

May 29, 2020

*Via Electronic Submission*Securities and Exchange Commission
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www.lucbro.com**Re: Publication or Submission of Quotations Without Specified Information a/k/a OTC Disclosure File S7-14-19****Ladies and Gentlemen:**

Lucosky Brookman LLP supports the Commission’s goal of modernizing Rule 15c2-11 (the “Rule”) to better reflect current market realities, including and especially the risk of fraud and manipulation in OTC securities.¹ As “gatekeepers” of the OTC Capital Markets and the broader markets in general, we are grateful for the opportunity to comment on certain amendments to the Rule proposed (the “Proposal”) by the Securities and Exchange Commission (the “Commission”). The Jumpstart Our Business Startups Act (“JOBS Act”) was passed, as the Commission itself has stated, with the express purpose of “lessen[ing] the regulatory requirements in accessing public capital.”² It was intended to support start-up businesses and small companies, which were otherwise locked out of NASDAQ and the NYSE, and permit them access to capital markets. This goal was and remains of critical importance to the American economy. The OTC Capital Markets, in theory, are meant to provide a vehicle not only for capital raising for such companies, but also to afford such companies the ability to eventually advance to trading on a senior exchange, such as NASDAQ or the NYSE. However, in light of the immense regulatory burdens placed on brokers, the reality is that for many companies the risks of having their stock quoted on the OTC Capital Markets seem to far outweigh the rewards. Accordingly, these “start-up” companies often find themselves without brokers and without the ability to efficiently clear OTC stocks, effectively leaving these companies without the critical access to capital markets that the JOBS Act intended. We are hopeful in submitting this comment letter that the Commission will recognize this issue and amend its Proposal to reinvigorate the OTC Capital Markets and provide incentives—not deterrents—for market participants to meaningfully engage in this space again.

While we agree with the Commission that Exchange Act Rule 15c2-11 should be modernized, we believe that the Commission may have forgotten a key modern reality: broker-dealers are faced with extraordinarily burdensome diligence requirements and, when coupled with the immense

¹ See See Press Release, Securities and Exchange Commission, SEC Proposes Amendments to Enhance Retail Investor Protections: Actions Increase Availability of Issuer Information and Modernize the Rule Governing Quotations for Over-the-Counter Securities (Sept. 26, 2019), <https://www.sec.gov/news/press-release/2019-189> (stating, e.g., “The proposed amendments would provide greater transparency to the investing public by requiring that information about the issuer be current and publicly available before a broker-dealer can begin quoting that security.”).

² Lori Schock, Director, Office of Investor Education and Advocacy, Speech at InvestEd 2012 (June 9, 2012), available at <https://www.sec.gov/news/speech/2012-spch060912ljshtm>.

regulatory burdens of the Rule as well as the Proposal, many broker-dealers have dropped out of the market entirely, leaving a decimated OTC marketplace in its wake.

Specifically, the Proposal fails to (a) provide a workable standard of review for initial publication of quotations by broker-dealers; (b) explicitly define shell companies, which places an immense and ambiguous burden on broker-dealers, not issuers, to make such determinations; (c) provide a solution for FINRA's long, arduous and opaque process for reviewing Forms 211; and (d) account for sophisticated investors in an "Expert Market" who do not require the same degree of investor protection as typical retail investors.

We suggest that the Commission consider:

- reallocating the accuracy of shell-reporting requirements to the issuer alone;
- clearly defining what constitutes a shell company;
- streamlining the FINRA Form 211 process to (1) reflect the plain language of the rule and (2) account for duplicative reporting among qualified interdealer quotation systems ("IDQS") and broker-dealers; and
- creating an Expert Market.

We believe that these suggestions will accomplish the dual aims of Congress and the Commission of enabling start-up and other microcap companies to obtain financing while also protecting the most vulnerable investors.

A. Providing a Workable Standard of Review for Broker-Dealers and Qualified Interdealer Quotation Systems

At present, the Proposal requires that the qualified IDQS's and broker-dealers have a "reasonable basis under the circumstances for believing that company information is 'accurate in all material respects and from a reliable source'"³ before submitting a quotation. This standard of review improperly places the immense burden of ensuring accuracy on the wrong market participant. Instead of IDQS's and broker-dealers, it should be the issuer—and the issuer only—who is responsible for the accuracy of their disclosures. The Commission agreed in 2002, stating that "[e]xisting antifraud law, as well as the disclosure rules governing documents filed with or submitted to the Commission, already place responsibility for the accuracy and completeness of disclosure, and liability for failure to satisfy disclosure requirements, on corporate management and directors."⁴

Thus, to keep market participants' roles clear, minimize the deterrents to broker involvement in the OTC Markets, and place liability where it belongs, the accuracy burden should shift solely to issuers. We propose, as do many of our colleagues, that the standard of review for broker or qualified IDQS publication or submission of quotations should be "a reasonable belief that the required paragraph (b) information is 'complete in all material respects' and from a reliable source."⁵

³ See Preliminary Comment Letter, OTC Markets Group, Inc. at 2 (Nov. 25, 2019).

