

Notice to Members

MAY 2004

SUGGESTED ROUTING

Executive Representatives
Operations
Trading

KEY TOPICS

ACT Reporting Requirements
IM-6130
Rule 3350
Rule 6130
Short Sale Reporting Requirements

GUIDANCE

Short Sale Reporting Requirements

NASD Clarifies ACT Short Sale Reporting Requirements

Executive Summary

On May 20, 2004, NASD, through its subsidiary, The Nasdaq Stock Market, Inc. (NASDAQ), filed for immediate effectiveness with the Securities and Exchange Commission (SEC) proposed interpretive material to Rule 6130 clarifying that, as currently required by the text of Rule 6130 (Trade Report Input), a "short sale" or "short sale exempt" indicator, as applicable, is required in *all* short-sale transactions reported to the Automated Confirmation Transaction Service (ACT), including transactions in: (1) NASDAQ National Market (NNM) securities; (2) NASDAQ SmallCap Market (SmallCap) securities; (3) over-the-counter (OTC) transactions in exchange-listed securities; (4) OTC Bulletin Board; and (5) OTC equity securities.¹ New IM-6130 is set forth in Attachment A. Because of confusion that may have existed in the marketplace regarding the application of these requirements, NASD and NASDAQ are providing members additional time to re-program their systems, if necessary, to comply with the clarification. Accordingly, the operative date of these requirements is **July 26, 2004**.

Questions/Further Information

Questions concerning this *Notice* may be directed to Jeffrey S. Davis, Office of General Counsel, NASDAQ, at (202) 912-3035; the Legal Section, Market Regulation, NASD, at (240) 386-5126; or Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8071.

Background and Discussion

In 1994, the SEC approved on a temporary pilot basis NASD's short sale rule (Short Sale Rule or Rule 3350) generally prohibiting members from effecting short sales² in NNM securities at or below the inside bid when the current inside bid is below the previous inside bid.³ As part of early amendments to the Short Sale Rule, NASD also amended Rule 6130(d)(6) (previously ACT Rule (d)(4)(F)) to require that members indicate on ACT reports whether a transaction is a short sale or a short sale exempt transaction ("ACT short-sale reporting requirements").⁴

The amendments to Rule 6130(d)(6) did not limit the ACT short-sale reporting requirements to NNM securities transactions. Rather, the requirements in Rule 6130 require members to file ACT reports not just for NNM securities transactions, but for other securities transactions, including transactions in exchange-listed, SmallCap, convertible debt, OTC Bulletin Board, and OTC equity securities.

However, guidance issued on the ACT short-sale reporting requirements indicating that it applied only to NNM securities⁵ has created confusion in the marketplace regarding the types of securities that are subject to the ACT short-sale reporting requirements. To eliminate any confusion that may have existed, NASD and NASDAQ filed for immediate effectiveness with the SEC proposed interpretive material to Rule 6130 clarifying that, as required by the current text of Rule 6130, the ACT short-sale reporting requirements apply to all short-sale transactions in all securities reported to ACT, including:

- ◆ NNM securities;
- ◆ SmallCap securities;
- ◆ OTC transactions in exchange-listed securities;
- ◆ OTC Bulletin Board securities; and
- ◆ OTC equity securities.

Thus, all short-sale transactions in these securities reported to ACT must carry a "short sale" indicator (or a "short sale exempt" indicator if it is a short sale transaction in an NNM or exchange-listed security that qualifies for an exemption from the Short Sale Rule or Rule 10a-1 under the Exchange Act).⁶ Because of the potential for confusion in the marketplace relating to the application of these requirements, NASD and NASDAQ are providing members additional time to educate staff and re-program their systems, if necessary, to comply with the clarification. Accordingly, the operative date of these requirements is **July 26, 2004**.

Members also are reminded that where execution systems such as the NASDAQ Market Center trade report to ACT on behalf of the member, members remain responsible for the proper reporting of the short-sale indicator and, therefore, must ensure that applicable short-sale information is entered accurately into the execution system.

Endnotes

- 1 See File No. SR-NASD-2004-056 and Amendment No. 1 thereto.
- 2 A short sale is a sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller. To determine whether a sale is a short sale, members must adhere to the definition of a "short sale" contained in SEC Rule 3b-3, which is incorporated into NASD's short sale rule by NASD Rule 3350(k)(1).
- 3 See Securities Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994) ("Short Sale Rule Approval Order"). NASD and the Commission have subsequently extended the pilot on numerous occasions, most recently until June 15, 2004.
- 4 See Securities Exchange Act Release No. 31729 (January 13, 1993), 58 FR 5791 (January 22, 1993).
- 5 See ACT Notice 94-1 (August 22, 1994) and Nasdaq Fax #32 (April 2, 1997).
- 6 See, e.g., NASD Rule 3350(c), (h) and (i) (provisions detailing when a short sale in an NNM security is exempt from the Short Sale Rule requirements); see also *Notice to Members 94-68* (August 1994) and *Notice to Members 94-83* (October 1994) (providing guidance on, among other things, when a short sale in an NNM security qualifies for one of the Short Sale Rule exemptions).

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Attachment A

New language is underlined.

IM 6130. Trade Reporting of Short Sales

The NASD's short sale rule (Short Sale Rule or Rule 3350) generally prohibits members from effecting short sales in NNM securities at or below the inside bid when the current inside bid is below the previous inside bid. Rule 6130(d)(6) requires that members indicate on ACT reports whether a transaction is a short sale or a short sale exempt transaction ("ACT short sale reporting requirements"). Rule 6130 explicitly requires members to file ACT reports not just for NNM securities transactions, but for other securities transactions, including transactions in exchange-listed, SmallCap, convertible debt, OTC Bulletin Board, and OTC equity securities. Thus, all short sale transactions in these securities reported to ACT must carry a "short sale" indicator (or a "short sale exempt" indicator if it is a short sale transaction in an NNM or exchange-listed security that qualifies for an exemption from Rule 3350 or SEC Rule 10a-1).

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