



August 7, 2023

Via Email

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506
PubCom@finra.org

Re: Regulatory Notice 23-09: Request for Comment on FINRA Rules Impacting Capital Formation

Dear Ms. Mitchell,

OTC Markets Group Inc. (“OTC Markets Group”)¹ respectfully submits this letter in response to the request for comment by the Financial Industry Regulatory Authority, Inc. (“FINRA”) in Regulatory Notice 23-09 concerning FINRA’s rules impacting capital formation.²

We operate the primary over-the-counter (“OTC”) electronic trading market in the United States — where regulated broker-dealers trade over 12,000 securities. While there are many areas for FINRA to enhance and improve its ruleset for member firms trading OTC securities, such as improving the data around short sale activity,³ our comments today are narrowly focused on improving the regulatory guidance for member firms handling unregistered securities.

The OTC equities market represents a diverse mix of securities and trading activity. 85% of the total dollar volume on our markets is in larger international companies, such as Roche, Adidas and Heineken, with American Depositary Receipts (ADRs) or foreign ordinary shares that trade in the U.S. 67 companies on our OTCQX and OTCQB markets have a market capitalization over \$1 billion.

The OTC market is also home to many smaller, venture-stage companies based in the United States. The OTCQX and OTCQB markets include approximately 1,500 “small cap” companies (those with a market capitalization under \$250 million). These companies represent a wide spectrum of industries, including community banks, technology, science, and manufacturing. They employ Americans across the country and represent the lifeblood of our economy.

¹ OTC Markets Group Inc. (OTCQX: OTCM) operates regulated markets for trading 12,000 U.S. and international securities. Our data-driven disclosure standards form the foundation of our three public markets: OTCQX® Best Market, OTCQB® Venture Market and Pink® Open Market. Our OTC Link® Alternative Trading Systems (ATSs) provide critical market infrastructure that broker-dealers rely on to facilitate trading. Our innovative model offers companies more efficient access to the U.S. financial markets. OTC Link ATS, OTC Link ECN, and OTC Link NQB are each an SEC regulated ATS, operated by OTC Link LLC, a FINRA and SEC registered broker-dealer, member SIPC. To learn more about how we create better informed and more efficient markets, visit www.otcmarkets.com.

² FINRA Regulatory Notice 23-09 (May 9, 2023), available at <https://www.finra.org/rules-guidance/notices/23-09>.

³ Blog: What Investors Should Know About FINRA Daily Short Sale Volume Data (May 8, 2023), available at: <https://blog.otcmarkets.com/2023/05/08/what-investors-should-know-about-finra-daily-short-sale-volume-data/>.

Smaller public company securities are also often unregistered and trade on the OTC market in reliance on a valid exemption from registration. Characteristics inherent to small cap securities — lower trading volumes, closely-held shareholder base, a share price under \$5 — often constitute regulatory “red flags,” making it difficult and costly for broker-dealers to handle them.

To support capital formation for smaller public companies and their investors, we urge FINRA to update guidance that clarifies broker-dealers’ compliance obligations with respect to clearing, depositing and facilitating transactions in unregistered securities. Updated regulatory guidance would allow for more privately issued securities to enter the public market.

Deposit and transfer of unregistered, low-priced or thinly traded securities has become increasingly difficult in recent years. 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,⁴ FINRA issued Regulatory Notice 09-05, which was intended to establish guidelines and red flags for member firms with respect to facilitating transactions in unregistered or restricted securities. The wide-ranging issues raised in FINRA’s Notice 09-05 created uncertainty around how firms can adequately meet their compliance obligations when processing transactions in unregistered OTC securities. Regulatory uncertainty has contributed to rising compliance costs and caused a chilling effect.

As a result, many brokers and clearing firms indicate that increased regulatory concerns make it too arduous and cost-prohibitive to facilitate transactions for retail investors in securities of companies that are not SEC reporting, and those priced below \$5. A number of firms have determined not to engage in any OTC equities business because they believe the compliance costs and potential regulatory risks outweigh the benefits. Other firms pass the costs on to the shareholders, who either cannot deposit their shares or must pay a disproportionate fee to do so. As a result, investors lack an efficient trading option and small companies are unable to start down the path of becoming public, which further restricts liquidity and devalues the company’s shares and investors’ 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.

The regulatory environment, industry-wide compliance standards, and investor protection measures governing the over-the-counter marketplace have greatly improved since FINRA Notice 09-05 was issued nearly 15 years ago.

Most notably, the OTC equities market underwent a transformational regulatory change in 2021 with significant amendments to Securities and Exchange Act Rule 15c2-11 and related FINRA Rule 6432. Under an investor protection mandate, the amendments significantly enhanced the disclosure requirements for all OTC-traded issuers, including for unregistered securities under the updated “Catch-all” disclosure standard. The SEC noted that the amendments were also “designed to enhance the efficiency of the OTC market and facilitate capital formation for

⁴ 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 E022004011201, (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).

issuers for which information is current and publicly available.”⁵ Accordingly, the amended rule introduced a number of new exemptions and now permits qualified market operators — such as our OTC Link ATS — to conduct an “initial review” to bring a company to the public markets. In its final rule, the Commission also published a non-exhaustive list of 24 red flags to assist FINRA member firms in fulfilling their compliance obligations under the rule.⁶ Since the new rules became effective in September 2021, OTC Link ATS, in its capacity as a “Qualified Interdealer Quotation System,” publishes daily compliance determinations for over 12,000 securities, indicating which securities may be the subject of public broker-dealer quotes under the Rule. OTC Link ATS has also filed 117 Forms 211 with FINRA.

Over the years, OTC Markets Group has developed a comprehensive suite of marketplace designations and information flags displayed on our website and in our enterprise market data feeds. These compliance designations 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 the amended Rule 15c2-11 Final Rule and FINRA’s Notice 09-05 (e.g., promotion, hot sector, shell risk, bankruptcy, penny stock status, and affiliation with a prohibited service provider).⁷ This information is integrated into many broker-dealer compliance processes so firms can better analyze securities and identify risk.⁸

For the reasons set forth above, FINRA should re-issue guidance that encourages firms to leverage available data to safely deposit and transfer OTC securities in line with the standards and red flags set forth in Rule 15c2-11. The goal of regulatory reform in this area should be to enable market participants to whitelist customer securities that are clearly “OK to trade,” and distinguish those from potential affiliate securities that require additional due diligence. Such reform would increase capital formation opportunities for companies clearly acting in compliance with existing rules and guidelines and allow broker-dealer compliance departments to devote more time and resources to those companies requiring additional scrutiny.

We thank FINRA for taking the time to consider these important issues and seek industry feedback. We welcome the opportunity to discuss our comments with FINRA.

Respectfully submitted,



Daniel Zinn
General Counsel



Cass Sanford
Deputy General Counsel

⁵ Press Release: SEC Adopts Amendments to Enhance Retail Investor Protections and Modernize the Rule Governing Quotations for Over-the-Counter Securities (Sept. 16, 2020) available at: <https://www.sec.gov/news/press-release/2020-212>.

⁶ Final Rule: Publication or Submission of Quotations Without Specified Information, 85 FR 68124, 68170-68172 (Oct. 27, 2020).

⁷ A full list of OTC Markets Group compliance and information flags is available at: <https://www.otcm Markets.com/files/OTCM%20Compliance%20Flags.pdf>.

⁸ Additional information about OTC Markets Group Compliance Data Products is available at: <https://www.otcm Markets.com/market-data/compliance-data-products>.