⁴ SEC Proposed Rule: Certification of Disclosure in Companies' Quarterly and Annual Reports, Release No. 34-46079 (Jun. 17, 2002).

⁵ Preliminary Comment Letter, OTC Markets Group, Inc. at 2 (Nov. 25, 2019); Comment Letter, OTC Markets Group Inc. at 4 (Dec. 30, 2019).

This standard is consistent, and in fact exceeds that of the Commission’s Filing Review Process, which is “not a guarantee that the disclosure is complete and accurate—responsibility for complete and accurate disclosure *lies with the company* and others involved in the preparation of a company’s filings.”⁶

B. Clearly Defining Shell Companies and Requiring Issuers to Self-Identify

The Proposal currently places an immense and ambiguous burden on broker-dealers to determine what qualifies as a shell company. A grave concern with this is that it will disincentivize market makers, causing them to perceive the risks to be greater than potential rewards, leaving no opportunity for investments in the securities of legitimate early-stage companies. We are certain that this cannot be what either the Commission or Congress intend. To be clear, this is no mere hypothesis—it has already begun to happen. To combat this issue, we agree with the Securities Traders Association that the Commission should explicitly define what constitutes a shell company, and have the *shell* be the one to self-identify.⁷

Additionally, we agree with the OTC Markets Group’s proposed amendment to paragraph (e)(8) to more clearly define “shell company” as “a company that (i) discloses its shell status in paragraph (b) disclosure, or (ii) falls within defined financial metrics, including (x) having less than \$100,000 in annual revenue, assets and gross profits and loss; and (y) less than \$50,000 in research and development costs.”⁸ This definition would serve the Commission’s dual aims for this Proposal: ease and efficiency for the reviewing broker-dealer or qualified IDQS’s and an obstacle for the high risk shell, and preserving the OTC Markets while mitigating risk and potential fraud, particularly against retail investors.

It is also worth noting that while there is precedent for shell companies engaging in unlawful activities (though the same can be said of even some of the highest caliber companies on the most senior exchanges without having the negative connotation of the word “shell”), they serve as a critical capital formation mechanism; we therefore recommend that shell companies be more heavily regulated but not restricted entirely.

C. Streamlining Form 211 and Aligning FINRA’s Role with Rule 6432’s Intent

Another significant obstacle and source of delay is FINRA’s arduous Form 211 process. We suggest that the Commission establish that FINRA should (1) clarify that brokers can issue quotes after the prescribed three-day statutory time frame; (2) end the practice of conducting full reviews of the forms on their merits when conducted by a broker-dealer or qualified IDQS; and (3) amend Rule 6432 to no longer require broker-dealers to file duplicative and burdensome Form 211’s after the qualified IDQS has already done so. Implementing these proposals will provide more opportunities, ensure that issuers remain in compliance with Rule 15c2-11, and produce market efficiency.

FINRA Rule 6432 states: “A member shall demonstrate compliance by making a filing with, and in the form [(211)] required by, FINRA, which filing *must be received at least three business days*

⁶ See Preliminary Comment Letter, OTC Markets Group, Inc. at 2–3, n. 3 (Nov. 25, 2019) (quoting SEC Filing Review Process (Sept. 27, 2019)).

⁷ Comment Letter, Securities Traders Association.

⁸ See Comment Letter, OTC Markets Group, Inc. at 6 (Apr. 8, 2020).

*before the member's quotation is published or displayed in the quotation medium.*⁹ A plain text reading suggests that after the three day window is complete, a broker-dealer should be able to issue a quote. But harkening back to the Commission's goal of amending Rule 15c2-11 to reflect modern day practice, FINRA has turned the Form 211 process on its head, leading to yet another obstacle for early-stage companies to enter the capital markets and an additional deterrent for brokers to engage in those markets.¹⁰ FINRA does this primarily by withholding trading symbols or blocking brokers from issuing quotes until FINRA's in-depth merits review is complete, taking an average of 34 days to approve.¹¹ This delay is largely due to the additional information FINRA requests (and rarely makes public) prior to clearance, which further delays the process and disincentivizes brokers from engaging in the OTC Markets. Should FINRA cease conducting a merits review of the Rule 15c2-11 information provided in the Form 211, it will be significantly easier for FINRA to complete review within the prescribed three-day statutory time frame and allow issuers access to markets within the time frame intended. The Commission should thus establish clear guidance to FINRA and to brokers that they can—and in fact are statutorily prescribed to—quote the stock after the three-day window is complete.

