VIA Electronic Submission

Marcia Asquith

Office of the Corporate Secretary

FINRA

1735 K Street, NW

Washington, DC 20006-1506

Re: **Regulatory Notice 14-29; Form 211 Information Repository**

Dear Ms. Asquith:

OTC Markets Group Inc. [1] ("OTC Markets Group") respectfully submits to the Financial Industry Regulatory Authority ("FINRA") the following comments on FINRA's proposal to establish a publicly accessible online repository of Form 211 Information (the "Proposal").

We support the Proposal's objective to provide public access to Form 211 information to allow investors to make better informed decisions regarding newly public companies. Public access to information is the most effective method of informing investors, creating more efficient markets and combatting fraud. We believe that goal would be best achieved by providing access to Form 211 information, including attached documents, through the publicly available website of the interdealer quotation system on which the subject company is quoted by broker-dealers. The information should also be freely distributed to interested market data providers and financial portals to allow investors to access it when they analyze, value and trade securities. Companies traded on our marketplaces are incentivized to make current information publicly available through our OTC Disclosure & News Service®, where the information may be accessed on our website for free by all interested parties and is distributed to leading market data providers and financial portals. It follows that upon initiation of quotations in a security, Form 211 information should be made available to investors, broker-dealers and regulators in the same easily accessible location.

[1] OTC Markets Group Inc. (OTCQX: OTCM) operates Open, Transparent and Connected financial marketplaces for 10,000 U.S. and global securities. Through our OTC Link® ATS, we directly link a diverse network of broker-dealers that provide liquidity and execution services for a wide spectrum of securities. We organize these securities into marketplaces to better inform investors of opportunities and risks – OTCQX®, The Best Marketplace; OTCQB®, The Venture Marketplace; and OTC Pink®, The Open Marketplace. Our data-driven platform enables investors to easily trade through the broker of their choice at the best possible price and empowers a broad range of companies to improve the quality and availability of information for their investors.
OTC Link ATS is operated by OTC Link LLC, member FINRA/SIPC and SEC registered ATS.

We also take this opportunity to respond to FINRA's request for comment regarding the adoption of a requirement for broker-dealers to file periodic updates to Form 211 information. A Form 211 update requirement raises several difficult questions. Such a requirement would place undue burdens on broker-dealers, leading to lower market maker participation and fewer publicly available priced quotes. Ultimately a Form 211 update requirement would limit access to public trading markets and create a larger pool of companies trading either through unsolicited quotes, which lead to much wider spreads and increased volatility, or in the Grey Market[2], without publicly available quote price information. A Form 211 periodic update requirement has been proposed in different contexts for over twenty years and for the reasons described here and several others has wisely never been adopted. Today, currently company information is more freely available than ever before. The current level of information availability, combined with the recognized need to attract and support more non-affiliate market makers in smaller publicly traded companies, makes it clear that a periodic update requirement should not be adopted.

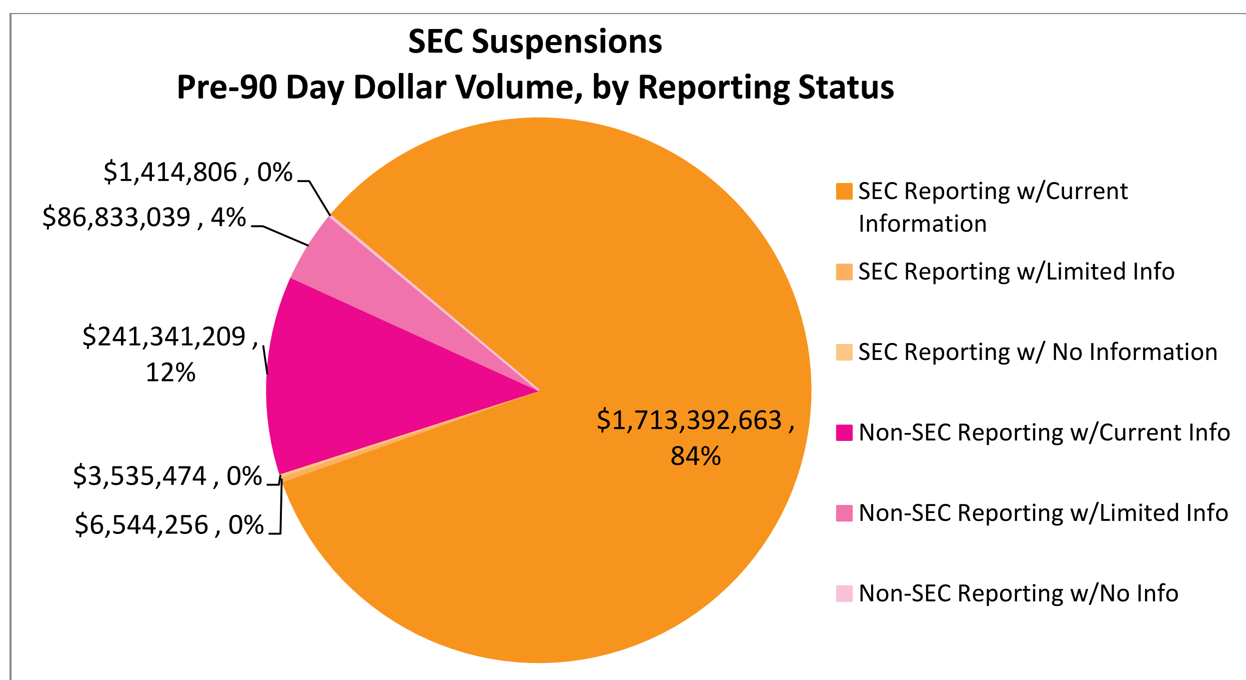
I. Background

In 1991, and again in 1998 and 1999, the Securities and Exchange Commission ("SEC") proposed rules[3] (the "15c2-11 Proposals") that would have required broker-dealers to annually update each Form 211. In its 1998 rule proposal, the SEC stated that "Microcap fraud frequently involves issuers for which public information is limited, especially when issuers are not subject to reporting requirements" and further noted that "Without information, it is difficult for investors, securities professionals, and others to evaluate the risks presented by microcap securities."

Circumstances have changed dramatically in the ensuing years, and now the majority of trading by dollar volume on our OTC Link ATS is in securities for which current information is freely available. Perhaps surprisingly, most microcap fraud by dollar volume takes place in SEC reporting securities that have made current information publicly available. The chart below shows the dollar volume of trading in the 90 days immediately prior to a security being suspended by the SEC:

[2] "Grey Market" means a security not currently traded on the OTCQX, OTCQB or OTC Pink marketplaces, and not quoted on any other U.S. "quotation medium" as defined in Exchange Act Rule 15c2-11(e)(1).

[3] See the SECs 1998 proposed rule at 63 FR 9661-01; Release No. 34-39670. The SEC received 199 comment letters, the vast majority of which opposed the update requirement.



At the time of the 15c2-11 Proposals, it was difficult to determine whether current information about a company was publicly available, or whether such information reflected material changes to the issuer. There was no central location where investors or regulators could access company information, and no way to organize the information that was made publicly available. To that extent, at least, Form 211 information was a unique and valuable source of data.

Over the past 15 years, OTC Markets Group developed the OTCQX, OTCQB and OTC Pink tiered marketplace system. The marketplace designations easily identify which companies make current information publicly available, what reporting standard the information meets[4], and whether the company has chosen to further engage investors

[4] OTC Markets Group recognizes four disclosure standards, each of which fulfills the information requirements of Rule 15c2-11:

- U.S. Reporting Standard: Companies may register a class of their securities with the SEC and comply with SEC reporting requirements.
- Alternative Reporting Standard: When SEC registration is not required, companies generally must make certain information publicly available to satisfy the requirements of Rule 10b-5 under the Exchange Act and Rule 144(c)(2) under the Securities Act. The Alternative Reporting Standard may be satisfied through compliance with the OTC Pink Basic Disclosure Guidelines or the OTCQX U.S. Disclosure Guidelines.
- International Information Standard: Rule 12g3-2(b) under the Exchange Act ("Rule 12g3-2(b)") permits non-U.S. companies with securities listed primarily on a non-U.S. stock exchange to make publicly available to U.S. investors in English the same information that is made publicly available in their home countries as an alternative to SEC Reporting.
- Bank Reporting Standard: U.S. banks can leverage their existing financial reports and regulatory disclosures, and are able to provide that information in a format and location that is easily accessible to investors.

by meeting additional disclosure standards. The OTC Pink marketplace is further divided into OTC Pink Current Information, OTC Pink Limited Information and OTC Pink No Information to inform investors of the level of disclosure each company makes publicly available.[5]

Our tiered marketplace system incentivizes company disclosure, as most companies strive to reach the highest possible marketplace in order to best engage their investors. Companies can publish their disclosure directly to our website using the OTC Disclosure & News Service, and the information is publicly accessible for free on the company quote pages on our www.otcmarkets.com website. Companies that do not provide a full set of current information, or provide no information at all, are clearly marked as OTC Pink Limited Information or OTC Pink No Information, as applicable. OTC Pink Limited or No Information companies that engage in promotion or other activity giving rise to a public interest concern are marked with a "Caveat Emptor," or buyer beware flag that appears as a skull and crossbones symbol on the companies quote page.[6] Put simply, the problem with the availability of and access to ongoing current company information has largely been solved.

This letter addresses two main issues raised by the Proposal. First, we raise several points to consider prior to creating a public Form 211 repository, and present alternatives to FINRA acting as the sole operator of such a system. Second, we describe the potential negative impacts of a Form 211 periodic update requirement and discuss alternative approaches.

II. An Alternative to the FINRA Form 211 Repository

Providing public access to Form 211 information aligns with OTC Markets Group's core mission to create better informed and more efficient financial markets. OTC Markets Group is the operator of OTC Link ATS, the primary interdealer quotation system for broker-dealers to quote and trade securities that are the subject of a Form 211, and thus is uniquely positioned to provide Form 211 information to the public. In fact, FINRA has traditionally provided copies of filed Form 211s to OTC Markets Group for distribution to any interested parties. Through our OTC Disclosure & News Service, as well as our agreements with several major newswire services, companies already post financial disclosure and material news to their quote pages on our www.otcmarkets.com website. Having OTC Markets Group host a publicly available Form 211 information repository, independently or in conjunction with FINRA, would allow investors to access a wide spectrum of company information through a single, easily accessible source.

[5] A further description of the OTC Markets Group tiered marketplace system is available at http://www.otcmarkets.com/learn/otc-market-tiers.
[6] OTC Markets Group's Caveat Emptor Policy is available at http://www.otcmarkets.com/learn/caveat-emptor.

Having the applicable interdealer quotation system host the repository, as opposed to FINRA, may decrease the perception that the information has been vetted or verified by FINRA.

Before moving forward with any type of Form 211 repository, however, several practical questions need to be carefully considered and addressed. For example, publicly available Form 211s would include company information provided directly by broker-dealers potentially without the involvement of the subject company. This arrangement could result in a broker-dealer facing private litigation from investors alleging that the information is misleading. Similarly, a company could claim copyright infringement and demand that the information be removed from public view. We should outline a course of action for each of these scenarios before moving forward with a public Form 211 repository.

The host of the Form 211 repository should be prepared to remove the information at the request of the subject issuer or a third-party claiming that the information infringes its intellectual property rights. Generally speaking, the host should strive to operate in a manner that qualifies it as an "internet service provider" benefiting from the corresponding limitation of liability under the Digital Millennium Copyright Act ("DMCA")[7]. Under the DMCA, the host would have policies in place to handle claims of infringement, and to remove certain content when warranted. This would ensure an appropriate outlet for any claims of infringement while limiting the liability of the host.

The repository should also be hosted on a website commonly used to research securities and trusted by investors and other market participants. According to the web analytics firm Alexa, www.otcmarkets.com ranks significantly higher in global and domestic popularity than www.finra.org, with significantly more page views per visitor.[8] This indicates that the general public and broker-dealers are familiar and comfortable with the www.otcmarkets.com website as a source of security and company information.

The format of the information made available in the repository must also be carefully considered. To limit the potential liability of broker-dealers filing Form 211s, it may be better to make available only certain information from the Form 211, instead of a copy of the Form 211 itself. The value of a Form 211 repository would be the company information it provides, not the format of that information. An alternative format could be

[7] The U.S. Copyright Office Summary of the Digital Millennium Copyright Act is available at: http://www.copyright.gov/legislation/dmca.pdf

[8] The Alexa.com data relating to www.otcmarkets.com is available at http://www.alexa.com/siteinfo/otcmarkets.com;
The similar data relating to www.finra.org is available at http://www.alexa.com/siteinfo/finra.org.

derived from the company profile information published on www.otcmarkets.com for companies trading on the OTCQX, OTCQB and OTC Pink marketplaces.[9]

We firmly believe that the responsibility to provide and update adequate current information resides with the issuer and its affiliates. OTC Markets Group's OTCQX, OTCQB and OTC Pink tiered marketplaces system incentivizes company disclosure by allowing investors, broker-dealers and regulators to easily discern the quantity and quality of each company's disclosure. Our OTCQX marketplace highlights the best, investor focused companies that meet our high disclosure and financial standards. OTCQB, the Venture Marketplace, distinguishes smaller, growth companies that are current with their regulatory reporting requirements. We recently introduced OTCQB verification standards that companies must meet within 120 days of their fiscal year-end in order to remain on, or qualify for, OTCQB. OTCQX and OTCQB companies publicly post audited annual financial information, periodic disclosure, and material news on our website. OTC Pink Current Information companies also make current disclosure available on our website or otherwise remain current with their regulatory reporting requirements. The OTC Pink Limited Information and No Information categories serve to warn investors and broker-dealers when companies have failed to provide current information, indicating a higher level of investment risk.

Current Rule 15c2-11 already contemplates broker-dealers providing Form 211 information directly to OTC Markets Group prior to publishing their quotes. Rule 15c2-11(d)(1) requires a broker-dealer submitting a quotation on the basis of the enumerated items in paragraph (a)(5) of the rule to furnish the information to the applicable interdealer quotation system, which, in most cases, is OTC Link ATS. In practice, this means that OTC Markets Group could receive the Form 211 information directly from the submitting broker-dealer as a matter of course, which would allow us to efficiently and timely incorporate the Form 211 information to the company's quote page on our website.

OTC Markets Group also has the technical capability to establish a Form 211 repository within a matter of days, and maintain it over the long-term. With our OTC Disclosure & News Service technology, we can add Form 211 information to each company's profile with minimal development work. Company profile information on our website can be verified directly by the company, and a green checkmark accompanies those profiles that have been verified as updated within the prior 6 months. The company information already publicly accessible on our website and distributed to market data providers and financial portals, coupled with the process efficiency made possible by Rule 15c2-

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[9] An example of OTC Markets Group's company profile information is available at: http://www.otcmarkets.com/stock/OTCM/profile.

11(d)(1) and our existing technology, makes OTC Markets Group, either on its own or in combination with FINRA, a logical host for a repository of Form 211 information.

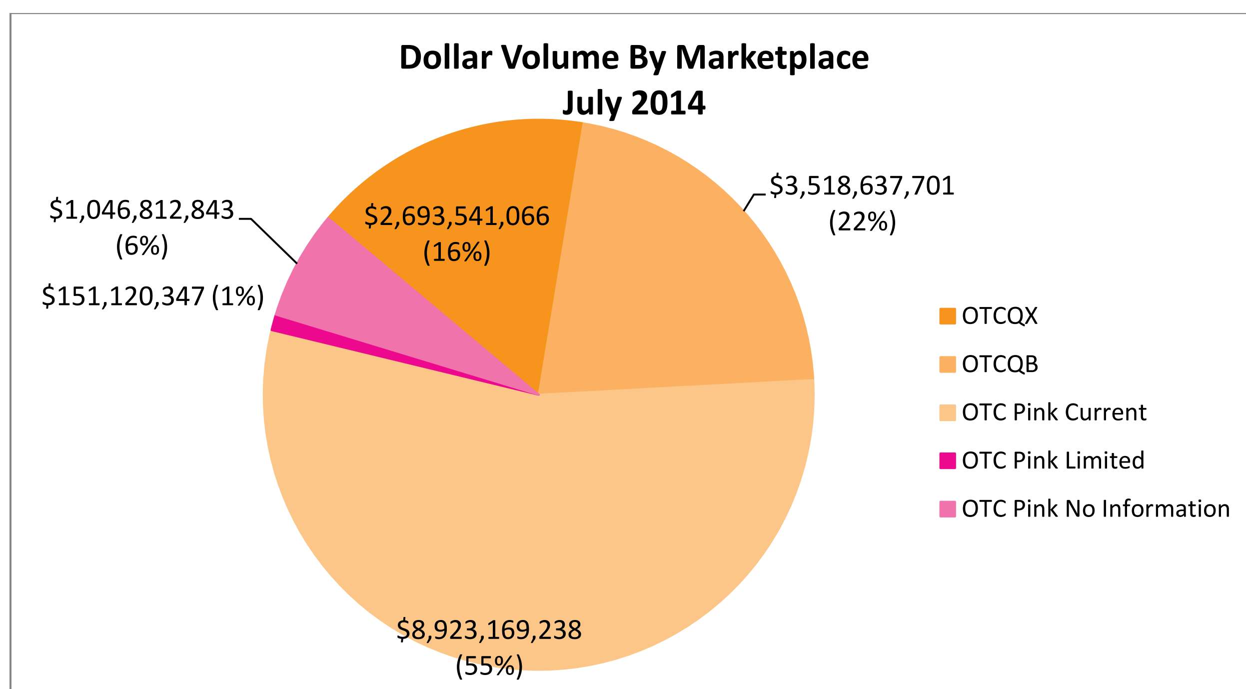
III. FINRA Should Not Adopt a Form 211 Periodic Update Requirement

The SEC's 15c2-11 Proposals, as well as others, have raised the question of whether broker-dealers should be required to periodically update Form 211s. The initial comments to the 1998 Proposal raise many important issues that remain relevant today, including the potential for a large decrease in public quotation activity, the potential for broker-dealer liability, "bad actor" company manipulation of secondary trading markets and investor disenfranchisement. FINRA must consider the full range of potential issues before moving forward with any type of periodic update requirement.

The goal of any FINRA reform relating to Form 211 information should be increased transparency, more liquid markets, and improved execution quality, and FINRA generally works to achieve that goal. A rule that places an increased burden on broker-dealers and potentially deters major market makers from publishing proprietary priced quotes would work against that goal. The best trading and investor experience flows from having multiple, competing priced quotes from well-capitalized broker-dealers. Unsolicited quotes provide significantly less benefit, and "Grey Market" trading, where no public quotes are available, provides the least public value.

FINRA should also consider whether a Form 211 periodic update would achieve its goal of increasing the availability of company information. Today, the majority of trading by dollar volume on our OTC Link ATS takes place in the securities of companies that make current information publicly available. Trading is done through specialized broker-dealers acting as market makers that are unaffiliated with the issuers they trade and that provide liquidity and execution services in publicly traded securities. These broker-dealers focus on efficiently meeting the supply and demand needs of other broker-dealers in order to provide best execution to investors. A company's OTCQX, OTCQB or OTC Pink marketplace tier, including strong risk warnings where warranted, makes it clear when a company has not made current information available.

