February 8, 2018

Via Electronic Submission

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

Re: FINRA Regulatory Notice 17-41: Response to FINRA's Request for Comment on the Effectiveness and Efficiency of Its Payments for Market Making Rule

Dear Ms. Mitchell:

OTC Markets Group Inc.[1] ("OTC Markets Group"), on behalf of its wholly owned subsidiary OTC Link LLC ("OTC Link ATS"), respectfully submits to the Financial Industry Regulatory Authority, Inc. ("FINRA") the following comments on FINRA Rule 5250 ("Rule 5250") in response to FINRA's request for comments in FINRA Regulatory Notice 17-41. We advocate for amendments to Rule 5250 that would allow issuers to compensate broker-dealers for preparing and submitting a Form 211.

OTC Link ATS is a FINRA member broker-dealer and SEC registered ATS that provides a network facilitating broker-dealer trading in OTCQX®, OTCQB®, Pink® and other securities. More than 90 FINRA member broker-dealers quote securities and provide liquidity in the approximately 10,000 securities that trade on our markets.

Introduction

Trading on OTC Link ATS is often a smaller company's first exposure to the public markets. The experience is akin a company going public on a U.S. national securities exchange.

When broker-dealers bring companies public on a U.S. national securities exchange, they are not restricted from receiving payment for the investment banking services

[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, 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 is operated by OTC Link LLC, member FINRA/SIPC and SEC regulated ATS.
To learn more about how we create better informed and more efficient markets, visit www.otcmarkets.com.

necessary to price the companies' securities and complete the public offering.[2] Filing a Form 211 requires information gathering and due diligence, and acts as an objective pricing analysis similar to that provided by an investment bank bringing a company public on a national exchange. By prohibiting payments for filing a Form 211, FINRA Rule 5250 restricts the ability of small companies to access public markets and limits the overall availability of company information.

While we have little doubt that the future of capital markets will be online, over the past year we have seen capital raising activities – in the form of "Initial Coin Offerings" – move away from regulated marketplaces. This shift can be viewed as a natural response to the significant regulatory barriers preventing smaller companies from engaging FINRA member broker-dealers to help them navigate the public markets. FINRA should conduct its retrospective review of Rule 5250 with an eye towards industry best practices in developing a straightforward and transparent pathway for small companies to access our capital markets.

Finding a broker-dealer to file a Form 211 presents a daunting initial hurdle for companies looking to access the public markets in an efficient and orderly manner. From the broker-dealer perspective, filing a Form 211 involves collecting, reviewing and analyzing the issuer's disclosures, as well as responding to FINRA's comments and questions. The process presents a significant cost and time commitment, with no possibility of remuneration.

The policy objectives underlying Rule 5250 are admirable – namely, to ensure that firms remain independent and unbiased when introducing a security to public markets or while making ongoing markets. However, in practice, the overbroad restriction interferes with the ability of investment banking professionals to create liquidity and price transparency in an orderly manner. Downstream, the burdens of filing a Form 211 ultimately limit investor access to higher quality company information and contribute to the shrinking number of public companies. Rather than the current ban on payment for useful investment banking or market making services, regulations should favor public disclosure and regulatory oversight.

As set forth more fully below, Rule 5250 should be amended to allow broker-dealers to receive reimbursements for the reasonable out-of-pocket expenses incurred in connection with the preparation and filing of a Form 211, provided that the amount of such reimbursements is fully disclosed to investors, as required by Section 17(b) under the Securities Act of 1933 (the "Securities Act").

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[2] *See* Sarah Gray, Spotify IPO: What You Need to Know About This Unusual Event, WWW.FORTUNE.COM (Jan. 16, 2018) available at: http://fortune.com/2018/01/15/spotify-ipo-date-why-know-tech/ ("Spotify paid just $30 million in [Equity Capital Market] fees to three banks: Goldman Sachs Group Inc., Morgan Stanley and Allen & Co. Those institutions will perform some of the traditional tasks expected of them, but in a less prominent way.").

OTC Markets Group has previously submitted written comments relating to the Form 211 process and Rule 5250 to the Securities and Exchange Commission ("SEC")[3] and, more recently, to FINRA on January 8, 2018.[4] The comments herein should be read in conjunction with our prior letters.

Background: Rule 5250

Rule 15c2-11 under Securities Exchange Act of 1934 (the "Exchange Act") represents the gateway to public trading and investor interaction for many smaller, growth-stage companies. To begin quoting a security on our markets, broker-dealers are required to collect, review and maintain certain information about the issuer, as specified in Rule 15c2-11. That information must then be submitted to FINRA, together with a completed Form 211 which includes the price at which the broker intends to quote the security and the basis thereof, in addition to other information. Under Rule 6432, the firm filing the Form 211 must also submit certifications that it has a reasonable basis for believing that the information is accurate and has been obtained from a reliable source.

Rule 5250 explicitly prohibits any payment by issuers or their affiliates and promoters, directly or indirectly, to a member for publishing a quotation, acting as a market maker, or submitting an application in connection therewith. This includes accepting payments for the expenses involved in the preparation and filing of a Form 211. To ensure compliance, firms must submit an additional certification confirming that they have not accepted any payments in violation of Rule 5250.

