

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54952; File No. SR-NASD-2006-039)

December 18, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change and Amendment Nos. 1 and 2 Thereto to Amend NASD Rules to Modify and Expand NASD's Authority to Initiate Trading and Quotation Halts in OTC Equity Securities

I. Introduction

On March 22, 2006, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to: (1) amend NASD rules to modify and expand NASD's authority to direct its members to halt trading and quotation in certain over-the-counter ("OTC") equity securities ("OTC Equity Securities");³ and (2) adopt factors that NASD may consider in determining, in its discretion, whether to impose a trading and quotation halt in OTC Equity Securities. On May 23, 2006, NASD filed with the Commission Amendment No. 1 to the proposed rule change.⁴ The proposed rule change, as amended, was published for comment in the Federal Register on June 7, 2006.⁵ The Commission received one comment letter in response to the proposal.⁶ On November 8, 2006, NASD filed Amendment No. 2 to the proposed rule change.⁷ The text of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See NASD Rule 6610(d).

⁴ Amendment No. 1 replaced and superseded the original rule filing in its entirety.

⁵ See Securities Exchange Act Release No. 53920 (June 1, 2006), 71 FR 33026 ("Notice").

⁶ See Letter from R. Cromwell Coulson, Chief Executive Office, Pink Sheets LLC ("Pink Sheets"), to Nancy M. Morris, Secretary, Commission, dated July 10, 2006.

⁷ In Amendment No. 2, which supplemented the proposed rule change as filed, NASD made typographical, non-substantive changes to the rule text contained in the proposed rule change. Two of the technical changes that are the subject of Amendment No. 2 were incorporated into the

Amendment No. 2 to the proposed rule change is available on NASD's Web site at <http://www.nasd.com>, at NASD's Office of the Secretary, and at the Commission's Public Reference Room. This order approves the proposed rule change, as amended.

II. Description of the Proposal

NASD proposes to expand the scope of its authority with respect to trading and quotation halts in OTC Equity Securities. Currently, NASD Rule 6545 provides NASD with limited trading and quotation halt authority solely for securities quoted on the OTC Bulletin Board ("OTCBB"). Specifically, under NASD Rule 6545, NASD can direct NASD members to halt trading and quotations in OTCBB securities only where: (1) the OTCBB security (or security underlying an OTCBB American Depository Receipt ("ADR")) is listed on or registered with a foreign securities exchange or market and the foreign securities exchange or market or regulatory authority 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 The NASDAQ Stock Market LLC or a national securities exchange or foreign securities exchange or market and that exchange or market halts trading in the underlying security; or (3) the issuer of the OTCBB security (or security underlying the OTCBB ADR) fails to comply with the requirements of Rule 10b-17 under the Act.⁸ NASD Rule 6545 provides NASD with authority

rule text that was published in the Notice. *See* Notice, *supra* note 5, at note 5 and accompanying text (citing to a conversation between Kosha Dalal, Associate General Counsel, NASD, and Tim Fox, Special Counsel, Division of Market Regulation, Commission, on June 1, 2006). In addition, in Amendment No. 2, NASD responded to the comments raised in the Pink Sheets Letter. In light of the purely technical nature of Amendment No. 2, the Commission is not publishing Amendment No. 2 for public comment.

⁸ 17 CFR 240.10b-17. Rule 10b-17 generally requires the issuer of a class of publicly-traded securities to provide NASD with notice no later than 10 days prior to the record date of a dividend or distribution.

to halt trading and quotations of OTCBB securities in the foregoing circumstances for up to five business days.

NASD proposes to expand the scope of its authority to direct NASD members to halt trading and quotations to cover all OTC Equity Securities,⁹ which includes ADRs that trade in the OTC market as well as securities quoted in quotation mediums other than the OTCBB (e.g., the Pink Sheets).¹⁰ Further, NASD proposes to modify and expand the scope of its trading and quotation halt authority beyond halts related to non-compliance with Rule 10b-17 under the Act,¹¹ while limiting such authority only to those extraordinary events that have a material effect on the market for the OTC Equity Security or that have the potential to cause major disruption to the marketplace and/or cause significant uncertainty in the settlement and clearance process. In addition, NASD proposes to increase from five business days to ten business days the maximum length a trading and quotation halt can be imposed under NASD Rule 6660. Finally, NASD proposes to adopt IM-6660-1 that sets forth certain factors that it will consider in determining, in its discretion, whether to direct NASD members to halt quoting and trading in an OTC Equity Security.¹² According to NASD, NASD staff would weigh the relevant information and make a

⁹ See NASD Rule 6610(d) (defining OTC Equity Security). The term “OTC Equity Security” also includes certain exchange-listed securities that do not otherwise qualify for real-time trade reporting because they are not “eligible securities” as defined in NASD 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.

¹⁰ Because the current NASD Rule 6500 Series relates solely to OTCBB securities, NASD is proposing to renumber NASD Rule 6545 as NASD Rule 6660, which would become part of the NASD rules relating to OTC Equity Securities.

