OTC Markets

September 24, 2019

Via Electronic Submission

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
rule-comments@sec.gov

Re: Comments to the Concept Release on Harmonization of Securities Offering Exemptions (File Number S7-08-19)

OTC Markets Group[1] is pleased to submit this comment letter in response to the Securities and Exchange Commission's ("SEC" or the "Commission") Concept Release on Harmonization of Securities Offering Exemptions. As the operator of markets where over 10,000 securities are traded, and as a publicly traded company ourselves, OTC Markets Group supports the benefits of public markets and their capacity to create capital growth opportunities for companies and investors.

Public trading markets serve a basic purpose: to support investors that lawfully own, or would like to own, a piece of property – in this case, shares of a company – and their fundamental right to trade that property with interested counterparties. The ability of a shareholder to walk into a broker's office, deposit their shares, and trade through their brokerage account has long been a central aspect of property ownership. Restrictions on an individual's ability to buy or sell securities are a reduction of private property rights.

As public trading has grown more complex over time, so too has the web of regulation designed to protect investors and promote orderly markets. These rules of fair play support our economy and have made our capital markets an example for the world to follow. We must also recognize that well-meaning regulation comes with a significant burden that has reduced the use of registered securities offerings, raised the costs of being SEC reporting, and lowered the number of companies that choose to be public. As we consider ways to simplify and modernize securities regulation, we should keep in mind the range of companies issuing securities, the breadth of securities traded, and investors' broad property interests.

Access to efficient, transparent and well-regulated secondary markets remains vital to supporting capital formation. The right of a shareholder to sell a seasoned security interest, and the market price setting process, are enhanced by providing investors with the tools they need to evaluate company disclosure and price investment risk. As the operator of a FINRA-member broker-dealer maintaining two SEC-registered Alternative Trading Systems ("ATS") subject to direct regulation and oversight enforcement by the SEC and FINRA, including one ATS subject

[1] OTC Markets Group Inc. operates the OTCQX® Best Market, the OTCQB® Venture Market and the Pink® Open Market for 10,000 U.S. and global securities. Through OTC Link® ATS and OTC Link ECN, we connect a diverse network of broker-dealers that provide liquidity and execution services. We enable investors to easily trade through the broker of their choice and empower companies to improve the quality of information available for investors. OTC Link ATS and OTC Link ECN are SEC regulated ATSs, operated by OTC Link LLC, member FINRA/SIPC.

to the SEC's Regulation Systems, Compliance and Integrity, we are familiar with the regulatory environment that is necessary to foster a healthy public market.

In the over-the-counter ("OTC") equity markets, transparency and technology have evolved rapidly over the years. What had been an opaque, paper-based market during the time when much off the current regulatory framework was adopted, has now become a vibrant, regulated electronic marketplace where investors can easily access real-time pricing and company information for free and our FINRA member broker-dealer subscribers can trade a wide variety of domestic and global securities. Our OTC Link ATS is the primary trading venue for non-exchange traded equity securities. The platform allows broker-dealers to provide best execution, and thousands of companies to be publicly traded, without the cost and complexity of listing on an exchange.

The discussion set forth below provides a background on our markets and describes the practical impact of the current regulatory landscape on capital formation, secondary markets and investor access to information. We propose a number of modernizations to public secondary market regulation and the exempt offering framework, including:

- **Supporting small company capital formation initiatives for qualified companies through**:
    - Expanding upon the offering exemptions under Regulation A and Securities Act Rule 144A
    - Encouraging companies to access public markets through direct listings and similar processes
    - Adopting a safe harbor for the sale of Regulation A and registered securities into the market
    - Ensuring that legislation intended to help venture stage companies includes exchange and non-exchange markets

- **Fixing the "plumbing" of small company public trading markets by:**
    - Clarifying the compliance obligations of brokers with respect to affiliate trading and lower-priced securities
    - Updating Securities Act Rule 144 guidance and filing requirements related to non-SEC reporting companies
    - Modernizing transfer agent regulations to provide greater information to the market
    - Considering the benefits of a uniform federal secondary trading exemption for the securities of companies that make adequate current information publicly available

- **Enhancing the disclosure required of company insiders, affiliates and other powerful market participants by:**
    - Requiring additional disclosure regarding paid stock promotion
    - Expanding Exchange Act Section 13(f) to require disclosure of institutional holdings in non-exchange listed securities
    - Prohibiting objecting beneficial owner ("OBO") accounts for company insiders and affiliates

Consider these proposals along a continuum. For example, a small company seeking to raise capital may choose to make a Regulation A offering to affinity investors, and, if they are able, to raise additional money from interested larger institutions. Under Regulation A, once those shares are issued, they are immediately publicly tradable, and shareholders should have the right to transact in their new, lawfully owned property. Unfortunately, uncertainty in the small company secondary trading process, including broker-dealer compliance concerns arising from the opacity of private market offerings and the difficulty of identifying company affiliates, often means that investors have trouble depositing newly issued Regulation A shares. This limits access to broker-dealer services and the overall public markets. Clarifying regulatory guidelines and providing market participants with information about securities from offering through deposit with a broker-dealer would facilitate the introduction of those shares into the market.

Once the shares are on the market, enhancing the disclosure required of company insiders, large institutions and stock promoters regarding share holdings and trading activity would help arm investors against abuses by powerful players. Working in concert, improvements to these aspects of the regulatory regime for small company securities would add to the depth and utility of securities offering exemptions and the public trading ecosystem.

I. The OTCQX and OTCQB Markets are the Leading Small Company Venture Markets

Our three public markets – OTCQX Best Market, OTCQB Venture Market, and Pink Open Market – are organized based on the quality, timeliness and sufficiency of information companies make available to investors. Many companies make such disclosure available on our website, www.otcmarkets.com. These tiered marketplaces are designed to encourage companies to make current information publicly available. As companies provide the required disclosure and make their way to our higher-tier marketplaces, their access to capital and liquidity greatly improves. Approximately 60 companies graduate to an exchange listing on Nasdaq or the New York Stock Exchange ("NYSE") from our markets each year – over 300 in the past five years – making them the most successful 'venture' markets in the world. Many of these companies, including large global companies and U.S. community banks, do not seek to graduate, and instead choose to remain public on the OTCQX or OTCQB markets, which provide liquidity and exposure with less compliance overhead.

