

October 26, 1999

Katherine England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-99-37 – Hard to Borrow List
Amendment No. 1**

Dear Ms England:

Pursuant to Rule 19b-4, enclosed herewith is Amendment No. 1 to the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Mary Revell, Associate General Counsel, at (202) 728-8203; e-mail Mary.Revell@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden Adkins
Senior Vice President and
General Counsel

Attachment

File No. SR-NASD-99-37
Amendment No. 1
Consists of 14 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) The National Association of Securities Dealers, Inc. (NASD), through its wholly owned subsidiary, NASD Regulation, Inc. (NASD Regulation), is amending SR-NASD-99-37 to revise the proposed rule language and the Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change. Below is the text of the proposed rule change as revised. Proposed new language is underlined; proposed deletions are in brackets.

Rule 3370. Prompt Receipt and Delivery of Securities

[Underlining indicates additions; brackets indicate deletions.]

(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.

2. Procedures of the Self-Regulatory Organization

No change.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the

Proposed Rule Change

(a) Purpose

Currently, NASD Rule 3370, which was designed to prevent abusive short selling and ensure that short sellers satisfied their settlement obligations, requires members to make an affirmative determination prior to executing certain short sales and to maintain a written record of that affirmative determination. This Rule essentially requires that a member must make an affirmative determination that it will receive delivery of the subject security, or can borrow or otherwise provide delivery of the security, by settlement date. Although the Rule provides that a member firm must record the identity of both the individual and the firm contacted who offered assurances that the subject security would be delivered by settlement date or be available for borrowing by settlement date, the manner in which compliance with this Rule is to be evidenced is not specified by the Rule.

The Rule does, however, in specified circumstances, permit member firms 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. Such “blanket” assurances are commonly referred to as “Easy to Borrow” lists.¹ The use of “Hard to Borrow” lists (i.e., lists reflecting stocks that are difficult to borrow or unavailable for borrowing) is prohibited by the Rule, although it is the understanding of NASD Regulation staff that the New York Stock Exchange (NYSE) currently permits its members to rely on such lists.

The proposed amendment will permit member firms to rely on a “Hard to Borrow” list for any short sales executed in The Nasdaq Stock Market (Nasdaq) National Market (NM) or

¹ See Release No. 34-36859 (February 20, 1996), 61 FR 7127 (February 26, 1996) (File No. SR-NASD-95-62), approving the use of “Easy to Borrow” lists.

national securities exchange-listed securities, provided that any stocks restricted pursuant to NASD Uniform Practice Code (UPC) 11830 must be included on such a list and the creator of the list attests in writing that any such securities not included on the list are easy to borrow or are available for borrowing.² Operationally, a member firm would refer to the “Hard to Borrow” list before executing a short sale in a given security. If the subject security is not on the list, the member firm would have conducted the requisite affirmative determination and can 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 firm would not be able to execute the short sale without taking additional steps to ensure the security’s availability. Member firms that rely on “Hard to Borrow” lists would be required, under the Rule, to maintain and keep such lists to satisfy the requirements of the Rule that such affirmative determinations be annotated. Lastly, the same requirements that apply to “Easy to Borrow” lists also will apply to “Hard to Borrow” lists.³

The use of “Hard to Borrow” lists will be permitted only for Nasdaq NM and national securities exchange-listed securities, and not for Nasdaq SmallCap and over-the-counter (OTC) equity securities, for two reasons. First, both because another comparable short-sale applies to Nasdaq NM and exchange-listed securities (NASD Rule 3350 and SEC Rule 10a-1, respectively) and because these securities are liquid and highly capitalized, they are less likely to be subject to

² A security becomes restricted pursuant to UPC 11830 when the total number of shares that market participants have failed to deliver in that security exceeds 0.5% of the total shares outstanding. In practice, securities with large fail-to-deliver positions are difficult to borrow.

³ A member firm is permitted to use an “Easy to Borrow” list if the information used to generate the “blanket” or standing assurance is less than 24 hours old and the member firm delivers the security on settlement date. If the member firm does not deliver the security on settlement date, disciplinary action could be initiated. As stated above, these same restrictions would apply to the use of a “Hard to Borrow” list.

short sale abuses. Second, Nasdaq SmallCap and OTC equity securities are not subject to NASD Rule 3350 or SEC Rule 10a-1 and generally are more thinly traded and illiquid and potentially more vulnerable to short sale abuses. Therefore, the use of “Hard to Borrow” lists will still not be permitted for Nasdaq SmallCap and OTC Equity securities, and member firms would continue to be required to take active steps to determine stock availability for these more illiquid securities, thus providing additional investor protection.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association’s 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. The NASD believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act because it will reduce the administrative burdens that are placed on member firms when they comply with the affirmative determination rule and expedite the process of executing short sale transactions, thus providing faster and possibly better executions for public investors. The proposed rule change also will conform the Rules of the Association with those of the NYSE and allow member firms to use the same affirmative determination procedures for both Nasdaq NM and national securities exchange-listed securities, thereby promoting uniformity and consistency in the application and interpretation of parallel NASD and NYSE rules and avoiding member firm confusion.

