OTC Markets

March 1, 2016

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Scott Garrett
Chairman
Subcommittee on Capital Markets and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Carolyn Maloney
Ranking Member
Subcommittee on Capital Markets and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

**Re: Main Street Growth Act (H.R. 4638)**

Dear Chairman Hensarling, Ranking Member Waters, Chairman Garrett and Ranking Member Maloney,

OTC Markets Group Inc. operates the OTCQX Best and OTCQB Venture markets with over 1,300 companies meeting financial standards and providing current disclosure to investors, including many innovative and entrepreneurial 'venture' companies, trading via our SEC registered alternative trading system ("ATS"). In advance of the House Financial Services Committee markup of the "Main Street Growth Act, " H.R. 4638, on March 2, we want to share our concerns about the bill and the approach it takes towards regulating the U.S. venture markets.

We generally support legislation aimed at improving the secondary trading of smaller company securities, however the Main Street Growth Act falls short. The bill would allow the creation of "Venture Exchanges" that are intended to have trading and listing rules tailored for smaller companies and regulatory privileges that are unavailable to non-exchange markets. The bill solely focuses on the exchange model, excluding other successful markets that currently operate venture and smaller company markets.

The bill's prescription of a single, centralized, exchange-only monopoly business model does not take into account the lessons to be learned from:

1) the historical success of the NASDAQ market maker driven automated quotation system for smaller companies;
2) OTC Markets Group in the U.S. today, which is the global leader in exchange graduates with over 200 companies moving to the NYSE or NASDAQ exchanges in the past three years; and
3) other successful smaller company markets around the world, such as the AIM in London or China's fast growing NEEQ[1], that support networks of competing broker-dealers supplying liquidity and execution services.

We are against the bill's mandate of a single business model for the trading of all venture securities, particularly when the mandate comes without meaningful discussion or study of the value of alternative business models that create a level playing field. For this reason, we support the approach taken by Ms. Waters mandating further SEC study of the issue.

Historically, the United States has benefited from the competition between organized Over-the-Counter markets and exchange markets. That benefit was lost in 2006 when NASDAQ registered as a national securities exchange to defend its largest listings and ceased to be a dealer market because of exchange registration requirements.

**OTC Markets Group and the ATS Model**

Not only has OTC Markets Group produced more than 200 exchange graduates since 2013, but many other companies, including more than 70 community banks on our OTCQX market, have established thriving secondary markets on our ATS platform without the cost and complexity of listing on an exchange. On February 19, 2016, Elio Motors, the first company to complete a successful offering using Regulation A+ under the Jumpstart Our Business Startups (JOBS) Act, began trading on the OTCQX market. We expect more Regulation A+ companies to follow.

These successes on our markets are attributable in part to the structure of our ATS as a dealer market, allowing competing broker-dealers to directly interact with one another, as opposed to an auction (exchange model) market where broker-dealers interact only with the exchange as the centralized trading facility. Dealer markets have been shown to work better for smaller company trading, and all market participants should be permitted to choose the type of trading venue that best suits their needs. Companies should be free to choose their listing or designation based on value and cost, while

[1] *Chinese start-ups flock to OTC equity exchange*, Financial Times (November 10, 2014). Available at: http://www.ft.com/intl/cms/s/0/21fd2fac-6631-11e4-898f-00144feabdc0.html#axzz41f5XlIfJ.

broker-dealers should be free to seek best execution from the market or broker-dealer of their choice. Forcing these participants to use a venue type prescribed by regulators is not in the best interest of the smaller company trading market.

For example, ATSs may offer a more efficient alternative with lower costs, and academic research indicates that the competing broker-dealer model used by OTC Markets Group compares favorably to other successful smaller company trading markets.

A study by professors Reena Aggarwal and James Angel[2] looked at the mistakes of a failed U.S. venture exchange, the Amex Emerging Company Marketplace, and highlighted the three common characteristics of historically successful smaller company secondary markets:

1) They grew out of the pre-existing Over-the-Counter markets;
2) They operated as dealer markets; and
3) They were separate from the existing national exchanges.

In other words, successful smaller company markets look a lot like the OTCQX and OTCQB markets today, and Nasdaq in the 1980s and 90s before it became a national securities exchange to compete with the New York Stock Exchange for large company listings.

**Liquidity and Competition**

A key tenet of securities regulation is that competition between exchange and non-exchange markets leads to more choice for companies and broker-dealers, and greater innovation in how trading markets are structured. While high-speed exchange matching engines can capture the substantial existing liquidity in the largest public companies, they cannot create liquidity for smaller companies. Only market makers can provide additional liquidty as a service, which is an important reason why dealer markets have been successful for smaller company securities without large amounts of natural liquidity. In the United States, we have an ecosystem of technology-driven online brokers and market makers providing high quality and low cost trading for individual investors that is the envy of other nations.

Market makers today can compete with the exchange markets for online broker orders based on quality of executions, costs and providing greater liquidity than is displayed on the exchanges. According to testimony by the Director of the SEC's Division of Trading and Markets, "for companies with less than $100 million in market capitalization, individuals dominate ownership with 80.1% of ownership or higher."[3] This structure

[2] The study, attached as Exhibit A, is titled: *The rise and fall of the Amex Emerging Company Marketplace*, Journal of Financial Economics 52 (1999), 257-289.

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

requires a competive, low-cost trading ecosystem that we should seek to foster, rather than disintermediate by restricting trading to a single, exchange license only model.

**Support a Future that is Online, Data-driven and Social**

With the JOBS Act as a guide, Congress and the securities regulators can take additional action to modernize securities laws for the Internet age. Forward thinking securities regulation should use the networking power of the internet to give smaller public companies greater access to capital while providing investors with more robust, timely disclosure and information.

In our experience, there are four simple ideas that would materially improve smaller company capital formation and trading:

1) Allow current SEC reporting companies to raise capital under Regulation A+ Tier 2 so they can raise capital online across state lines.
2) Grant margin eligibility to established companies trading Over-the-Counter and on regional exchanges by bringing back the OTC Margin List previously published by the Federal Reserve under Regulation T.
3) Improve disclosure, regulation and enforcement of online paid stock promotion.
4) Allow the SEC to study and make recommendations as to how public companies and investors can use online, data-driven and social tools to more efficiently and effectively raise capital, provide information and protect investors.

**Conclusion**

For the reasons outlined above, OTC Markets Group does not believe the Main Street Growth Act is free-market friendly, and does not support the bill in its current form. We applaud the approach taken by Ms. Waters that (i) promotes a study by the premier U.S. securities regulator, the SEC, of how to structure the most effective secondary trading markets for venture securities and (ii) recognizes that the ATS model must be a key part of such a study.

We remain hopeful that Congress, the SEC and market participants can work together to provide venture companies with all of the tools necessary to foster their growth and development. Please let me know if we can provide any additional information or insight in furtherance of that shared goal.

Sincerely,

Daniel Zinn
General Counsel
OTC Markets Group Inc.