Companies on the top-tier OTCQX and OTCQB markets must comply with the OTCQX Rules and OTCQB Standards, which set forth the disclosure, financial and corporate governance requirements of these markets.[2] Requirements include current public disclosure, meeting minimum financial requirements and compliance with recognized corporate governance standards. For example, all OTCQX and OTCQB companies must publish quarterly reports and audited annual financial statements, promptly disclose material events and information and maintain minimum bid price and public float requirements. OTC Markets Group's issuer compliance department oversees a company's initial and ongoing compliance with the OTCQX Rules and OTCQB Standards. Companies that fail to meet these standards are removed from OTCQX or OTCQB, as applicable. These two markets are distinguished from the Pink market, which does not impose any disclosure or financial requirements but tracks issuer disclosure

[2] The OTCQX Rules and OTCQX Standards are available at: https://www.otcmarkets.com/corporate-services/get-started.

through the sub-tiers Pink Current Information, Pink Limited Information and Pink No Information.

Rather than using a one-size-fits-all disclosure regime, OTCQX and OTCQB companies can leverage one of the following five recognized reporting standard that best fits their needs:

- **SEC Reporting**: filing reports with the SEC on the EDGAR system;
- **Regulation A Reporting**: making required filings under the SEC's Regulation A, Tier 2;
- **Bank Reporting**: reporting to their U.S. applicable banking regulator;
- **International Reporting**: for foreign issuers, remaining current with their home country disclosure requirements and making the information available in English in the U.S. in compliance with Exchange Act Rule 12g3-2(b); or
- **Alternative Reporting**: following the OTCQX U.S. and OTCQB Disclosure Guidelines, which are based on nationally-recognized standards.

These flexible standards allow companies of all types and sizes to efficiently provide relevant and current disclosure to the market, without imposing the cost and compliance burdens that come along with a national exchange listing. Most exchange-listed companies report spending between $1 - $2 million annually in legal, accounting and other costs to remain public.[3] Companies on the OTCQX and OTCQB markets typically spend much less, between $50,000 to $300,000 annually, to access the benefits of a public market.

Approximately 430 companies are traded on the OTCQX market and over 900 on the OTCQB market.[4] These companies have an aggregate market capitalization over $1.4 trillion and make up a vibrant community of companies across various industries.

- **650+ International Issuers**: Large-cap foreign companies – such as Roche, Adidas and Heineken – have chosen to have their American Depository Receipts (ADRs) and foreign ordinary shares traded on the OTCQX and OTCQB markets. These companies can rely on Exchange Act Rule 12g3-2(b) to leverage their extensive home country disclosure and compliance processes to access U.S. capital markets.
- **110+ Community Banks**: Since the adoption of the JOBS Act, many small community banks and bank holding companies based in the U.S. have moved from an exchange listing to the OTCQX and OTCQB markets, where they are able to leverage the disclosure made to applicable banking regulators.
- **230+ Science and Technology Companies**: Research-stage companies in the software, healthcare, pharmaceutical and biotechnology space use the OTCQX and OTCQB markets to raise capital and provide investors with liquidity options. A number of these companies ultimately graduate to a national exchange listing.
- **200+ Venture-Stage Companies in Developing Industries**: The OTCQX and OTCQB markets are home to many companies in new and emerging markets and issuers with innovative product offerings, such as cannabis and digital assets.

Over 600 of these OTCQX and OTCQB companies based in the U.S. are 'small companies' (those with a market capitalization of $250 million or less). These companies are based across

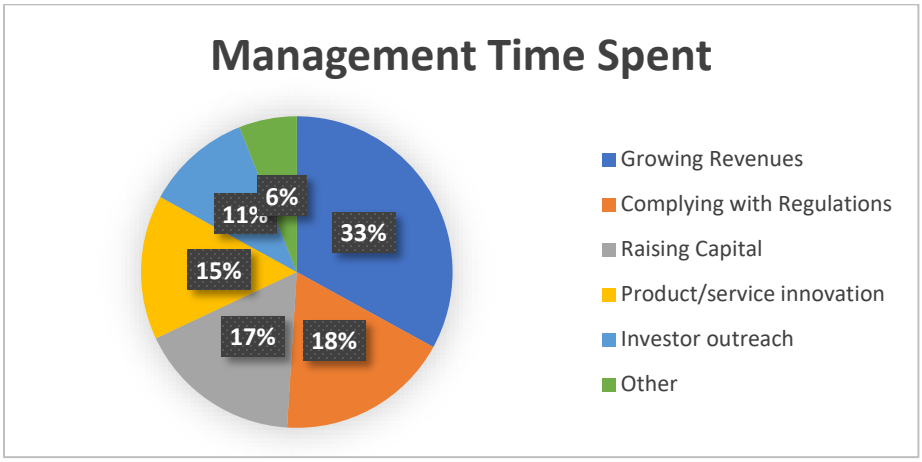
[3] *See* PwC (Nov. 2017), available at: https://www.pwc.com/us/en/deals/publications/assets/cost-of-an-ipo.pdf.
[4] Data provided herein is as of August 30, 2019, unless otherwise indicated.

46 states, have over 75,000 employees and span a host of industries, including natural resources, life sciences, manufacturing and technology. They have a median market cap of $20 million and median annual revenues of $4 million.

Through targeted regulatory reform, the Commission can help these companies, their shareholders and investors, and can incentivize more private companies to join them in the public markets. The recommendations set forth below are focused on (i) encouraging small company capital formation by streamlining access to public capital, (ii) improving our secondary trading mechanics by leveraging data-driven solutions, and (iii) facilitating transparency by requiring disclosure from powerful market participants.

II. ENCOURAGE HEALTHY GROWTH: Clear the pathway to the public markets by supporting small company capital formation initiatives for qualified companies

OTC Markets works closely with the small public companies on our OTCQX and OTCQB markets, listening to their concerns and providing cost-efficient solutions tailored to meet their needs. We asked over 100 CEOs and CFOs of OTCQX and OTCQB companies with market capitalization less than $2 billion how they spend their time:[5]



The companies in this survey indicated that their top three capital market challenges are (1) increasing the liquidity of their stock, (2) increasing their share price, and (3) raising capital.[6] The following set of targeted regulatory recommendations are designed to help small public companies achieve these goals, while also making public markets more attractive and incentivizing public capital raising.

a. Expand the Public Offering Exemptions Available to Retail and Institutional Investors under Regulation A and Rule 144A

As investing activities continue to move online, we remain optimistic about the potential for various offering exemptions established under the JOBS Act to transform our capital markets

[5] OTC Markets Group Small Cap CEO/CFO Survey Results (2017), available at: https://www.otcmarkets.com/files/Small_Cap_Survey_2017.pdf.

