

**HOW DO I SELL MY CROWDFUNDED SHARES? DEVELOPING EXCHANGES AND MARKETS TO TRADE SECURITIES ISSUED BY START-UPS AND SMALL COMPANIES**

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*Governments worldwide are increasingly recognizing that assisting the development of start-ups and small to medium enterprises may be critical to fostering job creation and economic growth. As such, there is a concerted effort to rework securities regulation to encourage the funding of these businesses through innovative approaches such as crowdfunding. However, one major problem with investing in securities issued through crowdfunding is that investors typically have limited-to-no ability to sell the securities. There are a number of over-the-counter, venture and small company markets trying to bridge that gap and proposals in some countries to develop new markets for these types of securities. However, such markets present significant regulatory challenges, as they have historically been plagued by fraud and “pump and dump” manipulation schemes. This Article considers these regulatory challenges and explores how regulators can work to improve the integrity of these markets as a way of encouraging their development.*

**I. Introduction**

Traditionally, start-ups and small to medium enterprises (SMEs) have had to turn to bank financing to fund both their establishment and expansion. However, obtaining debt financing can be challenging. Many entrepreneurs, particularly those in the tech industry, do not have the available assets required as collateral for a loan. Furthermore, paying interest means that a reliance on bank financing reduces cash flow, which can impact the ability of the business to grow while at the same time hinder its capacity to withstand economic downturns.

Faced with stagnant employment rates, governments are increasingly asking their regulatory agencies to look at novel ways to encourage the funding of start-ups and SMEs.<sup>1</sup>

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<sup>1</sup> See, e.g., *Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions’ Entrepreneurship 2020 Action Plan: Reigniting*

Because statistics show that these businesses are significant employers, their development can be pivotal to both the growth of an economy and the creation of new jobs.<sup>2</sup> For example, in the United States, in the wake of the global financial crisis, there were calls from politicians from both political parties to change the structure of securities regulation to encourage the funding of small businesses to stimulate growth and employment.<sup>3</sup> This ultimately led Congress to pass the Jumpstart Our Business Startups Act (JOBS Act), signed into law in 2012.<sup>4</sup> The JOBS Act directed the U.S. Securities and Exchange Commission (SEC) to make a number of important changes that were designed to increase sources of funding for small businesses. One significant change was that it asked the SEC to develop rules allowing equity crowdfunding.<sup>5</sup> Many other countries have also recently introduced rules to allow equity crowdfunding for small enterprises.<sup>6</sup>

However, despite this current enthusiasm for equity crowdfunding, one factor which may significantly hinder equity crowdfunding development is the lack of an exit strategy for investors. Investors purchasing securities via an equity crowdfunding issue are usually locked into their investment and almost invariably cannot quickly sell such securities through a secondary market or exchange if their investment preferences change.<sup>7</sup> Over time, this inflexibility may temper the willingness of investors to participate in such ventures. The lack of a secondary market may also limit the attractiveness of equity crowdfunding for entrepreneurs as a funding strategy given that they will not be able to readily unlock some of the value in the firm by selling their own securities.

A solution is to enable securities issued through an equity crowdfunding campaign to be sold via a secondary market such as an exchange or market specifically designed to trade securities issued by smaller companies. However, compared to the large stock exchanges, such secondary markets face a number of significant challenges. One is that there is generally less trading in the securities of a small company often simply because of the limited number of securities on issue. This can lead to a significant spread between the price at which a seller is willing to sell those securities and the price at which a buyer is willing to purchase them.<sup>8</sup>

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*the Entrepreneurial Spirit in Europe*, COM (2012) 795 final (Sept. 1, 2013).

<sup>2</sup> For example, in the EU, it is estimated that SMEs employ two out of every three people and produce 58 cents in every euro of value-added. PATRICE MULLER ET AL., *A PARTIAL AND FRAGILE ECONOMY: ANNUAL REPORT ON EUROPEAN SMES 2013/2014* 6 (2014). In the US, it is estimated that small businesses have provided 55% of all jobs and 66% of all net new jobs since the 1970s. *Manage Your Finances*, U.S. SMALL BUS. ADMIN. (2017), <https://www.sba.gov/managing-business/running-business/energy-efficiency/sustainable-business-practices/small-business-trends>.

<sup>3</sup> Andrew Fink, *Protecting the Crowd and Raising Capital Through the CROWDFUND Act*, 90 UNIV. DETROIT MERCY L. REV. 1, 2 (2012).

<sup>4</sup> See Jumpstart Our Business Startups Act of 2012, Pub. L. No. 112–106, 126 Stat. 306 (2012).

<sup>5</sup> *Id.* at 20. Another important change is commonly known as a Regulation A+ reform. This increased the amount that could be raised using a mini registration statement, rather than a full prospectus, from \$5 million in a 12-month period to \$50 million. *See id.* at 401–02.

<sup>6</sup> *See infra* Part III.

<sup>7</sup> For example, in Canada, investors who purchase crowdfunding securities can usually only sell those securities through utilizing an exemption from the requirement to issue a prospectus. *See* Prospectus and Registration Exemptions, Nat'l Instrument 45-106 (Can.). In relation to restrictions on selling crowdfunded securities in the United States, *see* U.S. SECS. AND EXCH. COMM'N, *REGULATION CROWDFUNDING: A SMALL ENTITY COMPLIANCE GUIDE FOR ISSUERS* (2016), <https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm>.

<sup>8</sup> Luis A. Aguilar, Comm'r, U.S. Secs. and Exch. Comm'n, *The Need for Greater Secondary Market Liquidity for Small Businesses*, Public Statement to the Advisory Committee on Small and Emerging Companies (Mar. 4, 2015), <https://www.sec.gov/news/statement/need-for-greater-secondary-market-liquidity-for-small-businesses.html>.

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This lack of liquidity can also make those securities vulnerable to manipulation, as a lack of supply makes it easier to artificially drive up the price dramatically with relatively few low-value trades. This kind of manipulation frequently takes the form of what is colloquially called a “pump and dump” manipulation scheme. In such a scheme, the manipulator gradually acquires a large number of securities in a particular company. Positive false or misleading information is then disseminated about the company. This may be accompanied by a flurry of matched purchases and sales between associates to give the appearance of heightened interest in the securities, which in turn has a tendency to further artificially inflate the price. When the price of the securities has become inflated, the manipulator sells, that is “dumps,” the securities before the price falls back to a more realistic level.

