OTC Markets

SEC ROUNDTABLE ON COMBATTING RETAIL INVESTOR FRAUD
Submission of OTC Markets Group: Regulatory Recommendations
September 26, 2018

Fraudulent and manipulative schemes corrupt the efficient market pricing process on national exchanges and the OTC markets, hinder small company capital formation, and harm retail investors. At OTC Markets Group, our mission to create better informed and more efficient financial markets goes hand in hand with protecting retail investors from fraud. We have made significant progress in our efforts to increase transparency and better expose risks for market participants.

We are challenged in that regulation alone is not a panacea for fraud. We strongly believe the electric light of data-driven markets that maximize market forces and incentivize disclosure, combined with individual responsibility and common-sense regulation, are the most efficient investor protection tools. The better we can educate and empower individuals with the information they need to research securities and make informed investment decisions, the more effective and attractive our public markets will be.

The following list of concrete, targeted regulatory recommendations, which include references to prior OTC Markets comment letters and petitions, would help to combat retail investor fraud, improve market efficiency and bring greater transparency to our public markets:

1. **Increase Paid Promotion Disclosure**: To deter misleading sales pressure and fraudulent "pump-and-dump" schemes, Securities Act Section 17(b) should be amended to require additional disclosure about paid stock promotion and make online information sources safer. Information related to the identity of the promotor, who paid for the promotion, the nature of the promotion and the amount paid should all be required to be made public. Online advertising networks, such as Google and Facebook, should take more responsibility to not accept paid advertisements from anonymous stock promoter web sites, and should be required to work with SEC enforcement to help identify the source of fraudulent promotion.

    - *See our Petition for Commission Action to Protect the Investing Public from Unlawful and Deceptive Securities Promotions (April 24, 2006); available at: https://www.sec.gov/rules/petitions/petn4-519.pdf*

2. **15c2-11 Materials Should be Made Publicly Available:** While broker-dealers must gather information about an issuer, there is currently no public disclosure requirement. The SEC should take a disclosure-based approach and require that all information

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collected under Rule 15c2-11 be made publicly available, providing sufficient information for investors to make an informed assessment of the financial position and prospects of an issuer. Under the European Securities and Markets Authority (ESMA) model for MTFs under MiFID II, the market operators are responsible for formally reviewing that there is current information publicly available for investors, and the issuer's management is responsible for the accuracy of the information. Adopting this framework would facilitate broker-dealer engagement with small-cap companies and increase the quality of information available to investors. Certain issuers that do not make information publicly available should have their quotes and trading restricted to sophisticated investors with the expertise to handle the risks of distressed and dark securities.

3. **Allow Trading Venues to Review and/or Submit FINRA Form 211 Filings**: Certain modern-day trading venues have become public repositories for information about the securities that trade there. To avoid informational redundancy, a registered alternative trading system (ATS) that publicly discloses whether securities on its market make current information available should play a greater role in the 15c2-11 process. Specifically, such an ATS should be permitted to submit FINRA Form 211s to initiate trading in qualifying securities on their platform and should be enlisted to perform a review of other brokers' submissions in certain lower risk securities, such as the securities of large cap foreign issuers.

    - *OTC Markets Group Response to FINRA Regulatory Notice 17-14 (January 8, 2018), available at: http://www.finra.org/sites/default/files/notice_comment_file_ref/17-14_OTCmarkets_comment.pdf*

4. **Allow Payments for Market Making**: Spotify's direct listing proved that investment banking advice and service are valuable for creating an efficient public market. FINRA Rule 5250 should be amended to allow issuers to compensate broker-dealers for the bona fide services, advice and out-of-pocket expenses involved in preparing and submitting a Form 211, provided that the amount of such reimbursements is fully disclosed to investors as required under Section 17(b) of the Securities Act of 1933.

