OTC Markets

June 13, 2017

VIA Electronic Submission

Eduardo A. Aleman, Assistant Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **Proposed Rule Change to Adopt a Fee Schedule to Establish the Fees for Industry Members Related to the National Market System Plan Governing the Consolidated Audit Trail; File No. SR-FINRA-2017-011**

Dear Mr. Aleman:

OTC Markets Group Inc.[1] ("OTC Markets Group"), on behalf of its wholly owned subsidiary OTC Link LLC ("OTC Link ATS"), respectfully submits to the Securities and Exchange Commission (the "SEC") the following comments on the proposed fee schedule (the "CAT Fee Schedule") for the Consolidated Audit Trail (the "CAT"). OTC Link ATS is a FINRA member broker-dealer and SEC registered ATS that provides a network facilitating broker-dealer trading in OTCQX®, OTCQB®, OTC Pink® and other securities.

INTRODUCTION

OTC Markets Group strongly opposes the CAT Fee Schedule to the extent that it places OTC Link ATS in the first tier of Execution Venues along with markets for NMS securities. The placement of OTC Link ATS in the first tier of Execution Venues, and the treatment of Execution Venues for OTC Equity Securities and smaller alternative trading systems (ATS) generally,

[1] OTC Markets Group Inc. (OTCQX: OTCM) operates Open, Transparent and Connected financial marketplaces for 10,000 U.S. and global securities. Through our OTC Link® ATS, we directly link a diverse network of broker-dealers that provide liquidity and execution services for a wide spectrum of securities. We organize these securities into marketplaces to better inform investors of opportunities and risks – OTCQX®, The Best Marketplace with Qualified Companies; OTCQB®, The Venture Stage Marketplace with U.S. Reporting Companies; and OTC Pink®, The Open Marketplace with Variable Reporting Companies. Our data-driven platform enables investors to easily trade through the broker of their choice at the best possible price and empowers a broad range of companies to improve the quality and availability of information for their investors.

are unfair and anti-competitive. OTC Markets Group submits that a more equitable approach would align fees with the resource usage and costs associated with each Execution Venue. Specifically, such an approach would create separate tiers for Execution Venues that facilitate markets for OTC Equity Securities and Execution Venues that represent less than one percent of the market for NMS securities, and allocate costs that appropriately reflects their impact on the operation of the CAT.

OTC Markets Group urges the SEC to abrogate the CAT Fee Schedule and require it to be refiled in accordance with Rule 608(a)(1) and reviewed in accordance with Rule 608(b)(2) of Regulation NMS, because this action is necessary and appropriate in the public interest, for the protection of investors, for the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system, and to further the purposes of the Securities Exchange Act of 1934 (the "Exchange Act").

THE CAT PLAN OPERATING COMMITTEE ABUSED ITS DISCRETION

The CAT Fee Schedule was proposed pursuant to the CAT NMS Plan, which was approved by the SEC on November 15, 2016.[2] Under the CAT NMS Plan, the Operating Committee of CAT NMS, LLC (the "CAT Company") has discretion to establish funding to operate the CAT. Section 11.1 of the CAT NMS Plan provides that in establishing funding for the CAT Company, the Operating Committee will establish an allocation of the CAT Company's costs that "fairly and reasonably" shares such costs among Participants and Industry Members. The Operating Committee is obligated to take into account, among other things, distinctions in the securities trading operations of Participants and Industry Members and their relative impact upon the CAT Company's resources and operations. The CAT NMS Plan further provides that the Operating Committee will seek "to avoid any disincentives such as placing an inappropriate burden on competition and a reduction in market quality."

Section 11.3(a)(i) of the CAT NMS Plan further provides that fees charged to CAT Reporters that are Execution Venues, including ATSs, will be based on the level of market share. Market share, for purposes of the CAT NMS Plan, is calculated by share volume.

[2] SEC Release No. 34-79318, November 15, 2016 (the "CAT Plan Adopting Release").

If it had exercised its discretion properly, the Operating Committee would have determined that OTC Link ATS and other Execution Venues in the market for OTC Equity Securities, as well as many ATS that are fledgling NMS Execution Venues, would bear a small share of the costs of CAT.

