SIFMA

Securities Industry and
Financial Markets Association

February 25, 2010

Via Electronic Mail (rule-comments@SEC.gov)

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

Re: File No. SR-FINRA-2009-077 (Notice of Filing of Proposed Rule Change Relating to the Restructuring of Quotation Collection and Dissemination for OTC Equity Securities), Exchange Act Release No. 60999

Dear Ms. Murphy:

The Market Data Subcommittee of the Securities Industry and Financial Markets Association ("SIFMA")[1] Technology and Regulation Committee appreciates the opportunity to comment on SR-FINRA-2009-077. This filing has two major proposals, as follows: 1) to permit FINRA to cease operation of the Over the Counter Bulletin Board ("OTCBB"); and 2) to require FINRA members to submit all their quotations in over-the-counter ("OTC") equity securities to a new, FINRA-controlled, Quotation Consolidation Facility (''QCF'') contemporaneous with such members' display of quotations in any interdealer quotation system that permits updates on a real-time basis (the "QCF Proposal"). FINRA would then give this data to the Nasdaq UTP Plan to include in NASDAQ's Level One quotation data, presumably generating additional value for Nasdaq and the UTP Plan's other exchange members.[2]

For this service, FINRA proposes to charge its members $4.00 per month for each security that they quote in the OTC markets. Currently, FINRA members pay no

---

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

[2] The proposal is silent whether FINRA itself would earn new market data value from passing along the OTC securities quote data to include in the Nasdaq UTP Plan Level One quote.

fees to FINRA in connection with their OTC equity quoting activities, except in the small number of instances where they quote on the OTCBB.

While SIFMA believes there is a significant benefit to a consolidated BBO for OTC equities, SIFMA is concerned about the consolidation of control of this market data under an SRO because of the potential monopoly and competitive advantage gained through an SRO's use of regulatory authority. FINRA as well as the SRO members of the UTP Plan will earn additional revenue from this proposal, while increasing costs to investors and SIFMA members and competitively damaging Pink OTC Markets – a private entity which has operated successfully its own interdealer quotation system.

Instead of approving FINRA's proposal – which FINRA has failed to demonstrate is consistent with the required standards for Commission approval under the Securities Exchange Act of 1934 ("Exchange Act") – to the extent the Commission believes regulatory intervention is necessary to foster the consolidation of quotations in OTC equity securities in the interest of investors, the Commission should oversee this activity itself under its authority to regulate securities information processors.[3]

I. SIFMA Opposes Moving from a Market that Enables Competition to One that Grants an SRO Monopoly in the Market for OTC Quotations

Market data is an integral part of our national market system, and SIFMA does not object to the consolidation of OTC quotes which is consistent with transparency goal of Section 11A of the Exchange Act.[4] SIFMA, however, as it has stated in past comment letters, opposes SRO monopolies over the collection and distribution of market data.[5] SIFMA supports competition in this arena and believes the

---

[3] SIFMA agrees with FINRA's goals of assuring that market participants and regulators have ready access to consolidated real-time data, to assure members' best execution obligations, facilitate market surveillance, and to extend certain Regulation NMS protections to the over-the-counter market. But FINRA has failed to show why those objectives require that the Commission approve this proposal when alternatives more consistent with the Exchange Act goals of facilitating competition, transparency, and investor protection are available as discussed below.

[4] *See*, 15 U.SC. § 78k-1. Section 11A(a)(1)(C)(iii) states that Congress finds "it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure … [t]he availability to brokers, dealers, and investors of information with respect to quotations for transactions in securities … "

[5] See Letter from Marc Lackritz, President, SIA, to Jonathan Katz, Secretary, SEC (Feb. 1, 2005) available at http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/4601.pdf; Letter from Marc Lackritz, President, SIA, to Jonathan Katz, Secretary, SEC (June 30, 2004) available at http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/30455376.pdf; and

Commission should limit the SROs' control over market data whenever possible. SRO monopolies, particularly those involving "for profit" SROs, should be disfavored as compared to a competitive free market that is flexible and subject to the quality-control pressures of competition. In the past, SRO monopolies have often resulted in rigid, unjustified price structures and excessive administrative burdens.

