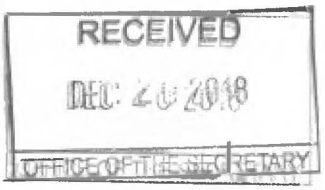

December 19, 2018

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F. Street NE
Washington, D.C. 20549

Re: Petition for Rulemaking Regarding Administration of the Financial Industry Regulatory Association

Dear Mr. Fields:

Pursuant to 5 U.S.C. § 553(e), Rule 192(a) of the SEC's Rules of Practice and Section 19(c) of the Securities Act, 15 U.S.C. § 77s, 78s(c), Alpine Securities Corp. ("Alpine") through undersigned counsel respectfully petitions the U.S. Securities and Exchange Commission ("SEC") to consider rulemaking proposals designed to return the governance of the Financial Industry Regulatory Association ("FINRA") to a closer alignment with its members and prevent continuing damage to particular markets and their participants. The specific proposals include requirements to ensure equal and fair representation to FINRA member firms on its Board of Governors and NAC, to require equal consideration of each vote cast by a member firm and to prevent the issuance and deployment of inappropriate "guidance" which is disproportionately impacting and damaging certain segments of the market.

As discussed below, these proposals are in response to FINRA's failure to represent a significant component of member firms as well as issuers and investors who participate in the microcap markets. To address those issues, we seek both greater representation within FINRA, so that the interests of those who participate in the market can be considered, and appropriate and essential constraints on FINRA's inappropriate usage of guidance.[1]

I. Background

A. The Formation and Purposes of the SRO

Under the Securities Exchange Act of 1934, Congress established the system of regulation over the securities industry that included administration of markets and oversight of industry participants by private organizations. Consistent with established models of self-

[1] The SEC, under section 15A(k), has the power to alter or modify association rules where necessary to ensure fair representation of members and fair procedures for admission and discipline. 15 USC § 780-3(k)(1).

regulation in relation to the securities exchanges,[2] the Exchange Act was amended in 1938 by the Maloney Act to authorize the formation and registration of national securities associations, which would address conduct of their members under the supervision of the SEC.[3] As with the stock exchanges, those associations would administer over-the-counter markets and regulate the "admission and conduct of members."[4]

The Maloney Act envisaged the following: the creation of a few organizations, democratic in character, in which membership would be voluntary; the regulation of relations between the members and the public; promotion of ethical standards; education of the members; and reduction of governmental expenses. It was intended also to prevent "tyranny of the organization toward its members" and a laxity of standards directed to promote the public interest.[5] As confirmed by SEC Commissioner George Matthews, "the industry should eventually play the predominant role in its own regulation and development along sound economic and social lines."[6] The industry organization, Mr. Mathews explained, would establish standards for conduct while the Commission would then address any "submarginal element" that refuses to abide by moral or legal standards.

The endeavor was described as a "unique experiment in supervised self-regulation" and, from the outset, the tension that would be inherent in the effort was acknowledged by the regulators and industry participants.[7] As one participant succinctly stated, "those of us who are large must remember the fears of the small, that they may be dominated by those who do not understand and appreciate their problems."[8]

B. The Development of FINRA and Its Increasing Disconnection from its Members

In critical respects, the eventual outcome was not what had been envisioned. First, only one organization came into existence, and it possessed "great disadvantages" because of the diversity of industry participants and the inability of a monolithic entity to serve the interests of

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[2] See Peirce, Hester, *The Financial Industry Regulatory Authority: Not Self-Regulation After All*, Mercatus Center, George Mason University, January 2015, available at www.mercatus.org/system/files/Peirce-FINRA.pdf (hereinafter "Peirce Article").

[3] *See* Bonner, Francis, *The Over the Counter Market and the Maloney Act*, Oct. 28, 1938, at 633, available at www.sec.gov/news/speech/1938/102838bonner.pdf (hereinafter cited as "Bonner Speech"); OVER-THE-COUNTER TRADING AND THE MALONEY ACT, 48 Yale L.J. 4 (1939), available at: http://digitalcommons.law.yale.edu/ylj/vol48/iss4/5l ; Peirce Article at 5.

