FINANCIAL SERVICES INSTITUTE
VOICE OF INDEPENDENT BROKER-DEALERS AND INDEPENDENT FINANCIAL ADVISORS
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VIA ELECTRONIC MAIL

February 27, 2009

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

RE: FINRA Regulatory Notice 08-08: Best Execution

Dear Ms. Asquith:

On December 16, 2008, the Financial Industry Regulatory Authority, Inc. (FINRA) requested comment on a proposal relating to FINRA's rule on best execution and interpositioning (Proposed Rule).[1] Adoption of the Proposed Rule would result in the following amendments to the existing best execution requirements:

1. The adoption of a new provision providing that a member firm has met its best execution obligations regarding orders for foreign securities with no U.S. market if certain conditions are met;
2. The replacement of NASD Rule 2320(g) with Supplementary Material addressing a member firm's best execution obligations when handling orders for securities with limited quotation information;
3. The codification of a member firm's obligation to regularly and rigorously review execution quality; and
4. The adoption of Supplementary Material addressing a member firm's obligations when handling an order that the customer has instructed the firm to route to a particular market for execution.

The Financial Services Institute[2] (FSI) commends FINRA for seeking industry comment on the Proposed Rule prior to submitting it to the SEC. In general, we support the Proposed Rule as a reasonable effort to merge the existing requirements of NASD Rule 2320[3] and IM-2320[4] into the FINRA rulebook. In addition, we note that the Proposed Rule simplifies and clarifies best execution and interpositioning requirements in several specific instances. However, we believe FINRA should take advantage of the opportunity presented by the rulebook consolidation process to enhance broker-dealer understanding of and compliance with the Proposed Rule by simplifying its language in certain provisions. Our specific comments are provided below.

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[1] See the Proposed Rule and FINRA's request for comment in FINRA Regulatory Notice 08-80 at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117553.pdf.

[2] The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 116 Broker-Dealer member firms that have more than 142,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 12,000 Financial Advisor members.

[3] See NASD Rule 2320 at http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=4320&element_id=3643&highlight=2320#r4320.

[4] See NASD IM-2320 at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3644.

Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 98,000 independent financial advisors – or approximately 42.3% percent of all practicing registered representatives – operate in the IBD channel.[5] These financial advisors are self-employed independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[6] Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments

The following is a summary of FSI's specific comments on the Proposed Rule:

- Section 5310(d) – This subsection of the Proposed Rule incorporates the language of NASD Rule 2320(d) into the new rule. The subsection is intended to clarify the

[5] Cerulli Associates Quantitative Update: Advisor Metrics 2007, Exhibit 2.04. Please note that this figure represents a subset of independent contractor financial advisors. In fact, more than 142,000 financial advisors are affiliated with FSI member firms. Cerulli Associates categorizes the majority of these additional advisors as part of the bank or insurance channel.

[6] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.

application of the Proposed Rule's requirements in certain specific factual circumstances. We find the original subsection flawed in that its language fails to achieve the clarity and simplicity necessary for member firms to develop a reasonable degree of certainty that they are properly interpreting it. Therefore, we encourage FINRA to take advantage of the rulebook consolidation process to simplify the subsection's language by using clearly defined industry terms (e.g., clearing firm) throughout its provisions instead of the more complex and arcane descriptions (e.g., "third party pursuant to established correspondent relationships under which executions are confirmed directly to the member acting as agent for the customer") currently contained therein. We believe such changes will greatly enhance understanding of and compliance with the Proposed Rule's requirements.

- Supplementary Material .04 Best Execution and Executing Brokers –Supplementary Material .04 consists of modest edits to a portion of NASD IM-2320. The original Interpretative Memorandum was intended to offer clarification of a broker-dealers' best execution requirements in any transaction "for or with a customer of another broker-dealer". However, the original drafters were apparently unsatisfied with their first attempt to clarify the requirements and, therefore, attempted to clarify the clarification twice more (i.e., "Stated in another manner..." and "This clarification is intended to..."). Since the rulebook consolidation process provides an opportunity to improve member understanding of the Proposed Rule's requirements, we believe FINRA should take advantage by simplifying this unnecessarily complicated language in the Supplementary Material.
- Supplementary Material .08 Regular and Rigorous Review of Execution Quality – Subsection (c) of Supplementary Materials .08 provides guidance to introducing firms that route order flow to their clearing firm. This provision is of particular significance to FSI because the vast majority of IBD firms engage in this activity. We urge FINRA to eliminate the Supplementary Material's requirement that introducing firms periodically review the execution quality of orders placed through their clearing firm. Most IBD firms simply do not have sufficient expertise to perform a meaningful evaluation of their clearing firm's execution quality. As a result, the requirements of Supplementary Material .08 amount to a pro forma review process that establishes a regulatory hurdle without adding meaningfully to investor protection. Should FINRA choose to leave this requirement in place, we ask that they provide more guidance to introducing firms by establishing more specific review requirements. The Supplementary Material states that introducing firms can rely upon the clearing firm's "regular and rigorous review as long as the statistical results and rationale of the review are fully disclosed to the introducing firm and the introducing firm periodically reviews how the clearing or executing firm is conducting that review, as well as the results of that review." We urge FINRA to improve the rule by specifying the statistical results and rationale of review information that clearing firms must provide to introducing firms and the frequency with which such information must be reviewed by introducing firms.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to achieve additional clarity in the application of the best execution requirements.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,

Dale E. Brown, CAE
President & CEO

February 17, 2009

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Proposed FINRA Rule 5310

Dear Ms. Asquith:

There are two specific issues in the proposed rule on which I wanted to comment. The first relates to the proposed changes to the former "Three Quote Rule" requirements for execution of non-exchange-listed securities on behalf of customers. I want to commend FINRA for taking a more principle-based approach for these types of transactions in the proposed new rule. The previous requirements to accumulate quotes and document same often served to delay the execution of the client order, oftentimes with the end result that the market in the security had changed and the investor received a less advantageous price than when the firm began the process of collecting the information. The proposed more principle-based approach should allow for more efficiency when executing these types of orders. Ideally this will result in timelier executions, and potentially more favorable prices for the customer.

The second area of the proposed rule that I would like to comment on is related to codification of the "Regular and Rigorous Review of Execution Quality". I know that over the last few years FINRA has been made aware of the concerns of introducing firms regarding the requirement to achieve "best execution". The argument has been made that when an introducing firm is entering 100% of their orders into another member firms' systems (who would also be required to comply with best execution requirements), that the introducing firm should be relieved of the requirement to obtain "best execution", as they have no control over how the order has been routed within the clearing firm's system. Although I would have preferred an exemption to the "best execution" requirement for introducing firms that direct 100% of their orders through their clearing firm, the proposed rule does specifically address sufficient steps the introducing firm can take to validate they are monitoring and documenting their review for best execution to be in compliance with the rule. This is significantly greater than what firms had to rely on in the past. I appreciate the inclusion of these clarifying comments in the new proposed rule.

Thank you again for the opportunity to submit comments on proposed FINRA Rule 5310.

Sincerely,

Deborah Castiglioni

CEO
Cutter & Company, Inc.
636-537-8770

R. Cromwell Coulson
Chairman and CEO

pink OTC MARKETS

March 20, 2009

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, D.C. 20006-1506

Subject: Comments to Proposed FINRA Rule Addressing Best Execution

Dear Ms. Asquith,

Pink OTC Markets Inc. ("Pink OTC", formerly Pink Sheets LLC) respectfully submits the following comments in response to Regulatory Notice 08-80 issued by the Financial Industry Regulatory Authority ("FINRA"), formerly known as the National Association of Securities Dealers, Inc. ("NASD"). Pink OTC supports regulations that improve market quality and FINRA member firm obligations to obtain best execution of customer orders for OTC Equity Securities. For that reason, we oppose certain parts of the proposed revisions to NASD Rule 2320(g) (the "Three Quote Rule" or the "Rule"). We believe the key parts of the proposal are flawed and the change runs counter to the salutary requirement of best execution.

