

## Trading on OTC Markets

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### ★ Over The Counter

OTC is short for: « **Over The Counter** », which refers to the trading of securities through direct negotiations between parties outside of a formal, regulated exchange. Because these transactions occur privately rather than on a centralized platform, they carry higher levels of risk, particularly regarding transparency and counterparty risk.

### ★ OTC Markets

OTC Markets facilitates the trading of financial instruments that do not have a listing on a regulated exchange such as the NYSE or Nasdaq.

Retail investors must execute their transactions in these securities through a FINRA-registered broker-dealer. (FINRA stands for the Financial Industry Regulatory Authority, a US regulator).

### ★ Broker-dealer

The broker-dealer plays an **important role** in the OTC Markets ecosystem.

The broker-dealer publishes the bid and ask prices at which trades can occur. These prices may be derived from internal customer orders, though this is not always the case. When an investor places an order for an OTC Markets instrument, the broker-dealer first attempts to determine if the order can be matched internally. This involves pairing a buy order and a sell order that have corresponding limit prices and quantities.

If internal matching is not possible, the broker-dealer may decide to execute the order for its own account in its capacity as a market maker, thereby providing liquidity to the instrument. If the broker-dealer cannot find matching orders internally and chooses not to act as the market maker for that specific transaction, he will attempt to execute the order by finding a counterparty through another broker-dealer.

This process is not automated; instead, broker-dealers representing the buyer and the seller must manually negotiate the execution price and quantity.

### ★ Trading via OTC Markets

**This is an important difference** between trading an instrument «off the exchange» (via OTC Markets) and trading a security via a regular exchange (such as NYSE or Nasdaq):

- On OTC Markets, there is **no central order book**.
- There is **no central system that matches or executes orders**.
- Orders are only executed when broker-dealers reach an **agreement**. This agreement can be facilitated via electronic trading platforms provided by OTC Markets to broker-dealers, but it can also be reached via telephone or other private communication channels.
- A broker-dealer does not necessarily have contact with all other broker-dealers active on OTC Markets. When searching for a counterparty, a broker-dealer may limit their reach to their own established network.
- Consequently, execution on OTC Markets is not automated and is significantly less transparent than on a regulated exchange

Additionally, the broker-dealer is responsible for reporting executed transactions and, where applicable, handling clearing and settlement.

Please note: Keytrade Bank is not a FINRA-registered broker-dealer but works in partnership with a FINRA-registered entity to facilitate these trades.

## ★ Segments on OTC Markets

OTC Markets currently categorizes instruments into the following four segments:

- **OTCQX (Best Market)** : This segment is reserved for companies with the highest average market capitalization. It imposes the most stringent requirements regarding financial standards, reporting obligations, and corporate governance for financial instruments traded via OTC Markets.
- **OTCQB (Venture)** : This segment is designed for growth-stage companies that do not yet meet the rigorous standards of OTCQX. The requirements for this segment are less demanding.
- **OTCID (Basic Market)** : Companies in this segment meet only a minimal information standard and publish limited data to the public.
- **Pink Limited Market** : This segment includes all other shares. Broker-dealers can trade these shares without any involvement from the companies themselves, meaning these entities are not required to comply with disclosure obligations or corporate governance standards. These shares are frequently marked with «red flags» (compliance flags, see further in the section "Manipulation") to warn investors of potential risks.

## ★ Manipulation

Trading shares on OTC Markets can be subject to extreme volatility. A primary cause of this is the often limited liquidity of these shares, typically characterized by low trading volumes or low market values.

Certain shares on OTC Markets are subject to intense promotion on social media, in chat groups, or via investor newsletters. Growth expectations sometimes seem to assume that trees grow to the sky. Driven by «investor greed,» a strong upward price momentum can develop, tempting investors to jump on the «moving train» to profit from the trend.

The US regulator, the SEC (Securities and Exchange Commission), explicitly warns against this type of herd behavior. While it may initially seem easy to acquire shares while the trend is upward, it may prove impossible to sell the position once the trend reverses. When the momentum shifts, the price often collapses, trading volume dries up, and investors are left with substantial losses.