¹¹ 17 CFR 240.10b-17.

¹² The proposed factors in IM-6660-1 that NASD may consider in determining whether to impose a trading and quotation halt under NASD Rule 6660(a)(3) include, but are 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

determination whether halting trading in the security is appropriate and may consult with NASD's Uniform Practice Code ("UPC") Committee (or any successor thereto) as it deems necessary or appropriate.¹³ In its proposal to expand its existing trading and quotation halt authority to all OTC Equity Securities, NASD stated its belief that its trading and quotation halt authority should apply uniformly to all OTC Equity Securities, and affirmed its belief that eliminating this disparity will further investor protections in this area of the securities market and enhance the quality of the OTC market.

NASD noted that, under the proposal, it would exercise significant discretion in determining whether a particular event affecting a security warranted a trading and quotation halt, and it would impose a halt only when it determines that halting trading and quotations in the security is the appropriate mechanism to protect investors and ensure a fair and orderly marketplace. According to NASD, its expanded trading and quotation halt authority would not be used to correct informational imbalances resulting from corporate news about an issuer because NASD does not have a listing or other agreement with the issuer and thus cannot compel the issuer to disclose material information.

NASD intends to announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval of the proposal.

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.

¹³ The UPC Committee is a standing committee of NASD, currently consisting of six professionals in the securities industry. The UPC Committee has the authority to advise NASD on issues of interest and concern to the securities industry, including interpretations with respect to the UPC. According to NASD, NASD staff may present matters relating to possible trading and quotation halts to the UPC Committee from time to time. However, the role of the UPC Committee in this regard is advisory only. NASD stated that NASD staff would retain full power and authority to make all determinations under proposed NASD Rule 6660 and IM-6660-1.

The effective date will be 30 days following publication of the Notice to Members announcing Commission approval of the proposal.

III. Summary of Comments and NASD's Response

The Pink Sheets generally supported NASD's proposed rule change, but recommended several modifications. First, the Pink Sheets objected (except in the case of foreign regulatory halts) to NASD's proposal to impose a trading and quotation halt for more than four business days¹⁴ because of the loss of "piggyback" eligibility under Rule 15c2-11 under the Act.¹⁵ According to the Pink Sheets, if a NASD member cannot rely on the piggyback provision, the member would have to comply with the provisions of Rule 15c2-11, including submitting a new NASD Form 211 to NASD, before initiating or resuming quotations in the security. The Pink Sheets also suggested that, because NASD's proposed rule change does not provide a forum to facilitate the exercise of due process, NASD trading and quotation halts should be limited to four business days. In addition, the Pink Sheets noted that trading and quotation halts are an effective anti-fraud weapon and should be used accordingly. Finally, the Pink Sheets indicated that its proposed four business day limit on NASD trading and quotation halts should not apply in the case of foreign regulatory halts.

NASD, in Amendment No. 2, responded to the Pink Sheets' comments.¹⁶ NASD reaffirmed its view that its proposed rule change is appropriate and furthers investor protection. In response to the Pink Sheets' concern about the potential loss of piggyback eligibility under

¹⁴ The Commission notes that under existing NASD Rule 6545, NASD can direct NASD members to halt trading and quotations in OTCBB securities for up to five business days.

¹⁵ 17 CFR 240.15c2-11. Under the "piggyback" provision of Rule 15c2-11, broker-dealers can publish quotations for securities subject to the Rule as long as the security has been quoted on each of at least twelve days within the previous thirty calendar days with no more than four successive business days without a quotation.

¹⁶ See Amendment No. 2, supra note 7.

Rule 15c2-11, NASD noted that it is critical to require market makers to review current information regarding the issuer, as set forth in Rule 15c2-11 under the Act. NASD indicated that such a “restart” of the Rule 15c2-11 process is appropriate and consistent with the operation of Rule 15c2-11 following a Commission-imposed trading suspension under Section 12(k) of the Act.¹⁷ NASD also responded to the Pink Sheets’ assertion that its proposed trading and quotation halt authority should be used more than just sparingly by explaining that its proposal clearly delineates the situations under which it would exercise its authority under the proposed rule. NASD noted that it intends to exercise the proposed trading and quotation halt authority in very limited circumstances to protect the market and investors, and does not believe this authority should be used liberally whenever there is a “problem” with a security.

In addressing the Pink Sheets’ concern that NASD trading and quotation halts in OTC Equity Securities would not be subject to due process, NASD stated that the proposed authority is consistent with its statutory obligations as a self-regulatory organization, including, among others, its responsibility under Section 15A(b)(11) of the Act¹⁸ to “ensure fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.” Further, NASD noted that not all determinations made by NASD staff are explicitly subject to a hearing process, and that decisions like trading and quotation halts require certainty and finality so that the marketplace can operate fairly and efficiently. NASD noted that a hearing process, even if adopted as part of its proposed rule, would not stay the trading and quotation halt or the Rule 15c2-11 process.