[4] Jennings, Richard W., *Self-Regulation in the Securities Industry,* 29 *Self-Regulation, Law & Contemporary Problems* 3 at 663, available at www.scholarship.law.duke.edu/lcp/vol29/iss3 (hereinafter cited as "Jennings Article").

[5] Bonner Speech at 5; Hed-Hoffman, Tamar, *The Maloney Act Experiment*, 6 Boston Coll. Law Rev. 2 at 187 (hereinafter "Maloney Act").

[6] Mathews, George, *A Discussion of the Maloney Act Program,* available at www.sec.gov/news/speech/1938/102338mathews.pdf (cited in Peirce Article at 6).

[7] *See* Maloney Act at 205.

[8] Bonner Speech at 5. *See also Concept Release Concerning Self-Regulation*, 69 Fed.Reg 71,256, 71,261-262 (Dec. 8, 2004).

all.[9] Even decades after the formation of the NASD, it was still anticipated that other national associations, better able to address the particular issues and responsibilities of its disparate members, would form.[10] However, the statutory provisions governing the formation of a national security association, set forth in Section 78o-3(b), include requirements that have the effect if not the purpose of creating a monopoly, *i.e.,* to be recognized, an association must have a sufficient quantity of participants, geographical distribution, and an existing organizational structure. Given the considerable obstacles to the formation of an alternative association, FINRA will likely remain the only organization through which securities firms can operate in the securities markets.

The diverse mission and goals of a national security association have also arguably been eclipsed, over time, by the view that FINRA should aggressively police and prosecute its own members rather than focusing on its equally critical obligations to "assure fair representation of the interests of all members and market participants," and "to remove impediments to and perfect the mechanism of a free and open market."[11] Those directives are plainly articulated as core obligations of the association. Section 15A(b) requires that FINRA's rules assure a fair representation of its members in the administration of its affairs and not enable "unfair discrimination between customers, issuers, brokers or dealers." The statute further expressly provides that FINRA may not fix rates or impose fees or regulations on "matters not related to the purposes of this title" and shall not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title."[12] Those mandates, and FINRA's obligations as a trade association and representative of members, are articulated with equal if not greater weight in its statutory underpinnings.

Included among the various statutory requirements contained in the enabling provision is reference to the promotion of just and equitable principles of trade, often cited as justification for aggressive prosecutorial actions toward members. It is useful, however, to place those words in the actual context of FINRA's obligations to promote and facilitate transactions, to "perfect" a free and open market, and to prevent unfair discrimination.

> The rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest and are not designed to permit unfair discrimination between customers, issuers, brokers or dealers to fix minimum profits, to impose any schedule or fix rates of commissions, allowances,

[9] Maloney Act at 207.

[10] Maloney Act at 217.

[11] Jennings Article at 675.

[12] 15 USC § 78o-3(b)(6), (9).

> discounts, or other fees to be charged by its members or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the association.[13]

FINRA's mission and obligations thus flow to various constituents including the market itself, issuers and customers – even those customers who are less wealthy and seek the ability to participate in the purchase and sale of lower priced securities.

While certainly the association was intended to promulgate standards of conduct and administer dealings as between members, it was not intended to replicate the regulatory functions of the SEC or, worse, devise and seek to enforce its own substantive interpretations of the federal securities laws.[14] It was intended to represent not only the interests of the SEC but also the interests of members, associated persons, customers, issuers, brokers and dealers. It is obligated to abjure any actions that are destructive to members, impede the operations of free and open markets, and/or that involve" unfair discrimination" in relation to members, issuers or customers.

C. FINRA Now Lacks Sufficient Oversight By and Transparency To its Member Firms

Notwithstanding these core obligations, FINRA's separate and more punitive function has risen to the fore and come to dominate FINRA's role. In 1996, the SEC began pressing to diminish the industry's role in the supposed self-regulatory organization, acknowledging the importance of "the knowledge, insight and expertise" of industry participants but insisting that it must give "primacy" to the protection of investors. It therefore required an increase in the role of public members on NASD's board and elevating the position and independence of its staff.