The chart below shows that over 92% of the dollar volume of trading on our OTC Link ATS is in the securities of companies that have made current information publicly available on the OTCQX or OTCQB marketplaces, or the OTC Pink Current Information marketplace tier.



OTC Pink No Information securities priced at a "penny stock" level of less than $5.00 make up an even smaller portion of total trading by dollar volume. From January 1 through August 31, 2014, over $9 billion in total dollar volume of transactions were executed in securities designated as OTC Pink No Information. Securities priced below $5.00 accounted for approximately $500 million, or less than 6% of that total. When considering the over $160 billion in dollar volume executed in all OTCQX, OTCQB and OTC Pink securities through August 31, 2014, trading in Pink OTC No Information securities priced under $5.00 represents just 0.3% of the overall market.

As the data above indicates, not all OTC Pink No Information companies are microcap securities. For example, two of the top three highest trading OTC Pink No Information securities by dollar volume in 2014 are the common stock and warrants of Tribune Media Company, which has a market capitalization of over $6 billion.[10] The top ten OTC Pink No Information companies also include Harry & David Holdings Inc., which trades at over $140.00 per share[11], and Boswell (J.G.) Co., which trades at over $1,000.00 per share.[12] It would be a disservice to investors and the public markets to

[10] Tribune Media Company makes current financial information available on its website, but not through www.otcmarkets.com.

[11] See http://www.otcmarkets.com/stock/HARR/quote. Harry & David Holdings makes current financial information available on its website, but not through www.otcmarkets.com.

[12] See http://www.otcmarkets.com/stock/BWEL/quote. As noted in an article on Seeking Alpha, financial information on Boswell (J.G.) is made available only to shareholders. The Seeking Alpha article is available at http://seekingalpha.com/article/301449-jg-boswell-for-shareholders-only.

enact a rule that would prevent these companies from being publicly quoted and traded. More targeted controls can be implemented at the broker-dealer level, where firms may choose to restrict trading in companies that do not make current information available.

A. The Burden on Market Makers

The burden on broker-dealers should be given significant consideration. Filing a Form 211 is solely the responsibility of the broker-dealer wishing to publicly quote a security not otherwise available for public quoting. Once quoting is established, Rule 15c2-11 provides a "piggyback" exemption that allows multiple market makers to compete in the quoting and trading of a security, and gives non-affiliate investors the confidence in a continuing market for their shares.

FINRA's rules on establishing a public market are designed to ensure that the subject company has as little involvement as possible with the entire Form 211 process. While the filing broker-dealer must provide a basic set of information about the subject company, neither the company nor any individual investor may file the form. Under FINRA Rule 5250, broker-dealers may not receive any payment from an issuer, an affiliate of an issuer or a promoter in exchange for submitting a Form 211. In accordance with recent amendments to FINRA Rule 6432, each broker-dealer is required to specifically attest that it has not received any payment for filing a Form 211 in violation of Rule 5250.

In OTC Markets Group's comment letter responding to FINRA's amendments to Rule 6432,[13] we discussed the valuable investment banking service performed by broker-dealers when they file a Form 211. An initial Form 211 is often a smaller company's introduction to the public markets, and provides a platform for a company's future capital raising efforts. While investment banks are paid for bringing large companies to market through IPO's, the broker-dealers performing the valuable Form 211 service are prohibited from receiving any compensation.

The lack of compensation is compounded by the increased risk of civil litigation from disgruntled investors and considerable expense incurred by broker-dealers to comply with the information gathering and review requirements of Rule 15c2-11. A 1999 study conducted by PricewaterhouseCoopers,[14] and included in a comment letter to the SEC's 1999 proposal regarding Rule 15c2-11,[15] estimated that broker-dealers would

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[13] Our comment letter is available at http://www.sec.gov/comments/sr-finra-2014-011/finra2014011-1.pdf.

[14] The study is attached hereto in its entirety as Appendix A.

[15] The Comment Letter, from Orrick, Herrington & Sutcliffe, LLP, is available at http://www.sec.gov/rules/proposed/s7599/miller2.htm.

spend over $4,500 per issuer to research, update and file Form 211s. Using the U.S. Department of Labor's inflation calculator,[16] the cost would rise to over $6,500 per security today. At that rate, with 10,000 securities and an average of just under 9 unique market makers per security, the cost burden on firms becomes significant very quickly and it is easy to see why many broker-dealers would simply choose not to file Form 211s at all.

A market maker's role is very straightforward - provide best execution for investors and support an efficient and liquid market by standing ready to buy or sell a particular stock on a regular and continuous basis at a publicly quoted price. The market maker role is distinguished from other broker-dealer activities that create an affiliation with the issuer or create demand for securities, such as underwriting securities offerings, publishing research reports or recommending transactions. A market maker is neither an affiliate nor a demand creator. Rather, they price securities and supply liquidity based on investor demand. Markets are best served by having multiple independent market makers competing to provide investors with best execution and continuous liquidity.

Market makers should not be made to opine on the quality or merits of a company. Such a requirement would significantly alter the role of the market maker. The costly and inefficient process would cause many of the best-capitalized and most technologically advanced broker-dealers to stop trading small company shares, leading to less transparent, less liquid markets. Independent market makers without company affiliation are vital drivers of liquidity, and without them companies and investors would feel substantial negative impact without any benefit in return. At best, a Form 211 annual review would provide information considered stale shortly after filing.

B. Bad Actor Companies and Investor Disenfranchisement

A Form 211 update requirement may allow companies that are shareholder hostile to manipulate the market in their shares by withholding information. For example, if a company would prefer not to have a competitive public market for its securities so that it can buy out its minority investors at a discount, the company would cease providing information to the public and prevent a broker-dealer from accessing the information needed for a Form 211 update. If an investor is holding shares of a company that provides current information, but a broker-dealer still fails to file a Form 211 update, what happens to the value of the investor's shares? Will the prospect of a failure to file a Form 211 update artificially depress the share value of otherwise reputable companies?

[16] Available at http://www.bls.gov/data/inflation_calculator.htm.

The disconnect between companies, investors and the Form 211 process has the potential to disenfranchise investors in the event a Form 211 periodic update requirement is adopted. Under such a requirement, an investor that purchased a publicly available, freely tradable security could see the market for that security evaporate because a broker-dealer failed to update the Form 211. This differs from trading halts or suspensions that generally involve company misconduct, improper news dissemination or a public interest concern related to the issuer. Removing a security from the public markets because a broker-dealer failed to file a Form 211 update could occur even when the company is actively making current information publicly available. Losing market makers is an important concern for the smallest public companies with limited trading volumes to support any additional costs imposed on market makers.

Trading is similar to all other forms of commerce in that supply and demand plus access to information make for efficient, effective markets. In a transparent market with priced quotes an interested investor can view publicly quoted prices in a company's stock, and determine to make a purchase. The investor can then monitor the value of the shares by following publicly available broker-dealer quotes in the security. The company has the option to make public disclosure available through SEC reporting, the OTC Disclosure & News Service or another source, and the investor can use the company disclosure and public quote information to make intelligent decisions about whether and when to sell the shares. In the event a company ceases providing current public information, the investor would know that as well and could factor that into future investment decisions.

However, if a Form 211 periodic update was required, the applicable broker-dealer(s) could choose not to take on the additional burden, resulting in a cessation of publicly available quotation information on the company. The security could still trade with unsolicited quotes reflecting customer orders or on the Grey Market, but spreads would be wider or quotes would not be publicly available and trading would be less efficient. The investor would have a very difficult time determining the appropriate market value of the security, and the company would see its public trading market grind to a halt. In this scenario both the investor and the company would suffer significant harm through no fault of their own.

FINRA may best achieve its goal of creating better markets by joining with the SEC to develop more targeted approaches to achieving its good intentions without harming the market for all publicly traded small companies.

C. Regulatory Alternatives

Instead of focusing on broker-dealers performing periodic valuations and merit reviews of publicly traded securities in order to continue publishing quotations, FINRA may want to restrict the trading of company insiders and affiliates if the company does not make

OTC Markets Group Inc.
304 Hudson Street, 3rd Floor
New York, NY 10013
E info@otcmarkets.com
T +1 212 896 4400
W otcmarkets.com

current information publicly available. Another solution may be to take a cue from the options market and put checks in place to ensure an investor has an appropriate level of sophistication and risk tolerance prior to purchasing[17] securities without adequate current information publicly available. This would retain the valuable public price discovery made possible by the publication of broker-dealer quotes, while adding a level of investor protection monitored by broker-dealers.

FINRA can also work to reduce microcap fraud by increasing use of their existing trade-halt authority to quickly stop trading when there are indications of fraudulent promotion in a security. A halt of four days or greater in a security with questionable activity or regulatory concerns would require the filing of a new Form 211 before quoting could resume. Recently, the security symbol “CYNK” was the subject of a widespread spam and promotion campaign. At the time of the SEC’s 1998 and 1999 proposals to reform Rule 15c2-11, public information on a security like CYNK was unavailable. Due largely to the system of disclosure we have developed over the past 10 years, investors who followed the press or performed any independent research were easily able to ascertain that something was drastically wrong with the trading of CYNK shares. FINRA ultimately determined to halt trading in CYNK.

FINRA also already performs valuable periodic reviews of certain company information, such as its review of issuer’s corporate actions through the Electronic Issuer Company-Related Action Notification Form and the Electronic ADR Company-Related Action Notification Form. With FINRA now regulating corporate actions for OTC issuers, it already has insight into material corporate changes. Corporate action filings come directly from the company, which removes the broker-dealer as the middle man and reduces the potentially liability involved with filing a publicly available Form 211. The corporate action notification process provides yet another reason why a Form 211 periodic update requirement would not be beneficial or necessary.

