

January 26, 2004

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: File No. SR-NASD-2004-014- Proposed Rule Change to Adopt Interpretative Material 3150 ("IM-3150") to Establish Exemptions From the Reporting Requirements of NASD Rule 3150

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Shirley H. Weiss, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8844; e-mail Shirley.Weiss@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Sweeney
Senior Vice President
and Deputy General Counsel

Enclosures

File No. SR-NASD-2004-014

Consists of 17 Pages

January 26, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

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

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(3)(A) under the Securities Exchange Act of 1934 ("Act"), the National Association of Securities Dealers, Inc. ("NASD") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to adopt Interpretative Material 3150 ("IM-3150") to establish exemptions from the reporting requirements of NASD Rule 3150. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

3150. Reporting Requirements for Clearing Firms

(a) No change.

(b) Pursuant to the Rule 9600 Series, [the Association] NASD may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member or class of members, unconditionally or on specified terms, from any or all of the provisions of this Rule that it deems appropriate.

IM-3150. Exemptive Relief

(a) Upon written request for exemptive relief pursuant to the Rule 9600 Series, NASD generally will grant an exemption from the reporting requirements of Rule 3150 to a self-clearing firm that:

(1) derives, on an annualized basis, at least 85 percent of its revenue from transactions in fixed income securities;

(2) conducts an institutional business that settles transactions on an RVP/DVP basis, provided that such exemption from reporting shall apply only with respect to such

institutional business unless NASD determines that any other remaining business otherwise qualifies for an exemption under this IM-3150 or is *de minimis* in nature; or

(3) does not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts (e.g., that engages solely in proprietary trading, or that conducts business only with other broker-dealers or any other non-customer counter-parties).

(b) Upon written request for exemptive relief pursuant to the Rule 9600 Series, NASD also generally will grant an exemption to a clearing firm with respect to one or more of the introducing firms for which it clears if the introducing firm meets one of the above-stated grounds for exemptive relief.

(c) Any self-clearing firm that, due to a change in the facts pertaining to the operation and nature of its business, no longer qualifies for an exemption previously granted by NASD from the reporting requirements of Rule 3150 must promptly report such change in circumstances to NASD, Department of Member Regulation, and commence compliance with the reporting requirements of Rule 3150.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change to adopt IM-3150 was approved by the Board of Governors of NASD ("Board") and authorized for filing with the SEC pursuant to a delegation of authority granted by the Board at its meeting on July 31, 2003, to the General Counsel of NASD

Regulatory Policy and Oversight (or his officer designee) ("Delegation of Authority") to submit proposed rule changes to the SEC as may be necessary to effectuate current provisions within existing rules that allow NASD staff to grant exemptions. No further specific Board authorization is required. The Nasdaq Stock Market and NASD Dispute Resolution were provided an opportunity to consult with respect to the Delegation of Authority pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. No other action by the NASD is necessary for the filing of this proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

(b) Questions regarding this rule filing may be directed to Shirley H. Weiss, Associate General Counsel, Regulatory Policy and Oversight, NASD, Office of General Counsel, at (202) 728-8844.

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

(a) Purpose

Rule 3150(a) requires each clearing firm (both those that are self-clearing and those that clear for other firms) to report to NASD, on a daily basis, and in a format determined by NASD, prescribed data pertaining to the member and any member broker-dealer for which it clears. This data is reported into NASD's electronic surveillance system, which identifies member "exceptions" based on historical and current comparisons of member data. The exceptions trigger follow-up reviews and possible member examinations. As provided in Rule 3150(b), NASD may, in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a

member or class of members, unconditionally or on specified terms, from any or all of the provisions of Rule 3150 that it deems appropriate.

NASD initially notified its members of the availability of certain exemptions in a letter dated June 20, 2002,¹ in which NASD stated that it would exempt the following classes of self-clearing members from the filing requirements of Rule 3150:

1. members that derive the preponderance of their revenue for the last two calendar years from fixed income securities;
2. members that conduct an institutional business and that settle transactions on an DVP/RVP basis;
3. members that conduct no traditional retail securities business.

Based on these classes and NASD's current regulatory needs, proposed IM-3150 would establish three classes of self-clearing members that may be exempt from the reporting requirements of Rule 3150(a).

Under proposed IM-3150(a)(1), NASD generally would exempt self-clearing firms that are primarily engaged in transactions in fixed income securities. Proposed IM-3150(a)(1) replaces the term "preponderance of their revenue" set forth in the June 20, 2002 letter with the phrase "at least 85 percent of their revenue" and eliminates the requirement that members must have derived at least 85 percent of their revenue for the last two calendar years. Instead, to qualify for this exemption, members must be able to ascertain that transactions in fixed income securities account for at least 85 percent of their annual revenue. Annualizing the 85 percent requirement takes into account daily, weekly, and monthly fluctuations in a firm's sources of revenue. Proposed IM-

¹ NASD has published this letter on the NASD web site at http://www.nasdr.com/in-site_mem_letters.asp.

