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SEC Adopts Final Amendments to Rule 15c2-11; Major Changes for OTC Markets Companies

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LAURA ANTHONY, ESQ.
FOUNDING PARTNER

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SEC Adopts Final Amendments to Rule 15c2-11; Major Changes for OTC Markets Companies

Despite an unusual abundance of comments and pushback, on September 16, 2020, one year after issuing proposed rules, the SEC has adopted final rules amending Securities Exchange Act ("Exchange Act") Rule 15c2-11. The primary purpose of the rule amendment is to enhance retail protection where there is little or no current and publicly available information about a company and as such, it is difficult for an investor or other market participant to evaluate the company and the risks involved in purchasing or selling its securities. The SEC believes the final amendments will preserve the integrity of the OTC market, and promote capital formation for issuers that provide current and publicly available information to investors.

From a high level, the amended rule will require that a company have current and publicly available information as a precondition for a broker-dealer to either initiate or continue to quote its securities; will narrow reliance on certain of the rules exceptions, including the piggyback exception; will add new exceptions for lower risk securities; and add the ability of OTC Markets itself to confirm that the requirements of Rule 15c2-11 or an exception have been met, and allow for broker-dealer to rely on that confirmation. Importantly, the new rule will not require OTC Markets to submit a Form 211 application or otherwise have FINRA review its determination that a broker-dealer can quote a security, prior to the quotation by a broker-dealer.

The final rule release contains an in-depth discussion of the numerous comments received (I was one of the many comment writers), especially related to the piggyback exception. As part of the comment process, the OTC Markets, and many of its supporters, suggested the creation of a new "expert market" which would allow the trading of securities with no or limited information, by institutions and other qualified individual traders. In rejecting the proposal, the SEC indicated that there was not enough detail and information around how such a market would operate, but that it was open to considering such a segregated expert qualified marketplace in the future following the appropriate groundwork.

The final rules entail a complete overhaul of the current rule structure and, as such, will require the development of a new infrastructure, compliance procedures and written supervisory procedures at OTC Markets, new compliance procedures and written supervisory procedures at broker-dealers that quote OTC Markets securities, and similar changes within FINRA to adapt to and accommodate the new system. I expect a period of somewhat chaos in the beginning with rapid execution adjustments to work out the kinks.

The final rule release contains a section on guidance related to the rules implementation and use. The guidance includes information on determining the reliability of information sources, conducting information reviews, and red flags that may heighten a review requirement.

The effective date of the rule is 60 days following publication in the federal register. The rule will be published any day now. Compliance with the majority of the rule is required nine months after the effective date. However, compliance with the provision requiring a catch-all category of company to have current information for the preceding two years in order to qualify for the piggyback exception is not until two years from the effective date. As discussed more fully below, a catch-all company is generally an alternatively reporting company on OTC Markets.

Background

Rule 15c2-11 was enacted in 1971 to ensure that proper information was available to a broker and its clients prior to quoting a security in an effort to prevent micro-cap fraud. The last substantive amendment was in 1991. At the time of enactment of the rule, the Internet was not available for access to information. In reality, a broker-dealer never provides the information to investors, FINRA does not make or require the information to be made public, and the broker-dealer never updates information, even after years and years. Since the enactment of the rules, the Internet has created a whole new disclosure possibility and OTC Markets itself has enacted disclosure requirements, processes and

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AnthonyPLLC.com • LAnthony@AnthonyPLLC.com

procedures. The current system does not satisfy the intended goals or legislative intent and is unnecessarily cumbersome at the beginning of a company's quotation life with no follow-through.

I've written about 15c2-11 many times, including HERE and HERE. In the former blog I discussed OTC Markets' comment letter to FINRA related to Rule 6432 and the operation of 15c2-11. FINRA Rule 6432 requires that all broker-dealers have and maintain certain information on a non-exchange-traded company security prior to resuming or initiating a quotation of that security. Generally, a non-exchange-traded security is quoted on the OTC Markets. Compliance with the rule is demonstrated by filing a Form 211 with FINRA.

The specific information required to be maintained by the broker-dealer when it initiates a quotation is delineated in Exchange Act Rule 15c2-11. The core principle behind Rule 15c2-11 is that adequate current information be available when a security enters the marketplace. The information required by the Rule includes either: (i) a prospectus filed under the Securities Act of 1933, such as a Form S-1, which went effective less than 90 days prior; (ii) a qualified Regulation A offering circular that was qualified less than 40 days prior; (iii) the company's most recent annual reported filed under Section 13 or 15(d) of the Exchange Act or Regulation A under wand quarterly reports to date; (iv) information published pursuant to Rule 12g3-2(b) for foreign issuers; or (v) specified information that is similar to what would be included in items (i) through (iv).

In addition, a broker-dealer must have a reasonable basis under the circumstances to believe that the information is accurate in all material respects and from a reliable source. This reasonable basis requirement has altered the initial quotation process dramatically over the last ten years. In particular, FINRA uses this requirement to conduct a deep dive into the due diligence and background of a company when processing a 211 Application.

As discussed below, although the amended rule continues to require that a broker-dealer have a reasonable basis to believe information is accurate and from a reliable source, the revamped structure itself may help shift the burden back to the broker-dealer, where it belongs, and reduce FINRA's overlapping merit review. Importantly as discussed, OTC Markets will not be required to submit a Form 211 but rather its determination of compliance with the rules will be self-effectuating, and a broker-dealer relying on OTC Markets review, will also not be required to submit a Form 211 to FINRA. This alone will make a tremendous difference in the process.

The 15c2-11 piggyback exception provides that if an OTC Markets security has been quoted during the past 30 calendar days, and during those 30 days the security was quoted for at least 12 days without more than a four-consecutive-day break in quotation, then a broker-dealer may "piggyback" off of prior broker-dealer information. In other words, once an initial Form 211 has been filed by a market maker and approved by FINRA and the stock quoted for 30 days by that market maker, subsequent broker-dealers can quote the stock and make markets without resubmitting information to FINRA. The piggyback exception lasts in perpetuity as long as a stock continues to be quoted. As a result of the piggyback exception, the current information required by Rule 15c2-11 may only actually be available in the marketplace at the time of the Form 211 application and not years later while the security continues to trade. The disparity is so extreme that a quotation can take on a life of its own and continue long after a company has ceased to exist or closed operations.

The SEC's rule release discusses the OTC Markets in general, noting that the majority of fraud enforcement actions involve either non-reporting or delinquent companies. However, the SEC also notes that the OTC Markets provides benefits for investors (a welcome acknowledgment after a period of open negativity). Many foreign companies trade on the OTC Markets and importantly, the OTC Markets provides a starting point for small growth companies to access capital and learn how to operate as a public company.

The final rules: (i) require that information about the company and the security be current and publicly available in order to initiate or continue to quote a security; (ii) limit certain exceptions to the rule including the piggyback exception where a company's information becomes unavailable to the public or is no longer current; (iii) reduce regulatory burdens to quote securities that may be less susceptible to potential fraud and manipulation; (iv) allow OTC Markets itself to evaluate and confirm eligibility to rely on the rule; and (v) streamline the rule and eliminate obsolete provisions.

The final rule adds the ability for new "market participants" to conduct the review process and allows broker-dealers to rely on that review process and the determination from certain third parties that an exception is available for a security.

The release uses the terms "qualified IDQS that meets the definition of an ATS" and "national securities association" throughout. In reality, the only relevant qualified IDQS is OTC Markets itself and the only national securities association in the United States is FINRA. However, if new IDQS platforms or national securities associations develop, they would also be covered by the rule.

Final Amendments

OTC Markets Review

The new rule allows a qualified IDQS to comply with the information review requirements. As mentioned, in reality, the qualified IDQS is OTC Markets. In complying with the information review requirements under Rule 15c2-11, OTC Markets will be subject to the same review, responsibility and record keeping requirements of a broker-dealer and must have reasonably designed written policies and procedures associated with the rule's compliance. OTC Markets would then "make known" to the public that it has completed a review and that a broker-dealer can quote or resume quoting the securities, and be in compliance with Rule 15c2-11. Likewise, OTC Markets can make a determination that a company qualifies for an exception to the 211 rule requirements and a broker-dealer can rely on that determination.

