

# Notice to Members

APRIL 2006

## SUGGESTED ROUTING

Internal Audit  
Legal & Compliance  
Operations  
Senior Management  
Systems  
Training

## KEY TOPICS

OATS  
Rule 6958  
Rule 9610(a)

## GUIDANCE

### Exemptive Relief from the OATS Electronic Recording and Reporting Requirements; Enhancements to the OATS Web Interface

SEC Approves Expansion of NASD's Exemptive Authority under the OATS Rules; NASD Provides Additional Guidance Regarding Exemptive Relief and Encourages Exempted and Other Small Firms to Test the Enhanced OATS Web Interface

#### Executive Summary

In November 2005, NASD issued *Notice to Members (NTM) 05-78* announcing Securities and Exchange Commission (SEC) approval of amendments to Rules 6950 through 6957 (OATS Rules) relating to the Order Audit Trail System (OATS), as well as questions and answers regarding the application of the amended OATS reporting requirements. Among other things, the amendments to the OATS Rules permit NASD to grant exemptive relief from the OATS reporting requirements in certain circumstances to members that meet specified criteria. On March 30, 2006, the SEC approved further amendments to the OATS Rules that expand NASD's OATS exemptive authority to include electronic recording requirements. As amended, NASD has the authority to grant exemptive relief from the OATS electronic recording and reporting requirements for manual orders to members that meet specified criteria. The exemptive authority, as amended, is set forth in Attachment A of this *Notice* and becomes effective on May 8, 2006.

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In this *Notice*, NASD staff also is reminding members of the criteria under which exemptive relief will be granted and is providing further information regarding the terms and conditions under which any such exemptive relief will apply. In addition, NASD staff is highlighting recent enhancements to NASD's OATS Interface that are designed, among other things, to facilitate OATS electronic recording and reporting of manual orders, especially for smaller firms. NASD is strongly encouraging members that may choose to use the enhanced Web OATS Interface system to contact NASD immediately to begin testing usage of the enhanced OATS Web Interface.<sup>1</sup> Member firms that are granted an exemption particularly are urged to consider testing the enhanced OATS Web Interface to determine whether it provides a viable tool to record and report their orders upon the expiration of any exemptive relief. The enhanced OATS Web Interface will be available in the testing environment as of April 24, 2006 and in the production environment as of May 8, 2006.

## Questions/Further Information

Questions regarding this *Notice* may be directed to the Legal Section, Market Regulation, at (240) 386-5126; or Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8071.

For technical questions regarding OATS reporting, please contact the OATS Help Desk at (800) 321-NASD. Detailed information regarding all aspects of OATS Phase III, as well as general information relating to OATS, may be found on NASD's OATS Web site at [www.nasd.com/oats](http://www.nasd.com/oats).

## Discussion

### Exemptive Relief from the OATS Requirements

On September 28, 2005, the SEC approved amendments to the OATS Rules.<sup>2</sup> The amendments permit NASD to grant exemptive relief from the OATS reporting requirements to members that meet specified criteria, in circumstances where reporting of such information would be unduly burdensome for the member or where temporary relief from the OATS Rules (in the form of additional time to achieve compliance) would permit the member to avoid unnecessary expense or hardship. Since approval of these amendments, certain firms that meet the reporting exemptive criteria have noted that the failure concurrently to receive exemptive relief from the heightened electronic record retention requirements of the OATS Rules will result in the firms absorbing most, if not all, of the costs and burdens the exemptive relief was designed to address. Given this concern, NASD proposed, and the SEC approved, amendments to the OATS Rules to expand NASD's OATS exemptive authority to include electronic recording requirements.<sup>3</sup>

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On March 30, 2006, the SEC approved new Rule 6958 and amended Rule 9610(a) to extend NASD's authority to grant exemptive relief to certain members from the reporting requirements of the OATS Rules for manual orders to include the requirement to record electronically such orders. Exemption requests will be evaluated under the procedures set forth in the Rule 9600 Series. At a minimum, members must meet the following criteria to be eligible for an exemption to the OATS electronic recording and reporting requirements for manual orders: (1) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud; (2) the member has annual revenues of less than \$2 million; (3) the member does not conduct any market making activities in NASDAQ Stock Market equity securities; (4) the member does not execute principal transactions with its customers (with limited exceptions for error corrections); and (5) the member does not conduct clearing or carrying activities for other firms. The expanded exemptive authority becomes effective May 8, 2006.

#### **Requests for Exemptive Relief from the OATS Requirements**

Members eligible for an exemption from the OATS Rules must formally request the exemption and receive a letter from NASD granting such exemption before the exemption becomes effective. Detailed exemption procedures, including the exemption application, are available on NASD's OATS Web site at [www.nasdaq.com/oats](http://www.nasdaq.com/oats). The deadline to submit an application for exemptive relief to ensure review and processing by NASD prior to the May 8, 2006 implementation date was February 1, 2006. NASD cannot guarantee that exemptive applications received after that date will be reviewed and processed prior to the May 8, 2006 implementation date, although NASD staff will make every effort to do so.

NASD will consider exemption requests received prior to the publication of this *Notice* for both the recording and reporting requirements. Therefore, members that already have submitted to NASD a request for an exemption to the reporting requirements need not submit a new exemption request to request an exemption to the recording requirements. Future exemption requests, however, must specify the type of exemption(s) requested. Members meeting the criteria to be eligible to request an exemption that do not formally request and receive such an exemption are not automatically exempted. As a result, such members must begin recording and reporting OATS data regarding manual orders on May 8, 2006.

With respect to the exemptive requests received to date, NASD will be issuing letters granting exemptions from the OATS electronic recording and reporting requirements for a period of six months to those members that meet the required criteria. This exemptive relief is intended to provide such members additional time to implement an effective mechanism for electronic recording and reporting OATS information to NASD and to afford NASD an opportunity to evaluate the efficacy of its enhanced OATS Web Interface, as discussed in more detail on the next page.

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### **Enhanced Web Interface for OATS Electronic Recording and Reporting**

NASD also is providing information regarding several enhancements to the NASD's OATS Web Interface designed to reduce significantly the OATS electronic recording and reporting burdens for firms with limited order volume.<sup>4</sup> Specifically, NASD is upgrading the OATS Web Interface, which is available at no cost to members, to improve usability and add functionality. First, the enhanced OATS Web Interface will include the creation of a Firm Profile, which will enable users to select specific fields for OATS to auto-populate and to set default values for specific fields that will be pre-populated on every order entry screen. The auto-generation and the pre-population of field values will significantly reduce the number of fields users are required to enter when electronic recording an OATS event.

Second, the enhanced OATS Web Interface will also include the creation of new data entry screens based on order events or actions on the order. Users will select a specific action to the order (e.g., Order Receipt or Origination or Order Execution instead of a report type code of NW, EX or OE). The new screens will allow users to enter order data throughout the day or to enter data all at once at any point during the day. The user may add any actions to the order until the reports are submitted. Upon submission, the OATS application will package and send the data to OATS on the firm's behalf. As with current OATS requirements, firms must submit OATS order events that occur during a particular OATS Business Day by 4:00:00 a.m. Eastern Time (ET) the following calendar day or they will be marked late by NASD.

Third, the enhanced OATS Web Interface will enable users to download the data to their own system prior to submission. This feature serves two purposes. It provides a medium for members to comply with their electronic recording requirements under NASD Rule 6954. It also allows users to maintain a record of events submitted to OATS.

NASD is publishing an updated OATS Subscriber Manual, which includes the OATS Web Interface enhancements. On April 10, 2006, the updated OATS Subscriber Manual will be available at [www.nasd.com/oats](http://www.nasd.com/oats). In addition, NASD will make the testing environment available for the OATS Web Interface enhancements as of April 24, 2006 and the production environment available as of May 8, 2006.

During the six-month exemption period, NASD will be evaluating the enhanced OATS Web Interface functionality to determine whether it reduces significantly the electronic recording and reporting burden for small members. The availability of an effective OATS Web Interface will be a major factor in NASD's decision to grant exemptions after the initial six-month exemptive period expires. For this reason, NASD strongly recommends that members granted an exemption contact NASD to begin testing usage of the OATS Web Interface enhancements.<sup>5</sup> As NASD and member firms gain experience with the OATS Web Interface, NASD will be better able to evaluate and consider the effectiveness of OATS Web Interface reporting. Accordingly, firms exempted from the electronic recording and reporting requirements for the six-month period must reapply for any further exemptive relief and NASD will expect any such firm applying for a future exemption to demonstrate that complying with the OATS requirements continues to be unduly burdensome.