Because securities traded on secondary markets created for smaller companies are susceptible to manipulation, these markets can be prone to developing a poor reputation that can result in unpopularity among brokers and investors. In addition, regulators responsible for maintaining the integrity of such markets have been forced to devote significant resources to detecting, investigating, and prosecuting such schemes in order to clamp down on abuse in these markets.<sup>9</sup> The task of tackling such abuse has become even more challenging in recent years because the growth of worldwide electronic trading has meant that in many instances, the manipulators are situated outside of the jurisdiction. Rampant abuse has even led to the closing of such markets, which occurred in the case of the First Board of the Open Market in Germany.<sup>10</sup>

This Article considers the challenges for markets designed for the trading of securities of smaller companies and, in particular, their vulnerability to fraud and market manipulation. It argues that safeguarding the integrity of such markets by eliminating, or at least minimizing, such abuse is a necessary part of ensuring the success of new innovations in the financing of smaller companies such as equity crowdfunding. To this end, this Article also suggests ways in which the integrity, and hence the reputation, of those markets can be enhanced. Part II briefly outlines the recent shift in securities regulation to facilitate the funding of start-ups and SMEs, as well as the growing recognition that secondary markets are needed to enable the trading of the anticipated “tsunami” of securities to be unleashed by these changes.<sup>11</sup> Part III considers venues which currently exist to trade such securities as well as proposals for the creation of new markets. Part IV describes how historically, markets for secondary trading of securities issued by smaller companies have frequently suffered from an unenviable reputation and as a direct consequence, have struggled to attract investors. Nevertheless, this kind of negative reputation is not inevitable. As such, Part V proposes possible ways in which the credibility of those markets can be enhanced by way of the structure of the market, obligations on market participants, and enforcement mechanisms calculated to deter those tempted to engage in fraud and abuse.

## II. Facilitating Equity Funding for Small Companies

The early 21<sup>st</sup> century is shaping up to be one characterized by rapid technological advances which can disrupt traditional industries. The demise of such industries can, in turn, result in significant job losses which may impact the social cohesion of society, resulting in political

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<sup>9</sup> See *infra* Part IV.

<sup>10</sup> *Id.*

<sup>11</sup> See Kay Koplovitz, *One Year After Title II and Equity Crowdfunding*, HUFFINGTON POST (Oct. 10, 2014), [http://www.huffingtonpost.com/kay-koplovitz/one-year-after-title-ii-a\\_b\\_5965466.html](http://www.huffingtonpost.com/kay-koplovitz/one-year-after-title-ii-a_b_5965466.html).

upheaval with governments finding themselves under pressure to generate solutions to tackle unemployment and underemployment.

Rather than resort to protection of traditional industries, one response has been to encourage the development of start-ups and SMEs which are known to be significant job creators. As such and as discussed below, an idea that has gained significant traction in recent years is that of loosening securities regulations to enable smaller companies to more readily raise equity capital rather than having to rely on debt finance. One approach which is becoming increasingly popular throughout the world is for regulations to be relaxed so smaller companies can raise capital through equity crowdfunding.

Equity crowdfunding allows a company to obtain funds from a large body of investors whereby each investor provides only a small amount of the funds required in exchange for securities in the company. A key feature of this approach is the use of the Internet to gather investors, with a licensed Internet platform typically being used to match investors with ventures seeking finance. Use of the Internet platform technology reduces search costs associated with finding appropriate investors.<sup>12</sup> Another advantage of equity crowdfunding for entrepreneurs is that they are able to maintain management control because ownership of the issued securities is dispersed across many investors. In contrast, raising funds by way of venture capital or private equity typically means that the entity or entities providing the finance will tend to have significant sway over the management and direction of the company. Equity crowdfunding may also enhance the profile of a company as investors become customers whose positive experiences may inspire them to invest in the business and who, in turn, may disseminate information about the company and its products through social media.<sup>13</sup>

It is also possible that equity crowdfunding may address another issue that has arisen in recent years—in many countries, there has been a marked fall in the number of initial public offerings (IPOs) and, in particular, smaller IPOs.<sup>14</sup> This has resulted in retail investors being effectively locked out of investing in innovative start-ups during what may be their most rapid-growth phase. Presently, well-developed private equity and venture capital markets supply most of the funding for new high-tech enterprises, with such start-ups only going public after they are well-established.<sup>15</sup> Equity crowdfunding may allow smaller investors to “get in on the ground floor” of what might be the next Apple or Facebook and thereby experience a substantial return on their investment if these companies rapidly expand.<sup>16</sup>

In the United States, the JOBS Act directs the SEC to develop rules to allow equity

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<sup>12</sup> WORLD FED’N OF EXCHS., SME FINANCING AND EQUITY MARKETS 36 (2017), <https://www.world-exchanges.org/focus/index.php/features/research/111-wfe-publishes-report-into-sme-financing-equity-markets>.

<sup>13</sup> See Alma Pekmezovic & Gordon Walker, *The Global Significance of Crowdfunding: Solving the SME Funding Problem and Democratizing Access to Capital*, 7 WILLIAM & MARY BUS. L. REV. 347, 384 (2016).

<sup>14</sup> See U.S. SEC. EXCH. COMM’N, REBUILDING THE IPO ON-RAMP: PUTTING EMERGING COMPANIES AND THE JOB MARKET BACK ON THE ROAD TO GROWTH 1 (Oct. 20, 2011), [https://www.sec.gov/info/smallbus/acsec/rebuilding\\_the\\_ipo\\_on-ramp.pdf](https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf).

<sup>15</sup> Chris Brummer has analyzed the reasons why this has occurred. In brief, it seems that reduced regulatory requirements and technological innovations have led to the growth of the private placement market. At the same time, listed public companies have been subject to additional layers of reporting and corporate governance requirements, decreasing the attractiveness of going public. See Chris Brummer, *Disruptive Technology and Securities Regulation*, 84 FORDHAM L. REV. 977 (2015).

<sup>16</sup> For a discussion on the benefits of crowdfunding for small investors, see Andrew Schwartz, *Inclusive Crowdfunding*, 4 UTAH L. REV. 661 (2016).

crowdfunding. The SEC released the final rules in 2015 which went into effect in 2016.<sup>17</sup> Many other countries have recently altered their securities regulation to allow equity crowdfunding, including the UK,<sup>18</sup> France<sup>19</sup> and New Zealand in 2014,<sup>20</sup> Germany in 2015,<sup>21</sup> Canada in 2016,<sup>22</sup> and Australia in 2017.<sup>23</sup> At the same time, while the equity crowdfunding industry is arguably still in its infancy, the number of Internet platforms offering equity crowdfunding is growing, and it is anticipated that it will continue to expand.<sup>24</sup> Similarly, the funds raised by equity crowdfunding are expected to grow exponentially over the coming years.<sup>25</sup>

However, the development of the equity crowdfunding industry is likely to be hindered unless the investors who subscribe to equity crowdfunding issues are able to onsell their securities. At present, unlike investors who obtain securities by subscribing to a registered prospectus, investors who subscribe for securities in a crowdfunding issue usually cannot onsell their securities to the public. As such, crowdfunding investors are generally locked in and must wait until the company either has an IPO or is taken over before the funds invested are returned to them. Unless this issue is addressed, over time, crowdfunding may be relegated to the position of a niche industry with most investors avoiding equity crowdfunding issues due to the inability to sell their securities quickly.

### III. Venues for Secondary Trading

To address this issue of investors being unable to sell their securities, there appears to be a renewed focus on establishing markets or exchanges for the secondary trading of securities issued by smaller companies. For example, in 2013, the SEC Advisory Committee on Small and Emerging Companies recommended the creation of a separate U.S. equity market for smaller companies and start-ups.<sup>26</sup> Following this recommendation, a number of SEC Commissioners suggested that the SEC consider approving one or more venture or regional exchanges with relaxed

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<sup>17</sup> Crowdfunding, 17 C.F.R. §§ 200, 227, 232, 239, 240, 249, 269, 274 (2015).

<sup>18</sup> See generally FIN. CONDUCT AUTH., THE FCA'S REGULATORY APPROACH TO CROWDFUNDING OVER THE INTERNET, AND THE PROMOTION OF NON-READILY REALISABLE SECURITIES BY OTHER MEDIA FEEDBACK TO CP13/13 AND FINAL RULES (2014), <https://www.fca.org.uk/publication/policy/ps14-04.pdf>.

<sup>19</sup> See Loi 2014-559 du 30 mai 2014 relative au financement participatif [Law 2014-559 of May 30, 2014 relating to the crowdfunding], JOURNAL OFFICIEL DE LA REPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], May 31, 2014, p. 9075.

<sup>20</sup> See Financial Markets Conduct Act 2013, subs 7 (N.Z.); Financial Markets Conduct Regulations 2014, reg 184 (N.Z.).

<sup>21</sup> Kleinanlegerschutzgesetz [Retail Investor Protection Act], July 9, 2015, BGBL I at 1115 (Ger.).

<sup>22</sup> See Multilateral Instrument Crowdfunding, O. Reg. 45/108 (Can.); Start-Up Crowdfunding Registration and Prospectus Exemptions, N.B. Reg. 45/506 (Can.).

<sup>23</sup> See *Corporations Amendment (Crowd-Sourced Funding) Act 2017* (Cth) sch 1 (Austl.).

<sup>24</sup> See OECD, FINANCING SMES AND ENTREPRENEURS 2016: AN OECD SCOREBOARD 65 (2017), [http://www.keepeek.com/Digital-Asset-Management/oecd/industry-and-services/financing-smes-and-entrepreneurs-2017\\_fin\\_sme\\_ent-2017-en#.WgJhG1ynET8](http://www.keepeek.com/Digital-Asset-Management/oecd/industry-and-services/financing-smes-and-entrepreneurs-2017_fin_sme_ent-2017-en#.WgJhG1ynET8).

<sup>25</sup> See Robert Wardrop et al., BREAKING NEW GROUND: THE AMERICAS ALTERNATIVE FINANCE BENCHMARKING REPORT 19 (2016).

<sup>26</sup> See U.S. SEC. EXCH. COMM'N, RECOMMENDATION REGARDING SEPARATE U.S. EQUITY MARKET FOR SECURITIES OF SMALL AND EMERGING COMPANIES (Feb. 1, 2013), <https://www.sec.gov/info/smallbus/acsec/acsec-recommendation-032113-emerg-co-ltr.pdf>. However, the SEC only recommended that accredited investors be allowed to trade on this market or markets. *Id.*

disclosure and other rules specifically designed for smaller companies.<sup>27</sup>

In other parts of the world, new venues for trading smaller companies are already emerging.<sup>28</sup> For example, in 2015, the New Zealand Stock Exchange launched a new market known as the NXT Market.<sup>29</sup> The NXT Market replaced the NZX Alternative Market, which was established in 2003 but struggled with low trading volumes.<sup>30</sup> The NXT Market is aimed at small- to mid-sized businesses with a market capitalization of \$10–100 million. These companies are required to have at least fifty members of the public as shareholders who cumulatively hold at least a quarter of the shares. There is a simplified disclosure regime with a focus on key operating milestones by which investors can measure and monitor the performance of the company. Each company must also use an NXT-registered adviser for the first three years.<sup>31</sup>

Another New Zealand market is also gearing up to deal with securities issued through crowdfunding. A market called “Unlisted” operates under an exemption to the Financial Markets Conduct Act 2013 (FMC Act). As such, investors trading in securities quoted on this market do not receive the kind of protections provided by the FMC Act.<sup>32</sup> In 2016, Armillary Private Capital, the company that manages the Unlisted market, launched a licensed equity crowdfunding platform called Crowdsphere. As such, Armillary Private Capital can now offer equity crowdfunding services as well as the capacity to trade securities issued through equity crowdfunding via the Unlisted market.<sup>33</sup>

The Korea Exchange, the sole securities exchange operator in South Korea, has opened a market to trade crowdfunded securities called the “KRX Startup Market” and is geared to attract companies by offering equity crowdfunding combined with the capacity to trade such securities.<sup>34</sup> As these companies grow, the Korea Exchange can enable them to progress to KONEX (Korea

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<sup>27</sup> See Daniel M. Gallagher, Comm’r, U.S. Sec. Exch. Comm’n, Remarks at FIA Futures and Options Expo (Nov. 6, 2013), <https://www.sec.gov/news/speech/2013-spch110613dmg>; Kara M. Stein, Comm’r, U.S. Sec. Exch. Comm’n, Supporting Innovation through the Commission’s Mission to Facilitate Capital Formation (Mar. 5, 2015), <https://www.sec.gov/news/speech/innovation-through-facilitating-capital-formation.html>. For an example of such a proposed regional exchange, see, e.g., Haw. Dep’t Com. & Consumer Aff., HAWAII EXCHANGE FOR LOCAL INVESTMENT: REPORT TO THE TWENTY-SIXTH LEGISLATURE (Feb. 2012), <http://files.hawaii.gov/dcca/dfi/reports/Final-Report-Hawaii-Exchange-for-Local-Investment-Pursuant-to-SCR-134-SDI.pdf>.

