

OTC Markets Group Capital Formation Recommendations

Small company capital formation is dependent on access to efficient and informed public markets. **Over 500 “small” U.S. public companies** (those having a market cap less than \$250M) **across over 40 states** trade on the OTCQX and OTCQB markets operated by OTC Markets Group. Collectively, these small companies have **over 75,000 employees** and represent a wide variety of industries, including technology, community banking, financial services, healthcare, real estate, natural resources and consumer goods. Approximately **60 companies graduate to an exchange listing** from the OTC market each year, **over 300 in the past five years**, making them the most successful ‘venture’ markets in the world.

Congress can help small companies like these access capital, while providing investors with opportunity and protection. Legislation and regulation that promotes transparency, disclosure and liquidity can invigorate the small-cap marketplace. While many lament the decrease in companies “going public” via traditional IPOs, we believe public trading markets (i.e. markets where securities are readily bought or sold by an investor through a regulated broker-dealer) should provide multiple avenues for companies and their investors to achieve price transparency, liquidity and capital formation. The following list of concrete, targeted recommendations would help to combat retail investor fraud, improve market efficiency and enhance capital formation opportunities for small businesses across the U.S.

1. **Improve and support adoption of Regulation A.** While the recent increase to the Regulation A maximum offering limit was a good start, two additional enhancements would promote wider adoption of Regulation A and increase opportunities for capital formation:
 - (i) Regulation A should be amended to allow for at-the-market offerings,¹ and
 - (ii) secondary transactions in securities of issuers current in their ongoing Regulation A reporting requirements should be exempt under state Blue Sky laws.
2. **Increase disclosure requirements for significant holders of publicly-traded equities, promoters and transfer agents.** Meaningful reform in OTC equities markets can be achieved by imposing additional disclosure requirements on important market participants.
 - (i) **Short Selling:** Mandate timely disclosure of significant short positions in all public issuers. There is ample evidence that short selling contributes to efficient price formation, enhances liquidity and facilitates risk management.
 - (ii) **Institutional Holdings:** Extend Exchange Act § 13(f) reporting obligations to require disclosure of holdings in over the counter (OTC)-traded securities.
 - (iii) **Insiders and Affiliates:**

¹ The 2017 and 2018 SEC Small Business Forums recommended that the SEC amend its rules to allow at-the-market offerings under Regulation A.

- Prohibit insiders and affiliates from holding shares in an objecting beneficial owner (OBO) accounts.
 - Require disclosure of insider and affiliate transactions in securities of non-SEC reporting companies, in a manner similar to SEC Forms 3, 4, and 5.
- (iv) **Paid Promoters:** Amend Securities Act § 17(b) and/or promulgate rules thereunder to require additional disclosure about paid stock promotion to make online information sources safer, deter misleading sales pressure and prevent fraudulent “pump-and-dump” schemes.
- (v) **Transfer Agents:** Modernize transfer agent regulations to increase the amount of information on the issuance, ownership and transfer history of shares available to broker-dealers and investors.
3. **Adopt a safe harbor for the sale of Regulation A and registered securities into the market.** The SEC should remove outdated restrictions on public offerings and adopt a safe harbor for Regulation A and SEC reporting companies to sell shares directly into the market through a registered broker-dealer. The safe harbor should impose manner of sale, timing, price, and volume restrictions similar to those under Rule 10b-8, as well as additional dilution and corporate governance requirements.
4. **Grant federal preemption under state Blue Sky laws for secondary transactions in OTC securities of companies that make adequate current information publicly available.** The lack of a uniform Blue Sky manual exemption means a broker-dealer with a national network of advisers will have concerns that limit the distribution of research to individual investors. Investors suffer from the resulting lack of available research, which is a disservice to the investor protection mission of state and federal regulators alike.
5. **Support venture market reform that recognizes both exchange and non-exchange markets.** In the past five years, over 300 companies have graduated from OTC markets to the national securities exchanges, making the U.S. OTC markets the most successful ‘venture’ markets in the world. The Main Street Growth Act (H.R. 2899) and similar proposals would disadvantage non-exchange markets by stifling competition amongst market operators and excluding markets that already serve small companies. Any U.S. venture market legislation should facilitate competition and include exchange and non-exchange (ATS) market structures.
6. **Allow small companies to effectively provide Employee Stock Ownership Plans (ESOPs).** IRS regulations limit the ability of non-exchange traded companies to offer ESOPs to their employees. Public companies quoted on the OTCQX market are forced to treat their stock as “private” for ESOP purposes. Despite having a publicly-quoted price, current regulations require these companies to use an independent appraisal to establish the value of their securities and offer a put option to all employee participants. The ESOP Fairness Act (S.3270) (H.R.5851), bi-partisan legislation introduced in the 116th Congress, would amend the definition of “readily tradable on an established securities market” to include qualified securities quoted on the OTCQX and OTCQB markets.

7. **Enable margin eligibility for qualified OTC securities.** Regulation T and related Federal Reserve guidance is outdated and disadvantages smaller, OTC-traded companies. In 1999, before Nasdaq became an exchange, the Board of Governors of the Federal Reserve System ceased its longstanding practice of publishing a quarterly list of “marginable” OTC securities, instead recognizing only Nasdaq-traded securities. Nasdaq became an exchange in 2006 and the guidance was never revised. Updating outdated regulations to make qualified OTC securities margin-eligible would increase the value of these securities and have a direct impact on small company capital formation.