April 6, 1998

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Mail Stop 10-1

Re: **File No. SR-NASD-98-33** - Exemption From Fidelity Bonding Requirement

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed herewith is the above-numbered rule filing. Also enclosed is a 3-l/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 Elliott R. Curzon, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8451; e-mail curzone@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

John M. Ramsay
Deputy General Counsel

Enclosure

File No. SR-NASD-98-33
Consists of 18 Pages

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

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 ("Act"), NASD Regulation, Inc. ("NASD Regulation") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend Rule 3020 of the National Association of Securities Dealers, Inc. ("NASD" or "Association") to grant to the staff authority to adjust the fidelity bond required of a member in certain circumstances upon a showing of good cause, either conditionally or unconditionally. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

3020. Fidelity Bonds

(a) Coverage Required

Each member required to join the Securities Investor Protection Corporation who has employees and who is not a member in good standing of the American Stock Exchange, Inc.; the Boston Stock Exchange; the Midwest Stock Exchange, Inc.; the New York Stock Exchange, Inc.; the Pacific Exchange, Inc.; the Philadelphia Stock Exchange, Inc.; or the Chicago Board Options Exchange shall:

(1) Maintain a blanket fidelity bond, in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America, covering officers and employees which provides against loss and has agreements covering at least the following:

(A) Fidelity

(B) On Premises

(C) In Transit

(D) Misplacement

(E) Forgery and Alteration (including check forgery)

(F) Securities Loss (including securities forgery)

(G) Fraudulent Trading

(H) Cancellation Rider providing that the insurance carrier will use its best efforts to promptly notify the National Association of Securities Dealers, Inc. in the event the bond is canceled, terminated or substantially modified.

(2) Maintain minimum coverage for all insuring agreements required in this paragraph (a) of not less than $25,000;

(3) Maintain required minimum coverage for Fidelity, On Premises, In Transit, Misplacement and Forgery and Alteration insuring agreements of not less than 120% of its required net capital under SEC Rule 15c3-1 up to $600,000. Minimum coverage for required net capital in excess of $600,000 shall be determined by reference to the following table:

Net Capital Requirement	Minimum Coverage
$600,001 - 1,000,000	750,000
1,000,001 - 2,000,000	1,000,000
2,000,001 - 3,000,000	1,500,000
3,000,001 - 4,000,000	2,000,000
4,000,001 - 6,000,000	3,000,000
6,000,001 - 12,000,000	4,000,000
12,000,001 - and above	5,000,000

(4) Maintain Fraudulent Trading coverage of not less than $25,000 or 50% of the coverage required in paragraph (a)(3), whichever is greater, up to $500,000;

(5) Maintain Securities Forgery coverage of not less than $25,000 or 25% of the coverage required in paragraph (a)(3), whichever is greater, up to $250,000.

(b) Deductible Provision

(1) A deductible provision may be included in the bond of up to $5,000 or 10% of the minimum insurance requirement established hereby, whichever is greater.

(2) If a member desires to maintain coverage in excess of the minimum insurance requirement then a deductible provision may be included in the bond of up to $5,000 or 10% of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum permissible deductible amount described in subparagraph (1) above must be deducted from the member's net worth in the calculation of the member's net capital for purposes of SEC Rule 15c3-1. Where the member is a subsidiary of another Association member the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

(c) Annual Review of Coverage

(1) Each member, other than members covered by subparagraph (2), shall annually review, as of the anniversary date of the issuance of the bond, the adequacy thereof by reference to the highest required net capital during the immediately preceding twelve-month period, which amount shall be used to determine minimum required coverage for the succeeding twelve-month period pursuant to subparagraphs (a)(2), (3), (4) and (5).

(2) Each member which has been in business for one year shall, as of the first anniversary date of the issuance of its original bond, review the adequacy thereof by reference to an amount calculated by dividing the highest aggregate indebtedness it experienced during its first year by 15. Such amount shall be used in lieu of required net capital under SEC Rule 15c3-1 in determining the minimum required coverage to be carried in the member's second year pursuant to subparagraphs (a)(2), (3), (4) and (5). Notwithstanding the above, no such member shall carry less minimum bonding coverage in its second year than it carried in its first year.

(3) Each member shall make required adjustments not more than sixty days after the anniversary date of the issuance of such bond.

<u>(4) Any member subject to the requirements of this paragraph (c) may apply for an exemption from the requirements of this paragraph (c). The application shall be made pursuant to Rule 9610 of the Code of Procedure. The exemption may be granted upon a showing of good cause, including a substantial change in the circumstances or nature of the member's business that results in a lower net capital requirement. An exemption may be</u>

subject to any condition or limitation upon its bonding coverage that is deemed necessary to protect the public and to serve the purposes of this Rule.

(d) Notification of Change

Each member shall report the cancellation, termination or substantial modification of the bond to the Association within ten business days of such occurrence.

