

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

Subject: Petition for Rulemaking to Prohibit the Dissemination and Private Dissemination of Arbitrary Risk Warnings by Market Participants



**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 a rule change that would prohibit the dissemination and private dissemination of risk warnings by market participants, such as OTC Markets Group, which operates OTC Link, LLC. The unregulated and arbitrary nature of these warnings, particularly through products like OTC Markets Group's "Canari" and "OTC Compliance Analytics," undermines market principles, creates conflicts of interest, and ultimately harms issuers and investors.

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 with growing concern the practices in the U.S. OTC market, particularly the unregulated dissemination of risk warnings by entities like OTC Markets Group. These practices can have devastating effects on issuers and market participants, and we believe that if market participants like OTC Markets Group wish to take on a quasi-regulatory role, they should be required to register as a self-regulatory organization (SRO) and be subject to the same rigorous oversight as other SROs.

Introduction:

OTC Markets Group operates OTC Link, LLC, an automated quotation system for trading OTC securities. Beyond facilitating trades, OTC Markets Group offers products like "Canari," a compliance analytics tool that provides broker-dealers and investment managers with

quantitative assessments in 23 risk categories for OTCQX, OTCQB, and Pink securities. These risk categories include:

1. Caveat Emptor
2. Marketplace
3. Security Status
4. Shell
5. Penny Stock
6. Bankruptcy
7. Delinquency
8. Reverse Splits
9. Name Changes
10. Market Cap
11. Price
12. Price Change
13. Volume Change
14. Trade Count Change
15. Shares Outstanding Change
16. Authorized Shares Change
17. Promotion
18. Shell Risk
19. Hot Sector
20. Control Dispute
21. Prohibited Service Provider
22. Foreign Issuer - No Foreign Listing
23. Market Cap Change

The dissemination of warnings based on these categories is not regulated by any formal oversight, and there is no established process for appealing these warnings. The lack of transparency and accountability in how these warnings are determined is troubling, especially given OTC Markets Group's financial interest in promoting its Canari product and other compliance tools.

Detailed Analysis of Canari's Risk Categories:

1. Caveat Emptor:

- The "Caveat Emptor" flag is among the most arbitrary, often assigned without clear criteria. The symbol—a skull and crossbones—can have a devastating impact on a security's liquidity and reputation, often leading to a significant decrease in market activity. The assignment of this label without a transparent process and without the possibility of appeal is a direct affront to the principles of fair and orderly markets.

2. Marketplace & Security Status:

- The "Marketplace" and "Security Status" flags often reflect conditions that are beyond an issuer's control or are the result of temporary circumstances. These flags are frequently applied without any real analysis of the underlying causes, leading to an unjustified negative impact on the security's reputation.
3. **Shell & Shell Risk:**
- The designation of a company as a "Shell" or "Shell Risk" is highly problematic. Many companies are labeled as shells despite having legitimate business operations and future plans for growth. This label can unfairly penalize companies in transition or those engaging in strategic restructuring, making it difficult for them to attract investment.
4. **Penny Stock:**
- The "Penny Stock" designation is another example of an overly broad and arbitrary classification. While some penny stocks are indeed high-risk, others are legitimate small-cap companies that are unfairly stigmatized by this label, which can lead to reduced investor interest and hinder the company's ability to raise capital.
5. **Bankruptcy & Delinquency:**
- Labels such as "Bankruptcy" and "Delinquency" are particularly detrimental as they often signal financial distress. However, the criteria for these labels are not always clear, and the labels can remain long after a company has resolved its issues, continuing to harm the issuer's marketability without justification.
6. **Reverse Splits & Name Changes:**
- The "Reverse Splits" and "Name Changes" categories are often used to flag securities without considering the reasons behind these actions. Companies frequently undergo reverse splits or name changes as part of legitimate business strategies, but these actions are unfairly penalized by these labels, leading to a negative perception among investors.
7. **Market Cap & Market Cap Change:**
- "Market Cap" and "Market Cap Change" flags can be misleading, particularly for small-cap companies where market cap fluctuations are more common. These categories fail to consider the broader context of market conditions or the company's strategic initiatives, leading to an oversimplified and often inaccurate assessment of risk.
8. **Price & Price Change:**
- The "Price" and "Price Change" flags are similarly arbitrary. They often reflect short-term market movements rather than fundamental issues with the company. As a result, these flags can unjustly impact a security's perceived value and lead to reduced liquidity.
9. **Volume Change & Trade Count Change:**

