

February 13, 2004

Ms. Katherine A. 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-2004-031 To Establish Effective Date For NASD Rule 3370,
Affirmative Determination Requirements**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find 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 Patricia Albrecht, Office of General Counsel, Division of Regulatory Policy and Oversight, NASD, Inc. at (202) 728-8104; e-mail patricia.albrecht@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President and
Corporate Secretary

Enclosures

File No. SR-NASD-2004-031
Consists of 12 Pages
February 13, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NASD

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

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”), the National Association of Securities Dealers, Inc. (“NASD” is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to establish April 1, 2004 as the effective date of the amendments to Rule 3370 (the “Affirmative Determination Rule”) that the SEC approved in November 2003.¹ The amendments expand the scope of the affirmative determination requirements to include orders received from broker/dealers that are not members of NASD (“non-member broker/dealers”). As revised, Rule 3370 applies to orders received by member firms from both customers and non-member broker/dealers, as well as most firm proprietary orders. The revisions also add an exception for “proprietary” short sales of non-member broker/dealers provided the member can establish that the order meets certain conditions.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The Board of Directors of NASD Regulation, Inc. approved the rule change at its meeting on October 24, 2001. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution were provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries (“Delegation Plan”). The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on October 25, 2001. No other action by NASD is necessary for the

¹ File No. SR-NASD-2001-85; SEC Release No. 34-48788 (Nov. 14, 2003); 68 F.R. 65978 (Nov. 24, 2003).

filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board to adopt amendments to NASD Rules without recourse to the membership for approval.

(b) Questions regarding this rule filing may be directed to Gary L. Goldsholle, Associate General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8104; or Patricia M. Albrecht, Assistant General Counsel, NASD Regulatory Policy and Oversight at (202) 728-8026.

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

(a) Purpose

NASD is filing the proposed rule change to establish April 1, 2004 as the effective date for the amendments to NASD Rule 3370 that the SEC approved in November 2003.² Now, Rule 3370(b)(2)(A) and the corresponding recordkeeping requirements under Rule 3370(b)(4)(B) to require that, prior to accepting a short sale order from a broker/dealer that is not an NASD member ("non-member broker/dealer"), a member must make an affirmative determination that the member will receive delivery of the security from the non-member broker/dealer or that the member can borrow the security on behalf of the non-member broker/dealer for delivery by the settlement date. In addition, Rule 3370(b)(2)(A) provides exemptions for, among others, proprietary orders of member firms that are bona fide market making transactions, or transactions that result in bona fide fully hedged or arbitrated positions. Proprietary orders of a non-member broker/dealer likewise are exempt from the affirmative determination requirements if they meet the same conditions for the exemptions applicable to proprietary orders of member firms, and the

² File No. SR-NASD-2001-85; SEC Release No. 34-48788 (Nov. 14, 2003); 68 F.R. 65978 (Nov. 24, 2003).

following two conditions are satisfied: (1) the non-member broker/dealer must be registered with the SEC; and (2) if using the market maker exemption, the non-member broker/dealer is registered or qualified as a market maker in the securities and is selling such securities in connection with bona fide market making.

Pursuant to the SEC's approval of SR-NASD-2001-85, the amendments to Rule 3370 will go into effect on February 20, 2004. However, NASD seeks to delay implementation of these provisions until April 1, 2004. NASD understands from input received by industry participants that it would be very difficult to comply with the new requirements without making significant technological changes to their systems. For example, when members receive orders from either another member or a non-member broker/dealer, the broker/dealers placing the orders are identified by a specific market participant identifier ("MPID"). Currently, members' systems do not distinguish between the MPIDs of members and non-member broker/dealers. To comply with the new affirmative requirements, members will have to be able to distinguish the members' MPIDs from the non-member broker/dealers' MPIDs. NASD understands that to do so, firms will have to make sizeable programming changes that will allow firms to tag each MPID as belonging to either a member or non-member broker/dealer and create a master list of MPIDs that show which MPIDs belong to members and which belong to non-member broker/dealers. NASD believes that extending the effective date of the Rule 3370 amendments until April 1, 2004 will provide members sufficient time to make the necessary changes to their systems.

(b) Statutory Basis

NASD 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 NASD 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. NASD believes that applying affirmative determination requirements to short sale orders of non-member brokers/dealers will ensure the integrity of the marketplace by minimizing possible fails to deliver and eliminate regulatory disparities created when certain short sale orders are not conducted in compliance with the affirmative determination requirements. NASD further believes that extending the effective date will ensure that members have sufficient time to make the necessary programming changes to be able to comply with the new affirmative determination requirements.

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

NASD 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.

5. 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.

6. Extension of Time Period for Commission Action

Not applicable.

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

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder, in that the proposed rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule, NASD Rule 3370, as previously approved by the SEC. The sole

purpose of the rule change is to establish an effective date of April 1, 2004 for rules previously approved.

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

Not applicable.

9. Exhibits

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

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

NASD

BY: _____
Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

Date: February 13, 2004

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-

; File No. SR-NASD-2004-031)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Establishing an Effective Date For NASD Rule 3370, Affirmative Determination Requirements

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on _____, NASD 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. NASD has designated the proposed rule change as constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule series under paragraph (f)(1) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. 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 is filing a proposed rule change to establish April 1, 2004 as the effective date of the amendments to Rule 3370 (the “Affirmative Determination Rule”) that the SEC approved in

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR § 240.19b-4(f)(1).

November 2003.⁴ The amendments expand the scope of the affirmative determination requirements to include orders received from broker/dealers that are not members of NASD (“non-member broker/dealers”). As revised, Rule 3370 applies to orders received by member firms from both customers and non-member broker/dealers, as well as most firm proprietary orders. The revisions also add an exception for ‘proprietary’ short sales of non-member broker/dealers provided the member can establish that the order meets certain conditions.

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its original rule filing with the Commission, NASD 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 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

NASD is filing the proposed rule change to establish April 1, 2004 as the effective date for the amendments to NASD Rule 3370 that the SEC approved in November 2003.⁵ Now, Rule 3370(b)(2)(A) and the corresponding recordkeeping requirements under Rule 3370(b)(4)(B) to require that, prior to accepting a short sale order from a broker/dealer that is not an NASD member (“non-member broker/dealer”), a member must make an affirmative determination that

⁴ File No. SR-NASD-2001-85; SEC Release No. 34-48788 (Nov. 14, 2003); 68 F.R. 65978 (Nov. 24, 2003).

⁵ File No. SR-NASD-2001-85; SEC Release No. 34-48788 (Nov. 14, 2003); 68 F.R. 65978 (Nov. 24, 2003).

the member will receive delivery of the security from the non-member broker/dealer or that the member can borrow the security on behalf of the non-member broker/dealer for delivery by the settlement date. In addition, Rule 3370(b)(2)(A) provides exemptions for, among others, proprietary orders of member firms that are bona fide market making transactions, or transactions that result in bona fide fully hedged or arbitrated positions. Proprietary orders of a non-member broker/dealer likewise are exempt from the affirmative determination requirements if they meet the same conditions for the exemptions applicable to proprietary orders of member firms, and the following two conditions are satisfied: (1) the non-member broker/dealer must be registered with the SEC; and (2) if using the market maker exemption, the non-member broker/dealer is registered or qualified as a market maker in the securities and is selling such securities in connection with bona fide market making.

Pursuant to the SEC's approval of SR-NASD-2001-85, the amendments to Rule 3370 will go into effect on February 20, 2004. However, NASD seeks to delay implementation of these provisions until April 1, 2004. NASD understands from input received by industry participants that it would be very difficult to comply with the new requirements without making significant technological changes to their systems. For example, when members receive orders from either another member or a non-member broker/dealer, the broker/dealers placing the orders are identified by a specific market participant identifier ("MPID"). Currently, members' systems do not distinguish between the MPIDs of members and non-member broker/dealers. To comply with the new affirmative requirements, members will have to be able to distinguish the members' MPIDs from the non-member broker/dealers' MPIDs. NASD understands that to do so, firms will have to make sizeable programming changes that will allow firms to tag each MPID as

belonging to either a member or non-member broker/dealer and create a master list of MPIDs that show which MPIDs belong to members and which belong to non-member broker/dealers. NASD believes that extending the effective date of the Rule 3370 amendments until April 1, 2004 will provide members sufficient time to make the necessary changes to their systems.

(b) Statutory Basis

NASD 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 NASD 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. NASD believes that applying affirmative determination requirements to short sale orders of non-member brokers/dealers will ensure the integrity of the marketplace by minimizing possible fails to deliver and eliminate regulatory disparities created when certain short sale orders are not conducted in compliance with the affirmative determination requirements. NASD further believes that extending the effective date will ensure that members have sufficient time to make the necessary programming changes to be able to comply with the new affirmative determination requirements.

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

NASD 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

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

The proposed rule change has been filed by NASD as a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule series under Rule 19b-4(f)(1) under the Act.⁶ Consequently, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(1) thereunder.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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 March 5, 2004.

⁶ 17 CFR § 240.19b-4(f)(1).

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

Jonathan G. Katz
Secretary