

Petition for Rulemaking to the Securities and Exchange Commission (SEC)

Subject: Petition for Rulemaking to Establish a Minimum Trading Increment of \$5.00 USD for U.S. OTC Equities to Enhance Market Integrity



**Submitted by: Jake P. Noch - Managing Director
Jake P. Noch Family Office, LLC.
August 18, 2024**

Dear Chair Gensler and Commissioners,

On behalf of Jake P. Noch Family Office, LLC, I am writing to respectfully submit this petition for rulemaking under Rule 192 of the Commission's Rules of Practice (17 CFR § 201.192). This petition advocates for the establishment of a minimum trading increment of \$5.00 USD for all U.S. over-the-counter (OTC) equities. The intent of this rule change is not to delist companies trading below this threshold but to compel issuers with heavily diluted capital structures to restructure their shares to support a higher, more legitimate share price. This proposal aims to enhance investor protection, reduce market manipulation, and transform the OTC market into a more stable, transparent, and reputable platform for small and medium-sized enterprises (SMEs).

Statement of Interest:

Jake P. Noch Family Office, LLC is a single-family office managing the investments of Jake P. Noch, who also serves as the Managing Director. Our firm has observed the significant risks associated with OTC equities, particularly those with heavily diluted share structures and minimal legitimate operations. These risks are compounded by the frequent use of these stocks in fraudulent pump-and-dump schemes, often orchestrated with the assistance of social media promoters. As a participant in the OTC market, our firm is committed to advocating for regulatory changes that protect investors and promote a healthier, more transparent market environment.

Introduction:

The OTC market plays a crucial role in providing capital access to small and emerging companies that may not meet the listing standards of major exchanges. However, the current environment allows for the proliferation of low-priced, heavily diluted stocks, which are often targeted by fraudsters for pump-and-dump schemes. These schemes are particularly harmful to novice retail investors, who may not fully understand the speculative nature of these securities.

The proposed rule change seeks to address these issues by establishing a minimum trading increment of \$5.00 USD for all OTC equities. Rather than delisting companies that cannot meet this threshold, the rule would require issuers to restructure their capital structures to support a higher share price. This would significantly reduce the prevalence of stocks with billions of outstanding shares and minimal legitimate operations, which are frequently used to perpetrate fraud.

Economic Benefits and Analysis of Potential Drawbacks:

Economic Benefits:

1. Enhanced Investor Protection:

- The primary benefit of this rule change is the protection it would offer to retail investors, particularly those who are inexperienced in navigating the speculative OTC market. By requiring a minimum trading increment of \$5.00 USD, the SEC would reduce the number of heavily diluted, low-priced stocks that are often used in fraudulent schemes. This would create a safer investment environment where investors are less likely to suffer significant losses due to market manipulation¹.

2. Reduction of Market Manipulation:

- Stocks with low prices and large outstanding share counts are prime targets for pump-and-dump schemes. Fraudsters can easily acquire large amounts of these shares at low prices, artificially inflate the price through misleading promotions, and then sell their holdings at a profit, leaving other investors with worthless shares. By requiring a minimum trading increment of \$5.00 USD, the proposed rule change would reduce the opportunities for such manipulation by encouraging companies to maintain a capital structure that supports a higher, more stable share price².

3. Improved Market Reputation:

- The OTC market's reputation has suffered due to its association with penny stocks and fraudulent activities. Establishing a minimum trading increment of \$5.00 USD would help restore confidence in the OTC market by ensuring that only companies with legitimate operations and sustainable capital structures can trade at this price level. This would make the market more attractive to serious investors and could lead to increased participation from institutional investors³.

4. Promotion of Responsible Capital Restructuring:

- The proposed rule would encourage companies to undertake responsible capital restructuring to meet the \$5.00 USD minimum trading increment. Companies with heavily diluted share structures would need to consolidate shares or otherwise adjust their capital structure to achieve a higher share price. This would

lead to a more sustainable and transparent market environment, benefiting both companies and investors⁴.

5. Facilitation of Margin Eligibility:

- With a higher share price threshold, OTC equities that meet the \$5.00 USD minimum trading increment could become eligible for margin trading. This would provide companies with additional financing options and could increase market liquidity. Margin eligibility would also attract more sophisticated investors, further enhancing the market's stability and reputation⁵.

Potential Drawbacks:

1. Impact on Market Liquidity:

- The implementation of a \$5.00 USD minimum trading increment could initially reduce the number of tradable securities in the OTC market, leading to lower trading volumes. However, this reduction in liquidity would be offset by the increased stability and transparency of the remaining securities, making the OTC market more attractive to serious investors⁶.

2. Challenges for Small Companies:

- Companies with heavily diluted share structures may face challenges in restructuring their capital to meet the \$5.00 USD minimum trading increment. While this may limit their ability to raise capital in the short term, it will encourage them to strengthen their financial health and transparency. Over time, this could lead to a more robust market environment that supports sustainable growth^[7].

3. Short-Term Market Disruption:

- The transition to a \$5.00 USD minimum trading increment may cause short-term market disruption as companies and investors adjust to the new requirements. However, the long-term benefits of a more stable and transparent market are likely to outweigh these short-term challenges^[8].

Proposed Amendments to Current Rules:

1. Amendment to SEC Rule 15c2-11 (Publication or Submission of Quotations Without Specified Information):

Current Text of Rule 15c2-11:

"No broker or dealer shall publish any quotation for a security in any medium unless such broker or dealer has in its possession the current information specified in paragraphs (a)(5) through (a)(10) of this section."^[9]

Proposed Amendment:

"No broker or dealer shall publish any quotation for an OTC equity security in any medium if the

price of such security is below \$5.00 USD, unless such quotation is accompanied by a clear and conspicuous statement that the security is subject to a pending amendment under SEC Rule 15c2-11 that may affect its trading status."

Reason for Amendment:

This amendment would require broker-dealers to ensure that the securities they quote are priced at or above the \$5.00 USD threshold. This change would compel companies with heavily diluted share structures to consolidate shares or otherwise restructure their capital structures to support a higher share price. The goal is to reduce the number of low-priced, speculative securities that are often targeted for fraud, thereby enhancing investor protection and market integrity^[10].

2. Amendment to FINRA Rule 6434 (Minimum Quotation Increment for OTC Equity Securities):

Current Text of Rule 6434:

"The minimum quotation increment for OTC equity securities priced below \$1.00 shall be \$0.0001."^[11]

Proposed Amendment:

"The minimum quotation increment for any OTC equity security, regardless of the security's market price, shall be \$0.01 USD. Furthermore, no OTC equity security shall be permitted to trade at a price below \$5.00 USD. Securities that do not meet this minimum price threshold shall not have any quotations published by broker-dealers."

Reason for Amendment:

This amendment would establish a \$5.00 USD minimum trading increment, encouraging companies with low-priced, heavily diluted shares to restructure their capital structures. The rule aims to create a more stable and transparent market by reducing the prevalence of low-priced stocks that are susceptible to manipulation. By ensuring that only companies with legitimate operations and sustainable capital structures can trade at this level, the amendment would enhance the overall integrity of the OTC market^[12].

3. Amendment to SEC Rule 611 (Order Protection Rule) of Regulation NMS:

Current Text of Rule 611:

"No trade shall be executed at a price inferior to the best bid or offer."^[13]

Proposed Amendment:

"For the purposes of OTC equity securities, no trade shall be executed at a price below \$5.00 USD. All broker-dealers shall implement procedures to ensure that no trade occurs below this threshold, thereby maintaining the integrity and stability of the OTC market."

Reason for Amendment:

This amendment would adapt the principles of Rule 611 to the OTC market, ensuring that all trades are executed at or above the \$5.00 USD threshold. By establishing this minimum trading increment, the amendment would further protect investors from the risks associated with low-

priced, heavily diluted stocks and promote a healthier, more transparent market environment^[14].

Justification and Rationale:

The proposed rule change is necessary to address the unique risks posed by the OTC market, particularly the prevalence of heavily diluted, low-priced stocks that are often used in fraudulent schemes. Unlike National Market System (NMS) securities, which are typically issued by larger, more established companies with significant public disclosure requirements, OTC equities are often issued by smaller, less transparent companies with minimal legitimate operations^[15]. These companies frequently have large outstanding share counts, which dilute the value of each share and make the stock more susceptible to manipulation.

