

not listed and registered on that exchange, *i.e.* by extending UTP to the security.<sup>7</sup> Prior to the UTP Act, Section 12(f) required exchanges to apply to the Commission before extending UTP to a security, and required the Commission to provide notice of each application for comment and opportunity for a hearing. The Commission also was required to review each application, and if the application met certain standards, the Commission issued an order approving the exchange's request to trade the security pursuant to its grant of UTP.<sup>8</sup> These requirements caused significant delays before exchanges could begin UTP trading in securities already traded on the listing exchange, even though over-the-counter ("OTC") dealers were not subject to UTP limitations.<sup>9</sup> The delay in trading, resulting from the previous application procedures, was especially criticized by competing exchanges because, while the Commission published for comment hundreds of exchange applications for the extension of UTP each year, comments on the applications were extremely rare. Indeed, virtually no comments had been submitted to the Commission on a UTP application in over ten years.

In response to the Concept Release that initiated the Market 2000 Study,<sup>10</sup> resulting in the Division of Market Regulation's ("Division") report, Market

<sup>7</sup>When an exchange "extends UTP" to a security, the exchange allows its members to trade the security as if it were listed on the exchange. For discussions of the history of UTP in U.S. markets and Section 12(f) of the Exchange Act, see, *e.g.*, Stephen L. Parker & Brandon Becker, *Unlisted Trading Privileges*, 14 Rev. Sec. Reg. 853 (1981); and Walter Werner, *Adventure in Social Control of Finance: The National Market System for Securities*, 75 Colum. L. Rev. 1233 (1975).

<sup>8</sup>Section 12(f) required the Commission to review each UTP application to ensure the maintenance of fair and orderly markets and the protection of investors with respect to the extension of UTP to the securities named in the application. Pursuant to this standard of review, the staff identified, over time, certain areas of particular concern as they related to UTP. Accordingly, these areas included ensuring that the applicant exchange had proper trading rules in place to provide a fair and orderly market in each security named and had sufficient standards for regulatory oversight of each security to provide for the protection of investors. While Commission review of the applications led to occasional discoveries of material deficiencies and errors in the applications, the overwhelming majority of applications raised no substantive issues.

<sup>9</sup>As a technical matter, Section 12(a) limits the trading of securities on an exchange to those securities that are listed and registered on that exchange. Section 12(f), both prior to and following this amendment, makes an exemption from this requirement for securities traded pursuant to UTP. OTC dealers are not subject to the Section 12(a) listing requirement because they do not transact business on an exchange.

<sup>10</sup>See Securities Exchange Act Release No. 30920 (July 14, 1992), 57 FR 32587 ("Concept Release").

2000: An Examination of Current Equity Market Developments, some commenters noted that the regulatory process for UTP could be a potential area for reform.<sup>11</sup> After publication of the Concept Release, on June 22, 1994, the Telecommunications and Finance Subcommittee of the House Committee on Energy and Commerce ("Subcommittee") held a hearing on the UTP Act, ultimately adopted on October 22, 1994.<sup>12</sup>

The UTP Act, among other matters, removed the application, notice, and Commission approval process from Section 12(f) of the Exchange Act, except in cases of Commission suspension of UTP in a particular security on an exchange. Thus, the UTP Act generally allows an exchange to extend UTP to any security when it becomes listed and registered on another exchange or included in Nasdaq, subject to certain limitations.<sup>13</sup>

Specifically, the UTP Act grants exchanges the authority to trade any security via UTP immediately upon listing on another exchange, provided that the security is not a listed IPO security, as defined in the UTP Act.<sup>14</sup>

<sup>11</sup>See letter from William G. Morton, Jr., Boston Stock Exchange; John L. Fletcher, Midwest (currently Chicago) Stock Exchange; Leopold Korins, Pacific Stock Exchange; and Nicholas A. Giordano, Philadelphia Stock Exchange, to Jonathan G. Katz, Secretary, Commission, dated December 11, 1992. See also, Division of Market Regulation, Securities and Exchange Commission, *Market 2000: An Examination of Current Equity Market Developments* (January 1994).

<sup>12</sup>A representative of the Division and representatives of several self-regulatory organizations testified at this hearing. The Unlisted Trading Privileges Act of 1994 and Review of the SEC's Market 2000 Study: Hearing Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. (1994) ("UTP Hearing").

<sup>13</sup>Section 12(f)(1)(E) prohibits extension of unlisted trading privileges in securities that are registered under Section 12(g) of the Exchange Act (generally, "OTC securities"), except pursuant to a rule, regulation or order of the Commission approving such extension or extensions. The Commission's order approving the on-going pilot program, including all limitations and conditions therein, is deemed such an order. See Securities Exchange Act Release No. 34371 (July 13, 1994), 59 FR 37103. Pursuant to Section 12(f)(1)(E), the Commission will consider issues involved in extensions of UTP to OTC securities as the Commission continues its on-going review of the operation of the pilot program.

<sup>14</sup>Section 12(f)(1)(B), read jointly with Section 12(f)(1)(A)(i), as amended, provides this exception for listed IPO securities. In defining securities that fall within the exception, new subparagraphs 12(f)(1)(G)(i) and (ii) provide:

(i) a security is the subject of an initial public offering if—

(I) the offering of the subject security is registered under the Securities Act of 1933; and

(II) the issuer of the security, immediately prior to filing the registration statement with respect to the offering, was not subject to the reporting requirements of section 13 or 15(d) of this title; and

For listed IPO securities, the UTP Act contains a temporary provision that requires exchanges to wait, before trading any listed IPO security, until the third day of trading in the security on the listing exchange. This provision also requires the Commission to prescribe by rule or regulation, within 180 days of the enactment of the UTP Act, the mandatory delay (or, "duration of the interval"), if any, that should apply to UTP extensions to listed IPO securities.<sup>15</sup>

The UTP Act also provides the Commission with rulemaking authority to prescribe additional procedures or requirements for exchange extensions of UTP to any security, and allows the Commission summarily to suspend UTP in a security at any time within 60 days of the commencement of trading on the relevant exchange pursuant to UTP. Upon suspension, the exchange must cease trading pursuant to UTP in the security. An exchange seeking to reinstate UTP in the security, following a Commission suspension, must file an application with the Commission pursuant to procedures that the Commission may prescribe by rule or order for the maintenance of fair and orderly markets, the protection of investors and the public interest, or otherwise in furtherance of the purposes of the Exchange Act. Public notice by the Commission of an exchange application to reinstate suspended UTP, and Commission review of the application, are also required. The amended Section 12(f) notice, review, and Commission approval provisions are substantially similar to the requirements that previously applied to an exchange's initial extension of UTP to a security under former Section 12(f).<sup>16</sup>

### III. Extensions of UTP to Listed Securities That Are the Subject of an Initial Public Offering

#### A. Proposed Rule 12f-2

Proposed Rule 12f-2 would have allowed exchanges to extend UTP to a listed IPO security when at least one transaction in the security had been effected on the listing exchange and the

(ii) an initial public offering of such security commences at the opening of trading on the day on which such security commences trading on the national securities exchange with which such security is registered.

15 U.S.C. 78l(f)(1)(G).

15 U.S.C. 78l(f)(1)(C). The UTP Act temporary two-day delay provision for UTP in listed IPOs expires on the earlier of the effective date of a Commission rule prescribing the appropriate interval of delay, if any, or 240 days following the enactment of the UTP Act.

16 See Section 12(f)(2), as amended, 15 U.S.C. 78l(f)(2).