Pink OTC is the leading provider of pricing and financial information for the over-the-counter ("OTC") securities markets. Among other things, Pink OTC operates Pink Quote, a real-time Inter-Dealer Quotation System for OTC Equity Securities for market makers and other broker-dealers registered under the Securities Exchange Act of 1934.

Benefits of the Current Rule for Transparency of OTC Market Prices

The quotations submitted into Inter-Dealer Quotation Systems and their publication has fostered the development of a widely available national best bid or offer (NBBO) in the vast majority of OTC Equity Securities in which trades take place. This investor friendly market transparency in OTC Equity Securities is significantly different from the OTC bond market where there are more principle based best execution requirements. Much of the quote transparency available to investors in OTC Equity Securities is a result of the Three Quote Rule.

FINRA Regulatory Notice 08-80 proposes replacing the Three Quote Rule with Supplementary Material .06 to proposed FINRA Rule 5130. The proposed Supplementary Material would rely on member firms to develop written policies and procedures to determine the best inter-dealer market for OTC Equity Securities in situations where multiple published quotations are not available. The Supplementary

Material suggests that member firms should seek quotations from other broker-dealers, but are not required to do so. FINRA's stated reason for replacing the Three Quote Rule, which has served to protect the investing public for over two decades, is its belief that the current requirements can result in unnecessary delay in the execution of a customer's order.

The current Three Quote Rule contains an important electronic NBBO exception (Rule 2320 (g)(3)(A) or the "Electronic NBBO Exception") that speeds executions for investors. Under the Electronic NBBO Exception, Broker-dealers are not required to obtain three quotes where there is a NBBO of two or more firm priced quotations that are displayed on an Inter-Dealer Quotation System that permits quotation updates on a real-time basis. Pink Quote and the OTCBB® are the Inter-Dealer Quotation Systems that currently serve this function. Unfortunately, the proposed abandonment of the Three Quote Rule also eliminates the Electronic NBBO Exception. This has the effect of tossing the baby out with the bath water.

The broad dissemination of publicly available prices has transformed the market for OTC Equity Securities, vastly increasing price transparency since the adoption of the Three Quote Rule and the Electronic NBBO Exception. The Electronic NBBO Exception has led to important improvements in the speed and quality of order execution and it encourages dealers to submit quotations into Inter-Dealer Quotation Systems as they know that other member firms will have to either compete at that price or access their price. In turn, the prices generated by Inter-Dealer Quotation Systems are published in Bloomberg, Reuters and other public market information distributors as well as available in online brokerage customer trading applications. These prices are used by public investors to decide if they want to trade at the NBBO price, as well as determine the quality of executions received from their brokers. Investors that submit a market or marketable limit order in a market displaying an NBBO generally are expressing a desire to obtain an execution at the displayed NBBO price, an opportunity that exists only in transparent markets.

We therefore request that FINRA state, whether in the text of the Rule or the Supplementary Material, that member firms must execute customer orders at an equal or better price as displayed in any Inter-Dealer Quotation System that permits quotation updates on a real-time basis. The NBBO should be a minimum standard for all customer executions and conversely member firms that make their prices publicly accessible to all market participants by displaying firm quotes in an inter-dealer quotation system should be protected from having those prices ignored or traded through.

The Current Rule Promotes Straightforward Best Execution Compliance

The proposed Supplementary Material as proposed would abolish an effective and helpful regulatory guideline and introduces a level of subjectivity in an area where judgments are difficult to make. In the absence of actual quotations from willing buyers

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and sellers, there are no known reliable indicators of value. Without the benefits of a bright-line rule, it will be impossible for the compliance department of a member firm to determine with any degree of certainty whether a particular method of determining best execution is correct or incorrect. The Supplementary Material will therefore increase the tensions between the compliance department and the trading desk. For similar reasons, regulatory examinations will become more difficult and time-consuming. Any marginally increased efficiency in executing customer orders resulting from the proposed rule change will be greatly outweighed by the increased risk of best execution violations by member firms, costly and time-intensive self-reviews by FINRA member firms, and the cost and difficulty for FINRA in determining whether best execution violations have occurred.

It is worth noting that "grey market" securities, that is securities not quoted in inter-dealer quotation systems, are traded by means of telephone conversations among traders. This method has not changed substantially since the Three Quote Rule was originally promulgated in 1988. These are illiquid securities that trade infrequently. Accordingly, speed of execution is relatively less-important as an element of best execution. We believe that the delay in execution required to obtain three quotations is necessary to establish a market price for securities for purposes of best execution. We do not believe it is useful to change a rule that has served regulators and member firms well for two decades when there has not been any substantial change in the technology of the business.

Principle Based Regulation is May Not Be Appropriate

We think the proposed abolition of the Three Quote Rule may reflect a poorly considered preference for regulations based on principles, rather than rules. We think that both approaches are necessary in any sensible system of securities regulation.

Rules have the advantage of providing "bright-line" standards with which member firms must comply. Member firms know what they can and cannot do, and FINRA can more easily determine whether the rules have been violated. Principles-based systems, by contrast, provide more general principles for member firms to follow. FINRA must then evaluate each action a member firm takes to determine if it adheres to the appropriate general principles.

In theory, principles-based regulation ensures greater compliance with the principles the regulators are protecting. This advantage is counter-balanced by the practical difficulties inherent in any principles-based regulatory system. FINRA's task, as well as the burden placed on compliance professionals, becomes much more arduous, as FINRA's representatives or a firm's compliance professionals must, in each case, evaluate the action taken by a registered person and determine whether it is in keeping with the regulatory principles. Moreover, member firms receive less guidance and as a

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result often are uncertain how to comply or how an act will be interpreted according the principles.[1]

We think there are situations where principles-based regulation makes sense. Suitability is an area where rules-based regulation is unlikely to protect investors from abuse because the spirit of the rule is more important than bright-line distinctions. In some aspects of best execution, principles-based regulation may be more likely to take account of customer preference in some situations. On the other hand, FINRA Regulatory Notice 08-80 provides a particularly salient example of a situation – determining market value in relatively illiquid OTC Equity Securities -- where principles-based regulation can lead to confusion, reductions in market and execution quality, and decreased compliance.[2]

The Three Quote Rule is based on the premise that market prices – the prices offered by willing buyers and sellers – are the best indication of the value of a security. The Rule therefore requires member firms to determine the existing market and helps member firms meet FINRA's best execution requirements. It mandates specific actions, obtaining three quotations from three dealers – thereby establishing a current market price – that must be taken before executing a customer order in a non-exchange listed security not otherwise exempted by the Rule. Where two quotations have been published in an Inter-Dealer Quotation System Inter-Dealer Quotation Systems that permits real-time updates, member firms and their customers can rely on the presence of a publicly available, transparent, ready market to determine best execution. The Three Quote Rule provides FINRA a clear basis for enforcement if a member firm does not comply with a standard that is readily understood within the industry. In this way, the Three Quote Rule minimizes non-compliance.

If the Three Quote Rule were to be replaced with the proposed Supplementary Material to FINRA Rule 5130, the Rule's clear compliance guideline would be substituted with a general principle. The premise would be that for OTC Equity Securities, market prices are not necessarily the best indication of the value of a security. Presumably some member firms would develop valuation algorithms to establish best execution. Others would attempt to obtain quotes, but it would not be clear whether one or two quotations, or perhaps in some cases, nine or ten, would be sufficient to establish best execution. Any set of procedures developed by a member firm would be subject to question, on the basis of twenty-twenty hindsight, that the procedures failed to establish value based on some other metric and therefore failed to achieve best execution. Compliance professionals would be in conflict with the trading desk over best execution, with traders insisting that their view should prevail as having more credibility in the market. FINRA examinations would be tedious affairs, and customer complaints would increase. The

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[1] *See* John H. Walsh, *Institution-Based Financial Regulation: A Third Paradigm*, 49 Harv. Int'l L.J. 381 (2008). Mr. Walsh is the Associate Director and Chief Counsel in the SEC's Office of Compliance Inspections and Examinations.

[2] *See generally* David B. Bayless, *A Matter of Principles*, GC California, Winter 2007. Mr. Bayless is a partner in the San Francisco office of Covington & Burling and is a former head of the SEC's San Francisco office.

