

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

Margaret H. McFarland,

Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49383; File No. SR-NASD-2004-014]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 by National Association of Securities Dealers, Inc. to Adopt Interpretative Material 3150 to Establish Exemptions From the Reporting Requirements of NASD Rule 3150

March 9, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 27, 2004, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. On February 20, 2004, NASD amended the proposed rule change.<sup>3</sup> NASD filed the proposal pursuant to Section 19(b)(3)(A) of the Act,<sup>4</sup> and Rule 19b-4(f)(1)<sup>5</sup> thereunder, in that the proposed rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule, which renders the proposal effective upon filing with the Commission. 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 is proposing to adopt Interpretative Material 3150 (“IM-3150”) to establish exemptions from the reporting requirements of NASD Rule 3150. The text of the proposed rule change is below. Proposed new language is in italics; proposed 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 its 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.*

\* \* \* \* \*

### 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 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 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

##### 1. Purpose

NASD 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 NASD 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

<sup>13</sup> 17 CFR 200.30-3(a)(12).

<sup>14</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated February 20, 2004 (“Amendment No. 1”). In Amendment No. 1, NASD made technical corrections and minor language revisions to the filing. For purposes of calculating the 60-day abrogation period, the Commission considers the period to have commenced on February 20, 2004, the date NASD filed Amendment No. 1. *see* 15 U.S.C. 78s(b)(3)(C).

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(f)(1).

NASD 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>6</sup> in which NASD stated that it would exempt the following classes of self-clearing members from the filing requirements of NASD Rule 3150:

1. members that derive the preponderance of their revenue for the last two calendar years from fixed income securities;

2. members that conduct an institutional business and that settle transactions on an RVP/DVP basis;

3. members that conduct no traditional retail securities business.

Based on these classes and NASD's current regulatory needs, proposed IM-3150 would establish three classes of self-clearing members that may be exempt from the reporting requirements of NASD Rule 3150(a).

Under proposed IM-3150(a)(1), NASD generally would exempt self-clearing firms that are primarily engaged in transactions in fixed income securities. Proposed IM-3150(a)(1) replaces the term "preponderance of their revenue" set forth in the June 20, 2002 letter with the phrase "at least 85 percent of its revenue" and eliminates the requirement that members must have derived at least 85 percent of their revenue for the last two calendar years from fixed income securities. Instead, to qualify for this exemption, members must be able to ascertain that transactions in fixed income securities account for at least 85 percent of their annual revenue. Annualizing the 85 percent requirement allows firms to average their fixed income business over one year and takes into account daily, weekly, and monthly fluctuations in a firm's sources of revenue. Proposed IM-3150(a)(1) further clarifies that members must have derived at least 85 percent of their revenue from transactions in fixed income securities. These changes are consistent with the exemptions NASD staff has granted under this standard pursuant to the June 20, 2002 letter.

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

NASD is proposing to modify the language of the exemption pertaining to "members that conduct no traditional retail securities business" in order to clarify the types of firms that might qualify for this exemption. Accordingly, proposed IM-3150(a)(3) would create an exemption for firms that do not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts (e.g., engage solely in proprietary trading, or conduct business only with other broker-dealers).

Additionally, under proposed IM-3150(b), NASD may 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 falls within one of the three proposed classes. Proposed IM-3150 continues to require members to request all exemptions from NASD Rule 3150(a) in writing pursuant to the Rule 9600 Series, including possible exemptions under proposed IM-3150. Members that do not fall within one or more of the three enumerated classes set forth in proposed IM-3150 are not precluded from requesting an exemption from NASD Rule 3150(a), pursuant to Rule 3150(b) and the Rule 9600 Series, if they believe their business activities justify such a request.

NASD is currently reviewing the electronic surveillance system's data requirements in view of current regulatory developments. Among other things, NASD will be reassessing whether firms that primarily conduct an institutional business should be exempted from the reporting requirements of NASD Rule 3150. In the event NASD seeks to amend or rescind the classes of firms for which exemptions from NASD Rule 3150 generally will be available under proposed IM-3150, NASD will file a proposed rule change to amend IM-3150. Additionally, in the event there is a change in the facts pertaining to a self-clearing firm's business such that the firm would no longer qualify for an exemption granted by NASD under IM-3150, the exemption is revoked under IM-3150(c), and the affected self-clearing firm must notify the Department of Member Regulation and commence reporting under NASD Rule 3150.<sup>7</sup>

