

# NASD Notice to Members 99-69

NASD Regulation Requests Comment On Proposed Trading Halt Rules; Comment Period Expires **September 30, 1999**

## Suggested Routing

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## Executive Summary

As part of the effort to address abuses in the trading and sales of thinly traded, thinly capitalized (microcap) securities and to increase investor protection in the trading of over-the-counter (OTC) securities, this *Notice* requests comment on a rule proposal that would authorize NASD Regulation, Inc. (NASD Regulation®) to halt quotations and trading in OTC securities under certain circumstances. For purposes of this rule, OTC securities include securities that are not listed on an exchange or on The Nasdaq Stock Market, Inc. (Nasdaq®) and securities that are not quoted on the OTC Bulletin Board® (OTCBB).

Under the proposed rule, NASD Regulation would be authorized to impose halts:

(1) in conjunction with regulatory trading halts imposed by foreign regulatory authorities because of potential fraudulent conduct; and

(2) when the security is a derivative of a security listed on Nasdaq or on a national securities exchange and Nasdaq or an exchange halts trading in the underlying security.

Nasdaq has filed a rule proposal with the Securities and Exchange Commission (SEC) requesting authorization for similar authority with regard to OTCBB securities.

## Request For Comment

NASD Regulation encourages all interested parties to comment on the proposal. Comments must be received by **September 30, 1999**. Comments should be mailed to:

Joan Conley  
Office of the Corporate Secretary  
NASD Regulation, Inc.  
1735 K Street, NW  
Washington, D.C. 20006-1500

or e-mailed to:  
[pubcom@nasd.com](mailto:pubcom@nasd.com)

**Important Note:** The only comments that will be considered are those submitted via e-mail or in writing.

Before becoming effective, any rule change developed as a result of comments received must be adopted by the NASD Regulation Board of Directors, may be reviewed by the National Association of Securities Dealers, Inc. (NASD®) Board of Governors, and must be approved by the SEC.

## Questions/Further Information

As noted, written comments should be submitted to Joan Conley. Questions concerning this *Notice to Members—Request for Comment* may be directed to Mary Revell, Associate General Counsel, NASD Regulation, at (202) 728-8203.

## Foreign Regulatory Authority Trading Halts

Currently, NASD rules do not provide for the implementation of trading or quotation halts in any security that is not listed on an exchange or on Nasdaq. Thus, NASD Regulation and Nasdaq are unable to impose trading halts in securities that are quoted on the OTCBB (OTCBB securities) or in securities that are quoted and traded in other quotation media, such as the National Quotation Bureau's Pink Sheets or Instinet (OTC securities).

This *Notice* solicits comment on whether NASD Regulation should have the authority to impose regulatory trading and quotation halts in OTC securities, in conjunction with certain halts imposed by a foreign securities exchange, market, or regulatory authority overseeing the foreign market (foreign regulatory authority). The proposed rule would apply only to OTC securities that are not included in the OTCBB and are not listed on a national securities exchange or Nasdaq.<sup>1</sup>

Foreign regulatory authorities impose trading halts for various reasons, depending on the jurisdiction, including the dissemination of material news, an issuer's failure to meet regulatory filing requirements imposed by a foreign market or regulatory authority, operational reasons (e.g., an order imbalance), and public interest reasons. The proposed rule would authorize NASD Regulation to impose trading and quotation halts in OTC securities in conjunction with a foreign regulatory authority halt that is imposed because of potential fraudulent conduct or other public interest concerns, when this is stated in the foreign trading halt order. NASD Regulation would not impose a halt in conjunction with a

foreign regulatory authority trading halt that is imposed solely for late filings, the dissemination of material news, or operational reasons.<sup>2</sup> The halt would be imposed for a maximum of five trading days. At that time, Market Makers would be required to fulfill their obligations under SEC Rule 15c2-11 prior to initiating either a priced or unpriced quotation in the security.<sup>3</sup>