FINRA and the SEC maintain rules providing additional safeguards for investors. Under the SEC’s Penny Stock rules, [18] broker-dealers are required to conduct additional due diligence and provide disclosure to a client before soliciting a transaction in these securities. FINRA Rule 2114, the “recommendation rule,” requires broker-dealers to review current financial statements and current material business information of many OTCQX, OTCQB and OTC Pink securities before recommending such a security to a

[17] Non-affiliate investors should be able to liquidate their positions if a company has ceased making current information publicly available.

[18] Securities Exchange Act Rules 15g-2 through 15g-9. The term “Penny Stock” is defined in Securities Exchange Act Rule 3a51-1. Generally, a Penny Stock is any security trading on OTC Link ATS at a price less than $5.00 per share, with net tangible assets less than $2 million and average revenue over the past three years of less than $6 million.

customer. The only securities exempt from Rule 2114 are those that (i) have at least $50 million in total assets and $10 million in shareholders' equity, (ii) are securities of a bank or insurance company, or (iii) have a bid price of at least $50 per share.

The interdealer quotation systems on which securities trade can also adopt practices designed to encourage company disclosure of adequate current information and warn investors when information is not available. OTC Markets Group has found success with our tiered marketplace system and Caveat Emptor policy. We regularly flag OTC Pink No Information companies with the Caveat Emptor flag when we see promotion occurring without adequate current information being made publicly available. Broker-dealers use the Caveat Emptor flag in our market data feeds to immediately place restrictions and risk controls on the trading of those securities. Our ability to track available information, distinguish companies based on the information they provide and build marketplace standards and compliance processes has drastically improved the level of ongoing current public information in securities for which Form 211s have traditionally been filed.

IV. Conclusion

We commend FINRA for the spirit behind the Proposal, and believe a discussion of the issues relating to the creation of a Form 211 information repository will benefit the marketplace as a whole. When and if a Form 211 information repository becomes a reality, OTC Markets Group is best positioned to host a repository that can efficiently provide the applicable information to the public. Investors should have the best possible opportunity to see all company information, rather than finding only stale data in a location where the company does not have the ability to provide updates.

In contrast, the potential for a Form 211 periodic update requirement for market makers raises a multitude of significant concerns without any corresponding benefit, indicating that it would do more harm than good. A Form 211 periodic update requirement would burden broker-dealers, and could lead to fewer market makers and limited trading markets in nearly all securities that are publicly traded on the basis of a Form 211. Investors may be wary of holding any security on which Form 211 update would be required, which could artificially depress prices, skew the operation of the public trading markets and make it difficult for smaller companies to go public and engage investors.

Through the Jumpstart Our Business Startups Act and other recent legislative initiatives, Congress has made clear its intent to revitalize the capital markets for small and growing companies. A Form 211 periodic update requirement would be a giant step backwards by moving trading out of the light and into dark, non-public markets. The small, growth-stage companies that largely rely on Form 211 filings to access the public markets would suffer the greatest harm, and the resulting lack of capital for these companies would negatively impact economic growth.

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We appreciate the opportunity to comment on the Proposal. Please contact me at (212) 896-4413 or dan@otcmarkets.com with any questions.

Very truly yours,

Daniel Zinn

General Counsel

OTC Markets Group Inc.

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
1301 K Street, NW, 800W
Washington DC 20005-3333
Telephone (202) 414 1000

Sam Scott Miller, Esq.
Orrick, Herrington & Sutcliffe, LLP
666 Fifth Avenue
New York, New York 10103

Dear Mr. Miller:

You have asked us to review the analysis and procedures that we believe could be viewed as constituting reasonable steps to be taken by a broker-dealer in seeking to comply with the requirements under the proposed amendments to Rule 15c2-11 (the "Rule") under the Securities Exchange Act of 1934, as amended, as proposed by the Securities and Exchange Commission ("SEC") in its release number 34-41110 (File S7-5-99) dated 25 February 1999 (the "Release").

We have performed this analysis of the proposed rule changes to assist you in advising your clients concerning operational and procedural compliance with the Rule, should the proposed amendments be adopted by the SEC. You have also requested estimates of the costs that a broker-dealer would incur in complying with these proposed rule changes.

The procedures that we have outlined are for discussion purposes only and we do not take any position regarding the necessity or sufficiency of any or all of the procedures that we have described herein, singly or as a whole, in constituting adequate compliance with the Rule, should the amendments in the Release be adopted by the SEC as proposed. This analysis is solely for your use in developing legal advice for your clients.

The Proposed Requirements

The Release basically seeks to impose additional information gathering, storage, and delivery obligations on broker-dealers that publish quotations on micro-cap securities in a quotation medium other than a national securities exchange or Nasdaq. The SEC asserts that these additional obligations are necessary to deter fraud in connection with securities that the SEC believes are more "prone to fraud and manipulation." In the Release, the SEC has also attempted to be helpful in providing examples of "red flags" – special events or other indications in the financial statements or other information about an issuer that the SEC has found in past enforcement actions may indicate that information about an issuer may be materially inaccurate.

Our methodology has been to analyze the Release for explicit and implicit requirements, including identifying those steps that logically result from the requirements contained in the Release. We used as a base for analysis the discussion by the SEC both in the main text of the Release and in the accompanying "Appendix: Guidance on the Scope of a Broker-Dealer's Review Under Current Rule 15c2-11 and the Amendments." The SEC included estimates of time required to accomplish some of the tasks to comply with the revised regulations as well as estimates of costs. Our review of these estimates is discussed below.

In attempting to create a framework around which a broker-dealer's compliance, legal and accounting staff could address the Release's requirements, we have identified five procedures and mapped out possible steps to accomplish those procedures. All of these steps are formulated for execution by trained professional staff, either internal staff of the broker-dealer or outside professionals. We anticipate and strongly recommend additional review by senior legal staff, either internal staff or outside counsel, especially with regard to questions or preliminary findings concerning "red flags" as the various steps are executed.

The procedures that we have outlined are:

I. Identifying the securities that would be covered under the Release.

II. Collecting and recording information for reporting and non-reporting domestic and foreign issuers.

III. Reviewing information for reporting and non-reporting domestic and foreign issuers.

IV. Submission of information to the NASD and system for retaining and supplying information to customers, prospective customers, other broker-dealers, and information repositories.

V. Periodic monitoring.

We have estimated the costs associated with undertaking each of these procedures. We have also estimated other cost considerations for initial and subsequent years that include training, revising policies and procedures, updating databases, and periodic auditing. Additional costs associated with this business should also be considered, including contingencies for litigation expenses that may arise from disputes with customers or others regarding information that the broker-dealer has given out (or not given out).

We note that the reproposed Rule would require a broker-dealer to obtain information regarding extraordinary financial events and disciplinary history of insiders only if the issuer does not meet several criteria, including being a reporting company, a non-reporting company that is willing to give a statement to the broker-dealer that there are no disciplinary problems or extraordinary financial events, or certain other categories of issuers that are not technically reporting companies under the SEC's rules, such as banks and insurance companies. (Section (c)(6) of the Rule). The Release requests comment regarding whether the SEC should require broker-dealers to obtain such additional information with respect to foreign non-reporting issuers. Paradoxically, the issue that the SEC was concerned about in that context seemed to be the cost of compliance.

We also note that, although the SEC states that there is no continuing duty on the broker-dealer to obtain and review issuer information outside of an annual review or other discrete quotation event as described in the Release (Appendix at Part III.C.), the Release itself sets up a situation in which a broker-dealer would arguably be drawn into such continuous monitoring. The Release requires that a broker-dealer review "any other material information, including adverse information, that comes to the broker-dealer's knowledge or possession before publication of the quotation. . . . [T]his information must be taken into account by the broker-dealer if it comes to the broker-dealer's knowledge or possession *at the time that a review is required*." (Release at Part III.C., emphasis added)

Although this language indicates that the broker-dealer needs to consider the material information only at review time (*i.e.*, yearly or upon an event triggering a review), when combined with the requirement that a broker-dealer "provide information upon request to any current customer, prospective customer, information repository, or other broker-dealer" (Release at Part III.D.), it becomes awkward for a broker-dealer to ignore information that could be deemed to be in its possession during the period between reviews. The practical business demands of providing good customer service (to say nothing about avoiding litigation exposure) argue against supplying information that may have become superseded by information in possession of the broker-dealer's personnel, regardless of when they obtained it.

Furthermore, what constitutes "in a broker-dealer's knowledge or possession" is problematic. Would the appearance of a news item on a Bloomberg, Reuters, or Dow Jones screen, which a broker-dealer's personnel likely look at every day, or even information in a micro-cap "chat room" on the Internet constitute "knowledge or possession"? In addition, what standard governs "materiality" in the context of this Rule? As a point of comparison, some of the red flags that the SEC has listed are not on their face "material" within the normal use of that term. A red flag might be revealed as material only after investigation, if fraud or questionable practices are discovered. For example, the "hot industry," "substantially similar offering documents," and "suspicious documents" red flags are very subjective criteria that are susceptible to acquiring more significance in a post-hoc analysis. What may not seem extraordinary when one does not have all the facts may look quite extraordinary with 20/20 hindsight.

To stay on top of these possibilities, the broker-dealer's staff would have to monitor continuously internal and external sources of information, unless the SEC provides a safe harbor to this Rule. The logistics of monitoring such information for dozens or even hundreds of issuers (or in some cases thousands), depending on the size of the broker-dealer's business and the personnel associated with that business, would be daunting.

Considering these factors, including the lack of clarity of the SEC's proposal, the exigencies of day-to-day customer service, and the impracticality of continuous monitoring from a cost and personnel perspective, we have built in a process of monitoring all issuers for material information on a limited basis once every quarter, to be timed with the issuance of Form 10-Q (or similar form) for reporting issuers and every calendar quarter for non-reporting issuers. This monitoring process would include running the issuer's and related insiders' names through databases to search for news articles and scanning these for red flags, events that may be material, or other questions. We recognize that this procedure may be conservative, but we believe that legal and compliance officers could conclude that they and their firms are best protected in the context of this Rule by instituting such a procedure.

