

Short Sale Delivery Requirements

Amendments to NASD Rule 3210 to Conform with Amendments to the SEC's Regulation SHO Delivery Requirements

Effective Date: October 15, 2007

Executive Summary

FINRA is issuing this *Notice* to advise firms and other interested parties of changes to NASD Rule 3210 (Short Sale Delivery Requirements) to conform with amendments to the SEC's Regulation SHO delivery requirements.

Beginning on October 15, 2007, firms are required to close out within 35 consecutive settlement days any previously "grandfathered" fail-to-deliver positions in a non-reporting threshold security¹ that is on the Rule 3210 threshold list on that date. Any new fails in a non-reporting threshold security after October 15, 2007 will be subject to Rule 3210's 13 consecutive settlement day close-out requirements. There is, however, one exception; as of October 15, 2007, firms will have 35, rather than 13, consecutive settlement days to close out fails to deliver resulting from sales of non-reporting threshold securities pursuant to SEC Rule 144.

The text of NASD Rule 3210, as amended, is set forth in Attachment A of this *Notice*. The compliance date of the amendments is October 15, 2007, to coincide with the compliance date of the amendments to the Regulation SHO delivery requirements.

Questions regarding this *Notice* may be directed to the Legal Section, Market Regulation, at (240) 386-5126, or the Office of General Counsel at (202) 728-8071. For questions regarding the NASD Rule 3210 Threshold Securities List, contact FINRA Operations at (866) 776-0800.

September 2007

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Executive Representatives
- Internal Audit
- Legal
- Operations
- Senior Management
- Systems
- Trading
- Training

Key Topic(s)

- Non-Reporting Threshold Securities
- Short Sales
- Short Sale Delivery Requirements

Referenced Rules & Notices

- NASD Rule 3210
- NTM 06-28
- SEC Regulation SHO
- SEC Rule 144

Background and Discussion

On August 7, 2007, the Securities and Exchange Commission (SEC) adopted amendments to the mandatory close-out requirement in Rule 203 of Regulation SHO, which applies to reporting securities.² The amendments, among other things, eliminate the “grandfather”³ provision contained in Rule 203(b)(3)(i) of Regulation SHO and extend the close-out requirement from 13 to 35 consecutive settlement days for fails to deliver resulting from sales of threshold securities⁴ pursuant to SEC Rule 144. The compliance date of the amendments to Rule 203 of Regulation SHO is October 15, 2007.⁵

Rule 3210 applies substantially similar delivery requirements to non-reporting threshold equity securities.⁶ FINRA has applied and interpreted the Rule 3210 delivery requirements consistent with the SEC’s application and interpretation of the Regulation SHO delivery requirements. Moreover, in the adopting release relating to the amendments to Regulation SHO delivery requirements, the SEC indicated that it anticipates that Rule 3210 would be similarly amended.⁷ Therefore, to maintain consistency with the SEC’s amendments to Rule 203 of Regulation SHO, FINRA filed for immediate effectiveness a proposed rule change to make conforming amendments to Rule 3210.⁸

As amended, Rule 3210 requires that any previously grandfathered fail-to-deliver position in a non-reporting security that is on the Rule 3210 list on October 15, 2007 be closed out within 35 settlement days of that date. If the fail-to-deliver position has persisted for 35 consecutive settlement days from October 15, 2007, a clearing agency participant and any broker-dealer for which it clears transactions, including market makers, are prohibited from accepting any short-sale orders or effecting further short sales in the particular non-reporting threshold security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the participant closes out the entire fail-to-deliver position by purchasing securities of like kind and quantity.

If a security becomes a non-reporting threshold security after October 15, 2007, any fails to deliver in that security that occurred prior to the security becoming a non-reporting threshold security will be subject to Rule 3210’s mandatory 13 settlement day close-out requirement, similar to any other fail-to-deliver position in a non-reporting threshold security. These positions will no longer be “grandfathered” from the Rule 3210 delivery requirements.

Additionally, as amended, firms have 35, rather than 13, consecutive settlement days to close-out fail-to-deliver positions in SEC Rule 144 restricted securities. If the fail-to-deliver position persists for 35 consecutive settlement days in a non-reporting threshold security sold pursuant to SEC Rule 144, a participant of a registered clearing agency and any broker-dealer for which it clears transactions, including market makers, are prohibited from effecting further short sales in the particular non-reporting threshold security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the participant closes out the entire fail-to-deliver position by purchasing securities of like kind and quantity.

Consistent with the compliance date of the amendments to Rule 203 of Regulation SHO, the compliance date of the amendments to Rule 3210 is October 15, 2007.

Endnotes

- 1 The term “non-reporting threshold security” means any equity security of an issuer that is not registered pursuant to Section 12 of the Exchange Act and for which the issuer is not required to file reports pursuant to Section 15(d) of the Exchange Act 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 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. In the event there is no reported last sale on any settlement day during such five-day period, the value of the aggregate fail position would be based on the previously reported last sale.
- 2 The term “reporting security” means any equity security of an issuer that is registered under Section 12 of the Exchange Act or that is required to file reports under Section 15(d) of the Exchange Act.
- 3 The “grandfather” provision excludes from the Regulation SHO close-out requirement fail-to-deliver positions that were established prior to the security becoming a threshold security or prior to the Regulation SHO effective date. Specifically, the grandfather provision applies in two situations: (1) to fail-to-deliver positions occurring before the January 3, 2005 Regulation SHO effective date; and (2) to fail-to-deliver positions that were established on or after January 3, 2005, but prior to the security appearing on the Regulation SHO threshold securities list. *See* Securities Exchange Act Release No. 54154 (July 14, 2006), 71 FR 41710 (July 21, 2006). *See also* SEC Division of Market Regulation: Key Points About Regulation SHO, dated April 11, 2005.
- 4 The term “threshold security” means any reporting security that (1) for five consecutive settlement days had aggregate fails to deliver at a registered clearing agency of 10,000 shares or more, and the level of fails is equal to a least one-half of one percent of the issue’s total shares outstanding; and (2) is included on a list published by a self-regulatory organization.
- 5 *See* Securities Exchange Act Release No. 56212 (August 7, 2007), 72 FR 45543 (August 14, 2007).
- 6 *See* Securities Exchange Act Release No. 53596 (April 4, 2006), 71 FR 18392 (April 11, 2006) (order approving SR-NASD-2004-044). *See also* Notice to Members 06-28 (June 2006).
- 7 *See* endnote 5 at 45544, note 7.
- 8 *See* File No. SR-FINRA-2007-013.