[6] We believe that much of the respondents' focus on liquidity stems from current regulations that force smaller public companies to raise their capital in private offerings, often from unregulated third parties. These intermediaries pose as institutions and quickly sell their shares into the public markets. From the company perspective, this means that financing availability is often tied to the speed at which shares can be resold in secondary markets.

and democratize access to investment opportunities. This includes the ability for a startup company to use an online funding portal, or its own website, to conduct a "direct-to-consumer" public offering to retail investors under Regulation A, or the ability for institutional investors to leverage general solicitation under Rule 144A to distribute transparent offering and pricing information to other institutional investors. These offering and resale exemptions can be used to create categories of public markets for different types investors – from unaccredited investors to large, sophisticated institutions. The Commission should consider the public markets where these securities trade in its efforts to evaluate and improve the various JOBS Act offering exemptions.

While Regulation A has not seen the widespread adoption that was initially anticipated when the JOBS Act first became effective, this offering exemption has proven to be a successful capital raising tool for community banks. A 2018 Barron's article highlighted the success of 8 community banks that conducted Regulation A offerings, noting a 9% gain on average in their stock price during the first six months of trading after the offering.[7] Many of these banks are traded on the OTCQX and OTCQB markets and have leveraged Regulation A as part of a merger or acquisition.[8]

There are additional modifications that can be made to improve the overall utility of Regulation A. An excellent example of this kind of enhancement is the recent SEC rulemaking that expanded the pool of eligible companies under Regulation A to include SEC Reporting companies.[9] We support industry proposals to (i) allow for at-the-market offerings,[10] (ii) encourage the Commission to issue guidance to intermediaries with respect to transactions in non-exchange traded Regulation A securities,[11] and (iii) provide exemptions for secondary trading in securities of issuers subject to ongoing Regulation A reporting requirements.[12]

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[7] *See* Alpert, Bill, Most Mini-IPOs Fail the Market Test, BARRONS.COM, (Feb. 13, 2018), available at: https://www.barrons.com/articles/most-mini-ipos-fail-the-market-test-1518526753.

[8] For example, Coastal Banking Company, Inc. conducted a Regulation A offering in February 2016, while its shares were publicly traded on the OTCQX market, in connection with an acquisition of First Avenue National Bank. *See* Press Release, Coastal Banking Company Reports Fourth Quarter 2015 Earnings, Obtains Regulatory Consent for Bank Acquisition (Mar. 14, 2016), available at: https://www.accesswire.com/437795/Coastal-Banking-Company-Reports-Fourth-Quarter-2015-Earnings-Obtains-Regulatory-Consent-for-Bank-Acquisition.

[9] *See* Amendments to Regulation A, Release No. 33-10591 (Dec. 19, 2018), available at: https://www.sec.gov/rules/final/2018/33-10591.pdf.

[10] The 2017 and 2018 Small Business Forums recommended that the Commission amend its rules to allow at-the-market offerings under Regulation A. *See* Final Report of the 2017 SEC Government-Business Forum on Small Business Capital Formation (Mar. 2018), available at: https://www.sec.gov/files/gbfor36.pdf; *see also* Final Report of the 2018 SEC Government-Business Forum on Small Business Capital Formation (Jun. 2019) available at: https://www.sec.gov/info/smallbus/gbfor37.pdf.

[11] The 2017 and 2018 Small Business Forums requested guidance for broker-dealers, transfer agents, and clearing firms, regarding Regulation A securities and OTC securities. *Id.*

[12] *See* Notice of Request for Public Comments Regarding a Proposed Model Rule to Designate Nationally Recognized Securities Manuals for Purpose of the Manual Exemption and a Proposed Model Rule to Exempt Secondary Trading in Securities Issued by Regulation A –Tier 2 Issuers (Jul. 19, 2018), available at: http://www.nasaa.org/wp-content/uploads/2018/07/NASAA-Secondary-Trading-Proposal-PublicComment-Request.pdf.

We also support proposals calling for a higher maximum offering amount under Regulation A.[13] The Commission may also want to consider raising the Regulation A offering threshold by allowing an SEC reporting company that exceeds the $50 million limit to raise additional capital from accredited investors and institutions. As discussed in Section II.c, below, we could also see Regulation A used as a framework for SEC reporting issuers that are listed on a national securities exchange or traded on an established public market to sell shares directly into the market, provided that the company does not dilute its total shares outstanding by more than 20% during any 12 month period.

Under the same framework, but on the other end of the spectrum, the Commission should encourage institutional participation in public "experts only" markets, available only to experienced investors with appropriate risk tolerances. For example, Rule 144A establishes a safe harbor from the registration requirements of Section 5 of the Securities Act for offers and sales of restricted securities to qualified institutional buyers ("QIB") who are not issuers of the security. Under the JOBS Act, 144A issuers can now engage in general solicitation to publicize the offering, provided that sales remain limited to QIBs. While non-QIB investors can sell into 144A offerings, purchases are limited to sophisticated, institutional investors. This structure can be used to create institutional-only, "gated" trading markets for restricted securities or complex, higher-risk securities that are not suitable for Main Street investors, while still encouraging public disclosure and price transparency.

b. Encourage companies to access public markets through direct listings and similar processes

While many in the industry lament the decrease in companies "going public" via traditional IPOs, we see the public trading markets, *i.e.* securities readily bought or sold by an investor through a regulated broker-dealer, as a much broader tent that provides, and should encourage, multiple avenues for companies and their investors to achieve the benefits of public trading. As the private markets have become the primary source of growth capital, today's public markets now must provide liquidity for existing shareholders and encourage disclosure for companies seeking to build more sustainable organizations.

For example, "direct listings" to the national exchanges have become a hot topic recently[14], following Spotify Technology's direct listing onto NYSE in 2018. The concept is not new to the OTC markets, however. Our markets have long been a home for companies seeking a direct pathway to the public markets without engaging in a traditional IPO. We refer to the practice a "Slow PO." It is a well-worn path that has been traveled by community banks and companies exiting bankruptcy reorganizations. More recently, the Slow PO has been used by a wider range of private companies and others, including innovative structures that securitize crypto assets. OTC Markets Group also utilized the Slow PO process when we became a public company.