Historically, SRO monopolies over the collection and distribution of market data have led to insufficient disclosures regarding fee setting and frequent rate increases, which in turn have led to suspicions among market participants that SROs use access fees to force broker-dealers and investors to subsidize a significant portion of the SROs' regulatory and administrative costs through inflated fees. For example, the Commission found that in 2003 the three networks disseminating market data for the NYSE, Amex and NASDAQ charged access fees that represented a 1000 percent mark up when compared the actual expenses incurred by the networks to provide the service.[6] In its recent Concept Release on Equity Market Structure, the Commission reported that Network C (the Nasdaq UTP Plan) charged fees resulting in $134,861,000 in revenue for its SRO members in 2008, representing almost 24 times the Network costs incurred of just $5,729,000.[7]

Additionally, SRO market data monopolies create excessive administrative burdens for users. Users are routinely required to enter into heavily papered relationships – vendor agreements, subscriber agreements, customer agreements and data use policies – as well as submit to annual audits, in order to receive data. Finally, historically, the governance structure of SRO monopolies, such as the joint industry market data plans (the CTA Plan, the CQ Plan, and the NASDAQ UTP Plan) have been opaque, clouded by the entrenched interests of their formidable operating committee members. In 2005, SIFMA called for governance rules to apply to these committees in the same manner the Commission instituted strict rules governing impartiality among corporate boards. Consequently, SIFMA believes the Commission should not further extend SRO control over market data, especially where an alternative exists.

Letter from Marc Lackritz, President, SIA, to Jonathan Katz, Secretary, SEC (April 11, 2000) available at http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/30966597.pdf

[6] Exchange Act Release No. 49325, 69 Fed. Reg. 11126 (Mar. 9, 2004)at 11179.

[7] Concept Release on Equity Market Structure, Release No. 34-61358, 75 Fed. Reg. 3594, at Table 1 (January 14, 2010).

The Open Market has Met the Demand for a Consolidated OTC Equity Quotation; Consolidation by FINRA is Unnecessary

Currently, there is competition with respect to the display of OTC equity quotations between the two interdealer quotation systems operated by Pink OTC Markets and the OTCBB. Although there is no regulatory requirement for the consolidation of OTC equity quotations, in response to market demand, Pink OTC Markets buys OTCBB quote data and provides the functional equivalent of a consolidated quotation stream for OTC equities, as do other market data vendors. If FINRA wishes to compete as a purveyor of consolidated OTC equity quotations, FINRA is free to purchase quotation data from Pink OTC Markets on the same terms as any other person may do so.

Instead, under the QCF Proposal, FINRA proposes to cease operating the OTCBB – which competes with Pink OTC Markets. This FINRA act will remove competition and leave Pink OTC Markets as the sole operator of an interdealer quotation system for OTC equities. FINRA then proposes to take what it could not garner competitively by imposing a quote consolidation requirement, and provide the resulting OTC quotes as part of the NASDAQ Level One market data feed. But as a practical matter, if the Commission approves FINRA's shuttering of the OTCBB, there will be nothing left to consolidate because the FINRA quote consolidation proposal will simply take quotes from Pink OTC Market's and sell them under NASDAQ's name.

If Pink OTC Markets becomes the sole interdealer quotation system and sole source of real-time, OTC equity quotations, the Commission itself should consider regulating Pink OTC Markets to ensure the distribution of such quotes meets the interests of investors, including dissemination on fair and reasonable terms. Pink OTC Markets meets the definition of "securities information processor" ("SIP") in the Exchange Act.[8] If Pink does not make its OTC quotes available to broker-dealers, investors or market data redistributors on fair and reasonable terms or consistent with other applicable standards under the Exchange Act, Commission could use its authority under Section 11A(b)(1), either by issuing an order or promulgating rules, to require Pink to register as a non-exclusive SIP subject to any rules the Commission believes are necessary relative to the operation of such non-exclusive

[8] Section 3(a)(22)(A) of the Exchange Act defines the term "securities information processor" to mean "any person engaged in the business of (i) collecting, processing, or preparing for distribution or publication, or assisting, participating in, or coordinating the distribution or publication of, information with respect to transactions in or quotations for any security (other than an exempted security) …"

SIP.[9] This model – which enables competition – is preferable to replicating the current monopoly SRO model.

II. The FINRA Proposal is Inconsistent with Section 3(f)

Section 3(f) of the Exchange Act provides that "whenever pursuant to this title the Commission is engaged in ... the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[10] SIFMA believes that the QCF Proposal hinders efficiency, competition, and capital formation.