A broker-dealer can rely on the OTC Markets determination of the availability of the rule or an exception to quote a security without conducting an independent review. Keeping the rule's current three business day requirement, a broker-dealer's quotation must be published or submitted within three business days after the qualified IDQS (OTC Markets) makes a publicly available determination.

Importantly, the new rule specifically does not require that OTC Markets comply with FINRA Rule 6432 and does not require OTC Markets or broker-dealers relying on OTC Markets' publicly available determination that an exception applies, to file Forms 211 with FINRA. I believe that the system will evolve such that OTC Markets completes the vast majority of 211 compliance reviews.

Current Public Information Requirements; Location of Information

The final rule changes will (i) require that the documents and information that a broker-dealer must have to quote an OTC security be current and publicly available; (ii) permit additional market participants to perform the required review (i.e., OTC Markets); and (iii) expand some categories of information required to be reviewed. In addition, the amendment will restructure and renumber paragraphs and subparagraphs.

To initiate or resume a quotation, a broker-dealer or OTC Markets must review information up to three days prior to the quotation. The information that a broker-dealer needs to review depends on the category of company, and in particular: (i) a company subject to the periodic reporting requirements of the Exchange Act, Regulation A or Regulation Crowdfunding (Regulation Crowdfunding was not included in the proposed rule but was added in the final); (i) a company with a registration statement that became effective less than 90 days prior to the date the broker-dealer publishes a quotation; (iii) a company with a Regulation A offering circular that goes effective less than 40 days prior to the date the broker-dealer publishes a quotation; (iv) an exempt foreign private issuer with information available under 12(g)3-2(b) and (v) all others (catch-all category) which information must be as of a date within 12 months prior to the publication or submission of a quotation.

The catch-all category encompasses companies that alternatively report on OTC Markets, as well as companies that are delinquent in their SEC reporting obligations – provided, however, that companies delinquent in their SEC reporting companies can only satisfy the catch-all requirements for a broker-dealer to quote an initial or resume quotation of its securities, not for the piggyback exception.

For companies relying on the catch-all category, the information required to rely on Rule 15c2-11 includes the type of information that would be available for a reporting company, including financial information for the two preceding years

that the company or its predecessor has been in existence. The information requirements were expanded from the proposed rule to also include (i) the address of the company's principal place of business; (ii) state of incorporation of each of the company's predecessors (if any); (iii) the ticker symbol (if assigned); (iv) the title of each "company insider" as defined in the rule; (v) a balance sheet as of a date less than 16 months before the publication or submission of a broker-dealer's quotation; and (vi) a profit and loss and retained earnings statement for the 12 months preceding the date of the most recent balance sheet.

Certain supplemental information is also required in determining whether the information required by Rule 15c2-11 is satisfied. In particular, a broker-dealer or OTC Markets must always determine the identity of the person on whose behalf a quotation is made, including whether that person is an insider of the company and whether the company has been subject to a recent trading suspension. The requirement to review this supplemental information only applies when a broker-dealer is initiating or resuming a quotation for a company, and not when relying on an exception, such as the piggyback exception, for continued quotations.

Regardless of the category of company, the broker-dealer or OTC Markets must have a reasonable basis under the circumstances to believe that the information is accurate in all material respects and from a reliable source. In order to satisfy this obligation, the information and its sources must be reviewed and if any red flags are present such as material inconsistencies in the public information or between the public information and information the reviewer has knowledge of, the reviewer should request supplemental information. Other red flags could include a qualified audit opinion resulting from failure to provide financial information, companies that list the principal component of its net worth an asset wholly unrelated to the issuer's lines of business, or companies with bad-actor disclosures or disqualifications. I've included a brief discussion of red flags in the section titled guidance below.

The existing rule only requires that SEC filings for reporting or Regulation A companies be publicly available and in practice, there is often a deep-dive of due diligence information that is not, and is never made, publicly available. Under the final rule, all information other than some limited exceptions, and the basis for any exemption, will need to be current and publicly available for a broker-dealer to initiate or resume a quotation in the security. The information required to be current and publicly available will also include supplemental information that the broker-dealer, or other market participant, has reviewed about the company and its officer, directors, shareholders, and related parties.

