May 31, 2007

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-2001

Subject: **Comments to SEC Release 34-55717**
File No. SR-NASD-2007-029

Dear Ms. Morris:

Pink Sheets LLC ("Pink Sheets") respectfully submits the following comments on the amendment proposed by the National Association of Securities Dealers, Inc. (the "NASD") to NASD Rule 6540(c). Pink Sheets is the leading provider of pricing and financial information for the over-the-counter ("OTC") securities markets and, among other things, operates an Internet-based, electronic quotation and trade negotiation service for OTC equities and bonds used by over 200 market makers and other broker-dealers registered under the Securities Exchange Act of 1934 (the "Exchange Act").

I. <u>Executive Summary</u>

As explained in greater detail below, we are against introducing access or post-transaction fees to the OTC markets. We are stunned that the NASD has chosen to introduce the controversy of access fees without a clear regulatory basis and the regulatory oversight required to prevent the harmful effects of access fees on the behavior of market participants. In the marketplace for NMS securities, these fees have a well-documented history of causing major disruption to the orderliness of the market, especially if limited to a few privileged participants. We believe the proposed amendment, if adopted, will create an anti-competitive monopoly for ATSs and ECNs that is based on regulatory privilege, rather than competition, in the market for limit orders. The NASD's creation of a fee charging monopoly for ATSs and ECNs will be to the detriment of other competitive broker-dealers and the investing public. In addition, we foresee bitter disputes caused by locked and crossed markets, refusals to pay access fees, and denials of access by ATSs and ECNs.

Nonetheless, if the Securities and Exchange Commission ("SEC" or the "Commission") determines to approve this ill-conceived rule, then all NASD members should be allowed to levy and collect access fees. Moreover, we believe that if access fees are approved as proposed, we see no reason to limit them to OTCBB securities. The Commission should take this opportunity to permit all broker-dealers to charge access fees for all equity securities traded on the OTC market.

Irrespective of whether a few or all market participants may levy access or post-transaction fees for OTCBB securities or all OTC equity securities, to avoid market disruption and harm to the investing public, the Commission should clearly describe the legal and regulatory basis for access fees. The NASD must have corresponding rules and adequate market oversight to ameliorate the harmful effects that allowing non-subscriber access fees will introduce to the OTC equity markets. We all have learned much from the history of such fees with NMS securities and should strive to avoid repeating the same mistakes in the market for OTCBB securities.

II. Background

The subject NASD rule filing has supplanted a prior rule filing by the NASD, SR-NASD-2005-95, which was also withdrawn by the NASD as part of SR-NASD-2007-029. In the NASD's original rule filing, the NASD had proposed to amend NASD Rule 6750 to prohibit NASD members from displaying quotations in sub-penny increments in any quotation medium for any OTC Equity Securities with a value of $1.00 or more per share.[1] In its first amendment to its original rule filing, the NASD proposed to eliminate the current requirement of NASD Rule 6540(c) that Electronic Communications Networks ("ECNs") and alternative trading systems ("ATSs") display access fees in their displayed OTCBB quotations.[2] The NASD proposed the elimination of the access fee display requirement of Rule 6540(c) in response to one comment on the original proposal claiming that the proposed prohibition of sub-penny quotations conflicted with the obligations of any ECN or ATS to include access fees in their OTCBB quotations.

The subject NASD rule filing now only focuses on the access fee display requirement found in NASD Rule 6540(c). The new filing drops the prohibition on displaying quotations in sub-penny increments, which was the basis for permitting access fees in the first amendment to the original rule filing. Under the new proposed amendment, that display requirement would arise only for access fees that exceed or accumulate to more than: a) 3 mills per share for published quotations priced equal to or greater that $1.00; or b) 0.3% per share of the published quotation price for published quotations priced less than $1.00.

The NASD justifies its current efforts on the following two grounds: First, requiring the incorporation of access fees in the published quotation potentially leads to the publication of different priced quotations in two different quotation media, *i.e.*, the OTCBB with the fee so

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[1] *See generally*, Exchange Act Release No. 52280 (August 17, 2005).

[2] *See generally*, Exchange Act Release No. 53024 (December 27, 2005).

incorporated and the ATS/ECN without it. NASD Rule 2320(g)(2) requires that the two priced quotations be the same in the two different quotation media, and thus subscribers will trade without the imposition of the fee. Second, requiring an ATS/ECN to incorporate its access fee in its published quotation potentially leads to the effecting of two different trades by the ATS/ECN, one as agent and one as principal.