Originally introduced in 1975 and codified in 1997, Rule 5250 was designed to ensure that broker-dealers are independent and unbiased when publishing a quotation or making a market in a security. This blanket prohibition on market making compensation is based out of a concern that broker-dealers receiving payments from issuers, or promotors, creates a conflict of interest that would influence the broker-dealer's decision as to whether to quote the security and at what price.[5] With investor protection in mind, Rule 5250 is meant to deter manipulation of market prices that result from backdoor

[3] *See* OTC Markets Group Inc. Comment Letter to the SEC in Response to Proposed Amendments to FINRA Rule 6432; File No. SR-FINRA-2014-011, available at https://www.sec.gov/comments/sr-finra-2014-011/finra2014011-1.pdf.

[4] *See* OTC Markets Group Inc. Response to FINRA Regulatory Notice 17-14 (the "17-14 Comment Letter"), available at http://www.finra.org/sites/default/files/notice_comment_file_ref/17-14_OTCmarkets_comment.pdf.

[5] *See* FINRA Regulatory Notice 14-26: Prohibition on Payments for Market Making (July 7, 2014) ("FINRA Notice 14-26"), pg. 2, available at: http://finra.complinet.com/net_file_store/new_rulebooks/f/i/FINRANotice_14_26.pdf. ("Accepting [payments prohibited by Rule 5250] compromises the independence of a firm's decision regarding its quoting and market making activities and, among other things, harms investor confidence in the overall marketplace because investors are unable to ascertain which quotations are based on actual interest and which quotations are supported by issuers or promoters.")

agreements between issuers and market makers. In a 2013 Notice, the SEC reiterated these policy concerns:

> In particular, the existence of undisclosed, private arrangements between market makers and an issuer and/or its promoters may make it difficult for investors to ascertain the true market for the securities, such that what might appear to be independent trading activity may well be illusory.[6]

Rule 5250 Unfairly Restricts Capital Formation for Small Companies

The information gathering and review process required under Exchange Act Rule 15c2-11 cannot be performed without cost. The "reasonable basis" standard under FINRA Rule 6432 potentially subjects firms to considerable liability. The firm must also shoulder the out-of-pocket expenses involved in conducting this review, including preliminary due diligence, legal and administrative costs. These costs cannot easily be recouped, largely because secondary trading margins have compressed.

Many of the companies that trade on our markets are smaller, growth-stage companies that could greatly benefit from professional advice and guidance on creating a public market. Unfortunately, the inability to receive payment for undertaking the process of approving a security for quoting gives broker-dealers little incentive to develop relationships with these companies. In many cases, the inability to find a firm willing to take on this financial and regulatory burden, without compensation, ultimately prevents otherwise qualified companies from accessing the public markets and supporting their existing shareholders' liquidity needs. Companies that cannot find a broker-dealer to file a Form 211 and quote their security are often relegated to the opaque Grey Market, which has wider spreads, less liquidity and less transparency.

If the Form 211 process was financially incentivized, firms could demand higher quality disclosure from issuers and submit quotations that better reflected issuers' operations and prospects. Enhanced review and research of small cap companies would benefit investors and the company's overall access to capital. Payments for these services would offset the costs of gathering and reviewing issuer information, encourage relationships between companies and investment banking professionals, incentivize higher quality disclosures and promote competitive price transparency and liquidity in public secondary markets.

Once a security has passed the initial hurdle of having a Form 211 approved, the filing broker-dealer cannot accept payments for making a market in the security going forward. This prohibition frustrates the creation of healthy secondary markets. The

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[6] *See* Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to FINRA Rule 5250 (Payments for Market Making), SR-FINRA-2013-020 (April 18, 2013), available at https://www.finra.org/sites/default/files/RuleFiling/p248390.pdf ("2013 Amendment").

objective of Rule 5250 should be to create straightforward pathways to markets where current information is publicly available and multiple market makers can compete with one another on price, execution quality and liquidity. Looking to the recent Spotify direct listing as an example of the significant barriers to entry to our capital markets, thousands of companies could benefit from the more efficient public secondary markets created by a combination of reforming the operation of FINRA Rules 6432 and 5250, and the JOBS Act.

Requiring Disclosure of Payments to Market Makers Would Serve the Policy Goals of Rule 5250

There is little justification for the belief that allowing broker-dealers to accept payments from issuers for submitting a Form 211 would compromise broker independence. Rather than banning payments all together, FINRA can more effectively deter market manipulation and protect investors by requiring disclosure of the financial relationship between the company and the broker-dealer filing its Form 211.

The solution is more disclosure – not less. Increased disclosure allows greater regulatory oversight that can quell bad practices. FINRA's ban on payments for research and review as part of bringing a company public via Form 211 effectively creates a prohibition-like environment. Although the practice of payment is not allowed, it will occur but be hidden from the regulator's view and facilitated through opaque relationships and unregulated advisors. Regulatory prohibitions on valuable, in-demand services only creates black markets and fosters substandard practices.

