

March 20, 2020

VIA ELECTRONIC SUBMISSION

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Rule-comments@sec.gov

Attn: Ms. Vanessa Countryman, Secretary

Re: Release No. 34-87115, File Number S7-14-19

Dear Ms. Countryman:

Canaccord Genuity LLC (“CG”) appreciates the opportunity to submit this comment letter on the proposed amendments (the “Proposed Amendments”) of the Securities and Exchange Commission (the “Commission”) to 17 CFR 240.15c2-11 (the “Rule”) under the Securities Exchange Act of 1934.

By way of background, CG is the U.S. registered broker-dealer subsidiary of Canaccord Genuity Group Inc., a leading independent, full-service financial services firm, publicly traded on the Toronto Stock Exchange. Canaccord Genuity Group Inc., together with its global subsidiaries, strive to generate value for their individual, institutional and corporate clients through comprehensive investment solutions, brokerage services, and investment banking services.

In the United States, CG is a leading liquidity provider in the over-the-counter (“OTC”) space, responsible for making markets in thousands of OTC domestic and foreign securities, including American Depositary Receipts (“ADRs”) and “F shares”. CG principally services wholesale retail order flow in OTC securities, which is directed through broker-dealer intermediaries, meaning that CG does not have a direct trading relationship with the retail client that is the source of the order in the OTC security. In most cases, CG’s decision to quote a security and/or file a Form 211 is driven by retail and institutional demand. CG’s OTC business operates on an unsolicited basis, meaning CG does not solicit transactions in OTC securities, and the vast majority of CG’s order flow in OTC securities comes into the firm on a “held” basis, requiring immediate handling without time or price discretion.¹

CG believes that the Proposed Amendments are an important step in the direction of modernizing the OTC markets. As a significant market participant, CG hopes to provide insight on parts of the Commission’s proposal that it believes will most significantly impact market makers, and as a result, investors and the marketplace. Given the breadth of comments already received by the Commission, CG is only briefly commenting on what it views as the most important aspects of the Proposed Amendments.

- A. CG supports the Proposed Amendments’ provision for the conduct by a qualified inter-dealer quotation system of the information review and exception availability determination, but agrees with OTC Markets Group Inc.’s proposal that the Rule’s information review standard be modernized and the process be streamlined.***

¹ CG also services institutional clients directly, but the vast majority of CG’s order flow in OTC securities comes from the major wholesale retail broker-dealers.

In its comment letter to the Commission dated December 30, 2019, OTC Markets Group Inc. (“OTCM”) succinctly summarized the roles of all relevant market participants, and based on those roles, advanced several arguments for why certain responsibilities should reside with certain parties.² The Commission’s proposal to allow qualified interdealer quotation systems (“IDQS”) to both complete the information review and determine the availability of exceptions under the Rule is very much in line with how responsibilities should be allocated across the market—as OTCM is already positioned to efficiently assess and monitor that an issuer’s information is from a reliable source and disclosure is current and publicly available.³ Specifically, OTCM currently amalgamates issuer information and furnishes this information to investors and the broker-dealer community, which makes them uniquely qualified to act in such gatekeeping capacity. However, CG agrees with OTCM that the Rule’s standard should be updated, such that (I) the reviewer should have a reasonable basis for believing that the required paragraph (b) information be *complete* in all material respects and be obtained from a reliable source,⁴ and (II) the Rule should permit broker-dealers to rely on the determination of the qualified IDQS to initiate quotes in these securities without filing a separate Form 211 with the Financial Industry Regulatory Authority (“FINRA”).⁵

While CG appreciates that the Commission historically has viewed market makers as gatekeepers to the OTC marketplace, market makers and/or qualified IDQs are not best positioned to review the financials of issuers to detect inaccuracies or material omissions, as neither have access to the information underlying the company’s financials and such other information required to be reviewed pursuant to the Rule. Indeed, it is impracticable to expect third party reviewers who have no meaningful nexus to an underlying issuer to glean, including from even an in-depth review of financials and similar information contemplated by the Rule, whether such information is accurate or without a material omission.⁶ Shifting the responsibility back to the issuers preparing the financials and making such disclosures is not only in line with the Commission’s standard in reviewing company disclosure, but is consistent with how this risk is allocated among market participants in other contexts.⁷ Instead, market makers should be focused on providing best execution to the ultimate customer and monitoring for suspicious trading occurring in the OTC markets. Shifting the responsibility back to those best situated to ensure accuracy in disclosure documents will ensure that the best possible disclosure is made to the marketplace. Indeed, the most

² See OTC Markets Comment Letter (Dec. 30, 2019), available at <https://www.sec.gov/comments/s7-14-19/s71419-6590623-202249.pdf>, (the “OTCM Letter”) at 2-3.