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proposals in FINRA Regulatory Notice 08-80 may therefore inadvertently lead to more breaches of the duty of best execution.[3]

Systems and Mediums have Different Market Functions

The existing definitions to "Quotation Medium" and "Inter-Dealer Quotation System" in the existing Three Quote Rule are drawn directly from Rule 15c2-11 under the Securities Exchange Act of 1934. Rule 15c2-11 governs quotations published by broker-dealers in Quotation Mediums and in Inter-Dealer Quotation Mediums under federal securities laws.

The Rule 15c2-11 definitions are as follows:

An "Inter-Dealer Quotation System" shall mean any system of general circulation to brokers or dealers which regularly disseminates quotations of identified brokers or dealers.

"Quotation Medium" shall mean any "interdealer quotation system" or any publication or electronic communications network or other device which is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

The proposed alterations to these definitions in other parts of FINRA Regulatory Notice 08-80 would diverge from Rule 15c2-11, suggesting they have a meaning different from the Rule. No reason is given in the Regulatory Notice for these changes, and we doubt that these changes reflect anything more than aesthetic considerations. Subtle alterations to these definitions can only cause confusion and counter-productive mischief. If there is some reason to make these changes, FINRA should explain them carefully in a Regulatory Notice. Otherwise, the definitions existing in the current Three Quote Rule should be reinstated.

Generally speaking, an Inter-Dealer Quotation System is a system that is widely available to all broker-dealers and identifies the source of quotations. The function provided the marketplace is that if a broker-dealer is willing to trade with any other broker-dealer by making their quotes accessible, and conversely if a broker-dealer desires to set a price other broker-dealers must compete against or access, they publish their quotation prices in an Inter-Dealer Quotation System.

A Quotation Medium is a much broader description which can cover anywhere a quote could possibly be published, including closed systems that are not widely accessible by competing broker-dealers. Quotation mediums have an important function, as closed or partially closed networks such as ECN's, ATS, Dark Pools, Web Sites, and other platforms where a broker-dealer may get a better execution for their order by showing

[3] *See id*, noting "if the goal is to prevent certain behavior, it is better to have a specific rule that addresses the particular conduct that puts everyone in the industry on notice. This will actually lead to a decrease in the conduct that the regulator is aiming to prevent."

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interest to a select group without alerting the whole market. Since Quotation Mediums are not readily available to other broker-dealers the Electronic NBBO Exception rightfully is limited to Inter-Dealer Quotation Systems. Any Quotation Medium can easily publish the quotes that they want to make widely accessible in an Inter-Dealer Quotation System.

Conversely, the requiring of broker-dealers to look for quotations in Quotation Mediums under the Section (f)(2)(A) of the Proposed Rule is not workable and Inter-Dealer Quotation System should be substituted with the definition from SEC Rule 15c2-11 used in Section (f)(2)(B).

Multiple Quotation Rule

Proposed Rule 6480 is overly restrictive of broker-dealer activities in attempting to locate liquidity for clients. The rule should use the definition of Inter-Dealer Quotation System as there are many situations when a firm may want to use a system that could be described as a Quotation Medium to discretely facilitate a trade without having to publish that same price publicly in an Inter-Dealer Quotation System.

Conclusion

Pink OTC has generally advocated modifications in existing regulations to accommodate changing markets and technological progress. But, we do not believe that markets and the investing public benefit from regulatory changes for the sake of change. This is one of those rare occasions where we believe that existing rules, which are working well, should be left alone. We think the changes proposed by FINRA Regulatory Notice 08-80 provide no obvious benefit to FINRA, members firms or the investing public, while risking confusion and harm to the market for OTC Equity Securities.

The Three Quote Rule, in its current formulation, properly reflects the significant technological changes in the market for OTC Equity Securities over the last two decades. Inter-Dealer Quotation Systems currently provide robust, transparent, ready markets in many OTC Equity Securities. The Rule has facilitated the formation of NBBOs in many securities, which are made available in robust Inter-Dealer Quotation Systems and widely disseminated to the investing public, and permitted the introduction of sophisticated order handling rules. At the same time, the Rule takes account of the fact that much of the market in OTC Equity Securities has not changed over the twenty years since its adoption.

Exchanging the clear standard embodied by the Three Quote Rule for the principles-based approach of Supplementary Material to FINRA Rule 5130 may undermine member firms' attempts to meet their best execution obligations while unnecessarily taxing the compliance resources of member firms and FINRA. The Rule reflects the reality that market prices are the best way to determine value and establishes a practical, easy to understand, regulatory standard. Ambiguous "principles-based"

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regulations in this area, while well-intended, would lead to confusion, customer complaints and a negative impact on the execution of customer orders.

Thank you for the opportunity to comment upon the proposals set forth in FINRA Regulatory Notice 08-80. Please call if you have any questions or require any additional information.

Very truly yours,

R. Cromwell Coulson
Chief Executive Officer

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January 28, 2009

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 08-80

Dear Ms. Asquith:

I am writing to comment on the rule proposals in Regulatory Notice 08-80 insofar as they apply to customer orders in foreign securities.

1. **Definition of "non-U.S. traded security."** Proposed Rule 5130(f) would deem a U.S. broker-dealer to have complied with the best execution requirements set forth in paragraphs (a) through (e) of the rule if a customer order is for a "non-U.S. traded security" and if the broker-dealer follows the procedures set forth in paragraph (f). To qualify as a "non-U.S. traded security," a security must both be issued by a foreign entity and there must be no quotations or indications of interest displayed in any "quotation medium" in the United States at the time the broker-dealer receives the order.

A. Relevance of ADR programs. Most foreign equity securities have their primary trading market in the issuer's home country, notwithstanding that the issuer (or a U.S. depositary bank) may have established in the United States an American Depository Receipt program based on the issuer's ordinary shares. It would be helpful if FINRA would clarify that the presence of an ADR program -- whether sponsored or unsponsored, and whether the ADRs trade on an U.S. exchange or in the "pink sheets" -- is irrelevant to the status of the issuer's ordinary shares as non-U.S. traded securities for purposes of the proposed rule.

B. Relevance of a quotation medium in the United States. The definition of "quotation medium" focuses on whether a system, publication or device regularly disseminates quotations of identified broker-dealers or is used by broker-dealers to make known to others their interest in transactions in a security. It is not clear to me how the availability of quotations or indications in the United States is relevant to the rule proposal's objectives. As the SEC recently observed, "third-party quotation systems have become increasingly global in scope such that the distinction between systems that distribute quotations primarily in the United States and those

that distribute quotations primarily in foreign countries is no longer a meaningful or workable distinction because most third-party quotations systems no longer serve a primary location." SEC Release No. 34-58047 (June 27, 2008). U.S. broker-dealers currently advertise as part of their electronic trading services the availability of real-time home country quotations on foreign securities, and quotations and indications regarding foreign securities will undoubtedly continue to become more available in the United States as technology progresses and as U.S. investors continue to be interested in trading in foreign securities. Neither U.S. broker-dealers nor their customers can control the increasing availability of such quotations and indications, and it would be a mistake if the benefits of proposed paragraph (f) could be lost merely because such quotations and indications become more accessible.

Nor is it a sufficient limitation on the proposed definition that a quotation medium be "general[ly] circulat[ed] to brokers or dealers" or that it be "used by brokers or dealers." The distinction between a professional and a retail quotation medium is elusive at best and likely to become more so as quotations and indications on foreign securities continue to become more available.

The order-handling policies and procedures contemplated by proposed paragraph (f) will undoubtedly take into account the relevance of any quotations or indications that are available in the United States. I therefore recommend that proposed paragraph (f) apply to orders for all foreign securities whether or not quotations or indications are available in the United States. If FINRA is concerned that paragraph (f) should not apply to orders in securities of foreign companies that have significant contacts with the United States, it could specify that paragraph (f) would apply only to securities of "foreign private issuers" within the meaning of SEC Rule 3b-4(c).

2. **Customer instructions regarding order handling.** Paragraph .07 of the proposed supplementary material specifies that a broker-dealer is not required to make best execution determinations when it receives an "unsolicited" instruction from a customer to route the customer's order to a particular market for execution. In the case of foreign securities, I suggest that FINRA delete the reference to an instruction's being unsolicited. A broker-dealer and a customer may on the basis of long usage and course of dealing have concluded that the customer's orders for foreign securities are most effectively executed in the principal market for such securities in the issuer's home country. The customer should not be deprived of the broker-dealer's advice in this area, and the broker-dealer should not be required to guess under these circumstances whether it has "solicited" the customer to instruct that the order be executed in that market.

Alternatively, FINRA could make paragraph .07 available to a broker-dealer in all cases where a customer has instructed that an order be executed in a foreign security's principal market.

SIDLEY AUSTIN LLP
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Please let me know of any questions regarding these comments.

Very truly yours,

Joseph McLaughlin

Enclosure

Dear Ms. Asquith:

Scottrade, Inc. appreciates the opportunity to comment on proposed Rule 5310 dealing with members' best execution obligations. Scottrade has the following comments about the Rule in its current form. Specifically:

- Paragraph .08(b) of the accompanying Interpretive Material contains a list of factors that a member should consider when reviewing and comparing execution quality. We offer the following comments about this section:

    - We believe that the traditional non-price factor of "efficiency of execution" has been excluded in FINRA's attempt to codify existing interpretations. The guidance about regular and rigorous review in NASD Notice-to-Members 01-22 specifically quoted a paragraph from the SEC's order handling rules release. One of sentences in that release said that "[t]he traditional non-price factors affecting the cost or efficiency of executions should also continue to be considered". Scottrade believes that this is an important component of regular and rigorous review. As a practical matter, efficiency of execution takes into account many sub-factors of an operational nature, including reliability of systems and service, stability of order routing destinations' platforms, capacity and scalability, load balancing for risk management, speed of recovery from an outage, performance and communication during outages, quality of connectivity, promptness in dealing with exceptions, quality of reconciliation and P&S services, support and back-up services, and history of unscheduled outages. Non-price factors are a traditional component of a regular and rigorous review. A codification of the factors that go into a regular and rigorous review would be inaccurate without including "efficiency of execution" and its sub-factors. Scottrade suggests that factor (6) be modified to read, "effects on costs or efficiency of execution."

    - Factors dealing with speed, size of order and transaction cost are currently modified by the qualifier "materially." The factor as described in NTM 01-22 says, "[o]ther material differences in execution quality such as the speed of execution, size of execution, and transaction cost[.]" The proposed rule eliminates this materiality standard without explanation. We believe that this standard should be retained. If FINRA is trying to alter the substance of an existing interpretation, it should at a minimum describe its rationale in making such a change.

- Paragraph .01 of the accompanying Interpretive Material states that "a member must make every effort to execute a customer market order that it receives promptly and fully". We agree that members have an obligation to execute orders promptly and fully. However, we believe that the time at which a firm "accepts" a market order should start the clock for the purposes of fulfillment and measurement of best execution obligations, particularly in the online brokerage sector. Online brokers (and non-online brokers) usually have a series of controls

that are engaged upon receipt of an order to comply with regulations and mitigate firm risks. These include tests to ensure that locate requirements are met, ensure that funds are available for payment, ensure that the order is valid or not a duplicate order, tests to verify large orders, etc. We believe that the Material could be clarified by either defining "receives" as the time at which an order is accepted by the member, acknowledging that the term "receipt" takes such considerations into account, or by changing the Rule's language to state that market order handling responsibilities begin once an order is accepted by the member.

- We have some concerns about the practical application and enforcement of Proposed Rule 5310(f)(1)(D). The Proposed Rule requires members to obtain consent of customers regarding the member's policies and procedures regarding handling of orders for non-US traded securities. We believe that it would be more appropriate for the Rule to require members to *disclose* such practices to its customers at the time of account opening and on an annual basis, as opposed to requiring *consent*. Our concern is twofold. First, a uniform practice of disclosing order routing and handling practices already exists. Rules 606 and 607 require ongoing disclosure of order routing practices. We believe that a similar standard could exist with regard to the routing and handling of orders for non-US traded securities that would allow members to describe its practices in full in one medium, which would provide full disclosure to the public regarding order routing practices and be less burdensome to members. Secondly, while Endnote 4 of Notice to Members 08-80 further elaborates that "a firm could receive its customers' consent in any reasonable manner, including negative written consent", we are concerned that the reasonableness standard could be interpreted and applied differently by different examining authorities in different contexts.

Scottrade appreciates FINRA taking its views into consideration when drafting the final version of the Rule, and would welcome the opportunity for further discussion or clarification.

Sincerely,

Christopher Meitz
Assistant Director of Compliance
Scottrade, Inc.
(314) 965-1555, extension 1052
cmeitz@scottrade.com
www.scottrade.com

liquidnet

Hong Kong

London

New York

Sydney

Tokyo

Toronto

April 24, 2009

Marcia E. Asquith

Office of the Corporate Secretary

Financial Industry Regulatory Authority

1735 K Street, NW

Washington, DC 20006-1506

Re: Regulatory Notice 08-80, Best Execution

Dear Ms. Asquith,

I am writing on behalf of Liquidnet, Inc. Liquidnet supports the proposal by the Financial Industry Regulatory Authority (FINRA) in Regulatory Notice 08-80 to replace Rule 2320(g) (the three quote rule) with the supplementary material proposed by FINRA. We believe this proposal will significantly reduce execution costs for our institutional customers and the tens of millions of individual beneficiaries of the accounts that they manage.

Liquidnet is a broker-dealer registered with the Securities and Exchange Commission and a FINRA member. Liquidnet operates two alternative trading systems: (i) the Liquidnet Negotiation ATS, which institutions access to negotiate block trades directly with other institutions, and (ii) the Liquidnet H2O ATS, which institutions access to execute their orders automatically against order flow sent from broker-dealer smart order routers.

We agree with FINRA's statement in the regulatory notice that the three quote rule is overly prescriptive. Because of the complexities of the three quote rule, Liquidnet does not allow trading of unlisted securities.

Market makers and other intermediaries play an important role to facilitate trading in unlisted securities by providing liquidity for securities that often are illiquid. Trading systems like Liquidnet can provide additional benefits for trading unlisted securities, including the following:

- Price improvement. In Liquidnet an institution can negotiate a trade at the mid-point with another institution. If a system like Liquidnet is not available, institutions often are limited to buying at the best offer or selling at the best bid.[1] This can be a significant cost to the institution because the spreads for unlisted securities can be wide.

[1] All trades in Liquidnet H2O are executed at the mid-point of the national best bid and offer (NBBO). A significant majority of trades in the Liquidnet Negotiation ATS also are executed at the mid-point of the NBBO.

liquidnet

- Market impact cost. In Liquidnet, an institution can negotiate and execute an order directly with another institution, avoiding the market impact costs associated with exposing the order to a traditional market intermediary. These market impact costs can be significant given the limited liquidity in many unlisted securities.
- Block trades. Because the quote sizes for unlisted securities often are small, it can be difficult for an institution to buy or sell an unlisted security in block size. The Liquidnet Negotiation ATS addresses this problem by enabling institutions to trade blocks directly with each other.[2]

For these reasons, we believe replacement of the three quote rule with the proposed supplementary material will make it easier for institutions to achieve best execution for the beneficiaries of the accounts that they manage.

We understand there are unique policy concerns relating to the trading of unlisted securities that FINRA must consider. We believe that the supplementary material proposed by FINRA in the regulatory notice properly identifies and addresses those concerns in a manner that will assist institutions in achieving best execution.

We appreciate FINRA's consideration of our comments. Please contact me at (646) 674-2044 if you would like further clarification on any of the points in our letter.

Very truly yours,

Howard Meyerson, General Counsel

[2] The average execution size for manual negotiations on the Liquidnet Negotiation ATS is approximately 53,000 shares (Q1 2009).

February 16, 2009

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 08-80
Proposed FINRA Rule 5310 Addressing Best Execution

Dear Ms. Asquith:

The National Association of Independent Brokers-Dealers, Inc. (NAIBD) was formed in 1979 to positively impact rules, regulations, and legislation by facilitating a consistent, productive relationship between industry professionals and regulatory organizations. The organization is national in scope and direction with a network of more than 350 Broker-Dealer and Industry Associate Members.

NAIBD welcomes FINRA's proposed consolidation of rules governing best execution, and in particular, appreciates the extent to which the proposal recognizes the benefit of modernizing rulemaking to accommodate the current practices, protocols and resources in use by industry professionals.

NAIBD favors the changes in proposed Rule 5310 that would replace the current Three Quote Rule with a principles-based alternative.

At Rule section a2(c), the proposal states that [certain third party executions] "are not prohibited if the cost is not borne by the customer." Because all transactions come at some cost to the customer, NAIBD requests clarification whether the FINRA intends to state that <u>all</u> costs, or simply any additional or undue costs related to the arrangement between the firms, are covered by this statement.

In the Supplementary Material at .08(c) the FINRA describes the extent to which introducing firms that route orders to a clearing firm or other executing broker-dealer may rely on the statistical information of the executing firm for validation of its execution quality. NAIBD appreciates this meaningful guidance for the consideration it grants to small and independent firms, whose access to execution data may be subject

to accessibility of data out of its direct control. In this regard, NAIBD requests the FINRA's confirmation that a review of those reports prepared and disclosed by executing firms in meeting their obligations under order routing regulations will suffice for the purposes of this review.

NAIBD appreciates the opportunity to comment on this proposal. If you have any questions or would like to request clarification, please contact the undersigned at 619-283-3107.

Sincerely,

// Lisa Roth //

Lisa Roth
Chairman, NAIBD

first allied
Member FINRA/SIPC
AN ADVANCED EQUITIES COMPANY

January 27, 2009

VIA E-MAIL

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Regulatory Notice 08-80:
FINRA Request Comment on Proposed FINRA Rule
Addressing Best Execution

Dear Ms. Asquith:

We are submitting this letter in response to Regulatory Notice 08-80, "FINRA Requests Comment on Proposed FINRA Rule Addressing Best Execution".

The proposed rule would have four primary amendments. First, the proposed rule would adopt a new provision providing that a member firm has met its best execution obligations regarding orders for foreign securities with no US market if certain conditions are met. Second, the replacement of NASD Rule 2320(g) with Supplementary Material addressing a member firm's obligation when handling orders for securities with limited quotation information. Third, the codification of a member firm's obligation to regularly and rigorously review execution quality. Lastly, the adoption of Supplementary Material addressing a member firm's obligation when handling an order that the customer has instructed the firm to route to a particular market for execution. Please see our comments which follow.

Best Execution for Foreign Securities

Proposal. As part of transferring NASD rule 2320 into the Consolidated FINRA Rulebook, FINRA is proposing to adopt a new provision addressing orders for foreign securities with no US market. Under the proposed provision, a firm would be deemed to have met its best execution obligations with respect to an order if: (1) the order is for a non-US traded security; (2) the firm has adopted written policies and procedures regarding its handling of the orders; (3) the firm reviews those policies and procedures at least annually, or more frequently; (4) the firm has obtained its customers' consent to its policies and procedures regarding the handling of orders for non-US traded securities; (5) and the firm handles the order in accordance with its policies and procedures.

Comment. We support the proposed rule adopting a new provision addressing orders for foreign securities with no US market with exception to obtaining its customers' consent to its policies and procedures. We believe that the proposed requirement would not serve the Securities Industry by allowing customers' consent to be a factor in a Broker Dealer determination of Best Execution.

Three Quote Rule

Proposal. Proposed FINRA Rule 5310 emphasizes a firm's best execution obligations when handling an order involving a non-exchange-listed security for which there is limited pricing information available, the Supplementary Material would require that member firms have written policies and procedures in place to address the steps the firm will take to determine the best market for such a security in the absence of multiple quotations and require that firms document how they complied with those policies and procedures.

Comment. We support the proposed rule adopting a new provision to have written policies and procedures in place to address the steps the firm will take to determine best execution.

Regular and Rigorous Review of Execution Quality

Proposal. Proposed FINRA Rule 5310 would add Supplementary Material that would codify a member firm's obligation to regularly and rigorously review execution quality likely to be obtained from different market centers.

Comment. We support the proposed rule that would codify a member firm's obligation to regularly and rigorously review execution quality to be obtained from different market centers.

Customer Instructions Regarding the Routing of Orders

Proposal. Proposed FINRA Rule 5310 would include Supplementary Material that addresses situations where the customer has, on an unsolicited basis, specifically instructed the firm to route its order to a particular market. Under those circumstances, the firm would not be required to make a best execution determination beyond that specific instruction.

Comment. We oppose the Supplementary Material proposing FINRA Rule 5310 that addresses situation where the customer has, on an unsolicited basis, specifically instructed the firm to route its order to a particular market. We believe that it is the firm's responsibility to always make a best execution determination in all cases whether specifically instructed to route its order to a particular market or not.

First Allied Securities, Inc. appreciates the opportunity to comment on the above proposed Rule changes and amendments. We would be happy to answer any questions you may have about our comment letter.

Sincerely,

Michele Samuelson
Compliance Trading Specialist
Compliance Dept.

Ms

February 26, 2009

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Re: **FINRA Regulatory Notice 08-80; Best Execution**

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") Regulatory Notice 08-80 (the "Notice"). In connection with its ongoing effort to develop a consolidated rule book, FINRA is proposing to adopt a new best execution rule, Rule 5310, and related Supplementary Material that together would replace current NASD Rule 2320, and to amend the rule in several respects. With this Notice, FINRA requests comments specifically on four primary proposed amendments, which would (1) address best execution of orders for foreign securities with no U.S. market, (2) replace the current "Three-Quote Rule" with a more flexible standard, (3) codify well-known and understood Securities and Exchange Commission ("SEC") and FINRA guidance concerning the "regular and rigorous review of execution quality," and (4) address best execution of orders in circumstances where customers direct the routing of such orders to particular markets. As currently drafted, these proposed amendments are not limited in scope to the best execution of orders for equity securities (collectively, the "Proposals").

The first two of the Proposals relate to customer orders for securities that are either not traded in the U.S. or trade in illiquid, dealer-driven and non-transparent markets. While such orders encompass a relatively minute percentage of the overall volume of orders for equity securities, they comprise most of the orders for the millions of fixed income securities currently outstanding. As described more fully in this letter, such markets are typically characterized by their limited transparency, real-time data and firm quotes, questions about the accessibility of quotes or indications that do exist, and highly circumstantial customer expectations. Therefore, SIFMA strongly believes that rules and standards regarding best execution in

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, DC and London, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

these markets must reflect their fundamental limitations, and object to rules that implicitly or explicitly import notions of best execution more appropriately applied to markets for more liquid equity securities.

As applied to equity securities, while firms do appreciate the additional deference the Proposals afford to them in developing order routing and execution protocols in certain respects, the firms would appreciate additional guidance from FINRA in order to arrive at a consistent industry standard or framework for these procedures. In addition, we have concerns about certain ambient requirements associated with the Proposals that may be burdensome, impracticable or unnecessary.

On the other hand, SIFMA has more fundamental concerns about the Proposals as they may be applied to fixed income securities. While SIFMA does not necessarily challenge the notion that member firms owe a duty of best execution to their clients where orders in fixed income securities are concerned, the scope of the duty and the methods of demonstrating satisfaction diverge substantially from the traditional notions of best execution for equity securities, and simply overlaying an equity-centric set of standards on top of fixed income securities is akin to fitting a round peg into a square hole. As discussed more fully below, we respectfully disagree with applying equity-based best execution standards to the fixed income market, and would welcome an opportunity to initiate a larger dialogue concerning best execution in corporate and government bonds with FINRA and the SEC to develop more appropriate and tailored standards for satisfying a duty of best execution where fixed income securities are concerned.

Comments Specific to Equity Securities

I. Foreign Securities with No U.S. Market

FINRA proposes to include in new Rule 5310 a provision that would consider a member firm to have satisfied its duty of best execution in the context of customer orders for foreign securities for which there is no U.S. trading market at the time of order receipt if the member (1) has developed written policies and procedures regarding the handling of such orders that are reasonably designed to obtain the most favorable terms available, (2) reviews those procedures at least annually to assess the quality of execution venues, (3) obtains its customers' consent to the policies and procedures, and (4) in fact handles such orders in compliance with such procedures. In contrast, current Rule 2320 imposes the same standard – in essence, the Three-Quote Rule – on all securities, domestic or foreign, that have little or no U.S. trading market.

In general, SIFMA supports the proposed rule change, albeit with concerns over several provisions. Fundamentally, the rule is a rational approach that recognizes that offshore markets have varying methods and standards for executing orders, which argues for a more flexible set of expectations for member firms handling such orders. These differences concern, for example, pre- and post-trade transparency, centralized versus fragmented liquidity and ease of access, and call for an approach that allows member firms to take into account the complexities of these markets. FINRA's Proposals effectively defer to the judgment of member firms that handle such orders to develop appropriate execution protocols that can be customized to take into account different types of securities and offshore markets and the extent to which the member will employ other brokers, either domestically or offshore, to obtain the requisite access needed to fulfill their clients' instructions.

This same flexibility and deference which firms find appealing comes, however, with certain concerns. Some firms believe that the standard – policies and procedures that are reasonably designed to obtain the most favorable terms available – may be too amorphous, and therefore invite a dialogue with FINRA staff concerning their expectations where such policies and procedures are concerned. The consensus among member firms is that their policies and procedures will need to be fairly high level and dynamic, as the

range of possibilities in terms of the kinds of orders, the characteristics and accessibility of the myriad local trading markets, the customer's instructions, and the relative liquidity of the security in question is too broad to adopt rigid protocols. Simply stated, the lack of uniformity in these markets does not lend itself to a one-size-fits-all approach. Nonetheless, the firms believe that an agreed-upon framework that suggests a non-exclusive list of elements for what a typical set of execution protocols might cover would provide useful guidance. Such a framework might include, for example, and without limitation, (1) identifying and perhaps differentiating between situations when orders are simply routed to the member's foreign affiliate, as opposed to an independent local broker, (2) establishing a protocol for routing and/or executing away from the foreign market (*e.g.*, when the foreign market is not open for trading, when there is an inadequate price discovery mechanism in the foreign market, when alternatives to the foreign market might be more appropriate under the circumstances), (3) identifying when heightened scrutiny of executions on an immediate, post-trade basis may be appropriate, as opposed to more routine post-trade checks and less frequent, holistic evaluations of execution quality (including specification of frequency, individuals responsible for conducting reviews, etc.), and (4) periodically assessing the performance of local brokers, and the member's own affiliates, to the extent that data exist to facilitate such an assessment.

SIFMA also has a concern with the proposed requirements that members draft and implement policies and procedures for orders in foreign securities (as well as for non-exchange listed securities with limited available pricing information) and that members obtain their clients' consent to their policies and procedures. In this regard, the proposed rule requires members to draft and implement two separate sets of procedures (both for foreign securities and for illiquid securities, including fixed income instruments). We believe that it would impose a burden on members to develop specific policies and procedures for both of these order types, especially in light of the fact that these order types are typically a small percentage of the overall order flow handled by U.S. member firms. Further, in addition to having to draft additional policies and procedures, the proposed rule places the obligation on the broker to disclose and obtain client consent to the procedures. FINRA did not articulate a reason why these particular procedures, as opposed to the many other sets of procedures maintained by member firms, would need to be disclosed to clients for their consent (negative or otherwise). Based on the administrative burdens associated with initially drafting and sending out the procedures and subsequent updates to those procedures (and triggering the separate transmittal of procedures for new clients), the firms believe strongly that the costs of the proposed drafting and consent requirements far outweigh any benefit that might be gained.

II. Non-Exchange Listed Securities with Limited Available Pricing Information

FINRA proposes to eliminate the current Three-Quote Rule in favor of a rule, which would be included in Supplementary Material .06, that would require member firms to implement written policies and procedures that address how the firm will ascertain the best inter-dealer market for a non-exchange listed security for which limited pricing information is available (reflected by the absence of multiple quotations), and to "document its compliance with those policies and procedures." While the Supplementary Material includes commentary on factors that "should" be considered by the member in its policies and procedures, it leaves enough flexibility for the member firm to apply different standards depending on the particular circumstances.

Like the proposed amendment concerning foreign securities, SIFMA supports the fact that this provision, at least in the context of equity securities, removes the rigidity of the Three-Quote Rule and allows member firms more flexibility in the manner in which they ascertain the best inter-dealer market for OTC securities and ultimately execute customer orders. This is an appropriate recognition of the structural

differences between the markets for illiquid securities and more traditional equities. While FINRA notes that members "should generally seek out other sources of liquidity, which may include contacting and obtaining quotations from other dealers," they recognize that such actions may in some cases hinder achieving best execution for a customer's order, particularly in the event that the customer prefers a more timely execution or where contacting multiple dealers for quotations might send signals into the marketplace and impact the market to the detriment of the customer. In addition, the added flexibility would allow a member to carry over previously obtained quotations to subsequent orders in appropriate circumstances (*e.g.*, orders are reasonably close in time and there is an absence of any intervening reported transactions in the security). Notwithstanding their general support for this provision, the firms nonetheless request a more specific description from FINRA with respect to the "more general documentation requirements" associated with it, as contrasted with the more specific order ticket marking provisions of the Three-Quote Rule. The firms are unclear as to what FINRA contemplates with such documentation requirements, and therefore are constrained in their ability to react in any meaningful way to that part of the Proposal.

III. Regular and Rigorous Reviews of Execution Quality

FINRA proposes to add Supplementary Material .08 to new Rule 5310 that would "codify" previously published SEC and FINRA guidance regarding member firms' obligations to regularly and rigorously review the quality of executions likely to be obtained from different market centers. SIFMA acknowledges that the guidance proposed to be codified is well understood in the industry and has become standard operating procedure for broker-dealers handling held, retail-sized orders in equity securities for their customers. Indeed, a veritable cottage industry has emerged in the years since this standard was first articulated by the SEC – including market centers providing not merely the execution quality statistics required by Rule 605 of Regulation NMS, but also more robust analyses of their execution quality; and vendors that have developed technological tools to assist order routing broker-dealers in analyzing the extensive execution quality statistics at their disposal. Firms formed best execution committees, evaluate and discuss execution quality statistics, have at times altered routing tables where appropriate, and draft minutes to memorialize their analyses and deliberations. SEC and FINRA examiners routinely assess the quality of member firms' processes in this regard. The "regular and rigorous" standard has largely been embraced by market participants handling and executing transactions in equity securities. It is therefore not clear to us why it needs to be codified in the consolidated FINRA rule book and we question whether codifying what has been a fluid and evolving standard is the best course to take. As a "standard" or "guidance," it is more easily altered as market and regulatory structures evolve than it would be as a rule subject to the SRO rule filing process under the Securities Exchange Act of 1934. We believe that is something FINRA should consider.

With respect to the "regular and rigorous review" requirement, we believe that this is an attempt to impose traditional equity markets principles on transactions that do not easily lend themselves to these principles. FINRA explains that the Supplementary Material "would not alter existing requirements" and that "it would merely codify previously published . . . guidance on the subject." The "regular and rigorous review" requirement, and all the considerations that are included in the guidance, grew out of and evolved in the context of held, retail-sized market, marketable limit and limit orders for equity securities (in other words, "covered securities" as defined by Regulation NMS Rule 605). In other words, the context has been orders for stocks that naturally lend themselves to apples-to-apples comparisons on an aggregate, retrospective basis given their relative fungibility and the precise nature of the regulatory requirements governing their handling and execution. The text of the Supplementary Material suggests this to be the case. For example, subparagraph (a) refers to conducting "reviews of the quality of the executions of customers' orders (as opposed to an order-by-order review)," the latter being in our view

more appropriately done in connection with non-fungible order types. In addition, the examples given for the types of orders to be included in the review are limit orders, market orders and market on open orders. Subparagraph (b)(1) and (2) speak to differences between execution prices and the prevailing quotes at time of receipt, which would typically be relevant only in connection with held market orders for which executions are required to be done "fully and promptly" upon order receipt. Subparagraph (b)(3) refers explicitly to limit orders. Subparagraph (b)(4) refers to the speed of execution, which is not typically a factor in connection with "not held" orders (in which case the broker-dealer is "not held" to time and price). Subparagraph (b)(8) refers to internalization and payment for order flow, which practices typically arise in the context of held, retail-sized orders.

We do not mean to suggest that members do not owe a duty of best execution in connection with not held orders. What we do mean is that assessment of execution quality for not held orders is quite different than that which would be done in connection with a regular and rigorous review. Such orders are simply not fungible enough to be assessed on any kind of apples-to-apples basis. With respect to not held orders, a plethora of factors enters into the manner in which a particular order is executed, including the size of the order relative to the liquidity in the market, the client's relative urgency for execution, special instructions relating to representing a certain percentage of volume in the market, benchmarking agency executions to the market volume weighted average price, and requests for capital commitment, among others – all of which will bear on best execution. Indeed, while regular and rigorous reviews are typically done periodically on a retrospective basis (where the impact of decisions made is prospective), the assessment of execution quality for not held orders is effectively done on an individual, order-by-order basis, in real-time and/or on a post-trade basis. Executing broker-dealers, their customers and third party vendors have developed and continue to refine tools that assist in evaluating a broker-dealer's performance in meeting clients' objectives.

We therefore request that FINRA state, whether in the text of the Supplementary Material or associated commentary, that the specific context in which regular and rigorous reviews are required is with respect to "covered orders," *i.e.*, the types and sizes of retail-sized, held orders in equity securities for which execution quality statistics are required to be published by market centers pursuant to Rule 605 of Regulation NMS. We would understand, however, if FINRA were reluctant to "box" itself into a rules-based standard that is limited in context to covered securities.[2] Because standards of best execution, and the means of verifying that best execution has been provided, are an evolving and dynamic concept, we are sympathetic to the notion that some form of regular and rigorous review, as described in the proposed rule, could someday be implemented in a context other than covered orders. Therefore, an alternative approach FINRA might take would be to include in associated commentary to a final rule that the regular and rigorous standard is most appropriately applied at the current time to covered securities and leave open the possibility that it could be extended to other situations depending on advancements in retrospective executive quality assessment techniques down the road.

Another aspect of Supplementary Material .08 that appears confusing is to whom it is intended to apply. Subparagraph (a) states clearly that a "member that routes customer orders to other broker-dealers for execution on an automated, non-discretionary basis, as well as a member that internalizes customer order flow, must have procedures in place to ensure the member periodically conducts regular and rigorous reviews." This makes sense, as the obligation to conduct the review should be on the broker acting as the agent for the customer, consistent with its duties owed to the customer. However, subparagraph (c) suggests that an "introducing firm" (as such term might be construed or defined) can rely on the "clearing

[2] This is essentially why we question the wisdom of codifying what has heretofore been a fluid guideline.

or executing firm's regular and rigorous review," subject to certain conditions. If what this is intended to cover is the situation where a clearing/executing broker has consciously undertaken to assume the agency duties of an introducing broker in terms of the handling and routing of the introducing firm's order flow, as distinguished from the situation where an executing firm is merely a destination of another firm (whether an introducing firm or otherwise, in which situation the introducing firm made the decision to route to the executing firm and did not delegate that decision to its clearing broker, for example), then we do not believe that distinction would be inconsistent with subparagraph (a). We believe, however, that this point needs to be clarified in subparagraph (c) to avoid confusion.

IV. Directed Orders

FINRA proposes adding Supplementary Material .07 to new Rule 5310 that would clarify that a member firm that receives an unsolicited instruction from a customer to route that customer's order to a particular market for execution is not required to make a best execution determination beyond that instruction. SIFMA supports this proposal as a sensible approach for dealing with customer-directed orders, although we question whether it is too limited in its scope. Specifically, the provision would effectively relieve the member of its best execution obligation with respect to the performance of the destination market center, provided the member promptly followed the client's instruction. But why is this relief limited solely to a routing instruction? We believe FINRA should consider a more expansive conceptualization of what should be considered a client directed order.

For example, over the past several years, institutional orders have become so laden with instructions as to take much of the time and price discretion out of the hands of the broker. As noted previously, such orders often include instructions to represent a certain percentage of the overall market volume over a specified time period, or to use reasonable efforts to execute as close to the VWAP as possible for a particular security over a specified time period. These instructions do not relate to routing destinations *per se*, but nonetheless weigh heavily on, and considerably restrict the brokerage judgment and discretion of, the member.

Comments Specific to Fixed Income Securities

SIFMA and its members unequivocally endorse principles of customer protection in the bond markets. However, the special characteristics of debt instruments and the differing structures in the fixed income markets require that rules be tailored specifically for these markets. Rules designed for the paradigm of the equities markets should not be imposed on the bond markets.[3] Doing so will only create problems of interpretation, application and enforcement. Much of the Proposals appears to have been developed solely in the context of the equity market and, as a result, creates issues for the fixed income securities markets.

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[3] The Bond Market Association ("TBMA") previously expressed concerns about the application of the Best Execution Rule to fixed income instruments at the time that NASD proposed to expand Rule 2320 in 2005 to include fixed income instruments. We wish to direct attention to our previous comments that we believe continue to remain issues today despite the fact that we do not raise all of the issues contained in these letters in this current letter. Following are the comment letters that BMA filed with respect to those proposals:

http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/111605.pdf

http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/090705B.pdf

http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/040505.pdf

We note that the SEC recently acknowledged that fundamental differences exist between the fixed income and equities markets. When the NASD Rule 2320 was last amended in 2006, the NASD stated: "At the time NASD adopted [Rule 2320], the equities markets operated in a framework similar to the current framework for bond trading." However, the SEC took issue with this point, and in its approval order stated that it "expects that the NASD will take into account the structure and operation of the debt markets when applying the rule to debt market participants"[4] Further, best execution concepts in the equities markets have changed over time, and applying those concepts to the bond markets raises difficulties. As a result, we respectfully request that FINRA take into account the differences between these markets, as they currently exist and function.

The equities-based notion of best execution is largely time and price centric. Complexities in the fixed income markets introduce several additional factors that may not be considerations for best execution in the equities markets. For example, in the fixed income markets, the manner in which the position is executed may be as significant as price in achieving optimal execution. A dealer may well minimize the cost of execution by "working" a large trade as smaller but still institutional size increments to minimize price impact in the marketplace. Alternatively, best execution could be achieved when the dealer executes a transaction in a security that includes all of the attributes (such as yield, maturity, call features, etc.) sought by the client. These facets of fixed income best execution imply an optimal result for the client can exist nearly independent of the outright price achieved in the execution.

From a structural perspective, in the equities markets the broker-dealer will often receive a firm order from its client which the broker-dealer then works in order to obtain the most beneficial execution reasonably available under the circumstances. This generally implies that an optimal price range or timeframe of execution was achieved for the client by the broker-dealer. Conversely, the OTC fixed income market, which consists largely of institutional market participants, is not an order-driven market. Instead, executions result primarily from negotiations between market participants that may culminate in an agreement to execute a quantity of a specific instrument at an agreed-upon price, but just as frequently do not. Firm orders are exceedingly rare in this marketplace. There are over 10 million fixed income CUSIPs, compared to about 5000 for equities, meaning that far more fixed income CUSIPs are not traded actively than the number of equity securities in aggregate. Given this, the bond markets are likely to remain negotiated markets and not change to a more order driven market.

