Response to Commission Statement on Market Structure Innovation for Thinly Traded Securities

[Release No. 34-87327; File No. S7-18-19]

Submitted by Ronald A. Woessner and Brett Bushnell, January 17, 2020.

Mr. Woessner, Principal of Woessner & Co., was Senior Counsel to the Financial Services Committee of the US House of Representatives in 2018 and served as special advisor to the Chairman for capital formation matters. Mr. Bushnell is a Texas A&M School of Law JD Candidate, Class of 2020.

Special thanks to Mr. David Weild IV, CEO of Weild & Co., whose research and publications are cited extensively throughout.

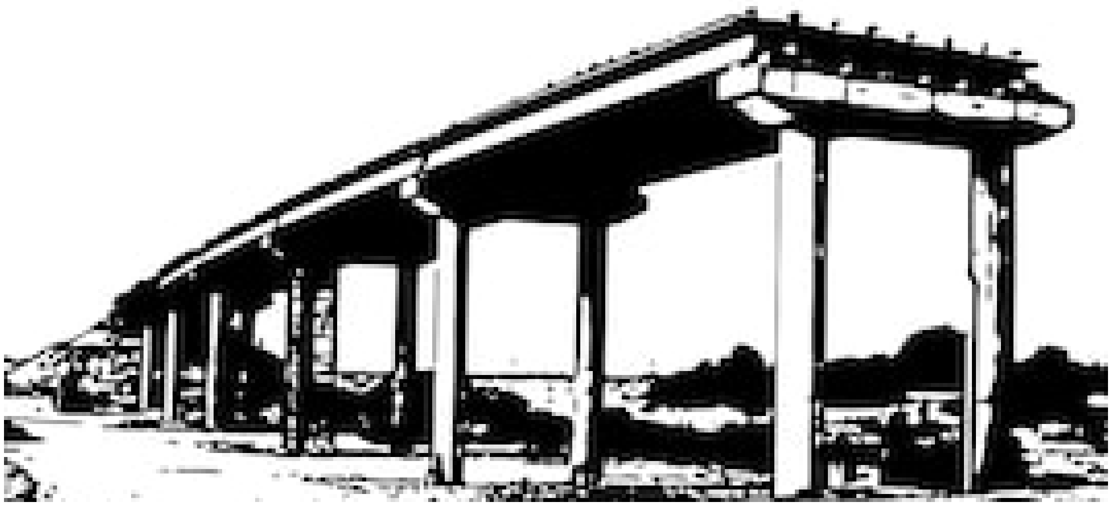
Public Offering Starts "Day One" as a Public Company

"[W]hile an IPO may be the most important step in an emerging growth company's development, it is only Day One of that company's life in the public market. Today, many small-cap companies are finding life there extremely difficult – not necessarily because of their performance, but rather due to the number of challenges afflicting the **aftermarket** support systems on which newly public companies depend for follow-on capital raises necessary for future growth. . . . "

As long as the view from the IPO "on-ramp" suggests that the prospects of taking on all the additional costs and risks of going public, but struggling to capitalize the benefits, many start-up founders, managers and investors will continue to think twice about choosing to finance their growth via the public market."[1]

[1] *From the On-Ramp to the Freeway: Refueling the Job Creation and Growth by Reconnecting Investors with Small Cap Companies* at p. 11, 14. Equity Capital Formation Task Force, November 11, 2013.

For Many Smaller-Cap Issuers, the U.S. Public Markets Are An "On-Ramp to Nowhere"



- There are thousands of smaller-cap public companies, including OTC Markets issuers, that have the potential to create millions of jobs and grow GDP.

- Many of these companies are "dying on the vine" because of their inability to access non-toxic capital and other inhospitable attributes of the US public markets.

- Thousands of these issuers with the potential to grow, thrive and become vibrant NYSE or NASDAQ issuers and veritable job and GDP creation machines, NEVER will achieve that. Many will stagnate; others will go out of business … with the foreseeable result that the number of US publicly listed issuers will continue to decline, and one day there will be <u>insufficient</u> large cap issuers for Fidelity, Vanguard, large pension funds, *etc.* to invest in.

The "On-Ramp to Nowhere" is Caused by Two Negative US Public Markets Trends

- Two current negative US public markets trends have resulted in the US public markets no longer being the envy of the world, as they once were.

