

**INFORMATIONAL**

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**Hard To Borrow List**

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**SEC Approves Use Of Hard To Borrow List To Comply With The Affirmative Determination Requirement For Short Sales (Rule 3370)****SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Executive Representatives
- Legal & Compliance
- Operations
- Registered Representatives
- Trading & Market Making

**KEY TOPICS**

- Affirmative Determination
- NASD Rule 3370
- Short Sales

**Executive Summary**

On March 23, 2000, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rule 3370, which is designed to prevent abusive short selling and ensure that short sellers satisfy their settlement obligations.<sup>1</sup> The amendments permit the use of a "Hard to Borrow" list to comply with the affirmative determination requirement for short sales in The Nasdaq Stock Market, Inc. (Nasdaq<sup>®</sup>) National Market (NM) and exchange-listed securities. The amendments become effective on June 9, 2000.

Attachment A includes the text of the amendments to Rule 3370.

**Questions/Further Information**

Questions concerning this *Notice* may be directed to Stephanie M. Dumont, Assistant General Counsel, Office of General Counsel, NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) at (202) 728-8176; or to the Legal Section, Market Regulation Department, NASD Regulation, at (301) 590-6410.

**Background And Discussion**

NASD Rule 3370 is designed to prevent abusive short selling and ensure that short sellers satisfy their settlement obligations. The rule requires an NASD member or associated person, prior to executing certain short sales, to make an affirmative determination that it will receive delivery of the subject security, or be able to borrow or otherwise provide delivery of the security, by settlement date. The rule also requires that the member or associated person keep a written record that includes the identity of the individual and the firm contact-

ed that offered assurances that the subject security would be delivered by settlement date or be available for borrowing by settlement date.

NASD Rule 3370 currently permits members and associated persons to rely on "blanket" or standing assurances that certain, specified securities will be available for borrowing on settlement date to satisfy their affirmative determination obligations, provided that the information used to generate the "blanket" or standing assurance is less than 24 hours old and the member delivers the security on settlement date.<sup>2</sup>

"Blanket" assurances are commonly referred to as "Easy to Borrow" lists. The rule further provides that if a member relying on a blanket or standing assurance fails to deliver the security on settlement date, the NASD will deem such conduct inconsistent with the terms of the rule, absent mitigating circumstances adequately documented by the member.

A "Hard to Borrow" list includes all securities that are difficult to borrow or unavailable for borrowing. A user of a "Hard to Borrow" list may believe it is reasonable to infer, under appropriate circumstances, that a specific security absent from the list is easy to borrow. In this regard, the amendment to Rule 3370 permits members and associated persons to rely on a "Hard to Borrow" list for any short sales executed in Nasdaq NM or exchange-listed securities, provided that:

- (1) the creator of the list attests in writing that any Nasdaq NM or exchange-listed securities not included on the list are easy to borrow or are available for borrowing; and

(2) any securities restricted pursuant to Uniform Practice Code (UPC) 11830 are included on the list.<sup>3</sup>

Under the amendment, member firms will be able to refer to the “Hard to Borrow” list before executing a short sale in a given security. If that security is not on the list, the member or associated person will be considered to have made the requisite affirmative determination and will be permitted to execute the short sale without taking any further steps to satisfy the affirmative determination rule. Conversely, if the security is on the list, then a member or associated person will not be permitted to execute the short sale without taking additional steps to ensure the security’s availability.

The amendment requires that the creator of a “Hard to Borrow” list attest in writing to the availability of securities not on the list and provide such written statement for each “Hard to Borrow” list created. When the creator of a “Hard to Borrow” list attests in writing, as the amendment requires, that any securities not included on the list are available for borrowing or are easy to borrow, reliance on such “Hard to Borrow” list is substantially similar to reliance on an “Easy to Borrow” list, which is already permitted under NASD Rule 3370. It is the responsibility of the member or associated person using the list to determine that the creator of the list is reliable.

