SEC Advisory Committee on Small and Emerging Companies

Dan Zinn, General Counsel, July 2016
OTC MARKETS GROUP INC. (OTCQX: OTCM)

Our Mission

To create better informed and more efficient financial markets

What We Do

OTC Markets Group Inc. (OTCQX: OTCM) operates the OTCQX® Best Market, the OTCQB® Venture Market, and the Pink® Open Market for 10,000 U.S. and global securities. Through OTC Link® ATS, we connect a diverse network of broker-dealers that provide liquidity and execution services. We enable investors to easily trade through the broker of their choice and empower companies to improve the quality of information available for investors.

OTC Link ATS is an SEC registered Alternative Trading System, operated by OTC Link LLC, member FINRA/SIPC and SEC regulated ATS.
OUR MARKETS

We organize 10,000 securities into three markets to better inform investors

The Best Market
The OTCQX® Best Market offers transparent and efficient trading of established, investor-focused U.S. and global companies. To qualify for the OTCQX market, companies must meet high financial standards, follow best practice corporate governance, demonstrate compliance with U.S. securities laws, be current in their disclosure, and be sponsored by a professional third-party advisor. Penny stocks, shells and companies in bankruptcy cannot qualify for OTCQX.

The Venture Market
The OTCQB® Venture Market is for early-stage and developing U.S. and international companies. To be eligible, companies must be current in their reporting and undergo an annual verification and management certification process. Companies must meet $0.01 bid test and may not be in bankruptcy.

The Pink Market
The Pink® Open Market is for broker-dealers to electronically trade all types of companies. With no minimum financial standards, this market includes foreign companies that limit distribution of their disclosure to their home market, penny stocks and shells, as well as distressed, delinquent and dark companies not able or willing to provide adequate information to investors. Pink requires the least in terms of company disclosure and the most in terms of investor research and caution.
REG. A+ | OTCQX

The OTCQX market is designed for operating companies that meet high financial standards and provide current disclosure

- Specific OTCQX Rules for Reg. A+ companies
  - Current in Reg. A Tier 2 ongoing disclosure requirements
  - Annual audit by PCAOB registered auditor
  - File quarterly financials under Form 1-U

- OTCQX Qualifications
  - Meet $0.10 minimum bid & market value or net income standards
  - No Penny Stocks
  - No Shell or Blank-Check Companies
  - Common sense corporate governance standards built on established best practices:
    - At least 2 Independent Directors
    - Audit Committee with Majority Independent Directors

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**OTCQX Market**

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<td>MM Median Mkt Cap.</td>
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Data as of 6/30/2016
THE IMPACT OF TRADING ON OTCQX

Independent study conducted by Oxford Metrica

“The evidence reveals a clear & consistent picture that liquidity is enhanced by a move to the OTCQX market.”

5 Key Takeaways

1. Trading volume by number of shares increases by 53%
2. Dollar volumes increase similarly by 57%
3. Bid-ask spreads narrow by 4%
4. The number of broker-dealers rises 16%
5. Institutional investors familiar with OTCQX value the market, citing its information quality and service, and the voluntary openness by members that signals confident management

‘Many companies realize that, to attract investors, they need to go beyond the statutory minimum of local financial reporting rules’

“Although international company reporting has improved in recent years, we find that OTCQX companies are a self-selection of the better reporters. It signals an attitude of openness to US investors.”

- Hedge fund manager

“We find the OTCQX service superb and the market information reported is essential for our trading.”

- Investment manager
The OTCQB market is designed for growing and venture stage companies

- Current in Reg. A Tier 2 ongoing disclosure requirements
- Reg. A Tier 2 ongoing disclosure meets OTCQB continuing disclosure requirements

- OTCQB - Standards
  - Must be current in reporting with US regulator (SEC, Bank) or listed on a Qualified Foreign Exchange
  - Annual management certification process to verify officers, directors, controlling shareholders, and shares outstanding
  - Minimum bid $0.01

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<tr>
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Data as of 6/30/2016
GLOBAL LEADER IN EXCHANGE GRADUATES

- OTC Markets had 60 companies graduate to national exchange in 2015 vs. 4 for LSE’s AIM and 9 for TSX’s Venture market

- OTC Markets has seen 200 graduates over the past 3 years
TRADING ON OTC LINK® ATS

