



November 26, 2013

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

Re: SR-FINRA-2013-031

Dear Ms. Murphy:

The National Stock Exchange, Inc. ("NSX")¹ is writing to provide further comment to the Securities and Exchange Commission ("Commission") on the Financial Industry Regulatory Authority, Inc.'s ("FINRA") proposed amendments to Rules 6271 and 6272 ("ADF Proposal" or "Proposal")² regarding members seeking registration as FINRA Alternative Display Facility ("ADF") Market Participants ("ADF Market Participants").

On July 18, 2013, FINRA filed with the Commission, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act") and Rule 19b-4 thereunder, the ADF Proposal.³ NSX first submitted comment to the Commission on the ADF Proposal in a letter dated September 9, 2013 ("NSX Letter").⁴

¹ The NSX provides order delivery functionality to electronic communication networks ("ECNs"). The order delivery function provides a standard access point through which market participants can access the quotations of an ECN participant. An ECN that participates in the order delivery program provides NSX with its best bids and offers for display in the consolidated quotation system. NSX receives orders from market participants seeking to access these quotes, and it delivers an order delivery notification to the ECN. The ECN responds to the order delivery notification confirming the number of shares to be executed. The resulting execution occurs on the NSX. The NSX reports all executions to the consolidated tape for public display. NSX also disseminates a consolidated depth of book product through which an ECN can provide attributed quotations. Two ECNs participate in NSX's order delivery program, with one order delivery participant accounting for over 90 percent of overall ECN volume. Three additional ECNs are in various stages of certification to participate in NSX's order delivery program.

² See Securities Exchange Act Release No. 70048 (July 26, 2013), 78 FR 46652 (August 1, 2013) (SR-FINRA-2013-031). ("ADF Proposal").

³ See ADF Proposal at pp. 7-13.

Under the ADF Proposal, FINRA proposes to recoup a portion of the specific costs of building the new ADF platform from ECNs that fail to use the ADF platform after becoming an ADF Participant. FINRA's ADF Proposal requires new ADF Participants to (i) provide FINRA with monthly volume projections, (ii) deposit either \$250,000 or \$500,000 in an escrow account in five equal installments ("Proposed Participant Fee"), and (iii) agree to forfeit some or all of the Proposed Participant Fee if (1) the ADF Participant fails to quote or report trade reports for a two year period to the ADF, or (2) the ADF Participant fails to submit 75 percent of its quotes and trades to FINRA ("Quote and Trade Commitment").

The Proposed Participant Fee's two-tiered rate is determined by the date that the ADF Participant begins quoting and reporting trades to FINRA. ADF Participants that request access to the ADF platform by the

On September 10, 2013, the Commission extended the time period in which to either approve, disapprove, or to institute proceedings to determine whether to approve or to disapprove the Proposal, to October 30, 2013.⁵ FINRA provided a response to the NSX Letter in a letter to the Commission dated October 25, 2013 (“FINRA Response”).⁶ On October 30, 2013, the Commission issued an order (“Order”) instituting proceedings to determine whether to approve or disapprove the ADF Proposal.⁷

In the Order, the Commission invited the written views of interested persons concerning whether the Proposal was inconsistent with Section 15A(b)(9) or any other provision of the Act, or the rules and regulations thereunder.⁸ With this letter, the NSX hereby provides additional comment on the ADF Proposal to the Commission. The NSX incorporates herein the comment contained in the NSX Letter, without restating in full the same, and expands on some of that comment in this letter.

NSX respectfully requests the Commission to disapprove the ADF Proposal because the Proposal is not consistent with the requirements of Sections 15A(b)(9), 15A(b)(5) and Section 11A of the Exchange Act.

scheduled completion date of mid 2014 must deposit \$250,000 in an escrow account. However, an ADF Participant can accelerate the completion date of the ADF platform to late 2013 if the ADF Participant deposits \$500,000 rather than \$250,000 in an escrow account. FINRA indicates that the higher amount reflects the increased costs associated with the accelerated development schedule. ADF Participants that begin quoting or reporting transactions to FINRA within 90 days of the ADF Participant requesting the accelerated completion must also pay the \$500,000 escrow amount.

An ADF Participant can recover the Proposed Participant Fee through market data rebates which are equal to 50 percent of FINRA’s market data revenue during any quarter. ADF Participants can recover up to 80 percent of the Proposed Participation Fee in the first quarter of participation while collecting the remaining 20 percent at the end of a two-year term, or 100 percent of the Proposed Participant Fee over the two-year term. ADF Participants must also agree to the Quote and Trade Commitment which requires them to provide FINRA with 75 percent of both quotes and trades during the same two-year period, or otherwise all or some of the Proposed Participant Fee will be forfeited to FINRA.

⁴ See Letter to Elizabeth M. Murphy, Secretary, Commission, from David Harris, Chairman and CEO, National Stock Exchange, Inc., dated September 9, 2013 (“NSX Letter”).

⁵ See Securities Exchange Act Release No. 70358, 78 FR 56967 (September 16, 2013) (SR-FINRA-2013-031).

⁶ See Letter from Stephanie M. Dumont, Senior Vice President and Director of Capital Markets Policy, FINRA to the Commission dated October 25, 2013, (“FINRA Response”).

⁷ See Securities Exchange Act Release No. 70776, 78 FR 66405 (November 5, 2013) (SR-FINRA-2013-031).

⁸ See ADF Proposal at text preceding Footnote 48.

I. Proposal Imposes an Inappropriate Burden on Competition

After many years of dormancy and at the request of a customer, FINRA is attempting to resurrect the ADF through the Proposal.⁹ Section 15A(b)(9) of the Exchange Act requires that FINRA rules do not impose a burden on competition not necessary or appropriate in furtherance of the provisions of the Act.¹⁰ NSX submits that the Proposal, as currently configured, imposes an inappropriate burden on competition for other self-regulatory organizations (“SRO” or “SROs”).

In FINRA’s Response, FINRA asserts that the ADF “...serves an important purpose for FINRA in fulfilling its statutory obligations, including those under Section 15A(b)(11) of the Act¹¹ and, as such, FINRA must operate the ADF, even at a loss.” (FINRA Response at page 3 of 7). Section 15A(b)(11) of the Act does not confer a unique status to FINRA that would allow it to utilize an unfair or subsidized pricing schedule to operate the ADF “at a loss.” By charging below cost or subsidized rates to ADF Market Participants, FINRA would have an unfair advantage against other exchanges that are offering competitive alternatives. NSX, and each national securities exchange also have a statutory obligation to collect, distribute, and publish quotations on behalf of its members pursuant to Section 11A(c)(1) of the Act.¹² NSX disagrees that the existence of a statutory requirement, one shared by every national securities exchange, can be interpreted to relieve FINRA from the requirement that it operate its facility in a manner that does not unnecessarily or inappropriately burden competition.

Exchanges charge transaction fees to members that utilize their trading facilities in order to cover the costs of the services offered including the costs associated with operating, regulating and maintaining these markets. FINRA should not be permitted to use the revenues it generates from performing various regulatory functions and services, including performing regulatory services on behalf of exchanges, to subsidize or cover the losses associated with operating the ADF. FINRA should compete with NSX in a fair and equitable manner for order delivery customers by requiring members that utilize the ADF to pay their fair share for its use. Like the NSX, ADF users should be required to self-fund the ADF platform, its operation, maintenance and

⁹ “Since the ADF was launched in 2002, no member has registered with FINRA as a registered reporting ADF Market Maker, and there have been four members that, at various points in time, were registered as registered reporting ADF ECNs (citation omitted). Since the second quarter of 2010 there have been no ADF Market Participants (citation omitted).” See ADF Proposal at text preceding and following Footnote 14.

¹⁰ 15 U.S.C. 78o-3(b)(9).

¹¹ Section 15A(b)(11) of the Act requires that “[t]he rules of the association include provisions governing the form and content of quotations relating to securities sold otherwise than on a national securities exchange which may be distributed or published by any member or person associated with a member, and the persons to whom such quotations may be supplied. Such rules relating to quotations shall be designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.”

