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Corporate & Securities Alert

For New OTC Issuers, an Overlooked Benefit of Recent Amendments to Rule 15c2-11



By **Howard Mulligan**

Key points:

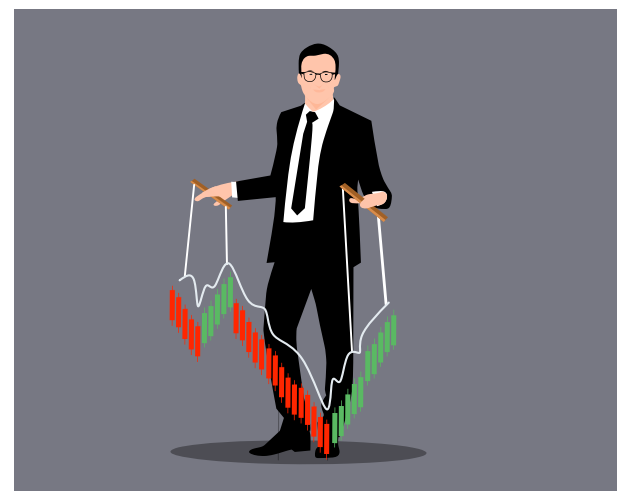
In a little-noticed provision, the latest SEC amendment to Rule 15c2-11 streamlines the process by which securities issuers can gain admittance to OTC markets

The amended rule enables an issuer to ask the OTC Group to conduct an “initial review” process in the stead of a market maker, relying on publicly available information

Rule 15c2-11¹ of the Securities and Exchange Act of 1934 (the “Rule”) governs the information, review and maintenance requirements for broker-dealers listed in the public over the counter (“OTC”) markets. The OTC markets are overseen by the OTC Markets Group, an SEC regulated institution, headquartered in New York City (“OTC Group”). The Rule was initially promulgated in 1971 and substantially modified in 1991; the most recent amendments to the Rule became effective on September 28, 2021.² Although the most recent amendments reflect the input of a wide range of institutions, regulators and interested parties over the course of a lengthy comment period and were highly publicized, one new procedure effectuated by the amendments has eluded the level of attention that market participants had conferred on other aspects of the 2021 amendments. These provisions, which have expanded the purview of the OTC Group to conduct an “initial review” process in the stead of a market maker, may be substantially beneficial to new issuer candidates in streamlining the process of becoming listed in the OTC markets.

The Rule sets forth the requirements for the submission and publication of

quotations by broker-dealers in the OTC markets, which essentially covers any quotation medium other than a national securities exchange, such as the New York Stock Exchange or NASDAQ.



OTC market securities are organized into three markets to inform investors of risks and opportunities: OTCQX, OTCQB and Pink. The Rule requires that, before a broker-dealer may initiate quotations for a security in a quotation medium, which enables the security to trade, the broker-dealer must review basic information about the security issuer. The Rule also requires that the relevant broker-dealer submit Form

211³ to the FINRA OTC Compliance Unit, which elicits disclosure of all of the information required by FINRA Rule 6432, the parameters of which have been expanded to be consistent with the SEC's recent revisions to the Rule.

The SEC's intent in promulgating the 2021 amendments was mainly to modernize the Rule, enhance disclosure and transparency requirements and to buttress the investor protection framework in the OTC markets. In effect, because broker dealers patrol the gateway to the OTC markets, the Rule, as amended, precludes such firms from publishing quotations for an issuer's security, unless such issuer's current information has been made publicly available. Among other changes, the amendments now permit broker dealers to rely on publicly available determinations of a "qualified interdealer quotation system"⁴ ("IDQS") with respect to required information and the public availability of such information. OTC Group qualifies as such an IDQS under the Rule, as amended.

