

January 10, 2000

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001
Mail Stop 10-1

Re: **File No. SR-NASD-00-01**
Notice to Members on Extended Hours Trading

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed herewith is the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Gary L. Goldsholle, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8104; e-mail gary.goldsholle@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Joan C. Conley
Senior Vice President
and Corporate Secretary

Enclosure

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”), is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a Notice to Members reminding members of their obligation under just and equitable principles of trade and advertising rules to disclose to customers the material risks of extended hours trading. The text of the Notice to Members is provided below.

* * *

NASD Notice to Members

Disclosure To Customers Engaging In Extended Hours Trading

Suggested Routing

Legal & Compliance
Senior Management

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 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*.

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.

* * *

(b) Not applicable

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The Notice to Members was approved by the Board of Directors of NASD Regulation at its meeting on December 8, 1999, which authorized the filing of the Notice to Members with the SEC. The Nasdaq Stock Market has been provided an opportunity to consult with respect to the Notice to Members pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the Notice to Members at its meeting on December 9, 1999. No other action by the NASD is necessary for the filing of the Notice to Members. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to issue interpretations of NASD Rules without recourse to the membership for approval.

(b) Questions regarding this rule filing may be directed to Gary L. Goldsholle, Assistant General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-8104.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

A number of member firms have recently 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 the next several 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: (1) lower liquidity; (2) higher volatility; (3) changing prices; (4) unlinked markets; (5) an exaggerated effect from news announcements; and (6) wider spreads. In light of these risks, NASD Regulation believes that members have an obligation to their retail customers to disclose the material risks of extended hours trading before permitting them to engage in extended hours trading.

The Notice to Members states that just and equitable principles of trade (Rule 2110) require members to disclose to customers the material risks of extended hours trading. The Notice to Members also states that the advertising rule (Rule 2210) requires that all communications with the public shall be based upon principles of fair dealing and good faith, and that members describing the benefits of extended hours trading must also describe the material risks.

The Notice to Members does not require any standardized disclosure. However, to assist members with their disclosure obligations, NASD Regulation staff has developed model extended hours trading risk disclosures that address each of the six risk factors identified above. The model disclosures are provided as guidance only. Members will be

free to modify the model disclosures or draft their own disclosures so long as all of the material risk factors are addressed.

(b) Statutory Basis

NASD Regulation believes that the Notice to Members is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that member firms that permit customers to engage in extended hours trading have an obligation under just and equitable principles of trade to disclose to such customers the material risks of extended hours trading. Similarly, members that advertise the opportunities and benefits of extended hours trading must also disclose the material risks. NASD Regulation believes that this Notice to Members is an important element to protect investors and the public interest with respect to extended hours trading.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3)

The Notice to Members is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder, in that the Notice to Members is a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed Notice to Members for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY: _____
Joan C. Conley, Senior Vice President and
Corporate Secretary

Date: January 10, 2000

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34 ; File No. SR-NASD-00-01)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to a Notice to Members on Extended Hours Trading

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on _____, the National Association of Securities Dealers, Inc. (“NASD”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a Notice to Members as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. The Notice to Members is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder, in that the Notice to Members is a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Regulation is issuing a Notice to Members reminding members of their obligation under just and equitable principles of trade and the advertising rules to disclose to

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

customers the material risks of extended hours trading. The text of the Notice to Members is provided below.

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II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD Regulation included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD Regulation has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) **Purpose**

A number of member firms have recently 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 the next several months.

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(b) Statutory Basis

NASD Regulation believes that the Notice to Members is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that member firms that permit customers to engage in extended hours trading have an obligation under just and equitable principles of trade to disclose to such customers the material risks of extended hours trading.

Similarly, members that advertise the opportunities and benefits of extended hours trading must also disclose the material risks. NASD Regulation believes that this Notice to Members is an important element to protect investors and the public interest with respect to extended hours trading.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

The Notice to Members is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder, in that the Notice to Members is a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the

Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C.

20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is, approved.]

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary