

Notice to Members

DECEMBER 2002

SUGGESTED ROUTING

Legal & Compliance
Operations
Registered Representatives
Senior Management
Trading

KEY TOPICS

Quotations
Trading Halts

INFORMATIONAL

Trading Halts

Frequently Asked Questions Relating to Trading Halts

Executive Summary

This *NASD Notice to Members* addresses frequently asked questions arising under NASD Rule 3340 (Rule 3340 or the Rule) regarding trading halts. Rule 3340 prohibits members or associated persons from effecting, directly or indirectly, any transaction in a security in which a trading halt is in effect. Rule 3340 was amended in 2001 also to prohibit NASD members from publishing quotations or indications of interest in a security during a trading halt. The trading and quoting conduct prohibited by Rule 3340 is only triggered when a trading halt is in effect. To facilitate compliance with the Rule, this *Notice* addresses questions that have been raised with respect to the application of the Rule to particular circumstances.

Questions/Further Information

Questions concerning this *Notice* may be directed to Kathleen O'Mara, Assistant General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8071; or Afshin Atabaki, Attorney, NASD Regulatory Policy and Oversight, at (202) 728-8902.

Background

On June 5, 2001, the Securities and Exchange Commission (SEC) approved amendments to Rule 3340 to prohibit publication of quotations or indications of interest in a security during a trading halt. Previously, Rule 3340 expressly prohibited members from directly or indirectly effecting a transaction in a security during

a trading halt, but did not expressly prohibit members from publishing quotations or indications of interest during a halt. The rule change was originally scheduled to become effective on August 13, 2001.¹ At the request of member firms, NASD delayed the effective date until October 9, 2001, to allow members additional time to make any necessary systems changes.

Rule 3340, as amended, specifically prohibits members or associated persons from, directly or indirectly, effecting any transaction or publishing a quotation, a priced bid and/or offer, an unpriced indication of interest (including “bid wanted” and “offer wanted” and name only indications), or a bid or offer accompanied by a modifier to reflect unsolicited customer interest, in any security for which a trading halt is in effect. NASD believes that prohibiting the publication of quotations or indications of interest during a trading halt will prevent members from seeking to trade at a time when they cannot execute a trade. Further, the amended rule is designed to protect investors and to ensure the integrity of quotations by preventing fictitious or misleading quotations.

Following the SEC’s approval of the amendments to the Rule, some members requested guidance from NASD on the application of the Rule to particular scenarios. The following questions and answers are published to address some of these scenarios and to provide additional guidance. However, the guidance contained herein is not intended to provide an exhaustive analysis of all circumstances that could possibly arise under the Rule. Members should contact the NASD staff listed above in the event they have further questions.

Frequently Asked Questions

Trading Halts

Question 1: May an electronic communications network (ECN) continue to disseminate quotations or indications of interest to subscribers in a security when trading in that security has been halted?

No. Rule 3340 prohibits NASD members, including ECNs, from “publishing” quotations or indications of interest in a security during a trading halt. For purposes of the Rule, publication involves the dissemination of information to sources outside the member. Distribution of quotations to external subscribers would constitute publication. Some ECNs have asserted that this would require them to delete their book of orders in the subject security. Rule 3340 does not require ECNs to delete their book when there is a trading halt; they are, however, required to stop distributing quotations or indications of interest in a security during a trading halt. In this regard, an ECN can comply with the Rule by blanking out quotations and indications of interest in a security during a trading halt.

Question 2: What are NASD member firms’ responsibilities with respect to pulling back orders for a security sent immediately preceding a trading halt for that security?

If an order is entered into a facility/system that publishes quotations and such quotations are not distributed during a trading halt, then the member

firm is not required to pull back the order. However, if an order is sent to a facility/system that continues to publish quotations or indications of interest in a security during a trading halt, the firm that entered the order prior to the trading halt would be responsible for pulling back the order.

Question 3: Are NASD members required to stop distributing quotations and indications of interest on internal proprietary systems for a particular security during a trading halt?