3150(a)(1) further clarifies that members must have derived at least 85 percent of their revenue from transactions in fixed income securities. These changes are consistent with the exemptions NASD staff has granted under this standard pursuant to the June 20, 2002 letter.

Under proposed IM-3150(a)(2), NASD generally would continue to exempt the institutional business of self-clearing firms that settles on an RVP/DVP basis. With respect to any other remaining business of such self-clearing firms, NASD will determine whether that business otherwise qualifies for an exemption under IM-3150 or is sufficiently de minimis as to not require reporting under Rule 3150.

NASD is proposing to modify the language of the exemption pertaining to "members that conduct no traditional retail business" in order to clarify the types of firms that might qualify for this exemption. Accordingly, proposed IM-3150(a)(3) would create an exemption for firms that do not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts (e.g., engage solely in proprietary trading, or conduct business only with other broker-dealers).

Additionally, under proposed IM-3150, NASD may grant an exemption to a clearing firm with respect to one or more of the introducing firms for which it clears if the introducing firm falls within one of the three proposed classes. Proposed IM-3150 continues to require members to request all exemptions from Rule 3150(a) in writing pursuant to the Rule 9600 Series, including possible exemptions under proposed IM-3150. Members that do not fall within one or more of the three enumerated classes set forth in proposed IM-3150 are not precluded from requesting an exemption from Rule 3150(a), pursuant to Rule 3150(b) and the Rule 9600 Series, if they believe their business activities justify such a request.

NASD is currently reviewing the electronic surveillance system's data requirements in view of current regulatory developments. Among other things, NASD will be reassessing whether firms that primarily conduct an institutional business should be exempted from the reporting requirements of Rule 3150. In the event NASD seeks to amend or rescind the classes of firms for which exemptions from Rule 3150 generally will be available under proposed IM-3150, NASD will file a proposed rule change to amend IM-3150. Additionally, in the event there is a change in the facts pertaining to a self-clearing firm's business such that the firm would no longer qualify for an exemption granted by NASD under IM-3150, the exemption is revoked under IM-3150(c), and the affected self-clearing firm must notify the Department of Member Regulation and commence reporting under Rule 3150.²

(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 is designed to accomplish these ends by publishing the grounds upon which NASD generally will exempt self-clearing and clearing firms from the reporting requirements of Rule 3150(a).

² It is the position of NASD that any exemptive letter granted may be rendered a nullity when the material facts upon which such exemptive letter is premised have changed or are otherwise determined to be false. In view of the fact that NASD processes the information collected under Rule 3150 for use in effectuating its examination program, NASD believes it is important to expressly state this position in the rule and require affected self-clearing broker-dealers to notify the Department of Member Regulation of the lapse of any exemption under IM-3150 because of a disqualifying change in the material facts.

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

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

Not applicable.

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

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder,³ in that the proposed rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. Proposed IM-3150 provides members with notice of the grounds upon which NASD generally will grant exemptions from the reporting requirements of Rule 3150(a).

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

Not applicable.

9. Exhibits

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

³ 17 CFR 240.19b-4(f)(6).

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

NASD, INC.

BY: _____
Barbara Sweeney
Senior Vice President and Deputy General Counsel

Date: January 26, 2004

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2004-014)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Proposed Rule Change to Adopt Interpretative Material 3150 ("IM-3150") to Establish Exemptions From the Reporting Requirements of NASD Rule 3150

Pursuant to Section 19(b)(3)(A) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on January _____, 2004, the National Association of Securities Dealers, Inc. ("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 Regulation. 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)(iii) of the Act² and Rule 19b-4(f)(1) thereunder,³ which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

The National Association of Securities Dealers, Inc. ("NASD") is proposing to adopt Interpretative Material 3150 ("IM-3150") to establish exemptions from the reporting requirements

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78s(b)(3)(A)(iii).

³ 17 CFR 240.19b-4(f)(1).

of NASD Rule 3150. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

3150. Reporting Requirements for Clearing Firms

(a) No change.

(b) Pursuant to the Rule 9600 Series, [the Association] NASD may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member or class of members, unconditionally or on specified terms, from any or all of the provisions of this Rule that it deems appropriate.

