OTC Markets

November 10, 2011

VIA Electronic Submission

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

Re: **File No. SR-FINRA-2011-058; Release No. 34-65568**

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").

OTC Markets Group respectfully submits the following comments on the proposal by FINRA to amend FINRA Rule 6433 (the "Proposed Rule"). The Proposed Rule would reduce the minimum quotation size requirements for firm quotations entered into interdealer quotation systems and would expand the scope of the existing rule to apply to all quotations or orders entered into an interdealer quotation system, rather than only to quotations published by OTC Market Makers. As a practical matter, this would require quotations published in interdealer quotation systems by an ATS, and publications of customer interest by non-market maker brokers representing a customer order, to comply with minimum quotation size requirements.

OTC Markets Group supports expansion of Rule 6433 to include all quotations or orders published in interdealer quotation systems. We believe that the broader scope of the Proposed Rule would level the playing field among OTC market participants and foster competition, rather than favoring particular business models.

We strongly oppose the reduction of minimum quotation sizes contained in the Proposed Rule without any supporting economic analysis or study to indicate that such a move will improve liquidity or lower transaction costs for the majority of investors. We believe this part of the Proposed Rule has not been shown by FINRA to benefit investors and has a significant risk that it will degrade market quality. We strongly refute FINRA's dogmatic reasoning that all NMS-principled rules – developed to govern trading in the largest issuers – should be applied to the OTC market, where small, development stage companies often trade. FINRA has provided no compelling evidence to bolster its argument in favor of instituting NMS rules in the OTC market. Recently, prominent commentators have persuasively argued in the press that NMS rules cause severe harm to the trading markets for smaller companies.[1] There have also been distinguished academics recommending higher minimum increments in less liquid securities.[2]

In fact, academic studies have shown that NMS-type rules are harmful when applied to smaller companies. A study of tick sizes in relation to NYSE and NASDAQ trading concluded that, "[f]or the majority of less active stocks, however, the move to smaller price increments did not reduce average trading costs. We show that the optimal tick size may vary across markets and across stocks within a market as a function of trade price, trading volume, volatility, and the like. Thus, any discussions of optimal tick sizes must take into account both market features and stock characteristics."[3] FINRA has provided no comparable academic research supporting the Proposed Rule.

Moreover, we believe FINRA's simplistic statistical analysis relating to the Proposed Rules is flawed, and further study is necessary to determine whether minimum quotation sizes should be modified. Among other things, additional study should consider the merits of increased minimum quotation sizes and tick sizes, as well as reductions.

FINRA's primary objective in reducing minimum quotation sizes is to facilitate the publication of customer limit orders in interdealer quotation systems. FINRA's analysis regarding a sample of data submitted into the Order Audit Trail System (OATS) indicates that only 50% of customer limit orders currently satisfy the minimum quotation sizes specified in Rule 6433, as compared to over 90% of customer limit orders under the Proposed Rule. OTC Markets Group does not have access to the data contained in OATS, but we believe FINRA's simplistic analysis is flawed on its face.

The analysis ignores FINRA's own rules, under which a market maker that receives customer limit orders is required to aggregate those orders for purposes of the limit order display rule. If the orders, as aggregated, would satisfy the minimum quotation requirements of Rule 6433 for a security, the market maker must publish the aggregated orders in any interdealer quotation system in which it is publishing quotations for that security. FINRA's simplistic analysis fails to take account of the aggregation requirement, and as a result the statistics it cites in support of the Proposed Rule are grossly inaccurate.

OTC Markets Group believes that the effect of aggregation makes the number of customer limit orders not displayed under current Rule 6433 significantly smaller than FINRA states. When taking into account the dollar volume represented by the limit

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[1] See David Weild, *How to Revive Small-Cap IPOs*, Wall St. J., October 27, 2011.
[2] See William G. Christie, *A Minimum Increment Solution*, Trader Magazine, October 2003 http://www.tradersmagazine.com/issues/20031031/1743-1.html?pg=1
[3] W. Christie, J. Harris and E. Kandel, "Tick Size, Market Structure, and Trading Costs," *Stock Market Liquidity*, Chapter 10, 2008.

orders that fall below current tier size, the number likely drops significantly further. We believe the percentage of limit orders displayed under current Rules are already in line with the percentage of limit orders FINRA estimates would be published under the Proposed Rule.

What is clear is that the change in quotation sizes will reduce the minimum size shown in some tiers by 80% when a market maker is displaying a proprietary quote. FINRA must address how this decrease in displayed liquidity may substantially increase effective spreads and transaction costs for all investors.

Accordingly, OTC Markets Group respectfully requests that the Office of Economic Analysis of Securities and Exchange Commission (the "Commission") conduct a thorough review of the actual effect of the Proposed Rule on the display of customer limit orders. OTC Markets Group firmly believes that the Proposed Rule would, at most, have a negligible effect on the display of customer limit orders in OTC Equity Securities. However, the Proposed Rule could have an extremely negative effect on market quality.

It is our experience that many quotations are submitted at minimum quotation sizes, even if the actual liquidity available is larger than the minimum. So, the immediate effect of the Proposed Rule will be less displayed liquidity. Since displayed liquidity under the Proposed Rule will not represent actual order sizes, there could be more volatility. Less liquidity at the inside can also have the effect of increasing realized spreads, as orders will ultimately be filled away from the inside quote value. This raises the true cost of trading. More executions will be required to fill the same amount of orders.

For many years, OTC Markets Group has urged FINRA to undertake a study of minimum quotation sizes and tick sizes, and we have reviewed independent studies and conducted our own, with a view to determining sizes that maximize market quality.[4] We believe that there is much more to market quality than whether or not a given percentage of customer limit orders satisfies display requirements. Instead, market quality and the resulting benefits to investors are maximized by policies that balance the competing goals of increased displayed size, and therefore increasing liquidity for larger orders, while not artificially widening spreads. The minimum quotation sizes in the Proposed Rule fail this test.

We believe that FINRA's current analysis is inadequate, indicates a lack of understanding of different market structures, and fails to address whether the Proposed Rule would benefit investors or improve capital formation. One size fits all is not always the answer when the goal is proper market structure and efficient capital formation.

We urge the Commission to reject the Proposed Rule and have the Commission's Office of Economic Analysis study this issue further to determine the appropriate

[4] Bollen, N., and W. Christie. "Microstructure of the Pink Sheets Market" (2006). A copy of this study has been included in our electronic submission with these comments.

minimum quotation sizes and ticks that would maximize market quality. We also intend to submit additional information and analysis for the Commission's review within the next week.

Please contact me if you have any questions or require any additional information.

Very truly yours,

Daniel Zinn
General Counsel
OTC Markets Group Inc.

CC: Hon. Mary Schapiro, Chairman
Hon. Luis Aquilar, Commissioner
Hon. Daniel Gallagher, Commissioner
Hon. Troy Paredes, Commissioner
Hon. Elisse Walter, Commissioner

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Bollen, Nicholas P.B., and William G. Christie. "Microstructure of the Pink Sheets Market." Vanderbilt University, 16 Nov. 2005. Web. 14 Nov. 2011. <http://www.owen.vanderbilt.edu/vanderbilt/data/research/1650full.pdf>