Finally, NASD explained that the term “foreign regulatory halt” in proposed NASD Rule 6660(a)(1) would include the Canadian provincial exchanges or markets. NASD noted,

¹⁷ 15 U.S.C. 78j(k).

¹⁸ 15 U.S.C. 78q-3(b)(11).

however, that, as proposed, it would not impose its own trading and quotation halt if a foreign regulatory halt covering a given security was imposed for material news, a regulatory filing deficiency, or operational reasons.

IV. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change, the comment letter, and NASD's response to the comment letter, and finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities association, including the provisions of Section 15A(b)(6) of the Act,¹⁹ which requires, among other things, that NASD rules be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing transactions in securities, and, in general, to protect investors and the public interest, and Section 15A(b)(11) of the Act,²⁰ which requires, among other things, that NASD rules relating to quotations be designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.²¹

The Commission believes that NASD's proposal to permit trading and quotation halts in OTC Equity Securities can benefit the marketplace and investors when an extraordinary event occurs 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 or significant uncertainty in the settlement and clearance process. NASD Rule 6660 is designed to provide the marketplace with

¹⁹ 15 U.S.C. 78o-3(b)(6).

²⁰ 15 U.S.C. 78o-3(b)(11).

²¹ In approving this proposed rule change, as amended, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

the opportunity to widely digest and disseminate the information that precipitated the market condition and provide NASD with the opportunity to consider whether further regulatory action is warranted in a particular circumstance.²² The Commission believes that NASD's proposed trading and quotation halt rule for OTC Equity Securities, when appropriately applied under the circumstances specified in the proposed rule, is designed to foster the integrity of quotations for these securities and to promote the protection of investors and the public interest.

In particular, the Commission believes that NASD's proposal to expand its trading and quotation halt authority to situations involving extraordinary events with respect to OTC Equity Securities should enable NASD to impose trading and quotation halts in OTC Equity Securities under a broader set of circumstances than it may impose today for OTCBB securities. The Commission believes that the proposal is intended to strike a reasonable balance between NASD's interest in imposing trading and quotation halts for OTC Equity Securities under circumstances warranting a halt, while establishing a clear standard that limits the imposition of trading and quotation halts for these securities to exigent circumstances.

In the Commission's view, the proposed factors set forth in proposed IM-6660-1, to be considered by NASD when determining whether a trading and quotation halt would be the appropriate mechanism to protect investors and ensure a fair and orderly marketplace, would help provide transparency to NASD's trading and quotation halt process. The Commission believes that NASD's proposed factors are tailored to assist NASD's determination of whether

²² The Commission notes that quotations in an OTC Equity Security may not automatically resume when a trading and quotation halt expires. In particular, if a trading and quotation halt was in effect for more than four consecutive business days, the "piggyback" exception in Rule 15c2-11(f)(3) under the Act would not be available and, in that case, broker-dealers would be required to comply with the requirements of Rule 15c2-11 and NASD Rule 6740 before initiating or resuming quotations for the subject security.

an extraordinary event has occurred that warrants the imposition of a trading and quotation halt. The Commission further believes that NASD's ability to consult with the UPC Committee (or any successor thereto), in an advisory capacity only, as it deems necessary, is an appropriate mechanism for NASD staff to benefit from the insight of market professionals, while NASD retains ultimate authority to determine whether to impose a trading and quotation halt.

The Commission believes that it is appropriate for NASD to expand its authority to halt trading and quotation to all OTC Equity Securities. This proposal would enable NASD to impose trading and quotation halts in OTC Equity Securities that are quoted in trading venues other than, or in addition to, the OTCBB, and would thereby assist NASD in carrying out its self-regulatory responsibilities for the over-the-counter marketplace.

The Commission further believes that extending from five to ten the maximum number of business days for which NASD may impose a trading and quotation halt is reasonably designed to protect investors and the public interest and to foster the integrity of quotations for OTC Equity Securities. This change would provide NASD with the ability to impose a trading and quotation halt of up to ten business days in the event that NASD believes that, under the circumstances, a halt of this length is necessary to protect investors and ensure a fair and orderly marketplace.

Finally, the Commission notes that the proposal permits NASD to halt trading and quoting of an OTC Equity Security when NASD determines that an extraordinary event has occurred that, under NASD Rule 6660, justifies the imposition of such a halt. In such case, imposition of a trading and quotation halt would provide a measure of certainty and finality to the marketplace and investors. The Commission notes that NASD's administration of its proposed rule is subject to continuing Commission oversight, and that NASD, as a registered

national securities association, remains bound by its obligations as a self-regulatory organization under the Act and all relevant rules and regulations thereunder.

For the reasons described above, the Commission believes that NASD's proposed rule change promotes the protection of investors and the public interest by expanding NASD's authority to direct NASD members to halt quotation and trading in an OTC Equity Security under appropriate circumstances.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²³ that the proposed rule change (SR-NASD-2006-039), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁴

Florence E. Harmon
Deputy Secretary

²³ 15 U.S.C. 78s(b)(2).

²⁴ 17 CFR 200.30-3(a)(12).