

be reported under the Rule are those resulting from short sales as the term is defined in Rule 3b-3 under the Act,<sup>4</sup> with limited exceptions.

NASD staff has received inquiries from members concerning the application of Rule 3360 in light of the definition of "customer" in NASD Rule 0120(g). Specifically, Rule 0120(g) provides that the term "customer" does not include a broker or dealer, unless the context otherwise provides. As a result, members have inquired whether short sale positions in accounts held for other broker/dealers are required to be reported under Rule 3360.

In response to such inquiries, the staff has advised members that short sale positions held for other broker/dealers that fall within the definition of short position provided in Rule 3360(b) must be reported under Rule 3360(a), unless these positions already are reported to an SRO. This long-standing position is consistent with that taken by other SROs with respect to their short interest reporting requirements.<sup>5</sup> Non-self-clearing broker/dealers generally are considered to have satisfied their reporting requirement by making appropriate arrangements with their respective clearing organizations. In addition, because non-member broker/dealers are not subject to NASD rules and, therefore, are not required to comply with Rule 3360, it is particularly important that members understand that they must report such positions under the Rule, unless these positions are otherwise reported to an SRO. Accordingly, to eliminate all ambiguity, NASD proposes to amend Rule 3360(a) to clarify that short sale positions in accounts held for other broker/dealers must be reported, unless the position is otherwise reported to an SRO.

## 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 the NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable

<sup>4</sup> Rule 3b-3 under the Exchange Act provides, in part, the following: "The term 'short sale' means any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller."

<sup>5</sup> See Securities Exchange Act Release No. 35287 (January 27, 1995), 60 FR 6743 (February 3, 1995), approving amendments to short interest reporting rules of NASD, New York Stock Exchange, Philadelphia Stock Exchange, Pacific Stock Exchange, Boston Stock Exchange, Chicago Stock Exchange, and Chicago Board Options Exchange, to ensure uniform short position reporting across each of the SROs.

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

principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change is necessary to ensure that members' short interest reporting is accurate and complete.

## 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.

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

NASD has neither solicited nor received written comments on the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

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" under Section 19(b)(3)(A) of the Act<sup>7</sup> and Rule 19b-4(f)(1) thereunder,<sup>8</sup> which renders the proposal effective upon receipt of this filing by the Commission.

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 change is 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. 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

<sup>7</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>8</sup> 17 CFR § 240.19b-4(f)(1).

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 NASD. All submissions should refer to file number SR-NASD-2002-178 and should be submitted by February 6, 2003.

For the Commission, by the Division of Market Regulation, pursuant to the delegated authority.<sup>9</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47147; File No. SR-NFA-2002-07]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Futures Association Regarding the Interpretive Notice to NFA Compliance Rule 2-9 Concerning Enhanced Supervisory Procedures

January 9, 2003.

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-7 under the Act,<sup>2</sup> notice is hereby given that on December 2, 2002, the National Futures Association ("NFA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule changes described in Items I, II, and III below, which Items have been prepared by the NFA. The Commission is publishing this notice to solicit comments on the proposed rule changes from interested persons. NFA also has filed the proposed rule change with the Commodity Futures Trading Commission ("CFTC").

On November 27, 2002, NFA requested that the CFTC make a determination that review of the proposed rule change is not necessary. The CFTC made such a determination on December 9, 2002.

#### I. Self-Regulatory Organization's Description of the Proposed Rule Change

Section 15A(k) of the Act<sup>3</sup> makes NFA a national securities association for the limited purpose of regulating the activities of Members who are registered as brokers or dealers in security futures products under Section 15(b)(11) of the

<sup>9</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(7).

<sup>2</sup> 17 CFR 240.19b-7.

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

Act.<sup>4</sup> Some of the firms that are affected by this rule change could be broker-dealers registered under Section 15(b)(11).

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

NFA has prepared statements concerning the purpose of, and basis for, the proposed rule change, burdens on competition, and comments received from members, participants, and others. The text of these statements may be examined at the places specified in Item IV below. These statements are set forth in Sections A, B, and C below.