Instead, the Operating Committee determined that OTC Link ATS was the *largest* Execution Venue, at 29.90%, for purposes of funding the CAT. The vastly larger Nasdaq Stock Market LLC was assigned the third rank, at 9.67%, followed by the also vastly larger New York Stock Exchange LLC, at 9.08%. OTC Link ATS was therefore unreasonably and unfairly placed in the first tier of Execution Venues, along with the giant NYSE and Nasdaq. The assignment of OTC Link ATS to the first tier of Execution Venues unfairly burdens the market for OTC Equity Securities, which is a competitor for investment capital with the markets operated by the Participants.

In 2016, the cash equity trading and clearing revenues of Intercontinental Exchange, Inc. ("ICE"), the owners of The New York Stock Exchange, LLC ("NYSE"), amounted to approximately $223 million. Nasdaq, Inc. ("Nasdaq"), the owner of The Nasdaq Stock Market (the "Nasdaq Market"), reported cash equity trading revenues less transaction based expenses of $255 million. ICE and Nasdaq operate a number of cash equity markets internationally, and neither of them separately discloses revenues from trading NMS Stocks on NYSE or the Nasdaq Market, but it is a safe assumption that trading in NMS Stocks comprises a large portion of these reported cash equity revenues. In contrast, OTC Link ATS reported revenues of $10.5 million in 2016. By any reasonable measure, the revenues of each of NYSE and Nasdaq derived from trading NMS Stocks are approximately 20 times greater than the revenues of OTC Link ATS derived from trading OTC Equity Securities. It follows that any fair allocation of the amount of CAT Company costs to OTC Link ATS would amount to no more than 5% of the amounts allocated to NYSE or Nasdaq.

The following chart illustrates the relative burden on estimated trading revenues from equity securities of the entities in the first tier:

Market Participant	Trading Revenues[3]	Tier
OTC LINK ATS	$10.5	1
FINRA	Unk	1
The NASDAQ Stock Market LLC	$201.4	1
The New York Stock Exchange LLC	$124.9	1
NYSE Arca, Inc.	$95.9	1
Bats EDGX Exchange, Inc.[4]	$90.8	1
Bats BZX Exchange, Inc.	$80.4	1
Bats BYX Exchange, Inc.	$57.1	1
NASDAQ BX, Inc.	$38.3	1
UBS ATS	Unk	1
Bats EDGA Exchange, Inc.	$31.13	1
Investors' Exchange, LLC	Unk	1
CROSSFINDER	Unk	1

HOW THE CAT NMS PLAN OPERATING COMMITTEE GOT IT WRONG

The members of the Operating Committee got it wrong by failing to consider, as they were obligated to do, the relative impact of the securities trading operations of OTC Link ATS on the CAT Company's resources and operations. Reportable message traffic is the key component of the costs of operating the CAT.[5] In turn, message traffic is correlated with the number of trades. The number of trades in the OTC markets is relatively small and, *as noted by the SEC, inclusion of OTC Equity Securities in the CAT NMS Plan is "unlikely to represent [a] major contribution . . . to the overall costs of the Plan*."[6] Yet, somehow, OTC Equity Securities ended up bearing an unreasonably large share of the costs of the Plan. An appropriate exercise of discretion would have allocated fees based on actual processing and usage costs, resulting in an allocation of a relatively low share of the costs to OTC Link ATS, other Execution Venues for OTC Equity Securities, and Execution Venues representing less than one

[3] Trading revenues for entities other than OTC LINK ATS are estimated from publicly available sources. Amounts shown are in millions of dollars.
[4] BATS information is drawn from 2015 financial information because BATS was acquired by CBOE in February 2017. The data represents U.S. cash equity trading revenues less the costs of revenues.
[5] See CAT Plan Adopting Release, 405.
[6] See SEC Release No. 34-77724, Apr. 27, 2016 (the "CAT Plan Proposing Release"), 486. See also, Id., n. 978 ("Because of low trading activity in the OTC equity markets, any significant costs associated with including OTC Equity Securities would be in implementation costs.")

percent of NMS market share (primarily lower volume ATS), rather than requiring them to bear the same costs as high impact users, such as the NASDAQ Stock Market, The New York Stock Exchange, and the Bats Group, which are prominent Execution Venues for NMS Stocks.

