OTC Markets

By Electronic Mail

June 6, 2016

Mr. Brent J. Fields Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Petition for Rulemaking to Amend Regulation A to make SEC Reporting Companies Eligible Issuers and Permit At the Market Offerings

Dear Mr. Fields:

OTC Markets Group Inc. respectfully submits this Petition for rulemaking to the U.S. Securities and Exchange Commission (the "Commission" or "SEC") pursuant to Rule 192(a) of the Commission's Rules of Practice. Through this Petition we are requesting that the Commission implement, pursuant to the Commission's rulemaking powers, amendments to Regulation A, to (i) broaden the ability of all small issuers, including issuers reporting under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"); and (ii) modify the provisions of Regulation A to permit "at the market offerings" for smaller reporting issuers.

Regulation A provides a vital lifeline for bringing small company capital raising into the 21st century. Through Regulation A offerings, companies can raise capital transparently, online, from the community of investors who will often be the issuer's customers and supporters: that group of people most enthusiastic and knowledgeable about the company's products and services. In short, SEC regulated companies and broker-dealers can now use the power of the internet to raise capital in the same transparent, technology driven publicly connected manner in which Amazon sells books.[1]

Unfortunately, thousands of fully SEC reporting companies – those that meet the high disclosure and reporting standards set forth by the SEC and the federal securities laws - have been excluded from the new Regulation A capital raising opportunity.

The Commission redesigned Regulation A pursuant to the Jumpstart Our Business Startups Act ("JOBS Act"). The resulting 'Regulation A+' includes an internet friendly, modern solicitation process designed to protect and inform investors, with a transparent electronic audit trail unparalleled by older means of personal communication. In its March 2015 Regulation A+ adopting release (the "Final Rules"), the Commission noted:

> "We believe that issuers should be accountable for the content of solicitation materials and that such information must be consistent with the information contained in the offering circular. ***We believe that making these materials publicly available as an exhibit to the offering***

[1] In a 1997 letter to shareholders, CEO Jeff Bezos recognized the transformative power of online markets, noting "Today, online commerce saves customers' money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets." *Available at*: http://media.corporate-ir.net/media_files/irol/97/97664/reports/Shareholderletter97.pdf.

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> ***statement, and thereby subjecting them to staff review and comment and scrutiny by the public, will help ensure that issuers use solicitation materials with appropriate caution.***"[2]

The Commission's determination with respect to public availability of offering materials represents a momentous philosophical change. Through Regulation A+, and related Commission rules allowing for general solicitation and advertising in certain private offerings under Regulation D,[3] the Commission embraced transparency and technology with respect to small company capital raising and investor protection. Throughout much of the Commission's history, smaller companies not yet ready for the complexity and cost of full Commission registration could offer securities only to the wealthy and well connected through an opaque, backroom process, using confidential offering materials and private phone conversations, that was designed to be completely hidden from the general public and the press. These kinds of deals are anathema to both market efficiency and an open, democratic society.

Based on its commentary in the Regulation A+ adopting release, the Commission clearly recognizes the danger of small company offerings being sold through private, phone-based sales, hidden from public and regulatory scrutiny. It is impossible for a regulator or a compliance officer at a broker-dealer or investment bank to tell how forthcoming a broker has been in a single phone conversation, and extremely hard for an investor to double-check statements or receive the wisdom of the crowd with confidential offering materials that are restricted from public dissemination. This is particularly worrisome with securities that involve potential risks that should be clearly disclosed. When the offering material is made publicly available in a Regulation A+ offering, it has been reviewed by regulators and the issuer's counsel. The public and the press can then analyze and discuss the information, and raise questions as appropriate. Online securities offerings help ensure that investors have equal access to full and complete information prior to investing. Public availability of information protects investors not only in online offerings, but in offerings sold through traditional broker-dealer sales forces as well. Transparent markets drive efficiency, and sunlight is the best disinfectant.

As described in further detail below, online capital raising under Regulation A+ has the potential to change and modernize the capital markets using the power of connectivity and information distribution through the Internet. The exciting new community of online funding portals and innovative, technology enabled investment banks forming around Reg A+ has the power to disrupt and democratize small company capital formation. The next logical step in this evolution is expanding the scope of Regulation A+, which is tailor made for online securities offerings, to include SEC reporting issuers already providing in-depth periodic disclosure to the public.

BACKGROUND

On April 5, 2012, the JOBS Act was signed into law. The purpose of the JOBS Act was succinctly captured in its first sentence: "To increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies." Many important details of the JOBS Act were placed in the hands of the Commission through its newly expanded rulemaking powers.