- These two negative trends are:
  - the disappearing US public company
  - the public markets are inhospitable to smaller cap issuers: consequently, fewer are going public; many that do go public have delayed doing so

- The SEC seeks comment as to what can be done to remedy the trading illiquidity that afflicts smaller-cap issuers.

- Trading illiquidity is but ONE manifestation of the inhospitability, illuminated on slide 13, of the US public markets to smaller-cap[1] issuers.

- These two negative trends have their roots in a common cause

[1] Smaller cap issuers as used herein refers to nanocap and microcap issuers (*i.e.*, those with a market capitalization smaller than "small cap"). The definition of "small cap" varies as some firms define it as beginning at $300M in market cap, while others define it as beginning at $500M in market cap. Regardless, this filing relates to those issuers whose market capitalizations reside in the lower end of the market capitalization spectrum.

The Origin of the Two Negative Trends was the Destruction of "Aftermarket Incentives"

Aftermarket incentives were destroyed, as follows:

- Trading Spreads Collapsed
    - Order Handling Rules, Reg. ATS, Decimalization
- Sales Commissions Collapsed
    - Low (no)-cost self-directed model gutted high-cost distribution

Small-cap companies and capital formation			
	Before 1997	After 2001	% change
Tick sizes ("bankable spread")	$0.25 per share	$0.01 per share	-96%
Retail commissions	$250 per trade	$5 per trade	-98%
Investment banks (acting as a bookrunner)	167 (1994)	39 (2006)	-77%
Small company IPOs	2,990 (1991–1997)	233 (2001–2007)	-92%

Source: IssuWorks

The destruction of these after market incentives resulted in smaller investment banks and smaller broker-dealers making FAR LESS money, which has … => see next page

[1] *IssuWorks: Hearing on Legislation to Further Reduce Impediments to Capital Formation,* Statement of D. Weild, before the Financial Services Committee, at p. 15. October 23, 2013. (herein cited as "IssuWorks October 23, 2013 Statement")

Resulted in Fewer Investment Banks for IPOs and Fewer Broker/Dealers

IPO Book-Runners Declined 81% from 162 in 1994 to 31 in 2014[1] = 128 out of business

1994

162 Lead managers of at least 1 small IPO in 1994[3,4]

2014

128 Out of business by 2014[3,4]

31 Lead Managers of at least 1 small IPO in 2014[3,4]

Number of Broker/Dealers Has Decreased

29.1% decrease in BD's from 5,261 in 2003 to 3,726 in 2017[2] = 1,535 out of business

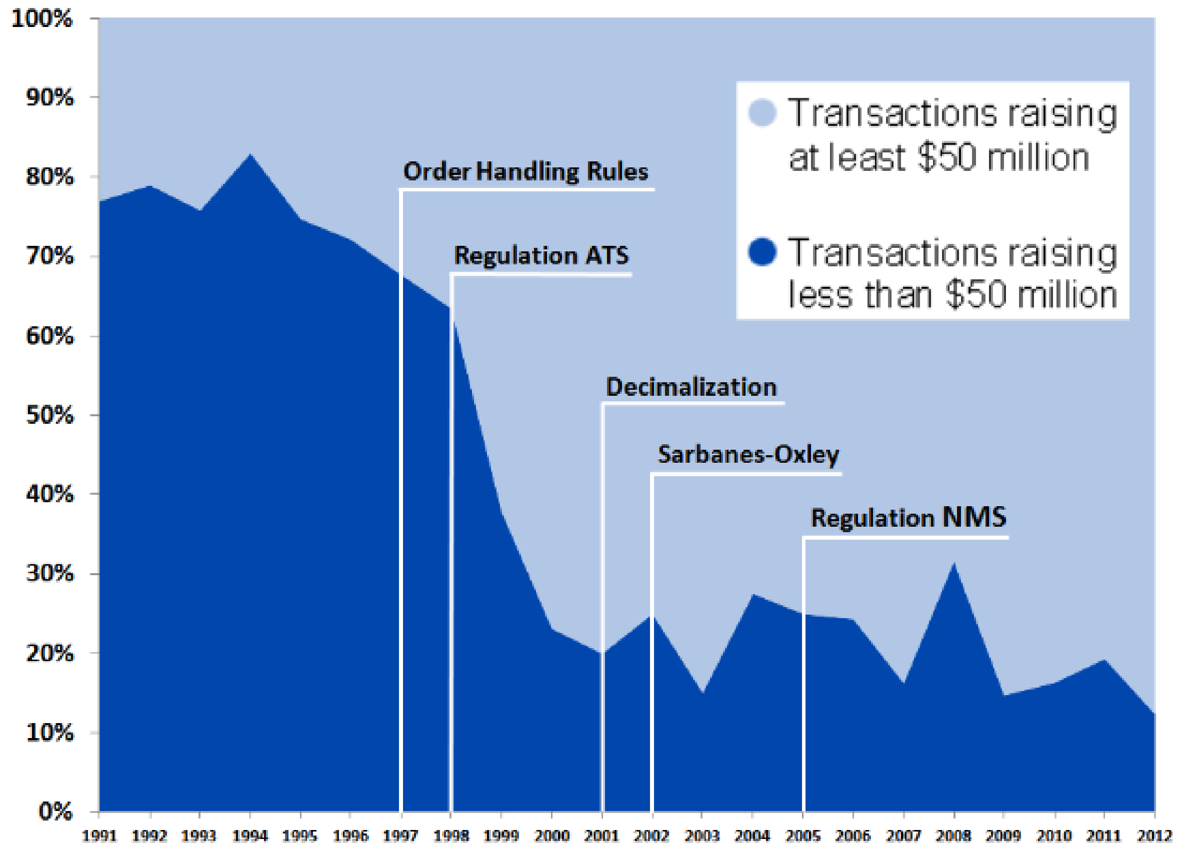
Fewer BD's and Investment Banks to "sponsor" smaller-cap issuers