The SEC's Time and Cost Estimates – Our Test

The SEC's time and cost estimates are at best overly optimistic, if not naïve. In reaching this conclusion, we conducted tests of the requirements of the reproposed Rule with respect to randomly chosen micro-cap issuers and we examined the cost assumptions in the Release as against the current business environment facing broker-dealers.

For example, the SEC estimates that "it will take a broker-dealer about 4 hours to collect, review, record, retain, and supply to the NASD the information pertaining to a reporting

issuer, and about 8 hours to collect, review, record, retain, and supply to the NASD the information pertaining to a non-reporting issuer." (Release at Part VIII.D.1.)

To test this statement, we undertook the task of gathering basic information about randomly chosen micro-cap issuers reporting to the SEC. We used several "testers." Two were junior professionals with post-graduate degrees, one of whom has served with a diversified financial services firm in an SEC/NASD compliance position. Both are very adept at research. It is likely that someone at this level or below at a broker-dealer (or outside professional services firm on an outsourcing basis) would do most of the initial research and screening of information under our procedures. The third tester was a supervisor-level director who has had more than 13 years' compliance and risk management experience on Wall Street with respect to market-making activities in listed and OTC securities at three firms (including one of the Street's largest clearing and prime broker firm). He knows many of the "tricks of the trade" regarding sources of information on OTC securities. It is likely that someone approximating his level of experience or below would be a supervisor reviewing the research.

Our "testers" focused on Procedures I and II and the preliminary steps for Procedure III – determining whether the Rule applies to the issuer, gathering information, and reviewing for any "red flags" that would require further investigation. We wished to determine, without contacting an issuer itself, how long it reasonably could take to conclude that a security is subject to the Rule, gather the required information, and scan available information for red flags that would indicate the need for further investigation.

Although we found that the SEC's time estimate for reporting companies is most likely adequate to perform most of the necessary tasks with respect to the "easiest" cases (*i.e.*, "clean" reporting issuers with uncomplicated financial statements that are clearly subject or not subject to the Rule on the basis of average daily trading volume ("ADTV") and other financial information and that have no red flags), the slightest complication increases significantly the amount of time necessary to comply with the Rule's requirements. For example, it is relatively easy to determine that ADTV for some issuers meets the threshold under the Rule by "eyeballing" daily volume and price charts, but for many other issuers a broker-dealer would have to perform calculations and make telephone calls to be able to arrive at the necessary conclusions. Possible red flags or other questions also significantly increase the time necessary for review.

For an uncomplicated reporting company audited by a "Big Five" firm,[1] our testers found that two hours were required merely to retrieve information from databases such as EDGAR to determine whether or not the issuer is subject to the Rule (including "eyeballing" presentations of relevant trading and financial information), search for recent registration statements and other pertinent documents, download documents for further analysis and subsequent review by supervisors, review the annual report, and check for red flags. These two hours did not include the search for material adverse information or for other information that a broker-dealer would be required to find and document under the Rule, including

[1] An example that we identified at random was a reporting company under section 12(g) of the Exchange Act that manufactures high-technology equipment for medical, scientific, and research applications. Its stock is quoted for less than $0.50 per share and trades infrequently, and the issuer has assets of less than $10 million. It is audited by a Big Five firm and seemed to our testers to have no red flags, other than that it is in what some might view as a "hot industry." This arguably is the simplest scenario of issuers subject to the Rule.

affiliations with the issuer, or other administrative steps necessary for compliance and documentation thereof. Red flags or other questions would have required substantially more time to resolve, including conferences among the reviewing parties, discussions with the issuer and its agents (including auditors and counsel), documentary support, and supervisory review.

We also found that the length of time required to review for material adverse information differs significantly from company to company, depending on the number of articles or other items found about an issuer in various information databases,[2] the nature of the material found, and the questions related thereto. In addition, administrative time must be factored into the time allotted per issuer, as well as the periodic review that we have suggested should be conducted regarding these issuers under the proposed Rule's framework.

Thus, we concluded from our testing that the total time necessary to comply with the Rule as proposed will be substantially more than the four hours for most reporting companies estimated by the SEC.[3] Similarly, based on this experience with reporting companies, we concluded that the amount of time required to comply with the proposed Rule for most non-reporting companies will be substantially more than the eight hours estimated by the SEC. We have indicated our estimates for time to complete the various procedures later in this letter.[4]

Moreover, the cost estimates in the Release do not reflect current market realities and the experience level of personnel needed to do those tasks. The SEC has used for its cost estimates an "average cost of $40 per hour (based on a *blended compensation rate* for clerical and supervisory compliance staff) to obtain and review the necessary information required by the Rule." (Section VI.B., emphasis added) Footnote 96 to this quoted statement specifies that "[t]he cost estimate assumes that clerical staff are paid at an average rate of $15 per hour and supervisory compliance staff are paid at an average rate of $100 per hour. The blended compensation rate assumes that 70% of the time is clerical and 30% is supervisory compliance . . . ." We note that a principal's review is required under NASD Rule 6740 for any filings under this Rule.

Because overhead, employer-related taxes, health coverage, social security, real estate, training, and other costs to the broker-dealer typically increase the costs of an employee in the financial services industry by more than 2½ times the employee's stated wages,[5] the SEC

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[2] In fact, local sources of information (*e.g.*, local newspaper websites and other sources not necessarily readily available through "national" databases) should be searched to provide reasonable coverage for these micro-cap issuers as they often do not attract national attention.

[3] Because of the imprecision and subjectivity of red flags as described in the Release, we did not attempt to conduct a statistically valid sampling of all micro-cap issuers to draw conclusions as to what percentage may raise red flags. Our conclusions are derived from the issuers that we examined at random.

[4] The estimated times depend very much on the training and skill level of the persons performing the investigations. Our time estimates presume the skill level of our testers, who are well-trained and proficient at research and analysis. Staff that are not so proficient, such as the evidently lower levels ("clerical" staff) that the SEC's cost estimates imply (discussed below), will likely spend more time during the initial review and require more supervision, correction, and re-work by supervisors than staff with the calibre of our testers. Thus, the time needed by workers of the skill level suggested by the SEC and their supervisors will likely be more than our estimates.

[5] Common multipliers, including those used by U.S. government agencies and international organizations, formulated to capture the fully loaded variable and fixed costs of an employee vary

has not taken into account in its cost estimates a large component of the employer's cost. Stated another way, by not taking into account the entire cost to the employer of its employee's time and using a $15 per hour total figure, the SEC's cost estimates reflect the efforts of an employee earning less than minimum wage doing 70% of the compliance work with respect to this Rule. The SEC also ignores collateral costs of its proposal: for example, the time and effort expended on this process will necessarily mean that other compliance duties will be postponed or be curtailed or that it will be necessary to hire and train additional staff.

Of course, more important than the SEC's cost numbers themselves is its underestimation of the level of experience and expertise, as reflected by compensation, that the SEC has assigned to these various tasks. The kinds of judgements that are demanded by the reproposed Rule cannot be delegated to clerical workers, and should properly be assigned to trained professional staff, working closely with more senior legal/compliance officers. [6]

This is especially appropriate in the case of the "red flag" analysis. Indeed, the SEC states only that the red flags it lists are "examples" that are "not exhaustive." Some red flags that the SEC lists are extremely subjective and could require close scrutiny, such as "hot industry" micro-cap stocks, "altered financial statements," "extraordinary gains in year-to-year operations," and "substantially similar offering documents from different issuers."[7] The SEC's discussion of red flags is very experience-based – the Release repeatedly cites SEC enforcement cases – and thus implies that experience enhances the ability to spot red flags. Thus, in reviewing for red flags, staff would be expected to inform their investigation with the knowledge and experience that they will have gained over a period of years of having been in the "real world." Moreover, in any case, experienced personnel are necessary to review for fraud, especially because issuer fraud is often sophisticated and well disguised. Because of the importance that the SEC obviously places on the examination for red flags in the context of this Rule (in fact, it arguably is the central rationale for the Release), it would be inappropriate and extremely inadvisable for a broker-dealer to delegate the search for red flags to a clerical staff level. To suggest that clerical staff are sufficient for such a review slights the often difficult challenge of discovering well-concealed fraud that is part of a sophisticated scheme.

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between 1.5 and 3.5 times an employee's salary, depending on bonus, fringe benefits, the amount of technical and other administrative support the employee is provided, the cost of real estate and square footage provided an employee, special equipment or other services, training, and other such overhead costs. The broker-dealer community generally would be on the higher end of this scale because of the higher cost of doing business in the nation's financial centers.

[6] That the proposed review requirements would necessitate the employment of experienced professionals is confirmed by the Commission's own procedures for reviewing issuer disclosure information. As a general matter, issuer filings reviewed by the Commission's Division of Corporation Finance are first assigned to an accountant and a staff attorney or financial analyst, and, after a second level of review by senior level staff, may be referred to specialists within the Division of Corporation Finance (such as mining or petroleum engineers) for additional review. *See, e.g.*, Testimony of Michael R. McAlevey, Deputy Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, before the Subcommittee on Energy and Power, Committee on Commerce, U.S. House of Representatives, March 10, 1999.

[7] Because the SEC's description of "red flags" lacks precision, experienced staff is needed to apply the Rule meaningfully and consistently. Indeed, large multinational companies such as Novartis, Citigroup (especially the Travelers side), and Lockheed Martin could also be said to have "red flags" because of name change, merger, and "hot industry" characteristics.