NASD Regulation would notify the trading community and the public of the halt through the NASD Regulation and Nasdaq Trader Web Sites ([www.nasdr.com](http://www.nasdr.com) and [www.nasdaqtrader.com](http://www.nasdaqtrader.com)) and upon issuance of the notice will prohibit quotations in any quotation medium and trading by any NASD member. The trading halt notice (noting the beginning and end dates) would remain on the Web Sites for a period of time to inform the public and the trading community of the halt, and ensure ongoing compliance with Rule 15c2-11.<sup>4</sup>

## Derivative Security Trading Halts

NASD Rule 4120 provides Nasdaq with the authority to halt trading in a derivative security, in conjunction with a halt imposed by Nasdaq or a national securities exchange in the underlying equity security, but only if the derivative is listed on Nasdaq. Thus, when Nasdaq or an exchange halts trading in a listed security, trading is allowed to continue in the underlying unlisted derivatives on the OTCBB and in other OTC quotation media. It is difficult to accurately price the derivative in the absence of current price information for the underlying security. This difficulty in pricing may lead to disorderly markets and investor confusion.

This *Notice* solicits comment on whether NASD Regulation should have the authority to halt trading in

OTC derivatives in conjunction with a trading halt imposed by Nasdaq or an exchange in the underlying listed security. Like the provision described above, this rule will apply only to OTC securities that are not included in the OTCBB and are not listed on a national securities exchange or Nasdaq.<sup>5</sup>

## Plan of Allocation and Delegation of Functions

Finally, NASD Regulation proposes to amend the Plan of Allocation and Delegation of Functions to clarify that the Stockwatch section of Nasdaq would have the authority to handle trading halt functions for securities traded in the OTC market.

## Text of Proposed Rule

(Note: New text is underlined; deletions are in brackets.)

### **Rule 3900. Trading and Quotation Halts in Non-Nasdaq, Non-OTCBB Over-the-Counter Securities**

#### **(a) Authority to Initiate Trading and Quotation Halts**

In circumstances in which it is necessary to protect investors and the public interest, NASD Regulation may direct members, pursuant to the procedures set forth in paragraph (b), to halt trading and quotations in the over-the-counter ("OTC") market of an American Depositary Receipt ("OTC ADR") or a security ("OTC Security") that is traded in the OTC market and that is not otherwise listed on The Nasdaq Stock Market ("Nasdaq") or a national securities exchange or included in the OTCBB when:

(1) the OTC Security or the security underlying the OTC ADR is listed on or registered with a foreign securities

exchange or market, and the foreign securities exchange, market, or regulatory authority overseeing such issuer, exchange or market, halts trading in such security for regulatory reasons ("Foreign Regulatory Halt"); provided, however, that NASD Regulation will not impose a trading and quotation halt if the Foreign Regulatory Halt was imposed solely for the dissemination of material news, a regulatory filing deficiency, or operational reasons; or

(2) the OTC Security is a derivative or component of a security listed on a national securities exchange or Nasdaq ("listed security") and a national securities exchange or Nasdaq imposes a trading halt in the listed security.

#### **(b) Procedure for Initiating a Trading and Quotation Halt**

(1) For a halt initiated under subparagraph (a)(1) of this rule, NASD Regulation will promptly evaluate information received from a foreign securities exchange or market on which the OTC Security or the security underlying the OTC ADR is listed or registered or from a foreign regulatory authority overseeing such issuer, exchange, or market about a Foreign Regulatory Halt and determine whether a trading and quotation halt in the OTC Security is appropriate.

(2) For a halt initiated under subparagraph (a)(2) of this rule, NASD Regulation will promptly evaluate information received from Nasdaq or a national securities exchange about a trading halt imposed in a listed security and determine whether a trading and quotation halt in the OTC Security is appropriate.

(3) Should NASD Regulation determine that a basis exists under this Rule for initiating a trading and quotation halt, NASD Regulation shall disseminate appropriate public notice that a trading and quotation halt is in effect and the commencement of the trading and quotation halt will be effective simultaneous with appropriate public notice.

