

Transactions in OTC Equity Securities

FINRA Reminds Firms of Their Obligations Regarding Transactions in OTC Equity Securities Quoted Pursuant to a Submitted Form 211

Summary

In consultation with SEC staff, FINRA is reminding members of legal obligations that apply when initiating a quote in an OTC security in addition to filing a Form 211.

Questions regarding this *Notice* should be directed to:

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- ▶ for legal and interpretive questions, Racquel Russell, Associate General Counsel, Office of General Counsel, at (202) 728-8363 or by email at racquel.russell@finra.org; or Cara Bain, Counsel, OGC, at (202) 728-8852 or at cara.bain@finra.org.

Background and Discussion

SEA Rule 15c2-11 is intended to deter broker-dealers from initiating or resuming quotations for OTC securities that may facilitate a fraudulent or manipulative scheme.¹ The rule generally prohibits a broker-dealer from publishing (or submitting for publication) a quotation in an OTC security in a quotation medium unless it has obtained and reviewed current information about the issuer. Among other things, a broker-dealer must have a reasonable basis for believing that such information, when considered along with any supplemental information, is accurate and is from a reliable source.

September 24, 2018

Notice Type

- ▶ Guidance

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Registered Representatives
- ▶ Trading
- ▶ Training

Key Topics

- ▶ Form 211
- ▶ OTC Equity Securities
- ▶ Quoting and Trading
- ▶ Unregistered Securities

Referenced Rules

- ▶ FINRA Rule 6432
- ▶ Section 4 of the Securities Act
- ▶ Section 5 of the Securities Act
- ▶ Securities Exchange Act Rule 15c2-11 (“SEA Rule 15c2-11”)

FINRA Rule 6432 provides that a firm must file a Form 211 with FINRA to demonstrate compliance with SEA Rule 15c2-11. Among other things, the Form 211 requires that members provide information on the subject security, the issuer, the circumstances surrounding the member's quotation and current information as set forth in SEA Rule 15c2-11(a), such as the issuer's prospectus, annual report or similar information, as applicable. FINRA conducts a review of the Form 211 and accompanying information and notifies the firm whether it is permitted to initiate or resume quotations in the subject security. The firm is not permitted to initiate or resume quotations without such notification (unless the member may rely upon an exception to, exemption or other relief from SEA Rule 15c2-11 and FINRA Rule 6432 to quote the security).²

FINRA is reminding members that filing a Form 211 is not a substitute for a firm's responsibility to fully discharge its obligations under other applicable rules or regulations, including complying with the provisions of Section 5 of the Securities Act of 1933 ("Section 5")³ or determining whether the security, by its terms, limits trading in the U.S.⁴ The submission of a Form 211 relates solely to the firm's obligation to comply with FINRA Rule 6432 and SEA Rule 15c2-11 when quoting a security. Thus, for example, the fact that a firm is permitted to publish a quotation in a security pursuant to a submitted and processed Form 211, or may rely on an exception to Rule 15c2-11 when publishing a quotation, would have no bearing on the application of Section 5, which generally prohibits the offer or sale of securities in interstate commerce without an effective registration statement, unless an exemption is available.⁵ In this regard, in evaluating the application of Section 5 or a potential exemption thereto, such as Section 4(a)(4) of the Securities Act,⁶ the SEC has stated that firms cannot act as a mere order taker, and must make "whatever inquiries are necessary under the circumstances to determine that the transaction is a normal 'brokers' transaction' and not part of an unlawful distribution."⁷

Multiple considerations can come to bear on whether a particular transaction is permissible under all applicable regulatory requirements for the parties involved in the activity, and each firm is responsible for complying with the regulatory obligations applicable to its activities, despite being permitted to quote a security pursuant to a Form 211 it submitted or pursuant to an exception from Rule 15c2-11. Firms serve an "important gatekeeping function" in the securities markets and have a responsibility to ensure that they do not become involved in an unregistered transaction in securities if the requirements of the Securities Act of 1933 are not being followed.⁸

