pink sheets

September 27, 2004

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Subject: Proposed Short-Swing Profits Rules
File No. S7-27-04

Dear Mr. Katz,

Pink Sheets LLC ("Pink Sheets") believes the requirements of Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act") should be extended to corporate insiders of publicly traded securities that are not registered under Section 12 of the Exchange Act ("unregistered securities"). We recognize that the Commission has not sought comment on this issue in the above-referenced rule. Nonetheless, we believe that trading in the public OTC markets by corporate insiders in unregistered securities is a matter of vital and pressing concern for investors and regulators. We have therefore taken this opportunity to call the Commission's attention to this urgent matter in an important sector of the market. Pink Sheets is the leading provider of pricing and financial information for the over-the-counter (OTC) securities markets and, among other things, operates an Internet-based, electronic quotation and trade negotiation service for OTC equities and bonds for market makers and other broker-dealers registered under the Exchange Act.

Trading of Unregistered Securities

Among publicly traded securities, two different standards exist for controlling abusive trading practices by an issuer's officers and directors and the beneficial owners of more than 10 percent of the issuer's equity securities (collectively, "corporate insiders").

With respect to securities registered under Section 12 of the Exchange Act, Section 16(a) requires a corporate insider to file reports with the Commission disclosing his or her beneficial ownership of all equity securities of the issuer. To keep this information current, Section 16(a) also requires corporate insiders to report changes in such ownership. Section 16(b) provides the issuer (or shareholders suing on behalf of the issuer) a private right of action to recover from a corporate insider any profit realized by the corporate insider from any purchase and sale (or sale and purchase) of any equity security of the issuer within any period of less than six months.

An investor in unregistered securities derives no benefit from Section 16. There is no requirement of reporting transactions under Section 16(a) and the Commission has taken the view that transactions exempt from the reporting requirements of Section 16(a) should not be subjected to the liability provisions of Section 16(b). Exchange Act Rule 16a-10. Instead, the investor must rely on insider trading prohibitions contained under general antifraud provisions, which are violated if a trader knew or was reckless in not knowing of material nonpublic information at the time of the trade.

We contend that the application of these rules should be turned on their head, for four reasons. First, the opportunities for abusive trading by insiders are much greater for unregistered securities. Second, the likelihood of abuse when corporate insiders trade creates a greater need for a strict liability prophylactic test, such as Section 16, with respect to unregistered securities. Third, the market for unregistered securities is large and important. Fourth, there is an essential need for regulators to easily access insider-trading records to identify pump-and-dump situations that require enforcement actions.

Greater Opportunities for Abuse. Investors in registered securities are provided with annual, quarterly and periodic reports on Forms 10K, 10Q and 8K, proxy statements and other special reports from time to time. This vast quantity of information is mailed to investors and made available electronically to anyone with Internet access through the EDGAR system maintained by the Commission. Moreover, registered securities are often traded on national securities exchanges or NASDAQ, which impose additional public disclosure requirements on issuers. As a result, there is less material nonpublic information available with respect to these securities, diminishing the opportunities for profitable trading on the basis on material nonpublic information.

In contrast, investors in unregistered securities are sometimes provided with little or nothing in the way of information by issuers, and the information that is provided can be woefully deficient. Poor disclosure is especially prevalent in cases where insiders intend to mislead or defraud investors. Many unregistered securities trade in the Pink Sheets. They are also traded among broker-dealers specializing in “gray market” stocks by telephone, without accessing any quotation medium. Pink Sheets encourages issuers to provide information to investors and provides a convenient Internet site to accommodate issuers that wish to provide information. However, neither Pink Sheets nor any of the other venues for the trading of unregistered securities can require issuers to disseminate information to investors. Corporate insiders therefore have access to much more material nonpublic information and consequently possess abundant opportunities to abuse ordinary investors in unregistered securities.[1]

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[1] This is not a new issue. As the Commission’s Director Loomis testified in 1963: "The overwhelming preponderance of fraud cases before the Commission in past years have involved the securities of companies which have not been subject to the reporting requirements of the Exchange Act." SEC Legislation, 1963, Hearings on S. 1642, before Senate Comm. on Banking & Currency, 88th Cong., 1st Sess. 288--307 (1963), as quoted by Loss and Seligman, Securities Regulations, 3d, § 1-G-1, at n. 95.

Likelihood of Abuse. Section 16 operates without consideration of whether a corporate insider actually was aware of material non-public information. Instead, Section 16 requires reports of transactions by corporate insiders, even for innocent transactions, and creates strict liability for short-swing profits by insiders. Strict liability is appropriate when corporate insiders trade because short-swing transactions present a sufficient likelihood of involving abuse of inside information that a strict liability prophylactic approach is appropriate.

In the case of unregistered securities, the greater opportunities to exploit material nonpublic information increases the likelihood that short-term transactions will involve abuse. There is all the more reason for creating a strict liability standard with respect to unregistered securities to prevent abusive trading by corporate insiders.

Size of the Market. Exact numbers are not known, but we estimate there are at least as many unregistered issues trading in the public markets as registered issues.

Regulatory Disparity. While Section 16 ignores unregistered securities, Rule 144 under the Securities Act of 1933 requires reports and disclosure when corporate insiders are selling registered and unregistered securities. We do not see any valid argument why the Exchange Act Section 16 requirements for disclosure when insiders trade on the public markets should not meet the same information requirements and reporting required under Securities Act Rule 144.

Conclusion

Section 16 was adopted early in the history of the federal securities regulation. It is therefore not entirely clear, and only of passing interest, why unregistered securities were not included within its provisions. We submit that the time has come to reconsider this exclusion in the light of more recent experience.

We therefore urge the Commission to require corporate insiders of publicly traded unregistered securities to report transactions[2] in these securities in a manner similar to reports made under Section 16(a). If authority to mandate such reports is lacking in Section 16(a), then these reports can be required under the Commission's general anti-fraud rulemaking authority under Section 10 of the Exchange Act. We also believe the Commission should require that adequate public information be available before insiders can trade in the public OTC markets similar to the safe harbor under section 144 (c).[3] The information gleaned from such reports will provide great benefits to

[2] We would limit it to transactions that directly or indirectly were reported by a broker-dealer to the NASD under NASD Rule 6600.

[3] The Commission should explicitly ban trading by insiders in registered securities when the issuer is delinquent in its SEC reporting obligations.

investors and may indicate a further need to extend the strict liability consequences of Section 16(b) to the market for unregistered securities.

Please call me if you have any questions.

Very truly yours,

/s/ R. CROMWELL COULSON

R. Cromwell Coulson
Chief Executive Officer