

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-42345; File No. SR-NASD-99-33)

January 18, 2000

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Establishment of Trade and Quote Halt Authority for the NASD's OTCBB Service

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 14, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly-owned subsidiary, Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. On November 16, 1999, Nasdaq filed Amendment No. 1 to the proposed rule change.³ On December 3, 1999, Nasdaq filed Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from John F. Malitzis, Esq., Assistant General Counsel, Nasdaq to Nancy Sanow, Senior Special Counsel, Division of Market Regulation, SEC dated November 12, 1999. (Amendment No. 1 added language to proposed NASD Rule 6545(a)(2) giving the NASD the authority to halt the trading of a derivative or component of a security listed on a foreign market or exchange if the foreign securities exchange or market imposes a trading halt in the listed securities.)

⁴ See letter from John F. Malitzis, Esq., Assistant General Counsel, Nasdaq to Nancy Sanow, Senior Special Counsel, Division of Market Regulation, SEC dated December 3, 1999. (Amendment No. 2 revised the definition of "quotation medium" in Rule 6545(c)(ii) and conformed the language in footnote 12 to reflect the requirements of NASD Rule 6740 and SEC Rule 15c2-11.)

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The NASD and Nasdaq are proposing to amend the rules of the NASD to establish authority to halt trading in certain specific circumstances in securities included in the OTC Bulletin Board Service (“OTCBB”). The NASD and Nasdaq are also proposing to make changes to the Plan Of Allocation And Delegation Of Functions By NASD To Subsidiaries to clarify that the Stockwatch section of Nasdaq would have authority to effectuate OTCBB halts. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in [brackets].

* * *

Rule 6545. Trading and Quotation Halt in OTCBB-Eligible Securities

(a) Authority for Initiating a Trading and Quotation Halt

In circumstances in which it is necessary to protect investors and the public interest, Nasdaq may direct members, pursuant to the procedures set forth in paragraph (b), to halt trading and quotations in 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 OTCBB security or the security underlying 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 Nasdaq 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 OTCBB security or the security underlying the OTCBB ADR is a derivative or component of a security listed on or registered with a national securities exchange, The Nasdaq Stock Market, or foreign securities exchange or market (“listed security”) and the national securities exchange, The Nasdaq Stock Market or foreign securities exchange or market, imposes a trading halt in the listed security⁵; or

⁵ See Amendment No. 1, supra note 3.

(3) 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 OTCBB security or the security underlying the OTCBB ADR is listed or registered, or from a regulatory authority overseeing such issuer, exchange, or market, Nasdaq will promptly evaluate the information and determine whether a trading and quotation halt in the OTCBB security is appropriate.

(2) Should Nasdaq 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 Nasdaq determines that the basis for the halt no longer exists, or when five business days have elapsed from the date Nasdaq initiated the trading and quotation halt in the security, whichever occurs first. Nasdaq shall disseminate appropriate public notice that the trading and quotation halt is no longer in effect.

(c) Violation of OTCBB 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:

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

(ii) 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.⁶

⁶ See Amendment No. 2, *supra* note 4.

Plan Of Allocation And Delegation Of Functions By NASD To Subsidiaries

I - III. No Change

IV. Stockwatch

The Stockwatch section handles the trading halt functions for The Nasdaq Stock Market securities [and], exchange-listed securities traded in the over-the-counter market (i.e., the Third Market), and securities quoted in the Over-the-Counter Bulletin Board. Review of all questionable market activity, possible rule infractions or any other matters that require any type of investigative or regulatory follow-up will be referred to and conducted by NASD Regulation, which will assume sole responsibility for the matter until resolution. This responsibility will include examinations, investigations, document requests, and any enforcement actions that NASD Regulation may deem necessary. NASD Regulation staff at all times will have access to all records and files of the Stockwatch function.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background. As part of the NASD's ongoing effort to address abuses in thinly traded, thinly capitalized securities and to increase investor protection in the trading of over-the-counter ("OTC") market, the NASD, Nasdaq, and NASD Regulation have been reviewing whether to establish trading and quotation halt authority for securities that are not listed on an exchange or on Nasdaq, but are traded by NASD members in the OTC market. Nasdaq specifically focused on expanding its current trading halt authority, which generally extends to Nasdaq-listed securities and exchange-listed securities traded off an exchange⁷ (i.e., third market), to those securities quoted on the OTCBB. The OTCBB is an NASD system which, pursuant to delegated authority, The Nasdaq Stock Market, Inc. is responsible for operating.

