



Securities Industry Association

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December 1, 1997

Ms. Joan Conley
 Office of the Corporate Secretary
 NASD Regulation, Inc.
 1735 K. Street N.W.
 Washington, D.C. 20006-1500

Re: NASDR Notice to Members 97-79

Dear Ms. Conley:

The Clearing Firms Committee, the Local Firms Committee¹ and the Ad Hoc Clearing Subcommittee (the "Committees") of the Securities Industry Association ("SIA")², are taking this opportunity to respond to the request for comments contained in the above referenced Notice to Members.

The Notice to Members addresses proposed amendments to NASDR Conduct Rule 3230 governing clearing agreements. The amendments were filed with the SEC on October 14, 1997 in accordance with Rule 19b-4 under the Securities Exchange Act of 1934. Such amendments closely parallel amendments to New York Stock Exchange ("NYSE") Rule 382 which were filed with the SEC in September 1997, and which were the subject of a comment letter filed by the Committees with the SEC on November 3, 1997.³

Copies of the comment letter were contemporaneously forwarded to senior NASDR officials. Therefore, in responding to the instant request for comment, we will limit our comments to those areas in which the NASDR amendments differ from those filed by the NYSE, as well as to certain other matters on which NASDR has requested comment that were not addressed in our November 3rd letter.

The specific differences from the NYSE amendments appear in subsections (c)(3), (c)(4), and (d) of Conduct Rule 3230. Each is discussed below:

Annual Reporting Regarding Exception and Other Reports (Conduct Rule 3230 (c)(3))

Similar to the companion NYSE amendment, subsection (c)(3) would require that the clearing broker ("CB") notify in writing both the introducing broker ("IB") and the introducing broker's designated examining authority of the exception and other "reports" which it offered to the IB, and the reports requested by or supplied to the IB. However, whereas the NYSE amendments apply to reports offered, requested or supplied as of a specific date, subsection (c)(3) appears

to apply to all reports offered, requested or supplied during the twelve months prior to the filing of the written notice. We strongly urge NASDR to conform their rule to the NYSE amendment by specifying that the notification requirement applies to reports offered, requested or supplied as of a specific date. It simply is not feasible to track all of the different reports which particular IB's may have been offered, requested or received over the course of a year.⁴

Reports Offered to But Not Requested by IB's (Conduct Rule 3230(c)(4))

This portion of the NASDR amendments, for which there is no corresponding NYSE provision, contains the requirement, that, upon request of the IB's designated examining authority, the CB provide reports or information or data from which the reports could have been prepared with respect to reports that "were offered to the IB but which the IB did not request." It thus appears the CB is being requested to either provide a copy of something which never existed, or to store data, in order to be able to create reports which were never requested by the IB. The former is impossible, and the latter, at a minimum, is burdensome and not the best use of record storage capabilities. It should also be noted that certain reports are not based on raw data, but rather require calculations which there would be no reason to perform if the offered report is not requested. In such circumstances neither a hard copy nor the underlying data would exist. Thus, we urge the NASDR to delete subsection (c)(4) from the final amendmts. As a practical matter, CB's, on a regular and cooperative basis, fulfill SRO requests for information on IB transactional activity, and generally are able to do so from data bases maintained in the ordinary course of business, so subsection (c)(4) is unnecessary.

Issuance of Negotiable Instruments (Conduct Rule 3230(d))

In our November 3rd comment letter on the NYSE amendments we objected to that portion of the amendments to NYSE Rule 382(f) which stated that the supervisory procedures adopted by the IB with respect to writing negotiable instruments on the CB's account had to be "satisfactory to the carrying organization." Our objection was based on the fact that this could be construed as placing a supervisory responsibility on the CB for the check issuance procedures of the IB, in direct contradiction to the allocation provisions of Rule 382. We therefore applaud NASDR for deleting this language from its own proposal. We however, must take strong issue with the NASDR's discussion of subsection (d) in the Notice to Members where it states that:

"...This rule is intended to protect customers by clearly establishing that the clearing member will be the maker of drawer of such instruments and, therefore, liable for any mistakes or fraud by the introducing firm in the making or drawing of the check. This provision is intended to establish that clearing firms are liable to the introducing firm's customer if the introducing firm misuses the authority, thereby protecting the customer with the clearing member's funds..."

