

April 10, 2000

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

Re: **File No. SR-NASD-99-05, Amendment No. 5** - Amendments to Rule 2520 (Margin Rules) Relating to Margin for Exempted Borrowers, Good Faith Accounts, Joint Back Office Arrangements and Options Transactions

Dear Ms. England:

NASD Regulation hereby amends the above-referenced rule filing to incorporate certain proposed maintenance margin requirements for non-equity securities and options-related requirements, both of which are the subject of more recent NASD rule filings (SR-NASD-00-08, submitted March 3, 2000, and SR-NASD-00-15, submitted March 31, 2000, respectively), to maintain consistency between this proposed rule change and the two more recently proposed rule changes.

Specifically, SR-NASD-99-05 currently requires that haircuts under Rule 15c3-1 of the Securities Exchange Act of 1934 (the "Net Capital Rule") be used when a member computes its capital charges for Rule 2520 purposes. In SR-NASD-00-08, NASD Regulation proposed net capital deductions under Rule 2520 for non-equity securities for broker/dealer proprietary accounts that are less than the haircut requirements under the Net Capital Rule. Therefore, through this Amendment No. 5, the requirements as proposed in SR-NASD-00-08 are being incorporated into the proposed rule change set forth in SR-NASD-99-05.

With respect to options transactions in a cash account, SR-NASD-99-05 proposes that certain debit put spreads be permitted in the customer cash account. SR-NASD-00-15 proposes to expand the types of options transactions permissible in a cash account as part of proposed Rule 2520(f)(2)(M)(ii) through (iv), and in doing so, replaces proposed Rule 2520(f)(2)(M)(ii) of SR-NASD-00-05 in its entirety. Therefore, through this Amendment No. 5, Rule 2520 (f)(2)(M)(ii)

proposed in SR-NASD-99-05 is being deleted and incorporates by reference the corresponding requirements proposed in SR-NASD-00-15.

In addition, NASD Regulation is clarifying the intent of proposed Rule 2520(e)(6)(B)(ii)c., which describes the requirements when the equity in a Joint Back Office ("JBO") participant's account falls below the prescribed requirements. The proposed rule change provides requirements for establishing and maintaining JBO arrangements and requires each participant to maintain a minimum net liquidating equity of \$1 million in its account. If the amount of equity in the participant's account drops below this prescribed minimum, the participant would no longer be an eligible JBO participant pursuant to Rule 2520 unless the necessary minimum equity was reestablished in the account within the prescribed number of days (i.e. 5 business days). Participants who lose their Rule 2520 JBO eligibility and are not "exempted borrowers" (as defined in Regulation T) would be subject to the margin account requirements prescribed for customers in Regulation T. In addition, such participants would be subject to the maintenance margin requirements pursuant to the other provisions of Rule 2520.

Therefore, through this Amendment No. 5, the proposed changes described above are being incorporated into the proposed rule change set forth in SR-NASD-99-05, and the text of Rule 2520(e)(5) and (6) of the proposed rule change is hereby amended as follows (additions made pursuant to this amendment are included and are indicated by doubleunderline; additions and deletions made as part of previous filings and amendments to SR-NASD-99-05 are indicated by underscoring and [brackets], respectively):

2520. Margin Requirements

* * *

(e)(5) Specialists' and Market Makers' Accounts

(A) A member may carry the account of an "approved specialist or market maker," which account is limited to specialist or market making transactions, upon a margin basis which is satisfactory to both parties. The amount of any deficiency between the equity in the account and the [margin required by the other provisions of this paragraph and the] haircut requirements pursuant to SEC Rule 15c3-1 shall be charged against the member's net capital when computing net capital under SEC Rule 15c3-1. However, when computing net capital deductions for transactions in securities covered by paragraphs (e)(2)(F) and (e)(2)(G) of this Rule, the respective requirements of those paragraphs may be used rather than the haircut requirements of SEC Rule 15c3-1.

For the purpose of this subparagraph, the term "approved specialist or market maker" means either:

(i) a specialist or market maker, who is deemed a specialist for all purposes under the Act and who is registered pursuant to the rules of a national securities exchange; or

(ii) an OTC market maker or third market maker, who meets the requirements of Section 220.7(g)(5)[12(d)] of Regulation T [of the Board of Governors of the Federal Reserve System].

