

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52131; File No. SR-NASD-2005-093)

Self-Regulatory Organizations; National Association of Securities Dealers, Inc; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amendments to NASD Rule 3370

July 27, 2005

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> notice is hereby given that on July 20, 2005, the 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 below, which Items have been prepared by NASD. NASD has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by 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**

NASD is proposing to amend Rule 3370 to clarify that members must make certain affirmative determinations when effecting long sales and document compliance with those affirmative determination requirements. Below is the text of the proposed rule change.

Proposed new language is in italics; proposed deletions are in brackets.

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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> 17 CFR 240.19b-4.

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**3370. [Purchases] Prompt Receipt and Delivery of Securities**

**(a) Purchases**

No member or person associated with a member may accept a customer's purchase order for any security unless it has first ascertained that the customer placing the order or its agent agrees to receive securities against payment in an amount equal to any execution, even though such an execution may represent the purchase of only a part of a larger order.

**(b) Long Sales**

No member or person associated with a member shall accept a long sale order from any customer in any equity security unless the order meets the requirements applicable to long sales set forth in Regulation SHO. To the extent a member or person associated with a member does not have physical possession or control of the securities, the member or person associated with a member must document, at the time the order is taken, the communication with the customer as to the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the member by settlement date. For purposes of this rule, the term "customer" includes a non-member broker-dealer.

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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, NASD 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. NASD 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 June 23, 2004, the SEC adopted certain provisions of a new short sale regulation, designated Regulation SHO.<sup>4</sup> Regulation SHO consists of, among other provisions, SEC Rule 200(g), requirements for marking sell order of equity securities, and SEC Rule 203(a), delivery requirements for long sales.<sup>5</sup> Specifically, SEC Rule 200(g) of Regulation SHO requires that sell orders in all equity securities be marked either “long,” “short,” or “short exempt.” Pursuant to SEC Rule 200(g), an order can be marked “long” only when the seller owns the security being sold and the security either is in the physical possession or control of the broker-dealer or it is reasonably expected that the security will be in the physical possession or control of the broker-dealer no later than settlement. Subject to certain exceptions, SEC Rule 203(a) requires that a broker-dealer selling an equity security marked long will be able to deliver the security on settlement date without borrowing the security. Regulation SHO’s long sale delivery requirements, together with the long sale order marking requirements, require broker-dealers, prior to executing the order, to confirm the customer’s ownership of the security and its ability to deliver the security by settlement date.

As noted in the adopting release for Regulation SHO, the SEC has indicated its expectation that self-regulatory organization (“SRO”) rules that overlapped with the

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<sup>4</sup> See Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004).

<sup>5</sup> The compliance date for SEC Rule 200(g) and SEC Rule 203(a) was January 3, 2005.

provisions of Regulation SHO would be repealed. Accordingly, NASD repealed, among other rules, NASD Rule 3370(b) that, in part, required members to undertake the following obligations in connection with a long sale: (1) to make an affirmative determination as to the location of the securities, (2) to determine whether the securities are in deliverable form and in fact can be delivered within 3 business days; and (3) to document such information in writing (collectively, the “affirmative determination requirements”). NASD staff has received inquiries as to whether the affirmative determination requirements continue to apply, given that these requirements are not explicitly provided in Regulation SHO.

As a result, NASD is proposing to amend Rule 3370 to re-adopt expressly the affirmative determination requirements as they now relate to member obligations with respect to long sales under Regulation SHO.<sup>6</sup> NASD believes that this proposed amendment will clarify a member’s obligations in connection with sale transactions that are marked long. Specifically, the member must comply with the requirements applicable to long sales in Regulation SHO and, to the extent the member or person associated with the member does not have physical possession or control of the securities, make and document, at the time the order is taken, an affirmative determination as to the location of the security, that they are in good deliverable form, and the customer’s ability to deliver such securities on settlement date. As with Regulation SHO, absent countervailing circumstances, it may not be reasonable to rely on the representation of a customer that an order is “long” if the customer has had prior failures to deliver in a security.

NASD proposes to make the proposed rule change operative on the date of filing.

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<sup>6</sup> Note: The deletion of the affirmative determination requirements in connection with the adoption of Regulation SHO was unintentional.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)<sup>7</sup> of the Act, which requires, among other things, that NASD rules must 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. NASD believes that the proposed rule change will more clearly state a member's obligations in connection with sale transactions that are marked long, and is consistent with the Act.

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

NASD 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, as amended.

**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 proposed rule change is filed pursuant to paragraph (A) of Section 19(b)(3)<sup>8</sup> and Rule 19b-4(f)(6).<sup>9</sup> Because the foregoing proposed rule change does not:

(i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date

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<sup>7</sup> 15 U.S.C. 78o-3(b)(6).

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</sup> 17 CFR 240.19b-4(f)(6).

on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to the thirty days after the date of filing. However, pursuant to Rule 19b-4(f)(6)(iii), the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. NASD has requested that the Commission waive the thirty day operative delay requirement to re-adopt expressly the affirmative determination requirements as they now relate to member obligations with respect to long sales under Regulation SHO.

The Commission, consistent with the protection of investors and the public interest, has determined to make the proposed rule change effective as of the date of this order.<sup>10</sup> The Commission notes that the affirmative determination requirements with respect to member long sales were unintentionally deleted when NASD repealed rules that overlapped with the provisions of Regulation SHO.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such 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.

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<sup>10</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

#### **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](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-093 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-093. 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 20549-9303. Copies of such filing also will be available for inspection and copying at the principal office of NASD.

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 the File Number SR-NASD-2005-093 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>11</sup> 17 CFR 200.30-3(a)(12).