The initial proposal for NASD Rule 2460 (the predecessor to FINRA Rule 5250) allowed broker-dealers to recover their actual costs by making the following exception to the prohibition on accepting compensation from issuers for publishing quotes in their securities:

> "[A member shall not be precluded] from accepting . . . reimbursement of reasonable out-of-pocket expenses on an accountable basis, not including the member's overhead, in connection with the member's initial review process in determining whether to agree to publish a quotation or to act as a market maker in a particular security."[7]

This worthwhile exception was ultimately abandoned due to concerns that reimbursements for Rule 15c2-11 information gathering and review could violate Section 17(b) of the Securities Act and potentially be used inappropriately to evade the requirements of Rule 17(b). However, Section 17(b) prohibits any person from receiving consideration from an issuer to publish or circulate any material that describes the issuer's securities without fully disclosing the nature and amount of the

[7] NASD Notice to Members 96-83 (December 1996), available at: http://www.finra.org/sites/default/files/NoticeDocument/p004707.pdf.

consideration. Full and complete disclosure of market making payments under Rule 17(b) would deter fraudulent market manipulation and align with the disclosure-based philosophy of the federal securities laws.

Online Disclosure is Consistent with Industry Practice

Public disclosure under Section 17(b) would mitigate any concern that a quoted price has been manipulated or influenced by the issuer's payment. Trading activity has changed significantly from the undisclosed "backdoor" deals that prompted FINRA (then, NASD) to prohibit market maker payments in 1975. Much of the information and disclosure that market makers rely on to price securities has moved online.

In the past, FINRA has made exceptions for market maker payment programs, in part on the premise that objective disclosure requirements mitigate the policy concerns of Rule 5250.[8] In an online world, FINRA should look to industry best practices and leverage existing disclosure rules like Section 17(b) to promote transparency and access to information for investors.

For example, the OTC Markets Group website, www.otcmarkets.com, features real-time pricing, a repository of each company's current and prior public disclosures, the company's corporate action history, independent research from third parties, contact information and other tools and information investors may use in their due diligence processes. OTC Markets Group could easily make publicly-available all the relevant details about a Form 211 when a company goes public, including:

- the relationship between the company and the broker-dealer;
- whether any payment was made;
- the amount and frequency of any payments; and
- any additional services provided by the broker-dealer beyond the filing of the Form 211.

[8] In 2013, FINRA amended Rule 5250 to exempt payments to market makers pursuant to Nasdaq's Market Quality Program ("MQP"), designed to incentivize market makers to quote ETP securities:

> […] the terms of the NASDAQ MQP generally are ''objective, clear, and transparent'' and includes [sic] disclosure requirements to help alert and educate potential and existing investors about the program. Specifically, and among other things, the NASDAQ program provides for Web site disclosure of certain information, including the identities of the companies, securities and market makers participating in the NASDAQ MQP, as well as the amount of the supplemental fee, if any, per security that would be in addition to the fixed basic fee. FINRA believes the level of transparency available regarding the structure of the program, participation of the parties and possible payments to market makers, provides important disclosure to investors in NASDAQ MQP securities, enabling them to identify which exchange-traded funds are and are not subject to the NASDAQ MQP.

See 2013 Amendment, available at https://www.finra.org/sites/default/files/RuleFiling/p248390.pdf.

Global regulators are adopting a disclosure-based approach for investor protection and enforcement, with trading venues serving as information repositories for issuer disclosure. For example, the European Securities and Markets Authority ("ESMA") has created a new SME Growth Market designation ("SME-GM") for non-exchange markets that serve smaller companies. ESMA supports a disclosure-based framework where SME-GM market operators are responsible for ensuring that sufficient information is made publicly available, enabling investors to make an informed investment decision.[9]

Adding Form 211 information – including the payment information – to a company's profile on our website would give investors access to the full range of company-related information in one location. Along these lines, our 17-14 Comment Letter advocated for allowing a FINRA member operating an interdealer quotation system to perform certain functions in the Form 211 process, including reviewing a Form 211 for completeness, submitting it to FINRA and thereafter making the information publicly-available online. Allowing market operators to participate in the Form 211 process would help create a more efficient pathway for companies to reach regulated public markets.

Conclusion

Accordingly, and for the reasons set forth above, Rule 5250 should be amended to allow broker-dealers to accept compensation from issuers for the reasonable out-of-pocket expenses involved in preparing and submitting a Form 211. These compensation arrangements should be fully disclosed to investors, as required by Section 17(b) under the Securities Act.

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We appreciate the opportunity to comment on FINRA Regulatory Notice 17-41. Please contact me at (212) 896-4413 or dan@otcmarkets.com with any questions.

Very truly yours,

Daniel Zinn
General Counsel
OTC Markets Group Inc.

[9] *See* Final Report: ESMA's Technical Advice to the Commission on MiFID II and MiFIR, p. 367, ESMA/2014/1569 (December 19, 2014) ("ESMA considers that the primary means for publishing and also disseminating information should be the internet. The pre-dominant current market practice appears to be that information needs to be published either on the website of the issuer, the website of the market or both.")