The dominance of public over industry representatives increased even more in 2007 when the NASD merged with the NYSE) and FINRA was formed. Even as of the time of the consolidation, the shift away from representation of industry participants was underway. As discussed in Release No. 34-77786, in connection with the 2007 consolidation of the NASD and NYSE Regulation, the SEC approved changes to the NASD By-Laws "that apportioned public and industry representation on the FINRA Board of Governors."[15] Notwithstanding the obligation of fair representation, the By-Laws require "that the number of Public Governors serving on the FINRA Board *exceed* the number of Industry Governors."[16] With respect to the NAC, it consisted at that point of 14 members, 7 Industry and 7 Public, usually appointed based on recommendations from the Nominating Committee. FINRA proposed in 2007 that the NAC be expanded to 15 members for the precise purpose of having the number of Non-Industry Members *exceed* the number of Industry Governors.

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[13] 15 U.S.C. 78o-3(b)(6).

[14] *See* Maloney Act at 209.

[15] Sec. & Exch. Comm'n, Rel. No. 34-77786, at 2 (May 9, 2016).

[16] *Id.* at 3.

Since the consolidation in 2007, FINRA has developed a bureaucratic existence and aggressive regulatory approach that fails adequately to reflect the interests of a significant component of its members, the needs of certain issuers and investors, and its critical obligation to develop, not thwart, capital raising activities of start-up companies. For decades, FINRA was under the control and direction of primarily non-industry members. FINRA's Board of Governors includes the only member firm representatives who could have any meaningful impact on the administration of FINRA, and yet the members elect only seven of its 23 members. By definition, the policies and practices of FINRA are, therefore, determined by unelected individuals appointed by the FINRA Board from candidates nominated by a nominating committee.[17] Further, of the seven seats that are elected by FINRA members, only three of those seats can be filled by "small firm" governors; three other seats are dedicated to representatives of large firms, i.e., those with more than 500 registered representatives.

As explained by Commissioner Peirce,

> The board structure, which is intentionally weighted away from the industry, is not consistent with self-regulation. An organization run by a board that is dominated by people who are not in the industry is not an SRO; it is a regulator with industry representation. Onnig H. Donaldson, professor of law at Tulane University Law School, has documented the trend away from an SRO staff with deep industry expertise and its replacement with a bureaucratized staff.[18]

Similarly, of the 31 committees that "provide feedback on rule proposals, regulatory initiatives and industry issues," only one is focused on "issues of particular interest and concern to small firms."[19] Yet in 2017, for example, small firms comprised 3,353 of FINRA's total of 3,726 member firms.[20] In terms of distribution by size of firm, 90% of FINRA's membership consisted of small firms.

Even more critical is that, after a tradition of *industry participants* serving as Chairman of the Board of Governors, that position was then taken and held for almost twenty years, from 1997 to 2016, by the Chief Executive Officers of NASD and then FINRA. Most recently, Richard Ketchum obtained and kept the position of Chairman for 7 years, from 2009 through

[17] According to the Notice, only 20% of the Nominating Committee members must be industry governors associated with a FINRA member firm to satisfy the statutory requirements of "fair representation" under SEA 15A(b)(4). *See* FINRA, "Special Notice: Engagement Initiative" at 4, n. 3 (Mar. 21, 2017), *available at* http://www.finra.org/sites/default/files/notice_doc_file_ref/Special-Notice-032117.pdf (hereinafter "FINRA Special Notice"). . A firm not selected by the Nominating Committee must petition for inclusion and challenge the nominee. FINRA By Laws, Article VI § 6.2.

[18] Peirce Article at 18.

[19] FINRA Special Notice, *2018 Involvement and Election Process Overview*, February 1, 2018, at 5-11.

[20] FINRA, *2018 FINRA Industry Snapshot*, at 12 (Aug. 2018), *available at* https://www.finra.org/sites/default/files/2018_finra_industry_snapshot.pdf (hereinafter "2018 FINRA Industry Snapshot").

2016. During the same period, Brad Bennett acted as Chief of Enforcement and touts the dramatic increase that occurred in actions against members and associated persons. According to Mr. Bennett, during his tenure FINRA brought cases "on a scale of size, sanction and sophistication that can *compete* with federal regulators," increased industry bars and expulsions by 20% and increased monetary sanctions from an annual total of $41 million to a total of $175 million in 2016.