In Title IV of the JOBS Act, entitled "Small Company Capital Formation," Congress delegated important details to the Commission, to be addressed in the rulemaking process. The Congressional

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[2] SEC Release Nos. 33-9741; 34-74578; 39-2501; File No. S7-11-13] at page 149.
[3] *See* 17 CFR 230.506(c).

mandate in Title IV was relatively simple, with very few constraints on the Commission's broad rulemaking powers.

In particular, in less than 500 words, Congress set forth the basic parameters of Title IV:

- The aggregate offering amount of all securities offered and sold within the prior 12-month period in reliance on the exemption added in accordance with this paragraph shall not exceed $50,000,000.
- ***The securities may be offered and sold publicly.***
- The securities shall not be restricted securities within the meaning of the Federal securities laws and the regulations promulgated thereunder.
- The civil liability provision in Section 12(a)(2) shall apply to any person offering or selling such securities.
- ***The issuer may solicit interest in the offering prior to filing any offering statement, on such terms and conditions as the Commission may prescribe in the public interest or for the protection of investors.***
- The Commission shall require the issuer to file audited financial statements with the Commission annually.
- Such other terms, conditions, or requirements as the Commission may determine necessary in the public interest and for the protection of investors.

The breadth of the discretion delegated by Congress to the Commission in the Title IV rulemaking process was underscored by new Section 3(b)(2) of the JOBS Act, which, other than a requirement that a Title IV issuer file annual audited statements, left the breadth and depth of periodic reporting entirely in the hands of the Commission.

The Commission's Final Rules provide an efficient structure for issuers seeking to use this new exemption from the Securities Act of 1933, as amended (the "Securities Act"). Notably, some of these measures are more protective for non-accredited investors than a fully registered offering under Form S-1 or S-3, which do not screen out "bad actors" or set investment limits for non-accredited investors. By utilizing an efficient, federal one-stop SEC filing process to qualify offerings that removed the duplicative state level review and adding a $50 million per year offering limit, the Commission removed two obstacles that the related GAO study[4] pointed to as being responsible for the minimal use of Regulation A offerings prior to June 2012.

The time period from Regulation A+ filing to qualification, and the comment process itself, suggest that the Staff of the Division of Corporation Finance has shown its commitment to administering Regulation A+ in order to meet its stated objectives – a more efficient and economical "registration" process, both in time and expense. The average time from filing to qualification thus far is less than 75 days, and Staff comment letters are generally shorter than their counterparts for an S-1 filing, with some initial comment letters as short as three or four pages.

Market participants in critical areas, such as underwriting and secondary markets, have shown their willingness to accommodate this new marketplace. OTC Markets Group, for example, has updated the initial and ongoing disclosure requirements for the OTCQX Best Market and the OTCQB Venture

[4] *Factors that May Affect Trends in Regulation A Offerings*, GAO-12-839 (July 2012) (*available at*: http://www.gao.gov/assets/600/592113.pdf).

Market to allow issuers to leverage the modified periodic reporting requirements of Tier 2 Regulation A+. We are also witnessing the participation in this new marketplace by a number of innovative online funding portals and smaller investment banks.

Based upon testimony at an oversight hearing by the House Financial Services Committee Capital Markets Subcommittee on April 14, 2016, the securities industry widely views Regulation A+ thus far as a positive change.

Against this background, and for the reasons discussed below, we believe that the Commission should consider and adopt additional rules that will allow fully SEC reporting companies to conduct Regulation A+ offerings under the existing statutory framework.

EXPANSION OF ISSUER ELIGIBILITY TO ALL SMALLER REPORTING COMPANIES

The JOBS Act does not limit the types of companies that may be afforded access to Title IV's streamlined qualification process. Title IV of the JOBS Act is entitled "Small Company Capital Formation," presumably reflecting a Congressional intent to see Title IV expand avenues of capital formation for *all* small companies. The exemption that Congress crafted, Section 3(b)(2), creates a new class of securities known as "small issues," simply defined as offerings that in the aggregate do not exceed $50 million in a 12-month period, subject to periodic upward adjustment of the offering ceiling.

The Regulation A+ Final Rules limit issuer eligibility based, among other things, upon whether a company is subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act. The Commission noted that this was consistent with traditional Regulation A rules, and that it would prefer to wait until the Regulation A+ market developed before expanding the scope of issuers authorized to conduct Regulation A+ offerings.

The Commission's decision to exclude otherwise qualified companies that meet the high disclosure requirements of full SEC reporting from Regulation A+ is counterintuitive, and inconsistent with the JOBS Act mandate to expand avenues of capital formation for all small companies. Congress and the Commission developed Regulation A+ to revitalize an important offering exemption for small companies. Limiting the scope of Regulation A+ solely because it excluded fully SEC reporting companies in its prior, seldom used form, does not give effect to the Congressional intent behind the JOBS Act.

