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## Guest Expert: Yes, Virginia, There is a Secondary Market!

I am often asked by lawyers and business people alike if there is “really” a secondary market for Reg A securities, often with that same jaundiced eye you get from that grade schooler who is starting to build a healthy sense of cynicism and asks about the elf from the north. My answer is a lot like Church’s famous editorial in the New York Sun where he explained to Virginia that Saint Nick existed within all of us and in the spirit of the holiday for whom he is a central figure.

First, let’s consider exactly what we’re talking about when we say “secondary market.” My suspicion is that most people reflexively envision something akin to Wall Street – big floats, heavy arbitrage activity and, whether they like it or not, volatility. But does, or has in history, ANY secondary market come out of the gate at that level? Aren’t we really talking about a basic infrastructure where investors can reliably find information on a given security, price that security and either sell our purchase that security without the regulatory and contractual impediments one sees with other types of exempt securities?

Let’s now consider what we have under the new Tier II rules. We have periodic reporting with mandated informational requirements (including audited financials), the ability of broker-dealers to provide a price quotation for those securities by relying on that reporting, the carve-out to the 12(g) trigger that requires ’34 Act registration for Tier II securities so issuers do not need to be concerned about sales of positions increasing their investor counts.

Finally, as always, you have the ability to sell or buy that security without meeting specific regulatory requirements like you might find under Rule 144 – just sell the security.

But Rob?! What about the fact that blue sky laws are not pre-empted when it comes to secondary activity?! It’s not ideal, but it’s not fatal. Let’s remember that concepts of wholesale preemption of state blue sky laws did not really emerge until 1996(!) with NSMIA. Let’s also remember that alternative trading systems, like OTCQB and OTCQX, operate daily without pre-emption from blue sky laws. The fact is that a variety of exemptions exist under state laws for secondary activity. 42 states have adopted some form of the “manual exemption,” and virtually every state has iterations of one or more exemptions for secondary activity not for the benefit of the issuer that does not constitute arbitrage activity.

So we have the ability of investors (note: NOT professional or day traders) to buy and sell Reg A securities with the basic infrastructure to do so with confidence. The legal impediments to this kind of secondary activity are relatively low.

The current situation may not be ideal, but, at the same time, consider the volatility we see on Wall Street. A market this “thin” and new at the present time probably could not handle a fraction of that similar

volatility. Could blue sky regulations act as a “governor” on volume trading that could help to mitigate against volatility that could adversely affect these securities, perhaps in an unduly amplified manner? Investors focus, therefore, is on the fundamentals of these securities rather than market trends.

Admittedly, further work needs to be done on the regulatory front to take away some of the lack of clarity that comes with having overlapping regulatory regimes. Furthermore, I do find compelling the arguments made by many out there that a greater degree and variety of participation in this market will be necessary in order to keep it meaningful as it grows. But given the nascence of the Reg A+ market, I would argue that what we have is workable until professional resources, industry standards and best practices and informational media develop further to sustain a more diversified market.

OTC has already provided their standards and process for listing Reg A+ securities. I recently came across another group, Alternative Securities Market Exchange, based in Los Angeles, which is providing an auction style trading system for Reg A+ securities.

The infrastructure and foundation is there, so I tell people, much like the answer to Virginia concerning Santa, there IS a secondary market! It’s simply in our power to provide the securities to the marketplace for that market to thrive and grow into what many envision.

Posted by: Robert R. Kaplan Jr.

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