(B) In the case of a joint account carried by a member in accordance with subparagraph (i) above in which the member participates, the equity maintained in the account by the other participants may be in any amount which is mutually satisfactory. The amount of any deficiency between the equity maintained in the account by the other participants and their proportionate share of the [margin required by the other provisions of this paragraph] the haircut requirements pursuant to SEC Rule 15c3-1 shall be charged against the member's net capital when computing net capital under SEC Rule 15c3-1. However, when computing net capital deductions for transactions in securities covered by paragraphs (e)(2)(F) and (e)(2)(G) of this Rule, the respective requirements of those paragraphs may be used, rather than the haircut requirements of SEC Rule 15c3-1.

(6) Broker/Dealer Accounts

(A) A member may carry the proprietary account of another broker/dealer, which is registered with the Commission, upon a margin basis which is satisfactory to both parties, provided the requirements of Regulation T [of the Board of Governors of the Federal Reserve System] are adhered to and the account is not carried in a deficit equity condition. The amount of any deficiency between the equity maintained in the account and the [margin required by the other provisions of this paragraph] haircut requirements pursuant to SEC Rule 15c3-1 shall be charged against the member's net capital when computing net capital under SEC Rule 15c3-1. However, when computing net capital deductions for transactions in securities covered by paragraphs (e)(2)(F) and (e)(2)(G) of this Rule, the respective requirements of those paragraphs may be used, rather than the haircut requirements of SEC Rule 15c3-1.

(B) Joint Back Office Arrangements

An arrangement may be established between two or more registered broker/dealers pursuant to Regulation T Section 220.7, to form a joint back office

("JBO") arrangement for carrying and clearing or carrying accounts of participating broker/dealers. Members must provide written notification to the Association prior to establishing a JBO arrangement.

(i) A carrying and clearing, or carrying member must:

a. maintain a minimum tentative net capital of \$25 million as computed pursuant to SEC Rule 15c3-1, except that a member whose primary business consists of the clearance of options market-maker accounts may carry JBO accounts provided that it maintains a minimum net capital of \$7 million as computed pursuant to SEC Rule 15c3-1. In addition, the member must include in its ratio of gross options market maker haircuts required by the provisions of SEC Rule 15c3-1 gross deductions for JBO participant accounts. Clearance of option market maker accounts shall be deemed a broker/dealer's primary business if a minimum of 60% of the aggregate deductions in the above ratio are options market maker deductions. In the event that a carrying and clearing, or a carrying member's tentative net capital, or net capital, respectively, has fallen below the above requirements, the firm shall: 1. promptly notify the Association in writing of such deficiency, 2. take appropriate action to resolve such deficiency within three consecutive business days, or not permit any new transactions to be entered into pursuant to the JBO arrangement;

b. maintain a written risk analysis methodology for assessing the amount of credit extended to participating broker/dealers which shall be made available to the Association on request; and

c. deduct from net capital haircut requirements pursuant to SEC Rule 15c3-1 amounts in excess of the equity maintained in the accounts of participating broker/dealers. However, for net capital deductions for transactions in securities covered by paragraphs (e)(2)(F) and (e)(2)(G) of this Rule, the respective requirements of those paragraphs may be used, rather than the haircut requirements of SEC Rule 15c3-1.

(ii) A participating broker/dealer must:

a. be a registered broker/dealer subject to the SEC's net capital requirements;

b. maintain an ownership interest in the carrying/clearing member organization pursuant to Regulation T of the Federal Reserve Board, Section 220.11; and

c. maintain a minimum liquidating equity of \$1 million in the JBO arrangement exclusive of the ownership interest established in (ii)b. above. When the minimum liquidating equity decreases below the \$1 million requirement, the participant must deposit an amount sufficient to eliminate this deficiency within 5 business days or be subject to margin account requirements prescribed for customers in Regulation T, and the margin requirements pursuant to the other provisions of this Rule.

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(f)(2)(M) Cash account transactions - A member may make option transactions in a customer's cash account, providing:

(i) The transaction is permissible under Regulation T, Section 220.8;
or

(ii) [The transaction is a debit put spread in listed broad-based index options with European-style exercise comprised of a long put(s) coupled with a short put(s) overlying the same broad-based index with an equivalent underlying aggregate index value and the short put(s) and long put(s) expire simultaneously, and the strike price of the long put(s) exceed the strike price of the short put(s).]

If you have any questions, please contact Stephanie M. Dumont, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8176; e-mail Stephanie.Dumont@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden S. Adkins
Senior Vice President
and General Counsel

cc: Yvonne Fraticelli