

October 20, 2011

## VIA Electronic Submission

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

**Re: File Number SR-FINRA-2011-051; Release No. 34-65388**

Dear Ms. Murphy,

OTC Markets Group Inc., (“OTC Markets Group”) a financial information and technology services company, operates OTC Link, an electronic interdealer quotation and messaging system in the United States OTC securities market that enables its broker-dealer subscribers (all of which are members of the Financial Industry Regulatory Authority, Inc. (“FINRA”)) to post quotes and communicate with each other regarding the execution of transactions. OTC Link LLC, a wholly-owned subsidiary of OTC Markets Group, has applied for FINRA membership. OTC Markets Group has informed FINRA that it intends for OTC Link LLC to operate the OTC Link interdealer quotation and messaging system as an Alternative Trading System (“ATS”) (the “OTC Link ATS”).

OTC Markets Group respectfully submits the following comments on the proposal by FINRA to adopt Rules 6183 and 6625 (the “Proposed Rules”).<sup>1</sup> The Proposed Rules would give the FINRA staff the authority to exempt from FINRA’s equity trade reporting obligations any ATS that meets the criteria specified in the Proposed Rules.

### Introduction

OTC Markets Group generally agrees with the basic premise underlying the Proposed Rules - that an ATS that meets the specified criteria should not be the party obligated to report transactions effected by other FINRA members through systems provided by the ATS. We believe the Proposed Rules are unnecessary because they propose to grant the FINRA staff the authority to exempt broker-dealers from FINRA rules that do not apply to such broker-dealers in the first instance. Under current FINRA rules and guidance, trade reporting obligations apply to the FINRA member firm that meets the FINRA definition of an “executing party.” Any ATS qualifying for the exemption under

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<sup>1</sup> See Exchange Act Rel. No. 65388, File No. SR-FINRA-2011-051, September 23, 2011 (the “Notice”).

the Proposed Rules would not meet the definition of an “executing party” under current FINRA rules, and thus does not need an exemption from the trade reporting obligations.

The Proposed Rules therefore contradict current FINRA rules and guidance, are unnecessary, and should not be approved. If, despite our objection, the Commission determines to approve the Proposed Rules, certain modifications should be made prior to approval, as follows and as more fully-discussed below: (i) expand the Proposed Rules to include securities eligible for FINRA’s Trade Reporting and Compliance Engine (“TRACE-Eligible Securities”), (ii) clarify the meaning and applicability of the Proposed Rules in certain areas, and (iii) make the exemption provided by the Proposed Rules automatic upon an ATS showing that it meets the criteria of the Proposed Rules, not subject to the FINRA staff’s discretion.

### **The Proposed Rules Contradict Current FINRA Rules and Guidance and Should not be Approved**

The Proposed Rules would enable the FINRA staff to exempt an ATS from the trade reporting obligations applicable to “executing parties” in NMS, OTC and restricted stocks. Specifically, the Proposed Rules would give the FINRA staff express exemptive authority relative to the trade reporting obligations under paragraph (b) of each of FINRA Rules 6282, 6380A, 6380B and 6622 (the “Trade Reporting Rules”).

Paragraph (b) of each of the Trade Reporting Rules indicates that “[i]n transactions between two members, the executing party shall report the trade,” and goes on to define “executing party” as “the member that receives an order for handling or execution or is presented an order against its quote, does not subsequently re-route the order, and executes the transaction.” Under that definition, an entity that has not received an order for handling or execution and has not been presented with an order against its quote is not an “executing party” and therefore does not have trade reporting responsibilities. Similarly, even if a broker-dealer receives an order for handling or execution, it will not be an “executing party” if it re-routes the order to another broker-dealer or otherwise does not execute the transaction.

Under the Proposed Rules, the FINRA staff would have the authority to grant an exemption from the Trade Reporting Rules to any member ATS on which:

- (1) Trades are between FINRA member subscribers to the ATS;
- (2) Subscribers are fully disclosed to one another at all times;
- (3) Automatic execution is not permitted, and subscribers are required to take affirmative steps beyond the submission of an order to agree to a trade;

- (4) Trades do not pass through any ATS account and the ATS does not hold itself out to be a party to the trade;
- (5) The ATS does not exchange shares or funds on behalf of member subscribers, take either side of the trade for clearing or settlement purposes, or in any way insert itself into the trade; and
- (6) The ATS and its subscribers agree in writing that the ATS shall not be deemed a party to the trade for purposes of trade reporting, and that trades shall be reported by the member subscriber that, as between the two member subscribers, would satisfy the definition of “executing party” under the FINRA trade reporting rules.<sup>2</sup>

We agree with FINRA that any ATS that meets these criteria should not be required to report transactions, because we believe any ATS that meets these criteria does not meet the definition of “executing party” in the Trade Reporting Rules. The Proposed Rules, however, clearly indicate that an ATS that meets these criteria would be the “executing party” required to report trades absent the FINRA staff using its discretion to grant an exemption. As such, the Proposed Rules conflict with the definition of “executing party” in the Trade Reporting Rules. There are several reasons why an ATS that meets the criteria specified in the Proposed Rules would not meet the definition of “executing party,” and therefore would not be subject to, or need an exemption from, the Trade Reporting Rules:

