

# NOTICE OF REQUEST FOR COMMENT REGARDING THE UNIFORM SECURITIES ACT MANUAL EXEMPTION

April 26, 2023

**Deadline for Comments: May 26, 2023**

The Corporation Finance Section Small Business/Limited Offerings Project Group (“Project Group”) of the North American Securities Administrators Association, Inc. (“NASAA”) is seeking comment from NASAA members and the public regarding potential promulgation of amendments to the so-called “manual exemption” from securities registration under state law. The Project Group requests comments on the use of the manual exemption and whether the existing requirements in the exemption, as promulgated in Section 202(2) of the Uniform Securities Act of 2002 (“USA (2002)”), provide an appropriate level of protection to investors who purchase securities from sellers relying on this exemption.<sup>1</sup> The Project Group further requests suggestions for how the manual exemption could be improved by the potential promulgation by NASAA of model statutory or regulatory language.

Comments are due by the deadline above. We are only accepting comments by electronic mail. Comments should be emailed to [NASAAComments@nasaa.org](mailto:NASAAComments@nasaa.org), with a cc: to the Project Group Chair, Faith Anderson ([faith.anderson@dfi.wa.gov](mailto:faith.anderson@dfi.wa.gov)). All public comments received in response to this request will be posted to NASAA’s website ([www.nasaa.org](http://www.nasaa.org)) without edit or redaction, though inappropriate comments will not be posted. Please do not include any information in your comment letter that you do not wish to become publicly available. After the close of the comment period, the Project Group will review all comments and consider whether to develop and propose amendments of the manual exemption. Any such proposal would proceed through NASAA’s rulemaking process, including periods for internal NASAA member comment and public comment.

## Background

The manual exemption is of “ancient vintage” and is available to issuers for which there is publicly available information though the issuer is not necessarily a public reporting company. *See* Uniform Securities Act of 1956 (“USA (1956)”) Draftsmen’s Commentary to §305(i), §305(j) and related sections on non-issuer distributions. Most states have adopted some form of the manual exemption.<sup>2</sup>

---

<sup>1</sup> The text of the manual exemption in Section 202(2) of the USA (2002) is reproduced for convenience at the end of this request for comment.

<sup>2</sup> According to a 2017 recommendation of the SEC’s Advisory Committee on Small and Emerging Companies, 39 of 54 U.S. jurisdictions have adopted some form of the manual exemption. Recommendation Regarding Secondary Market Liquidity for Regulation A, Tier 2 Securities, Advisory Committee on Small and Emerging Companies, May 15, 2017, *available at* <https://www.sec.gov/info/smallbus/acsec/acsec-recommendation-051517-secondary-liquidity-recommendation.pdf>.

When the USA (1956) was drafted, several states had already adopted some form of a manual exemption. The manual exemption contained in the USA (1956) exempted:

any non-issuer distribution of an outstanding security if a recognized securities manual contains the names of the issuer's officers and directors, a balance sheet of the issuer as of a date within eighteen months, and a profit and loss statement for either the fiscal year preceding that date or the most recent fiscal year of operations.

USA (1956) § 402(b)(2). The draftsmen noted the various protections to which the exemption was subject:

- The exemption could be denied or revoked by the Administrator;
- The term "recognized securities manual" could be defined by the Administrator by rule;
- Exempt transactions were subject to anti-fraud provisions;
- Broker-dealers and representatives were required to register;
- The Administrator could require registered broker-dealers to keep lists of securities sold under this exemption.

USA (1956) Draftsmen's Commentary to §305(i), §305(j) and related sections on non-issuer distributions. Further, the draftsmen noted that although not required by the uniform manual exemption, some states restricted the exemption "to sales by registered dealers, or require[d] that the sale be at a price 'reasonably related to the current market price,'" or otherwise restricted the exemption. *Id.*

The RUSA included a manual exemption that was substantially similar to the exemption in the USA (1956) but further conditioned on the security's having been outstanding in the hands of the public for at least 90 days. RUSA § 402(3). This change was advocated to "bar immediate secondary trading of nonregistered IPO securities." *See* Comment to RUSA § 402.

The Uniform Securities Act of 2002 also contains a manual exemption, but it is much more restrictive than the exemption in the USA (1956). The manual exemption in the USA (2002) reflects recommendations made by NASAA and generally conforms to NASAA's 1996 amendments to the USA (1956). USA (2002) Official Comments to § 202. These included a requirement that the issuer have a class of equity securities that is either listed on a national exchange or that is quoted on the NASDAQ. NASAA recommended this requirement "to address the problem of penny stock fraud." USA (1956) as amended by NASAA, 1996 NASAA Comment on § 402(b)(2). NASAA's comments specifically stated over-the-counter ("OTC") bulletin board companies were not intended to be eligible for the exemption. *Id.* The comments also mentioned that "safeguards [were] built into stocks listed on national stock exchanges and the NASDAQ System (by reason of the SEC's oversight of those securities and markets)," and

these safeguards rendered these securities “not as susceptible to penny stock fraud” as those trading on the OTC bulletin board. *Id.*

The manual exemption contained in Section 202(2) of the USA (2002) generally exempts “a nonissuer transaction by or through a broker-dealer registered, or exempt from registration . . . and a resale transaction by a sponsor of a unit investment trust registered under the Investment Company Act of 1940, in a security of a class that has been outstanding in the hands of the public for at least 90 days” provided all the following conditions are satisfied:

- The issuer is not in the organizational stage and is not a blank check, blind pool or shell company with no specific business plan;
- The security is sold at a price reasonably related to its current market price;
- The security is not part of an underwritten offering;
- The security is listed in a nationally recognized securities manual that is publicly available and that contains:
  - A description of the business and operations of the issuer;
  - The names of the issuer’s executive officers and the names of the issuer’s directors, if any;
  - An audited balance sheet of the issuer dated within 18 months of the transaction; and
  - An audited income statement for the past two fiscal years;<sup>3</sup> and
- One of the following requirements is met:
  - The issuer has a class of equity securities listed on a national exchange or designated for trading on the NASDAQ;
  - The issuer is a unit investment trust registered under the Investment Company Act of 1940;
  - The issuer has been engaged in continuous business for at least 3 years; or
  - The issuer has total assets of at least \$2,000,000 based on an audited balance sheet dated within 18 months prior to the transaction.

Most states recognize Mergent’s Investor Service (formerly known as Moody’s) as a nationally recognized securities manual under the exemption. A majority of states grant similar recognition to the website operated by the OTC Markets, Inc. with respect to securities of issuers

---

<sup>3</sup> This information is more limited than the information that is available about an issuer that files public reports under the Exchange Act of 1934. Public reporting companies are generally required to file annual reports (including audited financial statements) on Form 10-K within 60-90 days of the fiscal year end, quarterly reports on Form 10-Q within 40-45 days from the end of the quarter, and current reports on Form 8-K within four days of a material event.

that trade through the OTCQX and OTCQB markets.<sup>4</sup> Other states have not granted such recognition based on concerns about the securities traded on the over-the-counter marketplace.<sup>5</sup>

## **Request for Comment**

As explained above, some form of the manual exemption has existed since before the promulgation of the uniform securities acts. Since that time, the advent of electronic trading platforms has greatly expanded the ability of investors to engage in secondary trading of securities that are not otherwise listed on an exchange in reliance on the manual exemption. As noted in a 2016 report by staff at the U.S. Securities and Exchange Commission, securities of issuers that trade on these platforms present significant risks.<sup>6</sup> Some of these risks (such as lack of liquidity) apply to securities traded in reliance on the manual exemption outside an electronic trading platform. Given these risks, the members of the Project Group question whether the existing requirements of the manual exemption as promulgated in the USA (2002) sufficiently mitigate the risks to investors who purchase securities under the manual exemption.

As an initial matter, the members of the Project Group request information concerning the use of the manual exemption to effect transactions in securities. Data concerning the frequency of its use would be particularly helpful.

The Project Group also seeks comments on whether the existing requirements of the manual exemption provide an appropriate level of protection to investors who purchase securities from sellers relying on the manual exemption.

Finally, the Project Group would like to receive suggestions for how the manual exemption could be amended if commenters believe the 2002 version of the manual exemption provides inadequate investor protection. For example, some possible revisions to the manual exemption to mitigate investor risks include:

---

<sup>4</sup> OTC Markets operates an SEC-registered Alternative Trading System called OTC Link® ATS as opposed to a registered securities exchange. Issuers whose securities trade through the OTCQX and OTCQB markets are required to provide specific disclosure through the OTC Markets website. The disclosure that is required to participate in these markets includes the information that must be published under the manual exemption contained in the USA (2002) and more. OTC Markets Group monitors disclosure by these issuers and will remove issuers from these markets if they become delinquent in providing the required disclosure. According to the OTC Markets Group, 39 U.S. jurisdictions have recognized the OTC Markets website for purposes of the manual exemption with respect to securities traded on the OTCQX while 35 jurisdictions recognize their website with respect to securities traded on the OTCQB. *See* Blue Sky, OTC Markets, Inc., at <https://www.otcmarkets.com/corporate-services/products/blue-sky>.

