



January 20, 2006

Ms. Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

**Re: Response to Comments to File No. SR-NASD-2005-112 – Proposal to Amend NASD Rule 3360 to Expand the Short Interest Reporting Requirements to OTC Equity Securities**

Dear Ms. Morris:

On September 20, 2005, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) proposed rule change SR-NASD-2005-112, proposing to amend NASD Rule 3360 to expand the short interest reporting requirements to over-the-counter (“OTC”) equity securities.<sup>1</sup> On November 3, 2005, the Commission published for comment the proposed rule change in the Federal Register.<sup>2</sup> The Commission received six comment letters in response to the Federal Register publication of SR-NASD-2005-112.<sup>3</sup> NASD is hereby responding to the comments made therein.

The commenters generally support the proposal, with some urging prompt implementation of the proposal, but argue for additional changes to the current short interest reporting requirements or other changes that are outside the scope of this proposed rule change. For example, some commenters question the exceptions to the

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<sup>1</sup> The term “OTC equity securities” herein refers to equity securities that are neither included in the Nasdaq Stock Market nor traded on any national securities exchange.

<sup>2</sup> See Exchange Act Release No. 52679 (October 26, 2005), 70 FR 66875 (November 3, 2005).

<sup>3</sup> Comments were submitted by the following: Donald L. Smith, Jim DeCosta, Paul Vuksich, David Patch, Daniel Opdyke and Chris Meredith. The SEC also received correspondence from Greg Hogberg, however, this correspondence reflects the same comment letter from Jim DeCosta. Andrea Orr, Assistant General Counsel, NASD, also received email correspondence from William Minshall regarding the proposed rule change. In this email correspondence, Mr. Minshall contends that, in addition to short sale positions, reporting requirements for fail to deliver positions be reported to NASD. NASD notes that reporting requirements for fails to deliver positions are not germane to this proposal.

current short interest reporting requirements. Specifically, Rule 3360 provides that short positions required to be reported under the rule are those resulting from short sales as the term is defined in Rule 200 of Regulation SHO, subject to certain exceptions contained in subsections (e)(1),<sup>4</sup> (6),<sup>5</sup> (7),<sup>6</sup> (8)<sup>7</sup> and (10)<sup>8</sup> of Rule 10a-1 of the Securities Exchange Act of 1934.<sup>9</sup> Commenters recommend that the current exceptions be eliminated and all short interest positions be reported and publicly disseminated.

One commenter proposes amendments to Rule 3360 that would require issuers to cause their transfer agents to report long and short interest positions to NASD at the close of each trading day. Further, this commenter's recommendation would also require transfer agents on behalf of issuers to report certain share information, such as authorized shares, total shares outstanding, and shares held in street name.

Other commenters assert that further action in the short selling area is necessary, in particular to address naked short selling abuses and certain perceived loopholes in Regulation SHO. Some commenters raise issues with certain provisions of Regulation SHO, including without limitation, the bona-fide market maker exception and the exception to the close-out requirements for open fail positions in securities that existed prior to the effective date of Regulation SHO. Another commenter raises concerns

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<sup>4</sup> Subsection (e)(1) of Rule 10a-1 permits short sales to be effected without regard to the SEC's short sale price test restrictions contained in Rule 10a-1 (commonly referred to as the "tick test") if the seller owns the security sold and intends to deliver such security as soon as is possible without undue inconvenience or expense. See 17 CFR 240.10a-1(e)(1).

<sup>5</sup> Subsection (e)(6) of Rule 10a-1 contains an exception for certain sales of a security effected with the approval of an exchange which are necessary to equalize the price of such security with the current price of such security on another national securities exchange, which is the principal exchange market. See 17 CFR 240.10a-1(e)(6).

<sup>6</sup> Rule 10a-1(e)(7) contains an exception for certain bona fide domestic arbitrage transactions. See 17 CFR 240.10a-1(e)(7).

<sup>7</sup> Subsection (e)(8) of Rule 10a-1 contains an exception for certain international domestic arbitrage transactions. See 17 CFR 240.10a-1(e)(8).

<sup>8</sup> Subsection (e)(10) of Rule 10a-1 generally excepts from the tick test sales of securities by underwriters or syndicate members participating in a distribution in connection with an over-allotment, and any lay-off sales by such a person in connection with a distribution of securities through rights or a standby underwriting commitment. See 17 CFR 240.10a-1(e)(10).

<sup>9</sup> Rule 10a-1 governs short sales in exchange registered securities. Subsection (e) of Rule 10a-1 contains certain exceptions to the tick test. The exceptions in Rule 10a-1(e) were designed to permit certain types of trading activities that were intended to benefit the markets or that were believed to carry little risk of the kind of manipulative or destabilizing trading that the rule was designed to address. See Securities Exchange Act Release No. 48709 (October 28, 2003), 68 FR 62972 (November 6, 2003).

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regarding hedge fund regulation, the continuous net settlement system, and Depository Trust & Clearing Company and its stock loan program.

The proposed rule change is limited to expanding the current short interest reporting requirements to OTC equity securities. Because the changes recommended by these commenters are not germane to this proposal, beyond the purview of NASD, or relate to amendments to another self-regulatory organization's rules or SEC rules, NASD is not responding to those recommendations specifically herein. As applicable, NASD will review and analyze these recommendations in the same manner in which it would consider any requests for rulemaking, and, based on such review and analysis, will

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NASD believes that the foregoing responds to the material issues raised by commenters to this rule filing. If you have any questions, please contact me at (202) 728-8156; email: andrea.orr@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

A handwritten signature in black ink, appearing to read "Andrea D. Orr", with a stylized flourish at the end.

Andrea D. Orr  
Assistant General Counsel

cc: Victoria Crane (SEC)