

NETWORK **1** FINANCIAL SECURITIES, INC.

May 28, 2025

Response to Regulatory Notice 25-06

As a participant in the capital formation process for the true micro-cap companies (ie, those entities now referred to as nano-cap companies) for more than 50 years, I can honestly say that I have witnessed the total destruction of the capital markets for these types of companies. There is no way these companies can take advantage of the capital markets in the current regulatory and economic environment. This type of environment completely alters who we are as a country and the ability of the small emerging companies to use our capitalist system.

We were a country dedicated to supporting all of its citizens and we had a system that could be used by the smallest and least connected members to help achieve the American Dream. If such a person worked hard, built a business, developed new and innovative strategies, technologies, services and industries, they too could use the capital markets to advance their dreams.

In fact, I would always comment to my associates in other countries that the difference between their economic systems and ours was the ability of small and new companies to obtain the capital needed to fulfill their owners' objectives.

This drastic change of events has occurred for many reasons, but the overwhelming cause has been the regulatory environment. Our regulators have acted, in many instances to assist the largest financial institutions, private equity players and traders, enhancing their markets and activities. In doing so they have ignored the fact that their new rules and regulations have made it almost impossible for a true micro-cap market to exist.

This regulatory environment has largely contributed to the decrease in the number of broker/dealers from 5026 in 2006 to 3298 in 2023; 1728 fewer broker/dealers, a 34% decrease. The most significant decrease comes from the loss of mid-size and smaller broker/dealers. Those were the type of broker/dealers that participated in the micro-cap markets.

The question is why has this occurred and what could be done to revitalize the industry.

Ironically, one reason may very well relate to the unintended consequences associated with the Penny Stock Reform Act and the subsequent rules adopted by the SEC to address sales-practice abuses and manipulation involving speculative, low-priced over-the-counter securities. SEC Rules 15g-2 through 15g-9, for example, implemented requirements associated with risk disclosure, compensation disclosure, account statements and sales practices. Good rules that were well deserved at the time and designed to maintain the integrity of our capital markets. But unfortunately, they also tended to limit the ability and/or willingness of a broker/dealer to recommend or promote small companies. The rules led broker/dealers and investors to be overly concerned about doing transactions in these types of securities. In fact, most of today's broker/dealers have strict rules relating to the recommendation of over-the-counter securities and many will not allow their registered representatives to solicit companies that trade in those markets.

Also, because of the actions of some individuals owning stock in companies trading under \$5 in the over-the-counter market, regulatory bodies have applied significant pressure on the clearing firms for these securities. Again, the unintended consequence of this is that many clearing firms will not accept micro-cap stocks. Broker/dealers are therefore reluctant to recommend micro-cap stocks to investors given their concern that investors may have difficulty having their securities deposited with clearing firms.

Another sign that the over-the-counter micro-cap market is dying is the inability to find market making broker/dealers that are soliciting or even supporting these types of companies. The majority of today's major market making firms are competing to attract transactions in the large-cap companies. It would be very hard to find one that is willing to commit any capital to support and trade companies in the micro-cap market.

If broker/dealers are discouraged from soliciting micro-cap stocks, if clearing firms are reluctant to clear and accept them, and if market makers have no reason to trade them, how could there be a working capital raising industry for these companies.

These smaller companies often find themselves attempting to qualify for one of the national exchanges, such as NYSE American or the Nasdaq. However, the companies have difficulty meeting the listing requirements. One initial listing standard for NYSE American is a market cap requirement of \$50 million and \$15 million raise; and one Nasdaq listing standard also requires a \$50 million market value and a \$15 million raise. These requirements in effect eliminate true micro-caps from being able to use these exchanges for capital raising.

Where does a company go that has \$2 to \$10 million in revenue, a very interesting new technology or a unique product, and needs \$3-7 million dollars in capital to prove out their business plan? A company who's beginning market cap might be between 20 and 25 million dollars.

The answer today is that the company is effectively shut out of the public capital raising markets.

I don't believe it was our regulator's intent to destroy this market. However, that has occurred. If an investment banking firm wants to provide these true micro-cap companies with the ability to use the IPO markets, the challenge has become unreasonably daunting based upon a regulatory environment that appears to frown upon these companies. Indeed, if a banker should make a mistake in the process, there is no expectation that a regulator will provide guidance. In fact, there has been no evidence that our regulators want to encourage this type of offering. Most small to mid-size broker/dealers feel that any attempt to develop a system and market would be met with scrutiny and suspicion by its regulators.

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CALL TO ACTION:

FINRA should developed a task force of members that want to participate in this market. I believe that within a short period of time a plan can be developed that will restore this important part of the American Dream and economy.

I have no doubt that this would lead to an explosion of new companies that will provide new opportunities, new jobs, new technologies and a brighter future for our country and a fairer chance for all members of our society to participate in the U.S. Capital markets.

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