

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59717; File No. SR-FINRA-2009-021)

April 7, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Codify the Extended Hours Trading Risk Disclosure Obligation as New FINRA Rule 2265

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 27, 2009, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II [sic], which Items have been prepared by FINRA. FINRA has designated the proposed rule change as “constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule” under Section 19(b)(3)(A)(i) of the Act³ and Rule 19b-4(f)(1) thereunder,⁴ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

FINRA is proposing to adopt new FINRA Rule 2265 (Extended Hours Trading Risk Disclosure) to codify the existing obligation to disclose to customers the risks of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(i).

⁴ 17 CFR 240.19b-4(f)(1).

extended hours trading. The text of the proposed rule change is available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

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

In its filing with the Commission, FINRA 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. FINRA 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

On January 10, 2000, FINRA, then NASD, filed with the SEC a Notice to Members reminding members of their obligation under just and equitable principles of trade⁵ and the advertising rule⁶ to disclose to all customers the material risks of extended hours trading (i.e., trading outside regular trading hours of 9:30 a.m. to 4:00 p.m. Eastern Standard Time).⁷ In its filing with the Commission, FINRA noted that, while the growth of extended hours trading provides customers with greater opportunities to trade

⁵ Rule 2010 (Standards of Commercial Honor and Principles of Trade).

⁶ NASD Rule 2210 (Communications with the Public).

⁷ See Securities Exchange Act Release No. 42363 (January 28, 2000), 65 FR 5715 (February 4, 2000) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to a Notice to Members on Extended Hours Trading) (SR-NASD 00-01) ("NTM 00-07").

securities and manage their portfolios, it also involves material risks that are specific to extended hours trading.

NTM 00-07 provided a model extended hours risk disclosure statement for retail and institutional customers that addressed 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. This disclosure statement defined certain essential terminology (e.g., “liquidity,” “volatility,” and “spread”) and explained the risks that are present during extended hours trading, specifically:

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

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.

In addition, FINRA notes that certain regulatory protections are not in effect after the end of “regular trading hours” on any trading day. For example, the SEC’s Regulation NMS’s “trade-through” rules do not apply to executions after 4:00 p.m. EST.⁸

FINRA is proposing to transfer this existing disclosure obligation into new FINRA Rule 2265 (Extended Hours Trading Risk Disclosure) for administrative and ease of reference purposes. As is currently the case, members would retain a measure of flexibility in the wording of the risk disclosure (so long as, at a minimum, the above six areas are addressed). In addition to the above specific disclosures, members must include any additional disclosures as are relevant and appropriate to the member’s business consistent with their obligations under just and equitable principles of trade.

As noted in Item 2 of this filing, FINRA has filed the proposed rule change for immediate effectiveness. The effective date and the implementation date will be the date of filing, March 27, 2009.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of

⁸ A trade-through occurs when one trading center executes an order at a price that is inferior to the price of a protected quotation. See 17 CFR 242.600(77).

Section 15A(b)(6) of the Act,⁹ 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, and, in general, to protect investors and the public interest.

FINRA continues to believe that members that permit customers to engage in extended hours trading have an obligation to disclose to such customers the risks specific to extended hours trading. Similarly, members that advertise the opportunities and benefits of extended hours trading must also disclose the material risks. FINRA believes that this disclosure requirement is an important element in protecting investors and informing investors of the risks specific to extended hours trading.

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

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁰ and paragraph (f)(1) of Rule 19b-4 thereunder.¹¹ At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such

⁹ 15 U.S.C. 78o-3(b)(6).

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(x).

rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2009-021 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2009-021. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-021 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹²

Florence E. Harmon
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).