OMB APPROVAL
OMB Number: 3235-0045
Expires: June 30, 2007
Estimated average burden
hours per response...........38

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2004 - 044
Amendment No. 1

Proposed Rule Change by National Association of Securities Dealers

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

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☐	☑	☐	☑	☐	☐

Rule
☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Pilot ☐

Extension of Time Period for Commission Action ☐

Date Expires

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name: Andrea
Last Name: Orr
Title: Assistant General Counsel
E-mail: andrea.orr@nasd.com
Telephone: (202) 728-8156
Fax: (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date: 10/06/2005

By: Stephanie Dumont
(Name)

Vice President and Associate General Counsel
(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

STEPHANIE DUMONT,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information Add Remove View	The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.
Exhibit 1 - Notice of Proposed Rule Change Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications Add Remove View Exhibit Sent As Paper Document ☐	Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.
Exhibit 3 - Form, Report, or Questionnaire Add Remove View Exhibit Sent As Paper Document ☐	Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.
Exhibit 4 - Marked Copies Add Remove View	The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.
Exhibit 5 - Proposed Rule Text Add Remove View	The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.
Partial Amendment Add Remove View	If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. <u>Text of Proposed Rule Change</u>

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act"), the National Association of Securities Dealers, Inc. ("NASD") is filing with the Securities and Exchange Commission ("SEC" or "Commission") Amendment No. 1 to SR-NASD-2004-044 to require participants[1] of registered clearing agencies[2] (referred to herein as "clearing agency participants") to take action on failures to deliver that exist for 13 consecutive settlement days in certain specified securities. In addition, if the fail to deliver position is not closed out in the requisite time period, a clearing agency participant or any broker-dealer for which it clears transactions would be prohibited from effecting further short sales in the particular specified security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the fail to deliver position is closed out. Amendment No. 1 to SR-NASD-2004-044 replaces and supersedes in its entirety the text of the original rule filing filed on March 9, 2004. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

3210. [Reserved.]<u>Short Sale Delivery Requirements</u>

<u>(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</u>

---

1 <u>See</u> Section 3(a)(24) of the Act.

2 A "registered clearing agency" is a clearing agency, as defined in Section 3(a)(23)(A) of the Act, that is registered with the SEC pursuant to Section 17A of the Act.

settlement days, the participant shall immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity.

(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)(1) shall be the lesser amount.

(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, 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.

(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.

(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.

(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 (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.

(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.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. **Procedures of the Self-Regulatory Organization**

The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on November 17, 2004, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The Board of Governors of NASD had an opportunity to review the proposed rule change at its meeting on November 18, 2004. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the Board of Governors of NASD to adopt NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

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

(a) Purpose

Rule Filing History

On March 9, 2004, NASD filed with the Commission proposed rule change SR-NASD-2004-044, proposing amendments relating to short sale delivery requirements in all classes of equity securities. Given the SEC's adoption of Regulation SHO under the Exchange Act, which imposes delivery requirements related to short selling activities, NASD is filing this Amendment No. 1 to SR-NASD-2004-044 to, among other things, narrow the scope of its proposal to those equity securities not otherwise covered by the delivery requirements of Rule 203 of Regulation SHO.[3]

Background

On June 23, 2004, the SEC adopted Regulation SHO under the Exchange Act, which provides a new regulatory framework governing the short selling of equity securities.[4] Regulation SHO includes several new provisions relating to short sales, one of which imposes delivery requirements on clearing agency participants for certain securities that have a substantial level of failures to deliver. Specifically, Rule 203(b)(3) of Regulation SHO requires clearing agency participants to close out all failures to deliver 10 days after the normal settlement date (i.e. 13 consecutive settlement days) for securities that meet the definition of "threshold security." Regulation SHO defines a "threshold security" as 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

---

3 On November 30, 2004, NASD filed for immediate effectiveness a rule change that repealed, among others, Rule 3210 and Rule 11830 in light of the requirements of the SEC's new short sale regulation, Regulation SHO under the Act. See Exchange Act Release No. 50822 (December 8, 2004), 69 FR 239 (December 14, 2004) (File No. SR-NASD-2004-175). Therefore, deletion of those rules as part of this filing is no longer necessary.

4 See Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004).

Exchange Act (commonly referred to as "reporting securities") that (1) for five consecutive settlement days has had aggregate fails to deliver at a registered clearing agency of 10,000 shares or more; (2) the level of fails is equal to a least one-half of one percent of the issue's total shares outstanding ("TSO"); and (3) is included on a list published by a self-regulatory organization ("SRO").