¹² A reading of the text of Section 11A(c)(1) applicable to national securities exchanges and comparison to the text to Section 15A(b)(11) cited by FINRA confirms that there is no greater statutory requirement imposed on FINRA with respect to disseminating quotations than those imposed on national securities exchanges.

regulation. ADF Participants should choose between the ADF platform and NSX based upon technology, service and actual cost to them to participate on the competing platforms. Subsidizing the cost of the ADF, or running the ADF at a loss is, on its face, an unnecessary and inappropriate burden on competition as it relates to NSX.

In addition, ADF Market Participants must agree to submit at least 75 percent of their quotes to, or report trades on, the ADF for a two-year period, or they will lose their ability to recoup all or some of the Proposed Participant Fee (“Quote and Trade Commitment”).¹³ The Quote and Trade Commitment is a highly unusual, if not unprecedented, approach by an SRO, and appears to be antithetical to the statutory requirement under Section 15A(b)(6) of the Act that FINRA’s rules be designed to remove impediments to and perfect the mechanism of a free and open market and national market system.¹⁴ The operational combination of the Proposed Participant Fee with the Quote and Trade Commitment has the potential to negatively impact competition from another SRO for ECN transaction services, if not eliminate that competition altogether.

The combination of (i) subsidized pricing, (ii) the Proposed Participant Fee, and (iii) the Quote and Trade Commitment may enable the ADF to monopolize ECN transaction services. In essence, an ADF Market Participant would be compelled to send a substantial portion of its quotes and trades to the ADF or it would suffer a significant financial penalty. Were the ADF were able to attract merely one or two large ECNs as an ADF Market Participant, then the ADF would essentially have the ability to dominate ECN transaction services in such a manner that no other SRO could provide those services.

In particular, the Quote and Trade Commitment represents a burden on competition for any SRO that is seeking to offer ECN quote display, and this burden is neither necessary nor appropriate. It is unlikely that any SRO could compete with FINRA for ECN transaction services given the costs of operating and regulating an SRO that provides order delivery functionality in a fair and nondiscriminatory manner.

FINRA notes, in partial justification of this burden on competition, that the Proposed Participant Fee, in combination with the Quote and Trade Commitment, would enable FINRA to recoup the expenses it will incur in connection with a new ADF Market Participant.¹⁵ NSX recognizes that the combination of the Proposed Participant Fee with the Quote and Trade Commitment will help to defray the costs of developing the ADF but posits that the mitigation of FINRA costs does not satisfy the requirements of Section 15A(b)(9). Irrespective of FINRA cost recovery, the ADF Proposal must still be consistent with the requirements of Section 15A(b)(9) and Section 11A.

FINRA further attempts to justify the Quote and Trade Commitment by claiming that ADF Market Participants can voluntarily choose to meet the Quote and Trade Commitment, and that

¹³ Id. at p.8.

¹⁴ See Cf. 15 U.S.C. 78f(b)(5).

¹⁵ See FINRA Response at p.7.

ADF Market Participants retain discretion in determining the level of quoting and trading activity which is sent to the ADF.¹⁶ However, in this highly competitive environment where quoting and transaction fees are key determinants behind market participants' choices of venues, it is easy to foresee a set of circumstances whereby such a commitment would lead to an ECN transaction services monopoly, thereby effectively eliminating the justification that meeting the commitment is voluntary. Additionally, the Exchange believes that, irrespective of the FINRA claim that the Quote and Trade Commitment is voluntary, the ADF Proposal must still be consistent with the requirements of Section 15A(b)(9) and Section 11A of the Act.

Neither the Proposed Participant Fee nor the Quote and Trade Commitment contain any unique characteristic such that their operational combination would advance the protection of investors or the public interest. Their purpose appears to be simply and solely to ensure that FINRA can recover a portion of its ADF costs, and impose requirements that would assure a level of activity in the facility. The proposal as structured would provide FINRA a unique advantage in that it would both recoup the costs of the technology changes to the ADF (which apparently it intends to make in any event) and assure a level of activity that would justify the expense and hopefully attract more volume as other market participants attempt to access the liquidity that it has essentially compelled into the ADF.

