

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change, as amended (SR-ISE-2003-34) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49285; 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

February 19, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 13, 2004, 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,<sup>3</sup> 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 November

2003.<sup>4</sup> 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

###### 1. 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.<sup>5</sup> Now, Rule 3370(b)(2)(A) and the corresponding recordkeeping requirements under Rule 3370(b)(4)(B) 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 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, according to the NASD, 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.

###### 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act,<sup>6</sup> 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

of Market Regulation, Commission, to Michael J. Simon, Senior Vice President and General Counsel, ISE, dated February 19, 2004.

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240 19b-4.

<sup>3</sup> 17 CFR 240 19b-4(f)(1).

<sup>4</sup> See Securities Exchange Act Release No. 48788 (Nov. 14, 2003); 68 FR 65978 (Nov. 24, 2003).

<sup>5</sup> *Id.*

<sup>6</sup> 15 U.S.C. 78o-3(b)(6).

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.<sup>7</sup> Consequently, it has become effective pursuant to section 19(b)(3)(A) of the Act<sup>8</sup> and Rule 19b-4(f)(1) thereunder.<sup>9</sup>

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, including whether the proposed rule changes are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments may also be submitted electronically at the following email address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-NASD-2004-031. This file number should be included on the subject line

if email is used. To help the Commission process and review your comments more efficiently, comments should be sent in hard copy or by email but not by both methods.

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule changes that are filed with the Commission, and all written communications relating to the proposed rule changes 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 filings will also be available for inspection and copying at the principal offices of the NASD. All submissions should refer to the file numbers SR-NASD-2004-031 and should be submitted by March 17, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-49269; File No. SR-NASD-2004-05]

#### **Self Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Accelerated Approval of Proposed Rule Change to Amend NASD Rule 2370 Relating to Certain Lending Arrangements Between Registered Persons and Customers**

February 18, 2004.

On January 9, 2004, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend NASD Rule 2370. Specifically, NASD proposed to exempt lending arrangements between family members as well as lending arrangements between registered persons and a financial institution or other entity or person regularly engaged in the business of providing credit, financing, or loans from the rule's notice

and approval requirements and to indicate that the scope of the rule is limited to lending arrangements between registered persons and their own customers, rather than any customer of the firm. The proposed rule change was published for comment in the **Federal Register** on January 23, 2004.<sup>3</sup> The Commission received no comment letters on the proposal.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association,<sup>4</sup> and, in particular, the requirements of section 15A(b)(6) of the Act,<sup>5</sup> which, among other things, requires that NASD rules be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and, in general, protect investors and the public interest. The Commission believes that the proposed rule change should allow NASD members to allocate supervisory and compliance resources to those loans where a potential for substantial abuse exists. The Commission notes that the proposed rule change only removes lending arrangements for which NASD believes the potential for misconduct is minimal from the rule's notice and approval process and that NASD members may continue to prohibit all lending arrangements between registered persons and customers altogether. The Commission also notes that NASD may bring a disciplinary action against a registered person who has entered into an unethical lending arrangement with a customer under NASD Rule 2110.

Furthermore, the Commission finds good cause for approving the proposed rule change prior to the thirtieth day after notice of the publication in the **Federal Register**. The Commission believes that acceleration of the approval of this proposal should allow NASD members to immediately focus on lending arrangements covered by amended NASD Rule 2370. Accordingly, the Commission finds good cause, consistent with section 19(b)(2) of the Act,<sup>6</sup> to approve the proposed rule change on an accelerated basis.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act<sup>7</sup>, that the

<sup>3</sup> See Securities Exchange Act Release No. 49081 (January 14, 2004), 69 FR 3410.

<sup>4</sup> In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>5</sup> 15 U.S.C. 78o-3(b)(6).

<sup>6</sup> 15 U.S.C. 78s(b)(2).

<sup>7</sup> 15 U.S.C. 78s(b)(2).

<sup>7</sup> 17 CFR 240.19b-4(f)(1).

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</sup> 17 CFR 240.19b-4(f)(1).

<sup>10</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.