In consultation with SEC staff, FINRA reminds members that they should check whether securities have been the subject of a suspension or revocation prior to seeking to initiate or resume quotations in such securities. Members also are reminded that, to satisfy the requirements of Rule 15c2-11 to resume quotations after a trading suspension, members will need to obtain information that they reasonably believe resolves the information issues that resulted in the trading suspension. For instance, before seeking to resume quoting in previously suspended products, a member's Rule 15c2-11 analysis should, at minimum, address the issues raised in the suspension order, including the member's reasonable basis for a conclusion that these instruments appropriately can be traded in the U.S. in light of the suspension.⁹

Endnotes

1. See Securities Exchange Act Release No. 41110 (February 25, 1999), 64 FR 11124, 11126 (March 8, 1999); see also Securities Exchange Act Release No. 29094 (April 17, 1991), 56 FR 19148 (April 25, 1991).
2. See 17 CFR 240.15c2-11(f)(1), (2), (3) and (5) and 15c2-11(h); and FINRA Rule 6432(a).
3. See 15 U.S.C. § 77e.
4. For example, foreign ETFs, including Undertakings for Collective Investments in Transferable Securities (UCITS), generally are not permitted to publicly offer their shares in the U.S. See Section 7(d) of the Investment Company Act of 1940.
5. See 15 U.S.C. § 77e. In addition, Section 5(a) of the Securities Act generally prohibits any person, including broker-dealers, from using interstate means to sell, either directly or indirectly, any security unless a registration statement is in effect or an exemption from the registration requirements of Section 5 applies. Section 5(c) of the Securities Act generally prohibits any person, including broker-dealers, from using interstate means to offer to sell or offer to buy, either directly or indirectly, any security unless a registration statement has been filed or an exemption from the registration requirements of Section 5 applies.

The SEC has stated that broker-dealers “have a responsibility to be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act and should be reasonably certain such an exemption is available.” See Responses to Frequently Asked Questions About a Broker-Dealer’s Duties When Relying on the Securities Act Section 4(a)(4) Exemption to Execute Customer Orders, SEC’s Division of Trading and Markets (Oct. 9, 2014) (“SEC Section 4(a)(4) FAQs”). See also *In the Matter of World Trade Financial Corp.*, Exchange Act Release No. 66114, 13 (Jan. 6, 2012) (quoting *Stone Summers & Co.*, Exchange Act Release No. 9839, 3 (Nov. 3, 1972)) (“*World Trade Financial*”). The SEC stated in *World Trade Financial* that “the responsibility to be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act” applies to both the broker and the registered representative executing the transactions.
6. See 15 U.S.C. § 77d. Section 4 of the Securities Act (“Section 4”) provides enumerated exemptions from the registration requirements of Section 5 for offers and sales of securities. For example, Section 4(a)(4) provides an exemption for a broker-dealer with respect to brokers’ transactions executed upon customers’ orders on any exchange or in the over-the-counter market, but not the solicitation of such orders. Other exemptions that may be available include those contained in Section 4(a)(1), Section 4(a)(2), and SEC Rule 144.
7. See *In the Matter of Midas Securities, LLC and Jay S. Lee*, Exchange Act Release No. 66200 (Jan. 20, 2012); see also *In the Matter of Merrill Lynch, Pierce, Fenner & Smith Incorporated*, Exchange Act Release No. 82826 (March 8, 2018); SEC Section 4(a)(4) FAQs.
8. See e.g., U.S. Securities and Exchange Commission, SEC Charges Current and Former E*TRADE Subsidiaries With Improperly Selling Penny Stocks Through Unregistered Offerings, Press Release No. 2014-225 (Oct. 9, 2014). See also U.S. Securities and Exchange Commission, SEC Staff Issue Risk Alert and FAQs on Customer Sales of Securities, Press Release No. 2014-226 (Oct. 9, 2014).
9. See e.g., Securities Exchange Act Release No. 41110, 64 FR 11124 (March 8, 1999) (File No. S7-5-99) at 11149.

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