These critical issues were examined by now Commissioner Hester Peirce in her 2015 paper, *The Financial Industry Regulatory Authority: Not Self-Regulation After All.* Ms. Peirce observed that "FINRA's structure and monopoly status shield it from oversight."[21] It is not accountable to the industry "in the way a self-regulator would be," "nor is it accountable to the public, Congress, the president or the courts."[22] It has slowly but certainly evolved into what some describe as a "fifth branch of government," "likely to behave as if they are an extension of the Commission's own compliance and enforcement arms, with the added benefit that they are *subsidized directly by industry fees*."[23] Possible solutions, according to the Peirce Article, include acknowledging that FINRA acts like the SEC and "fold FINRA into the SEC." Alternatively, "*FINRA could be remade into an organization that is run by the industry it regulates*," and perhaps then, Ms. Peirce suggests, "competing SROs might emerge to tailor regulation to a particular group of firms such as smaller broker-dealers."[24]

D. Recent Developments Are Positive But Not Sufficient

Only after an industry participant resumed the position of Chair in 2016 was there any recognition of the extent to which FINRA had become an enforcement agency, apparently seeking to outdo the SEC, while failing to properly consider and address the very legitimate concerns of the members regarding excessive, costly and inconsistent regulation of the industry. Only recently, since the change of control in 2016, has there been a seemingly genuine acknowledgement of FINRA's failure to represent its members: in March 2017, FINRA issued a Special Notice concerning its "Engagement Initiative," in which it reviewed its means of engaging with its member firms, and sought comments regarding how to enhance its mission and effectiveness.[25] The Special Notice acknowledged and sought to address some of these issues,

[21] Peirce Article at 2.

[22] *Id.* at 3.

[23] *Id.* at 21. Commissioner Peirce also emphasizes that amounts collected by the SEC as penalties and disgorgement are often used to compensate victims or are paid to the Treasury while amounts collected by FINRA are not subject to Congressional directives. And rulemaking at the SEC level requires actual economic analysis to identify the problem, potential solutions and the costs and benefits, while the SEC has "generally not raised the issue" in relation to SRO rules. FINRA has also, to this point, avoided being classified as a state actor and thereby avoided the kind of accountability that usually exists among those that exercise governmental powers. *Id.* at 22-24.

[24] *Id.* at 28.

[25] *See generally* FINRA Special Notice, 3/21/17, available at www.finra.org/industry/special-notice-032117; FINRA News Release 3/21/17, FINRA Seeks Comment on its Engagement Programs, available at www.finra.org/newsroom/2017/finra-seeks-comment-in-its-engagement-programs.

emphasizing that FINRA "can (and should) actively engage with its member firms" and that member firms must be permitted to "participate where appropriate in developing FINRA's rules and programs."[26] FINRA also recognized that "insufficient member engagement may result in FINRA failing to fully achieve the benefits of its SRO model."[27]

Having identified the lack of responsiveness to and participation by members, FINRA's initiative focused on its committee structure as a means of interacting with member firms, and referred to FINRA's election process whereby vacancies to the Board, the NAC and the District Committees are filled. But that initiative failed to tackle the causes of or remedies for FINRA's overzealous enforcement activities and the resultant and real damage to market participants and sectors.

The Progress Report on FINRA360, published in April 2018, reiterated the same themes regarding FINRA's core mission including its need to work with members, investor and other stakeholders to cultivate a deep expertise in the securities industry that enables a more effective regulatory framework and promotes vibrant capital markets."[28] That Report identified some progress that had been made, including trying to increase transparency in relation to operations and working more cooperatively with members, but also confirmed that FINRA360 is a "multi-year initiative" and that there remained "much more work ahead" to improve interactions with member firms and the investing public.[29]

E. The Damage Done

Under the leadership of non-industry participants, FINRA has engaged in a series of actions that were designed to and have impaired key components of the microcap markets. As participants in that market, we have seen first-hand the regulatory disdain for these markets and watched as increasingly aggressive actions were taken against those who dare to participate in that market.

