

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52059; File No. SR-NASD-2005-58)

July 19, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Relating to the Reporting of Data to Clearing Firms by Correspondent Firms

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 2, 2005, 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 July 14, 2005, NASD filed Amendment No. 1 to the proposed rule change.³ 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 amend NASD Rule 3150 and Rule 3230 governing the reporting of data to clearing firms by correspondent firms. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1, which replaced and superseded the original filing in its entirety, clarifies which piggybacking arrangements will be subject to the rule and modifies certain rule language to conform with other terms used in NASD rules.

3150. Reporting Requirements for Clearing Firms

(a) No change.

(b) Each member that is a clearing firm is required to report prescribed data to NASD under this Rule in such a manner as to enable NASD to distinguish between data pertaining to all proprietary and customer accounts of an introducing member and data pertaining to all proprietary and customer accounts of any member for which the introducing member is acting as an intermediary in obtaining clearing services from a clearing firm. The reporting requirements of this paragraph (b) shall apply to the proprietary and customer accounts of members that have established an intermediary clearing arrangement with an introducing member on or after [insert effective date of this paragraph (b)].

~~[(b)]~~(c) Pursuant to the Rule 9600 Series, 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.

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3230. Clearing Agreements

(a) through (g) No change.

(h) All clearing agreements shall require each introducing member to maintain its proprietary and customer accounts and the proprietary and customer accounts of any member for which it is acting as an intermediary in obtaining clearing services from the clearing firm in such a manner as to enable the clearing firm and NASD to identify data

belonging to the proprietary and customer accounts of each member. The requirements of this paragraph (h) shall apply to intermediary clearing arrangements between a member and an introducing member that are established on or after [insert effective date of this paragraph (h)].

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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

By way of background, some NASD members choose not to contract for clearing services directly with a clearing firm. The reasons vary. For example, the member may not do a sufficient business to satisfy clearing firm financial and other requirements to support a separate clearing agreement. In such cases, a member may contract for clearing services with an introducing, or intermediary, firm that, in turn, contracts directly with a clearing firm for clearing services. Members that contract for clearing services with an introducing firm are often referred to as "piggybacking" firms, or "piggybackers." Under this arrangement, only the introducing firm has a contractual

arrangement with the clearing firm, which clears for both the introducing firm and the introducing firm's piggybacking firms. Under current practice, the intermediary firm may assign account numbers to the piggybacker's accounts (both proprietary and customer accounts) that do not identify them to the clearing firm as belonging to a piggybacking firm. For example, the introducing firm may assign account numbers that identify these accounts as branch offices of the introducing firm.

Although these piggybacking arrangements may satisfy the business needs of the parties -- the clearing firm, the introducing firm, and the piggybacking firm -- they impede NASD regulatory programs and may cause problems for the clearing firm. For example, under Rule 3150, clearing firms are required to report certain data to NASD for purposes of the surveillance component of its National Examination Program ("NEP"). In fulfilling its reporting obligation under Rule 3150, a clearing firm whose clients include introducing firms that have contracted with piggybackers may be reporting the combined data of the introducing firm and its piggybackers as only belonging to the introducing firm. In such cases, NASD staff is not able to distinguish between data belonging to the introducing firm and data belonging to the piggybacking firm(s) for purposes of conducting surveillance.

This inability to separate out the data can, and already has, become a serious issue where the intermediary firm goes into SIPC ("Securities Investor Protection Corporation") liquidation. If the data from the intermediary and piggybacking firms are not distinguishable, the clearing firm will be unable to facilitate the orderly transfer of accounts without doing time-intensive research and creating a special program to separate

accounts belonging to the introducing firm and its piggybacker(s).

To resolve these issues, NASD is proposing to adopt amendments to Rule 3150 (governing reporting requirements for clearing firms) and Rule 3230 (governing clearing agreements) that would permit regulators and clearing firms to distinguish between data belonging to an introducing firm and data belonging to its piggybacker(s). The proposed amendments to Rule 3150 would require clearing firms to report data to NASD about each piggybacking firm separately from the introducing firm's data. The proposed requirements would apply to the data pertaining to the proprietary and customer accounts of piggybacking firms only if the piggybacking relationship with the introducing firm was established on or after the effective date of this proposed rule change.

The proposed amendments to Rule 3230 would require introducing firms to maintain data in such a way as to enable NASD and the clearing firm to be able to identify the data pertaining to the proprietary and customer accounts of the introducing firm and the data pertaining to the proprietary and customer accounts of any piggybacking firm. These proposed rule changes will enable NASD staff to surveil data reported by piggybacking firms as part of its NEP Surveillance program and facilitate any future SIPC liquidations. The requirements of the proposed rule change would apply only to the data belonging to the proprietary and customer accounts of any piggybacking firm only if the piggybacking relationship was established on or after the effective date of the proposed rule change.⁴

⁴ NASD understands that requiring firms to convert existing accounts would potentially burden customers as the clearing firm may need to issue new account numbers and, as applicable, new debit cards, checking accounts, and passwords

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. NASD is proposing an effective date of 180 days following Commission approval. This will give members time to make necessary changes to their systems.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD 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 giving regulators and clearing firms the ability to determine whether data being reported to clearing firms belongs to an introducing firm or a piggybacking firm. The proposed rule change will enable NASD staff to more clearly identify data being reported to NASD for purposes of NASD's NEP Surveillance and, in those instances where an introducing firm enters a SIPC liquidation, will help to facilitate an orderly liquidation.

issued in connection with the accounts. Accordingly, the piggybacking firms would have to advise these customers in writing that they would be getting new account numbers, and why, and would need to change their records to reflect new customer account numbers. Further, NASD understands that some clearing firms would have to convert such existing accounts to accounts under the customers' names manually, entry by entry. Other data, such as cost basis information, also might have to be manually transferred to the new accounts. Accordingly, while NASD recognizes that there is some risk in not being able to surveil data belonging to accounts held by firms who are currently in piggybacking clearing relationships, it does not believe that the regulatory benefit in requiring such conversion would outweigh the expense and inconvenience to customers and firms.

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

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 Exchange 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 should be disapproved.

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. Please include File Number SR-NASD-2005-58 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-58. 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, 100 F Street, NE, Washington, DC 20549. 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-2005-58 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.⁵

Margaret H. McFarland
Deputy Secretary

⁵ 17 CFR 200.30-3(a)(12).