Prior to the implementation of the 2021 amendments and, at the option of a candidate under the Rule as amended, if a security issuer desired to gain admittance to the OTC markets, it had to find a sponsoring qualified market maker that agreed to review the proposed issuer's information and submit Form 211 to the FINRA OTC Compliance Unit. There are over 90 of such qualified market makers in the OTC sector, but a list of the leading firms in the sector would include Citadel Securities, GTS, Jane Street Group LLC, StoneX Group Inc., Susquehanna Securities LLC, G1X Execution Services LLC and Virtu Financial Inc. Under this protocol, after the Form 211 has been filed by the relevant market maker, another FINRA unit will then open discourse with that market maker and the

listing process will then play out. In most cases, FINRA will require additional information or clarifications regarding information previously submitted and often will have substantial comments on the content or manner in which the information had been provided. This entire process must be completed before the issuer's stock may trade in the OTC markets. Needless to say, this protracted procedure can be burdensome, time consuming and expensive.

Even under the Rule as amended, candidates for listing in the OTC markets may continue to follow this cumbersome process. However, recently, certain implementation procedures, designed to better effectuate the intent of the 2021 amendments to the Rule, have become operative. One of these new procedures enables prospective security issuers to circumvent the need to request a market maker to initiate the process to facilitate listing. Under this new procedure, the prospective issuer may elect approach the staff of OTC Group (as an IDQS) directly to request an "initial information review."⁵ The OTC Group will review the current financial information of the candidate as well as its material business information and will undertake to make a determination of whether such information is sufficiently publicly available. Once it has completed the initial information review procedure, the OTC Group will conduct all necessary interactions with FINRA and, if satisfied, will ultimately disseminate its determination that the candidate complies with the Rule.

Thus, by application of the 2021 amendments to the Rule, OTC Group has been empowered by the SEC to onboard new issuers directly onto its OTCQX and OTCQB markets, thereby broadening the pathway for companies to raise

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capital and provide liquidity for their shareholders. The initial information review process also provides the added benefit of not requiring the candidate to complete, and collaborate with a market maker to file, Form 211. Given the increasing SEC costs of going public as a reporting company⁶ (not to mention the legal and professional expenses), these new amendments provide companies with an alternative to listing on NASDAQ or NYSE that is quicker, less expensive and more efficient and transparent.

Through this novel initial information review process, the OTC Group is now capable of working directly with the nascent security issuer through the process of initiating listing on a quotation system, obtaining a trading symbol and embarking on the pathway of becoming a publicly traded company. These new provisions also enable investors to conduct trades in the new issuer's security through the broker of their choice, rather than being limited to the market maker that guided the new issuer through the listing process.

By taking advantage of the IDQS procedures which were largely overlooked at the time the SEC rolled out the 2021 amendments to the Rule, new issuers may avail themselves of the benefits of this novel streamlined process. Moreover, in concert with the other features of the recent 2021 amendments to the Rule, this new procedure promotes continuous liquidity and more favorable execution services for investors in the OTC markets. ▲

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ENDNOTES

- ¹ 17 CFR 240.15C2-11.
- ² See Securities Exchange Act Release No. 92932 (September 10, 2021), 86 FR 51700 (September 16, 2021) (Order Approving File No. SR – FINRA – 2021 – 04)
- ³ Form 211 had been modified consistent with the 2021 amendments and contains the same requests for information specified in the Rule, but now must be reviewed and signed by a principal of the broker dealer and certified by such principal that the firm has not received any monetary compensation for filing Form 211.
- ⁴ Defined by the Rule as “an interdealer quotations system that meets the definition of “alternate trading system” under Rule 300 (a) of Regulation ATS and operates pursuant to the exemption from the definition of an “exchange” under Regulation ATS.
- ⁵ Paragraph (b) of FINRA Rule 6432 establishes an after the fact filing requirement for any IDQS that performs an initial review under subsection (a)(2) of the Rule.
- ⁶ A “reporting company” is a company that is required to file reports periodically with the Securities and Exchange Commission under Section 12, 13 or 15(d) of the Securities Exchange Act of 1934.

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