Interestingly, the SEC release specifies that a deep-dive due diligence is not necessary in the absence of red flags and that FINRA, OTC Markets or a broker-dealer can rely solely on the publicly available information, again, unless a red flag is present. Currently, the broker-dealer that submits the majority of Form 211 applications does a complete a deep-dive due diligence, and FINRA then does so as well upon submittal of the application. I suspect that upon implementation of the new rule, OTC Markets itself will complete the vast majority of 15c2-11 rule compliance reviews and broker-dealers will rely on that review rather than submitting a Form 211 application to FINRA and separately complying with the information review requirements.

Information will be deemed publicly available if it is posted on: (i) the EDGAR database; (ii) the OTC Markets (or other qualified IDQS) website; (iii) a national securities association (i.e., FINRA) website; (iv) the company's website; (v) a registered broker-dealer's website; (vi) a state or federal agency's website; or (vii) an electronic delivery system that is generally available to the public in the primary trading market of a foreign private issuer. The posted information must not be password-protected or otherwise user-restricted. A broker-dealer will have the requirement to either provide the information to an investor that requests it or direct them to the electronic publicly available information.

Information will be current if it is filed, published or disclosed in accordance with each sub-paragraph's listed time frame. The rule has a catch-all whereby unless otherwise specified, information is current if it is dated within 12 months of a quotation. A broker-dealer must continue to obtain current information through 3 days prior to the quotation of a security.

The final rule adds specifics as to the date of financial statements for all categories of companies, other than the "catch-all" category. A balance sheet must be less than 16 months from the date of quotation and a profit and loss statement and retained earnings statement must cover the 12 months prior to the balance sheet. However, if the balance sheet is not dated within 6 months of quotation, it will need to be accompanied by a profit-and-loss and retained-earnings statement for a period from the date of the balance sheet to a date less than 6 months before the publication of a quotation. A catch-all category company, including a company that is delinquent in its SEC reporting obligations, does

not have the six-month requirement for financial statements but a balance sheet must be dated no more than 16 months prior to quotation publication and the profit and loss must be for the 12 months preceding the date of the balance sheet.

The categories of information required to be reviewed will also expand. For instance, a broker-dealer or the OTC Markets will be required to identify company officers, 10%-or-greater shareholders and related parties to the company, its officer and directors. In addition, records must be reviewed and disclosure made if the person for whom quotation is being published is the company, CEO, member of the board of directors, or 10%-or-greater shareholder. As discussed below, the unsolicited quotation exception will no longer be available for officers, directors, affiliates or 10%-or-greater shareholders unless the company has current publicly available information.

The rule will not require that the qualified IDQS – i.e., OTC Markets – separately review the information to publish the quote of a broker-dealer on its system, unless the broker-dealer is relying on the new exception allowing it to quote securities after a 211-information review has been completed by OTC Markets. In other words, if a broker-dealer completes the 211 review and clears a Form 211 with FINRA, OTC Markets can allow the broker-dealer to quote on its system. If OTC Markets completes the 211 review and clears a Form 211 with FINRA, the broker-dealer, upon confirming that the 211 information is current and publicly available, is accepted from performing a separate review and can proceed to quote that security.

Exceptions in General

The final rule amendments add new exceptions that will reduce regulatory burdens: (i) for securities of well-capitalized companies whose securities are actively traded; (ii) if the broker-dealer publishing the quotation was named as an underwriter in the security's registration statement or offering circular; (iii) where a qualified IDQS that meets the definition of an ATS (OTC Markets) complies with the rule's required review and makes known to others the quotation of a broker-dealer relying on the exception; and (iv) in reliance on publicly available determinations by a qualified IDQS that meets the definition of an ATS (i.e., OTC Markets) or a national securities association (i.e., FINRA) that the requirements of certain exceptions have been met.

Piggyback and Unsolicited Quote Exception Changes

The current 15c2-11 piggyback exception provides that if an OTC Markets security has been quoted during the past 30 calendar days, and during those 30 days the security was quoted for at least 12 days without more than a four-consecutive-day break in quotation, then a broker-dealer may "piggyback" off of prior broker-dealer information. As discussed, currently the piggyback exception lasts in perpetuity as long as a stock continues to be quoted. As a result of the piggyback exception, the current information required by Rule 15c2-11 may only actually be available in the marketplace at the time of the Form 211 application and not years later while the security continues to trade. Moreover, as the SEC notes, by continuing to quote securities with no available information, that are being manipulated or part of a pump-and-dump scheme, a broker is perpetuating the scheme.