The Commission's determination with respect to Exchange Act reporting companies is a lost opportunity to create more efficient paths for capital formation for all small issuers. Allowing smaller, fully SEC reporting companies to raise capital publicly via Regulation A+ offerings would engage a wider circle of investors and ultimately enhance liquidity in the secondary market.

Under Securities Act Rule 251(b), fully reporting issuers seeking to take advantage of the streamlined Regulation A+ offering process face an unfortunate choice: (i) deregister as a fully reporting company and then file Form 1-A, in the process ceasing their more frequent and detailed periodic reporting; or (ii) elect other available options, *e.g.,* a costly full Form S-1 or S-3 registration or a private placement under Regulation D, the latter of which would shut out many of the important individual investors Regulation A+ was designed to include. For those issuers that do not meet the minimum thresholds for Exchange Act deregistration, the Regulation A+ window is completely shut.

We recognize that some fully reporting issuers will be eligible to utilize Form S-3, with its streamlined disclosure format. However, there are significant limitations associated with this option for companies that are not listed on a national exchange. For example, the use of Form S-3 requires that the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant be at least $75 million. This cuts against the Commission's determination not to exclude smaller issuers from Regulation A+. The $75 million requirement alone would exclude a wide swath of otherwise eligible SEC reporting companies. Form S-3 issuers are required to meet the high standards necessary to be fully SEC reporting, and accordingly should have access to the same offering tools as Regulation A+ issuers, specifically "testing the waters" and state law preemption allowing for national dissemination of offering materials. Modern securities offerings through Commission-regulated broker-dealers or conducted online are necessarily part of interstate commerce, and should be definitively regulated at the federal level.

Unless listed on a national securities exchange, an SEC reporting company's Form S-3 securities are not "covered securities" within the meaning of Section 18 of the Securities Act, thus requiring Blue Sky compliance in each state where these securities are offered and sold. Securities issued in Regulation A+ transactions, however, are eligible to be classified by the Commission as covered securities. The inability of a Form S-3 issuer to engage in "testing the waters" activities, coupled with state restrictions on advertising, further limit public information regarding an issuer's Form S-3 registered offering.

Other capital raising options for smaller reporting issuers lack the protections and advantages that investors receive in Regulation A+ offerings. For example, Regulation D securities are not freely tradable, leading to a lower price per share in many instances and to the potential for increased dilution to an issuer's existing shareholders. Moreover, private placements by publicly reporting companies, known in the marketplace as "PIPES" (private investment in public equity), though an important source of capital for small issuers in recent years, have, at their lower end, been associated with unsavory market participants and practices, including toxic structures that harm public investors with aggressive share discounting and dilution. Structural PIPES investors can be short term, transactional capital providers, and the existence of such dilutive securities in a smaller company's capital structure may scare away the institutional and long-term, fundamental investors small companies seek to attract.

The ability of smaller fully SEC reporting issuers to utilize Regulation A+ for securities offerings would be expected to provide a cost-effective alternative, with greater market transparency and regulatory oversight. For SEC reporting companies, Regulation A+ offers a less fertile environment for the bad actors sometimes found in the PIPES markets, some of whom simply do not fit within the current statutory bad actor definition. Just as the availability of Regulation A+ will likely reduce the number of back door offerings through "reverse mergers," an expanded Regulation A+ inclusive of fully SEC reporting issuers could be expected to reduce a reporting issuer's reliance on the PIPES marketplace. As discussed in greater detail below, a cost-effective alternative to Regulation D offerings would also facilitate greater participation by individual investors, who already own a vast majority of smaller company shares.

REGULATION A+: THE RENAISSANCE OF THE SMALLER INVESTOR AND THEIR IMPORTANCE TO SECONDARY VENTURE MARKETS

A fully SEC reporting issuer using Regulation A+ to market and sell their freely tradable securities to non-accredited investors could be expected to have a beneficial effect on liquidity and the overall growth and vitality of venture markets. Specifically, many proponents of Regulation A+ offerings have pointed to the need for more robust secondary markets uniquely tailored to the needs of early stage and emerging companies. Sadly, most of the dialogue has centered around the need for new types of markets, which ignores the success of the existing markets, namely the OTCQX Best Market and OTCQB Venture Market operated by OTC Markets Group. The first successful Regulation A+ offering has successfully commenced trading on the OTCQX Best Market, and we expect more companies to follow suit.

