

Notice to Members

FEBRUARY 2007

SUGGESTED ROUTING

Legal & Compliance
Operations
Registered Representatives
Senior Management
Trading

KEY TOPICS

IM-6660-1
OTC Equity Securities
Quotations
Rule 6660
Trading Halts

GUIDANCE

NASD's Trading and Quotation Halt Authority Expanded

SEC Approves Amendments to NASD Rules to Modify and Expand NASD's Authority to Initiate Trading and Quotation Halts in Over-the-Counter (OTC) Equity Securities; **Effective Date: March 16, 2007**

Executive Summary

On December 18, 2006, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 6660 to expand the scope of NASD's authority to initiate trading and quotation halts in OTC Equity Securities and new IM-6660-1 to identify certain factors that NASD may consider in determining, at its discretion, whether imposing a trading and quotation halt in an OTC Equity Security is appropriate.¹

Rule 6660 and IM-6660-1, as approved, are set forth in Attachment A of this *Notice*. The amendments will become effective on March 16, 2007.

Questions/Further Information

Questions or comments regarding this *Notice* may be directed to Elliot Levine, Chief Counsel, Transparency Services, at (202) 728-8405; or Kosha K. Dalal, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6903.

Operational questions concerning trading and quotation halts in OTC Equity Securities should be directed to NASD Operations at (866) 776-0800, or please refer to the Web site at *OTCBB.com*.

Background and Discussion

Effective October 1, 2005, NASD transferred ownership and operations of the OTC Bulletin Board (OTCBB) from The Nasdaq Stock Market, Inc. (NASDAQ) to NASD. Prompted in part by the transition of the OTCBB, NASD has been analyzing the regulatory framework in this sector of the marketplace to determine whether changes in this area are appropriate. As part of this ongoing effort, NASD is adopting several changes related to its current authority under Rule 6545 to halt trading and quotations in certain OTC Equity Securities.²

Currently, Rule 6545 provides NASD with limited trading and quotation halt authority solely for securities quoted on the OTCBB. Specifically, Rule 6545(a) currently provides NASD with authority to halt trading and quotations of OTCBB securities only where: (1) the OTCBB security (or security underlying an OTCBB American Depository Receipt, otherwise known as an ADR) is listed on or registered with a foreign market and the foreign regulatory authority or market halts trading in the security; (2) the OTCBB security (or the security underlying the OTCBB ADR) is a derivative or component of a security listed on or registered with NASDAQ, a national securities exchange or foreign exchange, and the exchange or market halts trading in the underlying security; or (3) the OTCBB issuer fails to comply with the requirements of SEC Rule 10b-17, which generally requires the issuer of a class of securities that are publicly traded to give notice to NASD no later than 10 days prior to the record date of a dividend or distribution. Pursuant to Rule 6545, NASD has authority to halt trading and quotations of securities quoted on the OTCBB for up to five business days.

On December 18, 2006, the SEC approved amendments to expand the scope of NASD's authority to initiate trading and quotation halts in OTC Equity Securities.³ Specifically, Rule 6545, as amended and renumbered to Rule 6660,⁴ expands the scope of NASD authority to initiate trading and quotation halts in all OTC Equity Securities, which includes ADRs that trade in the OTC market, securities quoted in quotation mediums other than the OTCBB (e.g., the Pink Sheets), and other OTC Equity Securities. This expansion will allow NASD to impose its trading and quotation halt authority uniformly to all OTC Equity Securities eliminating the disparity between OTCBB securities and other quotation mediums.

Further, Rule 6660 expands NASD's existing trading halt authority to provide more general trading and quotation halt authority beyond halts related to non-compliance with SEC Rule 10b-17, while limiting such authority to only those extraordinary events that have a material effect on the market for the OTC Equity Security and have the potential to cause major disruption to the marketplace and/or significant uncertainty in the settlement and clearance process. Specifically, under Rule 6660(a)(3), NASD has the authority to impose a trading and quotation halt for material events, where NASD determines, at its discretion, based on the facts and circumstances of the particular event, that halting trading in the security is the appropriate mechanism to protect investors and ensure a fair and orderly marketplace.

In addition, Rule 6660 increases the maximum number of business days that NASD can impose a trading and quotation halt from up to five business days to 10 business days. A halt for a period of up to 10 business days is consistent with the SEC's authority to temporarily suspend trading in securities in accordance with Section 12(k) of the Exchange Act. Increasing the maximum number of days from five to 10 business days will allow more time for regulators to act and for the market of the subject security to stabilize.