We find neither NASD justification persuasive. First, compliance with the prohibition found in Rule 2320(g)(2) is not achieved through a limited display requirement under amended Rule 6540(c). If it is unacceptable for an ATS or ECN to put its fee in its quote, inclusion of fees of a particular size remains inconsistent with the requirements of Rule 2320(g)(2). Moreover, if an ECN determines as a matter of business judgment not to charge its customers an access fee, it is not clear why a regulation should permit the ECN to charge non-customers. The argument that without access fees non-customers are permitted to use the facilities of an ECN without paying for the service is also unsound. Every broker-dealer that interacts with the public markets on its customer's behalf must necessarily allow its competitors to benefit from its order-gathering abilities, but this fact of life has never justified charging those competitors an access fee. Second, ATSs and ECNs are registered on SEC Form BD and thus acting as either a broker or dealer, or as both broker and dealer is well within their SEC registrations. The NASD should not be crafting rules to favor ATS or ECN broker-dealers and that furthering of the business model of certain member firms raises serious fairness questions under Exchange Act Section 15A(6).[3]

III. <u>The Pink Sheets Viewpoints</u>

First, we reiterate all that we said in our past letter regarding access and post-transaction fees, submitted in your request for comments to the original NASD rule filing.[4] We believe that our comments in the past are just as relevant today, even though the NASD is attempting only to modify its access fee display requirement rather than eliminate it. The NASD's approach does not change the result that such fees of any size have a long history of causing disruption to the orderliness of the marketplace if limited to a few privileged players. Succinctly stated, given the tumultuous history in the marketplace for Nasdaq securities, we strongly believe the marketplace for OTCBB securities should be free of these fees completely. This latest proposal to allow only ATSs or ECNs to attempt to levy these fees is unfair, anticompetitive and may well lead to an

[3] Among other things, Exchange Act Section 15A(6), requires that registered national securities association design their rules to remove impediments to and perfect the mechanism of a free and open market and a national market system, and not design their rules to permit unfair discrimination between its members.

[4] Letter dated January 24, 2006 from R. Cromwell Coulson, Chief Executive Officer to Ms. Nancy M. Morris, Secretary. See http://www.sec.gov/rules/sro/nasd/nasd2005095/rccoulson012406.pdf.

ATS and ECN monopoly on the market for limit orders in OTCBB securities, raising transaction costs and ultimately resulting in harm to the investing public.

If, however, the Commission determines to approve the imposition of access fees in the OTC equity markets, the interests of fairness demand that the NASD permit all its members to levy them on their publicly displayed quotations. We see any attempt to levy access fees by ATSs/ECNs on the rest of the broker-dealer community without the same explicit right by the rest of the broker-dealer community as anticompetitive and promoting bitter disputes within the NASD membership. In the absence of clear regulatory authority, we foresee market disruption caused by a market makers refusing to pay, and ATSs and ECNs thereby denying access to displayed liquidity. As a result, an increased number of locked and crossed markets will occur, as will the number of arbitration claims between member firms.

Second, there are questions as to the regulatory basis on which ATSs and ECNs alone now seek to levy access fees on non-subscriber broker-dealers.[5] The existing body of rules and regulations applies to NMS securities only and not also to OTCBB securities. That body of rules and regulations has evolved greatly over time, from footnote 272 of the adopting release to the SEC's Order Handling Rules, to Regulation ATS, and finally to Regulation NMS. Along the way, the SEC staff issued innumerable no-action letters, first with the minimum price increment ("MPI") as $.0625 and then again with the MPI of $.01. We see no reason to put the cart before the horse by approving this proposed amendment but leaving unclear the regulatory basis on which certain member firms seek to levy those fees. We implore the Commission not to allow the imposition of access fees without the rules, regulations, and related guidelines in place first.

Third, access or post-transaction fees will reduce the orderliness of the current market for OTC Equity Securities as it did in the past in the marketplace for Nasdaq securities. The Commission has acknowledged this phenomenon in the adopting release to Regulation NMS where it states:

> "[t]he fees for access to ECN quotations in Nasdaq stocks, as well as the absence of standards for quotations that lock and cross markets, have been the source of disputes among participants in the market for Nasdaq stocks for many years."[6]

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[5] Rule 6540(c) provides no authority implicit or otherwise for the imposition of access fees by ATSs and ECNs on non-subscribers. We do not believe that it is reasonably and fairly derived from the stated rule that but for that rule, access fees are permissible or authorized by the NASD. SEC Rule 19b-4 requires that the NASD submit a rule filing if it seeks to regulate the existence and amount of any access fee that may subsequently be authorized or permitted.

[6] Exchange Act Release No. 51808 (June 9, 2007), 2005 SEC Lexis 1349 p.80.

Access fees dramatically increased the number of locked and crossed Nasdaq markets as participants fought over the 6 mill difference generated when one party receives a fee rather than pays it. Most market participants have considered the 6 mill difference another spread but without the benefit of transparency, *i.e.*, a hidden cost on public markets.

