

Extended Hours Trading Risk Disclosure

FINRA Reminds Firms of Extended Hours Trading Disclosures

Executive Summary

FINRA reminds firms of their obligations under FINRA Rule 2265 to disclose to a customer the material risks of extended hours trading. This disclosure should include the risks described in the Model Extended Hours Trading Risk Disclosure Statement in FINRA Rule 2265 as well as any additional disclosures as necessary to address product-specific or other specific needs.

Questions concerning this *Notice* should be directed to Kathryn Moore, Associate General Counsel, Office of General Counsel, at (202) 728-8200 or Kathryn.Moore@finra.org.

Background & Discussion

While extended hours trading can provide customers with greater opportunities to trade securities and manage their portfolios, it also involves material risks that are specific to extended hours trading. FINRA is reminding firms of the disclosure requirements of FINRA Rule 2265 that highlight such risks to customers. The rule provides a Model Extended Hours Trading Risk Disclosure Statement (*see* Attachment A) that addresses six primary trading risks: (1) lower liquidity; (2) higher volatility; (3) changing prices; (4) unlinked markets; (5) an exaggerated effect from news announcements; and (6) wider spreads. As an alternative to the model disclosure, firms have flexibility in the developing the risk disclosure statement so long as, at a minimum, the six areas are addressed.

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Notice Type

- ▶ Guidance

Suggested Routing

- ▶ Advertising
- ▶ Compliance
- ▶ Institutional
- ▶ Legal
- ▶ Operations
- ▶ Options
- ▶ Registered Representatives
- ▶ Risk
- ▶ Senior Management
- ▶ Trading
- ▶ Training

Key Topics

- ▶ Extended Hours Trading Risk Disclosure

Referenced Rules & Notices

- ▶ Rule 2265

In addition, FINRA Rule 2265(c) provides that firms must consider whether to develop and include additional disclosures in the extended hours trading risk disclosure statement as necessary to address product-specific or other specific needs. For example, the Securities and Exchange Commission has recently approved a Chicago Board Options Exchange (CBOE) proposal to adopt extended trading hours for certain listed options.¹ As part of the proposal, CBOE will adopt Rule 6.1A (Extended Trading Hours) that, among other things, requires firms to make certain disclosures to customers as provided in Rule 6.1A(j) regarding material trading risks that exist during extended trading hours for such options.² FINRA member firms that intend to participate in such extended trading hour sessions should review and consider these additional risks and disclose such risks to their customers who may trade options during extended trading hours. As noted above, pursuant to Rule 2265(c), FINRA member firms must consider these CBOE disclosures, as well as disclosures any other trading market might require, with respect to the risks of extended hours trading of specific products.

Endnotes

1. See Securities Exchange Act Release No. 73704 (November 28, 2014), 79 FR 72044 (December 4, 2014) (Notice of Filing of Amendment Nos. 1 and 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, To Adopt Extended Trading Hours for SPX and VIX, File No. SR-CBOE-2014-062).
2. For example, CBOE Rule 6.1A(j) includes an additional risk in subparagraph (vi): “Risk of Lack of Calculation or Dissemination of Underlying Index Value or Intraday Indicative Value (“IIV”) and Lack of Regular Trading in Securities Underlying Indexes. For certain products, an updated underlying index or portfolio value or IIV will not be calculated or publicly disseminated during Extended Trading Hours. Since the underlying index or portfolio value and IIV are not calculated or widely disseminated during Extended Trading Hours, an investor who is unable to calculate implied values for certain products during Extended Trading Hours may be at a disadvantage to market professionals. Additionally, securities underlying the indexes or portfolios will not be regularly trading as they are during Regular Trading Hours, or may not be trading at all. This may cause prices during Extended Trading Hours to not reflect the prices of those securities when they open for trading.”

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Attachment A

Model Extended Hours Trading Risk Disclosure Statement

You should consider the following points before engaging in extended hours trading. “Extended hours trading” means trading outside of “regular trading hours.” “Regular trading hours” generally means the time between 9:30 a.m. and 4:00 p.m. Eastern Standard Time.

- ▶ 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 trading 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 trading hours. As a result, your order may only be partially executed, or not at all, or you may receive an inferior price when engaging in extended hours trading than you would during regular trading 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 trading hours, or upon the opening the next morning. As a result, you may receive an inferior price when engaging in extended hours trading than you would during regular trading 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 trading hours. Similarly, important financial information is frequently announced outside of regular trading 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.