Our Methodology

Our approach to outlining procedures for compliance with this proposed rule change and quantifying the costs with respect thereto has been to hypothesize a broker-dealer that publishes quotations in 250 micro-cap stocks that are not exempt under the Rule, 150 of which are reporting (120 of which are domestic and 30 foreign) and 100 of which are non-reporting (80 of which are domestic and 20 foreign).[8] Such a broker-dealer would have a medium-sized book of this business – not among the largest publishers of OTC quotations, which have 500 quotations and more, and not the smallest on the Street, which may publish only a few quotations.

We have assumed that the internal legal, compliance, financial, and auditing functions of the broker-dealer would perform the procedures that we have outlined, with the participation of more senior legal department officers or outside counsel when appropriate. In particular, senior legal advice would be necessary, at a minimum, in the identification and analysis of red flags.

Our approach seeks to take into account not only the actual time and materials needed to perform the various procedures, but also the collateral and opportunity costs of these efforts. To quantify the hourly cost of personnel devoted to these tasks, we have taken as a model the hourly fees charged by professional services firms for outsourced compliance projects. These fees reflect the complete market rate for qualified talent, including overhead and other non-salary costs on an hourly basis, and the opportunity cost in devoting resources to these procedures.

Thus, we have applied estimated average hourly standard rates of $159 for a junior financial, legal, or compliance professional and $300 for a managerial-level officer (or a senior associate in a law firm) as the basis for our estimates.[9] Where more senior-level experience is required, as in the consideration of red flags, we have used a $400 average hourly rate to denote director/partner supervision. Of course, depending on the nature of the question and the complexity of the situation that would affect the resources used, these average hourly

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[8] This 80/20 percent split between domestic and foreign issuers that we have hypothesized for reporting and non-reporting issuers would likely change in the coming years, with the foreign component rising because of the potential growth of securities markets for micro-cap companies in Europe and elsewhere. EASDAQ, the consolidation and linkage of European securities markets, and the adoption of the euro are expected to increase the available capital pool and liquidity in Europe for smaller issuers.

[9] *See* PRICEWATERHOUSECOOPERS' 1998 LAW DEPARTMENT SPENDING SURVEY MANAGEMENT REPORT, an extensive survey of corporate legal departments nationwide. The survey found that $159 was the median fully loaded hourly cost (total inside spending per attorney, excluding value or stock options or other long-term compensation, divided by average annual "chargeable" hours per attorney) for a legal staff member in a corporate law department. Of course, costs for more senior officers are higher. This survey covers legal departments of corporations in all industries; lawyers in securities firms generally are paid higher salaries than their counterparts in other industries, even among other financial services firms. However, we have used the more conservative $159 figure. Our informal survey of billing rates for junior associates in law firms with significant broker-dealer practices found that rates begin around $180 per hour plus expenses.

rates could be higher.[10] We have included in this hourly rate overhead costs that outside professional services firms would commonly bill separately, such as telephone, telefax, and copying charges.

In estimating the hours that would be required to perform the procedures, we have used the results of our tests described above as well as our experience in compliance matters and research. The nature of the issuer significantly affects the amount of time necessary to discover information. Information regarding non-listed micro-cap issuers generally is not so prevalent and is more difficult to obtain than that regarding listed issuers. Likewise, non-reporting micro-cap issuers present even more difficult investigatory and analysis challenges, because much less of the information is readily available in public and thus must come from the issuer itself.

In addition, the quality control aspect of these procedures should not be discounted. During our testing, for example, our testers found that the human error factor can add significantly to the time required to complete a procedure.[11] For example, one tester made the mistake of assuming that simply because a database indicated that an issuer had filed documents with the SEC that were available through EDGAR that it is a reporting company.[12] As is relatively common with micro-cap issuers, this particular issuer had been a reporting company, was delisted from Nasdaq because it no longer met listing criteria, and subsequently ceased being a reporting company after filing a Form 15. Of course, under the Release's Appendix, these facts would be red flags indicating that further investigation of the company is necessary.

We also have considered in our analysis that "practice makes perfect" and that, over time, people assigned to these tasks will become more proficient at them and thus the time required to perform the tasks should generally decrease. On the other hand, countervailing realities of the workplace serve to increase the amount of time necessary to complete these tasks, including the human error factor, employee turnover (especially among junior-level employees), the effect that unpredictable workload demands have on quality, inconsistencies in training and ability of the employees performing the tasks, and the constantly changing universe of micro-cap issuers. Hence, we have found that supervisory personnel will need to play an active role in these procedures and in reviewing work product, especially during peak review times, to ensure quality and consistency.

In practice, certain times of the year will engender heavier volumes of work, especially for those companies with fiscal years ending with the calendar year. Domestic and foreign issuers will be analyzed at different times during the year, not only because of differing year ends, but also because the reproposed Rule specifies that domestic issuers must be analyzed within four months of fiscal year end and foreign issuers within seven months of fiscal year end. Depending on which issuers are quoted by the broker-dealer and when their fiscal years end, there may or may not be times of heavy workload when extra staff and supervisors will be needed to handle the volume. This may add to the cost and complexity of the overall task

[10] These rates reflect generalized standard hourly rates in effect in financial centers in the United States at professional services firms that in our experience would be hired by securities firms for outsourcing projects and compliance matters. In our experience, these rates are conservative.

[11] We did not include this time in arriving at our estimates for time required to complete the various procedures. However, it indicates that, as is true for all estimates, unforeseen events commonly lengthen the actual time for completion of projects beyond the estimated time.

[12] This incident also indicates the complexity of relying on possible automation of this step – appearance in EDGAR of documents does not necessarily indicate a reporting issuer.

and to the error rate. Outsourcing in those instances may be the most cost-effective alternative.

Our Estimates of Time and Cost

We have identified the following procedures, and the estimated annual costs associated therewith:

Procedure I: Identifying the securities that would be covered under the Release.

This procedure is designed to identify the OTC securities for which the broker-dealer publishes quotations and sort for those that are subject to the Rule. The test described in the Release is disjunctive in that if the OTC security meets any one of the criteria for exemption, the OTC security does not fall within the Rule. We have separated reporting from non-reporting securities because the level of effort that the broker-dealer's staff would have to devote to each would be markedly different. The statistics for reporting issuers are much more readily available – those for non-reporting companies likely would have to be found by contacting the issuer directly and its market maker, if any. Likewise, the availability of information regarding foreign issuers, especially outside of North America, can be more problematic than that of domestic issuers. Several different databases[13] as well as telephone calls and faxes will be necessary for non-reporting issuers, foreign and domestic.

Step #1: Create a listing of all securities for which the broker-dealer publishes quotations in a quotation medium other than a national securities exchange or Nasdaq.

Step #2: From the listing generated in step #1, create separate lists for reporting and non-reporting issuers.

Step #3: Create two sub-categories of domestic and foreign private issuers within the reporting and non-reporting lists.

Step #4: For the issuers in the listing created in item #3, obtain current financial statements and securities price and trading information for the past six months and perform the following tests to determine whether any issuers satisfy any one of the following exemptions from the proposed Rule:

a) Securities with a worldwide ADTV of at least $100,000 during each month of the six full calendar months immediately preceding the date of publication of a quotation, and convertible securities where the underlying security satisfies this threshold; ADTV thresholds will be calculated by developing a process or program, for each issuer, that multiplies the

[13] *E.g.*, Bloomberg, Reuters, Lexis/Nexis, Westlaw, EDGAR, local newspaper websites, as well as less-reliable Internet services.

number of shares by the price in each trade during that period. This process will be documented to facilitate a supervisory review.

b) Securities with a bid price of at least $50 per share at the time the quote is published; this process will be documented to facilitate a supervisory review.

c) Securities of issuers with net tangible assets in excess of $10,000,000 as demonstrated by audited financial statements in accordance with the provisions of Rule 2-02 of Regulation S-X. Documents identifying the basis for determining net tangible assets must be saved to facilitate a supervisory review of this process.

d) Non-convertible debt and non-participatory preferred stock; and

e) Asset-backed securities that are rated as investment grade by at least one nationally recognized statistical rating organization.

Step #5: Create a report that summarizes all exempted securities and basis for satisfying the issuer exemptions, identified in item #4, to the reproposed Rule 15c2-11.

Step #6: Conduct a supervisory review of all phases of Procedure I to ensure accuracy and completeness.

Procedure I Cost Analysis

Steps 1 through 3 are preliminary steps to be taken to identify and sort for reporting and non-reporting issuers and domestic and foreign. The current listing of documents, if any, filed on EDGAR for each issuer must be viewed to determine reporting status. Step 4 requires some research and calculation to determine the applicability of any of the exemptions with respect to each issuer. Because some of the information to be gathered may not be readily available and might be obtained only through telephone calls and faxes, we have estimated that 1 hour per domestic and foreign reporting issuer and 2 hours per non-reporting domestic and foreign issuer will be necessary to gather the required information and to make the necessary calculations and conclusions. An additional 6 minutes per issuer has been allocated for supervisory review of the work performed in Procedure I. Although the time required may decrease somewhat in subsequent years because the broker-dealer’s staff would be building off of previous work, all of these procedures will have to be undertaken at each review period because exemptions may not continue to apply year after year and new developments must be taken into account.

