

Via Hand Delivery

June 17, 2003

Ms. 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-2003-74; Amendment No. 1 to Proposed Rule Change Regarding Regulation of Activities of Members Experiencing Financial and/or Operational Difficulties

Dear Ms. England:

Enclosed please find Amendment No. 1 to the above-numbered rule filing. As shown on the attached Exhibit 1, this amendment makes the following changes to the proposed rule change to NASD Rule 3130, Rule 3131, Rule 9412, and Rule 9413:

- (1) Rule 3130(e) - adds "The Department of Member Regulation may issue a notice to such member directing it to suspend all business operations; however, the member's obligation to suspend all business operations arises from its obligations under SEC Rule 15c3-1 and is not dependent on any notice that may be issued by the Department of Member Regulation."
- (2) New Rule 3130(f) - "Any notice directing a member to limit or suspend its business operations shall be issued by the Department of Member Regulation pursuant to Rule 9412."
- (3) Rule 3131(e) - adds "The Department of Member Regulation may issue a notice to such member directing it to suspend all business operations; however, the member's obligation to suspend all business operations arises from its obligations under Section 402.2 of the rules of the Treasury Department and is not dependent on any notice that may be issued by the Department of Member Regulation."

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- (4) New Rule 3131(f) - "Any notice directing a member to limit or suspend its business operations shall be issued by the Department of Member Regulation pursuant to Rule 9412."
- (5) Rule 9412 - removes underline from "business activities" and underlines "Rule"
- (6) Rule 9413 - adds "any of" to first sentence
- (7) Rule 9413(k)(2)(E) - underlines "restrictions"

If you have any questions, please contact Shirley H. Weiss, Office of General Counsel, Regulatory Policy and Oversight, 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,

Shirley H. Weiss
Associate General Counsel

Enclosures

cc: Kelly Riley
Lisa Jones
Ann Leddy
Bonnie Gauch

EXHIBIT 1

Below is the text of the proposed rule change. Additions pursuant to SR-NASD-2003-74 are underlined. Additions pursuant to Amendment No. 1 are double underlined. Proposed deletions are in brackets.

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3130. Regulation of Activities of Members Experiencing Financial and/or Operational Difficulties

(a) Application--For the purposes of this Rule, the term "member" shall be limited to any NASD member [of the Association who] that is not designated to another self-regulatory organization by the Commission for financial responsibility pursuant to Section 17 of the Act and SEC Rule 17d-1 thereunder. Further, the term shall not be applicable to any member [who] that is [subject to paragraphs (a)(2)(iv), (a)(2)(v) or (a)(2)(vi) of SEC Rule 15c3-1, or is otherwise exempt from the provisions of said rule or is] subject to Rule 3131.

(b) Each member subject to SEC Rule 15c3-1 shall comply with the net capital requirements prescribed therein and with the provisions of this Rule.

[(b)] (c) A member, when so directed by [the Association] NASD, shall not expand its business during any period in which:

(1) Any of the following conditions continue to exist, or have existed, for more than 15 consecutive business days:

(A) A firm's net capital is less than 150 percent of its net capital minimum requirement or such greater percentage thereof as may from time to time be prescribed by [the Association] NASD;

(B) If subject to the aggregate indebtedness requirement under SEC Rule 15c3-1, a firm's aggregate indebtedness is more than 1,000 per centum of its net capital;

(C) If, in lieu of paragraph [(b)](c)(1)(B) above, the specified percentage of the aggregate debit items in the Formula for Determination of Reserve Requirements for Brokers and Dealers under SEC Rule 15c3-3 (the alternative net capital requirement) is applicable, a firm's net capital is less than 5 percent of the aggregate debit items thereunder; or

(D) The deduction of capital withdrawals including maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in subparagraph (A), (B) or (C).

(2) [The Association] NASD restricts the member for any other financial or operational reason.