Lack of "sponsorship" has created an inhospitable public markets environment for smaller cap publicly traded issuers

[1] IssuWorks October 23, 2013 Statement at p. 15 – 16.
[2] FINRA member statistical review 2003 - 2017.
[3] *The U.S. Need for Venture Exchanges*, March 4, 2015, by D. Weild & E. Kim, p. 6 - 7, Published by Weild & Co.
[4] 128 of the 164 book-runners that led at least 1 small IPO in 1994 were out of business by 2014. Even though more than 31 book-runners existed in 2014, only 31 were able to complete a small IPO in 2014.

Which Precipitated the Collapse of the Smaller IPOs

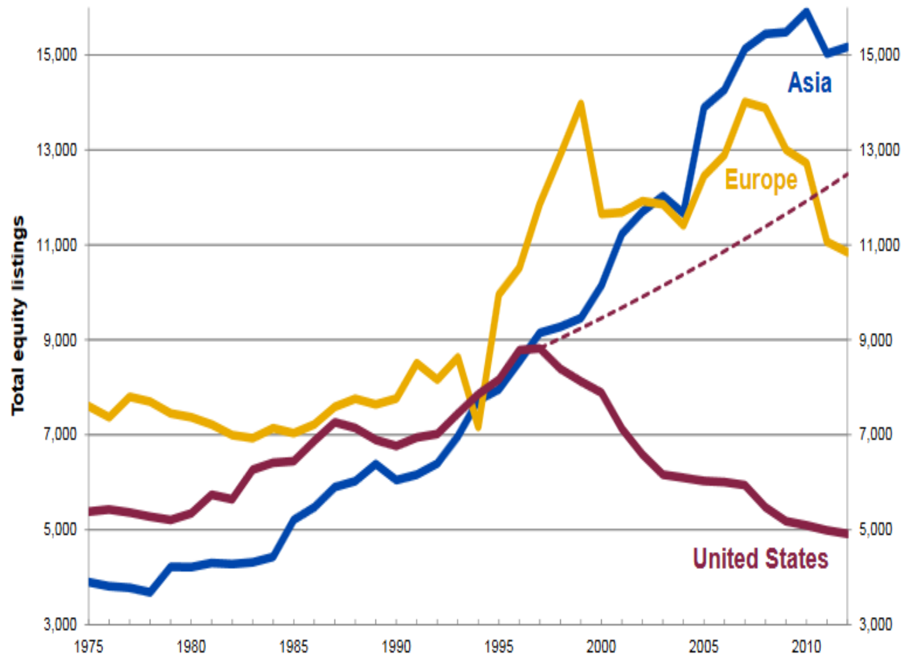
The Smaller IPO Collapse Began with the Collapse of Trading Spreads and Trading commissions[1]



[1] IssuWorks October 23, 2013 Statement at p. 4. The collapse of the small IPO accelerated with the introduction of low-cost electronic trading which caused the elimination of "friction" in the system.

