

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62533; File No. SR-FINRA-2010-028)

July 20, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, to Adopt NASD Rule 3210 (Short Sale Delivery Requirements) as FINRA Rule 4320 in the Consolidated FINRA Rulebook

On May 21, 2010, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt NASD Rule 3210 as FINRA Rule 4320 in the consolidated FINRA rulebook. On June 11, 2010, FINRA filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on June 17, 2010.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposed rule change, as modified by Amendment No. 1.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 was a partial amendment that made minor clarifications, provided additional detail and made technical edits to the purpose section of the proposed rule change.

<sup>4</sup> See Securities Exchange Act Release No. 62288 (Jun. 11, 2010), 75 FR 34496 (Jun. 17, 2010).

I. Description of the Proposed Rule Change

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),<sup>5</sup> FINRA has proposed to adopt NASD Rule 3210 (Short Sale Delivery Requirements), with minor changes, as FINRA Rule 4320 in the Consolidated FINRA Rulebook.

On April 4, 2006, the SEC approved NASD Rule 3210, which applies short sale delivery requirements to those equity securities not otherwise covered by the close-out requirements of Regulation SHO. The Regulation SHO close-out requirements apply only to the equity securities of “reporting” issuers (i.e., issuers that are registered pursuant to Section 12 of the Act<sup>6</sup> or that are required to file reports pursuant to Section 15(d) of the Act<sup>7</sup>).

NASD Rule 3210, among other things, requires participants of registered clearing agencies to take action on failures to deliver that exist for 13 consecutive settlement days in certain non-reporting securities. In addition, if the fail to deliver position is not closed out in the requisite time period, a participant of a registered clearing agency or any broker-dealer for which it clears transactions is prohibited from effecting further short

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<sup>5</sup> FINRA stated that the current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). FINRA also stated that FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

<sup>6</sup> 15 U.S.C. 78j.

<sup>7</sup> 15 U.S.C. 78q(d).

sales in the particular specified security without borrowing, or entering into a bona fide arrangement to borrow, the security until the fail to deliver position is closed out.

Pursuant to NASD Rule 3210, FINRA publishes a daily “Threshold Security List.”<sup>8</sup> The rule became effective on July 3, 2006. In adopting NASD Rule 3210, FINRA believed that the rule represented an important step in reducing long-term fails to deliver in this sector of the marketplace.

In July 2009, the SEC adopted the substance of temporary Rule 204T<sup>9</sup> under Regulation SHO as a permanent rule, Rule 204 of Regulation SHO.<sup>10</sup> This rule is intended to further the goal of reducing fails to deliver and addressing potentially abusive “naked” short selling in all equity securities by requiring that, subject to certain limited exceptions, if a registered clearing agency participant has a fail to deliver position resulting from a short sale at a registered clearing agency it must immediately purchase or borrow securities to close out a fail to deliver position by no later than the beginning of regular trading hours on the settlement day following settlement date.<sup>11</sup>

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<sup>8</sup> FINRA stated that, for purposes of Rule 3210, a non-reporting threshold security is any equity security that is not a reporting security and, for five consecutive settlement days, has: (1) aggregate fails to deliver at a registered clearing agency of 10,000 shares or more; and (2) a reported last sale during normal market hours (9:30 a.m. to 4:00 p.m., Eastern Time (ET)) for the security on that settlement day that would value the aggregate fail to deliver position at \$50,000 or more.

<sup>9</sup> See Securities Exchange Act Release No. 58785 (Oct. 14, 2008), 73 FR 61678 (Oct. 17, 2008).

<sup>10</sup> See Securities Exchange Act Release No. 60388 (July 27, 2009), 74 FR 38266 (July 31, 2009).

<sup>11</sup> Rule 204 of Regulation SHO further provides that fails to deliver resulting from long sales or certain bona fide market making activity must be closed out by no later than the beginning of regular trading hours on the third settlement day after settlement date (i.e., T+6).

Notwithstanding the SEC's adoption of this new rule, FINRA believes proposed FINRA Rule 4320 continues to be necessary to provide regulatory coverage for fails to deliver in non-reporting over-the-counter equity securities that pre-exist the SEC's implementation of temporary Rule 204T in September 2008.<sup>12</sup>

Therefore, FINRA has proposed to adopt NASD Rule 3210 as FINRA Rule 4320 with minor changes to delete language that provided allowances for "grandfathered" securities during the initial implementation period of NASD Rule 3210 and that, therefore, is no longer relevant. The proposed rule change also clarifies, consistent with Regulation SHO, the borrowing requirements for clearing agency participants, including broker-dealers for which they clear transactions, that sell short non-reporting threshold securities for which a fail to deliver position has not been closed out in the requisite time. Specifically, if a fail to deliver position is not closed out in accordance with Rule 4320(a), the clearing agency participant and any broker-dealer for which it clears, including market makers otherwise entitled to rely on the Rule 203(b)(2)(iii) exception of Regulation SHO, would not be able to short sell the non-reporting threshold security either for itself or for the account of another, unless it has previously arranged to borrow or borrowed the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency. In addition, the proposed rule change makes certain technical amendments to the rule, including changing references to "NASD" to "FINRA."

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<sup>12</sup> Likewise, the SEC is retaining Rule 203(b)(3) of Regulation SHO in order to cover pre-existing temporary Rule 204T fails in threshold securities as defined in Rule 203(c)(6) of Regulation SHO.

FINRA has represented that it will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no more than 180 days following Commission approval.

### III. Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.<sup>13</sup> In particular, the Commission believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission believes that the proposed rule change to adopt NASD Rule 3210 as FINRA Rule 4320 in the Consolidated FINRA Rulebook continues to be necessary to provide regulatory coverage for fails to deliver in non-reporting over-the-counter equity securities and will continue to help reduce long-term fails to deliver in this sector of the marketplace.

### III. Conclusion

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<sup>13</sup> In approving the 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).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (File No. SR-FINRA-2010-028), as modified by Amendment No. 1, be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR 200.30-3(a)(12).