Furthermore, third-party promotional campaigns are sometimes launched to stimulate trade in specific OTC shares, often without the underlying company's knowledge. This can be a sign of a «pump & dump» scheme: the price is artificially inflated through misleading information (the «pump» phase), after which the manipulators sell their positions at the peak (the «dump» phase). Investors who buy during the pump risk being left with an unmarketable and virtually worthless position.

On the [OTC Markets](#), instruments are assigned icons known as «compliance flags,» which indicate potential risks regarding reporting, financial health, and regulatory compliance.

## Caveat Emptor (Latin : "buyer beware")

OTC Markets applies the "Caveat Emptor" flag to warn investors to exercise extreme caution. Reasons for this flag include:

- The presence of a potentially misleading or manipulative promotional campaign.
- Suspicion of fraud or other criminal activity involving the company, its shares, or insiders.
- A regulatory halt or suspension of trading in the share.
- An ongoing corporate action (e.g., a split, reverse split, merger, or name change) of which the public may not be sufficiently aware.
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# OTC Markets

## Compliance Flags

OTC Markets Group has developed a suite of market “designations” and informational “flags” displayed below, to help identify opportunity and quantify risk. These visual data points are made publicly-available for free on the company’s quote page and distributed to broker-dealers and compliance departments as part of our Compliance Data feeds.

<b>Penny Stock Exempt</b>		This security is exempt from the definition of a Penny Stock under SEC Rule 240.3a51-1.
<b>Verified Profile</b>		The Company Profile data was verified by the issuer within the previous 6 months.
<b>Transfer Agent Verified</b>		The company’s share data, including authorized, outstanding, restricted and unrestricted shares, displayed on the company’s “Security Details” page, has been verified by its transfer agent.
<b>Hot Sectors</b>		The company is engaged in an emerging industry (Cannabis, Cryptocurrency/Blockchain).
<b>Shell Risk</b>		The company displays characteristics common to Shell Companies.
<b>Shell</b>		The company has self-reported as a Shell Company, as defined by Securities Act Rule 405 and Exchange Act Rule 12b-2, in its public filings.
<b>Promotion Flag</b>		The security is currently undergoing promotional activity.
<b>Bankruptcy</b>		The company is currently in bankruptcy or reorganization proceedings.
<b>Control Dispute</b>		Multiple parties are engaged in a dispute over control of the company.
<b>Prohibited Service Provider</b>		The company is affiliated or associated with an individual or firm on our “Prohibited Service Providers” list, which includes prohibited attorneys, accountants/auditors and other service providers.
<b>Unable to Contact</b>		OTC Markets Group is unable to verify contact information for the company.
<b>Delinquent SEC Reporting</b>		Company is not current in its reporting obligations under Section 13 or 15(d) of the Exchange Act.
<b>Pink Limited Information</b>		The company meets the minimum requirements for public quoting under Rule 15c2-11, but has made limited disclosure and/or financial information publicly available.
<b>Dark or Defunct</b>		The company is not able to provide disclosure to the public markets.
<b>Caveat Emptor</b>		Buyer Beware. There is a public interest concern associated with the company, which may include a spam campaign, questionable stock promotion, known investigation of fraudulent activity committed by the company or insiders, regulatory suspensions, or disruptive corporate actions.
<b>Expert Market</b>		Market serves broker-dealer pricing and investor best execution needs. Quotations in Expert Market securities are restricted from public view.

## ★ Restrictions at Keytrade Bank

To protect investors, Keytrade Bank restricts the trading of financial instruments on OTC Markets that carry one or more of the hereunder mentioned compliance flags. Purchase orders for such instruments are not permitted. For existing positions, Keytrade Bank will attempt to execute sell orders on a "best effort" basis, though execution is not guaranteed.