The Plan required the Operating Committee to avoid placing an inappropriate burden on competition. Instead of meeting this obligation, the Operating Committee abused its discretion by placing OTC Link ATS in the same tier of CAT fees as the behemoth trading operations represented by NYSE and the Nasdaq Market, placing a much higher burden on the modest trading revenues of OTC Link ATS than that borne by the trading revenues of Execution Venues for NMS Stocks.

To the extent that OTC Link ATS and other smaller Execution Venues attempt to recover those costs from their users, the Operating Committee will have exacerbated a difficult market environment. For example, the number of broker-dealers operating in the markets for OTC Equity Securities has been in significant decline for a number of years, reflecting the difficult economic environment for liquidity providers of OTC Equity Securities. In placing a disproportionate burden for CAT fees on OTC Link ATS, the principal market for trading OTC Equity Securities, the Operating Committee - through ATS subscription costs and direct broker-dealer CAT fees based on share volume - placed a disproportionately large cost burden on the broker-dealers that trade lower priced securities and on investors in that market.

The Operating Committee's failure to take into account the disconnect between costs to the CAT system and the burden being placed on OTC Link ATS, as well as the unfair burden being placed on the OTC Equity Securities market generally, likely can be explained by considering the make-up of the Operating Committee. The Members of the CAT Company (the "Participants"), which is governed by the National Market System Plan that excludes OTC Link ATS and other ATS, consist of national securities exchanges, except for FINRA, a national securities association. The members of the Operating Committee are representatives of the Participants. All the Participants operate Execution Venues for NMS stocks, except for FINRA, which has one vote on the Operating Committee, and NYSE ARCA, which is represented, along with two much larger affiliated entities, as part of the NYSE Group. Although FINRA operates an Execution Venue for OTC Equity Securities, FINRA primarily represents the interests of broker-dealers on the Operating Committee.[7] The interest of the NYSE Group in OTC Equity Securities is limited due to the Group's much more significant presence in the market for NMS Stocks. Therefore, the Operating Committee overwhelmingly consists of representatives of Participants that have a strong financial incentive to allocate the costs of CAT to ATS and the OTC equity markets, where they have few interests. Neither OTC Markets Group nor any other operator of an ATS is a Participant and there is no ATS representative to the CAT NMS Plan or on the Operating Committee.

The Operating Committee had no OTC equity market representation; however many of the Participants operate Options Execution Venues. With respect to the options market, the CAT NMS Plan clearly recognized that differing security types should be treated differently for purposes of allocating CAT costs. Had the Operating Committee also considered the relative impact on the CAT Company's resources and operations of the securities trading operations of Execution Venues for OTC equity securities and Execution Venues representing less than one percent of NMS equity market share, it may have avoided the CAT Fee Schedule's inequitable cost allocation proposal.

SHARE VOLUME IS THE WRONG METRIC FOR CALCULATING MARKET SHARE

Share volume is an inappropriate method for determining market share, because the costs of operating the CAT are not correlated with the number of shares traded in any particular Execution Venue. Instead, CAT's costs are impacted by the number of orders and executions. An order for 10,000 shares generally is no more costly for the CAT to process than an order for 100 shares or 1,000 shares. Moreover, the fees charged by Execution Venues, and their corresponding revenues, are not related to the number of shares traded, but are based on quote traffic and related message counts, securities positions, and executions. The fees charged for executing an order for 100 shares are equivalent to the fees charged for executing an order for 1,000 shares or 10,000 shares.

[7] See CAT Plan Proposing Release, 637-38.

It is not economically feasible to trade 100 shares of a low-priced stock because the costs of execution will be greater than the amount of the trade. As a result, low priced shares tend to trade in larger quantities.

Many OTC Equity Securities are priced at less than one dollar and a significant number at less than one penny. OTC Link ATS' records indicate that 92.75% of share volume during the first quarter of 2017 represented trades in stock priced at less than one cent. However, this share volume was accomplished through only 14.95% of all trades. In contrast, stocks priced at one dollar or greater represented 0.42% of share volume, but 55.44% of trading volume.[8] This leads to a flawed share volume metric due to the disproportionately large number of shares being traded on the OTC equity market as compared to the NMS market, while the cost for the CAT to process each transaction is unrelated to the number of shares being traded.