³ CG believes that for information to be considered “publicly available” for the purposes of the Rule, it should not be subject to a paywall. However, please see the concerns raised by Larry E. Bergman’s comment letter to the Commission dated December 10, 2019 as a result of FINRA’s recent Regulatory Notice 19-09 and the Proposed Amendments with respect to 12g3-2(b). Larry E. Bergman, Murphy McGonigle, P.C. Letter to the Commission dated December 10, 2019 (the “Larry Bergman Letter”) at 3-4.

⁴ See the OTCM Letter at 4-5.

⁵ See the OTCM Letter at 6.

⁶ It is also important to note that nefarious issuers will often take extra steps to keep their information current, so as not to hamper their manipulative schemes.

⁷ For example, in the context of investment banking engagements, the marketplace has developed such that it is common that responsibility for underlying information and disclosure is allocated to those best positioned to ensure that the information is accurate and does not contain a material omission (i.e. the issuers and their respective management). The securities laws also reflect this allocation. Section 11 of the Securities Act of 1933 imposes liability on underwriters of registered public offerings, subject to a due diligence defense, but with no or limited access to issuers, market makers simply are not in the same position to meet this standard as are underwriters in public offerings.

effective way to protect retail investors would be the Commission utilizing its power to suspend trading in securities that are engaged in conduct that appears suspicious or illegitimate and/or using the existing anti-fraud rules to pursue illegitimate companies and their management who actively prey on retail investors through stock promotion schemes.⁸ CG believes that even if the Commission changes the standard as proposed by OTCM, it can still continue to require that reviewers be on the look-out for “red flags” in issuer information when conducting the review required by the Rule (including such red flags set forth in Commission’s 1991 final rule release).⁹ In addition to compliance with its obligations to report suspicious activity to the Financial Crimes Enforcement Network, CG currently alerts FINRA’s Market Regulation Department of suspicious activity it identifies in names due to stock promotion, illegitimate name changes, or other suspect behavior, and is confident that other market makers similarly situated to CG escalate their concerns in the same manner. Providing a more formal channel to allow market makers to escalate these concerns to FINRA (and empowering the Commission decision makers to take action to suspend trading in these issuers) would result in better outcomes for identifying fraudulent issuers whose securities are trading in the OTC Markets.

CG also believes that the standard of “completeness” should be clarified to state that the information disclosed appears to be responsive to the requirements of the Rule. As stated above, neither market makers nor an IDQS is in the position to determine if there are underlying material omissions in the disclosure.

CG further agrees with OTCM that the Rule should permit broker-dealers to rely on the determination of a qualified IDQS to initiate quotes in these securities without filing a separate Form 211 with FINRA.¹⁰ In CG’s experience, FINRA’s review of a Form 211 application can take several months and can involve multiple rounds of back-and-forth with FINRA’s staff. As FINRA would still act as primary regulator to the qualified IDQS and is positioned to review its policies and procedures for compliance with the Rule, removing them from the approval process would lead to a more efficient on-ramp to liquidity for the issuers and investment community. To not do so will result in redundant reviews and unnecessary delays in the Form 211 filing process.

B. CG supports the expanded and updated Rule exceptions set forth in the Proposed Amendments, but respectfully requests that the Commission consider practical issues the Proposed Amendments create for maker makers.

As noted in OTCM’s December 30, 2019 letter,¹¹ the Commission’s proposal appears to presume that the qualified IDQS would conduct only initial determinations of the information requirements.¹² Further, the Commission appears to have designed the IDQS determination to be relied on for only 30 days, after which the piggyback exception would pick up, to the extent such exception is available.¹³ However, OTCM currently performs an ongoing review of issuer disclosure and asserts that it would continue to

⁸ CG also supports OTCM’s additional recommendations to address the Commission’s concerns relating to insiders set forth in the OTCM Letter on pages 12 and 13.

⁹ See Initiation or Resumption of Quotations Without Specified Information, Exchange Act Release No. 29094 (April 17, 1991), 56 FR 19148 (Apr. 25, 1991) at 19151. The Commission noted that “if ‘red flags’ appear at any stage of the review process, the broker-dealer may not publish quotations unless and until those ‘red flags’ are reasonably addressed.” *Id.*

¹⁰ See OTCM Letter at 6.

¹¹ See OTCM letter at 6.