IM-3150. Exemptive Relief

(a) Upon written request for exemptive relief pursuant to the Rule 9600 Series, NASD generally will grant an exemption from the reporting requirements of Rule 3150 to a self-clearing firm that:

(1) derives, on an annualized basis, at least 85 percent of its revenue from transactions in fixed income securities;

(2) conducts an institutional business that settles transactions on an RVP/DVP basis, provided that such exemption from reporting shall apply only with respect to such institutional business unless NASD determines that any other remaining business otherwise qualifies for an exemption under this IM-3150 or is *de minimis* in nature; or

(3) does not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts (e.g., that engages solely in proprietary trading, or that conducts business only with other broker-dealers or any other non-customer counter-parties).

(b) Upon written request for exemptive relief pursuant to the Rule 9600 Series, NASD also generally will grant an exemption to a clearing firm with respect to one or more of the introducing firms for which it clears if the introducing firm meets one of the above-stated grounds for exemptive relief.

(c) Any self-clearing firm that, due to a change in the facts pertaining to the operation and nature of its business, no longer qualifies for an exemption previously granted by NASD from the reporting requirements of Rule 3150 must promptly report such change in circumstances to NASD, Department of Member Regulation, and commence compliance with the reporting requirements of Rule 3150.

* * * * *

I. 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

(a) Purpose

Rule 3150(a) requires each clearing firm (both those that are self-clearing and those that clear for other firms) to report to NASD, on a daily basis, and in a format determined by NASD, prescribed data pertaining to the member and any member broker-dealer for which it clears. This data is reported into NASD's electronic surveillance system, which identifies member "exceptions"

based on historical and current comparisons of member data. The exceptions trigger follow-up reviews and possible member examinations. As provided in Rule 3150(b), NASD may, in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member or class of members, unconditionally or on specified terms, from any or all of the provisions of Rule 3150 that it deems appropriate.

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exemption, members must be able to ascertain that transactions in fixed income securities account for at least 85 percent of their annual revenue. Annualizing the 85 percent requirement takes into account daily, weekly, and monthly fluctuations in a firm's sources of revenue. Proposed IM-3150(a)(1) further clarifies that members must have derived at least 85 percent of their revenue from transactions in fixed income securities. These changes are consistent with the exemptions NASD staff has granted under this standard pursuant to the June 20, 2002 letter.

Under proposed IM-3150(a)(2), NASD generally would continue to exempt the institutional business of self-clearing firms that settles on an RVP/DVP basis. With respect to any other remaining business of such self-clearing firms, NASD will determine whether that business otherwise qualifies for an exemption under IM-3150 or is sufficiently de minimis as to not require reporting under Rule 3150.

NASD is proposing to modify the language of the exemption pertaining to "members that conduct no traditional retail business" in order to clarify the types of firms that might qualify for this exemption. Accordingly, proposed IM-3150(a)(3) would create an exemption for firms that do not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts (e.g., engage solely in proprietary trading, or conduct business only with other broker-dealers).

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exemption from Rule 3150(a), pursuant to Rule 3150(b) and the Rule 9600 Series, if they believe their business activities justify such a request.

NASD is currently reviewing the electronic surveillance system's data requirements in view of current regulatory developments. Among other things, NASD will be reassessing whether firms that primarily conduct an institutional business should be exempted from the reporting requirements of Rule 3150. In the event NASD seeks to amend or rescind the classes of firms for which exemptions from Rule 3150 generally will be available under proposed IM-3150, NASD will file a proposed rule change to amend IM-3150. Additionally, in the event there is a change in the facts pertaining to a self-clearing firm's business such that the firm would no longer qualify for an exemption granted by NASD under IM-3150, the exemption is revoked under IM-3150(c), and the affected self-clearing firm must notify the Department of Member Regulation and commence reporting under Rule 3150.⁵

(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 is designed to accomplish these ends by publishing the grounds upon which

⁵ It is the position of NASD that any exemptive letter granted may be rendered a nullity when the material facts upon which such exemptive letter is premised have changed or are otherwise determined to be false. In view of the fact that NASD processes the information collected under Rule 3150 for use in effectuating its examination program, NASD believes it is important to expressly state this position in the rule and require affected self-clearing broker-dealers to notify the Department of Member Regulation of the lapse of any exemption under IM-3150 because of a disqualifying change in the material facts.

NASD generally will exempt self-clearing and clearing firms from the reporting requirements of Rule 3150(a).

(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

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder, in that the proposed rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule.⁶ Accordingly, the proposed rule change will become effective upon filing pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(1) thereunder.

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

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary,

⁶ 17 CFR 240.19b-4(f)(1).

Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-NASD-2004-014. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

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

Margaret H. McFarland
Deputy Secretary