In contrast, very few NMS Stocks trade at prices less than one dollar per share, and there are proportionally many more executions of 100 share orders in the markets for NMS Stocks, as compared to OTC Equity Securities. The market for NMS Stocks is highly automated, resulting in many more quote updates and order cancellations, therefore imposing a greater burden on the operations of the CAT, than in the less-automated markets for OTC Equity Securities.

As a result, share volumes on the markets for NMS Stocks and OTC Equity Securities are not generally comparable, either in terms of market share for Execution Venues or on the relative impact of their trading on CAT costs.

A better metric for measuring market share would be number of trades, as this would better align the costs of operating CAT with the fees charged to Exchange Venues and Industry Participants.[9] Alternatively, dollar volume

[8] The total number of shares traded on OTC Link ATS during the first quarter of 2017 amounted to 281,021,674,277. The total number of trades in the same period amounted to 2,994,136, and the dollar amount of all trades was $12,909,004,991. During the first quarter of 2017, there were 447,593 trades representing 260,639,545,832 shares for a total amount of $240,089,285 of stock priced at less than one penny; 886,658 trades representing 19,194,227,602 shares for a total amount of $1,336,047,616 of stock priced between one penny and less than one dollar; and 1,659,885 trades representing 1,187,900,843 shares for a total amount of $11,332,868,090 of stock priced at or greater than one dollar.

[9] The total number of quotes, orders and trade executions, which would be roughly equivalent to messages, would also be a better measure than share volume for impact on CAT costs. If available, the total number of "unique events," a metric that would include quote updates, would be the best method of determining market share, as these "unique events" directly impact the costs of operating CAT.

would be a better measure of market share than share volume, when comparing the market for NMS Stocks with the market of OTC Equity Securities, as dollar volume tends to correlate with trading volume.[10]

THE OPERATING COMMITTEE ABUSED ITS DISCRETION BY PLACING LARGE EXECUTION VENUES FOR NMS STOCKS IN THE SAME TIER AS EXECUTION VENUES FOR OTC EQUITY SECURITIES

The Operating Committee was obliged by the terms of the CAT Plan to allocate fees to Exchange Venues by market share, and to calculate market share by reference to share volume. Nonetheless, the Operating Committee had the discretion to determine the number of tiers in which Exchange Venues could be placed, up to five. Nothing prevented the Operating Committee from assigning venues for OTC Equity Securities and smaller ATS trading NMS securities to their own distinct tier or tiers, and nothing prevented the Operating Committee from using a metric other than share volume to determine the portion of costs allocated to such tiers.

It was therefore wrong, and an abuse of discretion by the Operating Committee, to combine large Execution Venues for NMS Stocks and Execution Venues for OTC Equity Securities in the same tiers, and to use share volume to allocate the costs of implementing and operating CAT to these combined tiers. For purposes of aligning the costs of operating CAT with the fees charged to Execution Venues, Large Execution Venues for NMS Stocks are not equivalent to Execution Venues for OTC Equity Securities.

We believe that the Operating Committee should have placed OTC Equity Securities in different tiers from large Execution Venues for NMS Stocks, and allocated a portion of costs to those tiers based on number of trades (or, if available, the sum of orders, quotes and trades), such that the tiers more directly align with CAT usage and costs. We believe that this information was readily available to the Operating Committee. Alternatively, the Operating Committee could have allocated costs to tiers for OTC Equity Securities based on dollar volume. While dollar volume is not directly aligned with the costs of implementing and operating the CAT, dollar volume roughly correlates with trading volume and would provide a

[10] Allocation of CAT fees should also take into account the revenue generated by the national securities exchanges through the Securities Information Processor (SIP) Plans, of which OTC Link and other venues for OTC Equity Securities are not a part.

more equitable way of assigning costs to the tiers belonging to OTC Equity Securities than share volume. While imperfect, cost allocations within such a tier could be allocated according to share volume, as the CAT NMS Plan requires, without undue inequity.