¹² See Proposed Amendments at 96.

¹³ See Proposed Amendments at 98. The Commission further imposes an obligation that broker-dealers “remain vigilant regarding whether they may rely on, or continue to rely on, the piggyback exception if the issuer of that security becomes a shell company.” See Proposed Amendments at 68.

make ongoing determinations as to whether broker-dealers should be permitted to continue quoting in accordance with the Rule.¹⁴ Market makers such as CG are not in the best position to continue to monitor whether an issuer's information continues to be current and publicly available on an ongoing basis. This would require market maker firms to build an infrastructure to monitor issuer websites, IDQS websites, Edgar and other repositories of information. The expense and efforts required to do so would be significant and cost-prohibitive, preventing market makers from relying on the piggyback exception and, in turn, removing liquidity from the marketplace. Given OTCM is already positioned to do this monitoring and it is more efficient to centralize this ongoing diligence with a single party, CG believes it only makes sense to be able to rely on OTCM or such other qualified IDQS to make these determinations on an ongoing basis.

Similarly, when determining whether the unsolicited customer order exception applies, market makers such as CG, that receive order flow from retail broker-dealers, have no means to determine whether quotations submitted are by or on behalf of company insiders. As previously noted, CG does not have a direct customer relationship with the retail client that is the source of the order in the OTC security, and instead interfaces with the wholesale retail brokerage firms. As noted by OTCM, the Proposed Amendments impose upon market makers a requirement to "Know Your Correspondent's Customer".¹⁵ The gatekeeping function of identifying insiders contemplated by the Proposed Amendments should be at the level of issuers (who know its insiders) and/or transfer agents (who are responsible for processing requests from selling shareholders to remove restrictive legends) and/or at the broker-dealers accepting the order from the ultimate customer (who are likely the custodians of the account and/or are receiving remuneration that is priced to include the conduct of KYC diligence).¹⁶ At a minimum, CG requests that the Commission provide additional guidance clarifying that broker-dealers receiving wholesale retail flow can rely on a negative consent letter or similar approach from the broker-dealer interfacing with the ultimate customer to meet its obligations under the Rule. Otherwise, CG anticipates that it will be unable to make this insider determination on a real-time, order-by-order basis.

A similar issue arises in the Proposed Amendment's contemplation of the ADTV exception. Specifically, the Asset test of the proposed exception requires a determination of unaffiliated shareholders' equity.¹⁷ For many companies, including those that are not reporting issuers under the Securities Exchange Act of 1934, this information is not publicly available or determinable by market makers such as CG. Market makers would be at the whim of the applicable issuer to provide this information, rendering the exception unavailable.

C. CG believes that the Commission should permit the formation of an expert-only market instead of relegating OTC securities designated as having "limited" or "no information" to the grey market.

CG supports the formation of the Expert Market proposed by OTCM.¹⁸ The Proposed Amendment's changes to the piggyback exception will instantly relegate a substantial number of securities to the "grey"

¹⁴ See OTCM Letter at 6.

¹⁵ See OTCM Letter at 12.

¹⁶ See OTCM Letter at 12-13. Responsibility should be further backstopped by pursuing nefarious insiders via 10b5-1 as proposed by OTCM. *Id.*

¹⁷ See Proposed Amendments at 81.

¹⁸ However, CG echoes Virtu Financial Inc.'s comment in its letter to the Commission that it is unable to ascertain "what financial costs the market making community will incur for the services provided by"

market. This will inevitably lead to less liquidity, less price transparency, more volatility, and wider spreads for these securities. The “grey” market, as it currently exists, is a manual market that makes price discovery and best execution difficult to document and effectuate. Further, as several value investors have noted in their letters to the Commission,¹⁹ this will result in significant losses to not only current retail holders, but also current sophisticated shareholders of these companies who intentionally sought out these investments.

In order for the Expert Market proposed by OTCM to work efficiently, CG would expect that the SEC would permit market makers to quote proprietarily and that the SEC would ban solicitation of orders by market makers in securities being displayed in such market. Similarly, CG believes that the SEC should provide clear guidance that quoting activity in the Expert Market would qualify as *bona-fide* market making for the purposes of Regulation SHO, including, when a market maker is only posting a one-sided quote in such market, as discussed in further detail below.

D. CG believes that with respect to Regulation SHO the Commission should provide additional flexibility to market makers providing liquidity in “grey” and low-volume securities.