(e) Definitions

For purposes of fidelity bonding the term "employee" or "employees" shall include any person or persons associated with a member firm (as defined in Article I, paragraph (q) of the By-Laws) except:

(1) Sole Proprietors

(2) Sole Stockholders

(3) Directors or Trustees of member firms who are not performing acts coming within the scope of the usual duties of an officer or employee.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation at its meeting on March 19, 1998, which authorized the filing of the rule change with the SEC. The Nasdaq Stock Market has been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on March 19, 1998. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(2) of Article VI of the By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD Regulation will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Elliott R. Curzon, Assistant General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-8451.

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

(a) **Purpose**

Rule 3020 specifies that members are required to maintain fidelity bonds to insure against certain losses and the potential effect of such losses on firm capital. The rule applies to all members with employees who are required to join the Securities Investor Protection Corporation and who are not covered by the requirements of a national securities exchange. The amount of coverage a member is required to maintain is linked to the member’s net capital requirements under SEC Rule 15c3-1.

Under paragraph (c) of the Rule, each member is required to make an annual review of the adequacy of its fidelity bond coverage and is required to maintain coverage that is adequate to cover the member’s highest net capital requirement during the preceding 12 months. The staff have received several requests from members asking for a waiver or interpretation to relieve the member from this requirement in certain circumstances. For example, if a full-service member changed its business by divesting itself of clearing responsibilities so that it no longer holds customer funds or securities, it would still be required to maintain bond coverage that is based on the higher net capital requirement that applied during the preceding year. The Rule in its current form does not permit the staff to provide any relief to the member.

NASD Regulation is proposing to amend the Rule to permit the staff to exempt a member from the requirements of the rule in circumstances similar to those described above and upon a showing of good cause. This authority will permit the staff to adjust the fidelity bond requirements applicable to a member to better tailor them to changes in a member's business. In addition, the proposed amendment will also permit the staff to include conditions in an exemption to ensure that any subsequent increase in capital requirements is accompanied by a corresponding increase in coverage.

The rule change applies a "good cause" standard that will require a member to demonstrate that a modification from the bonding requirement is justified by the level of loss exposure that may be expected from the firm. NASD Regulation notes that the fidelity bonding premiums are set for certain net capital thresholds on the basis of loss experience, and the premiums are changed from time to time to reflect changes in loss experience and to ensure that there are sufficient funds to pay any losses reported to the insurer. In addition, generally losses incurred in a prior year are reported against the firm's current year. NASD Regulation intends to apply this authority only where it is clear that an exemption will not have any unintended impact on the insurance pool and the modified coverage would adequately protect the member against potential losses.

Requests for exemption would be considered under recently adopted Procedures for Exemption in the 9600 Series of Rules in the Code of Procedure. Under the procedures the staff issues written determinations that are subject to review by the National Adjudicatory Council.

(b) **Statutory Basis**

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, in that the proposed amendments are designed to accommodate members whose financial circumstances have changed so that they could obtain an exemption from maintaining fidelity bond coverage at higher previous levels if they can show that there is no regulatory reason for the higher coverage required by Rule 3020, without otherwise compromising investor protection.

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

NASD Regulation 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

NASD Regulation does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

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.

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 REGULATION, INC.

BY:____________________________________
Joan C. Conley, Secretary

Date April 17, 1998

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD- 98-33)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Exemptions From Fidelity Bonding Requirements

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on , NASD Regulation, Inc. ("NASD Regulation") 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. 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

NASD Regulation is proposing to amend Rule 3020 of the National Association of Securities Dealers, Inc. ("NASD" or "Association") to grant to the staff authority to adjust the fidelity bond required of a member in certain circumstances upon a showing of good cause, either conditionally or unconditionally. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

3020. Fidelity Bonds

(a) Coverage Required

Each member required to join the Securities Investor Protection Corporation who has employees and who is not a member in good standing of the American Stock Exchange, Inc.; the Boston Stock Exchange; the Midwest Stock Exchange, Inc.; the New York Stock Exchange, Inc.; the Pacific Exchange, Inc.; the Philadelphia Stock Exchange, Inc.; or the Chicago Board Options Exchange shall:

(1) Maintain a blanket fidelity bond, in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America, covering officers and employees which provides against loss and has agreements covering at least the following:

(A) Fidelity

(B) On Premises

(C) In Transit

(D) Misplacement

(E) Forgery and Alteration (including check forgery)

(F) Securities Loss (including securities forgery)

(G) Fraudulent Trading

(H) Cancellation Rider providing that the insurance carrier will use its best efforts to promptly notify the National Association of Securities Dealers, Inc. in the event the bond is canceled, terminated or substantially modified.

(2) Maintain minimum coverage for all insuring agreements required in this paragraph (a)

of not less than $25,000;

(3) Maintain required minimum coverage for Fidelity, On Premises, In Transit, Misplacement and Forgery and Alteration insuring agreements of not less than 120% of its required net capital under SEC Rule 15c3-1 up to $600,000. Minimum coverage for required net capital in excess of $600,000 shall be determined by reference to the following table:

Net Capital Requirement	Minimum Coverage
$600,001 - 1,000,000	750,000
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6,000,001 - 12,000,000	4,000,000
12,000,001 - and above	5,000,000

(4) Maintain Fraudulent Trading coverage of not less than $25,000 or 50% of the coverage required in paragraph (a)(3), whichever is greater, up to $500,000;

(5) Maintain Securities Forgery coverage of not less than $25,000 or 25% of the coverage required in paragraph (a)(3), whichever is greater, up to $250,000.