NASD is also adopting IM-6660-1 to identify certain factors that NASD may consider in determining, at its discretion, whether halting trading in an OTC Equity Security under Rule 6660(a)(3) is appropriate. Due to the general nature of quoting and trading in the OTC Equity market, and the fact that NASD lacks a direct contractual relationship with OTC Equity issuers, NASD does not favor imposing a trading halt and thus expects to exercise this authority in very limited circumstances. Specifically, IM-6660-1 provides that NASD will consider several factors in making its determination, including but not limited to: (1) the material nature of the event; (2) the material facts surrounding the event are undisputed and not in conflict; (3) the event has caused widespread confusion in the trading of the security; (4) there has been a material negative effect on the market for the subject security; (5) the potential exists for a major disruption to the marketplace; (6) there is significant uncertainty in the settlement and clearance process for the security; and/or (7) such other factors as NASD deems relevant in making its determination. NASD may review all or some of these factors as it determines appropriate. NASD staff will weigh the relevant information and make a determination whether halting trading in the security is appropriate and may consult with NASD's Uniform Practice Code Committee (or any successor thereto) as it deems necessary or appropriate.

Based on NASD's experience to date, each event presents a unique set of facts and circumstances. As a result, NASD expects to exercise significant discretion in determining whether a particular event affecting a security warrants a trading and quotation halt. Notably, Rule 6660 will not be used in cases solely where NASD suspects that corporate fraud or manipulative activity is occurring with respect to a security, because NASD does not believe this authority is the appropriate tool for addressing allegations of fraud. Nor will the authority be used to correct informational imbalances resulting from corporate news about the issuer—*e.g.*, financial results, release of new product, or pending regulatory investigation—because NASD has no listing or other agreement with the issuer of an OTC Equity Security and therefore cannot compel such issuers to disclose material information.

Impact of Trading and Quotation Halt on SEC Rule 15c2-11, NASD 6640 and Form 211

It is important to note that for OTC Equity Securities, in certain instances, quoting will not automatically resume when a trading halt ends. If trading is halted for four or more business days, quoting cannot resume for OTC Equity Securities until broker-dealers comply with the requirements of SEC Rule 15c2-11 and NASD Rule 6640. Such rules require a broker-dealer to review information about the issuer and have a reasonable basis under the circumstances to believe that the issuer information is accurate in all material respects and the sources of such information are reliable. As a result, any trading and quotation halt greater than four business days generally would require broker-dealers to comply with the requirements of NASD Rule 6640 before resuming publication of quotations on the subject security.

Operational Matters

Publication of Trading and Quotation Halts

NASD expects that announcements regarding trading and quotation halts will continue to be disseminated/published as they currently are for OTCBB securities, including through NASDAQ MarketWatch and *OTCBB.com*.

Foreign Regulatory Halts

With respect to trading and quotation halts under Rule 6660(a)(1) for foreign regulatory halts, information is received only from certain foreign markets, given that foreign markets generally have no obligation to provide halt information to NASD. As a result, the current ability to halt trading and quotations in a security pursuant to Rule 6660(a)(1) is limited. Thus, *OTCBB.com* currently posts and will continue to post the following message: "Non-US exchanges, markets and regulatory authorities are under no obligation to report halts or other information pertaining to securities in their markets to NASD or NASDAQ."

Domestic Halts

With respect to trading and quotation halts under Rule 6660(a)(2) for derivatives or components of exchange-listed securities, efforts will be made to coordinate with domestic markets to receive information regarding trading and quotation halts. If there are OTCBB or other OTC listings that are derivatives or components of the security halted on an exchange, generally a corresponding halt for such securities will be implemented.

New Halt Codes/Security Category

NASD is developing new halt codes and descriptions to correspond to Rule 6660. NASD anticipates that the new codes and descriptions will be implemented by the end of April 2007.

NASD will announce the new halt codes and descriptions in a future *Notice to Members*.