Which Caused Negative Trend #1 -- the Shrinking US Public Markets

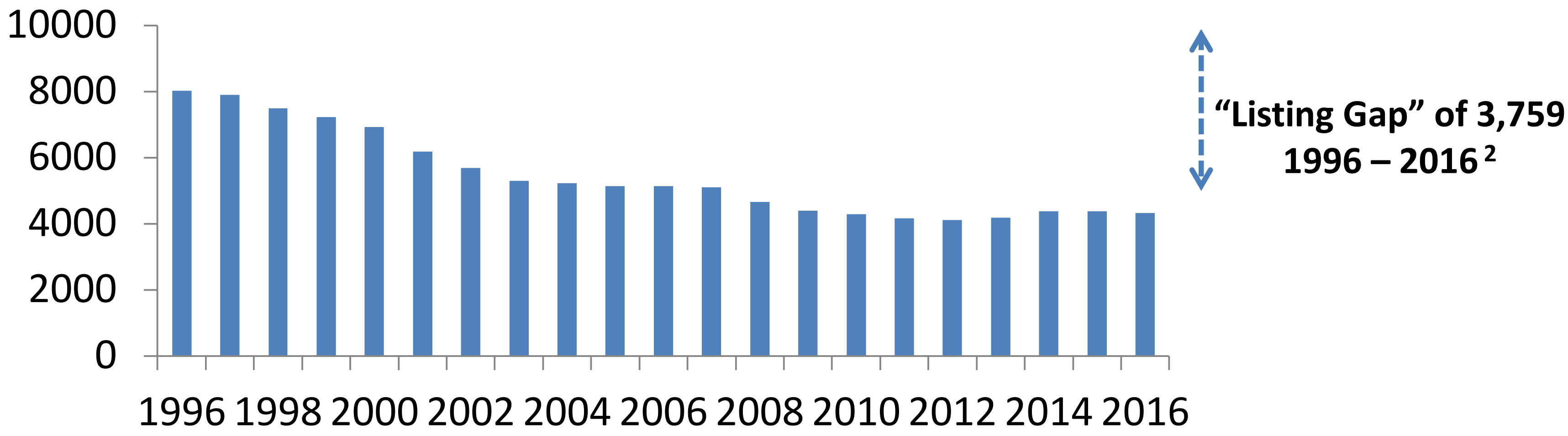
U.S. NMS Public Listings[1]



[1] IssuWorks October 23, 2013 Statement at p. 3.

Resulting in the "Great Depression" in Listings

Publicly-Listed Companies in the US 1996 – 2016 Decreased by 3,759[1]

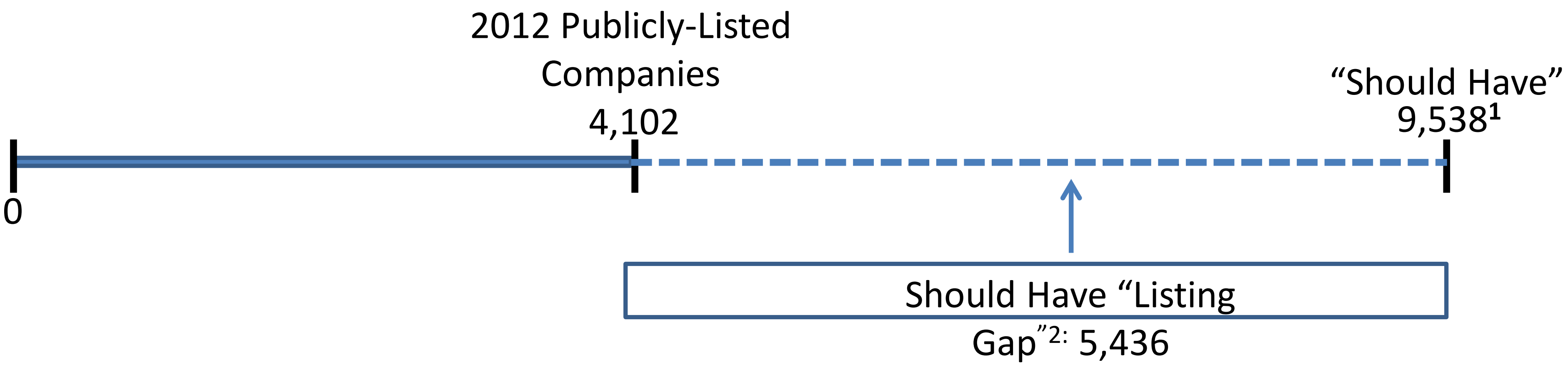


- *De-listings also impact the number of public companies*[3]