<sup>28</sup> For example, in Australia, the legislation introducing crowdfunding anticipated that secondary markets for crowdfunding would be established and provides the Minister with great flexibility for granting exemptions for such markets. See *Corporations Amendment (Crowd-sourced Funding) Act 2017* (Cth) sch 3 (Austl.).

<sup>29</sup> Calida Smylie, *NXT market launches today*, NAT’L BUS. REV. (June 18, 2015), <https://www.nbr.co.nz/article/nxt-market-launches-today-cs-174300>.

<sup>30</sup> *NZX’s Alternative Market Trading Dwindles*, SCOOP BUS. (Oct. 5, 2010), <http://www.scoop.co.nz/stories/BU1010/S00095/nzxs-alternative-market-trading-dwindles.htm>.

<sup>31</sup> See Smylie, *supra* note 29.

<sup>32</sup> *Important Information - Please Read Before Proceeding*, UNLISTED, [http://www.unlisted.co.nz:80/uPublic/unlisted.mt\\_public.home](http://www.unlisted.co.nz:80/uPublic/unlisted.mt_public.home) (last visited Nov. 6, 2017).

<sup>33</sup> *Market Places*, ARMILLARY PRIVATE CAPITAL, <https://www.armillary.co.nz/Market-Places> (last visited Nov. 6, 2017); see also James Murray, *Equity Crowdfunding and Peer-to-Peer Lending in New Zealand: The First Year*, JASSA FINSA J. APPLIED FIN. 2 (2015), [http://www.finsia.com/docs/default-source/jassa-new/jassa-2015/jassa-2015-issue-3/equity-crowdfunding-and-p2p-lending-in-new-zealand-the-first-year.pdf?sfvrsn=8fcd9793\\_4](http://www.finsia.com/docs/default-source/jassa-new/jassa-2015/jassa-2015-issue-3/equity-crowdfunding-and-p2p-lending-in-new-zealand-the-first-year.pdf?sfvrsn=8fcd9793_4).

<sup>34</sup> JUNG MIN-HEE, *PRIVATE MARKET FOR STARTUPS KRX TO ESTABLISH PRIVATE MARKET TO SUPPORT STARTUPS’ STOCK TRADING BEFORE IPO*, BUSINESS KOREA (Mar. 24, 2016, 11:30 AM), <http://businesskorea.co.kr/english/news/smestartups/14199-private-market-startups-krx-establish-private-market-support-startups%E2%80%99-stock>.

New Exchange) and finally to the Korea Exchange's principal exchange, the KOSDAQ.<sup>35</sup>

In Taiwan, although the Taipei Exchange is not directly engaged in crowdfunding, it has set up a platform to link businesses and crowdfunding providers.<sup>36</sup> Undoubtedly, this was implemented with the hope that as those companies grow they will eventually look to list on its exchange.

Although there is this renewed enthusiasm for establishing new exchanges or markets for the secondary trading of securities issued by smaller companies, globally there already exists a number of markets and exchanges with differentiated admission and disclosure standards to cater to the trading in the securities of SMEs. These have had varied degrees of success.

For example, the U.K. is home to what may be one of the most successful markets for SMEs, namely the Alternative Investment Market (AIM), owned by the London Stock Exchange and created in 1995. Since its inception, over 3,600 companies have listed on it, although the number of companies seeking a listing has fallen to just 47 new listings in 2015 from a high of 399 new listings in 2005.<sup>37</sup> To list on AIM, each company must appoint and retain a Nominated Advisor, referred to as a NOMAD, at all times. A NOMAD is a firm of experienced corporate finance professionals who are approved by the London Stock Exchange. There are no minimum criteria in relation to listing in terms of the company size, track record, country of origin or set number of shares to be allocated to the public. Rather, the determination for whether the company is appropriate for the market is decided by the NOMAD.<sup>38</sup>

In the United States, securities not listed on the major exchanges can be traded over-the-counter (OTC), principally by services provided by the OTC Markets Group and through the OTC Bulletin Board (OTCBB) operated by the Financial Industry Regulatory Authority (FINRA). The OTCBB is an inter-dealer quotation system that is used by subscribing FINRA members to reflect market-making interest in OTCBB-eligible securities.<sup>39</sup> The OTC Markets Group operates three financial marketplaces: (i) the OTCQX, the top tier marketplace with the most stringent eligibility and disclosure standards; (ii) the OTCQB, the venture stage marketplace for medium-sized or early-stage companies; and (iii) the OTC Pink, which comprises the lowest tier of the three marketplaces and features no reporting requirements.<sup>40</sup> These marketplaces require less disclosure

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<sup>35</sup> *Id.*

<sup>36</sup> See *Introduction*, TAIPEI EXCHANGE, GOFUNDING ZONE, <http://gofunding.tpex.org.tw/introduction.php?l=en-us&t=0> (last visited Nov. 6, 2017).

<sup>37</sup> *AIM 20 – The World's Most Successful Growth Market*, LONDON STOCK EXCHANGE, <http://www.londonstockexchange.com/companies-and-advisors/aim/aim/aim.htm> (last visited Nov. 6, 2017); Richard Wheat, *The Death of Aim: Can Equity Crowdfunding Eclipse the LSE's Junior Market?* (Apr. 28, 2016, 4:42 AM), <http://www.cityam.com/239865/the-death-of-aim-can-equity-crowdfunding-eclipse-the-lses-junior-market>; see also Susanne Espenlaub & Arif Khurshed, *Is AIM A Casino? A Study of the Survival of New Listings on the UK Alternative Investment Market (AIM)*, RESEARCH GATE 4 (Dec. 2010), [https://www.researchgate.net/publication/228380249\\_Is\\_AIM\\_A\\_Casino\\_A\\_study\\_of\\_the\\_survival\\_of\\_new\\_listings\\_on\\_the\\_UK\\_Alternative\\_Investment\\_Market\\_AIM](https://www.researchgate.net/publication/228380249_Is_AIM_A_Casino_A_study_of_the_survival_of_new_listings_on_the_UK_Alternative_Investment_Market_AIM).