Fourth, the solitary proponent of access fees has unclean hands. The NYSE Group, Inc. subsidiary, Archipelago Trading Services, Inc. ("NYSE"), currently participates in the OTCBB and locks the OTCBB market frequently during the course of the trading day. Our research indicates that on a recent day, Tuesday, April 24, 2007, NYSE locked or crossed the market for OTCBB securities over 1200 times and accounts for the vast majority of locked/crossed quotes on the OTCBB. From NASD quote feed and Pink Link data[7] it is clear that NYSE does not reasonably avoid locking or crossing markets and instead engages in a pattern of regularly locking or crossing OTCBB quotations. A typical occurrence happened at 9:56:36 when NYSE offer price of $1.15 locked the two market maker bids in the OTCBB quoted security CVBT. At 9:57:05, NYSE sent out a Pink Link message to one locked market maker to sell 2,000 shares @ $1.15 (their quoted price) that was completely executed at 9:57:11. At 9:57:35, NYSE again locked the market in CVBT. At 9:58:26 and 9:58:43, NYSE again sent out Pink Link messages to the market makers they had locked and received a 500 share execution and a 1,000 share execution. NYSE's statements in its comment letter regarding locked/crossed prices being the result of stale prices are not consistent with the facts as its system is designed to first lock the OTCBB in an attempt to generate access fees from subscribers, and then later approach non-subscribing contra parties through our Pink Link system if they are unable to generate access fees on the orders.[8] One net result of this is that its customers' marketable orders are widely exposed to the street before execution and thus easily front run. There is every reason to believe this activity will increase if the pool of potential access fee payers increases to include non-subscribers due to the NASD's proposed amendment.[9]

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[7] We would happily share with the Commission and/or NASD any Pink Link data they may require.

[8] From our data, we have determined that NYSE's use of Pink Link indicates that it experiences executions on over 90% of orders and turnaround times substantially similar to our overall customer average which seems at odds with its assertion that locked and crossed markets are a product of stale quotes.

[9] While not directly applicable to access fees, we take this opportunity to note that NYSE is regularly submitting quotations for publication on the OTCBB in many securities that are not exempted from SEC Rule 15c2-11 under the GlobeNet Letter and is not showing a UNS identifier. We are unable to permit our broker-dealer customers to do likewise in our quotation medium and would like to hear from NYSE or the NASD regarding the basis justifying their respective actions, *i.e.*, NYSE doing it and the NASD permitting it.

IV. If Access Fees are Allowed

First, as stated above, if the Commission determines that the modification of NASD Rule 6540(c) is appropriate, we believe the interests of fairness demands that the NASD extend the rule to all OTCBB participants and permit them all to levy access or post-transaction fees. The Commission has recognized the equality issue in its recent efforts to promulgate Regulation NMS. In its second proposing release the Commission states:

> To promote the equal regulation of markets, the Commission preliminarily believes that, if reproposed Rule 610(c) were adopted, it would be consistent with the Quote Rule for market makers to charge access fees. In particular, market makers would be permitted to charge fees for executions of orders against their protected quotations irrespective of whether the order executions are effected on an SRO trading facility or directly by the market [*205] maker.[10]

Moreover, the Commission should undertake the steps necessary to making the right to charge such fees explicit, *not just for OTCBB securities but for any OTC Equity Security*.[11] In the process of creating the explicit right of market participants to charge such fees, the Commission should also make explicit the corresponding or concomitant obligation for those same participants to pay those fees.

Extending the right to charge access fees to all broker-dealers publishing quotations, as compared to allowing only ECNs to charge access fees, would encourage all market makers to compete for limit orders, rather than simply sending their limit orders to an ECN for execution to receive a liquidity rebate. It would also be timely as the Commission recently approved the NASD's effort to expand Manning share for share and price for price limit order protection to all OTC Equity Securities under NASD Rule 2110 and IM-2110. As a result, market makers no longer have the ability to earn a spread by trading at prices superior to the limit orders they hold. Accordingly, a market maker's profits must be derived either by charging explicit agency commissions for handling limit orders, or by assuming risk on the orders by providing liquidity and taking the customer's position into its inventory. As the market for limit orders increasingly moves to an agency model, all broker-dealers should be permitted to compete for this business on an equal footing; if one firm can charge access fees, all firms should be permitted to charge access fees. Firms that offer the most attractive services to investors would garner the most profits, which would improve the market through competitive forces.

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[10] Exchange Act Release No. 50870 (December 27, 2004), 2004 SEC Lexis 3106 p.55.

[11] The term "OTC Equity Security" is defined in NASD 6600(d) to mean "any non-exchange-listed security and certain exchange listed securities that do not otherwise qualify for real-time trade reporting."