There are two main current exceptions to Rule 15c2-11: the piggyback exception and the unsolicited quotation exception. The final rule, which contains a 60-page discussion on the piggyback exception, will amend the exception to: (i) require that information be current and publicly available (ii) require at least a one-way priced quotation (either bid or ask) – which is a modification from the proposal which would have required a two-way quotation; (iii) eliminate the current 30-calendar-day window before the exception can be relied upon but retain the requirement that that no more than 4 days in succession can elapse without a quotation; (iv) eliminate the piggyback exception during the first 60 calendar days after the termination of a SEC trading suspension under Section 12(k) of the Exchange Act; (v) allow a period in which the exception can be relied upon for quotations of shell companies (modified from the rule proposal); and (vi) provide a conditional 15-day grace period to continue quotations when current information is no longer available (this provision was not in the rule proposal); and (vi) revise the frequency of quotation requirement.

Notably, the SEC does not include a delinquent reporting issuer in the "catch-all" category for purposes of qualification for the piggyback exception, rather, the amended rule provides a grace period for Exchange Act reporting companies that are delinquent in their reporting obligations. In particular, a broker-dealer can continue to rely on the piggyback exception for quotations for a period of 180 days following the end of the reporting period. Since most OTC Markets

companies are not accelerated filers, the due date for an annual Form 10-K is 90 days from fiscal year end and for a quarterly Form 10-Q it is 45 days from quarter end. Accordingly, a company can be delinquent up to 90 days on the filing of its Form 10-K or 135 days on its Form 10-Q before losing piggyback eligibility. Regulation A and Regulation Crowdfunding reporting companies are not provided with a grace period, but rather must timely file their reports to maintain piggyback eligibility.

The amended rule adds a 15-day conditional grace period for a broker-dealer to continue to quote securities which no longer qualify for the piggyback exception as a result of a company no longer having current available public information upon expiration of the time periods in the above chart. In order to use the grace period, three conditions must be met: (i) OTC Markets or FINRA must make a public determination that current public information is no longer available within 4 business days of the information no longer being available (i.e., expiration of the time periods in the chart) – this could be by, for example, a tag on the quote page or added letter to the ticker symbol; (ii) all other conditions for reliance on the piggyback exception must be effective (such as a one-way quote); and (iii) the grace period ended on the earliest of the company once again making current information publicly available or the 14th calendar day after OTC Markets or FINRA makes the public determination in (i) above.

To reduce some of the added burdens of the rule change, the SEC allows a broker-dealer to rely on either OTC Markets or FINRA's publicly announced determination that the requirements of the piggyback exception have been met. To be able to properly keep track of piggyback exception eligibility, OTC Markets will need to establish, maintain, and enforce reasonably designed written policies and procedures to determine, on an ongoing basis, whether the documents and information are, depending on the type of company, filed within the prescribed time periods. I think the amendments, especially requiring ongoing current public information, will have a significant impact on micro-cap fraud.

The initial rule proposal contained a provision that would have eliminated the piggyback exception altogether for shell companies. This provision received significant pushback and would have had a huge chilling effect on reverse merger transactions in the OTC Markets. In its rule proposal, the SEC admitted that there are perfectly legal and valid reverse-merger transactions. My firm has worked on many reverse-merger transactions over the years.

In response to the pushback and the final rule allows for broker-dealers to rely on the piggyback exception to publish quotations for shell companies for a period of 18 months following the initial priced quotation on OTC Markets. In essence, a shell company is being granted 18 months to complete a reverse merger with an operating business, or in the alternative, to organically begin operations itself. To be clear, the amended rules only allow the piggyback exception for a period of 18 months following the initial quotation. Accordingly, if a company falls into shell status after it has been quoted for 18 months, a new 15c2-11 review would need to be completed by either a broker-dealer or OTC Markets under the initial quotation standards. Upon that new initial review, and assuming compliance with the requirements to initiate a quote, a new 18-month period would begin. If the company remained a shell at the end of the 18-month period, it would lose piggyback eligibility and a new 211 compliance review would be necessary. That is, either a broker-dealer would need to file a new Form 211, or OTC Markets would need to conduct the review upon which the broker-dealer could rely.

