

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68874; File No. SR-FINRA-2012-010)

February 8, 2013

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Amend FINRA Rule 6440 (Trading and Quotation Halt in OTC Equity Securities)

I. Introduction

On December 20, 2012, Financial Industry Regulatory Authority, Inc. (“FINRA”) 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 amend FINRA Rule 6440 (Trading and Quotation Halt in OTC Equity Securities). The proposed rule change was published for comment in the Federal Register on December 31, 2012.³ The Commission received one comment letter regarding the proposal.⁴ This order approves the proposed rule change.

II. Description of the Proposal

FINRA Rule 6440 (Trading and Quotation Halt in OTC Equity Securities) generally provides that, in circumstances where it is necessary to protect investors and the public interest,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 68526 (December 21, 2012), 77 FR 77162 (“Notice”).

⁴ See web comment from Suzanne H. Shatto, dated January 3, 2013, available at <http://www.sec.gov/comments/sr-finra-2012-010/finra2012010.shtml>. This commenter stated that “this circuit breaker does not serve the public well and provides brokers/marketmakers/high frequency traders with the ability to limit their losses.” The Commission believes that this comment is not pertinent to the proposed rule change, which concerns trading and quotation halts for OTC Equity Securities and not market-wide circuit breakers.

FINRA may direct members to halt trading and quotations in OTC Equity Securities.⁵ FINRA may impose a “Foreign Regulatory Halt” when a foreign securities exchange, market, or regulatory authority halts trading for regulatory reasons in an OTC Equity Security or a security underlying an American Depositary Receipt (“ADR”) that is an OTC Equity Security (“OTC ADR”) listed on or registered with such foreign securities exchange or market.⁶ FINRA, however, 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.⁷ In addition, FINRA may impose a “Derivative Halt” when a national securities exchange or foreign securities exchange or market halts trading in a listed security of which the OTC Equity Security or the security underlying an OTC ADR is a derivative or component.⁸ Further, FINRA may impose an “Extraordinary Event Halt” when it 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.⁹

FINRA proposes to amend Rule 6440(a)(1) to permit FINRA to initiate a trading and quotation halt as a result of a Foreign Regulatory Halt when the foreign halt is imposed for news

⁵ FINRA Rule 6420 defines “OTC Equity Security” as “any equity security that is not an ‘NMS stock’ as that term is defined in Rule 600(b)(47) of SEC Regulation NMS; provided, however, that the term ‘OTC Equity Security’ shall not include any Restricted Equity Security.” See FINRA Rule 6420(f).

⁶ See FINRA Rule 6440(a)(1).

⁷ See FINRA Rule 6440(a)(1).

⁸ See FINRA Rule 6440(a)(2).

⁹ See FINRA Rule 6440(a)(3).

pending.¹⁰ FINRA indicates that historically it has not halted in these instances because FINRA lacks privity with OTC equity issuers and cannot compel such issuers to disclose information to FINRA.¹¹ FINRA believes that with the growth of foreign securities markets and the ease at which trading can occur across jurisdictions and markets, increased coordination of trading halts across markets would protect investors by reducing instances of potentially material disparities in information regarding the security, or even fraudulent or manipulative trading in the security, and would act to protect U.S. investors.¹²

FINRA Rule 6440(b)(1) provides that upon receipt of information from a foreign securities exchange or market on which an OTC Equity Security or a security underlying the OTC ADR is listed or registered, or from a regulatory authority overseeing such issuer, exchange, or market, FINRA will promptly evaluate the information and determine whether a trading and quotation halt in the OTC Equity Security is appropriate. FINRA proposes to amend Rule 6440(b)(1) to clarify that FINRA may initiate a trading and quotation halt in an OTC Equity Security as a result of a Foreign Regulatory Halt or Derivative Halt upon notice from another reliable third-party source (e.g., The Depository Trust & Clearing Corporation, broker-dealers, or financial news data vendors) where FINRA can validate the information provided.¹³ The proposed revision to Rule 6440(b)(1) will provide that upon notice, not simply receipt of

¹⁰ See Notice, supra note 3, 77 FR at 77163. The limitations in Rule 6440(a)(1) relating to FINRA's halt authority where the Foreign Regulatory Halt is imposed solely for a regulatory filing deficiency or operational reasons would remain.

¹¹ See id.

¹² See id.

