



Financial Industry Regulatory Authority

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

Re: File No. SR-FINRA-2013-031 (Proposed Rule Change Relating to Participation on the Alternative Display Facility) – Response to Comments

Dear Ms. Murphy:

This letter is being submitted by Financial Industry Regulatory Authority, Inc. (“FINRA”) in response to comments submitted to the U.S. Securities and Exchange Commission (“SEC” or “Commission”) regarding the above-referenced rule filing (“Proposal”).¹

FINRA proposes to amend the requirements for members seeking registration as FINRA Alternative Display Facility (“ADF”) Market Participants in light of the migration of the ADF to the Multi Product Platform (“MPP”) (“ADF migration”). The Proposal, among other things, would require that a potential ADF Market Participant submit an ADF Deposit Amount of \$250,000, or \$500,000 if requesting accelerated ADF migration. The potential ADF Market Participant can earn back some or all of the ADF Deposit Amount through a credit structure based on the market data revenue associated with the member’s trade reporting activity on the ADF and the ADF Market Participant submits at least 75% of both its quote and trade volume to the ADF.

The Commission received one comment letter on the Proposal from the National Stock Exchange, Inc. (“NSX”),² to which FINRA responded.³ After

¹ See Securities Exchange Act Release No. 70048 (July 26, 2013), 78 FR 4652 (August 1, 2013) (SR-FINRA-2013-031).

² See Letter to Elizabeth M. Murphy, Secretary, Commission, from David Harris, Chairman and CEO, NSX, dated September 9, 2013 (“NSX letter”).

³ See Letter to Elizabeth M. Murphy, Secretary, Commission, from Stephanie M. Dumont, Senior Vice President and Director of Capital Markets Policy, dated October 25, 2013 (“FINRA response letter”).

extending the time in which it was required to act on the Proposal,⁴ the Commission instituted proceedings to determine whether to approve or disapprove the Proposal.⁵ As part of those proceedings, the Commission solicited additional comments on the Proposal, and NSX submitted a second comment letter.⁶

In its initial submission, NSX opposed the Proposal and argued that (1) FINRA has not demonstrated that the proposed ADF Deposit Amount and the accompanying credit provisions are reasonable and equitably allocated; and (2) the proposed ADF Deposit Amount and accompanying credit provisions, particularly the proposed 75% quoting requirement, impose a burden on competition that is not necessary or appropriate and may inappropriately impede competition among market participants. In its supplemental letter, NSX raises the same arguments.

FINRA disagrees with the substance of the NSX supplemental letter and believes that NSX does not raise any new issues in its submission. For that reason, FINRA re-iterates the substance of its initial response as to why it believes that all aspects of the Proposal are consistent with the requirements of the Act. Nonetheless, FINRA will briefly respond to the issues raised by NSX in its supplemental letter.

1. The Proposed ADF Deposit Amount and Credit Provisions Do Not Pose any Burdens on Competition That are Not Necessary or Appropriate

NSX claims that FINRA is subsidizing the operation of the ADF, if not operating it at a loss, and that such a subsidy imposes a burden on competition both with respect to other ADF Market Participants and with respect to other market participants such as other self-regulatory organizations (“SROs”). NSX also asserts that the obligation for ADF Market Participants to send 75% of their quotes and trades to FINRA in order to potentially earn back their Deposit Amount is an unprecedented burden on competition for any SRO that is seeking to offer quote display for electronic communications networks (“ECNs”) and that other SROs, including NSX, may not be able to compete with the ADF if a large ECN opted to switch to the ADF. NSX states that, if it ceased to offer order delivery functionality, current and future ECNs would have little choice but to become ADF Market Participants.

NSX’s vague assertion that FINRA is either subsidizing the operation of the ADF or operating it at a loss, and that this creates an unfair competitive advantage

⁴ See Securities Exchange Act Release No. 70358, 78 FR 56967 (September 16, 2013).

⁵ See Securities Exchange Act Release No. 70776 (October 30, 2013), 78 FR 66405 (November 5, 2013).