The same requirements that apply to use of “Easy to Borrow” lists also will apply to “Hard to Borrow” lists. In particular, a member or associated person will be permitted to use a “Hard to Borrow” list under the amendment only if the information used to generate the list is less than 24 hours old and the member delivers the security on settlement date. If the member does not deliver the security on settlement date, the NASD will consider such conduct—absent documented mitigating circumstances—inconsistent with the terms of NASD Rule 3370. The member or associated person relying on a “Hard to Borrow” list is obligated to maintain a written record of the determination that the security was available for borrowing, including the identity of the individual and firm that offered the assurance that securities absent from the list were available for borrowing or easy to borrow. Although the rule does not specify the manner in which firms should record and maintain such information, a copy of the “Hard to Borrow” list relied upon may be necessary to demonstrate that the requirements of Rule 3370 were met, including that the information used in generating the list was less than 24 hours old, the creator attested in writing that the securities not on the list were easy to borrow, and that any securities restricted pursuant to UPC 11830 were included on the list.

The amended rule will permit the use of “Hard to Borrow” lists only for Nasdaq NM and exchange-listed securities. For Nasdaq SmallCap and over-the-counter (OTC) equity securities, members can continue to comply with the requirements of Rule 3370 through the use of “Easy to Borrow” lists. The reason for this distinction is that Nasdaq NM and exchange-listed securities are less likely to be subject to short sale abuses than Nasdaq SmallCap and OTC equity securities, which generally are more thinly traded.

### **Effective Date Of Amendments**

The amendments are effective on June 9, 2000.

### **Endnotes**

<sup>1</sup>See Securities Exchange Act Release No. 42571 (Mar. 23, 2000), 65 FR 16993 (Mar. 30, 2000) (File No. SR-NASD-99-37).

<sup>2</sup>See Securities Exchange Act Release No. 36859 (Feb. 20, 1996), 61 FR 7127 (Feb. 26, 1996) (File No. SR-NASD-95-62), approving reliance on “blanket” assurances.

<sup>3</sup>Securities restricted pursuant to UPC 11830 are Nasdaq securities that, as published by the NASD, show an aggregate clearing short position of 10,000 shares or more and that are equal to at least 0.5% of the total shares outstanding of the issue. In practice, securities falling into this category are difficult to borrow.

## ATTACHMENT A

### Text Of Amendments

(Note: New text is underlined; deletions are bracketed.)

#### Rule 3370. Prompt Receipt and Delivery of Securities

- (a) No change
- (b) No change
  - (1) No change
  - (2) No change
  - (3) No change
  - (4) "Affirmative Determination"
    - (A) No change
    - (B) No change
    - (C) The manner by which a member or person associated with a member annotates compliance with the "affirmative determination" requirement contained in subsection (b)(2) above (e.g., marking the order

ticket, recording inquiries in a log, etc.) is not specified by this Rule and, therefore, shall be decided by each member. Members may rely on "blanket" or standing assurances (i.e., "Easy to Borrow" lists) that securities will be available for borrowing on settlement date to satisfy their affirmative determination requirements under this Rule. [.] For any short sales executed in Nasdaq National Market (NNM) or national securities exchange-listed (listed) securities, members also may rely on "Hard to Borrow" lists indicating NNM or listed securities that are difficult to borrow or unavailable for borrowing on settlement date to satisfy their affirmative determination requirements under this Rule, provided that: (i) any securities restricted pursuant to UPC 11830 must be included on such a list; and (ii) the creator of the list attests in writing on the document or otherwise that any NNM or listed securities not included on the list are easy to borrow or are available for

borrowing. Members are permitted to use Easy to Borrow or Hard to Borrow lists provided: (i) the information used to generate the list ["blanket" or standing assurance] is less than 24 hours old; and (ii) the member delivers the security on settlement date. Should a member relying on an Easy to Borrow or Hard to Borrow list [blanket or standing assurance] fail to deliver the security on settlement date, the Association shall deem such conduct inconsistent with the terms of this Rule, absent mitigating circumstances adequately documented by the member.

- (5) No change
- (b) No change.
- (c) No change.

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