

from exempt accounts individually and in the aggregate; and

- Procedures providing for the regular review and testing of these risk management procedures by an independent unit such as internal audit, risk management, or other comparable group.

#### E. Amendment No. 2

Amendment No. 2 revises the proposal by modifying the definition of "exempt account" in proposed NASD Rule 2520(a)(13). The proposed changes to proposed NASD Rule 2520(a)(13), as published in the 2000 Release,<sup>25</sup> appear below. Proposed additions are in *italics*; proposed deletions are in [brackets].

### 2520. Margin Requirements

#### (a) Definitions

For purposes of this paragraph, the following terms shall have the meanings specified below:

(1) through (12). No change.

(13) The term "exempt account" means: [a member, non-member broker/dealer registered as a broker or dealer under the Act, "designated account," or any person having net worth of at least forty-five million dollars and financial assets of at least forty million dollars.]

(A) *a member, non-member broker/dealer registered as a broker or dealer under the Act, a "designated account," or*

(B) *any person that:*

(i) *has a net worth of at least forty-five million dollars and financial assets of at least forty million dollars for purposes of subparagraphs (e)(2)(F) and (e)(2)(G), and*

(ii) *either:*

a. *has securities registered pursuant to Section 12 of the Act, has been subject to the reporting requirements of Section 13 of the Act for a period of at least 90 days and has filed all the reports required to be filed thereunder during the preceding 12 months (or such shorter period as it was required to file such reports), or*

b. *has securities registered pursuant to the Securities Act of 1933, has been subject to the reporting requirements of Section 15(d) of the Act for a period of at least 90 days and has filed all the reports required to be filed thereunder during the preceding 12 months (or such shorter period as it was required to file such reports), or*

c. *if such person is not subject to Section 13 or 15(d) of the Act, it is a person with respect to which there is publicly available the information specified in paragraphs (a)(5)(i) to (xiv),*

*inclusive, of Rule 15c2-11 under the Act, or*

d. *furnishes information to the Securities and Exchange Commission as required by Rule 12g3-2(b) of the Act, or*

e. *makes available to the member such current information regarding such person's ownership, business, operations and financial condition (including such person's current audited statement of financial condition, statement of income and statement of changes in stockholder's equity or comparable financial reports), as reasonably believed by the member to be accurate, sufficient for the purposes of performing a risk analysis in respect of such person.*

### III. Summary of Comments

The Commission received one comment letter regarding the proposal.<sup>26</sup> The commenter generally supported the proposal, which is substantially identical to a proposal by the New York Stock Exchange, Inc. ("NYSE") that the Commission approved.<sup>27</sup> However, the commenter maintained that the written risk analysis methodology included in the NASD's proposal was not required under the NYSE's proposal and was unnecessary because NASD members already are subject to sophisticated external and internal oversight of credit practices. The NASD responded by noting that the written risk analysis methodology was in fact proposed to be required by the NYSE.<sup>28</sup>

In addition, the commenter referenced its comment letter regarding the NYSE's similar proposal.<sup>29</sup> Specifically, the

<sup>26</sup> See TBMA Letter, *supra* note 4.

<sup>27</sup> See Securities Exchange Act Release No. 48365 (August 19, 2003) (order approving File No. SR-NYSE-98-14) ("NYSE Order"). See also Securities Exchange Act Release Nos. 40278 (July 29, 1998), 63 FR 41822 (August 5, 1998) (notice of File No. SR-NYSE-98-14); and 48133 (July 7, 2003), 68 FR 41672 (July 14, 2003) (notice of Amendment Nos. 1, 2, and 3 to File No. SR-NYSE-98-14) ("2003 Release").

<sup>28</sup> See NASD Letter, *supra* note 5. The NYSE proposed the requirement that members maintain a written risk analysis methodology in Amendment No. 1 to its proposal, which was filed on January 5, 1999, and published for comment on July 14, 2003. The NYSE subsequently filed an Information Memo providing guidelines for a member's written risk analysis methodology. Amendment No. 1 to the NASD's proposal, set forth in Section II.D., *supra*, contains an NTM with written risk analysis methodology guidelines identical to the guidelines established in the NYSE's Information Memo.

<sup>29</sup> See letter from Paul Saltzman, Senior Vice President and General Counsel, TBMA, and Patricia Brigantic, Vice President and Senior Associate General Counsel, TBMA, to Jonathan Katz, Secretary, Commission, dated August 26, 1998 ("TBMA 1998 Letter"). The TBMA 1998 Letter, and the NYSE's response, are discussed in the 2003 Release, *supra* note 27. As noted in the NYSE Order, *supra* note 27, the Commission believes that

commenter requested clarification that: (1) the NYSE's proposed definition of "exempt account" would not supersede the existing definition of "exempt account" in NYSE Rule 431(f)(2)(D)(iv); and (2) existing extensions of credit to accounts that met the current requirements for exempt account status, but that would not meet the proposal's higher financial threshold for exempt accounts, would be "grandfathered" and maintained based on exempt account status even after the increased financial threshold became effective. In this regard, the NASD confirmed that the proposal's definition of "exempt account" does not replace the current definition of "exempt account" contained in NASD Rule 2520(f)(2)(D)(iv). With respect to an extension of credit to an account that currently qualifies as exempt but that would not qualify as an exempt account under the proposal, the NASD indicates that an account's exempt status will be determined as of the date of the initial extension of credit. Accordingly, accounts that meet the current requirements for exempt account status would be "grandfathered" on their existing credit transactions, and the proposal's requirements for exempt account status would apply to any new credit transactions or "roll-overs" of existing credit extensions.

### IV. Discussion

Section 15A(g)(3)(A) of the Exchange Act<sup>30</sup> provides, among other things, that a national securities association may condition membership privileges on compliance with the association's own financial responsibility rules. Pursuant to this authority, the NASD is authorized to promulgate rules governing the financial responsibility requirements of its members. In addition, the Commission finds that the proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder applicable to a national securities association.<sup>31</sup> In particular, as described above, for positions not maintained in exempt accounts, the proposal reduces the customer maintenance margin requirement for certain non-equity securities and establishes a customer maintenance margin requirement of 20% of current market value for other marginable non-equity securities. The Commission believes that these

the NYSE sufficiently addressed the questions raised in the TBMA 1998 Letter.

<sup>30</sup> 15 U.S.C. 78o-3(g)(3)(A).

<sup>31</sup> In approving the proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>25</sup> See note 3, *supra*.