[1] *Hunting High & Low: The Decline of the Small IPO and What to Do About It*. Lux and Pead, April 2018 at p. 3.
[2] The listing gap has been primarily caused by the precipitous drop in the number of smaller IPOs. See FN 2 on slide 10.
[3] 325 is the average # of de-listings between 2008 – 2012. *The U.S. listing gap* at p. 38. December 2015. C. Doidge, G. Karolyi, and R. Stulz.

The “Listing Gap” is Much Worse on a GDP Basis[1]

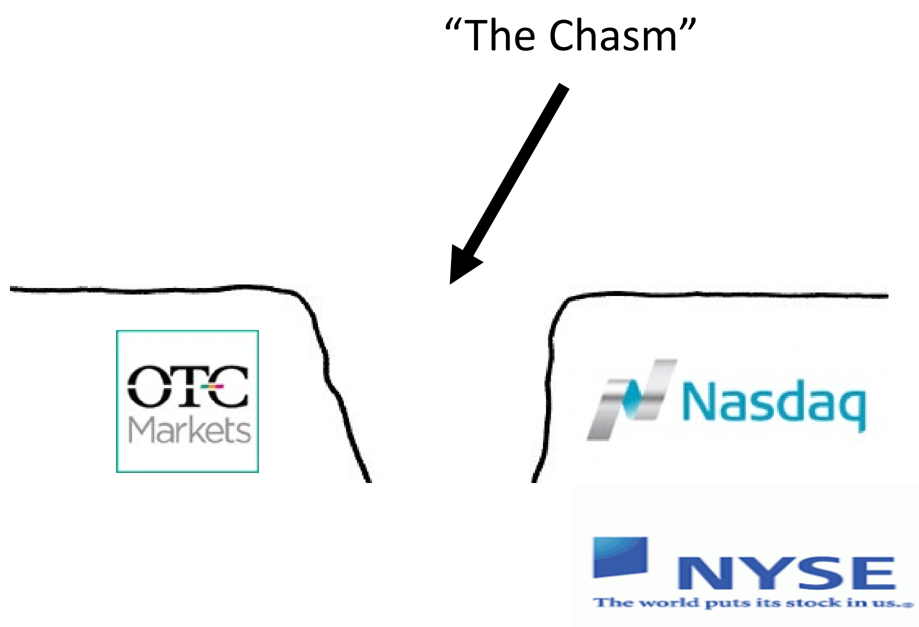
The “Should Have” Listing Gap was 5,436 as of 2012[2]



[1] 9,538 is the estimated “should have” number as of 2012. *The U.S. listing gap* at p. 13. December 2015. C. Doidge, G. Karolyi, and R. Stulz.
[2] The listing gap has been primarily caused by the precipitous drop in the number of smaller IPOs. The number of IPOs of < $100M since the year 2000 has decreased precipitously. The number of these IPOs averaged 401 annually in the 1990s, but then dropped to only 105 annually in the period 2000 - 2017. A delta of 296 per year * 18 years = **5,328** fewer public companies in the US, approximately the 5,436 “gap” shown above. In the 1990s, small IPOs made up 27% of all capital raised in public markets, whereas in the period from 2000 to 2017 they have represented only 7% of all capital raised. Lux and Pead, at p. 8.

With Fewer Small IPOs Occurring, "Crossing the Chasm" from OTC Markets to NASDAQ/NYSE is Harder than Climbing Mt. Everest

- On average, 500+ people per year summited Mt. Everest in recent years[1]



- On average, 64 issuers per year up-listed from OTC Markets to NASDAQ and NYSE in recent years[2]

[1] https://infographic.statista.com/normal/ChartOfTheDay_1157_Successful_mount_everest_ascents_per_year_n.jpg (Mt. Everest, 2007 – 2012)
[2] OTC Markets Data (NASDAQ, 2009 – 2017).

In Addition to Killing Small IPOs, the Lack of Aftermarket Incentives Killed the Broker/Dealer "Sponsorship" Model

- Under the former "sponsorship model," broker/dealers would nurture smaller-cap companies from private placement, to IPO, to trading in the aftermarket (market making), to research, and their retail brokers recommended the issuer's shares to their clients to purchase in the aftermarket.[1]

- The collapse of the aftermarket incentives of trading commissions and trading spreads killed the broker/dealer sponsorship model, with the following consequences[2]:

  - Virtually no retail salespersons to recommend purchase of smaller-cap stocks

  - Virtually no broker/dealers committing capital to make a market in smaller-cap stocks

  - Virtually no investment analysts providing investment research for smaller-cap stocks

- Lack of "sponsorship" has created universe of smaller-cap "orphaned" publicly-traded issuers

[1] Comments of Keith Testaverde, Sr. VP, Network 1 Financial Securities, Inc., filed December 5, 2019, in response to this SEC Request for Comment.
[2] *See* Division of Trading and Markets: Background Paper on the Market Structure for Thinly Traded Securities at p. 1 - 4, 6, 9 (citing remarks of A. Epstein at the SEC Staff Roundtable, Market Structure for Thinly Traded Securities, April 23, 2018).
See "The trouble with small tick sizes," Weild, Kim and Newport, September 2012 (Grant Thornton Capital Markets Series).

Trend #2: With No Sponsorship, Smaller-cap Issuers Face Inhospitable Public Markets

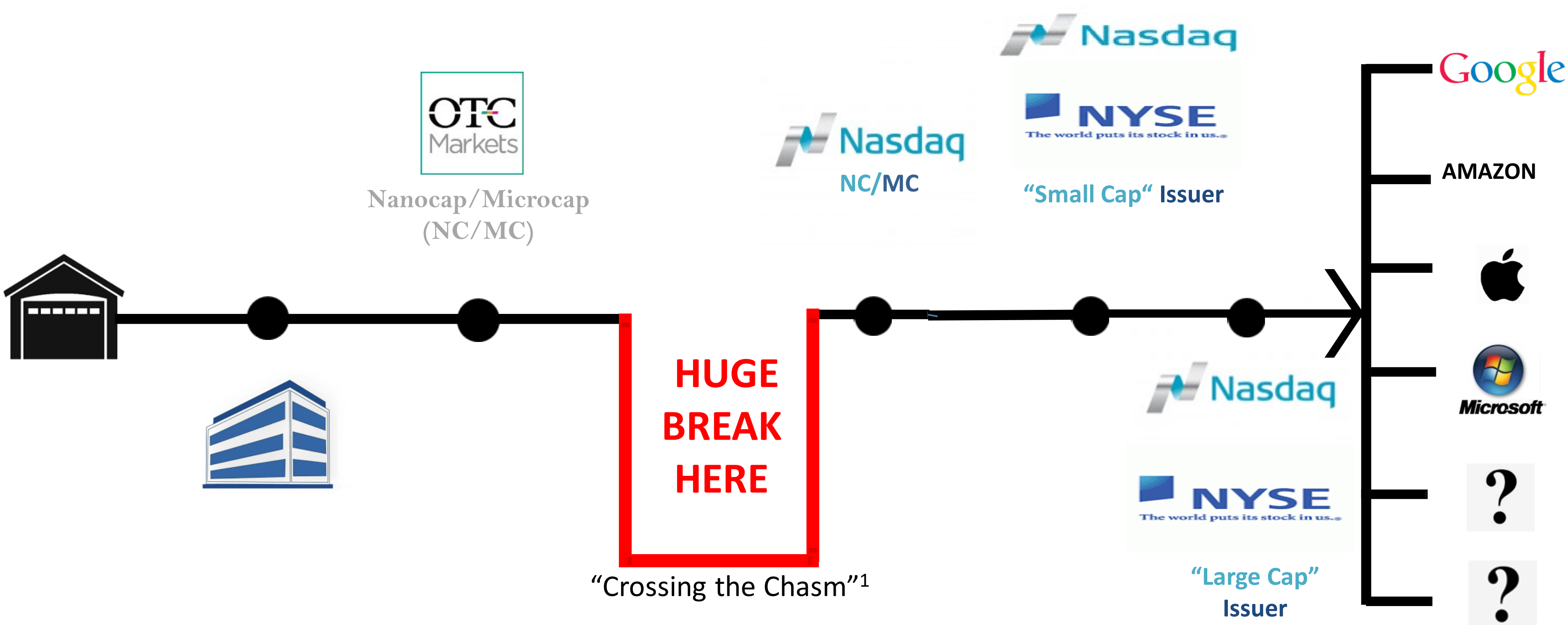
The inhospitability of public markets to smaller-cap issuers manifests as follows:[1]