4. Self-Regulatory Organization’s Statement on Burden on Competition

No change.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No change.

6. Extension of Time Period for Commission Action

No change.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

No change.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

No change.

9. Exhibits

1. Revised completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY: _____
Alden Adkins, Senior Vice President and General Counsel

Date: October 26, 1999

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD- 99-37)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the use of Hard to Borrow Lists

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), 15 U.S.C. 78s(b)(1), notice is hereby given that on , the National Association of Securities Dealers, Inc. (NASD), through its wholly owned subsidiary, NASD Regulation, Inc. (NASD Regulation) filed with the Securities and Exchange Commission (SEC or Commission) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. 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 Regulation is proposing to amend National Association of Securities Dealers, Inc. (NASD or Association) Rule 3370 to permit the use of a “Hard to Borrow” list to comply with affirmative determination requirements for short sales. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

Rule 3370. Prompt Receipt and Delivery of Securities

[Underlining indicates additions; brackets indicate deletions.]

(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

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 Regulation 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 Regulation 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

(a) **Purpose**

Currently, NASD Rule 3370, which was designed to prevent abusive short selling and ensure that short sellers satisfied their settlement obligations, requires members to make an affirmative determination prior to executing certain short sales and to maintain a written record of that affirmative determination. This Rule essentially requires that a member must make an affirmative determination that it will receive delivery of the subject security, or can borrow or otherwise provide delivery of the security, by settlement date. Although the Rule provides that a member firm must record the identity of both the individual and the firm contacted who offered assurances that the subject security would be delivered by settlement date or be available for

borrowing by settlement date, the manner in which compliance with this Rule is to be evidenced is not specified by the Rule.

The Rule does, however, in specified circumstances, permit member firms 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. Such “blanket” assurances are commonly referred to as “Easy to Borrow” lists.¹ The use of “Hard to Borrow” lists (i.e., lists reflecting stocks that are difficult to borrow or unavailable for borrowing) is prohibited by the Rule, although it is the understanding of NASD Regulation staff that the New York Stock Exchange (NYSE) currently permits its members to rely on such lists.

The proposed amendment will permit member firms to rely on a “Hard to Borrow” list for any short sales executed in The Nasdaq Stock Market (Nasdaq) National Market (NM) or national securities exchange-listed securities, provided that any stocks restricted pursuant to NASD Uniform Practice Code (UPC) 11830 must be included on such a list and the creator of the list attests in writing that any such securities not included on the list are easy to borrow or are available for borrowing.² Operationally, a member firm would refer to the “Hard to Borrow” list before executing a short sale in a given security. If the subject security is not on the list, the member firm would have conducted the requisite affirmative determination and can 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 firm would not be able to execute the

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short sale without taking additional steps to ensure the security's availability. Member firms that rely on "Hard to Borrow" lists would be required, under the Rule, to maintain and keep such lists to satisfy the requirements of the Rule that such affirmative determinations be annotated. Lastly, the same requirements that apply to "Easy to Borrow" lists also will apply to "Hard to Borrow" lists.³

The use of "Hard to Borrow" lists will be permitted only for Nasdaq NM and national securities exchange-listed securities, and not for Nasdaq SmallCap and over-the-counter (OTC) equity securities, for two reasons. First, both because another comparable short-sale applies to Nasdaq NM and exchange-listed securities (NASD Rule 3350 and SEC Rule 10a-1, respectively) and because these securities are liquid and highly capitalized, they are less likely to be subject to short sale abuses. Second, Nasdaq SmallCap and OTC equity securities are not subject to NASD Rule 3350 or SEC Rule 10a-1 and generally are more thinly traded and illiquid and potentially more vulnerable to short sale abuses. Therefore, the use of "Hard to Borrow" lists will still not be permitted for Nasdaq SmallCap and OTC Equity securities, and member firms would continue to be required to take active steps to determine stock availability for these more illiquid securities, thus providing additional investor protection.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's 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. The

³ A member firm is permitted to use an "Easy to Borrow" list if the information used to generate the "blanket" or standing assurance is less than 24 hours old and the member firm delivers the security on settlement

NASD believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act because it will reduce the administrative burdens that are placed on member firms when they comply with the affirmative determination rule and expedite the process of executing short sale transactions, thus providing faster and possibly better executions for public investors. The proposed rule change also will conform the Rules of the Association with those of the NYSE and allow member firms to use the same affirmative determination procedures for both Nasdaq NM and national securities exchange-listed securities, thereby promoting uniformity and consistency in the application and interpretation of parallel NASD and NYSE rules and avoiding member firm confusion.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation 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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

date. If the member firm does not deliver the security on settlement date, disciplinary action could be initiated. As stated above, these same restrictions would apply to the use of a "Hard to Borrow" list.

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary