

July 29, 2003

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-00-08 - Amendment No. 2 - Margin Rule Amendments Relating to Non-Equity Securities and Exempt Accounts**

Dear Ms. England:

NASD hereby amends the above-referenced rule filing to make its proposed rule change to NASD Rule 2520 consistent with the proposed rule change to New York Stock Exchange ("NYSE") Rule 431 that was filed with the Commission in SR-NYSE-98-14 (July 29, 1998), as amended by Amendment Nos. 1, 2 and 3. Except where NASD may not agree with a specific margin proposal of another self-regulatory organization ("SRO"), NASD generally believes it is important that NASD's and other SROs' margin rules be consistent in order to avoid subjecting firms that are members of more than one SRO to conflicting margin requirements.

NASD proposes to amend Rule 2520(a)(13) to require persons qualifying for "exempt account" status to meet, in addition to the \$45/40 million net worth and financial assets thresholds, specific registration and reporting requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934 (referred to in Rule 2520 as "the Act"), or make available to the member certain current information regarding such person's ownership, business, operations, and business condition. Accordingly, NASD proposes that, in addition to the \$45/40 million net worth and financial assets thresholds, persons qualifying for "exempt account" status would also have to satisfy one of the following requirements: (1) have securities registered pursuant to Section 12 of the Act and have been subject to reporting requirements of Section 13 of the Act; or (2) have securities registered pursuant to the Act and have been subject to the reporting requirements of Section 15(d) of the Act; or (3) if such person is not subject to Section 13 or 15(d) of the Act, that person must make available to the member information that is required pursuant to Rule 15c2-11 under the Act; or (4) furnish information to the Securities and Exchange Commission as required by Rule 12g3-2b of the Act; or (5) make available to the member such current information regarding such person's ownership, business operations and financial condition including such person's audited statement of financial condition, statement of income and statement of changes in stockholder's equity or comparable financial reports.

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Sections 13 and 15(d) of the Act require publicly held companies to furnish to the public on a continuous and ongoing basis certain information regarding their operations and financial condition. Pursuant to Commission rules promulgated under Sections 13 and 15(d) of the Act, companies are required to make the disclosures noted above on a quarterly (Form 10-Q), annual (Form 10-K), and interim basis (Form 8-K). Requiring persons qualifying for "exempt account" status to meet the disclosure requirements mandated by these sections and rules of the Act should provide adequate and sufficient information for a member to perform a risk analysis of such persons. Rule 15c2-11 under the Act precludes a broker-dealer from entering bid or asked quotations in a security, i.e., market making, unless it has specified current information in its possession, such as a copy of a prospectus included in a registration statement filed under the Act, or a copy of an issuer's most recent annual report filed pursuant to Section 13 or 15(d) of the Act.

If a person seeking exempt account status is not subject to reporting requirements under the Act, the proposed rule change would require that person to furnish to the member information similar to that mandated by Sections 13 and 15(d) of the Act and Rule 15c2-11 thereunder. NASD believes that the proposed financial requirements together with the proposed reporting requirements are consistent with the purpose of Rule 2520, which is to provide for extension of credit to financially sound customers and to promote the safety and soundness of NASD members.

This amendment also amends Rule 2520(a)(16)(e)(2)(H) to change "Member organizations" to "Members."

The text of the proposed rule change is set forth in Exhibit 1 and shows the net (cumulative) effect on the existing rule of the changes proposed in the initial filing (SR-NASD-00-08) and Amendment No. 1, as revised by this Amendment No. 2.

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,

Patrice M. Gliniecki  
Vice President  
and Deputy General Counsel

cc: Yvonne Fraticelli

Enclosure

**PROPOSED AMENDMENTS TO RULE 2520**

Additions pursuant to SR-NASD-00-08 and Amendment No. 1 are underlined.  
Additions pursuant to Amendment No. 2 are double underlined.  
Deletions pursuant to Amendment Nos. 1 and 2 are [bracketed].

**2520. Margin Requirements**

**(a) Definitions**

For purposes of this paragraph, the following terms shall have the meanings specified below:

(1) through (3) No Change

(4) The term "designated account" means the account of: [a bank, trust company, insurance company, investment trust, state or political subdivision thereof, charitable or nonprofit educational institution regulated under the laws of the United States or any state, or pension or profit sharing plan subject to ERISA or of any agency of the United States or of a state or a political subdivision thereof.]

(A) a bank (as defined in Section 3(a)(6) of the Act),

(B) a savings association (as defined in Section 3(b) of the Federal Deposit Insurance Act), the deposits of which are insured by the Federal Deposit Insurance Corporation,

(C) an insurance company (as defined in Section 2(a)(17) of the Investment Company Act of 1940),

(D) an investment company registered with the Securities and Exchange Commission (SEC) under the Investment Company Act,

(E) a state or political subdivision thereof, or

(F) a pension or profit sharing plan subject to Employee Retirement

Income Security Act (ERISA) or of an agency of the United States or of a state or a political subdivision thereof.

