INFORMATIONAL

Trading—Extended Hours

Disclosure To Customers Engaging In Extended Hours Trading

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Senior Management

KEY TOPICS

- Disclosure
- Trading, Extended Hours

Executive Summary

NASD Regulation, Inc. (NASD Regulation℠) reminds members of their obligation under just and equitable principles of trade and the advertising rule to disclose to customers the material risks of extended hours trading.

A model disclosure statement is included with this *Notice* in Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to Gary L. Goldsholle, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8104.

Background And Discussion

A number of member firms recently have started offering their retail customers various opportunities to trade stocks after regular market hours in what is known as "extended hours trading." An even greater number of member firms have announced plans to offer extended hours trading in coming months.

The growth of extended hours trading provides retail customers with greater opportunities to trade securities and manage their portfolios, and in so doing, provides access to markets that were previously limited to institutional customers. Participation in extended hours trading may offer certain benefits to retail customers, but entails several material risks. Depending on the particular extended hours trading environment, these risks may include:

- lower liquidity;
- higher volatility;
- changing prices;
- unlinked markets;
- an exaggerated effect from news announcements; and
- wider spreads.

In light of these risks, members have an obligation to their retail customers to disclose the material risks of extended hours trading to customers before permitting them to engage in extended hours trading. NASD Regulation commends the many members that have already provided detailed disclosures about the risks of extended hours trading. This *Notice* is a reminder that these disclosures are not only a laudable business practice, but are a regulatory requirement under just and equitable principles of trade.

To assist members with their disclosure obligation, NASD Regulation has developed a series of model disclosures dealing with the risks of extended hours trading. Members are free to develop their own disclosures or modify these model disclosures to meet their particular disclosure needs. In some cases, members may need to develop additional disclosures to address such issues as options trading, options exercises, the effect of stock splits, dividend payments, as well as any additional risks that may arise in the future.

In addition, members are reminded that Rule 2210 requires that all communications with the public shall be based on principles of fair dealing and good faith, and that exaggerated, unwarranted, or misleading statements are prohibited. Members should use caution in communications with the public about their extended hours trading systems to ensure that these requirements are satisfied. Members describing the benefits of extended hours trading must also describe the material risks.

Finally, members are also reminded that in *Notice to Members 99-11*, NASD Regulation described the types of general disclosure that firms may use to inform their customers about the risks associated with stock volatility. In preparing disclosures regarding extended hours trading, members may wish to review the types of disclosure suggested in that *Notice*.

Attachment A

MODEL EXTENDED HOURS TRADING RISK DISCLOSURE

- **Risk of Lower Liquidity.** Liquidity refers to the ability of market participants to buy and sell securities. Generally, the more orders that are available in a market, the greater the liquidity. Liquidity is important because with greater liquidity it is easier for investors to buy or sell securities, and as a result, investors are more likely to pay or receive a competitive price for securities purchased or sold. There may be lower liquidity in extended hours trading as compared to regular market hours. As a result, your order may only be partially executed, or not at all.

- **Risk of Higher Volatility.** Volatility refers to the changes in price that securities undergo when trading. Generally, the higher the volatility of a security, the greater its price swings. There may be greater volatility in extended hours trading than in regular market hours. As a result, your order may only be partially executed, or not at all, or you may receive an inferior price in extended hours trading than you would during regular market hours.

- **Risk of Changing Prices.** The prices of securities traded in extended hours trading may not reflect the prices either at the end of regular market hours, or upon the opening the next morning. As a result, you may receive an inferior price in extended hours trading than you would during regular market hours.

- **Risk of Unlinked Markets.** Depending on the extended hours trading system or the time of day, the prices displayed on a particular extended hours trading system may not reflect the prices in other concurrently operating extended hours trading systems dealing in the same securities. Accordingly, you may receive an inferior price in one extended hours trading system than you would in another extended hours trading system.

- **Risk of News Announcements.** Normally, issuers make news announcements that may affect the price of their securities after regular market hours. Similarly, important financial information is frequently announced outside of regular market hours. In extended hours trading, these announcements may occur during trading, and if combined with lower liquidity and higher volatility, may cause an exaggerated and unsustainable effect on the price of a security.

- **Risk of Wider Spreads.** The spread refers to the difference in price between what you can buy a security for and what you can sell it for. Lower liquidity and higher volatility in extended hours trading may result in wider than normal spreads for a particular security.