The amended rule adopts a definition of shell company that tracks Securities Act Rules 405 and 144 and Exchange Act Rule 12b-2, but also adds a "reasonable basis" qualifier to help broker-dealers and OTC Markets make determinations. In particular, a shell company is defined as any issuer, other than a business-combination-related shell company as defined in Rule 405 or asset-backed issuer, that has: (i) no or nominal operations; and (ii) either no or nominal assets or assets consisting solely of cash or cash equivalents. A company will not be considered a shell simply because it is a start-up or has limited operating history. In order to have a reasonable basis for its determination, a broker-dealer or OTC Markets can review public filings, financial statements, business descriptions, etc.

The current 15c2-11 piggyback exception provides that if an OTC Markets security has been quoted during the past 30 calendar days, and during those 30 days the security was quoted for at least 12 days without more than a four-consecutive-day break in quotation, then a broker-dealer may "piggyback" off of prior broker-dealer information. The amended rule eliminated both the 12- and 30-day frequency of quotation requirements but retains the four-day requirement.

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The piggyback exception rule change was the subject of a plethora of comments and pushback from the marketplace, including retail traders that were concerned they would in essence lose their livelihood; presumably, this is one of the reasons the SEC devoted a full 60 pages to its discussion on this topic. In a sort of comprise, the SEC stated that it understands that market participants may have unique facts and circumstances as to how the amended Rule affects their activities, and the SEC will consider requests from market participants, including issuers, investors, or broker-dealers, for exemptive relief from the amended Rule for OTC securities that are currently eligible for the piggyback exception yet may lose piggyback eligibility due to the amendments to the Rule.

In a request for relief, the SEC will consider all facts and circumstances including whether based on information provided, the issuer or securities are less susceptible to fraud or manipulation. The SEC may consider, among other things, securities that have an established prior history of regular quoting and trading activity; companies that do not have an adverse regulatory history; companies that have complied with any applicable state or local disclosure regulations that require that the company provide its financial information to its shareholders on a regular basis, such as annually; companies that have complied with any tax obligations as of the most recent tax year; companies that have recently made material disclosures as part of a reverse merger; or facts and circumstances that present other features that are consistent with the goals of the amended Rule of enhancing protections for investors. Requests for relief should be submitted as soon as possible to prevent a quotation interruption prior to the rule's implementation.

The requirement limiting the piggyback exception for the first 60 calendar days after a trading suspension will not likely have a market impact. A trading suspension over 5 days currently results in the loss of the piggyback exception and requirement to file a new Form 211. In practice, the SEC issues ten-day trading suspensions on OTC Securities, and there is no broker-dealer willing to file a new 15c2-11 within 60 days thereafter in any event. In fact, in reality, it is a rarity for a company to regain an active 211 after a trading suspension. Perhaps that will change with implementation of the new rules.

The existing rule excepts from the information review requirement the publication or submission of quotations by a broker-dealer where the quotations represent unsolicited customer orders. Under the final rule, a broker-dealer that is presented with an unsolicited quotation, would need to determine whether there is current publicly available information. If no current available information exists, the unsolicited quotation exception is not available for company insiders or affiliates including officers, directors and 10%-or-greater shareholders.

In the final rule, a broker-dealer may rely on a written representation from a customer's broker that such customer is not a company insider or an affiliate. The written representation must be received before and on the day of a quotation. Also, the broker-dealer must have a reasonable basis for believing the customer's broker is a reliable source including, for example, obtaining information on what due diligence the broker conducted. Like the piggyback exception, a broker-dealer will be able to rely on a qualified IDQS (OTC Markets) or a national securities association (FINRA) that there is current publicly available information.

Lower Risk Securities; New Exceptions

The final rule provides an exception for companies that are well capitalized and whose securities are actively traded. In order to rely on this exception, the security must satisfy a two-pronged test involving (i) the security's average daily trading volume ("ADTV") value during a specified measuring period (the "ADTV test"); and (ii) the company's total assets and unaffiliated shareholders' equity (the "asset test").