The QCF Proposal Hurts Competition among Interdealer Quotation Systems and Market Data Vendors

Exchange Act Section 3(f) requires that the Commission consider the effect of SRO rule proposals on competition. FINRA's QCF Proposal would hinder competition among OTC equity interdealer quotation systems by eliminating a significant source of their revenue (*i.e.*, revenue from the sale of quotation data). The absence of this revenue stream would hurt Pink OTC Markets and any other entity seeking to compete with Pink and might well preclude competitors from entering the interdealer quotation system business for OTC equities. This negative impact on competition among interdealer quotation systems and market data vendors is inconsistent with the statutory standard of Section 3(f). FINRA failed to analyze this impact.

Furthermore, the proposal to include OTC equity quotations into the existing NASDAQ quote consolidation monopoly raises antitrust concerns. The SRO Concept Release recognized the inherent conflict of interest in allowing SROs to use their regulatory functions to leverage a market monopoly, yet FINRA seems to be proposing something similar here.

---

[9] The Commission has the authority to require any or all non-SRO interdealer quotation systems to register as a non-exclusive SIP, subject to any rules the Commission chooses to promulgate, to ensure each provides quotes to other interdealer quotation systems or other SIPs on fair and reasonable terms for purposes of publishing/disseminating/selling consolidated OTC equity quotes.

[10] 15 U.SC. § 78c(f).

The QCF Proposal Would Hurt Capital Formation and Execution Quality, May Increase Costs on Investors

The FINRA Proposal also is inconsistent with the Section 3(f) goal of encouraging capital formation by increasing quoting costs on broker-dealers. It also may hurt execution quality and increase costs to customers.

We believe that the QCF Proposal may increase the cost of quoting OTC equities, both through FINRA's proposed "per quote" charge and an expected increase in fees charged by Pink OTC Markets to offset its loss of the revenue it currently earns from distributing its quotation data. According to the QCF Proposal, a mandatory position charge will be assessed on FINRA members for any quotations they display in an interdealer quotation system, yet the QCF Proposal does not include the provision of a system to allow other broker-dealers to interact with the quotations that FINRA publishes. This fee structure effectively results in a tax on the industry for displayed liquidity that is unrelated to any service offering. This "per quote" charge will discourage broker-dealers from quoting thinly traded companies. The result will be that some companies now quoted in the Pink OTC Market will cease to be quoted, while other companies will never be quoted; in both cases, it harms the ability of small issuers who are not quoted to raise capital. The absence of quotations will also harm transparency and result in worse execution quality. Furthermore, where a market maker continues to quote, the proposed fee structure would result in an increase in the overall costs related to OTC equity executions that will ultimately be borne by customers.

Irrespective of the QCF's proposed "per quote" fees, we believe that the QCF Proposal will significantly increase the cost of quoting OTC equities. The QCF will deprive Pink OTC Markets of its current ability to generate revenue through the distribution of its quotation data and will most likely result in an increase in user fees charged by Pink OTC Markets. As with the QCF fees, any increase in the fees charged by Pink OTC Markets would lead broker-dealers not to quote the least active issues. To the extent a market maker continues to quote a security on Pink OTC Markets subject to increased fees, these fees ultimately will be passed on to the customer.

Finally, the proposal does not contain estimates of the cost and revenue for FINRA and the Nasdaq UTP Plan that would result from approval of the proposal. Nor does it contain any analysis of the impact on fees investors would pay for quotes. As a result, neither SIFMA nor other members of the public are able to comment on, and the Commission is unable to consider fully, the impact on investors, exchanges, and other data providers.

III. Conclusion

For the reasons stated above, we believe the Commission should reject the QCF Proposal. SRO monopolies with respect to market data have considerable negative aspects that can and should be avoided. SIFMA does not see the necessity here. To the extent FINRA ceases operating the OTCBB, consolidation is not necessary as a practical matter. Even if FINRA sells OTCBB to a third party, consolidation can take place outside of the exchanges' control, as Pink OTC Markets does today with the OTCBB data. Furthermore, to assure that quotation data for OTC equities is generated and disseminated in the interest and protection of investors, the Commission should choose to instead use its authority to regulate Pink OTC Markets and any other entities that sell quotation data for OTC equities as SIPs.

If you have any questions, please contact me at 202-962-7385.

Respectfully submitted,

Melissa MacGregor

Melissa MacGregor
Managing Director and Associate General Counsel

cc: The Hon. Mary Schapiro, Chairman
The Hon. Luis Aguilar, Commissioner
The Hon. Kathleen Casey, Commissioner
The Hon. Troy Paredes, Commissioner
The Hon. Elisse Walter, Commissioner
Robert Cook, Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
Nancy Sanow, Assistant Director, Division of Trading and Markets