FINRA's actions were likely an outgrowth of efforts by regulators to "choke" certain businesses, *not* through the pursuit of those who engage in improper conduct but rather through

[26] Special Notice at 3.

[27] *Id.* The FINRA Special Notice also discussed the publication and the role of "regulatory guidance," discussed below. *See id.* at 15.

[28] FINRA, "Progress Report on FINRA360," at 1 (Apr. 2018), *available at* https://www.finra.org/sites/default/files/FINRA360ProgressReport_April2018.pdf (hereinafter "Progress Report").

[29] *Id.* at 2. The SEC, on May 25, 2018, provided notice of proposed rule changes relating to "the District Committee structure and governance." Sec. & Exch. Comm'n, Rel. No. 34-83332 (May 25, 2018). FINRA also established two new committees including the Clearing Firm Advisory Committee to "serve as a forum for clearing and introducing firms to advise and make recommendations on issues arising from member firm activities relating to the clearance, carrying and settlement of securities, including issues practices and activities affecting or relating to small member firms such as their access to clearing services." Progress Report at 27. Those actions, while positive, do not address any of the structural issues associated with FINRA's current operation.

the shift of enormous swaths of regulatory resources to the pursuit of those who engage in legitimate businesses that have, in the past, been used by those who engage in fraud. Through that allocation of regulatory resources, the supposed gatekeepers of business – primarily banks and brokerage houses – have been aggressively investigated, pursued and penalized for their alleged failures to perform investigative functions.[30] In the process, regulators have extracted literally billions of dollars of corporate earnings from their shareholders, while leaving in place the same precise members of management who engaged in the conduct that was supposedly egregious enough to warrant the massive fines. Corporate management at large institutions has been able and only too willing to go along with that regime, paying over to regulators what is quite literally other people's (shareholders') money – as long as management kept their own jobs, with resulting economic loss to the shareholders of those companies. Countless smaller businesses that lack the wherewithal to pay those massive penalties have been driven out of business, all to the benefit of the larger firms. And these are not companies that are themselves engaged in fraud; these are productive and even critical participants in our economy whose only fault was their supposed failure to "police" the markets. It constitutes, as stated in the report of the U.S. House of Representative, Committee on Oversight and Government Reform ("House Oversight Committee"), "inappropriate[] demands that bankers act as the moral arbiters and policemen of the commercial world."[31]

The government's aggressive approach led to Congressional inquiries that identified the invalidity of the government's actions.

> Forceful prosecution of those who defraud American consumers is both responsible and admirable. However, Department of Justice initiatives to combat mass market consumer fraud must be legitimate exercises of the Department's legal authorities, and must be executed in a manner that does not unfairly harm legitimate merchants and individuals.
>
> Operation Choke Point fails both these requirements. The Department's radical reinterpretation of what constitutes an actionable violation under § 951 of [Financial Institutions Reform, Recovery, and Enforcement Act of 1989] fundamentally distorts Congress' intent in enacting the law and inappropriately demands that *bankers* act as the moral arbiters and policemen of the commercial world. In light of the Department's obligation to act within the bounds of the law, and its avowed commitment not to 'discourage or inhibit' the lawful conduct of honest merchants, it is necessary to disavow and dismantle Operation Choke Point.[32]

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[30] *See* Ruce, Phillip, *The Bank Secrecy Act: Considerations for Continuing Banking Relationships After the Filing of a Suspicious Activity Report,* 30 Quinnipiac L. Rev. 43, 43-44, 55-64 (2011); Allen D. Boyer and Susan Light, *Dirty Money and Bad Luck: Money Laundering in the Brokerage Context,* 3 Va. L.& Bus.Rev. 81, 97-122 (2008).

[31] DARRELL ISSA, H. COMM. ON OVERSIGHT AND GOV'T REFORM, 113TH CONG., *The Department of Justice's "Operation Choke Point": Illegally Choking off Legitimate Businesses?*, at 11 (pub. May, 29, 2014) (hereinafter "Issa, *Operation Choke Point*").

[32] *Id.* (emphasis in original).