STEPS 1-3

All Issuers (250)	27 hours total at $159 avg. rate per hour (research, print out, and examine list of filings for 250 issuers at 0.1 hour per issuer plus 2 hours for creation of lists and documentation in Steps 1-3)	$ 4,293

STEP 4

Reporting Issuers (150)[14]		
• Domestic (120)	1 hour each at $159 avg. rate per hour	$ 19,080
• Foreign (30)	1 hour each at $159 avg. rate per hour	4,770
Non-Reporting Issuers (100)		
• Domestic (80)	2 hours each at $159 avg. rate per hour	25,440
• Foreign (20)	2 hours each at $159 avg. rate per hour	6,360

STEP 5

All Issuers (250)	2 hours total at $159 avg. rate per hour	$ 318

STEP 6

Supervisory Review of the foregoing analysis: All Issuers (250)	0.1 hour for each issuer at $300 avg. rate per hour	$ 7,500

<u>Miscellaneous</u>

Database research costs[15]		
• Reporting (150)	0.3 hour each at $4 per minute (retrieval of SEC filing information, financial and stock trading information)	$ 10,800
• Non-reporting (100)	0.3 hour each at $4 per minute	7,200
TOTAL (250 issuers)		**$ 85,761**

[14] We found that the time necessary to perform the procedures in step 4 was a low of approximately 45 minutes for a reporting issuer that clearly did not qualify for the ADTV, net tangible asset, bid price, or fixed income investment grade exemptions. Review time will be much higher for companies that have higher volume approaching the ADTV threshold or for which a net tangible asset calculation is necessary, and even more review time will be necessary for non-reporting companies.

[15] This cost reflects basic rates of commonly used and cited legal, news, and financial electronic database research services. Although searching Internet websites can be much less costly, we note that, in our staff's experience, this method of researching information has data integrity issues and is subject to delays and technical difficulties. One example is accessing EDGAR itself via the SEC's website, which is notoriously slow and prone to technical difficulties.

Procedure II: Collecting and recording information for reporting and non-reporting domestic and foreign issuers.

This procedure is designed to gather current information regarding reporting issuers (Securities Act documents and periodic Exchange Act reports) as well as information regarding non-reporting issuers. Supplemental and other material information, including adverse information, that has come into the broker-dealer's knowledge or possession is also gathered during this procedure. Staff performing this procedure would contact both internal sources of information as well as external databases and the issuer itself. For foreign issuers, time zone differences and language issues must be factored into the time estimates. For non-reporting issuers, the information required in section (c)(6) of the Rule must be obtained through independent research if the issuer does not provide a certification that none of the items in section (c)(6) apply to the issuer. We anticipate that the staff would attempt to verify with the issuer the information contained in the certification.

Step #1: Identify and document all issuers that have conducted a recent public offering either registered under the Securities Act of 1933 (the "Securities Act") or effected pursuant to Regulation A under the Exchange Act.

Step #2: Obtain a copy of the prospectus or offering circular for the issuers identified in Step #1.

Step #3: Identify and document all issuers that file reports with the Commission pursuant to Sections 13 or 15(d) of the Exchange Act.

Step #4: Obtain a copy of the all most recent annual or semi-annual and any subsequent quarterly and current reports for the issuers identified in Step #3 or, if none is yet available, the issuer's prospectus or registration statement.

Step #5: Identify and document all issuers that are not required to file reports with the Commission pursuant to Sections 13 or 15(d) of the Exchange Act and that are banks or savings associations or that are insurance companies exempt from section 12(g) of the Exchange Act.

Step #6: With respect to those issuers identified in Step #5, obtain a copy of the most recent annual and any subsequent reports filed with the appropriate federal or state banking authority with respect to banks or savings associations or the most recent annual statement filed with state insurance commissions with respect to insurance companies.

Step #7: Obtain and document supplemental information (*e.g.*, trading suspension orders and chapter 11 filings) and any other material information, including adverse information, that has come to the broker-dealer's knowledge.

Step #8: Identify and document any significant relationship, such as whether the broker-dealer has any affiliation with the issuer or arrangements to receive any consideration to publish the quote and whether the quote is being published on behalf of another broker-dealer or the issuer, any insider or large shareholder.

Step #9: For non-reporting issuers, obtain, document, and verify with the issuer the information required by section (c)(6) of the Rule, including a statement from the issuer that no insider has been subject to any disciplinary action and that no material event enumerated in the Rule has taken place.

Step #10: Conduct a supervisory review of all phases of Procedure II to ensure accuracy and completeness.

Procedure II Cost Analysis

The cost estimates for this procedure are subject to much variation because of the difficulty in predicting with any certainty whether any material, including adverse, information will be found with respect to any issuer or how many non-reporting issuers will not provide the section (c)(6) certification. Our approach to these estimates is not to assume the worst case, but to assume that questions will arise during research and will be resolved. In addition, with respect to non-reporting issuers, we have assumed that section (c)(6) certificates will be provided and that staff will take limited steps to verify the information.

Steps #1-6		
Reporting Issuers (150)	0.1 hour each at $159 avg. rate per hour	$ 2,385
Steps #7-9		
Reporting Issuers (150)		
• Domestic (120)	2 hours each at $159 avg. rate per hour	$ 38,160
• Foreign (30)	3 hours each at $159 avg. rate per hour	14,310
Non-Reporting Issuers (100)		
• Domestic (80)	3 hours each at $159 avg. rate per hour	38,160
• Foreign (20)	4 hours each at $159 avg. rate per hour	12,720
Step #10		
Supervisory Review of the foregoing analysis: All Issuers (250)	0.25 hour for each issuer at $300 avg. rate per hour	$ 18,750
Miscellaneous		
Database research costs		
• Reporting (150)	0.75 hour each at $4 per minute (retrieval of SEC filing information, financial and stock trading information, other material information regarding the issuer)	$ 27,000
• Non-reporting (100)	1.5 hour each at $4 per minute (retrieval of financial and stock trading information and other material information)	36,000
TOTAL (250 issuers)		**$ 187,485**

Procedure III: Reviewing information for reporting, non-reporting, domestic and foreign issuers.

This procedure primarily concerns the review of information gathered in the previous procedures for red flags and the resolution of any questions or possible red flags through additional research and through discussions with the issuer and others, including other broker-dealers.

Step #1: Identify and document the source (*e.g.,* EDGAR, commercial database, issuer, or another broker-dealer) of information gathered for all reporting issuers and document the reasonable basis for determining whether the source is reliable.

Step #2: Identify and document the source (*e.g.,* commercial database, news service, issuer, or another broker-dealer) of information gathered for all non-reporting issuers and document the reasonable basis for determining whether the source is reliable.

Step #3: Create a checklist to examine all materials gathered in Steps #1 & #2 to ensure that all information required by the Rule has been obtained.

Step #4: Analyze each issuer for which red flags were identified in Procedure II according to a checklist of the following red flags, the presence of which (or in some cases even the suspicion of which) would subject the issuer's information to more intense research and scrutiny, including a higher-level senior review:

1) The basis for all SEC trading suspensions;
2) The basis for all foreign regulatory trading suspensions;
3) Concentration in ownership of freely tradable securities;
4) Large reverse stock splits and issuance of large amounts of stock to insiders;
5) An issuer in which assets are large and revenue is minimal without any explanation.
6) The principal component of an issuer's net worth is an asset wholly unrelated to the issuer's line of business;
7) Shell corporation's acquisition of a private company;
8) Offerings under Rule 504 of Regulation D where one or more of the following are present:
    - Little capital is raised in the offering and there appears to be no business purpose, except to provide some shareholders with free-trading shares;
    - The offering is preceded by an unregistered offering to insiders or others for services tendered at prices well below the price in the subsequent offering;
    - Sales immediately following the Rule 504 offering are at substantially higher prices than those paid in the Rule 504 offering; or
    - A shell company and an operating company merge, which results in the operating entity becoming the surviving entity.

The surviving entity goes "public" by issuing shares pursuant to Rule 504.

9) A registered or unregistered offering raises proceeds that are used to repay a bridge loan made or arranged by the underwriter where:
   - The bridge loan was made at a high interest rate for a short period;
   - The underwriter received securities at below-market rates prior to the offering; and
   - The issuer has no apparent business purpose for the bridge loan.
10) Significant write-up of assets upon a company obtaining a patent or trademark for a product;
11) Significant asset consists of OTC Bulletin Board or Pink Sheet companies;
12) Assets acquired for shares of stock when the stock has no market value;
13) Significant write-up of assets in a business combination of entities under common control;
14) Unusual auditing issues (*e.g.,* auditors refuse to certify financial statements or they issue a qualified opinion or a change of accountants);
15) Extraordinary items in notes to the financial statements (*e.g.,* unusual related party transactions)
16) Suspicious documents (*e.g.,* inconsistent financial statements, altered financial statements or altered certificates of incorporation);
17) Broker-dealer receives substantially similar offering documents from different issuers with the following characteristics:
   - The same attorney is involved;
   - The same officers and directors are listed; and/or
   - The same shareholders are listed.
18) Extraordinary gains in year-to-year operations;
19) Reporting company fails to file an annual report;
20) Disciplinary actions against an issuer's officers, directors, general partners, promoters, or control persons;
21) Significant events involving an issuer or its predecessor, or any of its majority owned subsidiaries:
   - Change in control of the issuer;
   - Substantial increase in equity securities;
   - Merger, acquisition, or business combination;
   - Acquisition or disposition of significant assets;
   - Bankruptcy proceedings; or
   - Delisting from any securities exchange or the Nasdaq Stock Market.
22) Request to publish both bid and ask quotes on behalf of a customer for the same stock;
23) Issuer or promoter offers to pay a "due diligence" fee;
24) Regulation S transactions of domestic issuers;
25) Form S-8 stock;
26) "Hot industry" micro-cap stocks;
27) Unusual activity in brokerage accounts of issuer affiliates, especially involving "related" shareholders;
28) Companies that frequently change names;

29) Companies that frequently change their line of business.

Procedure III Cost Analysis

As with the cost estimates for Procedure II, the cost estimates for Procedure III are subject to much variation depending on whether or not red flags are found. Given the breadth of, and lack of clarity in, the Release's discussion of red flags and based on our limited testing, we believe that it is reasonable to assume that questions will arise with at least two-thirds of the micro-cap issuers regarding possible red flags. We note that this likely is a conservative estimate, and we believe that staff reviewing issuer information in the context of this Rule should be cautious and be encouraged to pursue questions. Of course, almost all of these questions will be resolved without any serious issues left unresolved (judging from the SEC's own enforcement statistics). However, substantial time will be expended in this effort. Some questions regarding possible red flags may be relatively easy to dispose of, while others may require much more effort. Thus, the costs actually experienced in practice could be much greater than those reflected in these estimates. The time estimates include preparation of memoranda documenting the reviewers' actions.