<sup>5</sup> A 2016 report by staff of the Securities and Exchange Commission analyzed the OTC marketplace and found that OTC securities “tend to be highly illiquid; are frequent targets of alleged market manipulation; generate negative and volatile investment returns on average; and rarely grow into a large company or transition to listing on a stock exchange.” *See* Joshua T. White, Outcomes of Investing in OTC Stocks, Dec. 16, 2016, *available at* [https://www.sec.gov/files/White\\_OutcomesOTCinvesting.pdf](https://www.sec.gov/files/White_OutcomesOTCinvesting.pdf).

<sup>6</sup> *See id.*

- Limiting purchases under the manual exemption to accredited investors;
- Establishing other investor suitability standards for investors, such as a minimum net worth or income requirement;
- Requiring an issuer of securities that trade in reliance on the manual exemption to have an operating history of at least two years immediately preceding the trade;<sup>7</sup>
- Requiring an issuer to have and maintain independent directors on its board;
- Increasing the required level of assets included on the issuer’s audited balance sheet from the current \$2 million threshold and/or excluding intangible assets from consideration;
- Requiring an issuer to have attained a minimum level of revenues based on the issuer’s audited income statement;
- Imposing “bad actor” disqualifications;
- Mandating additional disclosure, including, for example, disclosure of whether the transaction involves a control person or other insider, program fees, the availability or lack of a secondary trading market, and the risks of investment; and
- Requiring a purchaser to sign certain acknowledgements, including, for example, the risks of investment and the possibility of losing their entire investment.

These are but a few possible ideas to mitigate the risks to investors who purchase securities under the manual exemption. We are interested in receiving your comments on these or other issues.

---

<sup>7</sup> The concept for such a requirement draws from the Nasdaq’s adoption of a similar requirement for issuers seeking a listing in connection with a Regulation A offering. SEC Release No. 34-86246; File No. SR-NASDAQ-2019-017, available at <https://www.sec.gov/rules/sro/nasdaq/2019/34-86246.pdf>.

## Manual Exemption in the Uniform Securities Act of 2002

### Section 202(2)

- (2) a nonissuer transaction by or through a broker-dealer registered, or exempt from registration under this [Act], and a resale transaction by a sponsor of a unit investment trust registered under the Investment Company Act of 1940, in a security of a class that has been outstanding in the hands of the public for at least 90 days, if, at the date of the transaction:
- (A) the issuer of the security is engaged in business, the issuer is not in the organizational stage or in bankruptcy or receivership, and the issuer is not a blank check, blind pool, or shell company that has no specific business plan or purpose or has indicated that its primary business plan is to engage in a merger or combination of the business with, or an acquisition of, an unidentified person;
  - (B) the security is sold at a price reasonably related to its current market price;
  - (C) the security does not constitute the whole or part of an unsold allotment to, or a subscription or participation by, the broker-dealer as an underwriter of the security or a redistribution;
  - (D) a nationally recognized securities manual or its electronic equivalent designated by rule adopted or order issued under this [Act] or a record filed with the Securities and Exchange Commission that is publicly available contains:
    - (i) a description of the business and operations of the issuer;
    - (ii) the names of the issuer's executive officers and the names of the issuer's directors, if any;
    - (iii) an audited balance sheet of the issuer as of a date within 18 months before the date of the transaction or, in the case of a reorganization or merger when the parties to the reorganization or merger each had an audited balance sheet, a pro forma balance sheet for the combined organization; and
    - (iv) an audited income statement for each of the issuer's two immediately previous fiscal years or for the period of existence of the issuer, whichever is shorter, or, in the case of a reorganization or merger when each party to the reorganization or merger had audited income statements, a pro forma income statement; and
  - (E) the issuer of the security has a class of equity securities listed on a national securities exchange registered under the Securities Exchange Act of 1934 or designated for trading on the National Association of Securities Dealers Automated Quotation System, unless the issuer of the security is a unit investment trust registered under the Investment Company Act of 1940; or the issuer of the security, including its predecessors, has been engaged in

continuous business for at least three years; or the issuer of the security has total assets of at least \$2,000,000 based on an audited balance sheet as of a date within 18 months before the date of the transaction or, in the case of a reorganization or merger when the parties to the reorganization or merger each had the audited balance sheet, a pro forma balance sheet for the combined organization;

[Remainder of page intentionally left blank]