If the fail to deliver is not closed out in the requisite time period, the clearing agency participant and any broker-dealer for which it clears transactions, including market makers, are prohibited from effecting further short sales in the particular threshold security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the fail to deliver position is closed out. To the extent that the participant can identify the broker-dealer(s) or account(s) that have contributed to the fail to deliver position, the requirement to borrow or arrange to borrow prior to effecting further short sales should apply only to those particular broker-dealers or accounts.

Description of Proposed Rule Change

As noted above, the Regulation SHO delivery requirements apply only to reporting securities. NASD staff believes applying delivery requirements to non-reporting securities is an important step in reducing long-term fails to deliver in this sector of the marketplace.

Accordingly, NASD is proposing new Rule 3210, which would apply a delivery framework to non-reporting OTC equity securities substantially similar to that described above. Under the proposal, a non-reporting security that, for five consecutive settlement dates, has: (1) a failure to deliver equal to or greater than 10,000 shares; 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; would be deemed a non-reporting threshold security and thus, subject to the delivery requirements proposed herein. In the event there is no reported last sale on any settlement day during such five-day period, the aggregate fail position would be valued based on the previously reported last sale.

In its Regulation SHO adopting release, the SEC indicated that it did not apply the Regulation SHO delivery framework to non-reporting securities because of the difficulties in capturing TSO information for those securities to determine whether they met the Regulation SHO threshold requirements.[5] Under the proposed rule change described herein, the lack of TSO information for non-reporting securities would not be an issue, given that the only calculations necessary would be whether the failure to deliver position is equal to or greater than 10,000 shares and whether the failure to deliver position meets the dollar threshold test specified above.[6]

---

5 See supra note 4, Footnote 82.

6 Similar to the rationale behind the Regulation SHO threshold test relative to TSO, NASD has proposed the dollar threshold test to ensure that the non-reporting threshold security list is not overly broad or impracticable. NASD is concerned that having a security on the non-reporting threshold security list solely based on whether the failure to deliver position is equal to or greater than 10,000 shares may not represent a significant failure to deliver position relative to the price of the security, particularly given that many non-reporting securities trade at less than $1.00. As noted in the Regulation SHO adopting release, there may be many different causes of fails to deliver that could be unrelated to a market participant engaging in naked short selling. Thus, imposing too low of a threshold may be an overly broad method of addressing any potential abuses and also could disrupt the efficient functioning of the Continuous Net Settlement system ("CNS") operated by the National Securities Clearing Corporation ("NSCC"). See Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004).

NASD will publish a list daily of the non-reporting securities that meet the threshold requirements under proposed Rule 3210. To be removed from the list, a security must not meet or exceed either of the threshold tests described above for five consecutive settlement days.

As discussed previously, the proposed rule change would apply a delivery framework substantially similar to the Regulation SHO to non-reporting securities. As such, NASD intends to apply and interpret these proposed requirements consistent with the SEC's application and interpretation of Regulation SHO, and to the extent there are subsequent amendments to Regulation SHO, NASD will consider amending its requirement accordingly.

Among other issues relating to the filing, NASD is seeking comment on the proposed threshold tests for non-reporting OTC equity securities described above. Specifically, NASD is seeking comment on whether the proposed thresholds are an accurate indicator of non-reporting OTC equity securities with excessive fails to deliver, including but not limited to, whether the $50,000 aggregate fail to deliver position is the appropriate dollar threshold and whether the 10,000 shares or greater failure to deliver threshold is the appropriate share threshold, given the trading characteristics in this sector of the marketplace.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(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 the proposed rule change will reduce significant, long-term fails to deliver in the marketplace.

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

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

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

Not applicable.

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

NASD based the proposed rule change on the SEC's new short sale rule, Regulation SHO.[7]

9. Exhibits

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

Exhibit 4. Exhibit 4 shows the full text of rule change marking changes from this Amendment No. 1 to the originally filed proposed rule change, with the original language changes shown as if adopted, and the new language marked to show additions and deletions.

---

7 See supra note 4.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2004-044)
SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by National Association of Securities Dealers, Inc.
Relating to Proposed Amendments Relating to Short Sale Delivery Requirements

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on , the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") and amended on [3] the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. 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 proposing to amend Rule 3210 to require participants[4] of registered clearing agencies[5] (referred to herein as "clearing agency participants") to take action on

---

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 On March 9, 2004, NASD filed SR-NASD-2004-044 with the Commission (the "original filing"). Amendment No. 1 to SR-NASD-2004-044 replaces and supersedes in its entirety the text of the original filing.

4 See Section 3(a)(24) of the Act.

5 A "registered clearing agency" is a clearing agency, as defined in Section

failures to deliver that exist for 13 consecutive settlement days in certain specified securities. In addition, if the fail to deliver position is not closed out in the requisite time period, a clearing agency participant or any broker-dealer for which it clears transactions would be prohibited from effecting further short sales in the particular specified security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the fail to deliver position is closed out.

Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

3210. [Reserved.]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.

(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

---

3(a)(23)(A) of the Act, that is registered with the SEC pursuant to Section 17A of the Act.

threshold security, then the fail to deliver position excepted by this paragraph (b)(1) shall be the lesser amount.

(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, 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.

(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.

(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.

(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 (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.

(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.

* * * * *

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 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

1. Purpose

Rule Filing History

On March 9, 2004, NASD filed with the Commission proposed rule change SR-NASD-2004-044, proposing amendments relating to short sale delivery requirements in all classes of equity securities. Given the SEC's adoption of Regulation SHO under the Exchange Act, which imposes delivery requirements related to short selling activities, NASD is filing this Amendment No. 1 to SR-NASD-2004-044 to, among other things, narrow the scope of its proposal to those equity securities not otherwise covered by the delivery requirements of Rule 203 of Regulation SHO.[6]

Background

On June 23, 2004, the SEC adopted Regulation SHO under the Exchange Act, which provides a new regulatory framework governing the short selling of equity

---

6 On November 30, 2004, NASD filed for immediate effectiveness a rule change that repealed, among others, Rule 3210 and Rule 11830 in light of the requirements of the SEC's new short sale regulation, Regulation SHO under the Act. See Exchange Act Release No. 50822 (December 8, 2004), 69 FR 239 (December 14, 2004) (File No. SR-NASD-2004-175). Therefore, deletion of those rules as part of this filing is no longer necessary.

securities.[7] Regulation SHO includes several new provisions relating to short sales, one of which imposes delivery requirements on clearing agency participants for certain securities that have a substantial level of failures to deliver. Specifically, Rule 203(b)(3) of Regulation SHO requires clearing agency participants to close out all failures to deliver 10 days after the normal settlement date (i.e. 13 consecutive settlement days) for securities that meet the definition of "threshold security." Regulation SHO defines a "threshold security" as 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 (commonly referred to as "reporting securities") that (1) for five consecutive settlement days has had aggregate fails to deliver at a registered clearing agency of 10,000 shares or more; (2) the level of fails is equal to a least one-half of one percent of the issue's total shares outstanding ("TSO"); and (3) is included on a list published by a self-regulatory organization ("SRO").

If the fail to deliver is not closed out in the requisite time period, the clearing agency participant and any broker-dealer for which it clears transactions, including market makers, are prohibited from effecting further short sales in the particular threshold security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the fail to deliver position is closed out. To the extent that the participant can identify the broker-dealer(s) or account(s) that have contributed to the fail to deliver position, the requirement to borrow or arrange to borrow prior to effecting further short sales should apply only to those particular broker-dealers or accounts.

---

[7] See Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004).

Description of Proposed Rule Change

As noted above, the Regulation SHO delivery requirements apply only to reporting securities. NASD staff believes applying delivery requirements to non-reporting securities is an important step in reducing long-term fails to deliver in this sector of the marketplace.

Accordingly, NASD is proposing new Rule 3210, which would apply a delivery framework to non-reporting OTC equity securities substantially similar to that described above. Under the proposal, a non-reporting security that, for five consecutive settlement dates, has: (1) a failure to deliver equal to or greater than 10,000 shares; 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; would be deemed a non-reporting threshold security and thus, subject to the delivery requirements proposed herein. In the event there is no reported last sale on any settlement day during such five-day period, the aggregate fail position would be valued based on the previously reported last sale.

In its Regulation SHO adopting release, the SEC indicated that it did not apply the Regulation SHO delivery framework to non-reporting securities because of the difficulties in capturing TSO information for those securities to determine whether they met the Regulation SHO threshold requirements.[8] Under the proposed rule change described herein, the lack of TSO information for non-reporting securities would not be an issue, given that the only calculations necessary would be whether the failure to

---

8 See supra note 4, Footnote 82.

deliver position is equal to or greater than 10,000 shares and whether the failure to deliver position meets the dollar threshold test specified above.[9]

NASD will publish a list daily of the non-reporting securities that meet the threshold requirements under proposed Rule 3210. To be removed from the list, a security must not meet or exceed either of the threshold tests described above for five consecutive settlement days.

As discussed previously, the proposed rule change would apply a delivery framework substantially similar to the Regulation SHO to non-reporting securities. As such, NASD intends to apply and interpret these proposed requirements consistent with the SEC's application and interpretation of Regulation SHO, and to the extent there are subsequent amendments to Regulation SHO, NASD will consider amending its requirement accordingly.

Among other issues relating to the filing, NASD is seeking comment on the proposed threshold tests for non-reporting OTC equity securities described above. Specifically, NASD is seeking comment on whether the proposed thresholds are an

---

9 Similar to the rationale behind the Regulation SHO threshold test relative to TSO, NASD has proposed the dollar threshold test to ensure that the non-reporting threshold security list is not overly broad or impracticable. NASD is concerned that having a security on the non-reporting threshold security list solely based on whether the failure to deliver position is equal to or greater than 10,000 shares may not represent a significant failure to deliver position relative to the price of the security, particularly given that many non-reporting securities trade at less than $1.00. As noted in the Regulation SHO adopting release, there may be many different causes of fails to deliver that could be unrelated to a market participant engaging in naked short selling. Thus, imposing too low of a threshold may be an overly broad method of addressing any potential abuses and also could disrupt the efficient functioning of the Continuous Net Settlement system ("CNS") operated by the National Securities Clearing Corporation ("NSCC"). See Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004).

accurate indicator of non-reporting OTC equity securities with excessive fails to deliver, including but not limited to, whether the $50,000 aggregate fail to deliver position is the appropriate dollar threshold and whether the 10,000 shares or greater failure to deliver threshold is the appropriate share threshold, given the trading characteristics in this sector of the marketplace.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

2. 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 the proposed rule change will reduce significant, long-term fails to deliver in the marketplace.

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 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:

(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, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2004-044 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2004-044. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). 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, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NASD.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to the File Number SR-NASD-2004-044 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[10]

Secretary

---

[10] 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Exhibit 4 shows the full text of rule change marking changes from the original filing to this Amendment No. 1, with the language in the original filing shown as if adopted, and the new language marked to show additions and deletions.[1]

Proposed new language is underlined
Proposed deletions are bracketed

* * * * *

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.

(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)(1) shall be the lesser amount.

---

1 On November 30, 2004, NASD filed for immediate effectiveness a rule change that repealed, among others, Rule 11830 in light of the requirements of the SEC's new short sale regulation, Regulation SHO under the Act. See Securities Exchange Act Release No. 50822 (December 8, 2004), 69 FR 239 (December 14, 2004) (File No. SR-NASD-2004-175). Therefore, deletion of Rule 11830 as part of this filing is no longer necessary.

(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, 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.

(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.

(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.

(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 (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.

(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.

[(a) Except as specifically provided herein, each member that is a clearing firm must make delivery within 10 business days after normal settlement date on all short sales, whether for a customer or a broker/dealer, in equity securities executed by or through the clearing firm or by or through any broker/dealer for which it clears.]

[(b) If delivery cannot be made within 10 business days after settlement date, the clearing firm must, at a minimum, have taken affirmative steps to make delivery and must continue to engage in such affirmative steps until delivery is completed. Price or cost concerns associated with borrowing or buying in the securities would not be an acceptable basis for non-compliance with paragraph (a) of this rule. Further, the clearing firm must document the affirmative steps taken to make delivery and why delivery has not been made within the requisite time period and report this information to NASD within one business day of its failure to satisfy the 10-day delivery requirement. The clearing firm must continue to document and report such information to NASD for each business day until delivery is made.]

[(c) A clearing firm may request in writing from NASD an initial extension of up to five business days from the delivery and documentation requirements set forth in paragraphs (a) and (b) of this rule for any account of a market maker that sells short pursuant to bona fide market making, but only where such short position was taken to facilitate a customer purchase. The extension request must be received by NASD at least one business day in advance of the initial 10-day deadline and must include a description of the basis for the extension, including, but not limited to, an explanation of why delivery cannot be made within the 10-day period. Upon further written request by a member, NASD may grant no more than one additional extension of five days with respect to a market maker short position taken to facilitate a customer purchase. No extensions will be granted unless NASD deems the rationale and supporting information provided by the clearing firm as compelling.]

[(d) If delivery is not made within 10 business days after settlement date (or such longer period as may be granted by NASD pursuant to paragraph (c) of this rule), the account for which the failure to deliver occurred and all other accounts held at the clearing firm by a legal or beneficial owner of such account are restricted from selling short the security in which the failure to deliver occurred until such delivery is made. A violation of this paragraph (d) will be deemed inconsistent with Rule 2110, Standards of Commercial Honor and Principles of Trade.]

[(e) NASD will designate from time to time the content, format, method of transmission (including, at NASD's discretion, electronic transmission) and receiving location of any reporting requirement or request for extension of time provided for by this rule.]

[(f) For the purposes of this rule, the term "clearing firm" includes both clearing firms and self-clearing firms.]