

[Securities Regulation Daily Wrap Up, TOP STORY—SEC requires that current, public information underlie OTC securities quotes, \(Sept. 17, 2020\)](#)

Securities Regulation Daily Wrap Up

[Click to open document in a browser](#)

By [Anne Sherry, J.D.](#)

The SEC's revamp of its rule on broker-dealers' OTC quotations, the first substantive update in 30 years, requires that information about the issuer and the security be current and publicly available before a broker-dealer can begin quoting that security.

The SEC tightened the standards for quotations of securities on the over-the-counter market by requiring broker-dealers to review current, publicly available information about an issuer before commencing a quoted market in the issuer's security. The rule also updates the "piggyback" and "unsolicited quotation" exceptions, in both cases requiring that information about the issuer be current and publicly available. Chairman Jay Clayton said the rulemaking, which substantively changes Exchange Act Rule 15c2-11 for the first time in nearly 30 years, will hamper fraudulent schemes in "dark" securities that affect retail investors (*Publication or Submission of Quotations Without Specified Information*, [Release No. 33-10842](#), September 16, 2020).

The rule is effective 60 days after publication in the *Federal Register*. With one exception providing a longer transition period, the compliance date is nine months after the effective date.

Information-review requirement. The amended rule continues to require broker-dealers to obtain and review basic information about an issuer before initiating or resuming a quoted over-the-counter market in the issuer's security. Now, however, the information that the broker-dealer (or qualified interdealer quotation system) reviews generally must be current and publicly available. The broker-dealer or qualified IDQS must identify whether the quotation is published on behalf of the issuer or a company insider.

The broker-dealer must have a reasonable basis for believing the information is accurate and reliable. Qualified IDQSs may comply with the information review requirement, and broker-dealers in turn may rely upon the qualified IDQS's publicly available determination that it has so complied.

There are also several new or amended exceptions to the information-review requirement. A broker-dealer may publish a quotation for unsolicited customer orders without complying with the information review requirement, unless the customer is an affiliate of the issuer or a company insider (the broker-dealer may rely on a representation from the customer's broker that the customer is not an affiliate or insider). There is also an exception for highly liquid securities of well-capitalized issuers if the security meets a test involving daily trading volume, total assets, and shareholders' equity. The rule adds an underwritten offerings exception for quotations by a broker-dealer named as an underwriter in the security's registration or offering statement. Finally, there is an exception allowing broker-dealers to rely on publicly available determinations by a qualified IDQS or registered national securities association that the requirements of certain other exceptions are met.

Piggyback exception. In both its proposing release last September and in the final rule, the SEC [stressed](#) that broker-dealers act as a critical gatekeeper to OTC securities. Some of the rule's previous exceptions, however, allowed broker-dealers to maintain a quoted market for an issuer's security in perpetuity, even if there was no current, publicly available information about the issuer—and even if the issuer no longer existed. The new amendments modify the exceptions to place stricter requirements on broker-dealers, in turn enhancing investor protection, the Commission says.

The piggyback exception allows broker-dealers to publish quotations for a security in reliance on the quotations of another broker-dealer that initially performed the review of the issuer's information. Under the new

amendments, depending on the issuer's regulatory status, the issuer's information must be one of the following: (1) currently and publicly available; (2) timely filed; or (3) filed within 180 calendar days from a specified period.

Also, the amendments require at least a one-way priced quotation before a broker-dealer can rely on the piggyback exception. The proposed rule would have required that quotations represent both a bid and an offer at specified prices, but commenters observed that one-sided priced bids provide evidence of legitimate market interest and access to the exception in this event may help protect minority shareholders, provide price discovery, and enhance market development. The SEC concluded that requiring at least a one-sided quote will reduce the likelihood of fraud and manipulation without hampering liquidity.

The rule provides that broker-dealers must wait 60 days after the expiration of a trading suspension before relying on the piggyback exception as to that issuer. The amendments also provide an 18-month window during which broker-dealers may quote the securities of shell companies. The Commission believes this latter change strikes a balance between capital formation and investor protection: in recognition that shell companies "can be used as vehicles for fraud," the rule allows such companies a cost-effective means of maintaining a quoted market for a limited period but does not allow that market to carry on indefinitely.

Dark issuers and gray markets. Three members of the Commission described the inspiration and aims of the final rule. Chairman Clayton [said](#) that thousands of issuers of quoted OTC securities are "dark," meaning they do not publicly disclose current information. The SEC spends significant resources to address fraud stemming from dark issuers, which often affects retail investors particularly. Clayton believes retail investors may be less susceptible to manipulation like pump-and-dump schemes because they would no longer have access to those dark issuers' securities.

Commissioner Elad Roisman [echoed](#) the Chairman's comments, noting that the nature of 21st-century communications necessitated an overhaul of the information-review requirement. Roisman also highlighted where the proposal incorporated several suggestions from commenters, including a fifteen-grace period for a security that loses quote eligibility. He also acknowledged suggestions that IDQs be allowed to continue to publish quotes that otherwise lose eligibility to professional investors in an "expert market." While the final rule does not provide for such a market, it leaves an opening for the SEC to affect an expert market via exemptive relief. Roisman encouraged interested market participants to submit a request for such relief during the nine-month transition period.

Commissioner Hester Peirce also [said](#) she supported the amendments as "a more comprehensive solution" to fighting fraud, rather than one-at-a-time enforcement actions. She added that the final rule changed the proposal in view of comments that the new requirements could hurt investors by forcing divestitures or stifling competition. The rule's accommodation for shell companies was meant to help address these concerns, as was the allowance for one-sided quotations in the piggyback exception. Finally, Peirce said that while she does not like separating classes of investors, the "expert market" would be better than no market at all for so-called gray market securities.

This is [Release No. 33-10842](#).

MainStory: TopStory BrokerDealers Enforcement ExchangesMarketRegulation FraudManipulation GCNNews
PublicCompanyReportingDisclosure