Almost entirely overlooked is a focus on the fundamentals that drive these markets. Small companies need efficient, cost-effective methods of accessing public capital to build a strong shareholder base. While it may be beneficial to consider new legislation and regulations to lift existing restrictions that hinder the efficiency of trading smaller company securities, what is missing from this dialogue is an understanding of the primary investors in these markets today. According to testimony by the Director of the SEC's Division of Trading and Markets, "for companies with less than $100 million in market capitalization, individuals dominate ownership with 80.1% of ownership or higher."[5]

Unlike Title I and II of the JOBS Act, which derive their utility primarily or exclusively from institutional and other accredited investors, Title IV is uniquely positioned to be the premier gateway for individual investors and smaller institutions[6], for private companies and smaller reporting companies alike. Promising companies and innovative entrepreneurs that did not fit the VC or syndicated IPO mold in the past have been left with few good options for attracting needed growth capital.

Regulation A+ allows smaller companies, traditionally lacking the backing of bulge bracket investment banks and the large base of institutional ownership needed to fund ongoing research coverage, to reach out to a broader pool of potential investors through 'testing the waters' provisions and the efficient economical reach of the Internet and social media. Emerging companies can use Regulation A+ online offerings to tap into large numbers of individual investors and efficiently target smaller institutions. Allowing fully SEC reporting companies the same ability to leverage technology and transparency to reach potential investors would be expected to provide a ready source of growth capital, and, equally important, an increase in liquidity in the secondary market.

Opening up Regulation A+ to smaller reporting issuers would also allow smaller investors a greater opportunity to participate in what otherwise might be private offerings, limited to a small club of savvy professional investors. These private offerings are often coupled with warrants, rights or toxic convertible reset provisions – all tools that tilt the risk-reward calculus for smaller companies' private offerings more heavily in favor of the short term, structural investor.

The ability of smaller investment banks to widely market Regulation A+ offerings to institutions and high net worth investors, as well as the rise of new online funding portals to serve self-directed individuals interested in companies raising capital, will democratize capital raising in the same way online brokers such as E*Trade and Schwab dramatically lowered costs and greatly expanded investor access to secondary stock trading.

Additional channels of capital formation for smaller reporting issuers, such as access to Regulation A+, could be expected to favor those companies who are not well served by the high cost and complexity of a national exchange listing. The burdens of exchange listing often make it painful to

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[5] *Testimony on Venture Exchanges and Small-Cap Companies*, Stephen Luparello, Director, Division of Trading and Markets (March 10, 2015). Available at http://www.sec.gov/news/testimony/testimony-venture-exchanges.html.

[6] We recommend that fully SEC reporting companies also be allowed to conduct JOBS Act Title III offerings under the Commission's Regulation Crowdfunding.

be a smaller public company. Creation of this new channel of capital formation for smaller reporting issuers could be an important factor in improving the pathway from the markets operated by OTC Markets Group to a national exchange, with enhanced listing and maintenance protections. From 2013 through 2015, more than 200 companies "graduated" from OTC Markets Group's markets to a national securities exchange listing, making it by far the world's most successful venture market.

AT THE MARKET OFFERINGS

Regulation A+ prohibits "at the market" offerings. Though this might be appropriate for a company with no prior secondary market for its securities, this limitation would effectively preclude the use of Regulation A+ by fully reporting companies. The secondary market can and will react to offering activity. The inability of an issuer to reprice the offering from time to time in response to market conditions would likely impede this new channel of capital formation as a viable option for fully reporting issuers. Accordingly, the expansion of Regulation A+ to smaller reporting companies should also allow an issuer to conduct an "at the market" offering. We recommend that the commission review whether additional protections or disclosure should be required in instances of excessive discounts or dilution related to any offering.

CONCLUSION

At OTC Markets, our mission has been to create better informed and more efficient financial markets. As we have brought transparency and technology to secondary trading, we have seen the OTC equity markets drastically improve, with greater availability of disclosure and an enhanced investor experience when buying or selling securities through online and institutional brokers. Making a once opaque market open, transparent and connected has vastly enhanced regulators' ability to oversee markets, market makers' ability to commit capital, brokers' ability to execute trades, and investors' ability to analyze, value and trade securities. Regulation A+ and other online securities offerings will allow smaller companies to efficiently access capital. These innovations provide a much needed alternative to the opaque private offering club that has dominated small company capital raising for decades.

We believe that, for the reasons set forth above, expanding the scope of eligible issuers under Regulation A+ to include fully SEC reporting companies would enhance capital formation for these job creating companies, while at the same time affording an appropriate degree of investor protection. Perhaps of equal importance, we believe that allowing fully reporting companies to utilize Regulation A+ would have a positive impact on the liquidity and vibrancy for the secondary market for all small issuers.

If you have any questions, or if we can provide any additional information that would be helpful to the Commission or the Staff, please feel free to contact me at (212) 896-4413, or Sam Guzik of Guzik & Associates at (310) 914-8600.

Respectfully submitted,

Dan Zinn
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