Endnotes

- 1 See Exchange Act Release No. 54952 (December 18, 2006), 71 FR 78242 (December 28, 2006) (File No. SR-NASD-2006-039).
- 2 The term "OTC Equity Security" is defined in Rule 6610(d) to mean "any non-exchange listed security and certain exchange-listed securities that do not otherwise qualify for real-time trade reporting." Certain securities may not qualify for real-time reporting because they are not "eligible securities" as defined in Rule 6410(d). The term "OTC Equity Security" does not include "restricted securities," as defined by Rule 144(a)(3) under the Securities Act of 1933, nor any securities designated in the PORTAL Market under the NASD Rule 5300 Series.
- 3 See *supra* note 1.
- 4 Because the current NASD Rule 6500 Series relates solely to OTCBB securities, NASD has renumbered Rule 6545 as Rule 6660, which will become part of the NASD rules relating to OTC Equity Securities.

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ATTACHMENT A

New language is underlined. Deleted language is in brackets.

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[6545]6660. Trading and Quotation Halt in OTC[BB-Eligible] Equity Securities

(a) Authority for Initiating a Trading and Quotation Halt

In circumstances in which it is necessary to protect investors and the public interest, NASD may direct members, pursuant to the procedures set forth in paragraph (b), to halt trading and quotations in OTC Equity Securities (as such term is defined in Rule 6610) [the over-the-counter (“OTC”) market of a security or an American Depository Receipt (“ADR”), that is included in the OTC Bulletin Board (“OTCBB”)] if:

(1) the OTC[BB] Equity S[s]ecurity or the security underlying an American Depository Receipt (“ADR”) that is an OTC Equity Security (“OTC ADR”)[the OTCBB 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 because of public interest concerns (“Foreign Regulatory Halt”); provided, however, that NASD will not impose a trading and quotation halt if the Foreign Regulatory Halt was imposed solely for material news, a regulatory filing deficiency, or operational reasons; [or]

(2) the OTC[BB] Equity S[s]ecurity or the security underlying [the]an OTC[BB] ADR is a derivative or component of a security listed on or registered with a national securities exchange or foreign securities exchange or market (“listed security”), and the national securities exchange, or foreign securities exchange or market imposes a trading halt in the listed security[.]; or

(3) NASD determines that an extraordinary event has occurred or is ongoing that has had a material effect on the market for the OTC Equity Security or has caused or has the potential to cause major disruption to the marketplace and/or significant uncertainty in the settlement and clearance process. [the issuer of the OTCBB security or the security underlying the OTCBB ADR fails to comply with the requirements of SEC Rule 10b-17 regarding Untimely Announcements of Record Dates.]

(b) Procedure for Initiating a Trading and Quotation Halt

(1) When a halt is initiated under subparagraph (a)(1) of this rule, upon receipt of information from a foreign securities exchange or market on which the OTC[BB] Equity S[s]ecurity or the security underlying the OTC[BB] ADR is listed or registered, or from a regulatory authority overseeing such issuer, exchange, or market, NASD will promptly evaluate the information and determine whether a trading and quotation halt in the OTC[BB] Equity S[s]ecurity is appropriate.

(2) Should NASD determine that a basis exists under this rule for initiating a trading and quotation halt, the commencement of the trading and quotation halt will be effective simultaneous with the issuance of appropriate public notice.

(3) Trading and quotations in the OTC market may resume when NASD determines that the basis for the halt no longer exists, or when [five]10 business days have elapsed from the date NASD initiated the trading and quotation halt in the security, whichever occurs first. NASD shall disseminate appropriate public notice that the trading and quotation halt is no longer in effect.

(c) Violation of OTC[BB] 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:

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

(2) to 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: system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers; or publication, alternative trading system or other device that is used by brokers or dealers to disseminate quotations to others.

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IM-6660-1 Factors to be Considered When Initiating a Trading and Quotation Halt

NASD may impose a trading and quotation halt in an OTC Equity Security pursuant to Rule 6660(a)(3) where NASD determines, in its discretion, based on the facts and circumstances of the particular event, that halting trading in the security is the appropriate mechanism to protect investors and ensure a fair and orderly marketplace. As a general matter, NASD does not favor imposing a trading and quotation halt in an OTC Equity Security and will exercise this authority in very limited circumstances. In determining whether to impose a trading halt under Rule 6660(a)(3), NASD will consider several factors in making its determination, including but not limited to: (1) the material nature of the event; (2) the material facts surrounding the event are undisputed and not in conflict; (3) the event has caused widespread confusion in the trading of the security; (4) there has been a material negative effect on the market for the subject security; (5) the potential exists for a major disruption to the marketplace; (6) there is significant uncertainty in the settlement and clearance process for the security; and/or (7) such other factors as NASD deems relevant in making its determination. NASD may review all or some of these factors as it determines appropriate.

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