⁶ See Letter to Elizabeth M. Murphy, Secretary, Commission, from David Harris, Chairman and CEO, NSX, dated November 26, 2013 (“NSX supplemental letter”).

against exchanges that attempt to offer order delivery alternatives to the ADF, is both inapplicable and misleading. A primary purpose of the Proposal is to enable FINRA to recoup, through the ADF Deposit Amount, the expenses that it incurs in connection with the addition of a new ADF Market Participant and the ADF Migration. Thus, the Proposal is intended to *avoid* the need for FINRA to subsidize all of the costs associated with the ADF Migration and the addition of new ADF Market Participants. While NSX makes general references to “subsidized pricing” and FINRA’s cost of operating the ADF, it does not attempt to explain how the imposition of ADF Deposit Amount, which primarily relates to the MPP Migration and a new ADF Market Participant and not to future ongoing ADF operations, actually constitutes subsidized pricing.

NSX also argues that the ADF Deposit Amount, when considered together with the 75% quoting provision, may negatively impact competition because an ADF Market Participant “would be compelled to send a substantial portion of its quotes and trades to the ADF or it would suffer a significant financial penalty.” According to NSX, the cost of regulating and operating an SRO that provides order delivery functionality for ECNs is such that, if FINRA were to attract one or two large ECNs to the ADF, it would be unlikely that other SROs would be able to compete with the ADF for ECN transaction services.

As FINRA has previously stated, the proposed ADF Deposit Amount is designed to reasonably and equitably allow FINRA to recoup costs related to the ADF migration and the addition of a new ADF Market Participant. Additionally, the 75% quoting and trade reporting provision is voluntary and is narrowly linked to the ability of the ADF Market Participant to earn back some or all of its ADF Deposit Amount. As such, FINRA believes that the Proposal is designed to provide incentives for an ADF Market Participant to quote and trade report on the ADF and utilize the ADF capacity that FINRA has incurred costs to provide, thereby increasing the probability that FINRA will recoup a reasonable amount of the costs involved with launching a new ADF Market Participant, and, as noted above, reducing the likelihood of any subsidization by FINRA in that regard. FINRA thus believes that the Proposal meets the standards of both Section 11A and Section 15A(b)(9) of the Act,⁷ in that it does not impose a burden on competition that is not necessary or appropriate, and that it continues to assure fair competition among market participants.

⁷ Section 15A(b)(9) requires that FINRA’s rules do not “impose any burden on competition not necessary or appropriate in furtherance of the purposes” of the Act. See 15 U.S.C. 78o-3(b)(9). Section 11A(a)(1)(C)(ii) states that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets “to assure fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets.” See 15 U.S.C. 78k-1(a)(1)(C)(ii).

As noted above, NSX makes several speculative claims about the potential effects of the Proposal – for example, that the ADF would essentially dominate ECN transaction services and eliminate other SRO providers of such services if the ADF were able to attract just one or two large ECNs. Even if NSX were to substantiate these statements, it would not compel the conclusion that the Proposal somehow inappropriately impacts competition or is otherwise inconsistent with the Act. Rather, NSX seems to be suggesting that it is inconsistent with the Act for FINRA to be allowed to offer a viable alternative to SROs for ECN order delivery services, as this might adversely impact the business models of other SROs. FINRA believes that it is the rationale underpinning NSX’s objections, and not the Proposal itself, that seeks to place an inappropriate burden on competition.⁸

2. The Proposed ADF Deposit Amount and Credit Provisions are Reasonable and Equitable

NSX asserts that FINRA has failed to demonstrate that the proposed ADF Deposit Amount and accompanying credit provisions whereby an ADF Market Participant may earn back some or all of its ADF Deposit Amount are reasonable and equitably allocated, both with respect to ADF Market Participants and FINRA members that do not utilize the ADF. In order to properly evaluate the Proposal, NSX claims that FINRA should provide more specific information, including the percentage of total development costs that the ADF Deposit Amount represents, the basis for charging an ADF Deposit Amount that does not vary by that Participant’s overall quotation and trading volume, FINRA’s projected costs for operating the ADF, and transaction fees to be assessed ADF Market Participants.

