



# BETTER MARKETS

December 30, 2019

Mrs. Vanessa A. Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: Publication or Submission of Quotations Without Specified Information (Release No. 34–87115; File No. S7–14–19)

Dear Secretary Countryman:

Better Markets<sup>1</sup> appreciates the opportunity to comment on the above-captioned rule proposal (“Release” or “Proposal”) published for public comment by the Securities and Exchange Commission (“SEC” or “Commission”). The Proposal,<sup>2</sup> if approved as released, would require, among several other changes, that broker-dealers that submit quotations of Over-the-Counter (OTC) securities to OTC trading platforms to obtain and review certain information from issuers of such securities, and provide this information to investors if so requested.

The Proposal also makes changes to—**but does not repeal**—the so-called “piggyback exception:” a loophole that has permitted broker-dealers to solicit interest from and sell OTC securities to retail investors without verifying any of the details of the security, including, whether the issuer actually still exists. The Release also proposes to add new exceptions to the piggyback rules; offers an interpretative guidance to the SEC rules related to the Proposal; publishes a brief Concept Release on the need for an information repository for OTC securities; and offers technical and conforming changes. Our comment letter will focus on the piggyback exception changes and the new exceptions proposed in the Release.

## SUMMARY

While we agree with the Commission that OTC markets (also known as microcap markets) need improvements to better protect investors, the Proposal is unacceptably insufficient given the prevalence and severity of the dangers posed by broker-dealers that peddle unsuitable OTC securities and/or their propensity to manipulate the OTC markets through pump-and-dump and

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<sup>1</sup> Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

<sup>2</sup> See, Release No. 34–87115, File No. S7–14–19, 84 Fed. Reg. 58206 (October 30, 2019) available at <https://www.federalregister.gov/documents/2019/10/30/2019-21260/publication-or-submission-of-quotations-without-specified-information>.

other predatory schemes. The Commission has the authority—and statutory mandate—to radically improve how it regulates the OTC markets and the SEC-registered representatives (*i.e.*, broker-dealers) that operate in the OTC markets.

The Proposal is unjustifiably accommodative to the broker-dealer industry at the expense of investor protection and market integrity. The Proposal, and the new exceptions it adds, instead of simplifying and harmonizing the regulation of securities market, further fragments markets and introduces unnecessary complexity. The Proposal fails to adequately account for the harm caused to investors by OTC markets and the broker-dealers that traffic in those securities. The Proposal also fails to adequately value the benefit that up-to-date material information about a security or its issuer would provide to broker-dealers in their role as a financial professional who are supposed to act in the best interest of investors.

We urge the Commission to revamp its regulatory philosophy towards and tolerance of broker-dealers who engage in predatory practices through the OTC markets. At a bare minimum, we urge the Commission to repeal the piggyback exception completely and not add any more exceptions as it relates to a broker-dealer’s obligation to obtain, review, use, and make available all material and current information pertaining to any security, including OTC securities.

## BACKGROUND AND DESCRIPTION OF PROPOSAL

As the Commission is aware, there is a significant informational asymmetry between, the entities that issue securities, and the broker-dealers who sell these securities. There is also significant informational asymmetry between the broker-dealers who transact in securities and the investors in those securities. The Commission’s traditional remedy in similar circumstances is to require certain material information to be disclosed in a complete and timely fashion through a medium (*e.g.*, SEC’s Electronic Data Gathering, Analysis and Retrieval system (EDGAR)) that is publicly and freely available. But, as the Release notes, “there is no or limited current public information available about certain issuers of quoted OTC securities to allow investors or other market participants to make informed decisions regarding company fundamentals.”<sup>3</sup> This lack of transparency and heightened informational asymmetry between issuers of OTC securities and those who transact in them “can contribute to incidents of fraud and manipulation.”<sup>4</sup>