The ADTV test requires that the security have a worldwide reported ADTV value of at least $100,000 during the 60 calendar days immediately prior to the date of publishing a quotation. To satisfy the final ADTV test, a broker-dealer would be able to determine the value of a security's ADTV from information that is publicly available and that the broker-dealer has a reasonable basis for believing is reliable. Generally, any reasonable and verifiable method may be used (e.g., ADTV value could be derived from multiplying the number of shares by the price in each trade).

The asset test requires that the company have at least $50 million in total assets and stockholders' equity of at least $10 million as reflected on the company's publicly available audited balance sheet issued within six months of the end of its most recent fiscal year-end. This would cover both domestic and foreign issuers. The proposed rule would have

required that the $10 million of stockholder's equity be from unaffiliated stockholders, but that requirement was eliminated in the final rule.

The rule also creates an exception for a company who has another security concurrently being quoted on a national securities exchange. For example, some companies quote their warrants or rights on OTC Markets following a unit IPO offering onto a national exchange.

Like the piggyback exception, the SEC allows a broker-dealer to rely on either OTC Markets or FINRA's publicly announced determination that the requirements of the ADTV and asset test or the exchange-traded security exception have been met. Conversely, if OTC Markets or FINRA is publishing the availability of an exception, they will also need to publish when such exception is no longer available.

The final rule adds an exception to the rule to allow a broker-dealer to publish a quotation of a security without conducting the required information review, for an issuer with an offering that was underwritten by that broker-dealer and only if (i) the registration statement for the offering became effective less than 90 days prior to the date the broker-dealer publishes a quotation; or (iii) the Regulation A offering circular became qualified less than 40 days prior to the date the broker-dealer publishes a quotation. This change may potentially expedite the availability of securities to retail investors in the OTC market following an underwritten offering, which may facilitate capital formation.

This exception requires that the broker-dealer have the 211 current information in its possession and have a reasonable basis for believing the information is accurate and the sources of information are reliable. Since FINRA issues a ticker symbol, this new exception will still require a broker-dealer to file a Form 211 (or new form generated by FINRA to facilitate the exception).

Miscellaneous Amendments to Streamline

The SEC has also made numerous miscellaneous changes to streamline the rule and eliminate obsolete provisions. The miscellaneous changes include: (i) allowing a broker-dealer to provide an investor that requests company information with instructions on how to obtain the information electronically through publicly available information; (ii) updated definitions; and (iii) the elimination of historical provisions that are no longer applicable or relevant.

Guidance

As part of its rule release, the SEC eliminated the preliminary note that appeared with the former rule and adopted new guidance.

Reliable Source

As discussed, a broker-dealer must have a reasonable basis under the circumstances to believe that 211 information is accurate in all material respects and from a reliable source. In its guidance, the SEC specifies that a deep-dive due diligence is not necessary in the absence of red flags and that FINRA, OTC Markets or a broker-dealer can rely on information provided by another broker-dealer, company or its agents, including officers, directors, attorneys or accountants and information that is publicly available. Where a source of information indicates it was prepared by a company or one of its agents, the broker-dealer should confirm with the company or the particular agent.

Information Review

Upon reviewing all information in its possession and confirming that all information required by the rule has been received, the information review process can generally be completed. However, where a red flag presents itself such as a material inconsistency, a further review needs to be conducted. A reviewer either needs to resolve the red flag, or choose not to publish a quotation. This portion of the guidance stresses that investigations are not necessary beyond the specific information required in the rule, unless a red flag is present.

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AnthonyPLLC.com • LAnthony@AnthonyPLLC.com

Red Flags

The guidance provides a non-exclusive list of red flags: (i) SEC or foreign trading suspensions; (ii) concentration of ownership of the majority of outstanding freely tradeable stock; (iii) large reverse stock splits; (iv) companies in which assets are large and revenue is minimal without explanation; (v) shell company's acquisition of private company or other material business development; (vi) a registered or unregistered offering raises proceeds that are used to repay a bridge loan made or arranged by an underwriter where the loan is short term with a high interest rate, the underwriter received securities at below market prior to the offering and the company has no apparent business purpose for the loan; (vii) significant write-up of assets upon a company obtaining a patent or trademark; (viii) significant assets consist of substantial amounts of shares in other OTC companies; (ix) assets acquired for shares of stock when the stock has no market value; (x) unusual auditing issues; (xi) significant write-up of assets in a business combination of entities under common control; (xii) extraordinary items in notes to the financial statements; (xiii) suspicious documents; (xiv) a broker-dealer or qualified IDQS receives substantially similar offering documents from different issuers with certain characteristics; (xv) extraordinary gains in year-to-year operations; (xvi) reporting company fails to file an annual report; (xvi) disciplinary actions against a company's officers, directors, general partners, promoters, auditors or control persons; (xvii) significant events involving a company or its predecessor or any majority subsidiaries; (xviii) request to publish both bid and offer quotes on behalf of a customer for the same stock; (xix) issuer or promoter offers to pay a fee; (xx) regulation S transactions of domestic companies; (xxi) Form S-8 stock; (xxii) "hot industry" OTC stocks; (xxiii) unusual activity in brokerage accounts of company affiliates, especially involving related shareholders; and (xxiv) companies that frequently change their names or lines of business.

Conclusion

In general, I am happy with the rule changes. Allowing OTC Markets to separately review and make a determination as to initial compliance with Rule 15c2-11 or the availability of an exemption should improve the system dramatically. The existing rule was antiquated, simply did not meet its intended purpose, and provided unnecessary burdens on certain market participants and none at all on others. However, I would like to see additional changes. In particular, the proposing release did not address the prohibition on broker-dealers, or now, OTC Markets, charging a fee for reviewing current information, confirming the existence of an exemption and otherwise meeting the requirements of Rule 15c2-11 (as set out in FINRA Rule 5250). The process of reviewing the information is time-consuming and the FINRA review process is arduous. Although not in the rule, FINRA in effect conducts a merit review of the information that is submitted with the Form 211 application and routinely drills down into due diligence by asking the basis for a reasonable belief that the information is accurate and from a reliable source. Most brokerage firms are unwilling to go through the internal time and expense to submit a Form 211 application. I believe the SEC needs to allow broker-dealers and OTC Markets to be reimbursed for the expense associated with the rule's compliance.

625 N. Flagler Drive, Ste, 600, West Palm Beach, FL 33401 • Toll Free: 1.800.341.2684
AnthonyPLLC.com • LAnthony@AnthonyPLLC.com

The Author

Laura Anthony, Esq.,
Founding Partner
Anthony L.G., PLLC | A Corporate Law Firm
LAnthony@AnthonyPLLC.com

Palm Beach securities attorney Laura Anthony and her experienced legal team provide ongoing corporate counsel to small and mid-size private companies, OTC and exchange traded public companies as well as private companies going public on the Nasdaq, NYSE American or over-the-counter market, such as the OTCQB and OTCQX. For more than two decades Anthony L.G., PLLC has served clients providing fast, personalized, cutting-edge legal service. The firm's focus includes, but is not limited to Regulation D and Regulation S and PIPE Transactions, securities token offerings and initial coin offerings, Regulation A/A+ offerings, as well as registration statements on Forms S-1, S-3, S-8 and merger registrations on Form S-4; compliance with the Securities Exchange Act of 1934, including registration on Form 10, reporting on Forms 10-Q, 10-K and 8-K, and 14C Information and 14A Proxy Statements; all forms of going public transactions; mergers and acquisitions including both reverse mergers and forward mergers; applications to and compliance with the corporate governance requirements of securities exchanges including Nasdaq and NYSE American. Palm Beach attorney Laura Anthony is also the author of SecuritiesLawBlog.com, the producer and host of LawCast.com, Corporate Finance in Focus, and a contributor to The Huffington Post and Law360.

Ms. Anthony is involved throughout the community of Palm Beach. She is on the board of directors for the American Red Cross for Palm Beach and Martin Counties, and provides financial support to the Susan Komen Foundation, Opportunity, Inc., New Hope Charities, the Society of the Four Arts, the Norton Museum of Art, Palm Beach County Zoo Society, the Kravis Center for the Performing Arts and several other organizations. She is also a financial and hands-on supporter of Palm Beach Day Academy, one of Palm Beach's oldest and most respected educational institutions. She currently resides in Palm Beach with her husband and daughter.

Ms. Anthony is an honors graduate from Florida State University College of Law and has been practicing law since 1993.

Contact Anthony L.G., PLLC. Technical inquiries are always encouraged.

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