The concerns regarding the "choke point" approach continued even through 2017. A group of Republican congressmen, on August 10, 2017, sent a letter to regulators asking that they confirm that they are no longer pursuing that choke point approach that forced financial institutions to cease doing business even with legitimate businesses because of the risk of regulatory backlash.[33]

A similar approach has been deployed against the microcap markets. Given the highly speculative nature of low priced securities, Congress long ago addressed concerns regarding that market, and did so in a manner consistent with the premise of our securities laws: disclosure as opposed to prohibition. Through the passage of the Penny Stock Reform Act of 1990, Congress ensured that those who participate in those markets would receive more fulsome disclosures and imposed additional requirements on those transactions.

That fundamental concept of disclosure was not, however, enough for regulators who continued to press toward ways to *prevent* transactions in low priced securities. That process has progressed over years: provisions of the Patriot Act have been distorted and effectively rewritten by regulators; regulators developed "guidance" that purports to require industry participants not only to report what they see, but also to employ investigators to find, to research and unearth information regarding customers or their transactions. Superimposed on that structure was the regulators' "red flag" approach pursuant to which the regulators were able to label characteristics of certain kinds of transactions as "suspicious" -- and those "red flags" were then interpreted to encompass any transaction in low priced securities.[34] . Slowly but surely the regulators developed a new kind of "conventional wisdom," building a narrative that inherent characteristics of trading in low priced securities are "red flags" and suspicious, and transforming those dubious assumptions into predicates for aggressive regulatory enforcement. Whether by design or otherwise, the ineluctable consequence of these events is "derisking," resulting in fewer and fewer firms willing to arouse the ire of regulators by participating in the microcap market.

Among the techniques central to FINRA's actions against the microcap markets are its sweeping interpretation of its enforcement authority and its dissemination and use of purported "guidance." It has relied extensively on its own "guidance" publications in taking the position that microcap transactions constitute a violation of the provisions of the Securities Act of 1933 and the Bank Secrecy Act. Through that "guidance," FINRA seeks to create law by setting out its own extrapolations of actual statutory provisions, insisting that its interpretations are entitled to "deference," and then using its proclamations "for the purpose of coercing persons or entities

[33] Letter from Bob Goodlatte, et al., U.S. Congressmen, to Attorney General Jeff Sessions, et al. (Aug. 10, 2017), *available at* https://judiciary.house.gov/wp-content/uploads/2017/08/081017-Choke-Point-Letter.pdf.

[34] *See e.g.,* Jonathan N. Eisenberg, *AML Obligations of Broker-Dealers*, Harvard Law School Forum on Corporate Governance and Financial Regulation, (September 30, 2016).

outside the federal government into taking any action or refraining from taking any action beyond what is required by the terms of the applicable statute or regulation."[35] .

That tactic is improper. As a matter of law, agencies do not have the power to make law and are not permitted to simply promulgate guidance and then cite it as binding; an agency has only the power conferred on it by Congress.[36] Congress has plainly mandated that agencies are permitted to engage in "rulemaking," including the promulgation of any "substantive" or "legislative" directive, only in accordance with the comprehensive procedures set forth in the Administrative Procedure Act ("APA"). Absent compliance with the APA, an agency's publications do not have the force of law and are not entitled to the judicial "deference" that would apply to a statute or regulation.

The impropriety of an agency's deployment of its own purported "guidance" was underscored recently by a Justice Department memorandum, *Prohibition on Improper Guidance Documents*, issued in November 2017.[37] That memorandum confirmed that, in the past, guidance documents had been issued without rulemaking and then used to "coerce" persons or entities into engaging in or refraining from conduct beyond that which is required by any statute or regulation. And, according to the memorandum, the Justice Department would cease promulgating "guidance" documents that purport to "impose new requirements" or "create binding standards." It further directed that existing "guidance" be reviewed to identify that which should be repealed, replaced or modified.

Underscoring the prohibition against improper promulgation or use of guidance, Associate Attorney General Rachel Brand issued a subsequent memorandum, dated January 25, 2018, entitled *Limiting Use of Agency Guidance in Affirmative Civil Enforcement Cases.*[38] That memorandum prohibited the Department from acting "to effectively convert agency guidance documents into binding rules" or "using noncompliance with guidance documents as a basis for proving violations of applicable law."[39]

The "crackdown" in relation to the microcap markets, including the aggressive positions taken by FINRA, are crushing those markets and resulting in a dramatic reduction in the ability to purchase and sell those securities. [40] As of July, Bank of America Merrill Lynch announced that it would no longer permit transactions involving low priced securities that trade on the OTC

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[35] PHILIP HAMBURGER, *Is Administrative Law Unlawful*? University of Chicago Press (2014).

[36] *See La. Public Service Comm. v. FCC,* 476 U.S. 355, 374 (1986).

[37] Dep't. of Justice, Office of the Attorney General, "Prohibition on Improper Guidance Documents" (Nov. 16, 2017), *available at* https://www.justice.gov/opa/press-release/file/1012271/download.

[38] Dep't of Justice, Office of the Assoc. Attorney General, "Limiting Use of Agency Guidance in Affirmative Civil Enforcement Cases" (Jan. 25, 2018), *available at* https://www.justice.gov/file/1028756/download.

[39] *Id.* at 2.

[40] *See* Anthony, Laura, "Shifting Capital Markets," (Oct. 23, 2018), available at http://securities-law-blog/2018/10/23/shifting-capital-markets-bank-of-americas.

markets, and last month added further restrictions including restricting sales of stock of any low priced security with a market capitalization of less than $300 million. Last month, COR Clearing, in the face of aggressive regulatory action, finally agreed to cease transactions in OTC Market securities below $5.00 per share and will not accept deposits of such securities. COR's action left only a handful of firms that would continue to accept deposits of and clear transactions in low priced securities. Alpine is one of those few, and is itself now under enormous pressure to do precisely what COR did and exit that market.

Consider the impact if these efforts to drive firms out of the microcap market are actually successful. The distaste for the microcap markets that flows through Wall Street obviously reflects a great respect for wealthy and substantial companies, and the brokerage firms that service them, but it utterly fails to appreciate the value and critical importance of those not yet wealthy entrepreneurs and their emerging companies that need to raise capital, or the investors who also want to participate in the markets. Consider the analysis published in December 2016 by the SEC regarding investments in over-the-counter ("OTC") stocks.[41] That paper acknowledged the sheer size of the microcap market: "approximately 10,000 OTC stocks were quoted at the end of 2013 through 2015, generating a total trading volume of over $200 billion per year."[42] That volume increases each year; the "volume traded in 2015 ($200 billion) is almost 50% higher than 2012 ($136 billion)."[43] The obvious reason: there are an enormous quantity of retail investors who, oftentimes shut out of the higher priced stocks, still want to participate in the stock market: "OTC stocks are owned and traded almost exclusively by individual and 'retail' investors."[44] Those investors, according to the report, are drawn to OTC stocks for one of two reasons. Either they "are simply gambling" and actually enjoy the "lottery-like" aspect of the small cap markets, where a positive result is unlikely but, when it comes, is enormous.[45] In fact, "investors in stocks on a national securities exchange with lottery-type payoffs tend to have socioeconomic profiles similar to individuals who participate more often in state lotteries."[46]

The remarks of Chairman Jay Clayton certainly suggest that he is concerned about the impact of over regulation or overly aggressive or misguided enforcement actions on the efficacy of our markets:

> The reduction in the number of US listed public companies is a serious issue for our markets and the country more generally. To the extent companies are eschewing our

[41] White, Joshua, *Outcomes of Investing in OTC Stocks* (Dec. 16, 2016), available at www.sec.gov/files/White-OutcomesOTC-Investing.pdf.

[42] *Id.* at 1.

[43] *Id.* at 2.

[44] *Id.*

[45] *Id.* at 3.

[46] *Id.* at 14.

public markets, the vast majority of Main Street investors will be unable to participate in their growth. The potential lasting effects of such an outcome.

These actions are having a demonstrable and unhealthy impact on the marketplace and causing what may be a clearing firm crisis. Start-up companies will not be able to obtain services or investors because it will become impossible for any investor or service provider to sell those securities.[47] It is irrational and flatly contrary to its mandates for FINRA to so enthusiastically participate in the decimation of a legitimate marketplace, and its willingness to do so appears to be an outgrowth of the content of its leadership.