Fraud and manipulation are the middle-names of OTC markets. A study looked at 150 SEC-prosecuted pump-and-dump manipulation cases between 2002 and 2015 and found that over 86% of these cases involved OTC securities.<sup>5</sup> An SEC analysis of “4,000 SEC litigation releases between 2003 and 2012 found that the majority of alleged violations involving issuers of OTC securities were primarily classified as reverse mergers of shell companies or as market manipulation.”<sup>6</sup> It is not only fraud and manipulation that plagues these markets. OTC issuers are also habitual delinquent filers of material information necessary for investors and investment professional to make informed investment decisions. The Release notes that, “from a sample of 226 Commission enforcement actions filed in fiscal years 2017 and 2018 involving 502 OTC

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<sup>3</sup> See Release at 58207.

<sup>4</sup> See Release at 58207.

<sup>5</sup> See Release at 58252, fn. 249.

<sup>6</sup> See Release at 58252.

securities, 171 enforcement actions (76%) were classified as involving delinquent filings.”<sup>7</sup> The Commission outright lacks any data since 2017 from approximately 28% of OTC issuers. And the Commission cannot find any data from of over 14% of OTC issuers (2,297 of 15,851 issuers).

These facts are shocking. It is inexplicable how the SEC can tolerate such flagrant violations of its own rules and the resulting harm to investors.

Today, SEC Rule 15c2-11 contains a requirement that a broker-dealer review some basic, material information about the OTC security and its issuer before it can submit a quotation into the OTC markets.<sup>8</sup> **However, in practice**, the Rule’s own current exceptions

“permit broker-dealers to publish quotations in perpetuity even when there is no or limited current information about the issuer available to the public or the broker-dealer, and even when the issuer no longer exists or has ceased operations.”<sup>9</sup>

The Release discusses how, “once a broker-dealer has published a quotation pursuant to the Rule, under specified exceptions to the Rule, other broker-dealers may publish quotations for that security (without being subject to the Rule’s information review requirement).”<sup>10</sup> This loophole permits broker-dealers to dispense with the requirement to obtain and review the material information. This lack of review and the ability to submit quotations without obtaining the relevant information “can give the market for the securities an appearance of credibility.”<sup>11</sup> This situation artificially facilitates:

“the purchase or sale of securities even when there is no or limited current issuer information publicly available to investors. Without current public information about an issuer, it is difficult for an investor or other market participant to evaluate the issuer and the risks involved in purchasing or selling its securities. When there is little or no current information about an issuer available to investors, they can fall victim to fraudsters that make false and misleading statements about an issuer to promote sales of a security. Without current public information about an issuer, investors may not have the ability to assess the validity of the claims in a promotion campaign due to the lack of information against which to compare the claims. A fraudster’s promotional campaign with false claims and published quotations may generate trading volume for a thinly-traded security and the security’s market price may rise to an artificially high level (“pumping” the security). However, when the fraudster ceases its promotional campaign, the market price of the security may drop due to the fraudster selling its shares into the market it created by “pumping” the share prices up with false claims (“dumping” the security). The remaining investors may be left owning an essentially worthless security or one for which the price is artificially inflated.”<sup>12</sup>

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<sup>7</sup> See Release at 58252-3.

<sup>8</sup> This information may include, “a prospectus; an offering circular; periodic reports; and various financial information regarding the issuer, such as the issuer’s balance sheet, profit and loss statement, and retained earnings statement.” See fn. 7 at Release 58208

<sup>9</sup> See Release at 58207.

<sup>10</sup> See Release at 58208.

<sup>11</sup> See Release at 58208.