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## Endnotes

- 1 The OATS Web Interface is primarily designed to assist firms that have a relatively small number of OATS reportable events each day. As such, the OATS Web Interface will not likely be an effective mechanism for firms that are required to report a large number of OATS reportable events each day.
- 2 See Securities Exchange Act Release No. 52521 (September 28, 2005), 70 FR 57909 (October 4, 2005) (File No. SR-NASD-00-23). Those amendments, and applicable questions and answers, are further discussed in *NASD Notice to Members 05-78* (November 2005).
- 3 See Securities Exchange Act Release No. 53580 (March 30, 2006) (File No. SR-NASD-2006-040).
- 4 While the enhanced OATS Web Interface is designed to reduce significantly the OATS electronic recording and reporting burdens for manual firms with limited order volume, the enhanced OATS Web Interface is available as a mechanism for all eligible member firms, including member firms already required to report to NASD during OATS Phase I and Phase II.
- 5 Whether you are a firm planning to use the OATS Web Interface to submit order data to OATS, or if you are a firm that currently submits order data via the OATS Web Interface, please contact the OATS Help Desk at (800) 321-NASD or send an email to [OATSphaseIII@nasd.com](mailto:OATSphaseIII@nasd.com).

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©2006. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

### 6950. Order Audit Trail System

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### 6955. Order Data Transmission Requirements

(a) through (c) No Change.

[(d) Exemptions]

[(1) Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may exempt, subject to specified terms and conditions, a member from the order data transmission requirements of this Rule for manual orders, if such exemption is consistent with the protection of investors and the public interest, and the member meets the following criteria:]

[(A) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud;]

[(B) the member has annual revenues of less than \$2 million;]

[(C) the member does not conduct any market making activities in Nasdaq Stock Market equity securities;]

[(D) the member does not execute principal transactions with its customers (with limited exception for principal transactions executed pursuant to error corrections); and]

[(E) the member does not conduct clearing or carrying activities for other firms.]

[(2) An exemption provided pursuant to this paragraph (d) shall not exceed a period of two years. At or prior to the expiration of a grant of exemptive relief under this paragraph (d), a member meeting the criteria set forth in paragraph (d)(1) may request, pursuant to the Rule 9600 Series, a subsequent exemption, which will be considered at the time of the request, consistent with the protection of investors and the public interest.]

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[ (3) This paragraph shall be in effect until May 8, 2011.]

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### **6958. Exemption to the Order Recording and Data Transmission Requirements**

(a) Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may exempt, subject to specified terms and conditions, a member from the recording and order data transmission requirements of Rules 6954 and 6955, respectively, for manual orders, if such exemption is consistent with the protection of investors and the public interest, and the member meets the following criteria:

(1) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud;

(2) the member has annual revenues of less than \$2 million;

(3) the member does not conduct any market making activities in Nasdaq Stock Market equity securities;

(4) the member does not execute principal transactions with its customers (with limited exception for principal transactions executed pursuant to error corrections); and

(5) the member does not conduct clearing or carrying activities for other firms.

(b) An exemption provided pursuant to this Rule shall not exceed a period of two years. At or prior to the expiration of a grant of exemptive relief under this Rule, a member meeting the criteria set forth in paragraph (a) above may request, pursuant to the Rule 9600 Series, a subsequent exemption, which will be considered at the time of the request, consistent with the protection of investors and the public interest.

(c) This Rule shall be in effect until May 8, 2011.

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## 9600. PROCEDURES FOR EXEMPTIONS

### 9610. Application

#### (a) Where to File

A member seeking exemptive relief as permitted under Rules 1021, 1050, 1070, 2210, 2315, 2320, 2340, 2520, 2710, 2720, 2790, 2810, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3020, 3150, 3210, 3230, 3350, 695[5]8, 8211, 8212, 8213, 11870, or 11900, or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of NASD and provide a copy of the application to the Office of General Counsel of NASD.

(b) and (c) No Change.