First, broker-dealers providing liquidity in illiquid and low-volume securities (including grey market securities) should be deemed market makers engaged in *bona-fide* market making for the purposes of Regulation SHO (including, the locate requirement and the close-out rule), even in the instance where they are providing a one-sided quotation.²⁰ In the Adopting Release to the Amendments to Regulation SHO published in October of 2008 (the “Adopting Release”), the Commission commented on *bona-fide* market making activities for the purposes of the market maker exemption to the locate requirement.²¹ In the Adopting Release, the Commission stated that the term “market maker” includes “any dealer who, with respect to a security, holds itself out (by entering quotations in an inter-dealer quotation system *or otherwise*) as being willing to buy and sell such security for its own account on a regular or continuous basis.”²² The Adopting Release articulates that the determination of whether or not a market maker is engaged in *bona-fide* market making depends “on the facts and circumstances of the particular activity” and that standard appears to be designed to take into consideration the totality of the circumstances, rather than impose a rigid, bright-line rule.²³ However, in CG’s experience, the view imposed on broker-dealers

such qualified IDQs (namely, OTCM). *See* Comment 3 of Virtu Financial Inc.’s letter to the Commission dated February 7, 2020 (the “Virtu Comment Letter”).

¹⁹ *See, e.g.*, Mitchell Partners, L.P. Letter to the Commission dated October 9, 2019; Monroe Financial Partners Letter to the Commission dated December 30, 2019; Joseph Helmer, CFA, Caldwell Sutter Letter to the Commission dated December 24, 2019; Matt Geiger, Managing Partner, MJG Capital Fund LP Letter to the Commission dated October 28, 2019; David I. Waters, President, Alluvial Capital Management, LLC Letter to the Commission dated October 9, 2019.

²⁰ As a general matter, CG believes the Commission should reconsider many aspects of Regulation SHO in light of the unique characteristics of the OTC Markets, including, for example, considering an exception to the close-out requirement of Rule 204, that would allow market makers to rely on conversions of ordinary shares to American Depositary Receipts, in lieu of a purchase or borrow.

²¹ *See* SEC Amendments to Regulation SHO, Release No. 34-58775 (Oct. 17, 2008).

²² *Emphasis added.* *See* Adopting Release at 30.

²³ *See* Adopting Release at 31. The Commission provided examples of factors that indicate that a market maker is engaged in *bona-fide* market making activities, including whether the market maker incurs any economic or market risk with respect to the securities by (i) putting their own capital at risk to provide continuous two-sided quotes in markets, (ii) providing liquidity to a security’s market, (iii) taking the other side of trades when there are short-term buy-and-sell imbalances in customer orders, and/or (iv) attempting to prevent excess volatility. *See* Adopting Release at 31-32. Some of the indications of *bona-*

by staff at the SEC and FINRA is that certain illiquid securities, including “grey” securities, cannot qualify for the additional flexibility afforded by being designated as a market maker, engaged in *bona-fide* market making. The basis for this view is often predicated on the lack of a published quotation (in the case of grey market securities) or the lack of a two-sided quotation (in the case of low-volume but quoted securities), which in each case is an inherent component of many securities trading in these markets.²⁴ However, CG believes that broker-dealers acting as market makers in this marketplace are, in fact, engaged in *bona-fide* market making activities in these thinly-traded securities, notwithstanding the lack of those factors. A common scenario involves such a market making broker-dealer immediately executing a “held” buy order in an illiquid or grey security, resulting in that broker-dealer immediately being at risk (and with a short position), and providing immediate liquidity to the customer and the marketplace.²⁵ The principal market makers in the OTC Markets hold themselves out to one another, and to the wholesale retail broker-dealers and institutional customers that they service, as willing to provide liquidity in these less liquid and “grey” names. This is demonstrated by these market makers continually and reliably providing both bid and ask quotations in such securities upon request of wholesale retail broker-dealers and institutional customers (rather than displaying such quotes).

Second, in response to the Commission’s Question 133 in the Proposed Amendments, CG firmly believes that amending Regulation SHO to extend the time period required to close-out fails to deliver beyond the three days currently provided by Rule 204, would greatly enhance liquidity in the OTC market. Short squeezes are often an unintended consequence of the current application of Rule 204 Regulation SHO is

fide marketing noted by the Commission include a pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity to customers or other broker-dealers (this may include short selling into a declining market), and continuous quotations that are at or near the market on both sides and that are communicated and represented in a way that makes them widely accessible to investors and other broker-dealers. The Commission further noted that a market maker must hold itself out as being willing to buy and sell a security for its own account on a regular or continuous basis, such that a market maker’s quotes “must be *generally accessible* to the public for a market maker to be considered as holding itself out as being willing to buy and sell a security for its own account on a regular or continuous basis, and therefore, to be engaged in *bona-fide* market making activity.” See Adopting Release at 32. A market maker must also be a market maker in the security being sold and must be engaged in *bona-fide* market making in that security at the time of the short sale. See Adopting Release at 33.