(5) through (8) No Change

(9) The term "highly rated foreign sovereign debt securities" means any debt securities (including major foreign sovereign debt securities) issued or guaranteed by the government of a foreign country, its provinces, state or cities, or a supranational entity, if at the time of the extension of credit the issue, the issuer or guarantor, or any other outstanding obligation of the issuer or guarantor ranked junior to or on a parity with the issue or the guarantee is assigned a rating (implicitly or explicitly) in one of the top two rating categories by at least one nationally ranked statistical rating organization.

(10) The term "investment grade debt securities" means any debt securities (including those issued by the government of a foreign country, its provinces, states or cities, or a supranational entity), if at the time of the extension of credit the issue, the issuer or guarantor, or any other outstanding obligation of the issuer or guarantor ranked junior to or on a parity with the issue or the guarantee is assigned a rating (implicitly or explicitly) in one of the top four rating categories by at least one nationally recognized statistical rating organization.

(11) The term "major foreign sovereign debt" means any debt securities issued or guaranteed by the government of a foreign country or a supranational entity, if at the time of the extension of credit the issue, the issuer or guarantor, or any other outstanding

obligation of the issuer or guarantor ranked junior to or on a parity with the issue or the guarantee is assigned a rating (implicitly or explicitly) in the top rating category by at least one nationally recognized statistical rating organization.

(12) The term "mortgage related securities" means securities falling within the definition in Section 3(a)(41) of the Act.

(13) The term "exempt account" means: [a member, non-member broker/dealer registered as a broker or dealer under the Act, "designated account," or any person having a net worth of at least forty-five million dollars and financial assets of at least forty-million dollars.]

(A) a member, non-member broker/dealer registered as a broker or dealer under the Act, a "designated account," or

(B) any person that:

(i) has a net worth of at least forty-five million dollars and financial assets of at least forty-million dollars for purposes of subparagraphs (e)(2)(F) and (e)(2)(G), and

(ii) either:

a. has securities registered pursuant to Section 12 of the Act, has been subject to the reporting requirements of Section 13 of the Act for a period of at least 90 days and has filed all the reports required to be filed thereunder during the preceding 12 months (or such shorter period as it was required to file such reports), or

b. has securities registered pursuant to the Securities Act of 1933, has been subject to the reporting requirements of Section 15(d) of the Act for a period of at least 90 days and has filed all the reports required to be filed thereunder during the preceding 12 months (or such shorter period as it was required to file such reports), or

c. if such person is not subject to Section 13 or 15(d) of the Act, is a person with respect to which there is publicly available the information specified in paragraphs (a)(5)(i) to (xiv), inclusive, of Rule 15c2-11 under the Act, or

d. furnishes information to the Securities and Exchange Commission as required by Rule 12g3-2(b) of the Act, or

e. makes available to the member such current information regarding such person's ownership, business, operations and financial condition (including such person's current audited statement of financial condition, statement of income and statement of changes in stockholder's equity or comparable financial reports), as reasonably believed by the member to be accurate, sufficient for the purposes of performing a risk analysis in respect of such person.

(14) The term "non-equity securities" means any securities other than equity securities as defined in Section 3(a)(11) of the Act.

(15) The term "listed non-equity securities" means any non-equity securities that:

(A) are listed on a national securities exchange; or (B) have unlisted trading privileges on a national securities exchange.

(16) The term "other marginable non-equity securities" means:

(A) Any debt securities not traded on a national securities exchange meeting all of the following requirements:

(i) At the time of the original issue, a principal amount of not less than \$25,000,000 of the issue was outstanding;

(ii) The issue was registered under Section 5 of the Securities Act of 1933 and the issuer either files periodic reports pursuant to Section 13(a) or 15(d) of the Act or is an insurance company which meets all of the conditions specified in Section 12(g)(2)(G) of the Act; and

(iii) At the time of the extensions of credit, the creditor has a reasonable basis for believing that the issuer is not in default on interest or principal payments; or

(B) Any private pass-through securities (not guaranteed by any agency of the U.S. government) meeting all of the following requirements:

(i) An aggregate principal amount of not less than \$25,000,000 (which may be issued in series) was issued pursuant to a registration statement filed with the SEC under Section 5 of the Securities Act of 1933;

(ii) Current reports relating to the issue have been filed with the SEC; and

(iii) At the time of the credit extension, the creditor has a reasonable basis for believing that mortgage interest, principal payments and other distributions are being passed through as required and that the servicing agent is meeting its material obligations under the terms of the offering.

(b)(1) through (e)(1) No change.