- Stocks are illiquid
- Little-to-no investment analyst coverage
- Little-to-no investment banking “sponsorship” because of lack of “aftermarket” incentives
- Fewer Main Street “retail” investors investing in illiquid smaller cap stocks
- Few (if any) institutional investors invest in illiquid smaller cap stocks
- Little available capital and what is available is often “toxic”[2]

[1] *See* Division of Trading and Markets: Background Paper on the Market Structure for Thinly Traded Securities at p. 1- 4, 6, 9 (citing remarks of A. Epstein at the SEC Staff Roundtable Market Structure for Thinly Traded Securities, April 23, 2018). These attributes are common knowledge to participants in the smaller-cap public market ecosphere.

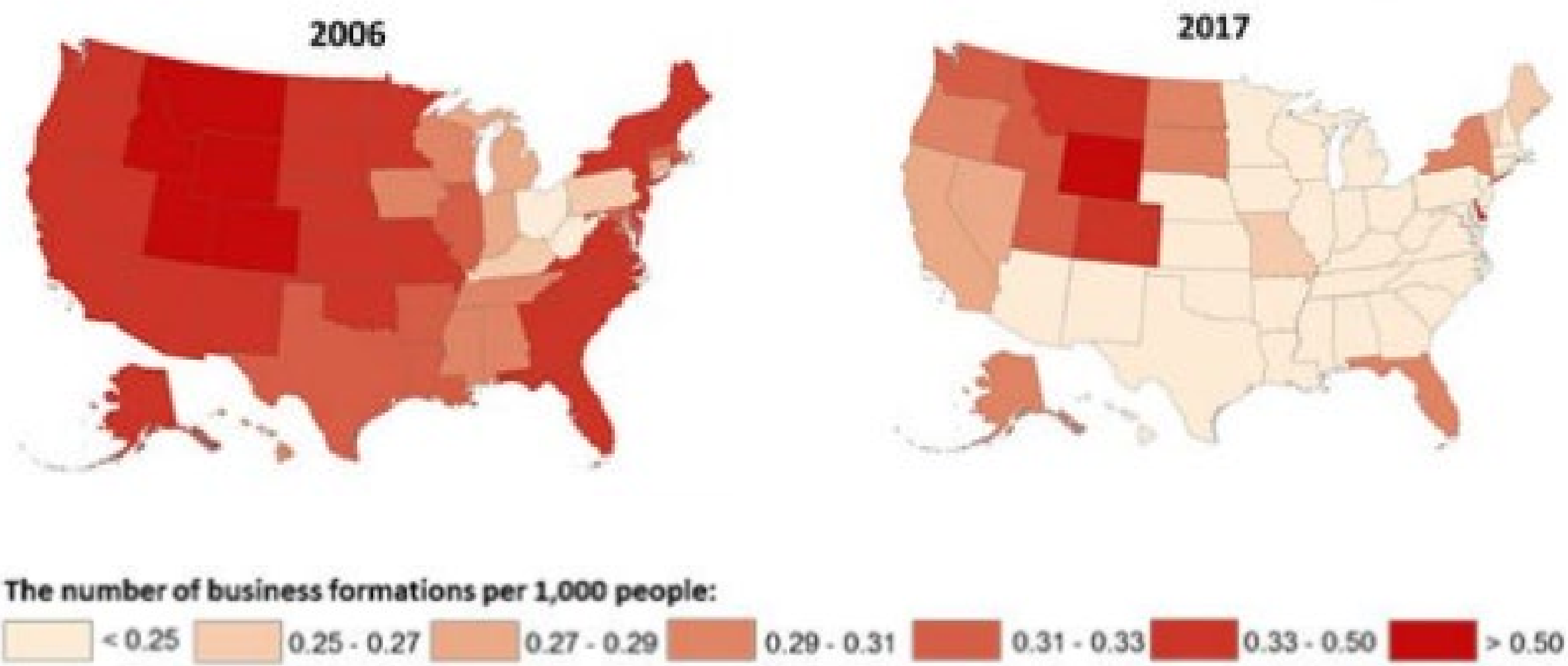
[2] *E.g.*, convertible notes that convert at a deep discount to then-current market prices, accompanied by onerous warrant coverage.

This Inhospitability Has Broken the "Pipeline" For Start-Ups to Grow from America's Garages to Becoming a Unicorn



[1] *Crossing the Chasm*. Geoffrey A. Moore. 1991.

Contributing to a Decline in US Entrepreneurship[1]



[1] “There are more rusty cars in America’s garages today than entrepreneurs starting new businesses,” quoting Jeb Hensarling, former Chairman of the Financial Services Committee of the US House of Representatives. As would be entrepreneurs see their friends’ businesses failing, either in the public markets or before -- many decide to keep their day jobs.
Map Source: US Census Bureau *https://www.census.gov/newsroom/blogs/research-matters/2018/02/bfs.html*.

The Cure is to Restore Former After Market Incentives

- Since decrease in aftermarket incentives killed the smaller IPOs and the former broker/dealer sponsorship model, common sense says reinstating aftermarket incentives will increase the number of smaller IPOs AND restore the broker/dealer sponsorship model.[1]

- US has the lowest aftermarket incentives of any market in the world, with 0% of smaller-cap stocks with large after-market incentives (> 1% of share price).[2]

- In countries with robust smaller IPO activity, 71% of their smaller cap stocks have tick sizes in excess of 1% of share price. In other words, larger tick sizes positively correlate to the number of smaller IPOs.[3]

- After market incentives can be restored for smaller cap issuers through a "venture exchange," such as that contemplated by Congressman Emmer's "Main Street Growth Act" included in JOBS Act 3.0.[4]

- With after market incentives restored for smaller cap issuers, broker-dealers will begin performing the tasks necessary to nurture these issuers[5] and enable them to grow and thrive in the public market ecosphere.

[1] IssuWorks October 23, 2013 Statement at p. 5. *See also* Comments of Keith Testaverde, Sr. VP, Network 1 Financial Securities, Inc., filed December 5, 2019, in response to this SEC Request for Comment. This is common sense.
[2, 3] IssuWorks October 23, 2013 Statement at p. 5.
[4] The "Main Street Growth Act" (H.R. 5877 in the 115th Congress), approved by the House of Representatives by vote of 406 - 4; reintroduced in the 116th Congress as H.R. 2899.
[5] See slide 12.

In Conclusion

- Two profoundly negative US public markets trends are rooted in a common cause: no robust aftermarket incentives
- **Trend #1:** The number of US publicly-listed companies is declining
- The gap ("Listing Gap") between the number of publicly-listed companies and the number the US "should have" is estimated to be 3,800 – 5,500 companies
- The Listing Gap is primarily attributable to the collapse in the number of smaller IPOs (< $50M - $100M)
- Smaller IPOs have collapsed because of the disappearance of smaller investment banks and regional broker dealers[1]
- **Trend #2:** Smaller-cap issuers face inhospitable US public markets
- This Inhospitability is caused by disappearance of former broker/dealer sponsorship model
- These two trends can be reversed by restoring aftermarket incentives by creating a venture exchange with special trading rules that permit robust aftermarket incentives

[1] And because smaller cap issuers face inhospitable US public markets.

Response to Commission Statement on Market Structure Innovation for Thinly Traded Securities

[Release No. 34-87327; File No. S7-18-19]

Submitted by Ronald A. Woessner and Brett Bushnell, January 17, 2020.

Mr. Woessner, Principal of Woessner & Co., was Senior Counsel to the Financial Services Committee of the US House of Representatives in 2018 and served as special advisor to the Chairman for capital formation matters. Mr. Bushnell is a Texas A&M School of Law JD Candidate, Class of 2020.

Special thanks to Mr. David Weild IV, CEO of Weild & Co., whose research and publications are cited extensively throughout.