<sup>12</sup> See Release at 58208

The Release proposes to limit this piggyback exception by mandating that the information the broker-dealer is required to obtain and review be current and publicly available. As noted above, under the current piggyback exception, broker-dealers can “continuously quote a security over many years, even when the issuer of the security no longer exists.”<sup>13</sup> The Release would prohibit the use of the piggyback exception if the information is not current and is not publicly available.<sup>14</sup>

Having finally taken this long-overdue action to provide the most minimal protection for investors in the OTC markets, the SEC then nevertheless unjustifiably proposes to add three more exceptions that broker-dealers could use to continue to exploit the piggyback exception. First, the Proposal would add a new exception to the piggyback exception that would permit broker-dealers to forego the review of the material information of the OTC security if the issuer has at least \$50 million in total assets, and the security’s average daily trading volume during the past 60 calendar days has been over \$100,000.<sup>15</sup> Second, the Proposal would also add another new exception to the piggyback exception “to reduce the burdens on broker-dealers that are quoting securities that were issued in an underwritten offering where the broker-dealer served as the underwriter.”<sup>16</sup> This new exception would allow broker-dealers to not obtain or review relevant information of the issuances that they themselves have underwritten. Third, the Proposal would add an exception “that would provide relief from the review requirement of the Rule, to permit a regulated entity, namely a qualified [interdealer quotation system] IDQS that meets the definition of an ATS, to conduct the information review that is currently only permitted to be conducted by broker-dealers that publish or submit quotations.”<sup>17</sup> To qualify for any of these exceptions, the Commission would require that a broker-dealer or the IDQS conduct an analysis and retain records demonstrating that the broker-dealer or the IDQS is in-fact eligible for the exception.<sup>18</sup>

## COMMENTS

We support the Commission in concept but oppose this unjustifiably weak and unreasonably accommodative Proposal. Given the scale of the devastating problem of pump-and-dump schemes that is present in the OTC markets and the peddling of highly risky OTC securities by unscrupulous financial professional to unsuspecting investors that lack the wherewithal to withstand the financial loss, the Commission must change its regulatory approach. Otherwise, the statistics stated above will not change and investors will continue to be victimized.

### **The SEC Must Prioritize Investor Protection Over Broker-Dealer De-Regulation**

In the policy choice between siding with financial professionals that lie and cheat to make a quick buck and those investors who are victimized and often suffer serious financial harm if not

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<sup>13</sup> See Release at 58208.

<sup>14</sup> See Release at 58208.

<sup>15</sup> See Release at 58227.

<sup>16</sup> See Release at 58208.

<sup>17</sup> See Release at 58209.

<sup>18</sup> See Release at 58209.

ruin, the Commission must unequivocally and always side with investors. Some of the victims of these financial crimes live a lifetime of shame and isolation due to their victimhood,<sup>19</sup> some fall into depression,<sup>20</sup> and some of them even commit suicide.<sup>21</sup>

According to the **SEC's own analysis**, OTC markets produce abysmal “lottery like” returns for the average investor and are ripe for abuse and manipulation.<sup>22</sup> Academic studies have found that OTC markets are subject to frequent price manipulation through both outright fraud and stock promotion campaigns which often employ dishonest or abusive strategies, such as high pressure “boiler-room” tactics.<sup>23</sup> Examining OTC market investor demographics reveals that older, retired, less educated, and low-income investors, who are frequently the targets of financial fraud, receive even worse outcomes than the typical OTC market investor.<sup>24</sup>

It is a disservice to retirees and hardworking Americans to have an independent government agency that is statutorily charged to protect investors and market integrity spend thousands of staff hours to draft and approve a Proposal that seems to be more concerned about reducing the “burdens on broker-dealers” than protecting investors, and asks dozens of multi-part questions gauging whether the Proposal is burdensome to broker-dealers.<sup>25</sup> While devoting less than half a page in the 61 pages of the Federal Register to describe in stark terms the toll financial crimes stemming from the OTC markets take on the very people that the SEC exists to protect: investors.