In general, internal display of quotations or indications of interest within a broker/dealer's proprietary system does not constitute "publication" and, as such, is not prohibited by the Rule. However, dissemination of quotations or indications of interest outside of the member broker/dealer, including to an affiliate or a customer, is prohibited.

Question 4: Are NASD members allowed to enter quotations into NASDAQ in anticipation of the end of a trading halt during what is commonly known as the "quote-only" or "grace period"?

Yes. After official notification by NASD or the primary market, quotations may be entered in conformity with the resumption process. When the primary market permits the entry of quotes, clearly identified as closed, a member, including an ECN, may resume disseminating quotes during that period provided that they are identified clearly as closed quotes.

Question 5: If an NASD member sends quotation information or indications of interest to third parties, such as an Internet search engine or Web site, what are the member's responsibilities under the Rule?

As stated above, an NASD member is prohibited from publishing quotations or indications of interest during a trading halt. If quotations or indications of interest are disseminated prior to the announcement of a trading halt, the NASD member is required to promptly notify the third party of the trading halt and request that the member's information be removed during the trading halt. Firms must be able to demonstrate compliance with Rule 3340, including maintaining records of requests made to third parties to stop displaying quotations in a particular security during a trading halt and compliance by third parties with such requests. Best practices suggest that NASD members that provide quotations or indications of interest to third parties do so pursuant to written agreements and that, as part of such agreements, the third parties agree immediately to cease the publication of quotations or indications of interest upon notice from the member firm of a trading halt. The written agreement should set forth an acceptable service level standard upon which the third party will act and failure of the third party to act, upon notice in accordance with such service level, should constitute a material breach of the written agreement. NASD member firms should proactively monitor third parties to ensure that publication of quotations and indications of interest during a trading halt does not occur. Furthermore,

member firms should require documentation of third party compliance with the established service level that should be retained in conformity with standard recordkeeping practices. NASD member firms should notify third parties in the event that compliance with the service level is not achieved and receive assurances that can be reasonably relied upon that the matter will be remedied in the immediate future or, if appropriate, terminate the agreement. Absent extraordinary circumstances, the assurances of a third party should not be relied upon when such third party has either: (1) not immediately acted to rectify its failure to cease publication of quotations or indications of interest upon notification; or (2) repeatedly failed to achieve the service level standard for ceasing publication during a trading halt.

Question 6: If an NASD member borrows stock to fulfill certain regulatory requirements and a trading halt is subsequently imposed, is the member prohibited under Rule 3340 from returning the stock while the trading halt is in effect?

Rule 3340 prohibits NASD members from effecting any transaction, directly or indirectly, during a trading halt. The Rule does not extend to the return of stock pursuant to a stock lending arrangement, assuming no other activities occur that would constitute "effecting" a securities transaction. Accordingly, Rule 3340 generally should not be relied upon as a basis for failing to either return or accept delivery of securities pursuant to a stock lending arrangement.

Question 7: If an NASD member receives a "not held" order for 100,000 shares, works the order throughout the day, and accumulates 60,000 shares, but then a trading halt is imposed, can the NASD member complete the transaction during the trading halt without violating Rule 3340?

A firm cannot execute any part of the order once a trading halt is declared, including the 60,000 shares accumulated prior to the trading halt. Once the trading halt is lifted, the firm may resume its efforts to work the order or decline to fill the balance of the order, in the wake of the trading halt, in the best interests of the customer.

Question 8: If an issue that is listed on a foreign market is subject to a trading halt on a U.S. market, but not halted on the foreign market, may an NASD member trade the security on the foreign market consistent with Rule 3340?

No. NASD members may not directly effect trades on international markets for their own accounts and may not solicit customer orders in these securities. If a member firm receives an unsolicited customer order in a security subject to the NASDAQ trading halt, it may route the order to a non-member entity or non-member affiliate not covered by the halt for execution in a foreign market. Customer transactions effected outside the United States through the non-member may involve an NASD member firm to the extent required by SEC Rule 15a-6.

Endnote

1 See *Notice to Members 01-47* (July 2001).

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