

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54265; File No. SR-NASD-2006-064)

August 2, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to Extension of Time Requests

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 May 15, 2006, the National Association of Securities Dealers, Inc. (“NASD”) 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. On May 25, 2006, NASD filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On July 25, 2006, NASD filed Amendment No. 2 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

NASD is proposing to adopt new Rule 3160 to require (1) all clearing firm members for which NASD is the designated examining authority (“DEA”) pursuant to Rule 17d-1 under the Act to submit to NASD requests for extensions of time under

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

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

<sup>3</sup> In Amendment No. 1, NASD made non-substantive changes to the discussion of the purpose of the proposed rule change.

<sup>4</sup> Amendment No. 2 replaces and supersedes the original proposed rule filing and Amendment No. 1 in its entirety.

Regulation T promulgated by the Federal Reserve Board (“FRB”), or pursuant to Rule 15c3-3(n) under the Act; and (2) each clearing firm member for which NASD is the DEA to file a monthly report with NASD indicating all broker-dealers for which it clears that have overall ratios of requested extensions of time to total transactions for the month that exceed a percentage specified by NASD. Below is the text of the proposed rule change. Proposed new language is underlined.

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3160. Extensions of Time Under Regulation T and SEC Rule 15c3-3

(a) When NASD is the designated examining authority pursuant to SEC Rule 17d-1 for a member that is a clearing firm, such member must submit requests for extensions of time as contemplated by Sections 220.4(c) and 220.8(d) of Regulation T of the Federal Reserve Board and SEC Rule 15c3-3(n) to NASD for approval, in such format as NASD may require.

(b) Each member that is a clearing firm for which NASD is the designated examining authority is required to file a monthly report with NASD in such format as NASD may require, indicating all broker-dealers for which it clears that have overall ratios of requests for extensions of time as contemplated by Sections 220.4(c) and 220.8(d) of Regulation T of the Federal Reserve Board and SEC Rule 15c3-3(m) to total transactions for the month that exceed a percentage specified by NASD. The report is due to NASD within five (5) business days following the end of each reporting month.

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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

Background

Regulation T, issued by the Board of Governors of the Federal Reserve System (“FRB”) pursuant to the Act, among other things, governs the extension of credit to customers by broker-dealers for purchasing securities.<sup>5</sup> Rule 15c3-3 under the Act, among other things, requires broker-dealers to promptly obtain and maintain physical possession or control of customer securities and designates periods of time within which broker-dealers must cure any deficiency by buying-in or otherwise obtaining possession or control of the securities.<sup>6</sup> Under SEC Rule 15c3-3(n), a self-regulatory organization (SRO) may extend certain specified periods to buy-in a security, for one or more limited periods commensurate with the circumstances, where the SRO: (1) is satisfied that the broker-dealer is acting in good faith in making the request; and (2) exceptional

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<sup>5</sup> 12 CFR 220.4(c) and 220.8(d). Regulation T provides that a customer has one payment period (currently five business days) to submit payment for purchases of securities in a cash account or in a margin account.

<sup>6</sup> 17 CFR 240.15c3-3.

circumstances warrant such action.<sup>7</sup> Regulation T has a similar standard to allow an extension of time for payment for purchases of securities.<sup>8</sup> The SROs that process extension requests, including NASD, have developed standards and procedures for evaluating, granting, denying, and controlling extension requests. The standards include acceptable reasons for requesting an extension, number of extensions permitted per reason, and special limitations and restrictions on customers.<sup>9</sup>

#### Required Submissions of Requests for Extensions of Time

Proposed NASD Rule 3160(a) would require all clearing firm members for which NASD is the designated examining authority (“DEA”) to submit to NASD requests for extensions of time under Regulation T and SEC Rule 15c3-3(n). While Regulation T currently requires that extension of time requests be directed to a broker-dealer’s DEA, Rule 15c3-3(n) provides that a broker-dealer may request an extension of time from any registered national securities exchange or a registered national securities association.

The SEC previously approved NYSE Rule 434 requiring each firm for which the NYSE is the DEA to submit extensions requests to the NYSE.<sup>10</sup> The SRO designated as a member’s DEA has responsibility for examining its members that are also members of

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<sup>7</sup> See Rule 15c3-3(n), authorizing SROs to extend the periods of time to buy-in a security specified in Rule 15c3-3(d)(2), (d)(3), (h), and (m).

<sup>8</sup> Under Regulation T, a firm’s examining authority may grant an extension unless the examining authority believes that the broker-dealer is not acting in good faith or that the broker-dealer has not sufficiently determined that exceptional circumstances warrant such action.

<sup>9</sup> See NASD Notice to Members 00-45.

<sup>10</sup> See Exchange Act Release No. 34073 (May 17, 1994), 59 FR 26826 (May 24, 1994) (SR-NYSE-88-35) (SEC Order Approving Proposed Rule Change by the NYSE Relating to Extensions of Time for Payment of Delivery of Securities). See also NYSE Information Memo 94-22 (June 10, 1994).

another SRO for compliance with applicable financial responsibility rules such as Regulation T and Rule 15c3-3. Requiring a member to submit extension requests to its DEA helps to ensure that the DEA receives complete extension information to assist it in performing this function. Such information, among other things, can serve as an early indicator of operational or other difficulties. Approval of the proposed rule change also would ensure uniform application of standards to all customers of firms for which NASD is the DEA. For these reasons, NASD believes that this proposed rule change would create a more effective review of extension requests.

#### Monthly Reporting Requirement

Proposed NASD Rule 3160(b) would require each clearing firm member for which NASD is the DEA to file a monthly report with NASD, in such format as NASD may require, indicating all broker-dealers for which it clears that have overall ratios of requests for extensions of time as contemplated by Sections 220.4(c) and 220.8(d) of Regulation T of the Federal Reserve Board and SEC Rule 15c3-3(m) to total transactions for the month that exceed a percentage specified by NASD.<sup>11</sup> The monthly report will require clearing firms subject to proposed Rule 3160(b) to identify, among other things: (1) the broker-dealer's name; (2) the number of transactions by the broker-dealer for the month; (3) the number of extension requests for the month; and (4) the ratio of the number of extensions requested to total transactions. Under the proposal, NASD would require that the reports be submitted no later than five business days following the end of

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<sup>11</sup> Rule 15c3-3(m) (Completion of Sell Orders on Behalf of Customers) requires that if a security sold long by a customer has not been delivered within 10 business days after the settlement date, the broker-dealer must either buy the customer in or apply for and receive an extension from the SRO.

each reporting month. For months when no broker-dealer exceeds the criteria, the clearing firm would submit a report indicating such.

Consistent with the NYSE's program,<sup>12</sup> NASD anticipates restricting the number of Regulation T and Rule 15c3-3(m) extension requests to 1% of total transactions for the month for clearing firms and 3% of total transactions for the month for introducing firms.<sup>13</sup> NASD currently is able to compute the ratio of extensions requested to transactions for clearing firms based on information provided in the extension requests and FOCUS report data; however, NASD would use the information submitted by the clearing firms in the new monthly report to monitor introducing firms' compliance with the anticipated 3% threshold. NASD is creating a new template within its existing electronic filing platform to permit clearing firms to submit the required electronic reports regarding their introducing firms' extension requests.

To the extent that firms exceed the proposed threshold limits, NASD will inform them that their ability to receive extensions for their customers will be stopped for a 90-

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<sup>12</sup> See Exchange Act Release No. 28726 (December 28, 1990), 56 FR 540 (January 7, 1991) (SR-NYSE-89-24) (SEC Order Approving NYSE Proposed Rule Change Relating to Reporting of Extensions of Time for Payment/Delivery of Securities by Correspondent Broker-Dealers); NYSE Information Memoranda 98-09 (March 5, 1998) and 94-22 (June 10, 1994); see also NYSE Information Memorandum 05-78 (October 12, 2005) (establishing pilot for reporting additional fields for extension requests).

<sup>13</sup> NASD anticipates requiring clearing firms to identify in the monthly reports those introducing firms that have overall ratios exceeding 2%, consistent with NYSE requirements, notwithstanding that the proposed limitations for introducing firms would not be triggered until the ratio exceeds 3%. The 2% threshold would provide NASD with an "early warning" notice as to the concentrations of extensions for these introducing firms. In the event NASD adjusts the 1% or 3% thresholds for imposing limitations, or the 2% filing threshold, in the future, it would advise members of the new parameters in a Notice to Members.

day period if such firm does not reduce the number of subsequent requests below the applicable limit by the next reporting period.<sup>14</sup> NASD also intends to direct clearing firm members to impose limits on introducing firms only where the introducing firm engages in 25 or more transactions per month. NASD believes that these limits are appropriate in light of the standard set forth in Regulation T and Rule 15c3-3 that extensions of time may only be granted under “exceptional circumstances.”<sup>15</sup>

NASD 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. To give members sufficient time to make necessary changes to their systems that may be required to comply with proposed Rule 3160, the effective date will be at least 60 days following publication of the Notice to Members announcing Commission approval.<sup>16</sup>

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<sup>14</sup> For example, if an introducing firm exceeds the applicable threshold for the month of January, its clearing firm would report that fact to NASD by February 5. NASD would advise the introducing firm that it had exceeded its threshold and that it must reduce the number of subsequent requests below the limit by the end of February. If the introducing firm exceeds the applicable threshold for the month of February, its clearing firm would report that fact to NASD by March 5 and the 90-day suspension would start at that time.

<sup>15</sup> In the event NASD adjusts these parameters in the future, it will advise its members by means of a Notice to Members.

<sup>16</sup> NASD also filed for immediate effectiveness a proposed rule change to amend Section 8 of Schedule A to NASD’s By-Laws to increase the service charge for processing extension requests to \$4.00 per request. The effective date of the service charge increase was July 1, 2006. See Exchange Act Release No. 53982 (June 14, 2006), 71 FR 35720 (June 21, 2006) (Notice of Filing and Immediate Effectiveness of SR-NASD-2006-063).

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>17</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 will further ensure that firms are complying with financial responsibility rules and preventing the excessive use of credit for the purchase or carrying of securities.

### 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.

### 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, as amended, or

(B) institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

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<sup>17</sup> 15 U.S.C. 78o-3(b)(6).

#### 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. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2006-064 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-064. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of NASD.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2006-064 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

Nancy M. Morris  
Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).