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

#### 1. Purpose

In 1993, NFA's Board adopted an Interpretive Notice to NFA Compliance Rule 2-9 that requires firms that employ a significant number of Associated Persons ("APs") who have previously worked at a Disciplined Firm to adopt enhanced supervisory procedures, including tape recording all conversations between APs and customers. Since 1993, the Interpretive Notice has defined a Disciplined Firm as one that meets the following three criteria:

1. The firm has been formally charged by either the CFTC or NFA with deceptive telemarketing practices or promotional material;
2. Those charges have been resolved; and
3. The firm has been closed down and permanently barred from the industry as a result of those charges.

Last month, the question was raised as to the proper interpretation of the phrase "closed down and permanently barred," as used in the third criterion. This issue arose in the context of a settlement of an NFA Business Conduct Committee ("BCC") sales practice complaint alleging telemarketing fraud against a south Florida firm.

The firm went out of business in February 2001 and withdrew its NFA membership and CFTC registration in April 2001. Although NFA had informed the firm that it was under investigation in the spring of 2001, the BCC issued the sales practice Complaint against the firm in October 2001 and the Complaint was settled in October 2002. Under the terms of the settlement, the firm agreed to be permanently barred from NFA membership.

The firm maintains that it should not be considered a "Disciplined Firm," under the Interpretive Notice, because it does not meet the third criterion listed above. Specifically, the firm argues that it was not "closed down" as a result of the charges in the recent BCC Complaint since it had already gone out of business and withdrawn its CFTC registration and NFA membership when the Complaint was issued.

NFA staff does not agree with the firm's position. NFA has always taken the view that "closed down" and "permanently barred" describe the same thing, namely, a *final* resolution in a sales practice case which results in a permanent bar and closure of a firm. Although it is true that, in this case, the firm ceased operations and withdrew its NFA membership prior to the issuance of the Complaint, there was nothing to prevent the firm from reapplying for NFA membership and resuming business. It was not until the firm agreed to be permanently barred from NFA membership in settlement of the BCC Complaint that the firm was finally and irreversibly "closed down and permanently barred" as contemplated by the Interpretive Notice.

If the firm's interpretation were to prevail, any firm that is the subject of a sales practice investigation could merely cease operations, prior to the issuance of a Complaint, reopen under a different name and, thereby, avoid being designated as a "Disciplined Firm." Such a result would neutralize the Interpretive Notice and render it useless. Therefore, NFA's Board determined to clarify the interpretive notice by deleting the phrase "closed down" from the third criterion.

#### 2. Statutory Basis

The rule change is authorized by, and consistent with, Section 15A(k) of the Act.<sup>5</sup>

### B. Self-Regulatory Organization's Statement on Burden on Competition

The rule change will not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act and the Commodity Exchange Act.<sup>6</sup>

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

NFA did not publish the rule changes to the membership for comment. NFA did not receive comment letters concerning the rule changes.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Pursuant to Section 19(b)(7)(B) of the Act,<sup>7</sup> the proposed rule change became effective on December 9, 2002.

Within 60 days of the date of effectiveness of the proposed rule change, the Commission, after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be refiled in accordance with the provisions of Section 19(b)(1) of the Act.<sup>8</sup>

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change conflicts with the Act. Persons making written submissions should file nine copies of the submission with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments also may be submitted electronically to the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). 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 these filings also will be available for inspection and copying at the principal office of NFA. Electronically submitted comments will be posted on the Commission's Web site (<http://www.sec.gov>). All submissions should refer to File No. SR-NFA-2002-07 and should be submitted by February 6, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

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

<sup>8</sup> 15 U.S.C. 78s(b)(1).

<sup>9</sup> 17 CFR 200.30-3(a)(75).

<sup>4</sup> 15 U.S.C. 78o(b)(11).

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

<sup>6</sup> 7 U.S.C. 1.