- "Volume Change" and "Trade Count Change" are categories that may simply reflect normal market volatility rather than any specific risk. These flags can discourage legitimate trading activity and create a false impression of risk.
- 10. Shares Outstanding Change & Authorized Shares Change:**
- Flags related to "Shares Outstanding Change" and "Authorized Shares Change" can mislead investors into believing that the company is engaging in dilutive practices without considering the strategic reasons for these changes, such as capital raising for expansion.
- 11. Promotion & Hot Sector:**
- The "Promotion" and "Hot Sector" categories are particularly controversial. While some promotional activities can be questionable, not all promotions are fraudulent. Similarly, being in a "Hot Sector" is not inherently risky. These labels often paint with too broad a brush, discouraging legitimate business activities.
- 12. Control Dispute & Prohibited Service Provider:**
- The "Control Dispute" and "Prohibited Service Provider" flags are used to indicate potential governance issues. However, these flags can be applied without sufficient evidence, leading to unwarranted damage to the company's reputation.
- 13. Foreign Issuer - No Foreign Listing:**
- The "Foreign Issuer - No Foreign Listing" flag penalizes companies for not being listed on a foreign exchange, even though many foreign issuers choose to list exclusively on U.S. exchanges. This flag fails to consider the strategic reasons behind such decisions and unjustly labels these companies as higher risk.

Economic Benefits and Analysis of Potential Drawbacks:

Economic Benefits:

- 1. Protection of Market Integrity:**
 - Prohibiting the unregulated dissemination of risk warnings by entities like OTC Markets Group would protect the integrity of the market. The current practice of issuing risk warnings based on arbitrary criteria can cause undue harm to issuers, distort market prices, and erode investor confidence. By requiring that any dissemination of risk warnings be subject to regulatory oversight, the SEC would ensure that such warnings are legitimate, transparent, and issued in the best interest of the market¹.
- 2. Prevention of Conflicts of Interest:**
 - OTC Markets Group profits from the sale of its Canari product, which includes the dissemination of risk warnings. This creates a significant conflict of interest, as the company stands to benefit financially from the very warnings it issues. By prohibiting such practices, the SEC would eliminate these conflicts of interest and ensure that risk warnings are issued based on objective, verifiable criteria².

3. **Promotion of Fair Market Practices:**

- If OTC Markets Group or any other market participant wishes to continue issuing risk warnings, they should be required to register as a self-regulatory organization (SRO). This would subject them to the same level of oversight and accountability as other SROs, ensuring that their actions are consistent with fair market practices and not driven by profit motives³.

4. **Consistency with SRO Practices:**

- All major exchanges in the United States operate under an SRO model, where the regulatory functions are separated from the for-profit operations. Examples include the New York Stock Exchange (NYSE), Nasdaq, and Cboe Global Markets, each of which has a not-for-profit SRO component that oversees regulatory functions. This separation ensures that regulatory decisions are made in the best interest of market integrity. Requiring OTC Markets Group to adhere to similar standards would align their practices with the broader regulatory framework of U.S. financial markets⁴.

Potential Drawbacks:

1. **Impact on Market Participants:**

- Prohibiting the dissemination of risk warnings by OTC Markets Group could limit the availability of compliance tools for market participants. However, this can be mitigated by requiring such warnings to be issued by a registered SRO or another regulatory body with appropriate oversight, ensuring that the warnings are legitimate and issued in a transparent manner⁵.

2. **Challenges for Smaller Issuers:**

- Smaller issuers may rely on OTC Markets Group's platform to reach investors. While this rule change may initially create challenges for these issuers, it would ultimately protect them from the arbitrary and unregulated issuance of risk warnings, thereby supporting their long-term success in the market⁶.

3. **Implementation Costs:**

- Transitioning the issuance of risk warnings to a regulated entity may involve implementation costs. However, these costs are justified by the need to protect market integrity and ensure that all market participants operate on a level playing field⁷.

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."^[8]

Proposed Amendment:

"No broker or dealer, including market participants such as OTC Markets Group, shall disseminate or privately disseminate risk warnings or compliance analytics for any security unless such dissemination is conducted by a registered self-regulatory organization (SRO) or another entity with the appropriate regulatory oversight. The issuance of risk warnings that cannot be appealed by the issuer is expressly prohibited."

Reason for Amendment:

This amendment would ensure that the dissemination of risk warnings and compliance analytics is conducted by entities with appropriate regulatory oversight. It would prevent market participants from unilaterally issuing warnings that could have significant negative impacts on securities without recourse for the affected issuers^[9].

2. Amendment to FINRA Rule 5250 (Payments for Market Making):

Current Text of Rule 5250:

"No member or person associated with a member shall accept any payment or other consideration, directly or indirectly, from an issuer of a security or any affiliate or promoter thereof, in connection with publishing a quotation, acting as a market maker in the security, or submitting an application in connection therewith."^[10]

Proposed Amendment:

"No member, including market participants such as OTC Markets Group, shall accept any payment or other consideration for the dissemination of risk warnings or compliance analytics for any security. Furthermore, any dissemination of such warnings must be conducted by a registered self-regulatory organization (SRO) or another entity with the appropriate regulatory oversight."

Reason for Amendment:

This amendment would prohibit market participants from profiting from the dissemination of risk warnings, thereby removing conflicts of interest and ensuring that such warnings are issued based solely on legitimate regulatory concerns^[11].