Steps #1-3

Reporting issuers (150)	2 hours total at $159 avg. rate per hour	$ 318
Non-reporting issuers (100)	8 hours total at $159 avg. rate per hour	1,272

Step #4 – Review for Red Flags; No significant issues found ("Clean Companies")[16]

Reporting Issuers (50)		
• Domestic (40)	1.5 hours each at $159 avg. rate per hour	$ 9,540
• Foreign (10)	2 hours each at $159 avg. rate per hour	3,180
Non-Reporting Issuers (30)		
• Domestic (24)	1.5 hours each at $159 avg. rate per hour	5,724
• Foreign (6)	2.5 hours each at $159 avg. rate per hour	2,385

Step #4 – Review for Red Flags; Questions require resolution[16]

Reporting Issuers (100)		
• Domestic (80)	3 hours each at $159 avg. rate per hour	$ 38,160
• Foreign (20)	4.5 hours each at $159 avg. rate per hour	14,310
Non-Reporting Issuers (70)		
• Domestic (56)	5 hours each at $159 avg. rate per hour	$ 44,520
• Foreign (14)	7 hours each at $159 avg. rate per hour	15,582

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[16] We have assumed that one third of the issuers will have no significant issues found on review and that two thirds will require more investigation to resolve questions raised. Thus, 50 of the 150 reporting issuers and 30 of the 100 non-reporting issuers will have no significant questions found that will require resolution.

Supervisory review and guidance in resolving questions: All Issuers (250)	1.0 hour for each issuer at $300 avg. rate per hour	$ 112,500
Guidance in resolving questions relating to red flags (190 issuers: 100 reporting and 90 non-reporting)	0.75 hour for each issuer at $400 avg. rate per hour	57,000

Miscellaneous

Database research costs

• Reporting (150 issuers)	1 hour at $4 per minute (retrieval of SEC filing information, financial and stock trading information)	$ 36,000
• Non-reporting (100 issuers)	1.5 hour at $4 per minute	36,000
TOTAL (250 issuers)		**$ 376,491**

Procedure IV: Submission of information to NASD; Information retention; Supplying information to customers, prospective customers, other broker-dealers, and information repositories.

This procedure provides for the steps necessary to ensure that the information gathered pursuant to the Rule as amended would be submitted to the NASD in a timely manner and in a form acceptable to it. The importance of this final procedure should not be minimized, because a final check of the information package, as well as a final call to the trading desk handling the quotation of the issuer and a quick search through a news database regarding the issuer, may turn up material information "in the knowledge or possession of the broker-dealer" that may not have been reflected in the information assembled in the package and would require repetition of a number of the steps.

Step #1: Assemble information collected with respect to each issuer and prepare standard transmittal form to NASD.

Step #2: Supervisory review to ensure package completeness and to do final quality check to determine if the broker-dealer has "a reasonable basis for believing that the information is accurate in all material respects and was obtained from reliable sources."

Step #3: Final check regarding any other material information not in the information to be submitted to the NASD, "including adverse information, that [has come] to

the broker-dealer's knowledge or possession before publication of the quotation," including a final call either to the trading desk handling the quotation of the issuer and a quick search through a news database regarding the issuer.

Step #4: Record the date the specified information was reviewed and the person at the broker-dealer responsible for compliance with the Rule.

Step #5: Send package to NASD.

Step #6: Establish a storage database to ensure that issuer information is retained for a period of not less than three years.

Step #7: Establish a system for efficient retrieval so all gathered information is promptly available upon request to customers, potential customers, broker-dealers, or information repositories.

Procedure IV Cost Analysis:

All Issuers (250)	1 hour each at $70 avg. rate per hour for clerical staff	$ 17,500
	0.5 hour each at $159 avg. rate per hour (final check internally and in databases regarding material information)	19,875
Supervisory Review of the foregoing analysis: All Issuers (250)	0.1 hour for each issuer at $300 avg. rate per hour	7,500
Miscellaneous		
Database research costs	0.25 hour at $4 per minute for 250 issuers	15,000
Cover form/letter preparation	0.5 hour at $70 per hour for 250 issuers	8,750
Postage for NASD submission	$1 each for 250 issuers	250
TOTAL (250 issuers)		**$ 68,875**

Procedure V: Periodic monitoring of material information that may be deemed to be in the broker-dealer's "knowledge or possession"

As discussed above, because of certain factors, including the lack of clarity in the Release of the effect of information that may have come into the broker-dealer's knowledge or possession between review periods and the desire to supply customers with current, correct information, a streamlined periodic monitoring function should be built in to a compliance program under the Rule. A major benefit of periodic monitoring is that the amount of effort for annual reviews should be less because the information on file presumably is more current.

This procedure would monitor all issuers for material information and red flags on a limited basis once every quarter, to be timed with the issuance of Form 10-Q (or similar form) for reporting issuers and every calendar quarter for non-reporting issuers. The review would be a streamlined procedure of searching news databases for any material adverse information or other red flags regarding insiders or the financial state of the company. (See Procedures II and III). Of course, the estimate below is for three quarters – the fourth is the annual review as outlined in the other procedures above.

Procedure V Cost Analysis:

Reporting Issuers (150)		
• Domestic (120)	0.75 hour each at $159 avg. rate per hour	$ 14,310
• Foreign (30)	1.5 hour each at $159 avg. rate per hour	7,155
Non-Reporting Issuers (100)		
• Domestic (80)	1.5 hours each at $159 avg. rate per hour	19,080
• Foreign (20)	2 hours each at $159 avg. rate per hour	6,360
Supervisory Review of the foregoing analysis: All Issuers (250)	0.1 hour for each issuer at $300 avg. rate per hour	7,500
Miscellaneous		
Database research costs		
• Domestic Reporting (120)	0.5 hour at $4 per minute	$ 14,400
• Foreign Reporting (30)	0.5 hour at $4 per minute	3,600
• Non-reporting (100 issuers)	0.75 hour at $4 per minute	18,000

TOTAL FOR ONE QUARTER (250 issuers)	**$ 90,405**
TOTAL FOR THREE QUARTERS (250 issuers)	**$ 271,215**

Other Cost Considerations

In considering the overall compliance structure regarding the reproposed Rule, a number of other costs should be included. Start-up costs of developing a proper database and internal forms and training with respect thereto are an integral part of a smooth-functioning compliance effort, especially if the broker-dealer has a large number of micro-cap securities that it is quoting. Other necessary items include training for brokers, especially with respect to policies and procedures necessary to ensure that material information that comes to the brokers' attention is reported in a timely manner, revisions to the firm's policies and procedures manuals, periodic auditing of the database and procedures, and the hiring of at least one full-time staff person to maintain the database, handle the information requests received from the public and other broker-dealers regarding information collected by the firm, and to follow on a daily basis information that may be published about quoted issuers. In addition, it would be appropriate to set aside a contingency for litigation costs that might be incurred in connection with Rule 15c2-11. Finally, it may be advisable to develop an "early-warning" system that would alert the broker-dealer's staff upon certain events or filings by a micro-cap issuer. Because of the subjectivity of many of the red flags cited by the SEC, it is unlikely that any system can be wholly automatic.

Of course, these are estimates only, and much will depend on the actual compliance and systems environment of the broker-dealer.

Other Costs (Recurring annually):

Periodic independent audit of database and procedures and clean up	$ 7,500
Full-time correspondence, documents, and database technician (base annual of salary $40,000 at fully loaded cost multiplier of 3)	120,000
Training for staff	5,000
Total Other Recurring Costs	**$ 132,500**

Other Costs (Initial year):

Although Rules 17a-3 and 17a-4 already require recordkeeping and monitoring systems to be in place, depending on the size and book of business of the broker-dealer, the existing procedures and systems may not be sufficiently robust to deal with the new requirements of the changes under the Release. For example, a critical capability under the changes to the Rule would be to alert the registered representatives that the last quotation published was more than five days before or that not all documents have been received and updated within three days of the quotation publication date.

Revisions to policies and procedures	$ 5,000
Database costs: development or updating, training	50,000
Total Other Initial Costs	**$ 55,000**

Budgetary Contingency for Litigation

Because the SEC has not provided for a safe harbor under the reproposed Rule, it is advisable for broker-dealers to anticipate disputes arising from information that they may provide (or fail to provide) to customers under the Rule. Micro-cap stocks tend to have volatile trading patterns, which in turn tend to attract litigation. Thus, the broker-dealer should consider with respect to the business unit handling these issuers a modest contingency for expenses related to litigation or arbitration. This contingency would vary from year to year and could be calculated depending on the volume of business in these securities and other contemporary market factors.

Litigation expense contingency	**$ 350,000**

Summary of Estimated Costs

• Procedure I	**$ 85,761**	
• Procedure II	**187,485**	
• Procedure III	**376,491**	
• Procedure IV	**68,875**	
• Procedure V	**271,215**	
Total Estimated Costs of Procedures		**$ 989,827**
• Other costs (recurring)		**132,500**
• Other costs (initial year)		**55,000**
Total Estimated Costs		**$ 1,177,327**
Litigation Expense Contingency		**350,000**
TOTAL		**$ 1,527,327**
Total Estimated Costs per Issuer		**$ 4,709.31**
Total Estimated Costs Per Issuer, including contingency		**$ 6,109.31**

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I trust that the foregoing discussion is responsive to your needs. If you have any questions, please do not hesitate to call me at 202-414-4549 or Tom Mahala in our New York office at 212-596-5437.

Sincerely yours,

/S/
Paul S. Atkins
Partner