(e)(2) Exempted Securities, [Marginable Corporate Debt Securities] Non-equity Securities and Baskets

**(A) Obligations of the United States and Highly Rated Foreign Sovereign Debt Securities**

On net "long" or net "short" positions in obligations (including zero coupon bonds, i.e., bonds with coupons detached or non-interest bearing bonds) issued or guaranteed as to principal or interest by the United States Government or [issued or guaranteed] by corporations in which the United States has a direct or indirect interest as shall be designated for exemption by the Secretary of the Treasury, or in obligations that are highly rated foreign sovereign debt securities, the margin to be maintained shall be the percentage of the current market value of such obligations as specified in the applicable category below:

- |  |           |
|--|-----------|
| (i) Less than one year to maturity                     | 1 percent |
| (ii) One year but less than three years to maturity    | 2 percent |
| (iii) Three years but less than five years to maturity | 3 percent |
| (iv) Five years but less than ten years to maturity    | 4 percent |



(v) Ten years but less than twenty years to maturity 5 percent[, or]

(vi) Twenty years or more to maturity 6 percent

Notwithstanding the above, on zero coupon bonds with five years or more to maturity the margin to be maintained shall not be less than 3 percent of the principal amount of the obligation.

When such obligations other than United States Treasury bills are due to mature in thirty calendar days or less, a member, at its discretion, may permit the customer to substitute another such obligation for the maturing obligation and use the margin held on the maturing obligation to reduce the margin required on the new obligation, provided the customer has given the member irrevocable instructions to redeem the maturing obligation.

**(B) All Other Exempted Securities**

On any positions in exempted securities other than obligations of the United States, the margin to be maintained shall be [15]7 percent of the current market value [or 7 percent of the principal amount of such obligation, whichever amount is greater].

**(C) [Non-Convertible Corporate Debt] Non-Equity Securities**

On any positions in [non-convertible corporate debt] non-equity securities, [which are listed or traded on a registered national securities exchange or qualify as an "OTC margin bond," as defined in Section 220.2(t) of Regulation T of the Board of Governors of the Federal Reserve System], the margin to be maintained

(except where a lesser requirement is imposed by other provisions of this Rule)

shall be:

(i) 10 percent of the current market value in the case of investment grade debt securities; and

(ii) 20 percent of the current market value or 7 percent of the principal amount, whichever amount is greater, in the case of all other listed non-equity securities, and all other marginable non-equity securities as defined in paragraph (a)(16) of this Rule [except on mortgage related securities as defined in Section 3(a)(41) of the Act the margin to be maintained for an exempt account shall be 5 percent of the current market value. For purposes of this subparagraph, an exempt account shall be defined as a member, non-member broker/dealer, "designated account" or any person having net tangible assets of at least sixteen million dollars].

(D) and (E) No Change.

**(F) [Cash] Transactions With [Customers] Exempt Accounts**

**Involving Certain "Good Faith" Securities**

[When a customer purchases an issued exempted security from or through a member in a cash account, full payment shall be made promptly. If, however, delivery or payment therefor is not made promptly after the trade date, a deposit shall be required as if it were a margin transaction, unless it is a transaction with a "designated account."]

On any position resulting from a transaction [in issued] involving exempted securities, mortgage related securities, or major foreign sovereign debt securities [made for a member, or a non-member broker/dealer, or] made for or with [a "designated] an "exempt account," no margin need be required and any marked to the market loss on such position need not be [marked to the market] collected. However, [where such position is not marked to the market, an amount equal to the loss at the market in such position] the amount of any uncollected marked to the market loss shall be [charged against] deducted in computing the member's net capital as provided in SEC Rule 15c3-1, subject to the limits provided in paragraph (e)(2)(H) below.

**(G) Transactions With Exempt Accounts Involving Highly Rated Foreign Sovereign Debt Securities and Investment Grade Debt Securities**

On any position resulting from a transaction made for or with an "exempt account" (other than a position subject to paragraph (e)(2)(F)), the margin to be maintained on highly rated foreign sovereign debt and investment grade debt securities shall be, in lieu of any greater requirements imposed under this Rule, (i) 0.5 percent of current market value in the case of highly rated foreign sovereign debt securities, and (ii) 3 percent of current market value in the case of all other investment grade debt securities. The member need not collect any such margin, provided the amount equal to the margin required shall be deducted in computing the member's net capital as provided in SEC Rule 15c3-1, subject to the limits provided in paragraph (e)(2)(H) below.

**(H) Limits on Net Capital Deductions for Exempt Accounts**

(i) Members [organizations] shall maintain a written risk analysis methodology for assessing the amount of credit extended to exempt accounts pursuant to paragraphs (e)(2)(F) and (e)(2)(G) which shall be made available to the Association upon request.

(ii) In the event that the deductions of securities positions from net capital deductions taken by a member as a result of marked to the market losses incurred under paragraphs (e)(2)(F) and (e)(2)(G) (exclusive of the percentage requirements established thereunder) exceed:

a. on any one account or group of commonly controlled accounts, 5 percent of the member's tentative net capital, or

b. on all accounts combined, 25 percent of the member's tentative net capital, and, such excess exists on the fifth business day after it was incurred, the member shall give prompt written notice to the Association and shall not enter into any new transaction(s) subject to the provisions of paragraphs (e)(2)(F) or (e)(2)(G) that would result in an increase in the amount of such excess under, as applicable, subparagraph a. or b. above.

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