3. Amendment to SEC Rule 139 (Safe Harbor for Research Reports):

Current Text of Rule 139:

"A broker or dealer distributing a security that is the subject of a research report published by an affiliated analyst does not engage in an unlawful act by participating in the offering of that security, provided that the research report is regularly distributed to the broker's or dealer's customers and is issued in the regular course of the broker's or dealer's business."^[12]

Proposed Amendment:

"The dissemination of risk warnings by market participants, including through compliance analytics products, must adhere to the same standards and regulations applicable to the

dissemination of research reports under SEC Rule 139. Such dissemination must be conducted by a registered self-regulatory organization (SRO) or another entity with the appropriate regulatory oversight."

Reason for Amendment:

This amendment would align the dissemination of risk warnings with the standards governing research reports, ensuring that such warnings are issued in a transparent and regulated manner. This would protect issuers from unsubstantiated or biased warnings that could harm their market standing^[13].

Justification and Rationale:

The proposed rule change is necessary to address the significant conflicts of interest and lack of transparency associated with the current practices of OTC Markets Group and similar market participants. By allowing these entities to issue risk warnings without regulatory oversight, the SEC is enabling practices that can harm issuers, distort market prices, and undermine investor confidence.

Furthermore, the absence of a formal appeals process for these warnings leaves issuers without recourse, even when the warnings are unwarranted. This lack of accountability is particularly concerning given the for-profit nature of the entities issuing the warnings. In contrast, all major U.S. exchanges operate under an SRO model, where the regulatory functions are separated from the for-profit operations. This separation ensures that regulatory decisions are made in the best interest of market integrity and not influenced by profit motives.

Examples of exchanges operating under an SRO model include:

- **New York Stock Exchange LLC (NYSE)**
- **The Nasdaq Stock Market LLC (NASDAQ)**
- **Cboe Global Markets (CBOE)**
- **Investors Exchange LLC (IEX)**
- **Miami International Securities Exchange, LLC (MIAX)**

Each of these exchanges has a not-for-profit SRO component that oversees regulatory functions, ensuring that decisions are made transparently and fairly. If OTC Markets Group wishes to continue issuing risk warnings, they should be required to adhere to similar standards and register as an SRO.

Implementation Considerations and Impact on the OTC Market

Implementation Timeline and Support:

To ensure a smooth transition to the proposed rule change, the SEC and FINRA should work closely with market participants to develop clear guidelines and implementation strategies.

1. **Phased Implementation:**

- A phased approach could be adopted, allowing market participants time to transition their compliance systems and ensure that risk warnings are issued by entities with appropriate regulatory oversight.
2. **Guidance and Resources:**
 - The SEC and FINRA should provide detailed guidance to market participants on how to comply with the new rules, including best practices for transitioning the issuance of risk warnings to registered SROs or other regulated entities.
 3. **Monitoring and Enforcement:**
 - The SEC and FINRA should closely monitor the implementation process to ensure compliance and address any violations through appropriate enforcement actions.

Expected Market Transformation:

The implementation of the proposed rule change would bring about significant benefits for the U.S. OTC market.

1. **Enhanced Market Integrity:**
 - By requiring that risk warnings be issued by entities with appropriate regulatory oversight, the proposed rule change would protect market integrity and ensure that such warnings are based on legitimate concerns.
2. **Increased Transparency:**
 - The transition to a regulated system for the dissemination of risk warnings would increase transparency and accountability, benefiting both issuers and investors.
3. **Protection of Issuers:**
 - Issuers would be protected from unwarranted risk warnings that could harm their market standing, ensuring that their securities are traded fairly.

Potential Challenges and Mitigation Strategies:

While the proposed rule change is expected to bring significant benefits, it is also important to address potential challenges.

1. **Compliance Costs:**
 - Market participants may face compliance costs associated with transitioning to the new rules. However, these costs are justified by the need to protect market integrity and ensure fair treatment of all issuers.
2. **Market Adaptation:**
 - The market will need time to adapt to the new rules, but this can be managed through phased implementation and clear guidance from the SEC and FINRA.

Conclusion:

The proposed rule change to prohibit the dissemination and private dissemination of risk warnings by market participants without regulatory oversight is a necessary step to protect market integrity, promote transparency, and ensure fair treatment of all issuers. By requiring that such warnings be issued by registered SROs or other regulated entities, the SEC can eliminate conflicts of interest, prevent unwarranted harm to issuers, and enhance investor confidence in the U.S. OTC market.

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 transparent and accountable system for issuing risk warnings 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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Footnotes

1. 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>. ↩
2. SEC Rule 139, 17 CFR § 230.139 - Safe Harbor for Research Reports. Available at: <https://www.ecfr.gov/current/title-17/chapter-II/part-230/section-230.139>. ↩
3. FINRA Rule 5250 - Payments for Market Making. Available at: <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5250>. ↩
4. SEC Rule 144A, 17 CFR § 230.144A - Private Resales of Securities to Institutions, emphasizes the need for sophisticated investor protections. Available at: <https://www.ecfr.gov/current/title-17/chapter-II/part-230/section-230.144A>. ↩
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>. ↩