Trade Reporting Notice

FINRA Reminds Firms of Their Trade Reporting Obligations Relating to Customer Sales of Low-Value OTC Equity Securities

September 23, 2011

Executive Summary

FINRA is issuing this *Notice* to remind firms that sales of low-value OTC equity securities positions from customer accounts (often deemed by the customer and firm to be "worthless") are subject to FINRA trade reporting rules and must be reported to FINRA for publication purposes.

Questions regarding this *Notice* may be directed to:

- Legal Section, Market Regulation, at (240) 386-5126; or
- Office of General Counsel, at (202) 728-8071.

Key Topics

- OTC Equity Security
- OTC Reporting Facility
- "Penny for the Lot" Transactions
- Trade Reporting
- "Worthless" Securities

Referenced Rules & Notices

- FINRA Rule 6420
- FINRA Rule 6622
- NASD Rule 2320

Background & Discussion

Some firms facilitate the sale of positions held by their customers in low-value OTC equity securities, as defined in FINRA Rule 6420, that they or their customer may deem to be "worthless." The firm purchases the shares to remove the position from the customer's account and to enable the customer to claim a capital loss for tax purposes.[1] The purchase price typically is nominal and set solely for purposes of liquidating the position. In some instances, it may not be a per share price, but may be sold, for example, for one penny or one dollar for the entire lot. Hence, these sales sometimes are referred to as "penny for the lot" transactions.

These sales are considered trades (*i.e.*, there is a beneficial change in ownership) and are not expressly excluded from FINRA trade reporting rules.[2] Accordingly, firms must report these sales to FINRA for public dissemination purposes as they would any other trade.

Because many of these sales are effected at a per lot price, the per share price may extend beyond six decimal places. FINRA notes that the OTC Reporting Facility (ORF) can accommodate six decimal places for purposes of reporting a per share price. If the per share price is equal to or less than $.000001,[3] firms should report a price of $.000001. Any trade reported at a per share price less than $.0001 will be publicly disseminated with a price of $.0000.[4]

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Finally, FINRA notes that some firms deem a security "worthless" solely on the basis that it currently has no bid and no longer trades.[5] Firms are reminded that in any transaction with a customer, including those involving securities that a firm may deem to be "worthless," best execution obligations under NASD Rule 2320 apply, and firms are required to use reasonable diligence to ascertain whether there is a market for the security.

Endnotes

1. It is FINRA's understanding that firms may make this accommodation so that their customers can claim a capital loss in the current year rather than wait for a bankruptcy or other event establishing that the security is "wholly worthless" for purposes of the Internal Revenue Code and IRS rules and regulations. Nothing in this *Notice* is intended to impact the analysis of whether a security is "worthless" or whether customer sales of securities deemed to be "worthless" constitute bona fide losses for tax purposes.

2. *See* FINRA Rule 6622.

   These sales do not fall within the exception for "away from the market sales" under FINRA trade reporting rules and must not be reported as such. *See* *Trade Reporting Frequently Asked Questions*, Section 601.

3. FINRA notes that the ORF will not accept a trade price of zero. Therefore, if a security is transferred for no consideration, the transfer would not be reportable to FINRA.

4. FINRA publicly disseminates last sale information for transactions in OTC equity securities via the Trade Data Dissemination Service (TDDS). TDDS disseminates price information out to four decimal places.

5. *See* note 1 herein.