The OTC market is also characterized by a higher proportion of novice investors who may not fully understand the speculative nature of these securities. The low price of penny stocks creates the illusion of affordability and potential for significant returns, leading many retail investors to allocate disproportionate amounts of their portfolios to these high-risk securities^[16]. Unfortunately, the reality is that many of these investors suffer significant losses due to the volatility and lack of transparency in the OTC market.

Given these factors, the current regulatory framework for OTC equities does not adequately protect the interests of retail investors. While the SEC has implemented various measures to mitigate the risks associated with penny stocks, including the Penny Stock Reform Act of 1990 and Rule 15c-9 under the Securities Exchange Act of 1934, these measures have not been sufficient to prevent significant harm to investors^[17]. The continued prevalence of low-priced, heavily diluted securities in the OTC market suggests that more stringent regulations are necessary to protect investors and promote market integrity^[18].

The proposed rule change to establish a \$5.00 USD minimum trading increment would compel companies to restructure their capital structures to support a higher share price, thereby reducing the prevalence of low-priced, speculative stocks. This would lead to a more stable and transparent market environment, benefiting both companies and investors. The rule change is also consistent with the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation^[19].

Implementation Considerations and Impact on the OTC Market

Implementation Timeline and Support:

To ensure a smooth transition to the \$5.00 USD minimum trading increment, it is essential that the SEC and FINRA work closely with market participants, including issuers, broker-dealers,

and investors. A phased implementation approach could be considered to allow issuers time to adjust their capital structures and comply with the new requirements.

1. Phased Implementation:

- A phased approach could involve setting incremental milestones over a 12- to 24-month period, gradually increasing the minimum trading increment. For example, an initial minimum increment could be set at \$1.00 USD for the first six months, increasing to \$2.50 USD for the following six months, and ultimately reaching \$5.00 USD at the end of the transition period. This would allow companies with heavily diluted shares to undertake necessary capital restructuring without causing significant market disruption.

2. Guidance and Resources:

- The SEC and FINRA should provide clear guidance to issuers on how to restructure their capital to meet the \$5.00 USD minimum trading increment. This could include detailed FAQs, webinars, and other educational resources to assist companies in understanding the requirements and taking appropriate action.

3. Monitoring and Enforcement:

- To ensure compliance, the SEC and FINRA should closely monitor the implementation process, with regular reporting requirements for issuers. Any companies that fail to meet the incremental milestones should be subject to increased scrutiny and, if necessary, enforcement actions to protect investors.

Expected Market Transformation:

The implementation of a \$5.00 USD minimum trading increment will likely result in a significant transformation of the U.S. OTC market. While this change will bring about certain challenges, the long-term benefits are expected to outweigh any short-term difficulties.

1. Shift in Market Composition:

- The most immediate impact will be a reduction in the number of low-priced, heavily diluted stocks in the OTC market. Companies that cannot meet the new requirements will either need to restructure their capital structures or risk becoming irrelevant as investors shift their focus to securities that comply with the \$5.00 USD minimum increment. This shift will likely result in a more concentrated market of higher-quality securities, which could attract more institutional investors and increase overall market credibility.

2. Improved Investor Confidence:

- By eliminating the most speculative and risky securities, the proposed rule change will help restore investor confidence in the OTC market. Retail investors, in particular, will benefit from a safer market environment where the potential for fraud and manipulation is significantly reduced. Over time, this increased confidence is expected to lead to higher participation rates and greater market liquidity, despite the initial reduction in the number of tradable securities.

3. Increased Capital Formation:

- As the OTC market becomes more stable and reputable, it is expected to play a more significant role in capital formation for SMEs. Companies that successfully restructure their capital to meet the \$5.00 USD minimum trading increment will benefit from access to a broader base of investors, including those seeking long-term growth opportunities. Additionally, the potential extension of margin eligibility to OTC securities that meet the \$5.00 USD threshold could provide these companies with even greater access to financing, further supporting their growth and development.