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[13] The 2017 and 2018 Small Business Forums, and the 2017 Treasury Report, recommended that the Commission increase the maximum offering amount under Tier 2 of Regulation A from $50 million to $75 million. *Id. See also,* Financial System That Creates Economic Opportunities Capital Markets, U.S. Dept. of the Treasury (Oct. 2017), available at: https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf, at p. 40.

[14] *See* Kruppa, Miles, "Silicon Valley bankers and lawyers push for alternative to IPOs" FINANCIAL TIMES (Sept. 23, 2019), available at: https://www.ft.com/content/ea6d9ad8-d99c-11e9-8f9b-77216ebe1f17.

Similar to a direct listing, a Slow PO enables a company to enter the public markets by making previously restricted shares that were issued in exempt offerings available for public trading. The Slow PO process starts with a private capital raise, typically using Regulation D, Rule 144A or a Rule 701 issuance to employees. Following the issuance, the company or shareholder can remove the restrictive legend from shares that have seasoned in the hands of the shareholder, as long as the company makes adequate current information publicly available as required under Securities Act Rule 144. The holding period is 6 months for SEC reporting companies or 12 months for non-SEC reporting companies. The information requirement can be met by complying with any of our five recognized reporting standards (SEC, Regulation A, Bank, International or Alternative Reporting).

A smaller company that does not need to raise additional capital from the public markets can use the Slow PO method to build investor confidence and grow liquidity organically without the cost and complexity of an IPO or exchange listing. The Commission and industry participants are aligned on the benefits of public markets, and should celebrate and support direct listings, the Slow PO process and other non-traditional pathways to going public.

c. Adopt a safe harbor for the sale of Regulation A and registered securities into the market

The Concept Release rightly focuses on the trend of private companies raising capital privately and staying private as they bloat to billion-dollar valuations with little to no public disclosure or share price discovery. However, largely overlooked is the widespread practice of *public* companies raising capital privately. Just in the first eight months of 2019, 184 companies currently listed on NYSE and Nasdaq, and 96 companies traded on the OTCQX and OTCQB markets, filed Form Ds with the SEC.

SEC reporting companies – already subject to quarterly, annual and periodic disclosure requirements – must go through the same process as private companies to sell shares to retail (non-accredited) investors: they must file a registration statement with the SEC and incur significant costs hiring underwriters, lawyers and accountants.[15] The registration statement provides very little new disclosure, as it largely duplicates information already provided in the company's SEC filings.

For the same reasons that private companies choose to conduct private raises, public companies also rely on private offering exemptions that allow them to raise an unlimited amount of capital from accredited investors and institutions without the time and costs associated with filing an SEC registration statement. In turning to the private markets for funding, smaller or venture-stage public companies often fall prey to opportunistic hedge funds seeking an arbitrage opportunity by acquiring the shares at a discount in a private offering and immediately selling them back into the public market for a profit. Not only are unaccredited retail shareholders unable to participate in the private round, but they are also often the victims of the toxic "death spiral" that results as the discounted shares are sold into the market and the stock value plummets. SEC reporting companies should not have to look to the private markets as their most viable source of capital. Rather, these companies should be able to raise capital by

[15] A 2017 PwC study found that it costs an average of $7.3 million to conduct a small public offering with proceeds between $25 million and $100 million. *See supra* Note 3.

selling stock directly into the market, much in the same way that they are permitted to buy their own stock on the market.

Exchange Act Rule 10b-18 establishes a safe harbor from liability under market manipulation rules for company share buybacks, allowing issuers to purchase a tranche of its own shares on the open market, provided that it meets the following four conditions designed to ensure that the buyback is not manipulative and adheres with fair market principles:

1. Manner: The transaction must be made through a single broker-dealer to avoid the false appearance that there is inflated interest from multiple broker-dealers in the security.
2. Timing: The transaction may not be made at market open or close to prevent the issuer from setting the price in the stock.
3. Price: To ensure fair pricing, the transaction must be at a price that does not exceed the highest bid or last transaction price in the security.
4. Volume: To prevent the company from cornering the market on that day, the total transaction volume may not exceed 25% of the average daily trading volume in the security.

These same principles can be adopted to carve out a safe harbor for SEC reporting companies selling shares directly into the market.[16] This type of safe harbor would require additional conditions as well, including:

5. Dilution: The safe harbor should be not be available for companies that have increased their shares outstanding more than 20% during the 12 months preceding the public sale.
6. Corporate Governance: The issuer should demonstrate compliance with corporate governance best practice standards during the 12 months preceding the public sale, including having an independent audit committee and outside directors.

With the safe harbor in place, existing rules governing public offerings can be modified, as further described below, to make the public offering process more efficient and effective for small companies.

First, all public companies traded on an "established securities market" should be permitted to conduct shelf offerings. Rule 415 of the Securities Act permits the filing of a registration statement for new issues of securities and/or resales of outstanding stock. The company can then take tranches of the registered stock "off the shelf" to sell into the public market. However, companies with a public float less than $75 million may only register a shelf offering if they are traded on a national securities exchange. This public float exemption should be extended to all public companies traded on an "established securities market," which would include the OTCQX and OTCQB markets.[17]

[16] With respect to the second condition (timing), we should consider allowing issuers selling shares into the market to participate in closing auctions.

[17] The SEC recognizes the OTCQX and OTCQB markets as "Established Public Markets" for the purpose of determining the public market price when registering securities with the SEC for resale in equity line financings. This recognition gives the OTCQX and OTCQB markets the status of "established public markets" or "established public trading markets" as those terms are used in Section 201(a) of Regulation S-K and comments from SEC staff to issuers. *See* 17 CFR 229.201; *see also* SEC Compliance and Disclosure Interpretations, Question 139.13 (May 16, 2013), available at: https://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm.

Second, public companies should not be required to file a supplemental registration statement to cover issuances of already authorized shares. Provided that a class of the company's securities is registered with the SEC, a supplementary registration statement provides little incremental value in terms of company disclosure and is an unnecessary burden for companies seeking to issue previously authorized shares.

Third, the proposed safe harbor should extend to the broker-dealer facilitating the sale with respect to potential underwriter liability under Section 11 of the Securities Act. Higher-quality public company reporting has eliminated the need for extensive underwriter liability. The broker, as with any retailer or distributor, should play the role of intermediary and sales agent. The public company, as issuer of the shares, should be responsible for appropriate disclosure, and be solely liable for any false statements.

d. Any venture "exchange" legislation or regulation should recognize venture markets more broadly, including alternative trading systems

Venture markets that support efficient trading in small company securities play a vital role in fostering capital formation and driving growth for early stage companies. The OTCQX and OTCQB markets provide the core functions of a venture market in the United States: (i) objective, publicly-available financials standards and recognized disclosure requirements, (ii) established compliance processes to incentivize company compliance and maintain the integrity of our markets, and (iii) wide distribution of current public information to investors and market participants.

