Security Traders Association
Dictum Meum Pactum Since 1934

May 5, 2015

Brent J. Fields
Federal Advisory Committee Management Officer
Securities and Exchange Commission
100 F Street, NE Washington, DC 20549-1090

Re: Securities and Exchange Advisory Committee on Small and Emerging Companies; File No. 265-27

Dear Mr. Fields,

The Security Traders Association ("STA")[1] wishes to offer comment on the agenda item: "Committee Discussion of Venture Exchanges and Secondary Market Trading Issues" discussed at March 4, 2015, meeting of the Securities and Exchange ("Commission") Advisory Committee on Small and Emerging Companies. The STA has a long history of offering comments on complex market structure issues. We as an industry association with a diverse membership as measured by geography and business model are well positioned to offer comments on the subject of venture markets and venture exchanges. The STA has twenty-four affiliate organizations, including four (4) in Canada, where a venture exchange called TSX Ventures is operated. In addition two (2) of STA advisory committees, the Buy Side Advisory and Retail Advisory committees, are comprised of financial service professionals from firms who hold investor assets and bear certain investment recommendation and execution responsibilities. We believe the combination of these perspectives will provide the Commission with invaluable insight into the current state of venture markets in the United States, along with recommendations on where the Commission should focus its attention for determining if improvements or new processes are needed.

[1] STA is a trade organization founded in 1934 for individual professionals in the securities industry. STA is comprised of 24 Affiliate organizations with 4,200 individual professionals- most of who are engaged in the buying, selling and trading of securities. The STA is committed to promoting goodwill and fostering high standards of integrity in accord with the Association's founding principle, Dictum Meum Pactum – "My Word is My Bond".

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Our remarks are based on the fundamental belief that the goal of any venture market model should be to build an ecosystem which enables newly formed companies that are not ready to meet exchange standards, and enables them to grow and progress to a state where they can meet the listing requirements of their respective national exchange(s) regardless of their size. The STA would have reservations if a goal or an attribute of changes to venture markets in the United States would result in moving a large number of long established companies currently trading on a listed exchange to an alternative venture market or venture exchange. While the STA continues to believe that today's market structure does not serve companies with small capitalizations well, we do not feel that large numbers of exchange listed securities moving to a venture market or a newly formed venture exchange, either by choice or regulatory mandate, best serves the needs of secondary trading and capital formation for these size companies.

Over-the-counter versus exchange model

Today, there are venture markets in the United States ("U.S."), Canada and United Kingdom. The STA will be limiting our remarks to those venture markets where we have expertise: the OTC Market Group in the U.S.; and the TSX Venture, ("TSXV") in Canada. Both of these markets have critical mass as measured by volume and the amount of companies trading on their platforms. In addition, these two markets are the global leaders at producing companies graduating to national exchange status. In 2014, OTC Market Group graduated eighty-three (83) companies and TSXV graduated twenty-two (22)[2]. These markets however, are constructed differently and as such, operate differently.

In the U.S., the venture market is an over-the-counter or multi-dealer market model. Price and liquidity information is provided by OTC Markets Group which operates three marketplaces: OTCQX; OTCQB; and OTC Pink. OTC Markets Group trading platform is registered with the Commission as an Alternative Trading System and regulated by FINRA. It is not associated with the national exchanges.

[2] OTC Markets Newsletter – March 2015

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In Canada, their venture market, TSXV, is based on an exchange model. TSXV is owned by the TMX Group, which also owns Canada's largest national exchange, TSX. All trading through the TSXV is done electronically, so the exchange does not have a "trading floor". TSXV operates a real-time, continuous auction market that matches individual orders with continual price discovery in the central limit order book (CLOB). Both TSX and TSXV accept all regular order types, including dark orders.

The STA recommends the Commission compare the attributes of these two venture market models in determining to what degree, if any, a gap exists between the current over-the-counter U.S. venture market and what may be achieved if an exchange alternative were introduced. Such an analysis would serve well in deciding how much change, if any, needs to be introduced in the U.S., and whether any changes take the form of improvements under the current OTC regime, the introduction of an exchange model option, or both.

In comparing these two venture market models, the Commission should take into consideration the size of each country's economy and their publicly traded markets for measuring results from such criteria as:

- Size of each nation's existing venture market;
- Levels of activity for companies graduating to exchange status; and
- Levels of activity for companies delisting from their respected venture model.