The Exchange respectfully submits that FINRA's analysis fails to satisfy the statutory burden of Section 15A(b)(9) and Section 11A in that it does not address whether the ADF Proposal imposes an inappropriate or unnecessary burden on competition for other SROs, such as the NSX. The combination of subsidized pricing, the Proposed Participant Fee with the Quote and Trade Commitment is likely to operate in such a manner to impose a clear burden on competition that is not necessary or appropriate. If the NSX ceased to offer order delivery functionality because of anti-competitive pricing, current and future ECNs would have little choice but to become ADF Market Participants.

In summary, the Exchange submits that the Proposal imposes a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The ADF Proposal is not consistent with Section 15A(b)(9) and Section 11A of the Act.

II. Proposal Fails to Provide for the Equitable Allocation of Reasonable Dues, Fees and Other Charges

Section 15A(b)(5) of the Exchange Act provides that FINRA rules must provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which FINRA operates or controls.¹⁷

The ADF Proposal fails in many respects to provide sufficient information to establish compliance with the requirements of Section 15A(b)(5). A FINRA member could not ascertain from the Proposal the costs of the ADF and how FINRA intends to cover those costs. For

¹⁶ Id. at text following Footnote 12.

¹⁷ 15 U.S.C. 78o-3(b)(5).

example, the Proposal fails to disclose the specific percentage of total development costs that the Proposed Participant Fee represents and how FINRA intends to cover the remaining development costs. It is not enough to make the mere assertion, unsupported by any data, that “bringing the new ADF infrastructure live in the MPP technology environment to accommodate a new ADF Market Participant will impose significant direct costs on FINRA . . .”¹⁸ and then to mention that these costs will conservatively be in excess of \$3 million.¹⁹ The Proposal provides insufficient information about the ADF development costs to determine if the Proposal satisfies the requirements of Section 15A(b)(5) of the Act.

Similarly, the Proposal contains little to no information on the ADF operational costs and how FINRA intends to cover those associated costs. The Proposal should provide complete cost information, not only on the costs of developing the ADF, but also on the ADF operating costs and should provide how FINRA intends to cover those costs. The bare description of the market rebate available to ADF Market Participants and the following conclusion that FINRA will have available one-half of the SIP market data revenue generated by trading activity on the ADF by ADF Market Participants is woefully insufficient. There is no way to determine the extent to which the ADF costs match the anticipated revenues and how FINRA intends to cover the remaining cost gap. Additional information about the ADF operational costs and how FINRA intends to cover those costs is necessary in order to establish compliance with the requirements of Section 15A(b)(5) of the Act.

NSX understands that the Proposal is designed to mitigate the ADF financial costs to FINRA. However, the mere assertion that these costs are substantial is not enough. The Proposal should be clear as to the aggregate development and operational ADF costs and how FINRA intends to cover those costs, especially if there is an anticipated revenue/cost mismatch. Without this information, compliance with the requirements of Section 15A(b)(5) of the Act cannot be determined.

Further, the Proposed Participant Fee will be the same for any member seeking to become an ADF Market Participant, regardless of the overall quotation and trading volume anticipated from the ADF Market Participant. This one-size fits-all approach appears to discriminate against smaller ADF Market Participants and may pose an unreasonable barrier to entry for them, especially if the combination of the Proposed Participant Fee with the Trading and Quote Commitment enables the ADF to dominate ECN transaction services. The Proposal fails to explain why it is equitable to charge all ADF Market Participants the same Proposed Participant Fee, which is inconsistent with the requirements of Section 15A(b)(5) of the Act.