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ATTACHMENT A

Below is the text of the rule change. New language is underlined; deletions are in brackets.

3210. Short Sale Delivery Requirements

(a) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a non-reporting threshold security for 13 consecutive settlement days, the participant shall immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity.

(1) Provided, however, a participant of a registered clearing agency that has a fail to deliver position at a registered clearing agency in a non-reporting threshold security on October 15, 2007, and which, prior to October 15, 2007, had been previously grandfathered from the close-out requirement in paragraph (a) (i.e., because the participant of a registered clearing agency had the fail to deliver position at a registered clearing agency on the settlement day preceding the day that the security became a non-reporting threshold security), shall close out that fail to deliver position within thirty-five settlement days of October 15, 2007 by purchasing securities of like kind and quantity. The requirements in paragraph (b) shall apply to all such fails to deliver that are not closed out in conformance with this paragraph (a)(1).

(2) Provided, however, if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency for thirty-five consecutive settlement days in a non-reporting threshold security that was sold pursuant to SEC Rule 144, the participant shall immediately thereafter close out the fail to deliver position in the security by purchasing securities of like kind and quantity. The requirements in paragraph (b) shall apply to all such fails to deliver that are not closed out in conformance with this paragraph (a)(2).

[(b) The provisions of this rule shall not apply to the amount of the fail to deliver position that the participant of a registered clearing agency had at a registered clearing agency on the settlement day immediately preceding the day that the security became a non-reporting threshold security; *provided, however*, that if the fail to deliver position at the clearing agency is subsequently reduced below the fail to deliver position on the settlement day immediately preceding the day that the security became a non-reporting threshold security, then the fail to deliver position excepted by this paragraph (b) shall be the lesser amount.]

(b)[(c)] If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a non-reporting threshold security for 13 consecutive settlement days (or 35 consecutive settlement days if entitled to rely on paragraphs (a)(1) or (a)(2) of this rule), the participant and any broker or dealer for which it clears transactions, including any market maker that would otherwise be entitled to rely on the exception provided in paragraph (b)(2)(iii) of SEC Rule 203 of Regulation SHO, may not accept a short sale order in the non-reporting threshold security from another person, or effect a short sale in the non-reporting threshold security for its own account, without borrowing the security or entering into a bona-fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity.

(c)[(d)] If a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer's short position, then the provisions of this rule relating to such fail to deliver position shall apply to the portion of such registered broker or dealer that was allocated the fail to deliver position, and not to the participant.

(d)[(e)] A participant of a registered clearing agency shall not be deemed to have fulfilled the requirements of this rule where the participant enters into an arrangement with another person to purchase securities as required by this rule, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase.

(e)[(f)] For the purposes of this rule, the following terms shall have the meanings below:

(1) the term "market maker" has the same meaning as in section 3(a)(38) of the Exchange Act.

(2) the term "non-reporting threshold security" means any equity security of an issuer that is not registered pursuant to section 12 of the Exchange Act and for which the issuer is not required to file reports pursuant to section 15(d) of the Exchange Act:

(A) for which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more and for which on each settlement day during the five consecutive settlement day period, the reported last sale during normal market hours for the security on that settlement day that would value the aggregate fail to deliver position at \$50,000 or more, provided that if there is no reported last sale on a particular settlement day, then the price used to value the position on such settlement day would be the previously reported last sale; and

(B) is included on a list published by NASD.

A security shall cease to be a non-reporting threshold security if the aggregate fail to deliver position at a registered clearing agency does not meet or exceed either of the threshold tests specified in paragraph ~~(e)~~[(f)](2)(A) of this rule for five consecutive settlement days.

(3) the term “participant” means a participant as defined in section 3(a)(24) of the Exchange Act, that is an NASD member.

(4) the term “registered clearing agency” means a clearing agency, as defined in section 3(a)(23)(A) of the Exchange Act, that is registered with the Commission pursuant to section 17A of the Exchange Act.

(5) the term “settlement day” means any business day on which deliveries of securities and payments of money may be made through the facilities of a registered clearing agency.

~~(f)~~[(g)] Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may grant an exemption from the provisions of this rule, either unconditionally or on specified terms and conditions, to any transaction or class of transactions, or to any security or class of securities, or to any person or class of persons, if such exemption is consistent with the protection of investors and the public interest.

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9610. Application

(a) Where to File

A member seeking exemptive relief as permitted under Rules 1021, 1050, 1070, 2210, 2315, 2320, 2340, 2520, 2710, 2720, 2790, 2810, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3020, 3150, 3210, 3230, 5150, 6958, 8211, 8213, 11870, or 11900, or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of NASD and provide a copy of the application to the Office of General Counsel of NASD.

(b) through (c) No change.