While we are strong proponents of venture markets, limiting the discussion to the creation of a single, centralized venture "exchange" misses the mark by a wide margin.[18] Regulators imposing a single market structure would harm small company markets, not grow them.

Much of the conversation concerning venture securities and markets is around supporting "the next Uber" or venture-backed startups with billion-dollar valuations. In reality, for every Silicon Valley "unicorn," there are hundreds of much smaller companies with unserved capital formation and public trading needs. For example, an emerging growth company, or ECG, as defined under the JOBS Act and adjusted for inflation, encompasses any issuer that had a total annual gross revenue of less than $1.07 billion during its most recently completed fiscal year. Many consider an EGC to be the equivalent of a venture security, however, in practice, the EGC definition encompasses a wide range of companies, from startups to established, exchange-listed companies.

Rather than a one-size-fits all exchange model, the Commission should develop a venture *market* designation to apply to markets such as OTCQX and OTCQB, which are actively serving the needs of smaller companies, investors, and broker-dealers, or to apply to a defined class of 'venture securities' regardless of where they choose to trade.

[18] Proposed venture exchange legislation would not permit non-exchange trading venues, such as Alternative Trading Systems (ATSs), to apply for designation as a venture market and would suspend Unlisted Trading Privileges (UTP) for all venture securities. *See* Main Street Growth Act H.R.2899, 116th Congress (2019).

III. FIX THE PLUMBING: Improve Small Company Public Trading Markets

After a company has issued shares to investors in an offering and raised capital – whether privately or publicly, to accredited or unaccredited investors – the full value of those shares can only be realized if there is an efficient secondary market where investors can easily buy and sell company shares.

Many of the functions of a public market are dependent on intermediaries – broker-dealers, transfer agents, clearing firms and attorneys – performing their regulatory compliance and due diligence obligations when processing secondary transactions in securities. These "gatekeeper" and "recordkeeper" functions are heightened when processing transactions using the resale exemptions applicable to securities issued in private or exempt offerings. In performing their regulatory obligations, each of these crucial market participants are often working with a different set of siloed information, despite having the same objective: to determine whether the transaction can be completed in compliance with applicable securities laws. The Commission should look to facilitate disclosure of valuable transaction data so that market participants can safely and efficiently process transactions. Expanding the availability of transaction information around insiders and affiliates would also help level the playing field and protect Main Street investors.

a. Issue guidance that clarifies broker-dealers' compliance obligations with respect to clearing, depositing and facilitating transactions in lower-priced securities

Deposit and transfer of low-priced and thinly-traded securities has become increasingly difficult in recent years because of the difficulty tracing the history of each share issuance and identifying affiliate owners of the stock. Brokers and clearing firms indicate that increased regulatory concerns and rising compliance costs make it too arduous and cost-prohibitive to facilitate transactions for small investors in securities priced below $5 and/or securities of companies that are not SEC reporting. A number of firms have determined not to engage in any OTC equities business because they believe the costs outweigh the benefits. Other firms pass the costs on to the shareholders, who either cannot clear or deposit their shares or must pay a disproportionate fee to do so. Investors in these securities are left without an efficient trading option and companies are unable to start down the path of becoming public, which further restricts liquidity and devalues the company's shares and the value of investor's holdings. With a devalued share base, companies face an uphill battle when seeking to raise capital from new investors or borrow against their market value.

This trend is due in part to regulatory guidance issued over a decade ago. In January 2009, in response to enforcement actions involving illegal distributions,[19] FINRA issued Regulatory Notice 09-05, which was intended to establish guidelines and red flags for member firms with

[19] Many of the SEC and FINRA enforcement actions that precipitated FINRA's Notice 09-05 involved particularly egregious behavior. *See e.g. NevWest Securities Corporation*, NASD AWC E0220040112-01, (Mar. 21, 2007), *see also SEC v. CMKM Diamonds, Inc., et. al*, U.S. Dist. Court for the District of Nevada, Civil Action No. 08-CV 0437 (Apr. 7, 2008) (involving the illegal issuance and sale of unregistered securities based on fraudulent opinion letters and stock transfer instructions resulting in $64.2 million in profits from an illegal promotional scheme).

respect to facilitating transactions in unregistered or restricted securities.[20] The wide-ranging issues raised in FINRA's Notice 09-05 had a chilling effect and created uncertainty around how firms can adequately meet their compliance obligations when processing transactions in lower-priced OTC securities. Compliance concerns and related costs have also caused firms to stop accepting physical certificates, further frustrating the public market process for many small company shareholders.

Transparency aimed at identifying bad actors in the small cap marketplace has greatly improved since FINRA Notice 09-05. Over the years, OTC Markets Group has developed a suite of marketplace designations and visual information flags that we make publicly available for free on a company's quote page on our website. These include the "Caveat Emptor" skull-and-crossbones icon, as well as a host of other visual "flags" that help investors easily identify risk, including many of the "red flags" identified in FINRA's Notice 09-05 (e.g. promotion, hot sector, shell risk, bankruptcy, penny stock status, affiliation with a prohibited service provider).[21] Broker-dealers and compliance teams use this information, and other valuable compliance data points, so they can better analyze securities and identify risk.[22]

The Commission should work with FINRA to re-issue guidance that encourages firms to leverage available data to safely deposit and transfer OTC securities. The goal of regulatory reform in this area should be to enable market participants to whitelist customer securities that are clearly "OK to trade," distinguish those from potential affiliate securities that require additional due diligence, and redline bad actors.

b. Facilitate disclosure of the information required under Rule 144 with respect to securities of issuers that are not SEC reporting

The inability to effectuate transactions in unregistered securities is further complicated if the issuer is not SEC reporting. This includes transfers of securities issued under Regulation A and privately issued securities that have "seasoned" by satisfying the applicable holding period. Securities Act Rule 144(c)(2) establishes a pathway for broker-dealers to transact in non-SEC reporting companies, provided that the company makes current public information available in accordance with Exchange Act Rule 15c2-11. The Rule 15c2-11 informational requirements include company financials and business description,[23] as well as quotation specific information regarding (i) whether the broker-dealer or any associated person is affiliated, directly or indirectly with the issuer,[24] and (ii) whether the quotation is being published or submitted on behalf of any other broker-dealer, and, if so, the name of such broker-dealer.[25]

Broker-dealers and clearing firms have a difficult time confirming compliance with these two informational requirements largely because timely disclosure of this information is not required.