    - *OTC Markets Group Response to FINRA Regulatory Notice 17-41 (February 8, 2018), available at: http://www.finra.org/sites/default/files/notice_comment_file_ref/17-41_OTCmarkets_comment.pdf*

5. **Allow Multiple Market Makers to Quote a Security after a Form 211 is Cleared**: To promote quote competition amongst market makers and price discovery for investors, FINRA should allow multiple market makers to quote a security immediately upon clearing a Form 211 if the information required by Rule 15c2-11 is made publicly available by the Interdealer Quotation System (IDQS) ATS on which the security is quoted. This would replace the current practice whereby only the sponsoring broker-dealer may publish quotations for the first 30 days after a Form 211 is cleared and cumbersome operational practice of FINRA reviewing multiple Form 211 fillings in the same security.

6. **Enable More Real-Time Regulatory Oversight and Enforcement**: The SEC and FINRA should develop a faster and more streamlined process for responding to fraudulent and manipulative trading in securities on ATS and IDQS. Market operators and broker-dealers are often in the best position to help identify questionable disclosure, problematic corporate actions, fraudulent promotional schemes and other manipulative behavior. The SEC and FINRA should be able to work with market operators and broker-dealers to quickly respond to indications of fraud in a timely manner, including initiating FINRA trading halts and SEC suspensions when the market pricing process has been materially disrupted by fraud or manipulative activities. This can be accomplished by allowing IDQS operators to request that FINRA halt, or otherwise take action, with respect to a security. FINRA should also be directed to refer evaluations of these requests to its Regulatory Operations Oversight Committee or a similar committee of industry participants. Issuers with which an IQDS operator has a written agreement to provide ongoing disclosure should be able to request news-based market wide trading halts through their IDQS.

7. **Adopt Investor Suitability Standards Based on Expertise and Risk Tolerance**: In a data-driven world where risk can be quantified, broker-dealers can establish customer risk profiles based on trading experience and overall risk tolerance, which has proven to be a successful practice in the options industry. For example, the SEC should work with FINRA to evaluate whether securities of certain issuers that do not make information publicly available (e.g., those designated by OTC Markets as 'Pink No Information') should be accessible to purchase only by experienced investors with appropriate risk tolerances.

8. **Improve Share Issuance and Transfer Compliance by Increasing Disclosure from Powerful Market Participants**: Greater transparency about trading in a company's securities can be achieved by increasing the disclosure requirements of transfer agents, insiders, affiliates and institutional positions.

    - Transfer Agents: To deter Section 5 violations, transfer agent regulations should be modernized to increase the amount of information on the issuance, ownership and transfer history of shares available to broker-dealers. The goal should be to make Transfer Agents trusted record keepers, so that broker-dealers are able to rely on information received from Transfer Agents for Section 5 compliance purposes. If required, the SEC should consider expanding FINRA's supervisory mandate to include agents.

    - Affiliates and Insiders: Affiliates, insiders and paid promoters should not be afforded the ability to hide their positions in an anonymous Objecting Beneficial Owner (OBO) account. The resulting transparency would give companies and retail investors greater insight into who holds their shares. Further, disclosure of transaction information for officers and affiliates of non-SEC reporting issuers should be required in a manner similar to SEC Forms 3, 4 and 5.

    - Institutions: Exchange Act Section 13(f) should apply to OTC-traded securities, which would require institutional investment managers to disclose their holdings of all publicly traded equity securities, including significant short positions.

9. **Short-Sale Reform:** Public disclosure of the positions of institutions and large short-sellers, as well as better disclosure of daily and aggregate industry activity, would greatly enhance the short-sale information currently available and would create more trusted public markets. In addition, bona-fide market makers in illiquid securities are often not able to provide liquidity to buyers because they cannot be sure that they will be able to cover their short position within the time prescribed by Regulation SHO (T+6). The current timeframe (2 days) for bona fide market makers to close out of short positions in certain securities with lower trading volumes, such as ETFs and OTC equity securities, should be extended. Additional time would incentivize market makers to provide greater liquidity and reduce volatility in these securities.