- An ATS eligible for an exemption under the Proposed Rules would not “receive an order for handling or execution” within the meaning of the definition of “executing party,” because the Proposed Rules require subscribers to the ATS to deal directly with each other by taking affirmative steps beyond the submission of an order to the ATS to complete a trade. Any order sent by a subscriber to the ATS would be directed to and received by another subscriber. The ATS is not being asked to handle or execute the order.
- An ATS eligible for an exemption under the Proposed Rules would not be “presented with an order against its quote” within the meaning of the definition of “executing party,” because the ATS would not be permitted to publish any quotes for its own account or act as a party to a trade in any way.
- If an ATS meets the criteria specified in the Proposed Rules, it could not be executing any transactions within the meaning of the definition of “executing party” because the “subscribers are required to take affirmative steps beyond the

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<sup>2</sup> The Proposed Rules also would require an ATS to agree to provide monthly data relating to the volume of trades by security executed by the ATS’s member subscribers using the ATS’s system.

submission of an order to agree to a trade.” If the subscribers are agreeing to the trade, the ATS cannot be the entity executing the trade.

In addition to the definition of “executing party” in the Trade Reporting Rules, existing FINRA guidance also supports our view that an ATS meeting the criteria specified in the Proposed Rules would not be the executing party responsible for trade reporting, further illustrating why the Proposed Rules are unnecessary. FINRA Trade Reporting FAQ 203.1<sup>3</sup> notes that “[i]f an ATS routes an order to another member firm for handling and/or execution, then the ATS would not be the executing party and would not have the reporting obligation.” An ATS meeting the criteria of the Proposed Rules (specifically, the criteria that “Trades are between FINRA member subscribers to the ATS” and that “subscribers are required to take affirmative steps beyond the submission of an order to agree to a trade”) must, by necessity, be passing (routing) to another FINRA member for handling or execution.

Similarly, FINRA Trade Reporting FAQ 201.1<sup>4</sup> posits that FINRA member BD1 uses FINRA member BD2 to route orders to FINRA member BD3. BD3 receives and executes the order. In this example, BD2 has no discretion over where BD1’s order goes; it just provides the routing mechanism. FAQ 201.1 states that in this circumstance, BD1 and BD3 have the trade reporting responsibilities, as BD3 should view the order as coming from BD1. This guidance clearly supports the view that an ATS meeting the criteria of the Proposed Rules would fit into the role of BD2 in FAQ 201.1, and therefore would not have trade reporting responsibility and not need the exemption available under the Proposed Rules. While the Notice states that an ATS is the “executing party” where the transaction is executed on the ATS, the guidance in FAQs 307 and 308<sup>5</sup> spells out that a FINRA member (including an ATS) is the “executing party” only where it matches orders. An ATS that meets the criteria in the Proposed Rules does not match or otherwise execute, and therefore is not an “executing party” under the Trade Reporting Rules.

For all these reasons, we believe an ATS that meets the criteria for an exemption under the Proposed Rules is clearly not an “executing party.” It follows that there is no reason to exempt such an ATS from trade reporting obligations that only apply to an “executing party.” Thus, the Proposed Rules create a contradiction with existing FINRA Rules and guidance.

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<sup>3</sup> Available at <http://www.finra.org/Industry/Regulation/Guidance/p038942#203>

<sup>4</sup> Available at <http://www.finra.org/Industry/Regulation/Guidance/p038942#201>

<sup>5</sup> Available at <http://www.finra.org/Industry/Regulation/Guidance/P038942>

To the extent the Commission is inclined to approve the Proposed Rules despite the contradiction with existing FINRA rules, certain modifications should be required, as discussed below.

### **The Proposed Rules Should be Expanded to Include TRACE-Eligible Securities**

The Proposed Rules as written would permit the FINRA staff to exempt a qualifying ATS from trade reporting obligations only for trades in NMS, OTC and restricted equity securities. The Proposed Rules do not apply to TRACE-eligible securities; however, FINRA's rules mandate trade reporting obligations for member firms that trade such securities. The Notice states that the Proposed Rules do not apply to TRACE-eligible securities or impact the reporting rules applicable to transactions in TRACE-eligible securities;<sup>6</sup> however, FINRA does not explain why TRACE-eligible securities should be treated differently. We see no reason to exclude TRACE trade reporting responsibilities from the Proposed Rules.

FINRA Rule 6730 requires any member that is a "Party to a Transaction" in a TRACE eligible security to report the transaction to the TRACE system. FINRA Rule 6710 defines a "Party to a Transaction" as "an introducing broker-dealer . . . executing broker-dealer, or a customer." For the reasons noted above, an ATS that meets the criteria set forth in the Proposed Rules cannot be considered "executing" for purposes of NMS or OTC trade reporting, and it follows that such an ATS should not be deemed the "executing broker-dealer" for purposes of TRACE reporting. Therefore, unless FINRA can provide adequate justification, FINRA should similarly exempt an ATS from trade reporting responsibility relative to TRACE-eligible securities under the same criteria specified in the Proposed Rules.

