

SEC INVESTOR ADVISORY COMMITTEE PANEL
Regulatory Approaches to Combat Retail Investor Fraud
Submission of R. Cromwell Coulson

REGULATORY RECOMMENDATIONS

- (1) **Increase Paid Promoter Disclosure:** Securities Act Section 17(b) should be amended to require additional disclosure about paid stock promotion, and the people associated with the promotions, to make online information sources safer.
 - a. *See our Petition for Commission Action to Protect the Investing Public from Unlawful and Deceptive Securities Promotions (April 24, 2006); available at <https://www.sec.gov/rules/petitions/petn4-519.pdf>.*
- (2) **Provide More Disclosure from Affiliates, Insiders and Institutions:** Create greater transparency about trading by company insiders and affiliates. This can be achieved by limiting anonymous Objecting Beneficial Owner accounts for affiliates of issuers, which would give companies greater insight into who holds their shares. Companies and investors would also benefit from requiring disclosure of transaction information for officers and affiliates of non-SEC reporting issuers in a manner similar to SEC Forms 3, 4 and 5. Further, expand Exchange Act Section 13(f) disclosure to OTC traded securities, which would require institutional investment managers to disclose their holdings of all publicly traded equity securities, including significant short positions.
- (3) **Improve Share Issuance Compliance:** To deter Section 5 violations, transfer agent regulations should be modernized to provide broker-dealers with reliable information on the issuance, ownership and transfer history of shares.
- (4) **Enable More Real-Time SEC Enforcement:** With the SEC's direction, Interdealer quotation systems (IDQS) should be responsible for developing a regime that monitors the ongoing disclosure of securities quoted on their markets, with issuers retaining responsibility for the accuracy of the disclosure. As part of its disclosure regime, each IDQS should have a system to publicly label, as late or deficient, the securities of issuers that fail to meet their disclosure obligations. With this system in place, the SEC could then work with market operators to quickly respond to indications of fraud in a timely manner, including initiating trading halts and suspensions when the market pricing process has been materially disrupted by fraud or manipulative activities.
- (5) **Short-Sale Reform:** Timely disclosure of the positions of large short-sellers, and of aggregate industry activity, would greatly enhance the short-sale information currently available and would create more trusted public markets. In addition, market makers are often not able to sell short to buyers because they cannot be sure they will be able to cover their short position within the time prescribed by Regulation SHO (T+6). The

current timeframe (2 days) for bona fide market makers to close out of short positions in certain securities with lower trading volumes, such as ETFs and OTC equity securities, should be extended. Additional time would incentivize market makers to provide greater liquidity and reduce volatility in these securities.

- (6) **Allow SEC Reporting Companies to use Reg A+:** Small SEC-reporting companies that would otherwise be well-equipped to conduct a successful Regulation A+ offering are currently shut out from the process. Companies that already meet the SEC's ongoing disclosure requirements should be allowed to engage their existing shareholders and raise additional capital online under Regulation A+.
 - a. *H.R. 2864 – Improving Access to Capital Act & S.2155, Sec. 508*

- (7) **Allow Companies to Sell Shares Directly into the Market:** Remove outdated restrictions on public offerings, and allow SEC reporting companies with securities listed on an exchange or traded on an “established public market” to sell their legally authorized shares directly in the market as easily as they can buy them back.
 - a. *Cromwell Coulson, Bloomberg, Give Companies Easier Access to Public Markets (March 22, 2017)*

- (8) **Facilitate Competition in Venture Exchange Legislation:** Monopoly venture exchanges, as proposed under the Main Street Growth Act (H.R. 4638), would stifle competition and ignore existing markets that already serve smaller companies. Any U.S. venture market legislation should follow the European SME Growth Market model, be disclosure-driven, and include exchanges and ATs that already serve smaller companies.

- (9) **Adopt Investor Suitability Standards Based on Experience and Risk Tolerance:** In a data-driven world where risk can be quantified, broker-dealers can establish customer risk profiles based on trading experience and overall risk tolerance, which has proven to be a successful practice in the options industry. For example, ‘Pink No Information’ securities should be accessible to purchase only by experienced investors with appropriate risk tolerances.

- (10) **Allow Payments for Market Making:** FINRA Rule 5250 should be amended to allow issuers to compensate broker-dealers for the out-of-pocket expenses involved in preparing and submitting a Form 211, provided that the amount of such reimbursements is fully disclosed to investors as required under Section 17(b) of the Securities Act of 1933.
 - a. *OTC Markets Group Response to FINRA Regulatory Notice 17-41 (February 8, 2018)*

- (11) **Bring Back the Federal Reserve OTC Margin List:** Investors in established non-penny stock OTC securities are unable to unlock additional value because they are not marginable. Under current rules, there is no path for such securities to become margin-eligible. Two possible solutions exist: 1) The Commission (rather than the Federal Reserve Board) should be given oversight of the margin eligibility of all equity securities, or 2) The margin list originally published by the Federal Reserve under Regulation T should be reinstated to make margin-eligible all non-penny stocks that are actively traded on “established public markets.”
- (12) **Allow Small Companies to Effectively Provide Employee Stock Ownership Plans (ESOPs):** IRS regulations significantly limit the ability of non-exchange traded companies to offer ESOPs to their employees. Public companies quoted on the OTCQX and OTCQB markets are forced to treat their stock as “private” securities, with significant limitations on ESOP plans. The definition of an “established securities market” contained in IRS regulations should be updated to include securities quoted on OTC Markets Group’s OTCQX and OTCQB markets.
- (13) **Allow Trading Venues to Review and/or Submit FINRA Form 211 Filings:** Modern day trading venues have become public repositories for information about the securities that trade there. To avoid informational redundancy, a trading platform registered with the SEC and FINRA should be permitted to submit FINRA Form 211s to initiate trading in a particular security on their platform, and should be enlisted to perform a review of other brokers’ submissions in certain lower risk securities.
- a. *OTC Markets Group Response to FINRA Regulatory Notice 17-14 (January 8, 2018)*
- (14) **Update the SEC Definition of Penny Stocks (Exchange Act Rule 3a51-1):** Currently, biotech and other research-heavy companies may not meet the net tangible assets exemption (Subsection (g)(1)) from the definition of a penny stock. The review standard for net tangible assets (Subsection (g)(3) should be updated to take into account interim capital raises for these types of companies.