(4) Trading and quotations in the OTC market may resume when NASD Regulation determines that the basis for the halt no longer exists or when five business days have elapsed from the date NASD Regulation initiated the trading and quotation halt in the security, whichever occurs first. NASD Regulation shall disseminate appropriate public notice that a trading and quotation halt is no longer in effect.

#### **(c) Violation of OTC Trading and Quotation Halt Rule**

If a security is subject to a trading and quotation halt initiated pursuant to this rule, it shall be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member:

(i) to effect, directly or indirectly, a trade in such security; or

(ii) publish a quotation, a priced bid and/or offer, an unpriced indication of interest (including "bid wanted" and "offer wanted" indications), or a bid or offer accompanied by a modifier to reflect unsolicited customer interest, in any "quotation medium." For purposes of this Rule, "quotation medium" shall mean any quotation system, publication, electronic communication network, or any other device, including any

issuer or inter-dealer quotation system, that is used to regularly disseminate quotations or indications of interest in transactions in equity securities.

## **Plan Of Allocation And Delegation Of Functions By NASD To Subsidiaries**

### **I - III. No Change**

### **IV. Stockwatch**

The Stockwatch section handles the trading halt functions for The Nasdaq Stock Market securities, exchange-listed securities traded in the over-the-counter market (i.e., the Third Market), securities quoted in the *Over-the-Counter Bulletin Board* [.] and all other securities traded in the over-the-counter market.<sup>6</sup> Review of all questionable market activity, possible rule infractions or any other matters that require any type of investigative or regulatory follow-up will be referred to and conducted by NASD Regulation, which will assume sole responsibility for the matter until resolution. This responsibility will include examinations, investigations, document requests, and any enforcement actions that NASD Regulation may deem necessary. NASD Regulation staff at all times will have access to all records and files of the Stockwatch function.

### **Endnotes**

<sup>1</sup>Nasdaq has filed a proposed rule change with the SEC seeking similar authority with respect to OTCBB securities. File No. SR-NASD-99-33, submitted to the SEC on July 13, 1999. NASD Rule 4120 already provides Nasdaq with the authority to halt trading of Nasdaq-listed securities and exchange-listed securities traded OTC.

<sup>2</sup>NASD Regulation and Nasdaq do not propose to halt for the dissemination of material news because Nasdaq does not have any

listing agreement with OTC issuers and thus cannot compel the full disclosure and dissemination of material news. NASD Regulation and Nasdaq do not propose to halt trading if an issuer fails to meet filing requirements imposed by a foreign regulatory authority on OTC issuers when such requirements may not currently exist in the United States for such issuers. Finally, NASD Regulation and Nasdaq are not proposing to halt trading based on a foreign exchange's operational halt, such as for an order imbalance, because Nasdaq does not generally halt trading for operational reasons.

<sup>3</sup>SEC Rule 15c2-11, with certain exemptions, prohibits a broker/dealer from publish-

ing a quotation for an OTC security in any quotation medium unless the broker/dealer reviews the information specified in the Rule regarding the security and its issuer and has a reasonable belief that the information is accurate and from a reliable source. NASD Rule 6740 requires a broker/dealer to make a filing on Form 211 with the NASD demonstrating compliance with SEC Rule 15c2-11 prior to publishing a quotation for an OTC security.

<sup>4</sup>When informed, NASD Regulation would also publish notice of foreign regulatory halts imposed for late regulatory filings on the Web Sites even though NASD Regulation will not impose a simultaneous trading halt.

NASD Regulation will not provide notice or impose a trading halt if a foreign regulatory authority halts trading for the dissemination of material news or for operational reasons (e.g., an order imbalance).

<sup>5</sup>The proposed rule change described in footnote 1 also seeks authority for Nasdaq to halt trading in OTCBB derivatives.

<sup>6</sup>Italics indicate language proposed to be added in rule filing described in footnote 1.

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