### **Clarification of the Proposed Rules**

#### *Section 2(D) of each of the Proposed Rules*

Section 2(D) of each of the Proposed Rules states that to qualify for the exemption an ATS must demonstrate that it "does not exchange shares or funds on behalf of the member subscribers . . ." The Proposed Rules address only trade reporting obligations, and the criteria for exemption set forth in the Proposed Rules would ensure that an exempted ATS would have no part in the execution, clearance or settlement of any trades. The reference to an exchange of funds, therefore, should be clarified to note that it relates only to funds transferred in settlement of a trade. The Proposed Rules

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<sup>6</sup> See Notice at footnote 3.

should not prohibit an ATS from charging, collecting, or paying any fees to or from its subscribers other than directly as part of the settlement of a transaction.

### *Section 2(B) of each of the Proposed Rules*

Section 2(B) of each of the Proposed Rules states that to qualify for the exemption an ATS must demonstrate that “a member subscriber must take affirmative steps beyond the submission of an order to agree to a trade with another member subscriber.” This language should be revised to make clear what constitutes an “affirmative step” and “the submission of an order.” As an interdealer quotation and messaging system, the OTC Link ATS will not follow the traditional order entry model.

For example, a simple transaction on the OTC Link ATS would take place as follows:

- 1) Subscriber A publishes a quote on the OTC Link system;
- 2) Subscriber B views the quote and sends an electronic trade message directed to Subscriber A; and
- 3) upon receipt of the trade message, Subscriber A agrees to execute the trade, and sends a trade message to Subscriber B to confirm acceptance of the trade.

In this example, Subscriber A has published a quote, and prior to executing the trade has taken an additional affirmative step by actively agreeing to the trade based on the trade message from Subscriber B. It seems without question that the actions by Subscriber A comply with the language in Section 2(B) of the Proposed Rules.

Subscriber B has taken an affirmative action by viewing Subscriber A’s quote and sending a directed trade message to Subscriber A. In keeping with the expressed intent of the Proposed Rules to ensure that the ATS is not providing automatic execution or matching services, Subscriber B is not obligated to agree to a trade based solely on the submission of a quote. Instead, Subscriber B determines to act upon Subscriber A’s quote, and must then take the affirmative step of sending a directed trade message to Subscriber A.

The language in Section 2(B) of each of the Proposed Rules should be revised to indicate that a subscriber sending a directed trade message in response to a published quote has taken an appropriate affirmative step under the Proposed Rules. Changing the word “order” in Section 2(B) to the word “quote” would be more precise and reduce the possibility of an unintended interpretation of the Proposed Rules.

## *The Exemption in the Proposed Rules Should Be Automatic, Not Subject to the FINRA Staff's Discretion*

The Proposed Rules, in pertinent part, state that "... the staff for good cause shown after taking into consideration all relevant factors, may exempt ...". We believe the Proposed Rules should not give the FINRA staff discretionary authority to grant an exemption. Rather, any exemption provided by the Proposed Rules should be automatically granted to any ATS that meets the criteria specified in the Rules. The Proposed Rules are clear as to the applicable criteria for an exemption, so there is no need for FINRA to have discretion. FINRA also has not explained the "relevant factors" that its staff would use to assess whether to grant an exemption. Permitting the FINRA staff such discretion without standards permits for an uneven application of the Proposed Rules.

### **Conclusion**

OTC Markets Group agrees with FINRA that an ATS that meets the criteria specified in the Proposed Rules should not have trade reporting responsibility. However, we also believe that existing FINRA rules and guidance are clear that such an ATS already would not be required to trade report. The Proposed Rules actually create a conflict with existing FINRA rules by suggesting an ATS that does not meet the definition of "executing party" needs to be exempted from trade reporting responsibility. The Proposed Rules are therefore unnecessary and should not be approved by the Commission.

In the event that the Proposed Rules are approved despite the issues we have raised, they should incorporate several changes. First, the scope of the Proposed Rules should be expanded to include an exemption for the trade reporting obligations applicable to TRACE-eligible securities. Second, Section 2(D) of the Proposed Rules should make clear that an ATS is only prohibited from exchanging funds or securities on behalf of member subscribers directly as part of the purchase and sale of securities, and that an ATS may exchange receive, exchange, pay and charge funds for related services. Third, Section 2(B) should be revised to (i) state that "a member subscriber must take affirmative steps beyond the submission of a *quote* to agree to a trade with another member subscriber," and (ii) indicate that a directed trade message in response to a viewed quote is a qualifying "affirmative step" under the Proposed Rules. Fourth and finally, the exemption provided by the Proposed Rules should be automatic and not subject to the discretion of the FINRA staff.

Please contact me at (212) 896-4413 if you have any questions or would like to discuss this matter further.

Very truly yours,



Daniel Zinn  
General Counsel  
OTC Markets Group Inc.

cc: Hon. Mary Schapiro, Chairman  
Hon. Luis Aguilar, Commissioner  
Hon. Troy Paredes, Commissioner  
Hon. Elisse Walter, Commissioner  
Robert Cook, Director, Division of Trading and Markets