

June 7, 1999

Mr. Jonathan Katz

Secretary

U.S. Securities and Exchange Commission

450 5th Street, N.W.

Washington, D.C. 20549

Re: Publication or Submission of Quotations

Without Specified Information

Rel. No. 34-41110

File No. S7-5-99

Dear Secretary Katz:

Please accept this comment letter on behalf of the North American Securities Administrators Association, Inc, ("NASAA") regarding the above-referenced release (the "Reproposed Release") originally proposed as Securities Exchange Release No. 39670 (the "Proposing Release") on February 17, 1998. NASAA welcomes the opportunity to provide input on this very important subject.

NASAA commends the Staffs of the Division of Market Regulation, the Division of Enforcement and the Division of Corporate Finance of the Securities and Exchange Commission ("Commission") for their vigilant efforts to address the problems of microcap fraud. Each Division has played a part in what is necessarily a joint effort to address this problem.

The Commission, the state securities regulators and the self-regulatory organizations ("SROs") have all used a variety of regulatory tools to attack microcap abuses. The Commission recently amended certain regulations to close loopholes that had unwittingly facilitated microcap fraud. The NASD issued several Notices to Members to address abuses in the trading and sale of thinly traded, thinly capitalized securities. The Commission, the states and the SROs have not only committed substantial resources on their own but have joined together to participate in joint inspections, sweeps and other enforcement efforts. The Commission and the state securities regulators have also held forums to educate investors on how to avoid becoming a victim of microcap fraud.

Not surprisingly, it appears that the regulatory efforts mentioned above have already had an impact. Many NASAA members report a decrease in complaints involving the OTCBB securities. In fact, because of the focus on the OTCBB, much of the activity has reportedly moved to NASDAQ Small Cap securities. Any regulatory focus on microcap securities should include the NASDAQ Small Cap to best protect small issuers and their investors.

NASAA supports the Commission's goals of preventing fraud and fostering greater access to information by investors. We supported the original proposal strongly, and we still agree with it in principle. Brokers should not be permitted to make recommendations of over-the-counter securities unless they have a substantive basis of information on file about the company whose shares are involved. However, since our initial comment, further research and a broader perspective have led us to believe the proposal has potential consequences not then evident to us. As we stated in our original letter, "...any regulation proposed to reduce fraud and abuse in the marketplaces in which so-called 'microcap' securities trade should be narrowly tailored to minimize any adverse effects on small business capital formation."

NASAA supports this important proposal to facilitate providing information to investors, but recommends the proposed rule be further narrowed. In proceeding with the Rule, the Commission should provide an exemption from its requirements for wholesale market makers whose customers are other broker-dealers exclusively. We believe that through such a narrower rule the Commission would still achieve the desired result but would avoid affecting adversely and unnecessarily both small business and the investors or potential investors interested in those companies. We believe that on balance, without this narrowing, the proposed rule may have an unnecessary detrimental impact on the small business community, legitimate market makers and investors, outweighing the potential benefits intended for the investing public. For these reasons, Form 211 should still be the quote initiation document but the wholesaler should be permitted to piggyback on the information in that form.

I. Historical Perspective

It has been our experience over the years that a typical microcap fraud/penny stock fraud is perpetrated by one or more related broker-dealers or a broker-dealer and an issuer who conspire to control the stock of a small company so that they can effectively "pump and dump" those securities. Before the establishment of the OTCBB, this particular scheme flourished. The participation of numerous market makers willing to quote a stock has made this more difficult, but obviously not impossible, because of the lack of control over the shares and the price of those shares.

NASAA believes microcap fraud is really a problem of market conduct. Usually the fraud begins with the broker-dealer disseminating false and misleading information about a small company's stock. That broker-dealer then sells as much stock as possible using high-pressure sales tactics (the "pump"). When they cannot get the investor to buy, brokers make unauthorized trades in the accounts of unsuspecting investors. When the stock price rises to the highest level the broker-dealer can support, it sells off securities at the inflated price (the "dump") and then withdraws. The price drops to its pre-manipulation price and the investors are left holding the almost worthless securities.

II. NASAA supports a thorough review of the impact of the Reproposal on small business issuers and their investors

NASAA believes adoption of the Reproposal in its current form may adversely impact small business issuers for several reasons. First, we believe the Reproposal may discourage large market makers who currently use their capital to maintain liquidity and price transparency in the stocks for which they make a market from quoting the stock of many non-reporting small businesses, thereby reducing liquidity in those stocks. If history is any indication, illiquidity and lack of transparency actually facilitate fraud and manipulation. It may also encourage marginal market makers who would no longer have to compete with well capitalized market makers to quote stocks of related companies and then go out of business, leaving the investor holding illiquid, or worthless, stock.

Second, to have a functioning, effective market for small business issuers, their securities must be protected from a brokerage firm that manipulates the market for its own benefit. NASAA believes transparency and liquidity in that marketplace help to protect the small business issuer by making it less likely any one broker or a group of brokers could control and manipulate the stock of that company.

Third, many small investors are leery of investing in small businesses if they do not perceive there to be sufficient market liquidity to allow them later to sell the shares if and when they so desire. If the informational requirements placed on wholesale market makers cannot be fulfilled and the aftermarket for small issues is significantly reduced, investors will be less likely to buy in the first place, and legitimate issuers will find it harder to raise capital.

Fourth, if the number of market makers willing to quote a company's securities is reduced, spreads will increase and investors in small companies will suffer a loss of value in their investments. Lastly, with limited and tightened access to capital, as described above, many small companies could go out of business risking the loss of thousands of jobs.

III. NASAA strongly supports requiring retail brokers to review current information about an issuer prior to recommending a transaction in that security or publishing a quotation in that security.

NASAA believes the right balance is struck by placing the regulatory responsibility on the retail broker to review current information about an issuer prior to recommending a transaction in that security or quoting a price for the security. This would necessarily include a record of that review so the regulators could audit the performance of that requirement by the broker. An NASD proposed rule is currently before the Commission by which such a requirement would be mandated. We encourage strongly its adoption as an excellent means of addressing this problem.

We acknowledge that a wholesaler could unknowingly abet fraud by posting quotations, but on balance, we believe the transparency and liquidity provided to small companies is worth that risk. The wholesale market maker also, by definition, does not have an outlet to the retail investor and therefore has no direct opportunity or motivation to manipulate the market. In fact, the wholesaler can help impede these frauds effectively by shorting the stock and lowering its ask quotations. The more market makers willing to quote a stock, the less likely that one broker-dealer can control the price and then manipulate it.

IV. NASAA supports the creation of information repositories

The Reproposal encourages the development of repositories of Rule 15c2-11 information. NASAA supports the development of these information resources. It will provide much needed information about non-reporting issuers to investors, professionals and regulators. It is certainly more cost-effective for market makers to have this information available from a limited number of sources rather than having to obtain this information on their own. It will also ensure there is no information gap between market participants that could disadvantage the uninformed. Once the information contemplated in the proposal is available, the issue of publishing quotations without specified information essentially becomes moot.

V. NASAA supports strengthening other regulatory authority

NASAA offers the following recommendations to the Commission to supplement its proposals to reduce fraud in the microcap market:

1. The Commission should work with the NASD to establish a framework to allow the NASD to suspend member firms from facilitating trades in non-NASDAQ securities. It would appear the NASDR is in the best position to detect and thwart unlawful conduct with respect to securities quoted on the OTCBB and, to a lesser extent, in the pink sheets. Consideration should be given to whether the NASDR should be granted suspension authority over securities quoted on the OTCBB. Although the NASDR currently has authority to sanction its member firms for engaging in prohibited conduct on the OTCBB, often times with microcap fraud both the issuer and the broker-dealer engage, in concert, in fraudulent conduct. NASAA believes that preventing those issuers from accessing the OTCBB will help to stop on-going manipulative schemes.
2. Given the proliferation of fictitious quotes, manipulative conduct and abusive sales practices taking place in non-traditional trading forms, such as over the Internet, NASAA believes the term "quotation medium" should be defined with sufficient breadth to encompass new and yet unforeseen quote publication and dissemination mechanisms.
3. In applicable circumstances, retail broker-dealers should be required to disclose, both before and after a trade, that (a) a recommended issuer does not file current financial information with the Commission and that current financial information regarding an issuer may not be available, and (b) a recommended issuer has one or more red flags present. This would put investors on notice that recommendations are being made without the benefit of financial information about the issuer and that there are reasons to be concerned about the recommendation.

VI. Conclusion

Therefore, NASAA recommends the Commission adopt the rule as proposed as soon as practicable with the following amendments:

1. Allow wholesale market makers to piggyback on information gathered and reviewed by other market makers to initiate a quote in a security and exempt wholesale market makers from the requirement to review certain information about the company in order to quote its security.
2. Define the term "quotation medium" with sufficient breadth to encompass new and yet unforeseen quote publication and dissemination mechanisms like the Internet.

Should the Commission or its staff desire additional information or clarification of the matters discussed in this letter, please feel free to contact Philip A. Feigin, NASAA Executive Director or Karen M. O'Brien, NASAA General Counsel, at (202) 737-0900, or Deborah R. Bortner, Director of the Washington Securities Division and Chair of NASAA's Corporation Finance and Administration Section at (360) 902-8760.

Sincerely,

Peter Hildreth

NASAA President

cc. The Honorable Arthur Levitt, Chairman

The Honorable Isaac Hunt, Commissioner

The Honorable Norman Johnson, Commissioner

The Honorable Paul Carey, Commissioner

The Honorable Laura Unger, Commissioner

Annette Nazareth, Director, Division of Market Regulation