

# Notice to Members

MARCH 2004

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Clearing Firms  
Exemptions to the Reporting  
Requirements of Rule 3150  
IM-3150  
National Examination Program (NEP)  
Surveillance (formerly referred to as  
INSITE)  
Rule 3150

## GUIDANCE

### Exemptions to Reporting Requirements of Rule 3150

SEC Announces Immediate Effectiveness of IM-3150  
Governing Exemptions from the Reporting Requirements  
of NASD Rule 3150; **Effective Date: February 20, 2004**

#### Executive Summary

The Securities and Exchange Commission (SEC) has announced the immediate effectiveness of IM-3150, regarding possible exemptions from the reporting requirements of NASD Rule 3150.<sup>1</sup> Under IM-3150, the following classes of self-clearing members will generally be exempt from the filing requirements of Rule 3150: (1) members that derive, on an annualized basis, at least 85 percent of their revenue from transactions in fixed income securities; (2) members that conduct an institutional business that settle 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 IM-3150 or is de minimis in nature; or (3) members that do not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts. In addition, a clearing firm may obtain an exemption for one or more of the introducing firms for which it clears if the introducing firm meets one of the above grounds for relief.

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 IM-3150. IM-3150(c) also clarifies that any clearing or self-clearing firm that, due to a change in the facts pertaining to the operation and nature of its business or the operation and nature of the business of a firm for which it clears, no longer qualifies for a previously granted exemption must promptly notify NASD and commence compliance with the reporting requirements of Rule 3150.

04-24

---

The text of IM-3150 is set forth in Attachment A.

## Questions/Further Information

Questions concerning this *Notice* may be directed to Victoria Berberi-Doumar, Counsel, Regulation Policy, Department of Member Regulation, at (202) 728-8905; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

## Background

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,<sup>2</sup> in which NASD stated that it would exempt the following classes of self-clearing members from the filing requirements of Rule 3150:

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

---

## Exemptions under IM-3150

Based on the classes described in the June 20, 2002 letter and NASD's current regulatory needs, IM-3150 establishes three classes of self-clearing members that may be exempt from the reporting requirements of Rule 3150(a).

- ▶ **The firm derives, on an annualized basis, at least 85 percent of its revenue from transactions in fixed income securities.**

IM-3150(a)(1) replaces the term "preponderance of [its] revenue" set forth in the June 20, 2002 letter with the phrase "at least 85 percent of its revenue" and eliminates the requirement that a member must have derived at least 85 percent of its revenue from fixed income securities transactions for the last two calendar years. Instead, to qualify for this exemption, a member must be able to ascertain that transactions in fixed income securities account for at least 85 percent of its annual revenue. Annualizing the 85 percent requirement takes into account daily, weekly, and monthly fluctuations in a firm's sources of revenue. These changes are consistent with the exemptions NASD staff has granted under this standard pursuant to the June 20, 2002 letter.

- ▶ **The firm 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 IM-3150 or is de minimis in nature.**

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

- ▶ **The firm 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 counterparties).**

NASD has modified the language of the exemption pertaining to "members that conduct no traditional retail business" to clarify the types of firms that might qualify for this exemption. Accordingly, under IM-3150(a)(3), NASD generally will exempt a member that does not execute transactions for customers or otherwise hold customer accounts or acts as an introducing broker with respect to customer accounts (e.g., engages solely in proprietary trading, or conducts business only with other broker-dealers or any other non-customer counterparties).

---

## Additional Provisions

### ▶ Exemptions for Introducing Firms

Under IM-3150(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.

### ▶ Procedures for Firms that No Longer Meet the Requirements for an Exemption

Under IM-3150, a clearing or self-clearing firm that no longer qualifies for an exemption previously granted by NASD from the reporting requirements of Rule 3150 because of a change in the operation and nature of its business, or the operation and nature of the business of a firm for which it clears, as applicable, must promptly report such change in circumstances to NASD, Department of Member Regulation, and comply with the reporting requirements of Rule 3150. In view of the fact that NASD processes the information collected under Rule 3150 for use in effectuating its National Examination Program (NEP), it is essential that clearing firms and self-clearing firms promptly notify the Department of Member Regulation when they, or any firms for which they clear, no longer qualify for an exemption and immediately comply with the reporting requirements of Rule 3150.

### ▶ Requests for Exemptions that Do Not Fall Within the Three Enumerated Classes

Members that do not fall within one or more of the three enumerated classes set forth in 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.

### ▶ Requests for Exemptions Must Be Made in Writing

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 IM-3150.

## Endnotes

1 See Exchange Act Rel. No. 49383 (March 9, 2004), 69 Fed. Reg. 12388 (March 16, 2004) (File No. SR-NASD-2004-014).

2 NASD has posted this letter on its Web Site at [www.nasdr.com/pdf-text/insite\\_ltr\\_062002.pdf](http://www.nasdr.com/pdf-text/insite_ltr_062002.pdf).

---

## ATTACHMENT A

New language is underlined; deletions are in brackets.

\* \* \* \* \*

### 3150. Reporting Requirements for Clearing Firms

(a) Each member that is a clearing firm or self-clearing firm shall be required to report to [the Association] NASD in such format as [the Association] NASD may require, prescribed data pertaining to the member and any member broker-dealer for which it clears. A clearing firm or self-clearing firm may enter into an agreement with a third party pursuant to which the third party agrees to fulfill the obligations of a clearing firm or self-clearing firm under this Rule. Notwithstanding the existence of such an agreement, each clearing firm or self-clearing firm remains responsible for complying with the requirements of this Rule.

(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 their 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 clearing or self-clearing firm that, due to a change in the facts pertaining to the operation and nature of its business or the operation and nature of the business of a firm for which it clears, as applicable, 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.

\* \* \* \* \*