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[20] FINRA Notice to Members 09-05, "Unregistered Resales of Restricted Securities," (Jan. 2009), available at https://www.finra.org/sites/default/files/NoticeDocument/p117716.pdf.
[21] A full list of OTC Markets Group compliance and information flags is available at: https://www.otcmarkets.com/files/OTCM%20Compliance%20Flags.pdf.
[22] Additional information about OTC Markets Group Compliance Data Products is available at: https://www.otcmarkets.com/market-data/compliance-data-products.
[23] 17 CFR 240.15c2-11(a)(5)(i)-(xii) and (xv).
[24] 17 CFR 240.15c2-11(a)(5)(xiv).
[25] 17 CFR 240.15c2-11(a)(5)(xvi).

A Form 144 is generally the only public notice that provides information concerning insider and affiliate sales for non-SEC reporting issuers. However, due to the filing requirements under Rule 144(h), a Form 144 is generally filed several days after the transaction occurs.[26] Complicating matters further, the Form 144 is required to be filed in paper format for non-reporting issuers, making it unavailable on EDGAR.[27] Even if electronic filing were permitted, EDGAR displays the Form 144 only on the seller's page, not the issuer's. Thus, due to the delay in timing and availability of the Form 144 filing, the relevant information is not reliably available for broker-dealers to use for the purposes of 144(c)(2) compliance. As a result, broker-dealers often refuse to accept these shares for deposit.

The Commission can facilitate the early provision of much needed information by requiring pre-publication of Form 144s on the market where the security trades. Modernizing the Rule 144 process would create an additional pathway for privately issued securities to enter the public markets.

c. Modernize transfer agent regulations to increase the amount of information on the issuance, ownership and transfer history of shares available to broker-dealers

The regulatory uncertainty preventing the efficient trading of small company securities is further compounded by the fact that broker-dealers are not relieved of the "reasonable inquiry" obligation under Securities Act Section 4(a)(4), even after a security has been accepted by DTC or a registered transfer agent has issued an opinion letter.

Transfer agents may hold the keys to the kingdom in terms of detecting and preventing illegal securities distributions. Their vital recordkeeping functions – such as maintaining lists of shareholders, affixing and removing restrictive legends from securities, and communicating with shareholders and beneficial owners – creates valuable information about how the stock was issued, who has held it, and for how long. Despite being central parties to the share issuance and transfer process, transfer agents are relatively underregulated. Instead, broker-dealers shoulder much of the regulatory risk and liability involved in preventing illegal sales of restricted securities in violation of Section 5 of the Securities Act,[28] as SEC precedent makes it clear that broker-dealers cannot rely on transfer agents in conducting Section 5 inquiries. [29]

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[26] 17 CFR 230.144(h).
[27] 17 CFR 232.101(c)(6).
[28] For example, Section 4(a)(4) of the Securities Act provides a registration exemption for unsolicited brokers' transactions, provided that, after reasonable inquiry, the broker is not aware of any circumstances indicating that the customer is violating Section 5 of the Securities Act. 15 U.S.C. 77d(a)(6).
[29] SEC guidance on this point often cites to authority that predates the SEC's 1977 regulation of transfer agents. *See* SEC Responses to Frequently Asked Questions about a Broker-Dealer's Duties When Relying on the Securities Act Section 4(a)(4) Exemption to Execute Customer Orders (Oct. 9, 2014), available at: https://www.sec.gov/divisions/marketreg/faq-broker-dealer-duty-section4.htm, *citing* Sales of Unregistered Securities by Broker-Dealers, Securities Act Release No. 5168, 2 (July 7, 1971) (stating that information received from little-known companies or their officials, transfer agent or counsel must be treated with great caution as these are the very parties that may be seeking to deceive the firm); *see also*, *Stead v. SEC*, 444 F.2d 713, 716 (10th Cir. 1971) (holding that the act of calling the transfer agent is obviously not a sufficient inquiry).

The "Reasonable Inquiry" standard charges broker-dealers with determining fact-based information that is more readily available to transfer agents – for example, whether a customer is an insider or whether the transaction is part of a distribution of securities of the issuer. Without an affirmative obligation on the part of the transfer agent to disclose transaction information, a lack of transparency related to share ownership and transfer history has created redundancies and inefficiencies that ultimately penalize the end investor. In 2019, transfer agents perform a crucial recordkeeping function and, as entities registered with and regulated by the SEC, should be encouraged to provide current and accurate share information that the broker-dealer community can rely on as part of their greater regulatory responsibilities.[30]

OTC Markets Group introduced the Transfer Agent Verified Shares Program in 2016 and now a majority of the industry's leading transfer agents submit current and reliable shares outstanding information for 99% securities on the OTCQX and OTCQB markets.[31] This information is displayed on the company's "Security Details" page on the www.otcmarkets.com website alongside a 'verified' logo ( ) indicating that the information is current and has been verified by the company's transfer agent.

Transfer agents should play the role of the 'trusted recordkeeper' that provides the marketplace with verified information on the issuance, ownership and transfer history of shares. The Commission sought comments on this issue in its 2015 concept release on transfer agent regulations[32] and the 2018 SEC Small Business Forum Report recommended allowing broker-dealers and clearing firms to rely on information from transfer agents.[33] Increased transfer agent disclosure would give investors the ability to efficiently deposit and transfer these securities and would allow broker-dealers and regulators to quickly identify and prevent promotions and illegal distributions before investors suffer harm.

d. Consider the relative benefits of preempting state Blue Sky laws for transactions in securities of companies that make adequate current information publicly available

Issues impacting small company secondary trading are not limited to the federal securities laws. State Blue Sky law compliance is a significant concern for companies that are not traded on an exchange. When a security or transaction is deemed out of compliance with Blue Sky laws for