Another important distinction between the equity and fixed income markets relates to pre-trade price discovery mechanisms. In equity markets, market makers, exchanges, and alternative trading systems are electronically integrated into trading systems that are accessible to all market center participants. The consolidated quotes published in this market integrated structure can be truly consolidated into a National Best Bid and Offer ("NBBO"). Equity dealers who publish such quotes are required to honor them pursuant to firm quote rules and trade through rules prevent other dealers from executing at prices less desirable than those quotes. Executions are reported to consolidated tapes which provide transparency as to current market conditions.
In contrast, fixed income markets are not integrated and quotes are ordinarily firm only while the customer is "on the wire." Indeed, while equity market makers are required to maintain continuous, two-sided markets and can thus be depended upon to be a trading center for a security, there are no such requirements for fixed income dealers. Thus, publication of a trade at a price provides no assurance that such price will be available to others upon inquiry and the execution of a trade by one dealer provides no assurance that other trades can or will be executed at comparable prices. There are no consolidated trade

[4] Securities Exchange Act Release No. 54339, 71 Fed. Reg. 50959, 50960 (August 21, 2006).

reporting systems for fixed income transactions. The facts that the bond markets are negotiated, not order driven, lack robust pre-trade price discovery mechanisms, and lack electronic access to firm quotes, assessing best execution in real time, let alone after the fact, is a much different process for a bond dealer than for an equity dealer. A bond dealer does not have the same pre-trade point of reference that an equity dealer has in seeking to obtain best execution and in reviewing executions after the fact to determine if, in fact, best execution was achieved. In developing best execution requirements for bond dealers, these differences must be taken into account.

Furthermore, the integration of equity markets and the requirements relating to market making and order execution have enabled the SEC to adopt provisions within Regulation NMS that have required equity market centers to compile detailed information relating to order routing and execution and to make this information available to the investing public. This information is an important tool in analyzing order execution quality.

However, since fixed income markets lack the features of equities markets, it is not possible for comparable data to be transmitted, compiled and analyzed. And, many fixed income transactions are of a size or involve special handling instructions that would exclude them from the requirements of many of these equity rules.

Under the Proposals, a firm would be required to maintain policies and procedures that would document the steps that it has taken to determine the best inter-dealer market for the security. Without a consolidated quote as a reference point, it is not clear what the dealer is expected to document. For example, a bond trader may seek quotes from other dealers, but depending on the facts and circumstances, doing so may not be in the interest of the customer as it would permit market participants to become aware of interest in a bond, which could have the effect of moving the market away from the customer. Further, unlike equity markets, there is no direct trading market between bond dealers in many fixed income markets, so the sheer act of contacting other dealers for quotes on fixed income securities does not necessarily result in a more timely or beneficial execution. Accordingly, we strongly disagree with any suggestion that the act of contacting other dealers would be the implicit or requisite procedure to evidence best execution.

Although some information about pricing is available through the TRACE System, execution data is often sporadic, stale and usually relevant only to orders of a certain size. In addition, the quality and the reliability of the information is not uniform and may not exist with respect to a particular bond, thus often making it difficult to obtain pricing information through that mechanism. As a result, we believe that there is no uniform way to determine how to obtain best execution for fixed income trades and, accordingly, we request that FINRA provide additional guidance.

The first two Proposals – the first relating to foreign securities with no U.S. trading market and the second relating to securities for which limited pricing information is available in the U.S. – address a comparatively small percentage of the overall orders with respect to equity securities. For those relatively small number of equity orders involving securities that do not trade on exchanges and for which there is very little publicly available quotation information available, FINRA is proposing that member firms develop special procedures to address how firms will ascertain the best price reasonably available under the circumstances, including, without limitation, by reaching out to other dealers for quotes/indications. In contrast to the equity markets, a preponderance of fixed income instruments are thinly or rarely traded securities for which limited or no quotation information is available. For the reasons stated above, it is extremely difficult for fixed income dealers to create and implement best execution procedures for fixed income securities. In particular, as discussed above, the delays involved in contacting other dealers for

quotes often operates to the detriment of customers. The Proposal's requirement to specifically document compliance against such procedures simply exacerbates the question as to how such a procedure should actually work. As a result, because we believe that there is no simple way to determine, for purposes of developing policies and procedures that our firms' traders will be required to follow, how to obtain best execution for fixed income trades and, accordingly, we request that FINRA provide additional guidance. For instance, the guidance provided by FINRA in its Interpretive Material 2440-2 represents a more tailored treatment for debt securities as it relates to ascertaining prevailing market prices.

The third Proposal, relating to "regular and rigorous" evaluations of execution quality on a look-back basis, is also inappropriately applied to fixed income securities, and indeed was never intended by the SEC or FINRA to apply in that context. In the Notice requesting comment on this rule, FINRA stated that "regular and rigorous" review is a longstanding obligation and cited the Exchange Act release which implemented changes to the Quote Rule and promulgated the Limit Order Display Rule. Borrowing from these rules, which apply strictly to pre-trade price discovery and order handling of Reg NMS securities (largely equities) and not to fixed income instruments, is an example of how this aspect of the proposed rule seeks to impose, without discussion or analysis, equity market best execution concepts onto the fixed income markets. Moreover, post-trade information is not readily disseminated for many fixed income securities and, as a result, it is difficult, if not impossible, to conduct any meaningful post trade review for trades that are done away from the dealer. Consequently, SIFMA respectfully requests that FINRA make clear, whether in the text of the Supplementary Material or associated commentary, that regular and rigorous reviews are specifically required only in the context of Reg NMS securities. Given the lack of available statistical information, it is not clear how a regular and rigorous review of bond market executions could be done at all.

As a general matter, we strongly believe that the issues raised in this letter with respect to fixed income securities would benefit from discussion with FINRA's Fixed Income Committee, to the extent such Committee has not already provided input or been consulted on the Proposals.

Displaying Priced Quotations in Multiple Quotation Mediums

On a separate but related issue, we wish to take this opportunity to raise certain concerns with Rule 6480. As drafted, Rule 6480 adopts the requirements previously codified in NASD Rule 2320 (g)(2) and (g)(4), including the requirement to display the same priced quotation for a non-exchange listed security when displaying a priced quotation on a real-time basis in two or more quotation mediums. Even though many members are contractually obligated to and do provide each electronic communications network ("ECN") with the same yield or price net of fees for a particular security, the priced quotations displayed by a firm for a particular security may differ. Priced quotations may differ due to (1) different underlying Treasury prices to which many corporate bonds are spread; (2) fees and/or settlement charges added by the ECN to the displayed priced quotation; (3) the need for members to charge different prices for different trade sizes in order to recoup their costs (*e.g.*, odd-lots); and (4) technical issues and errors associated with updating priced quotations (*i.e.*, timing, system outages, etc.). This is an issue with respect to non-exchange listed equity securities as well, particularly foreign securities where prices may be displayed in different currencies, different trade sizes may necessitate different prices, and the possibility that the ECN (or, in a foreign market, a multilateral trading facility (MTF)) might reflect fees and transaction charges in displayed prices. In recognition of these factors, most of which are beyond a member's control, SIFMA recommends that Rule 6480 be amended to require members to display "similar" priced quotations rather than the "same" priced quotation.

Furthermore, Rule 6480 requires that each "member" display the same priced quotation for a non-exchange listed security when displaying a priced quotation on a real time basis in two or more quotation

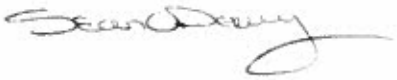
mediums. Since some members have separate institutional, middle market and retail liaison trading desks using quotation mediums, the rule as drafted forces traders at different desks to offer a security at the same price. These different desks within a given firm may have different views on the context of the market for a particular security, may be differently positioned to trade on that security (long vs. short) or may have different sizes (very small positions are sometimes offered very cheaply to clean up an inventory line item). They may not be able to use the same bid or offer price across the firm for practical/coordination reasons (*e.g.*, information wall restrictions) and, even if technology or business unit coordination hurdles were overcome such that different desks could align all prices, it would undoubtedly be at a price that was least advantageous to clients. In light of the issues raised above, SIFMA would request the opportunity to work with FINRA to revise Rule 6480.

* * *

We would be pleased to discuss these comments in greater detail with the FINRA staff. We can be reached in this regard at 202-962-7300 or 212-313-1000.

Sincerely,

Ann Vlcek
Managing Director and Associate General Counsel



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