<sup>38</sup> Darryl Levitt & Andrew Derksen, *The AIM listing Process: Steps to a Successful AIM Listing*, FASKEN MARTINEAU, [http://www.fasken.com/files/Publication/84c66c81-421b-47cd-bbfe-74eccafa86d5/Presentation/PublicationAttachment/5b5d87c4-07fe-44e0-b03e-9bf76acd6073/AIM\\_LISTING\\_PROCESS.PDF](http://www.fasken.com/files/Publication/84c66c81-421b-47cd-bbfe-74eccafa86d5/Presentation/PublicationAttachment/5b5d87c4-07fe-44e0-b03e-9bf76acd6073/AIM_LISTING_PROCESS.PDF) (last visited Nov. 6, 2017).

<sup>39</sup> *OTC Bulletin Board (OTCBB)*, FINRA, <http://www.finra.org/industry/otcbb/otc-bulletin-board-otcbb> (last visited Nov. 6, 2017).

<sup>40</sup> *OTCQX*, INVESTOPEDIA, <http://www.investopedia.com/terms/o/otcqx.asp> (last visited Oct. 31, 2017). See

and impose much lower fees than other U.S. exchanges and markets.<sup>41</sup>

In Canada, the Canadian Securities Exchange (CSE) provides a venue for the trading of microcap and emerging companies and has relatively few reporting and listing requirements.<sup>42</sup> It has over 300 listed companies and has recently grown due to the listing of a number of start-ups in the cannabis industry.<sup>43</sup> Canada is also home to the TSX Venture Exchange, which is designed for smaller cap companies, particularly those in the mining as well as oil and gas industries.<sup>44</sup>

Other significant markets and exchanges for smaller companies include the Euronext Growth market in Europe,<sup>45</sup> the Shenzhen Stock Exchange SME Board in China,<sup>46</sup> the BSE SME platform in India,<sup>47</sup> the AIM Italia in Italy,<sup>48</sup> and the Tokyo PRO market in Japan.<sup>49</sup>

#### IV. Regulatory Challenges in Relation to Secondary Markets for Smaller Companies

Despite the call for new exchanges and markets to trade securities issued by smaller companies, historically such markets have faced a number of significant challenges. These include the fact that some markets, particularly those which are more junior markets of the larger exchanges, gradually become populated by what could be seen as unsuccessful companies. This is because over time, successful firms graduate to larger exchanges, and companies in the larger exchanges that decline in value, sometimes referred to as “fallen angels,” may be relegated to the junior market.<sup>50</sup> In some cases this poor reputation, coupled with high levels of fraud, has led to the closing of such markets, as occurred with the Emerging Company Marketplace, the junior board of the American Stock Exchange, which opened in 1992 and closed in 1995, after only three years of operation.<sup>51</sup>

Another significant problem is a lack of liquidity for markets designed to trade the securities of smaller companies. Having fewer securities on issue means that it becomes more difficult for those securities to be bought or sold, as a buyer may find that there is just no one willing to sell securities at the price the buyer is willing to pay and vice versa. This illiquidity can

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generally Ulf Brüggemann et al., *The Twilight Zone: OTC Regulatory Regimes and Market Quality*, REV. FIN. STUDIES (2017).

<sup>41</sup> John Mackie, *Delisting Deluge: Stocks Under Pressure And What To Do About It*, SECNEWS – Securities Law Newsletters (2009).

<sup>42</sup> CANADA SECURITIES EXCHANGE, <http://thecse.com/en/about> (last visited Oct. 31, 2017).

<sup>43</sup> Christina Pellegrini, *TMX Considers Change that Could Hamper Marijuana Industry*, THE GLOBE AND MAIL (Aug. 11, 2011), <http://archive.li/m4YII#selection-6997.191-6997.199>.

<sup>44</sup> DAVID JOHNSTON, KATHLEEN ROCKWELL & CRISTIE FORD, CANADIAN SECURITIES REGULATION 565–66 (5th ed., 2014).

<sup>45</sup> *Eurogrowth*, EURONEXT, <https://www.euronext.com/en/listings/euronext-growth> (last visited Oct. 31, 2017).

<sup>46</sup> *Listing Q&A*, SHENZHEN STOCK EXCH., <http://www.szse.cn/main/en/ListingatSZSE/ListingQA/> (last visited Oct. 31, 2017).

<sup>47</sup> *Introduction*, BSE, <http://www.bseindia.com/static/about/introduction.aspx?expandable=0> (last visited Oct. 31, 2017).

<sup>48</sup> *AIM Italia*, LONDON STOCK EXCH., <http://www.lseg.com/areas-expertise/our-markets/borsa-italiana/equities-markets/raising-finance/aim-italia-mac> (last visited Oct. 31, 2017).

<sup>49</sup> *Overview*, JAPAN EXCH. GRP., <http://www.jpx.co.jp/english/equities/products/tpm/outline/> (last updated Jan. 16, 2017).

<sup>50</sup> See e.g., Reena Aggarwal & James Angel, *The Rise and Fall of the Amex Emerging Company Marketplace*, 52 J. FIN. ECON., 257, 259–265 (1999) (describing the history of the failed Amex Emerging Company Marketplace).

<sup>51</sup> *Id.* at 264.



also make securities sold on those markets particularly susceptible to pump and dump manipulation schemes.<sup>52</sup>

A plague of pump and dump schemes led to the closing of the First Board of the Open Market in Germany in 2012. The Open Market is a multilateral trading facility run by Deutsche Börse that used to be divided into First and Second Quotation Boards. The First Quotation Board, which was designed for smaller companies, had few listing and post-admission requirements. Admission was granted on application by an entity authorized for trading, normally a securities trading bank, and it was considered sufficient if an auditor confirmed the entity had equity of at least €500,000 with each share of at least €0.10 par value.<sup>53</sup> Over time, it became clear to Germany's securities regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), that the majority of the cases of market manipulation that it investigated each year were pump and dump schemes occurring in this market.<sup>54</sup> These cases were frequently complex and difficult to investigate, had the potential to inflict substantial damage to investors and often involved extensive cross-border activity, as many of the companies whose shares were used in this way came from abroad, particularly Switzerland and the UK.<sup>55</sup>

Because of the level of manipulation in the First Board of the Open Market, BaFin gradually became critical of the listing requirements.<sup>56</sup> Initially, Deutsche Börse's response was to tighten listing standards and to suspend trading in the shares of entities that did not meet those standards.<sup>57</sup> However, prompted by an onslaught of new incidents of suspected market manipulation, in December 2011, Deutsche Börse decided not to admit any new entities to the First

<sup>52</sup> For the profitability of pump and dump schemes, see Taoufik Bouraoui, *Does 'Pump and Dump' Affect Stock Markets?*, INT'L. J. TRADE, ECON. & FIN., 45, 48 (2015).