Other areas where the Commission should compare the current U.S. OTC model with that of TSXV include, but are not limited to:

- Operational capability;
- Investor protections; and
- Levels of enhanced liquidity provided to investors by trading operations, or trading centers.

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Recommendations

Operational capability

First and foremost, venture markets or exchanges need to have operational capability. In testimony before the Capital Markets and Government Sponsored Enterprises Subcommittee Committee on Financial Services U.S. House of Representatives June 20, 2012, STA stated:

"Investor confidence is influenced by several factors, none more than the operational capability of the markets. Failures of that capability, even as a rare or limited occurrence, destroy investor confidence, much more so than any other regulatory or market structure minutia. Fostering greater operational capability should be the foremost consideration of any regulatory or legislative entity that has oversight or influence on our financial markets."

The Commission should consider if one market structure serves operational capability better than another for these types of securities. General areas for consideration could include limiting single points of failure and providing operational verification.

Investor Protection

STA believes that the standards for investor protections should be a combination of adequate company disclosures as defined by the Commission and transparency for retail investors who, when at the point of execution, are afforded a means to know that the security in which they are transacting is a venture security. This transparency could be in the form of a modifier on the symbol. The STA acknowledges and respects that issuers may believe such a modifier creates a negative perception of their company. We respectfully disagree with this view and believe the perception of marketplaces and the companies that list on them are determined by the level of trust that investors have in that market or exchange. In addition, even if such a modifier may hurt the general perception of these companies, STA believes its implementation would offer investors a prudent caveat emptor warning.

Regulatory approach for companies graduating, de-listing, or moved off

In order for a venture market or exchange to perform its function, vibrant catalysts for graduating companies up to a national exchange or de-listing them from venture exchanges need to exist.

Incentives for newly formed companies to graduate up to a national exchange would include opportunities for that company to be eligible for a larger pool of investable assets and be exposed to liquidity in cross-market products such as ETFs and listed options.

A regulatory solution should be the primary catalyst for ensuring that companies which no longer meet the requirements of their respective venture market are de-listed or moved. It is our view that a venture market or exchange will be judged equally by its successes, such as price performance, and failures, such as instances of fraud. It is critical that companies which do not meet the requirements of the venture markets are removed or have a clearly designated caveat emptor warning to avoid harm to investors.

Levels of enhanced liquidity provided to investors

It has long been STA's view that investors benefit from enhanced liquidity provided by market makers and block traders in companies with small capitalizations. Enhanced liquidity is liquidity that exceeds what is publicly displayed and available in the marketplace. Enhanced liquidity could be the result of capital commitment, secondary offerings or institutional block trades. Exchanges by their regulatory requirements are not allowed to commit capital in facilitating liquidity for individual investors. However, as STA wrote in its testimony at the July 28, 2014 Roundtable on U.S. Market Structure Panel III: "Market Making and Trading in the 21st Century":

While the factors in enhanced liquidity provision are numerous, there are certain core ones which could be improved through regulatory actions….those core factors which nurture enhanced liquidity such as:

- *Quote quality. Improvements to displayed liquidity need to focus on size and ensuring that what is publically displayed is accessible in a fair and reasonable way.*

- *Volatility. Providers of enhanced liquidity are more inclined to commit capital and more able to conduct block trading if the prices of the security the provider transacts in remains stable.*
- *Reduction in costs. The withdrawal of market makers and block traders is partially related to the increased costs of trading illiquid securities*

Therefore, as the Commission conducts is analysis, it should consider how to best create the conditions which encourage enhanced liquidity.

Principles based rule making

Finally, when making any final determination(s) the STA recommends the Commission consider three (3) principles based statements that STA has long believed to be consistent for achieving successful changes in market structure;

- Incremental changes to market structure are best because they reduce the likelihood of negative unintended consequences.
- Regulation should not pick winners and losers.
- Investors are best served when there is a balance of regulation and competition.

Conclusion:

The STA recommends that should the Commission conduct an analysis on what can be done to regulations of U.S. stock exchanges and the OTC markets to improve the ecosystem for small companies raising capital, an effective approach would be to compare the attributes of the existing OTC venture market in the U.S. with those of the exchange model regime in Canada, under the TSXV. In such an analysis, the Commission should include a review on increasing efficiency, reducing barriers to entry, reducing unnecessary costs and complexity, while improving investor protections with better transparency at the point of sale.

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The STA appreciates the opportunity to comment on venture markets and exchanges and looks forward to continued dialogue with the Commission on this critical topic.

Rory O'Kane
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