Moreover, the Proposal does not disclose the proposed transaction costs that it intends to charge ADF Market Participants for shares executed and transactions reported to the ADF as a part of the Quote and Trade Commitment. While FINRA apparently has in place quote and transaction fees that are applicable to ADF Market Participants, these fees and charges are likely out of date. In order to comply with the requirements of Section 15A(b)(5) of the Act, the ADF Proposal

¹⁸ See ADF Proposal at p.5.

¹⁹ Id.

should clearly disclose updated ADF fees and charges to be imposed on ADF Market participants for the proposed new ADF configuration.

According to “Section 19(b)(2)(C) of the Act, the Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to such organization [citation omitted]. The Commission shall disapprove a rule change if it does not make such a finding [citation omitted]. The Commission’s Rules of Practice, under Rule 700(b)(3), states that the ‘burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder . . . is on the self-regulatory organization that proposed the rule change’ and that a ‘mere assertion that the proposed rule change is consistent with those requirements . . . is not sufficient [citation omitted].’ ”²⁰

The Proposal fails to provide the ADF cost and anticipated revenue information necessary to determine if there has been an equitable allocation of reasonable dues, fees and other charges. In addition, the Proposal fails to establish the reasonableness of the Proposed Participant Fee; the Proposal fails to establish that the Proposed Participant Fee is equitable among all FINRA members; and the Proposal fails to establish that the Proposed Participant Fee is equitable among all ADF Market Participants. The ADF Proposal does not provide the information necessary for the Commission to have a sufficient basis to make an affirmative finding that the Proposal is consistent with Section 15A(b)(5) of the Exchange Act.

Furthermore, NSX believes that FINRA’s assertion that it may operate the ADF at a loss because it is statutorily required to collect, distribute, and publish quotations on behalf of its members pursuant to Section 15A(b)(11) of the Act is unfair and inequitable for all FINRA members that do not use the ADF platform. Each exchange has a statutory obligation to collect, distribute, and publish quotations on behalf of its members pursuant to Section 11A(c)(1). However, the exchanges must not only seek to operate at a profit, or at the very least recover expenses, they must also ensure that fees are distributed fairly and equitably. For example, NSX charges order delivery participants higher fees because they comprise substantially all of the volume on the exchange. The lower fees charged to auto execution business is just and equitable because such activity does not utilize as much of the Exchange’s resources. The Exchange believes that this approach meets its statutory burden under Section 6(b)(4) of the Act that its rules “...provide for

²⁰ Securities Exchange Act Release No. 34-68629 (January 11, 2013);78 FR 3928 (January 17, 2013) (SR-NASDAQ-2012-059), at text preceding Footnote 23.

In this proceeding, the Commission issued an order disapproving a proposed rule change filed by the NASDAQ Stock Market LLC to offer Benchmark Orders that would seek to achieve the performance of a specified benchmark. In the order, the Commission pointed out that the “description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding (citation omitted). Any failure of a self-regulatory organization to provide the information elicited by Form 19b-4 may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Act and the rules and regulations issued thereunder that are applicable to the self-regulatory organization (citation omitted).

Id. at Footnote 23.



the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.”

Likewise, FINRA must charge ADF participants a rate which is fair and reasonable for the use of the ADF facility. This rate should be based on the cost of operation, regulation and development. FINRA should not be treated any differently than another SRO providing a quoting or trading facility. This means that it should not be able to comingle members’ fees or subsidize the losses associated with operating the ADF platform. This practice is not fair or equitable to those members that do not utilize the ADF, and it is inherently unfair to treat competing SROs differently under Section 11A(a)(1)(C)(ii) without showing that this difference is in the public interest and the maintenance of fair and orderly markets.

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For the reasons stated in the NSX Letter and expanded upon herein, the NSX respectfully requests the Commission to disapprove the ADF Proposal because the Proposal is not consistent with Sections 15A(b)(9), 15A(b)(5) and 11A of the Exchange Act.

The NSX appreciates the Commission's consideration of the views expressed in this letter. If you have any questions or seek any additional information, please do not hesitate to contact the undersigned.

Sincerely,

A handwritten signature in blue ink, appearing to read 'David Harris', with a long horizontal flourish extending to the right.

David Harris