



The information content of trading halts

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Abstract

We investigate the impact of trading halts of NYSE-listed stocks on informationally related securities that continue to trade during the period of the halt. Informational relationships are established for companies in the same four-digit SIC industry based on the correlation of returns, volume, volatility, and the adverse selection components of spreads. We find a significant liquidity impact on informationally related securities with spreads and price impact of trades having substantial increases. However, we also find that quoted depths, the number of trades, and trade volume significantly increase. Our results are consistent with the trading halt model of Spiegel and Subrahmanyam [2000. Asymmetric information and news disclosure rules. *Journal of Financial Intermediation* 9, 363–403] and with the informed trading model of Tookes [2008. Information, trading, and product market interactions: cross-sectional implications of informed trading. *Journal of Finance* 63, 379–413]. In addition, our results indicate that there is a common liquidity response of informationally related securities to firm-specific trading halts.

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0. Introduction

Under Rule 123D of the NYSE, the specialist, with the approval of a NYSE floor official, can suspend trading or delay the opening of a stock, to give investors time to assess new firm-specific information. These trading halts result from a variety of causes including order imbalances, news dissemination, or pending news relating to a specific company.³ However, recent theoretical and empirical studies indicate that firm-specific trading halts have a market impact beyond that of the halted stock. Spiegel and Subrahmanyam (2000) (hereafter, SS) present a model based on information asymmetry that shows trading halts are a necessary component of markets. In their model, trading halts act as a signal that substantial information asymmetry exists for stocks that are related to the halted stock, such as stocks in the same industry.

Tookes (2008) develops a model based on Easley et al. (1998) in which industry effects on market microstructure measures are specifically considered. Restricting her analysis to a Cournot duopoly, she demonstrates that firm-specific news at the product market level impacts other related firms' trading. To illustrate how this might work for trading halts, assume that a company intends to announce FDA approval for a new drug that competes with drugs of several other firms. The company informs the exchange of its pending news announcement and trading is halted in the stock. As Tookes points out, insider trading laws limit any informed trading by principles of the announcing company in its own stock, but these laws have limited restrictions to trading in the stock of competitors. A trading halt is identical to the application of insider trading laws with perfect monitoring. Insiders are unable to trade in their own company's stock due to the halt and must seek other venues to obtain rents from their insider information. Under the SS model, the trading halt acts as an information asymmetry signal, implying a broad reduction in liquidity for informationally related securities. However, under the Tookes model, an informational event in one stock in an industry can instigate informed and insider trading in related stocks in that industry, implying an increase in trading. In this study, we investigate the information content of firm-specific trading halts on informationally related securities in the same industry.

To our knowledge, our paper is the first to focus on informationally related securities that continue to trade during the halt period. However, there is a related body of research dealing with trading halts. Madhavan (1992) shows that firm-specific trading halts are a natural response to excessive asymmetric information. Utilizing a Walrasian framework, Bhattacharya and Spiegel (1991) also demonstrate that trading halts arise when the degree of information asymmetry outweighs other motivations of trading. Edelen and Gervals (2003) propose a model that uses firm-specific trading halts as a method to limit specialist power. Empirically, Lee et al. (1994b) investigate the impact of trading halts on the trading characteristics of the halted stock after the halt is lifted. Christie et al. (2002) examine trading halts on the NASDAQ market and find that volatility, spreads, and volume increase after a halt. Corwin and Lipson (2000) explore the impact of intraday trading halts on the limit order book of the halted stock. More recently, Chakrabarty et al. (2007) evaluate informational content on the limited number of off-NYSE trades of the halted

³Under NYSE rule 80B, given specified market conditions, circuit breakers are activated and trading is suspended for the entire market. We do not investigate this type of trading halt.

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