Moreover, if access fees are permitted, there is no good reason to limit them to agency orders. Regulation NMS does not prohibit access fees on proprietary orders. Allowing market makers to charge access fees on their proprietary orders, as well as agency orders, would encourage more aggressive quoting and thus tighter public markets through increased commitment of capital by market makers.

Second, purposefully locking or crossing the market to bait another OTCBB participant to access a quote is an unfair practice. As the Commission stated in the second proposing release of Regulation NMS:

> Locked and crossed markets can cause confusion among investors concerning trading interest in a stock. Restricting the practice of submitting locking or crossing quotations therefore would enhance the usefulness of quotation information.[12]

We believe that such conduct may constitute a manipulative and deceptive practice under NASD Rule 2120. Furthermore, such conduct raises serious 'best execution' concerns under NASD Rule 2320 because the firm locking or crossing the market is exploiting its customer's order to gain an fee for itself rather than promptly executing the order for its customer. Consequently, if access fees are introduced to non-NMS securities, we urge the SEC and the NASD to provide rulemaking or interpretive guidance to minimize the occurrence of locked and crossed markets and promote fair and orderly markets. The Commission also acknowledged this concern in the second proposing release of Regulation NMS:

> When two market participants are willing to trade at the same quoted price, giving priority to the first-displayed automated quotation would contribute to fair and orderly markets. Moreover, the basic principle underlying the NMS is to promote fair competition among markets, but within a unified system that also promotes interaction between all of the buyers and sellers in a particular NMS stock. Allowing market participants [*195] simply to ignore accessible quotations in other markets and routinely display locking and crossing quotations would be inconsistent with this principle.[13]

We believe the simplest approach would be for the SEC or NASD to require that NASD member firms document their attempt to access the publicly quoted inter-dealer market before they lock or cross it as well as not allow a firm that locks or crosses the publicly quoted inter-dealer market to charge an access fee upon that quote. Thus, the firm that initiates the lock or cross would have the fee incentive removed.

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[12] Exchange Act Release No. 50870 (December 27, 2004), 2004 SEC Lexis 3106 p.109

[13] Exchange Act Release No. 50870 (December 27, 2004), 2004 SEC Lexis 3106 p.53

V. Services Pink Sheets can Provide

If access fees are introduced into OTC markets, the NASD will have to monitor proactively locked and crossed publicly quoted markets in interdealer quotation systems. Pink Sheets would provide at no cost to the NASD real-time alerts when either the OTCBB or the Pink Sheets inside quotes are locked or crossed within each of the interdealer quotation systems as well as across the two different systems. This would facilitate the oversight of the OTC market and help prevent the manipulative practices that access fees can introduce to markets.

If access fees are allowed, Pink Sheets intends to provide to our broker-dealer customers a billing service to track access fees, as well as assist them in their billing efforts. To minimize market impact and avoid costly disputes, Pink Sheets would make every effort to establish a billing service that is as efficient as possible. Our service would be voluntary and designed to produce a running total of debits and credits for each participating broker-dealer customer. Our charges for providing this billing service would not be based on the number of shares traded, the volume of transactions involved, or the amount of access fees levied; instead we would charge a service based fee scaled to the number of broker-dealers billed for access fees by any particular broker-dealer customer. Our initial research indicates that such a billing service would be most efficient for transactions effected through use of the Pink Link messaging system.

VI. Conclusions

While we applaud the NASD's efforts to improve the OTC market, we believe that the existing access fee display requirements of Rule 6540(c) prevent a controversial, disruptive, and unfair practice and should not be eliminated or modified. Moreover, as stated in our previous letter, we believe that the current salutary requirements of Rule 6540(c) should be extended to include all quotations from all NASD members in all OTC Equity Securities. The Rule 6540(c) display requirements increase transparency, promote fair competition, and facilitate trading. The modification or deletion of Rule 6540(c) as proposed will change market structure for the benefit of only a few favored market participants at the expense of other, less favored market participants.

We urge the Commission to reject the introduction of a disruptive, unfair, and anti-competitive practice to the OTC market. Hidden access or post-transaction fees disrupt markets, frustrate the needs of investors to determine the prices at which transactions occur, and are contrary to the public interest. The Commission should therefore reject the proposed modifications to NASD Rule 6540(c).

If the Commission determines to permit access fees, we strongly urge the Commission to extend the right to charge fees to all broker-dealers and all OTC Equity Securities. In any event, the Commission should not permit access fees to be introduced into the OTC equity market until a regulatory regime is in place to limit disputes among members, minimize locked and crossed markets and prevent other disruptive trading practices that are detrimental to the investing public.

Please call if you have any questions.

Very truly yours,

/s/ R. CROMWELL COULSON

R. Cromwell Coulson
Chief Executive Officer