¹³ See id. FINRA states that it verifies all third-party information relating to trading and quotation halts in foreign markets before it acts upon such information. See id. at 77164. FINRA believes that having the authority to halt trading and quotation in an OTC Equity Security upon notice from a reliable third-party source that can be validated would allow FINRA to act more promptly to initiate trading and quotation halts in such securities. See id.

information, of a Foreign Regulatory Halt or Derivative Halt from (i) the national or foreign securities exchange or market on which the OTC Equity Security or the security underlying the OTC ADR is listed or registered; (ii) a regulatory authority overseeing such issuer, exchange, or market; or (iii) another reliable third-party source where FINRA can validate the information provided, FINRA will promptly initiate a trading and quotation halt in the OTC Equity Security.¹⁴

Currently, under Rule 6440(b)(3), trading and quotations in an OTC Equity Security may resume when FINRA determines that the basis for the halt no longer exists, or when ten business days have elapsed from the date FINRA initiated the trading and quotation halt in the security, whichever occurs first. FINRA proposes to add new Rule 6440(b)(2) to provide that, after it initiates a halt in an OTC Equity Security as a result of a Foreign Regulatory Halt or a Derivative Halt, FINRA may continue the halt in trading and quoting in the OTC market for the OTC Equity Security until such time as FINRA receives notice that the applicable regulatory authority has or intends to resume trading in the security, even if such halt is longer than ten business days.¹⁵

FINRA proposes to amend Rule 6440(b)(3) to provide that, with respect to a halt in an OTC Equity Security as a result of an Extraordinary Event Halt, trading and quotations in the OTC market for the OTC Equity Security may resume when FINRA determines that the basis for the halt no longer exists, or when ten business days have elapsed from the date FINRA initiated the trading and quotation halt in the security, whichever occurs first. In addition, FINRA will be

¹⁴ The commencement of the trading and quotation halt for the OTC Equity Security will be effective simultaneous with the issuance of appropriate public notice by FINRA. See proposed FINRA Rule 6440(b)(1).

¹⁵ FINRA stated that it will disseminate an appropriate public notice that a trading and quotation halt initiated under Rule 6440 is no longer in effect. See proposed FINRA Rule 6440(b)(4).

permitted to extend an Extraordinary Event Halt for subsequent periods of up to ten business days each if, at the time of any such extension, FINRA finds that the extraordinary event is ongoing and determines that the continuation of the halt beyond the prior ten business day period is necessary in the public interest and for the protection of investors.¹⁶

III. Discussion and Commission's Findings

After careful review of the proposed rule change, the Commission finds that the proposed rule change is consistent with the requirements of Section 15A(b) of the Act¹⁷ and the rules and regulations thereunder applicable to a national securities association.¹⁸ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,¹⁹ which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating 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 FINRA 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.

¹⁶ See proposed FINRA Rule 6440, Supplementary Material .01. FINRA believes that the authority to halt beyond the initial ten business day period is vital in the OTC marketplace where concerns regarding settlement and clearance, pricing, or other extraordinary events can take time to be resolved. See Notice, supra note 3, 77 FR at 77164.

¹⁷ 15 U.S.C. 78o-3(b).

¹⁸ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁹ 15 U.S.C. 78o-3(b)(6).

²⁰ 15 U.S.C. 78o-3(b)(11).

The Commission believes that FINRA's trading and quotation halt rule for OTC Equity Securities, when appropriately applied under the circumstances specified in the rule, as proposed to be amended, is designed to promote the protection of investors and the public interest and to produce fair and informative quotations, and to prevent fictitious or misleading quotations, for OTC Equity Securities. Permitting FINRA to initiate a trading and quotation halt as a result of a Foreign Regulatory Halt that is imposed for news pending should enable FINRA to initiate trading and quotation halts in OTC Equity Securities under a broader set of circumstances than currently exists, which could help to reduce the potential that investors may trade on incomplete or inaccurate information in these securities. In addition, permitting FINRA to initiate a halt as a result of a Foreign Regulatory Halt or Derivative Halt upon notice from another reliable third-party source where FINRA can validate the information provided should allow FINRA to initiate a halt more promptly when such a halt is warranted.

The Commission further believes that the provisions relating to the duration of a trading and quotation halt are reasonably designed to protect investors and the public interest and to produce fair and informative quotations, and to prevent fictitious or misleading quotations, for OTC Equity Securities. The Commission believes that it is reasonable for a halt in an OTC Equity Security as a result of a Foreign Regulatory Halt or a Derivative Halt to run concurrently with, and for as long as, the halt imposed on the security in the market on which it is listed or registered. In addition, allowing FINRA to extend an Extraordinary Event Halt for subsequent periods of up to ten business days will help allow for resolution of the event before trading and quoting in the OTC market for the OTC Equity Security resumes. The Commission notes that FINRA would be permitted to extend an Extraordinary Event Halt only if it finds that the extraordinary event is ongoing and determines that the continuation of the halt beyond the initial

ten business day halt period is necessary and appropriate in the public interest and for the protection of investors.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²¹ that the proposed rule change (SR-FINRA-2012-010) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

Kevin M. O'Neill
Deputy Secretary

²¹ 15 U.S.C. 78s(b)(2).

²² 17 CFR 200.30-3(a)(12).