

# Notice to Members

OCTOBER 2005

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Clearing Agreements  
“Piggybacking” Arrangements  
Rule 3150  
Rule 3230

## GUIDANCE

### Reporting Requirements for “Piggybacking” Arrangements

SEC Approves Amendments to NASD Rule 3150, Regarding Reporting Requirements for Clearing Firms, and NASD Rule 3230, Regarding Requirements for Clearing Agreements; **Effective Date: February 20, 2006**

#### Executive Summary

On August 26, 2005, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 3150, regarding reporting requirements for clearing firms, and NASD Rule 3230, regarding requirements for clearing agreements.<sup>1</sup> The new rule text is contained in Attachment A and is effective on February 20, 2006.

#### Questions/Further Information

Questions concerning this *Notice* may be directed to George Walz, Vice President and Director, National Examination Program, Department of Member Regulation, at (202) 728-8462; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

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## Background

By way of background, some introducing firms choose not to contract for clearing services directly with a clearing firm. The reasons vary. For example, the firm may not do sufficient business to satisfy clearing firm financial and other requirements to support a separate clearing agreement. In such cases, the firm may contract for clearing services with an introducing, or “intermediary” firm that, in turn, contracts directly with a clearing firm for clearing services. Firms that contract for clearing services with an intermediary firm are often referred to as “piggybacking” firms, or “piggybackers.”

Under this arrangement, only the intermediary firm has a contractual arrangement with the clearing firm, which clears for both the intermediary firm and the intermediary firm’s piggybacking firm(s). 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 intermediary firm may assign account numbers that identify these accounts as branch offices of the intermediary firm.

Although these piggybacking arrangements may satisfy the business needs of the parties—the clearing firm, the intermediary firm, and the piggybacking firm—they may 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 intermediary firms that have contracted with piggybackers may be reporting the combined data of the intermediary firm and its piggybackers as only belonging to the intermediary firm. In such cases, NASD staff is not able to distinguish between data belonging to the intermediary firm and data belonging to the piggybacking firm(s) for purposes of conducting surveillance.

In addition, this inability to separate the piggybacking firm data can, and already has, become a serious issue if an 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 intermediary firm and its piggybacker(s).

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## Discussion

To resolve these issues, NASD has adopted 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 intermediary firm and data belonging to its piggybacker(s).

**NASD Rule 3150.** The amendments to Rule 3150 require clearing firms to report data to NASD about each piggybacking firm separately from the intermediary firm's data. These requirements will apply to the data pertaining to the proprietary and customer accounts of piggybacking firms **only** if the piggybacking relationship with the intermediary firm was established on or after February 20, 2006.

**NASD Rule 3230.** The amendments to Rule 3230 require intermediary 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 intermediary firm and the data pertaining to the proprietary and customer accounts of any piggybacking firm. These amendments will enable NASD staff to surveil data reported by piggybacking firms as part of NASD's NEP Surveillance program and facilitate any future SIPC liquidations. These requirements will apply to the data belonging to the proprietary and customer accounts of any piggybacking firm **only** if the piggybacking relationship was established on or after February 20, 2006.

## Endnote

- 1 Exchange Act Rel. No. 52352 (Aug. 26, 2005), 70 FR 52460 (Sept. 2, 2005) (SR-NASD-2005-058).

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## ATTACHMENT A

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### 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 February 20, 2006.

[(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 February 20, 2006.

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