- **Caveat Emptor** : Financial instruments of companies for which OTC Markets Group has issued a formal warning.
- **Shell companies** : "Empty" entities that exist only on paper and have no remaining operational activities.
- **Expert market** : Companies that are unable or unwilling to meet minimal information obligations. Any available bid or ask prices are not public and are only accessible to broker-dealers. Investors have no visibility into potential demand or price discovery for these shares.

Additional Restrictions Trading in the "Grey market" segment is not supported.

Additionally, Keytrade Bank or its partners may choose to restrict trading in other OTC Markets shares at their sole discretion.

## ★ Delisting

To maintain a listing on a regulated exchange like the NYSE or Nasdaq, a company must satisfy specific **conditions**. These include requirements for market capitalization size, strict reporting obligations (such as the periodic publication of financial results), and maintaining a share price above a minimum threshold.

If a company fails to meet one or more of these **conditions** and does not take corrective action, the share is **delisted** from the exchange. Following this, the share is typically only tradable OTC.

### Consequences of Delisting:

- Reduced tradability due to lower liquidity and higher bid-ask spreads.
- Transition to a less regulated environment.
- Mandatory selling by certain institutional investors who are prohibited from holding non-exchange-listed shares.
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In summary, a delisting often puts downward pressure on the share price and results in an investment that is more difficult to trade. While a company can theoretically regain compliance and seek a new listing, this is rare in practice; a delisting is generally considered an ominous sign. Note that delisting can also be voluntary, such as in the case of an acquisition or a decision to take the company private.

## ★ American Depositary Receipts (ADR)

A share trading on OTC Markets is not by definition a low-quality or high-risk investment. A number of respected international companies trade on the OTC market as ADRs (American Deposit Receipts). Many US-based investors prefer to trade foreign shares in USD on a US platform during US trading hours. While many ADRs are listed on the NYSE or Nasdaq, a significant number are traded via OTC Markets.

- **Sponsored ADR**: A formal agreement exists between the foreign company and the US financial institution issuing the ADR.
- **Unsponsored ADR**: No such formal agreement exists. A critical difference is that holders of unsponsored ADRs do not always enjoy the same benefits as direct shareholders, such as voting rights.
- **Ratio** : The ratio indicates how many underlying foreign shares are represented by a single ADR.
  - **Ratio 1:1**: 1 ADR represents 1 share of the foreign company.
  - **Ratio 1:5**: 1 ADR represents 5 shares of the foreign company.
- **Exchange Rate** : The underlying foreign shares are denominated in their local currency (e.g., EUR, GBP, JPY), while the ADR is quoted in USD. Consequently, ADR holders are subject to exchange rate risk. The ADR price typically reflects the fluctuation of the foreign currency against the US Dollar. If discrepancies arise due to currency shifts, they are generally corrected via arbitrage by market participants.

- **OTC Markets** : Many ADRs are listed on OTC Markets, providing access to shares that might otherwise be difficult to trade. However, trading a share on its home exchange is often preferred due to higher trading volumes.

## \* Penny stocks

A "penny stock" generally refers to a share with a low nominative value, typically below 1 EUR or 1 USD. When a price falls below this level, the share is traded in cents or "pennies."

Because regulated markets like the NYSE and Nasdaq require companies to keep their share price above a minimum threshold, companies with poor performance are often delisted and subsequently move to OTC Markets. This has led to a common association between OTC Markets and penny stocks. However, this is not entirely accurate, as there are many financial instruments on OTC Markets that do not meet the definition of a penny stock.

## \* Characteristics of trading on OTC Markets

In general, the following characteristics apply to trading financial instruments on OTC Markets:

- Potentially higher volatility due to lower liquidity.
- Potentially higher BID-ASK spreads.
- Absence of a central order book.
- Absence of a central system that matches or executes orders.
- Lower transparency regarding available bid and ask prices.
- Lower transparency regarding order execution.
- Counterparty and execution risks inherent in the broker-dealer negotiation structure.
- Lower information and disclosure obligations compared to regulated exchanges.
- The presence of instruments from companies that fail to meet even minimal information standards.
- Increased risk of market manipulation.
- Limited or non-existent investor protection.
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