<sup>53</sup> BAFIN, ANNUAL REPORT 2011, 195 (2012).

<sup>54</sup> In 2005, BaFin reported that 55% of manipulation investigations were related to sham trading. See BAFIN, ANNUAL REPORT 2005, 158 (2006). These were transactions which are referred to as "matched orders," prearranged transactions between two entities, or were "wash sales," trades without changes in the beneficial ownership of the securities. *Id.* Another quarter of manipulation investigations were related to informational offenses, that is, misleading or incorrect information or the concealing of information. *Id.* It also reported that the transactions mainly impacted "illiquid equities or 'penny stocks' traded on the OTC market." *Id.* In 2006, BaFin reported that reports by investors in relation to market manipulation doubled and "related primarily to low-liquidity financial markets traded in the OTC market." See BAFIN, ANNUAL REPORT 2006 163 (2007). In 2007, it recognized the involvement of foreign companies in such schemes, noting that this "occurs when shares, mostly of foreign companies in the commodity sector, are included in . . . OTC trade[s] [on] German stock exchanges." BAFIN, ANNUAL REPORT 2007, 173–74 (2008). By 2008, BaFin reported that "the significance of OTC trading for market manipulation remained consistently high" and that it was identifying "increasing levels of cross border manipulation in the German market." BAFIN, ANNUAL REPORT 2008, 156, 162 (2009). In 2009, BaFin reported that "there has been a marked shift in the focus of BaFin's report analysis activities towards market manipulation. Sham actions, such as matched trades, were the focal point of these activities in 2009 . . . . The shift from insider trading to more market manipulation analyses is likely to be due to the fact that the current market environment makes it more difficult for potential insiders to exploit their insider information to their advantage." See BAFIN, ANNUAL REPORT 2009, 171 (2010) (citation omitted).

<sup>55</sup> See BAFIN, ANNUAL REPORT 2010, 187–89 (2011).

<sup>56</sup> *Id.* at 188 ("The regulated unofficial market is run by the stock exchanges, but does not count as exchange trading. It is used primarily to trade small and in some cases highly illiquid stocks that are frequently of foreign origin. The conditions to be met for companies to be included are extremely lax compared with the regulated market. There is no serious examination of the issuers, nor must the companies comply with any reporting obligations. Even companies in respect of which it is completely unclear whether they have, or are planning, operational business activities can be included in trading extremely easily and used for manipulative purposes. Although Deutsche Börse AG introduced stricter inclusion requirements in 2009, this has yet to have any noticeable effect.")

<sup>57</sup> See BAFIN ANNUAL REPORT 2011, 195 (2012).

Quotation Board and closed it down in 2012.<sup>58</sup>

In the United States, most of the market manipulations prosecuted by the SEC each year are pump and dump schemes in the OTC markets. While the details of these schemes vary, they typically follow the same pattern of a person taking a large stake in the target company. The person then “pumps” the securities by way of igniting interest via matched orders between associates and promoting the securities in false or misleading emails, Internet postings or social media postings.<sup>59</sup>

The approach of U.S. authorities in tackling the relatively high volume of such schemes in the OTC markets has been to utilize a specialized unit within the SEC to identify and suspend trading in the securities of dormant companies before they can be hijacked and used for pump and dump schemes.<sup>60</sup> Second, the Federal Bureau of Investigation (FBI) has engaged in sting operations, whereby an undercover FBI agent offers bribes to fund managers in exchange for those fund managers using investors’ funds to purchase penny stocks.<sup>61</sup> Third, the SEC has worked with the U.S. Department of Justice to criminally prosecute recidivist pump and dump scheme promoters with a view to those promoters being convicted and sentenced to lengthy prison terms.<sup>62</sup> Finally, FINRA has been active in taking action against brokers who have facilitated manipulative trading in these markets in an effort to deter brokers from acting for clients engaging in this type of illegal conduct.<sup>63</sup>

Nevertheless, despite these efforts, pump and dump manipulation schemes still appear to be a problem for U.S. OTC markets. In 2015, the SEC took action in relation to nineteen cases of manipulation that were primarily pump and dump schemes.<sup>64</sup> Like BaFin, the SEC has found that these schemes are often complex and frequently involve accounts or corporations located in foreign jurisdictions such as the British Virgin Islands, Anguilla, the Bahamas, and Turks and Caicos, presumably in an attempt to avoid detection by U.S. regulators.<sup>65</sup>

This prevalence of manipulation in markets for trading securities issued by smaller companies presents a festering problem going forward if these same markets are to be utilized to trade the expected significant increase in securities generated by equity crowdfunding. A recent survey by the World Federation of Exchanges found that a solid regulatory framework designed to

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<sup>58</sup> *Id.* at 168, 195.

<sup>59</sup> See U.S. Sec. Exch. Comm’n, *Annual Report 2010*, 2011 SEC 160; see also U.S. Sec. Exch. Comm’n, *Litigation Release Archive 2010* (2010), <https://www.sec.gov/litigation/litreleases/litrelarchive/litarchive2010.shtml> (reporting, in 2010, that the SEC took action in relation to seventeen cases of manipulation primarily involving pump and dump schemes in the OTC market).

<sup>60</sup> The SEC does this through its Microcap Fraud Working Group established in 2012. This group scrutinizes microcap stocks to identify dormant shell companies that could be used for potential fraud. U.S. Sec. Exch. Comm’n, *Annual Report 2012*, 2013 SEC 136; U.S. Sec. Exch. Comm’n, *Annual Report 2013*, 2014 SEC 137.

<sup>61</sup> U.S. Sec. Exch. Comm’n, *Litigation Release No. 22389* (June 4, 2012), <https://www.sec.gov/litigation/litreleases/2012/lr22389.htm>.

<sup>62</sup> See, e.g., United States v. Harold Bailey Gallison II, No. 1:15-CR-00178-AJT (E.D. Va. filed June 24, 2015).

<sup>63</sup> See, e.g., Sarah O’Brien, *Brokers, Firms Land on FINRA’s ‘Bad Guys’ List*, CNBC (May 11, 2016), <http://www.cnbc.com/2016/05/10/brokers-firms-land-on-finras-bad-guys-list.html>.

<sup>64</sup> *Litigation Release Archives 2015*, U.S. SEC. EXCH. COMM’N (last visited Nov. 6, 2017), <https://www.sec.gov/litigation/litreleases/litrelarchive/litarchive2015.shtml>.