<sup>7</sup> It is the position of NASD that any exemptive letter granted may be rendered a nullity when the material facts upon which such exemptive letter is premised have changed or are otherwise determined to be false. In view of the fact that NASD processes the information collected under NASD Rule 3150 for use in effectuating its examination program, NASD believes it is important to expressly state this position in the rule

In addition, the proposed rule change replaces several references to "the Association" in the text of the proposed rule change with "NASD." NASD no longer refers to itself using its full corporate name or "the Association." Instead, NASD uses "NASD" unless otherwise appropriate for corporate or regulatory reasons.<sup>8</sup>

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>9</sup> which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change is designed to accomplish these ends by publishing the grounds upon which NASD generally will exempt self-clearing and clearing firms from the reporting requirements of NASD Rule 3150(a).

### B. Self-Regulatory Organization's Statement on Burden on Competition

NASD 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

The foregoing proposal has become effective pursuant to Section 19(b)(3)(A) of the Act,<sup>10</sup> and Rule 19b-4(f)(1)<sup>11</sup> thereunder, in that it constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is

and require affected self-clearing broker-dealers to notify the Department of Member Regulation of the lapse of any exemption under IM-3150 because of a disqualifying change in the material facts.

<sup>8</sup> Telephone conversation between Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, and Sheila D. Swartz, Attorney, Division of Market Regulation, Commission (March 2, 2004).

<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>11</sup> 17 CFR 240.19b-4(f)(1).

<sup>6</sup> NASD has published this letter on the NASD Web site at [http://www.nasdr.com/insite\\_mem\\_letters.asp](http://www.nasdr.com/insite_mem_letters.asp).

necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-NASD-2004-014. This file number should be included on the subject line if e-mail is used. To help the Commission process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 file number SR-NASD-2004-014 and should be submitted by April 6, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49381; File No. SR-PCX-2004-11]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to the Exchange's Designated Examination Fee Exemption

March 9, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 18, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange"), through its wholly-owned subsidiary PCX Equities, Inc. ("PCXE"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. 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

The Exchange is proposing to amend the regulatory fee portion of its Schedule of Fees and Charges ("Fees") in order to make a technical change to its Designated Examination Fee ("DEA") Fee exemption. The text of the proposed rule change is attached as Exhibit A. The text of the proposed rule changes is available at the PCX and at the Commission.

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

In its filing with the Commission, the PCX 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. The Exchange 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

##### 1. Purpose

The Exchange is proposing to amend the regulatory fee portion of its Fees in order to make a technical change to the DEA Fee exemption.

On September 24, 2003, the Exchange submitted a filing with the Commission to amend the DEA Fee exemption.<sup>3</sup> In this filing, the Exchange amended the existing DEA Fee exemption to allow an exemption for any PCX Registered Floor Broker or Marker Maker<sup>4</sup> that effects at least 25% of all securities transactions, as measured in contract or share volume, on the PCX Floor or any other PCX Options trading facility, including PCX Plus. The amendment was intended to more accurately reflect the application of the exemption and references the Exchange's new trading platform, PCX Plus. This amendment became effective upon filing.

At this time, the Exchange proposes to make one technical change to the DEA Fee exemption, by adding the word "and" to the phrase "as measured in contract or share volume." As revised, the phrase would read "as measured in contract and/or share volume." The exemption is intended to be calculated using all securities transactions, as measured in contract and/or share volume. In other words, the 25% securities transactions threshold can be met based on either a combination of contracts and share volume, or exclusively contracts or share volume. The word "and" was inadvertently omitted from the previously filing and the Exchange wishes to make the technical correction at this time.

##### 2. Statutory Basis

The Exchange believes that the proposal is consistent with Section 6(b) of the Act,<sup>5</sup> in general, and Section 6(b)(4) of the Act,<sup>6</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among its members.

#### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose

<sup>3</sup> See Securities Exchange Act Release No. 48569 (September 30, 2003), 68 FR 57721 (October 6, 2003) (SR-PCX-2003-52).

<sup>4</sup> Pursuant to Rule 6.1(c)(2), the term "Market Maker" includes Lead Market Maker, Remote Market Maker, Floor Market Maker and Supplemental Market Maker.

<sup>5</sup> 15 U.S.C. 78f(b).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>12</sup> 17 CFR 200.30-3(a)(12).