The Proposal fails to meet the needs of retirees and falls short of what is necessary to significantly reduce the risk stemming from the OTC markets and broker-dealers who peddle these

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<sup>19</sup> According to the National Criminal Justice Reference Service, victims of financial fraud often experience social isolation and divorce, *see, Chapter 16 Financial Crimes* NCJRS (2000) available at [https://www.ncjrs.gov/ovc\\_archives/academy/chapter16.htm](https://www.ncjrs.gov/ovc_archives/academy/chapter16.htm). Also *see*, Interviews with UK financial fraud victims conducted by the UK National Fraud Authority found that a significant number were too ashamed or embarrassed about their victimization to report the crime to the police or watchdog organizations *See* Mark Button, Chris Lewis and Jacki Tapley, *A Better Deal for Fraud Victims: Research into Victims' Needs and Experiences*, National Fraud Authority (2009), available at [https://researchportal.port.ac.uk/portal/files/1924328/NFA\\_Report\\_1\\_15.12.09.pdf](https://researchportal.port.ac.uk/portal/files/1924328/NFA_Report_1_15.12.09.pdf).

<sup>20</sup> An analysis of the victims of financial crimes found that 45% of its victims were diagnosed with generalized anxiety disorder and nearly a third developed symptoms of clinical depression, *See* Linda Ganzini, Bentson McFarland, & Joseph Bloom, *Victims of Fraud: Comparing Victims of White Collar and Violent Crime*, *The Bulletin of the American Academy of Psychiatry and the Law*, Volume 18, No. 1 (1990), available at [https://www.researchgate.net/profile/Linda\\_Ganzini/publication/20971949\\_Victims\\_of\\_fraud\\_Comparing\\_victims\\_of\\_white\\_collar\\_and\\_violent\\_crime/links/00b7d5183d74b2f71e000000.pdf](https://www.researchgate.net/profile/Linda_Ganzini/publication/20971949_Victims_of_fraud_Comparing_victims_of_white_collar_and_violent_crime/links/00b7d5183d74b2f71e000000.pdf).

<sup>21</sup> As part of an investigation into online financial fraud on behalf on the Australian government the Australian Institute for Criminology identified multiple cases of suicide and serious self-harm directly caused by financial victimization *See* Cassandra Cross, Russell G Smith & Kelly Richards, *Challenges of Responding to Online Fraud Victimization in Australia*, *Trends and Issues in Crime and Criminal Justice*, No. 474 (May 2014), available at <http://eprints.qut.edu.au/72186/1/tandi474.pdf>.

<sup>22</sup> *See, e.g.*, Joshua T. White, *Outcomes of Investing in OTC Stocks*, (“White SEC Study”), (Dec. 16, 2016), available at [https://www.sec.gov/files/White\\_OutcomesOTCinvesting.pdf](https://www.sec.gov/files/White_OutcomesOTCinvesting.pdf), p.3.

<sup>23</sup> *See* White SEC Study, p.11.

<sup>24</sup> *See* White SEC Study, p.24.

<sup>25</sup> By our count, the Release states its intent to reduce burdens on broker-dealers, highlights the importance of burden reduction or asks for ways to further reduce burdens on broker-dealers at least 34 times.

often unsuitable and dangerous financial products. The Proposal's accommodative approach—and the policy choices that stem from that approach—to the broker-dealer firms that operate in the OTC markets is misplaced. The Commission's seemingly singular focus on the benefits that current material information would offer to investors is also misplaced. Such information is, in our view, more important to broker-dealers who are licensed—and are under regulatory obligations to know how—to analyze and use this information in making recommendations to investors whether the OTC securities are suitable or is in their best interest to purchase. Once it is accepted that current material information about a security or its issuer is essential for broker-dealers before they solicit investors, the maintenance of the piggyback exception—or the new ones offered in the Release—becomes untenable.

### **The Release Fails To Grapple With The Human Cost of OTC Market Fraud**

Permitting the lawlessness to proliferate in the OTC markets, the Commission risks generally eroding the confidence of the entire investing public and the public at large, who also lose faith in the regulators who are supposed to be vigilant against fraudsters. This lack of robust action from the Commission also risks unfairly sully the reputation of law-abiding broker-dealers who serve their clients honestly and effectively.