We believe that this interpretation could be incorrectly construed as placing liability on CB's with respect to any improper activity by the IB in connection with which a check happens to be issued on the CB's account. The text of subsection (d) does not support such an interpretation, nor is such an interpretation consistent with the discussions between SIA representatives and NASDR and NYSE officials prior to adoption of the subsection. The intended purpose of the subsection is to make clear that regardless of an allocation of the check issuance function to the IB, the CB remains responsible as the maker or drawer of the check and thus is responsible to the payee for the proceeds of the check to the extent set forth in the Uniform Commercial Code

("U.C.C."). In other words, the CB cannot avoid the responsibility it would otherwise have to the customer under the U.C.C. as maker or drawer, by allocating the check issuance function to the IB. The NASDR's interpretation of subsection (d) is misleading in that it implies that the CB could be liable for the acts of the IB independent of the CB's obligations as maker or drawer.

Comment Sought by NASDR

The NASDR has requested input on a number of matters relating to the proposed amendments to Conduct Rule 3230. In particular, NASDR expresses concern over the fairness of the requirement that upon receipt of a complaint from an IB customer relating to the IB, it must, among other things, inform such customer of his or her right to transfer their account. We have already addressed this issue in detail in the aforementioned comment letter on the NYSE amendments to Rule 382, and thus need not comment further here, other than to note that we believe NASDR's concern is justified, and that this requirement should be deleted from both proposals.

NASDR has also raised questions concerning the processing of complaints received by the CB, the nature of such complaints and the reasons why they are forwarded to the CB. We believe that under common practice CB's promptly forward such complaints to the IB and contemporaneously notify the customer that they have done so since the IB has the supervisory responsibility with respect to the activities described in the complaint letter. We know of no industry or individual firm surveys categorizing the types of complaints or the reasons why complaints might be forwarded to the IB, so any input that could be provided in this regard would be anecdotal at best. We would suggest that many of the complaint letters received by the CB, are merely copies of letters forwarded directly to the IB.

As previously noted, we have generally confined our comments regarding the Conduct Rule 3230 amendments to those aspects which differ from the NYSE Rule 382 proposal. To the extent the two proposals correspond our comments in the November 3rd letter apply equally to the instant proposal.

We appreciate the opportunity to comment. If you have any questions regarding this letter, please contact Michael D. Udoff, Staff Adviser to SIA's Ad Hoc Clearing Subcommittee at (212) 618-0509.

Sincerely,

Thomas J. Berthel
Chairman, Local Firms Committee

Edward Schlitzer
Chairman, Clearing Firms Committee

Thomas A. Franko
Ad Hoc Clearing Subcommittee

cc:
Hon. Arthur Levitt - SEC
Dr. Richard Lindsey - SEC
Richard Walker - SEC

Michael Macchiaroli - SEC
Edward Kwalwasser - NYSE
Sal Pallante - NYSE
Ray Hennessy - NYSE
Donald Van Weezel - NYSE
Mary Schapiro - NASD
Elise Walter - NASD
Mary Alice Brophy - NASD
Alden Atkins - NASD
Elliot R. Curzon - NASD
Robert J. Smith - NASD

Footnotes:

¹ Local firms are generally defined as broker-dealers serving one geographic area and having less than 50 employees. Local firms comprise more than half of SIA's membership and virtually all such firms clear through others.

² The Securities Industry Association is the trade association representing almost 800 securities firms. Its members include securities organizations of all types—investment banks, brokers, dealers, specialists, and mutual fund companies. SIA members are active in all markets, and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of investment services and account for approximately 90% of the securities industry's revenue in the United States.

³ Letter to Margaret H. McFarland, Deputy Secretary, dated November 3, 1997 re: Amendments to New York Stock Exchange Rule 382 (SEC Release No. 34-39,200, File No. SR-NYSE 97-25).

⁴ We note that NASDR and NYSE officials were present at meetings with industry representatives where these difficulties were discussed.