

INFORMATIONAL

INSITE Reporting Requirements

SEC Approves NASD
Rule Proposal Requiring
Member Clearing And
Self-Clearing Firms To
Report Prescribed Data;
Effective Date:
December 10, 2001

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Executive Representatives
- Legal & Compliance
- Operations
- Senior Management

KEY TOPICS

- INSITE
- Reporting Requirements

Executive Summary

On November 27, 2001, the Securities and Exchange Commission (SEC) approved proposed National Association of Securities Dealers, Inc. (NASD®) Rule 3150, "Reporting Requirements for Clearing Firms." Rule 3150 requires each member that is a clearing firm or self-clearing firm to report to the NASD in such format as the NASD may require prescribed data pertaining to itself and any member for which it clears.¹ This data will be used to facilitate the surveillance component of NASD Regulation's INSITE program. Through the use of INSITE's technology, NASD Regulation will enhance investor protection by identifying potentially high-risk situations as they develop.

The text of the amendments as provided in Attachment A became effective on December 10, 2001.

Questions/Further Information

Questions concerning this Notice may be directed to Frank J. McAuliffe, Member Regulation, NASD Regulation, at (240) 386-4670; Elizabeth A. Wollin, Member Regulation, NASD Regulation, at (240) 386-5156; or Shirley H. Weiss, Office of General Counsel, NASD Regulation, at (202) 728-8844.

The INSITE Program

The data gathered by NASD Regulation under Rule 3150 will be used to facilitate the surveillance component of INSITE (an acronym for Integrated National Surveillance and Information Technology Enhancements), a new business model that will permit NASD Regulation to use sophisticated

statistical analysis techniques to detect emerging risk patterns at member firms. Through INSITE, NASD Regulation will collect and analyze information about members and produce reports that identify "exceptions" based on historical and current comparisons of member data. The exceptions will trigger follow-up reviews and possible examinations. INSITE will permit NASD Regulation to concentrate its examinations on the higher-risk segments of the industry, focus the content of each examination on higher-risk topics, streamline the examination process for examiners and members, and better coordinate regulatory findings with other NASD Regulation departments.

Who Is Subject To The Requirements Of Rule 3150

Rule 3150 requires each member clearing and self-clearing firm to report prescribed data to NASD Regulation. Members may enter into an agreement with a third party, such as a service bureau, pursuant to which the third party agrees to fulfill the clearing or self-clearing firm's obligations under proposed Rule 3150. Notwithstanding the existence of such an agreement, each member that is a clearing or self-clearing firm will be responsible for complying with the reporting requirements of Rule 3150.

What Must Be Reported Under Rule 3150

The text of Rule 3150 does not specify the data that must be reported to NASD Regulation, but members may review the reporting requirements on the NASD Regulation Web Site at <http://www.nasdr.com/insite.asp> (INSITE Firm Data Filing Technical Specifications). The reporting

requirements have been designed to require firms to provide summaries of information that they are already collecting, including, among other things, aggregate net liquidating equity in each clearing firm's correspondents' proprietary accounts, exchange and non-exchange transactions, options transactions, debt transactions, customer accounts, short interest, unsecured customer debits, trade cancellations (T+1 forward), and as-of trades summaries. These data elements may change over time, and NASD Regulation will continue to work with its members and their service bureaus to identify the data that is needed to operate the surveillance component of INSITE and to modify the reporting requirements as necessary. The initial data elements will be reported daily. NASD Regulation will provide clearing and self-clearing firm members with advance notice (in an *NASD Notice to Members* or by other means of communication, such as the NASD Regulation Web Site) of any changes to the required data elements or filing frequency.

What Are The Technical Reporting Requirements Under Rule 3150

Rule 3150 does not specify the method to be used by members in reporting prescribed data. The technical requirements associated with all of the processes necessary for transmitting the required data to NASD Regulation can be found on NASD Regulation's Web Site at <http://www.nasdr.com/insite.asp> (INSITE Firm Data Filing Technical Specifications). Firms may report data via NASD Regulation's Form Filing Web Site or, for firms with connectivity to the NASD OATS private network, through that file transfer protocol. Members may

obtain additional information about reporting responsibilities, technical specifications, compliance issues, and more by contacting NASD Business and Technology Support Services at (800) 321-NASD, or by sending an e-mail to nasdregfiling@nasd.com.

As with any new program or technology, systems failures may arise. When that happens, NASD Regulation expects members to report these failures, correct them as expeditiously as possible, and restart the reporting process. Generally, NASD Regulation will not view a system failure as a disciplinary matter if it has occurred in the normal course of doing business, is not part of a series of systems failures, and the member is attempting to correct it.

The NASD Regulation Web Site also features information that will aid members in making programming changes that will enable them to create the daily summaries required by INSITE. NASD Regulation is also committed to developing a system on its Web Site that will permit members to review the information that they or their service bureaus have reported.

When Will NASD Regulation Require Clearing And Self-Clearing Firms To Report Data Under Rule 3150

NASD Regulation will implement Rule 3150 reporting requirements in phases. The three clearing firms that have been part of an ongoing pilot program will be phased in first, as soon after December 10, 2001, as possible. NASD Regulation will phase in all other members in several stages. NASD Regulation will publish the schedule of phase ins as soon as it has been established, but in no event will NASD Regulation give

member firms less than six months' notice of their start-up date. NASD Regulation will take into account broker/dealers' relationships with service bureaus in establishing the phase-in schedules. NASD Regulation expects Rule 3150 to be fully implemented by the end of 2002.²

Effective Date Of Amendments

These amendments became effective on December 10, 2001.

Endnotes

- 1 See Securities Exchange Act Release No. 45109 (Nov. 27, 2001), 66 FR 63271 (Dec. 5, 2001) (File No. SR-NASD-2001-19) (SEC Approval Order).
- 2 Rule 3150 includes a provision that permits members to request an exemption from Rule 3150's reporting requirements pursuant to the Rule 9600 Series. As stated in Rule 3150(b), exemptions from any or all of the Rule 3150 reporting requirements will be granted only under exceptional and unusual circumstances.

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ATTACHMENT A—RULE TEXT

New language is underlined.

3100. BOOKS AND RECORDS, AND FINANCIAL CONDITION

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 in such format as the Association 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 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.

* * *

PROCEDURES FOR EXEMPTIONS**9610. Application****(a) Where to File**

A member seeking exemptive relief as permitted under Rules 1021, 1070, 2210, 2320, 2340, 2520, 2710, 2720, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3020, 3150, 3210, 3230, 3350, 8211, 8212, 8213, 11870, or 11900, Interpretive Material 2110-1, or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of the Association and provide a copy of the application to the Office of General Counsel of NASD Regulation.

(b) and (c) No change