Investors who have been hurt by manipulative schemes, like the pump-and-dump schemes so prevalent in the OTC markets, are further demoralized and victimized when they see that the same fraudsters are still holding a license—a public privilege—and continue to work in the industry. Investors are the constituency SEC must serve, and all its regulatory actions and proposals should be designed for the maximal benefit of investors—and, by extension, the brokers who serve those investors honestly—and not the boiler-room operators trafficking in OTC securities that have decided to cheat time and time again.

The Release completely fails to quantify the harm to investors caused by brokers who peddle unsuitable investments that generate high commissions for themselves and profits for their brokerage firms. The Release further fails to analyze the additional harm to investors that will be realized if the piggyback exception remains on the books. These costs are real, and the SEC must take them account as it debates the merits of this Proposal and its regulatory approach to OTC markets.

The SEC has not been charged by Congress to ensure that those who traffic in unsuitable OTC securities and manipulate the markets through schemes like pump-and-dump have gainful employment. Furthermore, Congress has not charged the Commission to reduce burdens for those that specialize in harming unsuspecting and vulnerable investors in pursuit of their profits.

The Commission exists to protect investors, promote capital formation, and maintain fair markets by instilling market integrity. If the Commission indeed has investors' best interest in mind, it should not compromise that interest through this ill-advised Proposal that makes undue accommodations to broker-dealers and confuses de-regulation for investor protection. The direct and outright repeal of the piggyback exception would impact a very small number of broker-dealer

firms,<sup>26</sup> and the miniscule burden<sup>27</sup> that would be imposed on broker-dealers by requiring them to obtain and review current material information about the OTC security they intend to sell should never outweigh what is best for the investing public.

### **The SEC Should Fully Repeal The Piggyback Loophole**

The Commission must change its regulatory approach to OTC markets and broker-dealers who operate in the space. At a minimum, if the Commission moves forward with the Proposal, the Commission should repeal the piggyback exception in its entirety and offer no new exceptions. As the Commission is well-aware (and the Proposal speaks to this), market participants have successfully used exceptions as loopholes to harm retail investors, particularly those who are financially less sophisticated, including elders and those with language barriers.

Investors in the OTC markets, and particularly those harmed by such unscrupulous brokers and firms who retain them, deserve concrete, effective, swift and far-reaching protections from the Commission, not convoluted and weak attempts at regulation. The Commission has all the authority it needs to more forcefully and effectively clean-up the OTC markets and punish and expel those predators who benefit in those markets.

Investors need and deserve honest, qualified, and competent brokers and firms who respect and follow the rules when offering their services and financial products. Americans need these good brokerage firms and their brokers to help them meet their life goals, including saving for their children's college education, preparing for retirement, and enjoying a decent standard of living. As the Federal government's independent regulator of brokers and brokerage firms, the Commission has a paramount responsibility to ensure that all investors—especially the financially less sophisticated, elderly, and less educated—are protected from predatory and unscrupulous broker firms who lurk in and manipulate the OTC markets.

### CONCLUSION

We hope our comments are helpful to the Commission as it considers this Proposal and makes the necessary investor-first changes that the SEC should consider its priority.

Sincerely,

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<sup>26</sup> According to the Release, approximately 130 broker-dealer firms operate in the OTC markets, of approximately 3,700 that are registered with the Commission. The Commission projects that about 130 broker-dealer firms would be impacted by the Proposal, of which 32 that would be “subject to the burdens associated with the publishing or submitting a quotation without an exception” and 89 that “would be subject to the burdens associated with documenting reliance on an exception,” *see* Release at 58242.

<sup>27</sup> The Commission projects that it a broker-dealer would take between three to seven hours (depending on the type of OTC issuer) to review, record, and retain the relevant information, *see* Release at 58243. The Commission calculates in detail the costs these would impose on a broker-dealer: between \$240 to \$960 per security, *see* Release at 58256 and 58258.



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