Based on this review, the NASD and Nasdaq are proposing to expand Nasdaq's authority so that Nasdaq may impose quotation and trading halts in OTCBB securities when: (1) the OTCBB security is dually listed or registered and a foreign regulatory authority or market halts trading in the

⁷ See NASD Rule 4120. NASD Rule 4120 provides that Nasdaq may halt trading: (1) in the over-the-counter market of a security listed on Nasdaq to permit the dissemination of material news; (2) in the over-the-counter market of a security listed on a national securities exchange during a trading halt imposed by such exchange to permit the dissemination of material news; (3) by: (i) Consolidated Quotation System ("CQS") market makers in a CQS security when a national securities exchange imposes a trading halt in that CQS security because of an order imbalance or influx ("operational trading halt"); or (ii) Nasdaq market makers in a security listed on Nasdaq, when the security is a derivative or component of a CQS security and a national securities exchange imposes an operational trading halt in that CQS security; (4) in an American Depositary Receipt ("ADR") or other security listed on Nasdaq, when the Nasdaq-listed security or the security underlying the ADR is listed on or registered with a national or foreign securities exchange or market, and the national or foreign securities exchange or market, or regulatory authority overseeing such exchange or market, halts trading in such security for regulatory reasons; or (5) in a security listed on Nasdaq when Nasdaq requests from the issuer information relating to (i) material news; (ii) the issuer's ability to meet Nasdaq

security; (2) the OTCBB security is a derivative or component of a security listed on Nasdaq, a domestic exchange, or foreign exchange/market (e.g., a convertible security or warrant) and Nasdaq, the exchange, or foreign exchange/market halts trading in the underlying security⁸; or (3) the OTCBB issuer does not timely provide the NASD with information required by Exchange Act Rule 10b-17.⁹

Currently, NASD Rule 4120 authorizes Nasdaq to impose trading halts in Nasdaq-listed securities and securities listed on a national securities exchange and traded in the third market. There are, however, no rules that grant Nasdaq authority to impose trading or quotation halts in OTCBB securities. Additionally, unlike the Nasdaq market, there is no listing agreement between Nasdaq and OTCBB issuers, and thus Nasdaq does not have the ability to compel such issuers to disclose information to Nasdaq. Accordingly, it is difficult for Nasdaq to unilaterally impose halts in the OTCBB because, in most cases, information from the issuer is necessary to assess the situation and determine if a

listing qualification requirements, as set forth in NASD Rule 4300 and 4400 Series; or (iii) or any other information which is necessary to protect investors and the public interest.

⁸ See Amendment No. 1, supra note 3.

⁹ Separately, NASD Regulation focused on establishing authority to impose trading and quotation halts in non-Nasdaq, non-OTCBB, OTC securities. Based on its review, NASD Regulation is issuing Notice to Members 99-69, in which it is soliciting comments on whether NASD Regulation should have authority to halt trading in non-Nasdaq, non-OTCBB, OTC securities: (1) when the security is dually listed and a foreign regulatory authority or market halts trading; or (2) when the security is a derivative of a Nasdaq or exchange-listed security and Nasdaq or a national securities exchange halts trading in the underlying security. NASD Regulation is seeking comments from its membership prior to filing a rule proposal with the Commission because NASD Regulation's proposal is broader than that proposed in this filing. See Amendment No. 1, supra note 3.

halt and/or resumption of trading is appropriate.¹⁰ In light of the foregoing, the NASD and Nasdaq are proposing to vest Nasdaq with proscribed trading-halt authority.

Foreign Regulatory Authority Halts. First, the NASD and Nasdaq are proposing to impose trading and quotation halts in OTCBB eligible securities when a foreign market or regulatory authority has imposed a halt in the security in their market for regulatory reasons. This authority would permit Nasdaq to halt an OTCBB security or OTCBB ADRs when a foreign market on which the OTCBB issue is also traded, or a regulatory authority which has oversight authority for the OTCBB security, halts trading in the security or the security underlying the ADR for “regulatory” reasons. (Nasdaq currently has similar trading-halt authority for Nasdaq-listed securities.)¹¹ Under the proposal, upon receipt of information from a foreign securities market on which the OTCBB security or the security underlying the OTCBB ADR is listed or registered or from a regulatory authority overseeing such issuer, exchange, or market, Nasdaq’s Stockwatch section will evaluate the information (generally, a trade-halt order issued by the foreign market or regulatory authority) and determine whether a halt in the OTCBB security is appropriate. Nasdaq will impose such a halt only when the foreign market or regulatory authority has imposed its halt because of potential fraudulent conduct or other public interest concerns. Nasdaq will not impose a halt if the foreign entity’s halt is based on the dissemination of material news,

¹⁰ Under Section 12(k) of the Act, the Commission may impose trading suspensions in the U.S. securities markets. See 15 U.S.C. 78f-12(k). Additionally, NASD Rule 3340 prohibits members from trading any security as to which a trading halt is in effect. When the Commission suspends trading in an OTCBB security, Nasdaq announces the halt via the NEWS frame on the Nasdaq Workstation II and prohibits trading and quotations on the OTCBB.

¹¹ See NASD Rule 4210(a)(4).

an issuer's failure to meet regulatory filing requirements imposed by a foreign market or regulatory authority, or for operational reasons (e.g., order imbalance in the foreign market).¹²

For this and the proposed halts described below, an OTCBB halt would be lifted if Nasdaq determines that the basis of the halt no longer exists or upon the passage of five trading days, which ever occurs first.¹³ If a stock is halted for five days and then the halt is lifted, at the time the halt is lifted, market makers will be required to fulfill their obligations under Exchange Act Rule 15c2-11 prior to initiating a priced or unpriced quotation in the security.¹⁴ Nasdaq will notify market participants and the public of halts through the NASD Regulation and Nasdaq Websites (e.g., OTCBB.com, Nasdaqtrader.com, NASDR.com), as well as the Nasdaq NEWS frame on the Nasdaq Workstation

¹² The NASD and Nasdaq do not propose to halt for material news because Nasdaq does not have a formal listing agreement with OTCBB issuers, and thus cannot compel the full disclosure and dissemination of material news. The NASD and Nasdaq do not propose to halt trading if an issuer fails to meet filing/disclosure requirements imposed by a foreign regulatory authority or market, because Nasdaq would, in essence, be importing filing obligations of a foreign regulatory authority on OTCBB issuers when such requirements may not currently exist in the United States for such issuers. Lastly, the NASD and Nasdaq are not proposing to halt trading based on a foreign exchange's operational halt, such as an order imbalance, because Nasdaq generally does not halt for operational reasons.

¹³ Of course, if an issuer failed to meet the eligibility requirements contained in NASD Rules 6530 and 6540, which impose certain regulatory filing requirements for securities to be included in the OTCBB, the security would be removed from the OTCBB.

¹⁴ That is, if Nasdaq directs all members to cease quoting a security for five or more business days, pursuant to NASD Rule 6740 and Exchange Act Rule 15c2-11, members will be required to file a Form 211 prior to the resumption of quotations in the OTCBB. See 17 CFR 240.15c2-11. The NASD and Nasdaq note that the Commission recently issued for comment a reproposal of amendments to Exchange Act Rule 15c2-11. See Securities Exchange Act Release No. 41110 (February 25, 1999), 64 FR 11124 (March 8, 1999). The NASD and Nasdaq will monitor developments regarding Exchange Act Rule 15c2-11 and plan to make any necessary changes to conform the rules proposed in this filing with any changes to Exchange Act Rule 15c2-11.

II.

Halts in Derivative Securities. Nasdaq currently has the authority to halt trading in a Nasdaq-listed derivative security when a national securities exchange or Nasdaq halts trading in the underlying equity security that is listed on the exchange or Nasdaq.¹⁵ Halt authority only extends to derivatives listed on Nasdaq, and does not extend to derivatives quoted in the OTCBB. Thus, for example, Nasdaq or an exchange may halt trading in a security, but trading may continue in the OTCBB derivative security. Since the trading price of the OTCBB derivative is dependent on the price of the underlying listed security, it is difficult to accurately price the derivative security when there is no current pricing information on the underlying security. Such difficulty in pricing may lead to disorderly markets and investor confusion. Accordingly, the NASD and Nasdaq are proposing to halt trading and quotations in OTCBB securities when the OTCBB security is a derivative or component of a security listed on Nasdaq, a domestic exchange, or foreign market/exchange, and the exchange, Nasdaq, or foreign market/exchange imposes a trading halt in the underlying listed security.¹⁶

OTCBB Halts For Failure to Comply with Exchange Act Rule 10b-17. Finally, the NASD and Nasdaq are proposing to halt quotations and trading in an OTCBB security if the issuer fails to comply with the requirements of Exchange Act Rule 10b-17 regarding Untimely Announcements of

¹⁵ See NASD Rule 4120(a)(3)(ii).

¹⁶ See Amendment No. 1, supra note 3.

Record Dates.¹⁷ Exchange Act Rule 10b-17 requires issuers to give, in a timely fashion, the NASD information relating to: (1) a dividend or other distribution in cash or in kind; (2) a stock split or reverse split; and (3) a rights or other subscription offering. Under Exchange Act Rule 10b-17, the issuer is required to provide this information to the NASD no later than 10 days prior to the record date or, in case of a rights subscription or other offering if such 10 days advance notice is not practical, on or before the record date.¹⁸

For both Nasdaq-listed and OTCBB securities, Nasdaq publishes the record date of the action and the ex-date in its “Daily List” on the Nasdaq Websites. This provides information to broker-dealers, clearing agencies, and the public regarding the record date and settlement of such trades. For Nasdaq-listed securities, if an issuer does not provide the information in a timely manner, Nasdaq may request the Rule 10b-17 information from the issuer and halt trading pending receipt of such information.¹⁹ Nasdaq may then issue a Uniform Practice Code (“UPC”) notice informing members of the status of the record date and underlying event in order to clarify any confusion in the marketplace regarding the pricing or settlement of these trades.

While OTCBB issuers are also required to give the NASD information proscribed by Exchange Act Rule 10b-17 in a timely manner, Nasdaq does not currently have authority to institute trading halts in an OTCBB security when such information has not been timely provided. In the past, OTCBB issuers have failed to provide the NASD with the information required by Exchange Act Rule 10b-17,

¹⁷ See 17 CFR 240.10b-17.

¹⁸ Id.

such as a stock split or the payment of a cash dividend, which has caused confusion in the marketplace because the information has been disseminated unevenly. When this has occurred, some market participants had become aware of the information (which impacts the pricing of the security) and had adjusted their quotes and/or trading activity accordingly. Others, however, had been unaware of this information and did not adjust their quotes and/or trading activity, thus resulting in anomalous pricing. In these situations, unlike Nasdaq-listed stocks, Nasdaq was not able to halt trading, gather information and issue a clarifying UPC notice. Rather, trading continued despite the uneven distribution of information or the distribution of misinformation, while Nasdaq staff attempted to gather information to clarify the situation. To minimize the potential for disorderly markets and investor confusion, the NASD and Nasdaq are proposing to halt trading and quotations in an OTCBB security when the issuer fails to give the NASD notice of the information specified in Exchange Act Rule 10b-17.

Finally, the NASD and Nasdaq are proposing to amend the Plan Of Allocation And Delegation Of Functions By NASD To Subsidiaries to clarify that the Stockwatch section of Nasdaq would have authority to effectuate OTCBB halts.

2. Statutory Basis

The NASD and Nasdaq believe that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²⁰ which requires, among other things, that the Association's rules must

¹⁹ See NASD Rule 4210(a)(5).

²⁰ 15 U.S.C. 78o-3(b)(6).

be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. In addition, the NASD and Nasdaq believe that the proposal is consistent with the provisions of Section 15A(b)(11) of the Act.²¹ Section 15A(b)(11) of the Act requires that the rules of a registered national securities association be designed to produce fair and informative quotations, prevent fictitious or misleading quotations and to promote orderly procedures for collecting, distributing, and publishing quotations. As noted above, because the proposed rule change will expand Nasdaq's authority to initiate trading halts in OTCBB issues based on regulatory halts imposed by other markets or regulatory authorities, the proposed rule will prevent fraudulent practices and protect investors. Moreover, the proposal will authorize Nasdaq to halt trading when there is a failure to timely provide the NASD with information mandated by Exchange Act Rule 10b-17, which if not timely and evenly disseminated could have a dramatic impact on the pricing and trading of OTCBB issues. Thus, the proposal is designed to protect investors and to produce fair and informative quotations, prevent fictitious or misleading quotations and to promote orderly procedures for collecting, distributing, and publishing quotations.

B. Self-Regulatory Organization's Statement on Burden on Competition

The NASD and Nasdaq do not believe that the proposed rule change will impose any inappropriate burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

²¹ 15 U.S.C. 78o-3(b)(11).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD.

All submissions should refer to File No. SR-NASD-99-33 and should be submitted by [insert date 21 days from date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²²

Jonathan G. Katz
Secretary

Action as set forth or recommended herein
APPROVED pursuant to authority delegated by
the Commission under Public Law 87-592.

For: Division of Market Regulation

By: _____

Date: _____

²² 17 CFR 200.30-3(a)(12).

SEC NEWS DIGEST
SELF-REGULATORY ORGANIZATIONS

NOTICE OF PROPOSED RULE CHANGE BY THE NATIONAL ASSOCIATION OF
SECURITIES DEALERS, INC. RELATING TO THE ESTABLISHMENT OF TRADE AND
QUOTE HALT AUTHORITY FOR THE NASD'S OTCBB SERVICE

The National Association of Securities Dealers, Inc. ("NASD") has filed a proposed rule change (SR-NASD-99-33) under Rule 19b-4 of the Exchange Act relating to the establishment of trade and quote halt authority for the NASD's OTCBB service.

Publication of the proposal is expected to be made in the Federal Register during the week of _____, 2000. (Release No. 34-42345).

Jennifer Colihan
942-0735