

Community Banks and Compliance with FINRA Rule 6490

January 5, 2012 by [Susan Zaunbrecher](#) and [Christian Gonzalez](#)

As seen in the *Ohio Record* published by the Ohio Bankers League.

Several privately-held community banks have gotten a nasty surprise this year when they have received a letter from the Financial Industry Regulatory Authority ("FINRA") imposing fees of \$5,000 or more for late filings pursuant to FINRA Rule 6490. Community banks need to be aware that having a broker-dealer create a market in their securities can now result in a privately-held bank or holding company unknowingly becoming subject to FINRA reporting requirements that mimic that of a SEC-registered company.

FINRA Rule 6490

FINRA Rule 6490, which went into effect in September, 2010, codifies the requirements in Securities Exchange Act ("SEA") Rule 10b-17 for issuers of any class of publicly-traded, non-exchange listed securities quoted on the Over-the-Counter (OTC) markets to provide timely notice to FINRA of the following "Company-Related Actions":

- a dividend or other distribution in cash or securities;
- a stock split or reverse split; or
- a rights or other subscription offering.

Generally, issuers must provide notice at least ten days prior to the record date for these actions. In addition, issuers must also notify FINRA of certain *other* corporate actions no later than ten days prior to the effective date, including but not limited to: (i) the issuance or change of a trading symbol or name; (ii) merger, acquisition or any other company change in control transaction; (iii) dissolution; or (iv) bankruptcy.

The company submitting a Company-Related Action notice is required to pay a non-refundable fee related to the submission, review and processing of documentation by FINRA based on the following table:

RULE 10b-17 ACTION	FEE
Timely Rule 10b-17 action notification	\$200
Late Rule 10b-17 action notification (notice submitted at least five (5) calendar days prior to corporate action date)	\$1,000
Late Rule 10b-17 action notification (notice submitted at least one (1) calendar day prior to corporate action date)	\$2,000
Late Rule 10b-17 action notification (notice submitted on or after corporate action date)	\$5,000

In addition, the Rule permits FINRA to request other documents that it may deem necessary to verify issuer information. The Rule also provides FINRA, at its discretion, with the authority to conduct detailed reviews of submissions, on a case-by-case basis. Further, the Rule vests FINRA with the authority to deny the processing of any corporate action announcement if FINRA determines that such request is deficient and not processing it is necessary to protect investors and the public interest and to maintain fair and orderly

markets.

Failure to comply with the Rules reporting requirements are significant. Non-compliance or failure of an issuer to provide a Company-Related Action notice as required under the Rule can result in the imposition of monetary fines and result in violation of federal anti-fraud rules as it relates to any Rule 10b-17 action.

Implications and Applicability of FINRA RULE 6490 to Community Banks

FINRA's ability to fine non-SEC registered issuers is relatively new, and is a significant departure from FINRA's historically ministerial role with respect to such issuers. The Rule has given rise to ever increasing concern in the community banking industry because it indirectly imposes reporting requirements on non-SEC registered issuers. Many small community based financial institutions are not even aware that they may be subject to the Rule by virtue of having a small volume of stock trading. The revelation of this fact by some community banks has only recently come to light given the recent fines FINRA has sought under the Rule, which requires notification of Company-Related Actions by issuers with securities that are "publicly-traded". Unfortunately, FINRA views any securities that are quoted on the OTC markets, including the OTC Bulletin Board ("OTCBB"), as "publicly-traded" under SEA Rule 10b-17. Many community banks, with no SEC reporting requirements and a small volume of shares traded, are not aware of these rules and have never considered FINRA compliance. Most do not realize that the Rule has been extended to their institution until after having failed to provide a Company-Related Action notice and the imposition of fines and penalties by FINRA. As a consequence, many community banks now are scrambling to ascertain whether they are subject to the reporting requirements under the Rule.

It is clear the Rule is applicable to the extent that a bank or holding company has publicly traded stock, has stock traded on the OTCBB or trades in American Depositary Receipts ("ADRs"). The issue that has arisen is that community banks' stocks are being traded on the OTCBB without any notice to these institutions. There is no one specific triggering mechanism which a community bank may review to determine whether its stock will become OTC quoted; rather, it depends on certain facts and circumstances.

However, there are certain instances which FINRA has stated will result in a security becoming OTCBB quoted and subject to the Rule. A FINRA member broker-dealer, who makes a market in a security, may register that security by simply completing a FINRA form to have that security quoted on the OTCBB. The information that the broker-dealer must provide to the OTCBB includes minimal financials and basic management identification. This is unlike the New York Stock Exchange and NASDAQ where the issuer of securities (a holding company or bank) controls the application process. An issuer cannot apply directly to be quoted on the OTCBB.

The concern here is further elevated by the fact that there is no requirement that a market maker inform an issuer that it is seeking to have the issuer's security quoted on the OTCBB. While, one would hope that a market maker who has an existing or on-going relationship with the issuer would take steps to inform the issuer of such application, this does not seem to be the case in most situations we have observed as evidenced by the increase in FINRA fines and penalties under the Rule.

Other facts and circumstances that will trigger reporting requirements under the Rule include when a local broker-dealer places a security trade through a market maker or when a broker-dealer executes a trade in which the security does not have an OTC symbol. In these situations, a broker-dealer is required to report such trade to FINRA and request a symbol. By virtue of the broker-dealer requesting a symbol for the security to be traded on OTCBB, the broker-dealer has now subjected the issuer of such security to the reporting requirements under the Rule and put FINRA on notice of the existence of such issuer.

If a broker-dealer takes any of the above actions it will result in the issuer of such security being subjected to the Rule and its on-going reporting requirements. Again, the difficulty for community banks is that there is no specific requirement that the broker-dealer or FINRA inform the issuer that its security is quoted on the OTCBB.

Community Bank Compliance

In order to guard against unwittingly violating FINRA Rule 6940, it is important for community banks to be vigilant and monitor whether they have been placed on the OTCBB by a broker-dealer prior to taking one of the Rule's listed Company-Related Actions. The most effective and cost efficient way to do that is to check the OTCBB on-line security database at <http://www.otcbb.com/static/symbol.stm> ten or more days prior to the record date for one of these actions.

There is very little that a community bank can do to limit its risk associated with possible required compliance with FINRA Rule 6940, outside of placing specific restrictions in its organizational documents limiting the transfer of its securities. The Rule places an undue burden on community banks to continually monitor the exchange and trade of their securities and holding them liable for actions outside their immediate control. FINRA has stated that it has advised some community banks to seek an exemption from applicability of the Rule from the SEC, but it is unclear what the criteria for exemption is. Any such request would be reviewed on a case-by-case basis and there is no guarantee that an exemption would be granted.