FINRA has produced sufficient information to conclude that the ADF Deposit Amount is reasonable and equitable, and meets the standards of Section 15A(b)(5) of the Act.⁹ As stated in the Proposal, the purpose of the ADF Deposit Amount is to help

⁸ In the Regulation NMS adopting release, the Commission stated: “As a national securities association, [FINRA] is subject to different regulatory requirements than a national securities exchange. It is responsible for regulating the OTC market (i.e., trading by broker-dealers otherwise than on a national securities exchange) The Commission believes that market makers and ECNs should continue to have the option of operating in the OTC market, rather than on an exchange or The NASDAQ Market Center. As noted in the Commission’s order approving Nasdaq’s SuperMontage trading facility, this ability to operate in the ADF is an important competitive alternative to Nasdaq or exchange affiliation.” See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37542 (June 29, 2005) (S7-10-04).

⁹ Section 15A(b)(5) requires that FINRA’s rules “provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which [it] operates or controls.” See 15 U.S.C. 78o-3(b)(5).

FINRA defray the costs associated with a new ADF Market Participant, with a higher amount where ADF migration is accelerated. As previously stated, FINRA conservatively estimates that the cost of an accelerated ADF migration will be in excess of \$3 million. In light of the projected total costs for the ADF migration, FINRA believes that the ADF Deposit Amounts of \$500,000 for ADF Market Participants benefitting from accelerated migration and \$250,000 for other ADF Market Participants are reasonable, particularly given that these amounts (1) represent a portion of the costs FINRA will incur and (2) are recoverable in whole or in part by the ADF Market Participant. While NSX believes FINRA should be required to produce additional information to assess the reasonableness of the ADF Deposit Amount, FINRA does not believe that this is a reasonable request, or would yield useful information, as the information that NSX would have FINRA provide would be speculative in nature (e.g., FINRA cannot ascertain at this time how many ADF Market Participants will ultimately be assessed the ADF Deposit Amount or what their future ADF volume would be).

Furthermore, while NSX argues that the proposed ADF Deposit Amount does not take into account the ADF Market Participant's total quotation or trading volume, FINRA notes that a significant portion of the expenses associated with the ADF migration and adding a new ADF Market Participant are not dependent upon an ADF Market Participant's proposed capacity usage, but are rather fixed costs that do not vary by market participant. As such, FINRA believes that assessing the same ADF Deposit Amount among ADF Market Participants, depending upon whether the ADF Market Participant is requesting, or benefitting from, accelerated ADF migration, is both reasonable and equitable.¹⁰

NSX also asserts that it is not fair or equitable to FINRA members that do not use the ADF platform for FINRA to subsidize any losses associated with operating the ADF platform, or otherwise "comingle members' fees." FINRA reiterates that the core assumption behind the Proposal is that a member that is primarily responsible for the costs that FINRA must incur must assume responsibility for a larger proportion of those costs.¹¹ On this point, then, NSX and FINRA would actually appear to be in agreement. Ironically, should the Commission not approve the Proposal, as NSX lobbies for, the ADF Market Participant will be contributing less toward the costs associated with the ADF Migration and a new ADF Market Participant.

¹⁰ Further, once an ADF Market Participant begins quoting and trading through the ADF, separate quote and transaction fees apply, which do vary depending upon the level of activity. See FINRA Rule 7500 et seq.

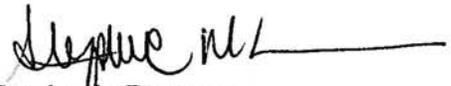
¹¹ As FINRA stated in the Proposal, "FINRA . . . believes that requiring individual members to ensure the recoupment of a portion of the specific costs FINRA incurs to accommodate their request to accelerate the migration of the ADF or use the ADF is a fair and equitable way to ensure that the members responsible for those costs are accountable should they not participate on the ADF to the extent anticipated."

Finally, FINRA disagrees with NSX's assertion that a proposal must include the development cost of a new product and its projected revenue, or a forecast of all future fees, including transaction fees, in order for the SEC to properly conclude that the proposal is consistent with the Act. FINRA reiterates that it is not aware of any such requirement in the Act, and if one did exist, it would be difficult, if not impossible, to comply with, particularly with respect to future fees, which must, themselves, be subject to a separate SEC rule filing. To the extent that FINRA may in the future propose changes to its quote and transaction fees that are applicable to ADF Market Participants, such changes will be made through a separate rule filing.¹²

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FINRA believes that the foregoing fully responds to the issues raised by the commenter to the rule filing. Please contact me at (██████████) or Brant Brown at (██████████) if you have any questions.

Very truly yours,



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¹² See FINRA Rule 7500 et seq.