accept entries for up to the maximum access fee permitted by Rule 6450. Attempts to publish entries greater than the amounts permitted under the Rule will be rejected with an error message. A FINRA member firm may charge different access fees for different stocks, and may change its access fee for any stock at any time during the trading day. The OTC Link

system has also been redesigned so that published quotations at the same price are ranked so that a quotation associated with a lower access fee is placed higher than a quotation associated with a higher access fee. Of course, Subscribers to OTC Link will continue to choose the firms to which they direct trades, through electronic trade messages, phone calls, or other means of communication, as OTC Link does not control routing, priority, or execution of trade messages.

Firms wishing to display their access fee in OTC equity securities that do not utilize the OTC Dealer software provided by OTC Markets Group will be able to do so through their order management system ("OMS"). OTC Markets Group has provided the leading OMS providers with technical specifications for the QAP field.

The default access fee in the OTC Link system will be zero. FINRA member firms must enter a value to populate the QAP field. We believe that it would be inconsistent with high standards of commercial honor and just and equitable principles of trade for a FINRA member to charge an access fee, while failing to disclose the access fee in the QAP field.

OTC Markets Group will be maintaining QAP rates entered by the subscribers of OTC Link in its Quote Data History for the length of time required under Rule 17a-4(a)² under the Securities Exchange Act of 1934. OTC Markets Group will provide its FINRA member firm subscribers a month-end report to identify the firms that have accessed their quotes and whose quotes they have accessed. OTC Markets Group will also make available the details for each trade in which a subscriber charged another firm to access their quote or was charged for accessing another firm's displayed quote, as disclosed in the QAP field. FINRA member firms will also be provided with tools to review summary and detail reports based on Market Participant ID, Security, Trader, Counter-Party Market Participant ID, and Counter-Party Trader ID. We believe this information will enable FINRA member firms to calculate accurately their revenue and liabilities for access fees at any particular time.

We are aware that FINRA may not wish to make the investment necessary to disclose access fees in the montage for its interdealer quotation system. As a low cost alternative, FINRA could make this information available on the OTCBB website. Broker-dealers are accustomed to searching for information there, and while this is not as useful as disclosure placed in the quote montage, at least broker-dealers will only

² SEA Rule 17a-4(a) states every member, broker and dealer subject to Rule 17a-3 shall preserve for a period of not less than 6 years, the first 2 years in an easily accessible place, all records required to be made pursuant to Rule 17a-3(a) (1), (2), (3), and (5).

have to search for the information on one website, rather than over 100 websites, as would be the case under the proposed rate-setting rule.

FINRA Members Should Be Allowed to Provide Undisclosed Discounts to Published Access Fees

FINRA Rule 5210 prohibits a member from publishing a quotation unless the quotation represents a bona fide bid for, or offer of, such security. FINRA Rule 5220 prohibits members from making an offer to buy from or sell to any person any security at a stated price unless such member is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell. It is fundamental to the integrity of the markets for OTC equity securities that quotations must be honored by member firms under the terms and conditions made at the time of the quotation which we reasonably believe should include any access fees displayed.

That said, nothing in Rule 5210 or Rule 5220 precludes a FINRA member from being willing to trade at a price that is better (higher than a bid, lower than an offer) than the one published in an interdealer quotation system. It is in fact a common practice for member firms to inquire as to another firm's willingness to trade at a better price. A better price may be available at higher volumes, because a member firm is hoping to obtain other business from the inquiring firm, or for any number of competitive reasons.

The reasons to trade at a better price generally exist at a particular time. So, a firm with a large order may readily agree to trade at a better price if a larger transaction amount is offered. The same firm may be unwilling to trade at a better price if it is only representing a small order or trading for its own account. Similarly, the opportunity to obtain more business may not come to fruition or may be abandoned, causing a firm to be less willing to trade at prices better than those that are published.

OTC Markets Group believes that access fees are like any other price established by a member firm. It is entirely consistent with FINRA Rule 5210 and Rule 5220, as well as fair and equitable principles of trade for FINRA members to price their services, and the terms of trade, flexibly for competitive reasons, provided that they are willing to honor quotations at published prices. Accordingly, FINRA members should be entitled to discount their access fees to particular firms for particular securities as they see fit, provided that the access fees charged are not greater than allowed or disclosed.

We submit that requiring FINRA member firms to disclose the exact amount of discounts available and the reasons such discounts are applied would hamper competition among member firms. It may be an important part of a FINRA member's

strategy not to disclose to other market participants the rates charged to others. Small firms, in particular, will need to make constant adjustments to their access fee pricing to chip away at business that would otherwise flow to larger firms. It is worth noting that larger firms compete on the basis of their larger range of services. As a result, a larger firm may offer discounts in other services offered to a particular firm to compensate for the imposition of a larger access fee. Smaller firms, whose service offering is limited, must therefore retain a larger degree of discounting fee flexibility to compete with their larger and less flexible competitors.

We believe the market for OTC equity securities benefits from the presence of a large and varied group of market participants, each seeking to obtain a competitive advantage over others. Investors are the ultimate beneficiaries of this competition, which leads ultimately to better prices and a larger range of services than would be available in a world of inflexible prices.

Conclusion

OTC Markets Group supports regulatory efforts to improve the quality of markets in OTC equity securities. In general, market quality is improved by greater transparency. Unfortunately, FINRA's proposed rate-setting rule will not achieve greater transparency and will hamper competition among member firms.

We believe that access fees should be disclosed within the interdealer quotation system in which quotations are published. Disclosure in that medium will deter efforts by member firms to hide the disclosure and can be made immediately, at the time a trading decision is made, thereby eliminating the deleterious consequences of a three-day lag time for information dissemination.

We also believe that access fee disclosure should represent the maximum amount a firm may charge with respect to any published quotation. A FINRA member firm should not be precluded from discounting its fees, as with other prices charged to other market participants and customers, where the firm sees fit for competitive reasons. FINRA's proposal would hamper competition and is therefore contrary to the interests of the investing public.

Please contact our Chief Compliance Officer, Michael Gutshall, at (212) 220-2165 if you have any questions or would like to discuss this matter further.

Very truly yours,



Daniel Zinn
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