II. NSCC Fees and Charges Are Also Contributing to the Rapid Demise of the Microcap Markets

The actions of FINRA directed at microcap transactions have been combined with NSCC's imposition of fees and charges associated with those transactions that are also preventing Alpine from processing lawful customer transactions and rendering it difficult if not impossible to clear even relatively small sales of microcap stocks.[48] A series of changes in the calculation of charges relating to microcap transactions, including the Clearing Fund Premium, "Illiquid" Charges and Credit Risk calculations as well as elimination of offsets pertaining to stock held at DTC, have combined to create an irrational monetary requirement for microcap transactions that is cost prohibitive and that bears no relationship to the underlying transaction. Those charges, and the impact on clearing firms who participate in the microcap markets, are detailed in a separate Petition, also filed by Alpine on this date, seeking rulemaking in relation to certain practices and rules of the NSCC.

[47] FINRA's position is demonstrably more extreme and more damaging to the market than is the position generally taken by the SEC. It was FINRA, for example, who took an approach against Sterne Agee that would have rendered virtually any microcap transaction by definition "suspicious" and reportable under the Bank Secrecy Act. That argument, fortunately, was rejected even by the Hearing Panel in that case but is still being trotted out and used to pursue other firms based on the view of a former FINRA employee that the Hearing Panel decision was "wrong."

[48] Attached as Exhibit A is the Rulemaking Petition filed by Alpine that details the various fees and charges at issue and their impact on microcap stock transactions.

III. PROPOSALS

1. FINRA'S BOARD OF GOVERNORS SHOULD BE COMPRISED OF A MAJORITY OF INDUSTRY GOVERNORS

This petition requests that the Commission amend FINRA's By-Laws to eliminate the requirement that the number of non-Industry Governors exceed the number of Industry representatives, and approve a new requirement that the Board of Governors be composed of a majority of industry governors.

2. THE NOMINATING COMMITTEE SHOULD BE COMPOSED OF A MAJORITY OF INDUSTRY GOVERNORS

This petition requests that the Commission amend FINRA By Laws to require that the majority of the Nominating Committee be composed of industry members.

2. ANY FINRA INDUSTRY MEMBER SHOULD BE ABLE TO PLACE THEIR NAME ON THE BALLOT AND STAND FOR ELECTION WITHOUT HAVING TO CHALLENGE THE ACTIONS OF THE NOMINATING COMMITTEE

This petition requests that the Commission amend FINRA By Laws to permit any industry member to place their name on the ballot and stand for election without having to challenge the nominee selected by the Nominating Committee.

3. FINRA RULES SHOULD PROHIBIT THE IMPROPER ISSUANCE AND USE OF "GUIDANCE"

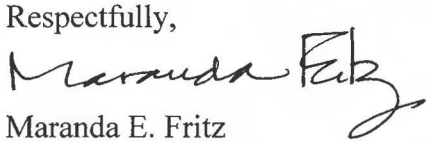
This petition requests that the Commission prevent the further improper issuance and use of "guidance" by:

- Adopting rules prohibiting FINRA from issuing any "legislative rule" without full compliance with the submission and notice and comment requirements;
- Requiring that FINRA identify any other publication or pronouncement as "guidance,"
- Requiring that FINRA affirmatively state in "guidance" that it does not have the force of effect of law,
- Requiring that FINRA state in "guidance" that it may not be used to coerce industry participants to take action or refrain from action beyond that which is required by any applicable statute; and
- Confirming that "guidance" may not be used as a basis for or evidence of any violation of law.

4. NAC SHOULD HAVE AN EQUAL OR GREATER NUMBER OF INDUSTRY REPRESENTATIVES

This petition requests that the Commission amend FINRA's By-Laws to eliminate the requirement that the number of non-Industry members of NAC exceed the number of Industry representatives, and reinstate the requirement that NAC be composed of an equal or greater number of industry governors.

Respectfully,



Maranda E. Fritz

cc: Financial Industry Regulatory Authority