[(c)] (d) A member, when so directed by [the Association] NASD, shall forthwith reduce its business:

(1) to a point [enabling its available capital to comply with the standards] at which the member would not be subject to a prohibition against expansion of its business as set forth in paragraph [(b)](c)(1)(A), (B) or (C) of this Rule if any of the following conditions continue to exist, or have existed, for more than [fifteen (15)] 15 consecutive business days:

(A) A firm's net capital is less than 125 percent of its net capital minimum requirement or such greater percentage thereof as may from time to time be prescribed by [the Association] NASD;

(B) No Change.

(C) If, in lieu of paragraph [(c)](d)(1)(B) above, the specified percentage of the aggregate debit items in the Formula for Determination of Reserve Requirements for Brokers and Dealers, under SEC Rule 15c3-3 (the alternative net capital requirement) is applicable, a firm's net capital is less than 4 percent of the aggregate debit items thereunder; or

(D) If the deduction of capital withdrawals including maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in paragraph [(c)](d)(1)(A), (B) or (C) of this Rule.

(2) As required by [the Association] NASD when it restricts a member for any other financial or operational reason.

(e) A member shall suspend all business operations during any period of time when the member is not in compliance with applicable net capital requirements as set forth in SEC Rule 15c3-1. The Department of Member Regulation may issue a notice to such member directing it to suspend all business operations; however, the member's obligation to suspend all business operations arises from its obligations under SEC Rule 15c3-1 and is not dependent on any notice that may be issued by the Department of Member Regulation.

(f) Any notice directing a member to limit or suspend its business operations shall be issued by the Department of Member Regulation pursuant to Rule 9412.

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3131. Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties

(a) Application--For the purposes of this Rule, the term "member" shall be limited to any member of [the Association] NASD registered with the Commission pursuant to Section 15C of the Act that is not designated to another self-regulatory organization by the Commission for financial responsibility pursuant to Section 17 of the Act and Rule 17d-1 thereunder. [Further, the term shall not be applicable to any member that is subject to Section 402.2(c) of the rules of the Treasury Department, or is otherwise exempt from the provisions of said rule].

(b) Each member subject to Section 402.2 of the rules of the Treasury Department shall comply with the capital requirements prescribed therein and with the provisions of this Rule.

[(b)](c) A member, when so directed by [the Association] NASD, shall not expand its business during any period in which:

(1) Any of the following conditions continue to exist, or have existed, for more than [fifteen (15)] 15 consecutive business days:

(A) A firm's liquid capital is less than 150 percent of the total haircuts or such greater percentage thereof as may from time to time be prescribed by [the Association] NASD.

(B) through (C) No Change.

(2) [The Association] NASD restricts the member for any other financial or operational reason.

[(c)] (d) A member, when so directed by [the Association] NASD, shall forthwith reduce its business:

(1) To a point [enabling its available capital to comply with the standards] at which the member would not be subject to a prohibition against expansion of its business as set forth in subparagraphs [(b)](c)(1)(A), (B), or (C) of this Rule if any of the following conditions continue to exist, or have existed, for more than [fifteen (15)] 15 consecutive business days:

(A) A firm's liquid capital is less than 125 percent of total haircuts or such greater percentage thereof as may from time to time be prescribed by [the Association] NASD.

(B) through (C) No Change.

(2) As required by [the Association] NASD when it restricts a member for any other financial or operational reason.

(e) A member shall suspend all business operations during any period of time when the member is not in compliance with applicable net capital requirements as set forth in Section 402.2 of the rules of the Treasury Department. The Department of Member Regulation may issue a notice to such member directing it to suspend all business operations; however, the member's obligation to suspend all business operations arises from its obligations under Section 402.2 of the rules of the Treasury Department and is not dependent on any notice that may be issued by the Department of Member Regulation.

(f) Any notice directing a member to limit or suspend its business operations shall be issued by the Department of Member Regulation pursuant to Rule 9412.