[30] Requiring transfer agent disclosure of company share ownership and transfer information is similar to the policy driving the development of the Consolidated Audit Trail (CAT) for regulators. *See* SEC Final Rule, Consolidated Audit Trail, Release No. 34-67457 (Oct. 1, 2012) ("In performing their oversight responsibilities, regulators today must attempt to cobble together disparate data from a variety of existing information systems lacking in completeness, accuracy, accessibility, and/or timeliness.")
[31] Additional information about the OTC Markets Group Transfer Agent Verified Shares Program is available here: https://www.otcmarkets.com/corporate-services/transfer-agent-verified-shares-program.
[32] *See* SEC Release No. 34-76743, File No. S7-27-25, at pg. 131 (Dec. 22, 2015), available at https://www.sec.gov/rules/concept/2015/34-76743.pdf. ("More specificity around transfer agents' responsibilities with respect to illegal distributions may help to better protect investors, facilitate the prompt and accurate clearance and settlement of securities transactions, and combat fraud and manipulation in the microcap market."); *see also id.* at pgs. 132-135, questions 32-49, seeking comments concerning transfer agents' requirements with respect to share issuance, removal of restrictive legends, recordkeeping and ownership history.
[33] *See* The Final Report of the 2018 SEC Government-Business Forum on Small Business Capital Formation (Jun. 2019), available at: https://www.sec.gov/info/smallbus/gbfor37.pdf.

secondary trading, broker-dealers are unable provide investment advice, distribute research to retail customers or facilitate trading in managed accounts on behalf of investors. These restrictions ultimately impact that security's secondary market liquidity and reduce investor access to information.

Many states have adopted "Manual Exemptions" from registration for secondary (non-issuer) transactions in securities where adequate current information about the issuer has been published in a securities manual. The Manual Exemption embraces a disclosure-based philosophy, that, when combined with additional factors for compliance that vary in each state, provides a pathway for compliant, informed secondary trading.[34]

As investment activity and investor access to information continues to move online, trading platforms like OTC Markets Group are increasingly recognized as information repositories and publishers of company information. As of the date of this letter, the OTCQX market is exempt under Blue Sky laws concerning secondary trading in 36 states and the OTCQB market is exempt in 33 states. We have achieved this status largely by engaging with individual state regulators and members of the North American Securities Administrators Association ("NASAA") over the past three years with the goal of recognizing the current disclosure provided by OTCQX and OTCQB companies.

We appreciate the involvement of NASAA and the individual state regulators for their work on this issue and intend to continue working with NASAA and the remaining states to achieve national recognition of our OTCQX and OTCQB market standards and company disclosure. At 36 states and counting, it is clear that a vast majority of state regulators believe that the annual audited financial information and dynamic periodic and material news reporting provided by OTCQX and OTCQB companies represents a significant upgrade over paper-based securities manuals and provides investors with the information necessary to make an informed trading decision.

It must be noted, however, that the pace of progress and the reluctance of certain states to engage in meaningful evaluation of the issue is indicative of the difficulty of effecting much-needed, and widely accepted nationwide change through interaction with more than fifty independent regulatory agencies.

Certain functions of our securities laws are decentralized in nature and greatly benefit from the proximity of a local regulator. For example, state securities regulators have proven an essential player in detecting and prosecuting enforcement actions.[35] In this respect, having enforcement authority across the states is clearly an effective tool in combatting fraud and protecting investors. They are on the ground and often the first to hear reports of wrongdoing.

In certain circumstances, these localized functions should be distinguished from other elements of our securities laws – such as registration and secondary trading exemptions – which could be far more efficiently administered under a federal regime. For example, the lack of a uniform Blue Sky manual exemption means a broker-dealer with a national network of advisers will have

[34] *See* 2002 Uniform Securities Act § 202(2).
[35] In 2018, state securities regulators conducted 5,320 investigations, took on 2,067 enforcement actions and were responsible for over $1 billion in monetary relief ordered as result. *See* NASAA 2019 Enforcement Report, available at: https://www.nasaa.org/policy/enforcement-statistics/.

concerns that limit the distribution of research to individual investors. Investors suffer from the resulting lack of available research, which is anathema to the investor protection mission of state and federal regulators alike. In circumstances such as this, the Commission should consider whether limited federal preemption to facilitate national OTC markets and interstate commerce through broker-dealers is in the best interest of investors.

IV. SHINE THE LIGHT: Increase transparency in the small cap marketplace by enhancing the disclosure required of powerful market participants

Our mission to bring informational organization and transparency to the markets is closely tied to our ongoing efforts to combat securities fraud. From stock promotion schemes to the sale of unregistered securities, fraud in the trading of small company securities, whether OTC or exchange traded, hurts overall investor confidence in our markets and ultimately impedes the capital formation process.

Disclosure remains the most effective way to protect investors, eliminate information asymmetries and deter fraud in our public markets. Investors already avoid trading in companies that do not provide current disclosure. For example, securities identified as “Pink Limited Information” or “Pink No Information” comprised less than 2% of the total dollar volume traded across all our markets over the past 2 years. Additional regulation in this area requires thoughtful proposals to restrict insiders and affiliates from transacting in securities without adequate current information while protecting the property rights of unaffiliated shareholders.

As discussed more fully below, heightened transparency in our secondary markets can be achieved, and securities fraud can be greatly reduced, by actively regulating stock promotion activities, adopting data-driven enforcement tools, making ownership and identity information more readily available, and requiring more disclosure from insiders and affiliates.

a. Amend Securities Act Section 17(b) to require additional disclosure about paid stock promotion

Section 17(b) of the Securities Act requires only that paid stock promoters disclose the nature and amount of compensation received for the promotion. These limited requirements were originally formulated to combat fraudulent paper mailers and have proven to be wholly insufficient in an online environment where promoters can easily hide their identity and employ sophisticated tactics to prey on their targets. The Commission can make great strides in combating retail investor fraud by enhancing the disclosure required of paid stock promoters.

In a typical stock promotion scheme, promoters are paid – either directly or indirectly – by the issuer, or insiders or affiliates of the issuer, to generate interest the company’s securities. Promoters use emails, investor websites, message boards, and other mediums to post favorable content about the issuers they are promoting, often without providing any factual basis for their optimistic claims (e.g. “Guaranteed to double your investment!” “This stock is going up 500%!”). Without adequate information concerning who is responsible for the content, and the responsible party’s affiliation with the subject company, investors are left in the dark, often with the impression that they are reading independent, unbiased analysis. These schemes are designed so that company insiders can sell their shares once the promotion (and resultant retail interest) has caused the price to rise, leaving investors as the ultimate victims, buying promoted securities at inflated prices only to see the value of their holdings plummet once the promotional campaign has ended.