(b) Deductible Provision

(1) A deductible provision may be included in the bond of up to $5,000 or 10% of the minimum insurance requirement established hereby, whichever is greater.

(2) If a member desires to maintain coverage in excess of the minimum insurance requirement then a deductible provision may be included in the bond of up to $5,000 or 10% of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum permissible deductible amount described in subparagraph (1) above must be deducted from the member's net worth in the calculation of the member's net capital for purposes of SEC Rule 15c3-1. Where the member is a subsidiary of another Association member the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

(c) Annual Review of Coverage

(1) Each member, other than members covered by subparagraph (2), shall annually review, as of the anniversary date of the issuance of the bond, the adequacy thereof by reference to the highest required net capital during the immediately preceding twelve-month period, which amount shall be used to determine minimum required coverage for the succeeding twelve-month period pursuant to subparagraphs (a)(2), (3), (4) and (5).

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first year by 15. Such amount shall be used in lieu of required net capital under SEC Rule 15c3-1 in determining the minimum required coverage to be carried in the member's second year pursuant to subparagraphs (a)(2), (3), (4) and (5). Notwithstanding the above, no such member shall carry less minimum bonding coverage in its second year than it carried in its first year.

(3) Each member shall make required adjustments not more than sixty days after the anniversary date of the issuance of such bond.

(4) Any member subject to the requirements of this paragraph (c) may apply for an exemption from the requirements of this paragraph (c). The application shall be made pursuant to Rule 9610 of the Code of Procedure. The exemption may be granted upon a showing of good cause, including a substantial change in the circumstances or nature of the member's business that results in a lower net capital requirement. An exemption may be subject to any condition or limitation upon its bonding coverage that is deemed necessary to protect the public and to serve the purposes of this Rule.

(d) Notification of Change

Each member shall report the cancellation, termination or substantial modification of the bond to the Association within ten business days of such occurrence.

(e) Definitions

For purposes of fidelity bonding the term "employee" or "employees" shall include any person or persons associated with a member firm (as defined in Article I, paragraph (q) of the By-Laws) except:

(1) Sole Proprietors

(2) Sole Stockholders

(3) Directors or Trustees of member firms who are not performing acts coming within the scope of the usual duties of an officer or employee.

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD Regulation 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 Regulation 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 3020 specifies that members are required to maintain fidelity bonds to insure against certain losses and the potential effect of such losses on firm capital. The rule applies to all members with employees who are required to join the Securities Investor Protection Corporation and who are not covered by the requirements of a national securities exchange. The amount of coverage a member is required to maintain is linked to the member’s net capital requirements under SEC Rule 15c3-1.

Under paragraph (c) of the Rule, each member is required to make an annual review of the adequacy of its fidelity bond coverage and is required to maintain coverage that is adequate to cover the member's highest net capital requirement during the preceding 12 months. The staff have received several requests from members asking for a waiver or interpretation to relieve the member from this requirement in certain circumstances. For example, if a full-service member changed its business by divesting itself of clearing responsibilities so that it no longer holds customer funds or securities, it would still be required to maintain bond coverage that is based on the higher net capital requirement that applied during the preceding year. The Rule in its current form does not permit the staff to provide any relief to the member.

NASD Regulation is proposing to amend the Rule to permit the staff to exempt a member from the requirements of the rule in circumstances similar to those described above and upon a showing of good cause. This authority will permit the staff to adjust the fidelity bond requirements applicable to a member to better tailor them to changes in a member's business. In addition, the proposed amendment will also permit the staff to include conditions in an exemption to ensure that any subsequent increase in capital requirements is accompanied by a corresponding increase in coverage.

The rule change applies a "good cause" standard that will require a member to demonstrate that a modification from the bonding requirement is justified by the level of loss exposure that may be expected from the firm. NASD Regulation notes that the fidelity bonding premiums are set for certain net capital thresholds on the basis of loss experience, and the premiums are changed from time to time to reflect changes in loss experience and to ensure that there are sufficient funds to pay any losses reported to the insurer. In addition, generally losses incurred in a prior year are reported against the firm's current year. NASD Regulation intends to apply this authority only where it is clear that an exemption will not have any unintended impact on the insurance pool and the modified coverage would adequately protect the member against potential losses.

Requests for exemption would be considered under recently adopted Procedures for Exemption in the 9600 Series of Rules in the Code of Procedure. Under the procedures the staff issues written determinations that are subject to review by the National Adjudicatory Council.

(b) **Statutory Basis**

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, in that the proposed amendments are designed to accommodate members whose financial circumstances have changed so that they could obtain an exemption from maintaining fidelity bond coverage at higher previous levels if they can show that there is no regulatory reason for the higher coverage required by Rule 3020, without otherwise compromising investor protection.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation 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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. by order approve such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

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

Jonathan G. Katz
Secretary