

# Regulation of the OTC Equities Market

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The Over-the-Counter (OTC) marketplace consists of OTCQX®, OTCQB®, OTCBB and OTC Pink® securities quoted by market makers on the OTC Link® ATS, OTC Market Group's interdealer quotation and trade messaging system, OTCBB securities quoted on FINRA's OTCBB system and securities with no quotes that are traded in the grey market. Broker-dealer activities in the OTC market, including their activities on the OTC Link and the OTCBB interdealer quotation systems are regulated by the Financial Industry Regulatory Authority (FINRA) and the U.S. Securities and Exchange Commission (SEC).

FINRA is the largest non-governmental regulator for all securities firms doing business in the United States, overseeing nearly 5,100 brokerage firms, about 174,000 branch offices, and more than 672,000 registered securities representatives. FINRA was formed through the merger of NYSE Regulation and the National Association of Securities Dealers. FINRA touches every aspect of the securities business, from registering and educating industry participants, examining securities firms, writing and enforcing rules and federal securities laws, and operating the OTCBB. FINRA informs and educates the investing public, provides trade reporting and other industry utilities, and administers the largest dispute resolution forum for investors and registered firms. Detailed information can be found on the website: [www.finra.org](http://www.finra.org)

## **Firm Quote**

FINRA Rule 5220 Offers at Stated Prices and 5220.01 Firmness of Quotations: To ensure the integrity of quotations, FINRA requires every member to trade at its publicly quoted prices. Integrity of quotes is essential to the normal operation of the OTC market as the failure to honor quotations, also known as "backing away", can be disruptive to a fair and orderly market.

## **Minimum Quote Sizes**

FINRA Rule 6450: Market participants posting priced quotations on OTC Link ATS or the OTCBB are firm for certain minimum sizes. Minimum quote sizes are based upon quote price. As the price of a quote decreases, the size associated with a price increases. Mandatory sizes assure a minimum amount of liquidity in the market and add weight to a member's firm quote obligation.

## **Best Execution of Customer Orders**

FINRA Rule 2320: FINRA requires member firms to ascertain the best market to execute their customer orders. OTC Link and the OTCBB are the two recognized interdealer quotation systems in the OTC market that can be relied upon for electronic best execution if there are two priced quotes. If fewer than two quotations are displayed on an inter-dealer quotation system that permits quotation updates on a real-time basis, FINRA members must contact at least three dealers by phone to obtain other quotations.

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## Protection of Customer Limit Orders

Manning Interpretation, FINRA Notice IM-2110-2: FINRA members may not trade for their own account at prices that are equal to or better than the prices of limit orders that they have received from their customers or from another FINRA member firm on behalf of its customers. Protecting customer limit orders encourages the use of such orders by the investing public and results in more capital committed to securities trading in the secondary markets by a source other than securities dealers. The protection of customer limit orders for all OTC securities was implemented in the 4<sup>th</sup> quarter of 2008.

## Real-Time Trade Reporting

FINRA Rule 6622: Within 30 seconds, members must report their transactions to FINRA's OTC Reporting Facility, its service to accommodate reporting and dissemination of last sale reports in all OTC Equity Securities. The rule creates a uniform method of reporting obligations of member firms, including who must report, when those reports are due, what must be reported, and how to cancel trades already reported. Subsequent dissemination of transaction information by NASDAQ, on behalf of FINRA, increases market transparency in securities in all tiers of the OTC market, which, improves pricing for investors and results in greater volumes and better overall liquidity. In 2008 FINRA expanded the rule to cover real-time trade reporting and dissemination of trade reports to include OTC ADRs and Foreign Ordinary shares.

## Recording of Quotation Information

FINRA Rule 6430: FINRA members must record quotations in OTC equity securities displayed on the OTC Link interdealer quotation system. OTC Markets Group, as a Reporting Agent recognized by FINRA, reports all quotes to FINRA under the Rule.

## Order Audit Trail Systems <sup>SM</sup>

OATS<sup>SM</sup> Rule 6950: FINRA has established OATS as an integrated audit trail of order, quote, and trade information for NASDAQ and OTC equity securities. FINRA uses this audit trail system to recreate events in the life cycle of orders and monitor more completely the trading practices of its members. OATS reporting for all OTC Equity securities commenced on February 8, 2008.

## Short Position Disclosure

FINRA Rule 4560: FINRA members must report their short interest positions in all OTC Equity Securities, including OTCQX, OTCQB, and OTC Pink securities, midmonth and end-of-month. Short interest reporting brings more transparency to the short selling activities by member firms, and reduces the possibility of manipulative behavior associated with naked short selling.