Additionally, brokers should be able to rely on the qualified IDQS's Form 211 and quote immediately after approval instead of being required to file their own duplicative Form 211. To provide background on the reliability of these qualified IDQS's, it is important to note that the OTC Markets has developed a series of review and compliance mechanisms in recent years. As mentioned above, the OTC Markets have provided essentially the only venture and growth market for penny stock issuers, investors, and brokerage firms. As such, they have taken compliance very seriously. And while the OTC has served as a forum for fraud in the past—an issue every market faces—the OTC Markets has done a disclosure and accountability overhaul, specifically by developing a disclosure framework for public companies, where investors have access to a plethora of current, publicly available information. Specifically, the OTC Markets Group's issuer compliance team oversees issuer information across the OTCQX, OTCQB, and OTC Pink markets to effectively ensure what the Proposal for Rule 15c2-11 seeks to accomplish.¹² In fact, companies on the OTCQX and OTCQB markets “must maintain up-to-date disclosure” at all times.¹³ Thus, because qualified IDQS's facilitate compliance checks, monitor ongoing disclosures, and collect and review information from the issuer prior to initiation of a quote, it should be the IDQS's alone who files the Form 211.¹⁴

D. Creating an Expert Market

While the Commission is correct that “[s]ecurities that trade on the OTC market are primarily owned by retail investors,”¹⁵ that does not mean that sophisticated investors are not also critical players in the OTC markets, and should not be subject to the same restrictions as retail investors. While it is

⁹ FINRA Rule 6432, Compliance with the Information Requirements of SEA Rule 15c2-11 (1990).

¹⁰ See Comment Letter, Anthony L.G., PLLC (Feb. 26, 2020).

¹¹ Comment Letter, OTC Markets Group, Inc. at 6, n. 10 (Dec. 30, 2019) (citing data from January 1, 2015 through November 31, 2019).

¹² See Preliminary Comment Letter, OTC Markets Group, Inc. at 1 (Nov. 25, 2019). Note that the Pink market differs from OTCQX and OTCQB in that “OTCQX and OTCQB markets must maintain current disclosure, while companies on the Pink market are designated as ‘Current Information,’ ‘Limited Information’ and ‘No Information’ in accordance with the sufficiency and timeliness of their disclosure.” *Id.*

¹³ Comment Letter, OTC Markets Group, Inc. at 3, Appendix A (Dec. 30, 2019) (describing each of the OTC Markets)

¹⁴ See *id.*

¹⁵ See Press Release, Securities and Exchange Commission, SEC Proposes Amendments to Enhance Retail Investor Protections: Actions Increase Availability of Issuer Information and Modernize the Rule Governing Quotations for Over-the-Counter Securities (Sept. 26, 2019), <https://www.sec.gov/news/press-release/2019-189>.

the case that investors with access to current and accurate issuer information are well-equipped to make informed decisions regarding their investments, not every investor is created equal in terms of their knowledge and sophistication in the marketplace. The JOBS Act certainly made this clear. In an Expert Market, quotes and market data would be exclusively available to sophisticated investors, with vulnerable retail investors locked out entirely.

The main concern with not having an Expert Market is that the market for micro-cap, mega-cap issuers, domestic community banks, exchange delists, and distressed companies will be significantly lessened as solid companies that do not provide current information or have assets primarily consisting of cash and securities will disappear, or be relegated to unregulated entities or “gray” markets that leave room for manipulation. Thus, we believe establishing an Expert Market where these “No Information” companies (a term coined by the OTC Markets Group and adopted in industry practice) can be quoted to risk-tolerant and sophisticated investors is crucial.

* * * *

We greatly appreciate the Commission’s efforts to make the OTC Markets a safer place for all investors and provide accurate and up-to-date information. That said, the OTC Markets cannot survive without active brokers and other market participants. The immense regulatory burdens currently in place, and the additional ones the Proposal seeks to impose, will devastate the OTC Markets and chill early-stage, micro-cap, and start-up company capital raising entirely. This will not only significantly harm the U.S. economy and be contrary to the intent of the JOBS Act, but it will be a death sentence for those companies that will have no access to capital markets through the OTC Markets and are not yet able to trade on the NASDAQ and NYSE. We hope you will consider our proposals to restore the very opportunities the JOBS Act set out to create.

Sincerely,

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