<sup>65</sup> See, e.g., U.S. Sec. Exch. Comm’n, *Litigation Release No. 19481* (Dec. 2, 2012), <http://www.sec.gov/litigation/litreleases/lr19481.htm>; *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088 (2005); U.S. Sec. Exch. Comm’n, *Litigation Release No. 22326* (Apr. 11, 2012), <http://www.sec.gov/litigation/litreleases/2012/lr22326.htm>.

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enhance the integrity of the market, coupled with strong supervision and enforcement, is a very important requirement for both investors and companies if they are to participate in markets for SMEs.<sup>66</sup> As such, it appears that unless action is taken to deter fraud and manipulation in these markets, they are likely to be avoided by investors. Therefore, it is critical to their success, and ultimately the success of equity crowdfunding, that there is an unwavering focus on minimizing fraud and manipulation in regulations governing both the design and ongoing supervision of these markets.

## V. How to Enhance the Integrity of Markets for Smaller Companies

Eliminating unfair trading practices such as fraud and market manipulation is pivotal in achieving two of the main objectives of securities regulation—to protect investors and to ensure markets are fair, efficient and transparent.<sup>67</sup> One of the most important ways in which regulators endeavor to meet these objectives is by imposing comprehensive listing requirements and thereafter continuous disclosure requirements on companies listed on the large exchanges. This is backed up by the threat of criminal and civil liabilities for failing to provide such information or for providing false or misleading information.

However, for small companies the cost of these kinds of comprehensive listing and disclosure requirements is prohibitive. The real challenge then is for securities regulators to protect investors and preserve the integrity of markets for the trading of securities issued by smaller companies in the absence of a full disclosure regime. While there appears to be no one solution to this problem, there are some mechanisms that could be employed, which may go some way to enhancing the integrity of these types of markets and protecting the investors who use them.

### A. Vetting of Companies

In the absence of comprehensive disclosure requirements, some degree of vetting needs to be imposed on companies to reduce the potential for outright fraud. The cheapest and perhaps most effective way for this to occur may be to make a market intermediary responsible for conducting due diligence to determine the bona fides of the company and its management team. This model has been used by some of the existing markets for small companies, including the AIM, which requires companies to use a NOMAD.<sup>68</sup> The advantage of requiring a market intermediary to vet companies is that most companies utilizing equity crowdfunding will already have a relationship with a licensed financial service intermediary, namely the licensed crowdfunding platform it used for the issue of its securities. Some of these crowdfunding platforms already undertake due diligence on projects listed on their portals. This can include background checks, site visits, credit

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<sup>66</sup> A 2017 survey conducted by the World Federation of Exchanges in relation to SME Financing and Equity markets found that for companies “a well-established regulatory and supervisory framework” was the most critical factor to the success of a market for SMEs. For retail and institutional investors, this was the second most important factor, the first being a mechanism to support SMEs to prepare disclosure documents. These factors were more important than liquidity, research analysis, tax incentives and simplified disclosure documents. *See* WORLD FED’N OF EXCHS., *supra* note 12.

<sup>67</sup> *See* Int’l Org. of Sec. Comm’ns, *Objectives and Principles of Securities Regulation* (June 2010), <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf>.

<sup>68</sup> *Supra* Part III.

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checks, account monitoring, and proof of transactions obtained from third parties.<sup>69</sup> As such, it seems like a logical step that such a firm could also serve to vet the company for listing.

Linking the reputation of the market intermediary to the companies it authorizes for listing should help ensure the quality of the companies traded on the exchanges and minimize the prospect of outright fraud. Of course, the effectiveness of the vetting process is arguably compromised, to some extent, in that the market intermediary is in a fundamental conflict of interest because the company to be vetted engages it and pays for its services. In fact, some argue that conflicts of interest and poor monitoring of NOMADs have led to the failure of many companies listed on the AIM.<sup>70</sup> Accordingly, for such a regime to be effective, it is critical that market intermediaries be coherently regulated and supervised by regulators. Subjecting market intermediaries to harsh penalties for failure to properly conduct their due diligence responsibilities would also further reduce the prospects of fraud by the company to be listed or its management team.<sup>71</sup>

### *B. Disclosure of Substantial Shareholders*

There is a strong argument in support of strict regulations to ensure that changes to substantial shareholders are rapidly and clearly disclosed, coupled with significant penalties for a failure to do so. This is because pump and dump schemes are usually characterized by a person and his or her associates gradually accumulating a significant holding in a stock. Disclosure of changes to holdings by substantial shareholders should alert market participants and the authorities to potential schemes and, as such, strict requirements to disclose substantial shareholdings may tend to deter those contemplating this type of manipulation.

### *C. Liquidity and Market Surveillance*

Improving the liquidity of markets for the trading of securities issued by smaller companies should significantly reduce the ability of perpetrators of pump and dump schemes to radically increase the price by virtue of there being a lack of supply of securities. Some suggestions that have been made for improving liquidity of such markets include:

- changing trading so that it is not continuous but only takes place in batch auctions at various intervals,<sup>72</sup>
- altering the tick size of trades to encourage market makers who traditionally have provided

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<sup>69</sup> Douglas Cumming & Yelin Zhang, *Are Crowdfunding Platforms Active and Effective Intermediaries?* 4–5 (Dec. 9, 2016) (unpublished manuscript) (on file with author) (finding that due diligence by crowdfunding platforms is associated with a higher percentage of successful campaigns and larger amount of capital raised on platforms).

<sup>70</sup> Ben Turney, *Does the London Stock Exchange Deserve its Licence to Regulate AIM*, UK INVESTOR MAGAZINE 26–27 (July 2015).

<sup>71</sup> See Joseph Gerakos, Mark Lang & Mark Maffett, *Post-Listing Performance and Private Sector Regulation: The Experience of London's Alternative Investment Market*, J. ACCT. & ECON. 189, 212 (2013) (finding that companies listed on the AIM underperformed similar firms listed on the NASDAQ, the OTC Bulletin Board, and the LSE Main Market but that firms subject to high quality auditors and NOMADs performed better although still not as well as the firms listed on the other markets—one reason may be that there were only few disciplinary actions taken against AIM firms and NOMADs and, even in those cases, the penalties were low).

<sup>72</sup> See Jeff Schwartz, *Venture Exchange Regulation: Listing Standards, Market Microstructure and Investor Protection* 15–16 (Sep. 8, 2016) (unpublished manuscript) (on file with author).