Despite public perception to the contrary,[36] this type of fraudulent stock promotion is a widespread issue not limited to microcap stocks and the OTC markets. In fact, the overall dollar impact of fraudulent promotional activities is far greater on securities exchanges such as Nasdaq or NYSE. The total dollar volume of promoted OTC securities from January through August of 2019 (approx. $600 million) was less than 1% of total dollar volume across the entire OTC market (approx. $222 billion) and far less than the total dollar volume of promoted exchange-listed securities (approx. $53 billion).[37]

OTC Markets Group recognizes the damage created by manipulative promotion and uses transparency to improve investor information and mitigate promotion risk. Our Issuer Compliance team monitors for promotional activities across our markets and flags securities with our promotion flag (📣) when we become aware of promotional activities in the stock. With this information, brokers can identify potentially problematic customers selling these securities and warn all investors of the clear risks of investing in promoted securities. The OTC Markets Group Policy on Stock Promotion[38] and Best Practices for Issuers[39] establishes a framework that allows market participants to easily identify and respond to fraudulent promotional activities.

Securities Act Section 17(b) should be amended to impose additional disclosure requirements on paid stock promoters, including (i) the identity and current contact information of the promoter and the individual or entity that paid for the promotion, (ii) the nature and amount of the consideration paid, (iii) whether the person or entity who paid for the promotion is affiliated with the issuer, and details around the affiliation, and (iv) where investors can find current public information about the issuer. Further, paid promotional activities should be prohibited where current information is not available. This proposal would make online information sources safer, deter misleading sales pressure and prevent fraudulent "pump-and-dump" schemes.

b. Amend Exchange Act Section 13(f) to include non-exchange listed securities

Another benefit of public secondary markets is the ability for companies and their investors to learn who has taken an interest in them. Section 13(f) of the Exchange Act mandates that institutional investment managers disclose their holdings. Unfortunately, this requirement extends only to exchange-listed securities and not to OTC-traded stocks. With disclosure of this information made only on a voluntary basis, if at all, companies are unable to determine which institutions hold positions in their securities.

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[36] A FINRA Investor Alert urges investors to approach articles promoting microcap stocks with caution: "[microcap stocks] typically trade over-the-counter and aren't bound by the same SEC rules governing reporting that exchange-traded stocks are subject to." FINRA Real Analysis or Paid Promotion? Beware of Investment Research Scams (Aug. 11, 2017), available at: https://www.finra.org/investors/insights/beware-investment-research-stock-scams.

[37] OTC Markets Group tracks promotions in OTC and exchange-listed securities with market capitalizations less than $2 Billion. Dollar volume presented represents the trading volume in promoted securities during an active promotional campaign.

[38] *See* OTC Markets Group Policy on Stock Promotion, available at: https://www.otcmarkets.com/files/OTC_Markets_Group_Policy_on_Stock_Promotion.pdf.

[39] *See* OTC Markets Group Stock Promotion: Best Practices for Issuers, available at: https://www.otcmarkets.com/files/Best_Practices_for_Issuers_Stock_Promotion.pdf.

When Congress mandated quarterly reporting under Section 13(f), it noted its intent to "create ... a central repository of historical and current data about the investment activities of institutional investment managers, in order to improve the body of factual data available and to facilitate consideration of the influence and impact of institutional investment managers on the securities markets and public policy implications of that influence."[40]

Expanding the scope of Section 13(f) to include all publicly-traded securities gives effect to Congressional intent and would generate valuable data for issuers, retail investors and regulators.[41]

c. Prohibit Objecting Beneficial Owner (OBO) accounts for company insiders and affiliates

Under current regulations, brokers holding shares on behalf of a beneficial owner are prohibited from disclosing the identity of the shareholder who objects to such disclosure (objecting beneficial owners or “OBOs”). Issuers are also prohibited from directly contacting OBOs and must do so through an intermediary. The ability of an OBO to hold shares in a discrete account allows company insiders to withhold their status as a corporate insider, further complicating a broker’s ability to deposit these shares.

OBOs are distinguished from non-objecting beneficial owners, or “NOBOs”, who allow disclosure of their holding in a particular security. The OBO/NOBO distinction is grounded in protecting shareholder privacy rights. However, the right to anonymity granted by OBO status should not extend to company insiders and affiliates. There is strong support within the industry for reforming, or entirely eliminating, the OBO/NOBO distinction.[42]

Consistent with the beneficial ownership reporting rules under Section 13(d) and 16(a) of the Exchange Act, company insiders and affiliates should be required to disclose to brokers that they are insiders when depositing shares and should not be permitted to hold such shares in an OBO account.

V. CONCLUSION

The history of OTC Markets Group predates the federal securities laws we know today. The company dates back to 1913, when it was known as the National Quotation Bureau, publisher of pink slips of paper with dealer names and pricing information that allowed brokers to more effectively trade securities over the counter. The listings were primarily stocks of companies that were not listed on the exchanges. In the more than 100 years since, we have looked to the public markets to raise capital, buy and sell shares of stock, and support the world’s greatest engine of economic growth.

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[40] Exchange Act Release No. 15461 (Jan. 5, 1979).
[41] OTC Markets Group submitted a petition for rulemaking to the Commission in 2013, seeking this relief. *See* Petition for Rulemaking Under Section 13(f) of the Securities Exchange Act of 1934, File No. 4-659 (Apr. 30, 2013), available at: https://www.sec.gov/comments/4-659/4659-13.pdf.
[42] In 2010, the SEC published a Concept Release seeking comment on reforms to the U.S. proxy system, including, among other things, the NOBO/OBO classification system. 77% of the approximately 200 respondents who submitted comment letters supported reforming or eliminating the NOBO/OBO distinction. *See* Securities Transfer Association, Inc., White Paper: Comment Letters on Proxy Reform Show Strong Support For Change, available at https://www.sec.gov/comments/s7-14-10/s71410-281.pdf.

Our markets, with technology and transparency, have evolved over time to better serve the needs of brokers, investors, companies, regulators and a host of other market participants. We look forward to continuing that evolution by working with the Commission, other federal and state regulators, and our industry colleagues to bring much needed improvements to small company capital raising and secondary trading. Our proposals are intended to facilitate discussion and introduce specific, actionable regulatory changes that, at their core, support the Commission's mission of protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation.

Please contact Dan Zinn, General Counsel [redacted]), or Cass Sanford, Associate General Counsel [redacted]), with any questions or to request additional information.

Very truly yours,

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