Network Model: Broker-dealer communication and trading

- Transparency on comprehensive full depth of book, ensuring National Best Bid and Offer (NBBO) where best price is assured and best execution regulations are met
- The network model of trading on OTC Link ATS facilitates liquidity seekers and providers. Exchange matching engines are not as well suited to companies without deep order books.
- Diverse subscriber community of FINRA member and SEC regulated broker-dealers
- Provides an efficient investor trading experience through online and institutional brokers

**Level 2 Quotes for RHHBY**

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REG. A+ | SECONDARY TRADING

Secondary Trading Process & Considerations

- Shares are freely tradable by non-affiliates after offering closes
- Broker-dealer may immediately file a Form 211 with FINRA to initiate quoting
  - Shares may not be quoted until FINRA clears the Form 211
  - FINRA not obligated to clear 211 in conjunction with close of offering
  - OTCQX or OTCQB eligibility dependent on cleared 211 price
  - Single market maker quoting for first 30 days
- Blue Sky laws relating to secondary trading are applicable (solicited trades)
- DTCC eligibility
- Role of the transfer agent
- Shareholder deposits into brokerage accounts
  - Educate brokers that qualified Reg A+ are different from problematic PIPES/equity lines
  - After Elio, broker and clearing firm compliance departments have much greater understanding of Reg. A+ securities
ELIO MOTORS INC. TRADING ACTIVITY

Elio Trading Snapshot

- Joined OTCQX 2/21/2016
- $14 Original Bid Price
- $13 MM $ Volume Traded
- 8 Market Makers a/o 6/30/2016
REG. A+ | USE IN M&A ACTIVITY

Coastal Banking Company, Inc. (OTCQX: CBCO)

- Regulation A+ offering February 29, 2016 (Tier 1)
- Shares used to acquire First Avenue National Bank on April 8, 2016
BLUE SKY FOR SECONDARY TRADING

Limitations if not Blue Sky Compliant

- Broker-dealer cannot distribute research
- No transactions in managed accounts
- No advice or solicitation relating to the security
- Rescission risk

Blue Sky Manual Exemption

- Transactional exemption
- Company information in a “nationally recognized securities manual”
- Working with NASAA & states to have OTCQX and OTCQB recognized as manuals

OTC Markets 's
INCREASED ACCESS TO REG. A+

OTC Markets Group Petition For Rulemaking

• Expand Reg. A+ to include SEC Reporting Companies
  • Current in SEC reporting requirements
  • S-1 and S-3 offerings impose significant cost
    • S-3 $75 MM public float requirement
    • No state law preemption
• Allow “at the market” offerings

Public Support for the Petition

Steven Dresner, Founder, Dealflow.com
"Given the existing framework for the "new" Regulation A, including provisions regarding financial and other qualitative disclosure, it would seem logical (and easy from a legislative and regulatory perspective) to broaden the utility of Regulation A by allowing smaller publicly reporting companies to use this capital-raising option."

"We believe that implementation of these requested amendments would be beneficial to smaller reporting issuers without compromising any investor protections since, as the Petition highlights, these issuers are already required to provide compliant and substantive disclosures."
VENTURE MARKET

OTC Markets Group is the Nasdaq of the 90’s, with today’s technology

- Dealer markets can work better for smaller company trading
  - Registered exchanges are centralized auction markets, cannot operate dealer markets
  - Dealers create liquidity in smaller companies
    - Market makers compete on cost, execution quality and liquidity provision
    - 80% individual ownership of companies with less than $100 million in market cap
  - Aggarwal & Angel study – characteristics of historically successful smaller company secondary markets:
    - Grew out of pre-existing Over-the-Counter markets
    - Operated as dealer markets
    - Separate from existing exchanges
- SEC and legislative proposals counterintuitively prescribe an exchange-only, monopoly model
  - Exchange Act Section 11A: “Congress finds that . . . it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . . fair competition . . . among exchange markets, and between exchange markets and markets other than exchange markets.”
  - Smaller companies will benefit from competition among exchanges, ATS and other trading venues

1 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.

AUCTIONS CAN BE RISKY FOR RETAIL

This @TiffanyAndCo bowl belonging to Joan Rivers' beloved dog Spike sold for $13,750, nearly 30x the low estimate!

"Many securities do not have the characteristics - e.g., trading volume, price and number of stockholders - which would justify auction-type trading." 1975 Senate Report