We also note that smaller Execution Venues assigned to the second tier by the Operating Committee pay two-thirds of the fees allocated to the enormous NYSE or Nasdaq exchanges. This is inequitable and creates a barrier to competition. We submit that the Operating Committee abused its discretion by failing to create a tier composed of NMS Execution Venues that represented less than one percent of the market for NMS Stocks, based on trading volume, to avoid placing an inappropriate burden on competition. If it would be too complicated to create three or four tiers of Execution Venues, the Operating Committee ought to have created at least one additional tier composed of OTC Equity Securities and small ATS that execute less than one percent of NMS Stocks, and assigned that tier a small share of the costs, based on trading volume, that are assigned to all Execution Venues.

OTC Markets Group estimates that, based on trade volume or dollar volume, the share of OTC Link ATS in the combined market for NMS Stocks and OTC Equity Securities would be approximately 0.15%. OTC Markets further estimates that the total share of all Execution Venues that trade OTC Equity Securities in the combined markets for NMS Stocks and OTC Equity Securities based on trade volume would be approximately 0.5%. Since the Operating Committee was required to allocate costs "fairly and reasonably" among Participants and Industry Members, the Operating Committee should have, at a minimum, created separate tiers for the Execution Venues for OTC Equity Securities and allocated to such tiers approximately 0.5% of the total costs assigned to all Execution Venues. Alternatively, the Operating Committee ought to have created at least one additional tier composed of small ATS executing in the aggregate less than one percent of NMS Stocks, based on trade volume, and OTC Equity Securities, and allocated to such a tier approximately 1.5% of the total costs assigned to all Execution Venues.

CONCLUSION

The SEC noted in the CAT Plan Adopting Release that the SEC "lacked detailed information regarding some of the individual costs and discretionary decisions in the [CAT] Plan, including the Funding Model." This uncertainty naturally limited the SEC's ability to evaluate the economic effects of the [CAT] Plan.[11] The CAT Fee Schedule provides more illumination regarding these economic effects and shows that the Operating Committee has exercised its discretion inappropriately to allocate costs unfairly and unreasonably to the Execution Venues that trade OTC Equity Securities. This burden can be expected to increase, as smaller, marginal ATS discontinue operations due to the increased costs imposed by CAT, and the amount of fees previously paid by such Execution Venues is shifted to remaining Execution Venues. Smaller ATS trading NMS ceasing to exist will raise cost allocations without any related increase in business for OTC Equity Security Execution Venues.

The CAT Fee Schedule is effective upon filing with the SEC. However, the SEC may summarily abrogate the CAT Fee Schedule within 60 days of its filing and require that it be refiled in in accordance with Rule 608(a)(1) and reviewed in accordance with Rule 608(b)(2) of Regulation NMS, if it appears to the SEC that such action is necessary or appropriate in the public interest, for the protection of investors, or the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system or otherwise in furtherance of the purposes of the Exchange Act.[12]

The CAT Fee Schedule discriminates unfairly against Execution Venues for OTC Equity Securities, such as OTC Link ATS, by an allocation that bears no relationship to their impact on the costs of operating the CAT. Since the markets for OTC Equity Securities compete for investment capital with NMS Stocks, the unfair and unreasonable CAT Fee Schedule places an inappropriate burden on competition. In recent years, the number of broker-dealers offering execution services in OTC Equity Securities has declined due to economic pressure. The unfair burden of the CAT Fee Schedule, if not abrogated by the SEC, will cause additional broker-dealers to eliminate their participation in the OTC Equity Securities markets, resulting in an unnecessary and unfortunate decline in liquidity and market quality. The investment public will suffer from a reduction of investment opportunities, and smaller companies trading in the OTC market will find it increasingly difficult to raise investment capital.

[11] CAT Plan Adopting Release, 437-8.
[12] CAT Plan Proposing Release, 526.

OTC Markets Group urges the SEC to protect investors in the OTC equity markets and the public interest in capital formation by abrogating the unfair and disruptive CAT Fee Schedule and requiring it to be refiled. In addition, we ask that the SEC conduct an economic study on the impact of the CAT fees on Execution Venues and other market participants in order to fairly evaluate and allocate costs. OTC Markets Group would be happy to provide any of its data that the SEC may require in pursuing such a study.

We appreciate the opportunity to comment on the CAT Fee Schedule. Please contact me at ([redacted] or [redacted] with any questions.

Very truly yours,

Daniel Zinn
General Counsel
OTC Markets Group Inc.

cc: The Honorable Jay Clayton, Chairman
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner

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