4. Long-Term Market Stability:

- In the long term, the proposed rule change is expected to lead to a more stable and sustainable OTC market. By requiring companies to maintain higher share prices and more responsible capital structures, the market will be better protected against the risks associated with low-priced, heavily diluted securities. This stability will benefit not only investors but also the broader financial system, reducing the potential for systemic risks associated with speculative trading in the OTC market.

Potential Challenges and Mitigation Strategies:

While the proposed rule change is expected to bring significant benefits, it is also important to acknowledge and address potential challenges that may arise during the implementation process.

1. Resistance from Issuers:

- Some issuers with heavily diluted share structures may resist the requirement to restructure their capital to meet the \$5.00 USD minimum trading increment. To address this, the SEC and FINRA could offer incentives for early compliance, such as reduced regulatory fees or expedited processing of capital restructuring applications. Additionally, clear communication of the long-term benefits of compliance, including increased investor confidence and access to financing, could help mitigate resistance.

2. Short-Term Market Volatility:

- The transition to a higher minimum trading increment may result in short-term market volatility as companies and investors adjust to the new requirements. To minimize disruption, the phased implementation approach mentioned earlier could be adopted, allowing market participants time to adapt. Additionally, the SEC and FINRA should closely monitor market conditions during the transition period and be prepared to intervene if necessary to maintain orderly market operations.

3. Impact on Small and Emerging Companies:

- While the rule change is intended to promote responsible capital restructuring, some small and emerging companies may struggle to meet the \$5.00 USD minimum trading increment. To support these companies, the SEC could provide

access to resources and guidance on capital restructuring, as well as explore options for temporary exemptions or extensions for companies that demonstrate a genuine commitment to compliance but require additional time to restructure their capital structures.

Conclusion:

The establishment of a \$5.00 USD minimum trading increment for U.S. OTC equities is a necessary step to protect investors, reduce market manipulation, and enhance the integrity of the OTC market. By requiring companies to restructure their capital to support a higher share price, this rule change would significantly reduce the prevalence of heavily diluted, low-priced stocks that are often used in fraudulent schemes. The proposed amendments to SEC Rule 15c2-11, FINRA Rule 6434, and SEC Rule 611 under Regulation NMS are essential to achieving these goals and transforming the OTC market into a more stable, transparent, and reputable platform for SMEs.

We urge the SEC to carefully consider this petition and take the necessary actions to implement the proposed changes. The long-term benefits of a more stable and reputable OTC market, including increased investor confidence, greater access to financing for legitimate companies, and a reduction in market manipulation, will far outweigh any short-term challenges associated with the transition.

Thank you for your attention to this important matter. We remain committed to working with the SEC to enhance the integrity of the OTC market and protect the interests of all investors.

Submitted by:



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Jake P. Noch Family Office, LLC.

Footnotes

1. Penny Stock Reform Act of 1990, Public Law No. 101-429, 104 Stat. 931. Available at: <https://www.congress.gov/bill/101st-congress/house-bill/4497>. ↩
2. U.S. Securities and Exchange Commission, "Pump and Dump Schemes," Available at: <https://www.sec.gov/fast-answers/answerspumpdumphtm.html>. ↩
3. SEC Rule 15c2-11, 17 CFR § 240.15c2-11 - Publication or Submission of Quotations Without Specified Information. Available at: <https://www.ecfr.gov/current/title-17/chapter-II/part-240/section-240.15c2-11>. ↩
4. FINRA Rule 6434 - Minimum Quotation Increment for OTC Equity Securities. Available at: <https://www.finra.org/rules-guidance/rulebooks/finra-rules/6434>. ↩
5. SEC Rule 611, 17 CFR § 242.611 - Order Protection Rule of Regulation NMS. Available at: <https://www.ecfr.gov/current/title-17/chapter-II/part-242/section-242.611>. ↩
6. SEC Rule 15g-9, 17 CFR § 240.15g-9 - Sales Practice Requirements for Certain Low-Priced Securities. Available at: <https://www.ecfr.gov/current/title-17/chapter-II/part-240/section-240.15g-9>. ↩