²⁴ It is important to note that it is not uncommon for a market maker to post a one-sided quotation in the OTC markets for a perfectly legitimate reason, including for example, posting a bid-only quotation to accumulate shares to close-out a potential fail-to-deliver position subject to Regulation SHO’s close-out requirement.

²⁵ CG will often immediately sell a security to a purchasing customer as a matter of providing best execution, even when there are temporary shortages of that security available in the market. This may occur, for example, if there is a sudden surge in buying interest in that security, or if few investors are selling the security at that time. As the Commission acknowledged, “[b]ecause it may take a market maker considerable time to purchase or arrange to borrow the security, a market maker engaged in *bona-fide* market making, particularly in a fast-moving market, may need to sell the security short without having arranged to borrow shares[, which] is especially true for market makers in thinly traded, illiquid stocks as there may be few shares available to purchase or borrow at a given time.” See U.S. Securities and Exchange Commission, *Key Points About Regulation SHO*, Section II “Naked” Short Sales, available at: <https://www.sec.gov/investor/pubs/regsho.htm> (“Key Points About Regulation SHO”).

currently applied, , and indeed, Regulation SHO can be a boon for those looking to manipulate share prices. As recognized by the Commission in its *Key Points About Regulation SHO*:

One of the primary purposes of Regulation SHO is to clean up open fail positions, but not to cause short squeezes. The term “short squeeze” refers to the pressure on short sellers to cover their positions as a result of sharp price increases or difficulty in borrowing the security the sellers are short. The rush by short sellers to cover produces additional upward pressure on the price of the stock, which then can cause an even greater squeeze. Although some short squeezes may occur naturally in the market, a scheme to manipulate the price or availability of stock in order to cause a short squeeze is illegal.²⁶

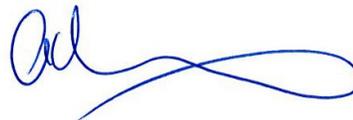
Enabling legitimate market makers the ability to provide instant liquidity to the market while having a short position in the underlying security, ultimately benefits retail customers by providing better prices to the market. A common example of this is when there is a price disparity between an illiquid ADR trading in the OTC Markets and the underlying ordinary shares trading in the foreign local market. Permitting market makers who are short the ADR to immediately fill the customer order in the illiquid ADR at an advantageous price, while simultaneously accessing the liquidity and beneficial price disparity in the local market, translates to better price efficiencies in the OTC Markets, as well as better prices for the end-customer. Where market makers are not provided this flexibility, the customer is ultimately disadvantaged, as the advantageous price, time, and/or ability to transact at all dissipates. Accordingly, CG believes the Commission should provide additional time to close-out fail-to-deliver positions and relief from the locate requirement of Regulation SHO to these market makers. If the Expert Market contemplated by OTCM and supported by many of the commenters is to work in an efficient manner, these changes will be necessary. However, this relief should be bestowed on grey and illiquid security market makers, even if the Expert Market is not approved by the Commission.

E. CG supports an exemption for certain securities of foreign issuers.

CG supports the proposal raised by Virtu Financial Inc. in its letter to the Commission dated February 7, 2020 to include an additional exemption that would allow broker-dealers to publish quotations in securities of certain well-capitalized foreign private issuers that currently trade on a “designated offshore securities market” designated as such by the Commission as satisfying the criteria in the Securities Act Rule 902(b)(2), and such trading is not suspended by a foreign financial regulatory authority.²⁷

Thank you again for providing CG the opportunity to provide comments to the Proposed Amendments. CG strives to serve as a meaningful liquidity provider and execution partner for the broker-dealer and investor community and hopes that the Commission will continue to address the industry’s concerns and aspirations for the Rule.

Very truly yours,



Andrew F. Viles

²⁶ See *Key Points About Regulation SHO* at IV.7.

²⁷ See Comment 4 of the Virtu Comment Letter. See also Larry Bergman Letter at 8 and footnote 34.

Canaccord Genuity LLC
March 20, 2020

U.S. General Counsel
Canaccord Genuity LLC

cc: Walter J. Clayton, III, Chairman
Robert J. Jackson, Jr., Commissioner
Allison H. Lee, Commissioner
Hester M. Peirce, Commissioner
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