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9400. [LIMITATION] PROCEDURES FOR ACTIONS TAKEN UNDER RULES 3130 AND 3131

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Rule 9412. Notice [of Limitations]

The Department of Member Regulation may issue a notice directing a member to [limit] restrict its business activities, either by limiting or ceasing to conduct those activities, if the Department of Member Regulation has reason to believe that [any] a condition specified in Rule 3130 or Rule 3131 exists. The notice shall specify the grounds on which such [action is being taken] restrictions are being imposed, the nature of the [limitations] restrictions to be imposed, the effective date of the restrictions [limitations], a fitting sanction that will be imposed if the member fails to comply with any [the] restrictions [limitations] set forth in the notice, and the conditions for terminating such [limitations] restrictions. The effective date of the [limitations] restrictions shall be at least seven days after the date of service of the notice. The notice also shall inform the member that it may request a hearing before the [Department of Member Regulation] Office of Hearing Officers under Rule 9413. The Department of Member Regulation shall serve the notice by facsimile or overnight courier.

9413. Hearing Panel Review

(a) Request for a Hearing

A member subject to a notice issued under Rule 9412 may file a written request for hearing before a Hearing Panel with the Office of Hearing Officers. The request shall state the specific grounds for withdrawing or modifying any of the [limitations] restrictions specified in the notice. The request shall be filed pursuant to Rules 9135, 9136, and 9137 within five days

after service of the notice under Rule 9412. The member may withdraw its request at any time by filing a written notice with the Office of Hearing Officers pursuant to Rules 9135, 9136, and 9137. The time limits set forth herein are to be strictly construed and cannot be modified except for good cause shown.

(b) No Change.

(c) Stay

Unless otherwise ordered by the NASD Board Executive Committee, the [initiation of a review under this paragraph shall stay the decision of the Department of Member Regulation or an uncontested notice until a decision constituting final action of the Association is issued] request for a hearing shall stay the effective date of the notice.

(d) through (h) No Change.

(i) Evidence Not Admitted

Evidence that is proffered but not admitted during the hearing shall not be part of the record, but shall be retained by the custodian of the record until the date when [the Association's] NASD's decision becomes final or, if applicable, upon the conclusion of any review by the Commission or the federal courts.

(j) Failure to Request Hearing

If a member does not request a hearing under paragraph (a), the [limitations] restrictions specified in the notice shall become effective on the date specified in the notice. Unless the Executive Committee calls the notice for review under Rule 9415, the [limitations] restrictions specified in the notice shall remain in effect until the Department of Member Regulation reduces or removes the [limitations] restrictions pursuant to Rule 9417(b).

(k) Decision

(1) Within seven days after the hearing, the Hearing Panel shall issue a written decision approving, modifying, or withdrawing the [limitations] restrictions specified in the notice. If the decision imposes [limitations] restrictions, the decision shall state the grounds for the [limitations] restrictions, the conditions for terminating such [limitations] restrictions, and provide for a fitting sanction to be imposed under Rule 9416 if the member fails to comply with the [limitations] restrictions. The Office of Hearing Officers shall promptly serve the decision by facsimile or overnight courier pursuant to Rules 9132 and 9134. The [limitations] restrictions imposed shall become effective upon service of the decision.

(2) Contents of Decision

The decision shall include:

(A) a description of the Department of Member Regulation's [decision] notice, including its rationale;

(B) a description of the principal issues regarding the imposition of [limitations] restrictions raised in the review and a statement supporting the disposition of such issues;

(C) No Change.

(D) a statement of whether the Department of Member Regulation's [decision] notice is affirmed, modified, or reversed, and a rationale therefor;
and

(E) if any restrictions [limitations] are imposed:

(i) a description of the [limitations] restrictions and a statement describing a fitting sanction that will be imposed under Rule 9416 if the member fails to comply with any of the [limitations] restrictions; and

(ii) the conditions for terminating the [limitations] restrictions.

(l) Issuance of Decision After Expiration of Call for Review Period

The Hearing Panel shall provide its proposed written decision to the NASD Board Executive Committee. The NASD Board Executive Committee may call the proceeding for review pursuant to Rule 9415. If the NASD Board Executive Committee does not call the proceeding for review, the proposed written decision of the Hearing Panel shall constitute the final action of [the Association] NASD.

(m) Ex Parte Communications

The prohibitions against ex parte communications in Rule 9143 shall become effective under the Rule 9410 Series when [Association] NASD staff has knowledge the NASD Board Executive Committee intends to review a decision on its own motion under this Rule.

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