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liquidity in the markets in which they operate;<sup>73</sup> and

- ensuring all of the trading of a particular company's securities is concentrated in one venue and not fragmented over a number of markets or by off-exchange, internal order matching by brokers.<sup>74</sup>

Concentrating the trading of a company's securities in one market also has a significant advantage for the authority responsible for detecting manipulation and other abusive practices. This is because currently, the main method by which market manipulation and insider trading is detected is via surveillance software used by the authorities. This software monitors trading on the markets and is designed to identify anomalous trading patterns. If the trading takes place in only one venue, this substantially simplifies the surveillance software systems needed for such detection. By way of comparison, if trading is fragmented over a number of different venues, to effectively conduct such surveillance, trading and order information from each of those markets needs to be collected and assembled before it can be analyzed. This significantly adds to the cost and complexity of the surveillance systems required, not to mention delays the entire analysis process.<sup>75</sup>

Of course, concentrating all trading within one trading venue creates a monopoly and could potentially result in that venue extracting excess profits from brokers and listed companies. However, the benefits of concentrating all trading in one venue for thinly-traded stocks seem to outweigh this possible disadvantage. Furthermore, given the fact that there are many venues for smaller companies to list their securities around the world, competition between venues should keep in check the possibility of extracting monopoly profits.

#### *D. Enforcement*

If the probability of wrongdoing being detected is high and the penalties are substantial, potential perpetrators will tend to be deterred from engaging in such conduct. Accordingly, it is essential that there be robust laws prohibiting fraud and manipulation coupled with significant penalties for violations, including the possibility of lengthy prison terms. However, this is not enough by itself. It is also necessary for there to be a high probability of both detection and prosecution, rather than just a theoretical risk.<sup>76</sup>

In addition to detection via market surveillance systems, another important detection method can be reports made by market intermediaries. In particular, regulations need to require that compliance systems be maintained by market intermediaries. These regulations should also impose on market intermediaries an obligation to immediately report suspicious transactions directly to the authorities. Ideally these reports should be made directly to the securities regulator

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<sup>73</sup> See *id.*; Press Release, U.S. Sec. Exch. Comm'n, SEC Approves Pilot to Assess Tick Size Impact for Smaller Companies (May 6, 2015), <https://www.sec.gov/news/pressrelease/2015-82.html> (stating that the SEC is currently conducting a tick size pilot program).

<sup>74</sup> See Gallagher, *supra* note 27.

<sup>75</sup> See generally Janet Austin, *Unusual Trade or Market Manipulation? How Market Abuse is Detected by Securities Regulators, Trading Venues and Self-Regulatory Organizations*, 1 J. FIN. REG. 263 (2015) (explaining how insider trading and market manipulation are detected by securities regulators).

<sup>76</sup> See generally Utpal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading*, 57 J. FIN. 75 (2002) (explaining the impact of enforcement); Laura Beny, *Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence*, 7 AM. L. & ECON. REV. 144 (2005).

responsible for taking action against market manipulation. In Europe, for example, market intermediaries are required to report directly to the regulator any suspicious transactions, including suspicious unexecuted orders. Failure to do so attracts a penalty of up to €1 million for a natural person and €2.5 million, or 2% of turnover, for other legal persons.<sup>77</sup> European securities regulators are also required to forward a copy of any suspicious transaction report to all other supervisory authorities of organized securities markets within the EU who may be affected by the report. Over time, such reports are proving to be an important way in which European securities regulators detect market manipulation.<sup>78</sup>

Another increasingly important detection mechanism for fraud and manipulation is voluntary reports from the public to securities regulators in the form of complaints, tip-offs, or whistleblowers. Such reporting appears to be significantly enhanced when the regulator offers monetary awards to whistleblowers, as is the case with the SEC and the Ontario Securities Commission.<sup>79</sup> These awards are most commonly made to individuals who have inside knowledge of the fraud, but can also be made to anyone who provides the regulator with original information derived from independent information or independent analysis.<sup>80</sup>

After initial detection, it is necessary that securities regulators be in a position to rapidly take action against the perpetrators of the abuse, even if those persons are outside of the jurisdiction. Currently, when a perpetrator is outside of the jurisdiction, most securities regulators can obtain access to the information they require to undertake an investigation relatively quickly via a memorandum of understanding established by the International Organization of Securities Commissions (IOSCO), which almost all the securities regulators in the world have signed.<sup>81</sup> However, a perpetrator can only be brought before the courts if an extradition arrangement is in place or the regulator where the perpetrator is situated is itself prepared to bring a prosecution. If neither occurs, apart from perhaps having assets frozen within the jurisdiction, the perpetrator will escape jail and perhaps even be emboldened to offend in the future. Given the risk to the integrity of the markets that fraud and manipulation pose, securities regulators should consider restricting access to the market from all persons who reside in countries where there is no extradition treaty or where the authorities in that country will not bring their own proceedings against the perpetrators.

## VI. Conclusion

For equity crowdfunding to continue to grow, it will be necessary for secondary markets to be developed for smaller companies and for such markets to succeed and thrive. A critical aspect of the success of such markets will be ensuring that investors have the confidence to trade in those

<sup>77</sup> 2014 O.J. (L 173) 179; Regulation 596/2014 (EU).

<sup>78</sup> Austin, *supra* note 75.

<sup>79</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 922(a), 121 Stat. 1841–49 (2010) (inserting a new § 21F into the Securities Exchange Act of 1934); OSC Policy 15-601 Whistleblower Program (Policy 15 – 601/2016) (Can.), [http://www.osc.gov.on.ca/documents/en/Securities-Category1/20160714\\_15-601\\_policy-whistleblower-program.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category1/20160714_15-601_policy-whistleblower-program.pdf).

<sup>80</sup> Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, 17 C.F.R. §§ 240, 249 (2011).

<sup>81</sup> See generally Janet Austin, *IOSCO's Multilateral Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information – A Model for International Regulatory Convergence*, 23 CRIM. L.F. 393 (2012).

markets without an unreasonable risk of becoming the victim of fraud or manipulation.

It is possible to have successful markets for the trading of securities issued by smaller companies, but there must be a clear focus on ensuring the integrity of those markets. This can be achieved by careful design of regulations and the structure of the market with a view to preventing fraud and manipulation schemes. Furthermore, the authorities need to demonstrate to market participants, including those contemplating engaging in manipulation, that any fraud or manipulation in the market will be rapidly detected and effectively prosecuted.