

SIFMA Operations Conference Clearing and Introducing Firms in an Evolving Regulatory & Operational Environment

**Gaylord Palms Resort
Kissimmee, FL
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Proposed Amendments to NYSE Rule 382

- ◆ Clearing firm can use standardized form without re-submitting/re-approval to NYSE for clearing agreements with registered broker-dealers
- ◆ Certain changes intended to address piggy-back arrangements
- ◆ Certain functions must be allocated to the clearing firm
- ◆ Allocation permitted to introducing firms that are other than registered broker-dealers of “opening and approving” accounts consistent with NYSE Rule 405 and SEC Rules 17a-3 and 17a-4
- ◆ Notification to customer of any material changes to the allocation of responsibilities or relationship between the clearing firm and introducing organization
- ◆ Clearing Agreement may provide for receipt of cash or securities by the introducing organization consistent with 15c3-1 and 15c3-3
- ◆ Clearing firm to provide 10-business day written notice prior to carrying of new correspondent’s accounts

Additional Services Provided by Clearing Firms

- ◆ In addition to the “traditional” services provided by a clearing firm to its correspondents (i.e. safeguarding of funds and securities, preparation of confirmations and statements), both NYSE Rule 382 and NASD Rule 3230 allow for firms to “specify the respective functions and responsibilities of each party” to a clearing agreement.
- ◆ For example, introducing firms could contract with their clearing firm to take on additional responsibilities such as:
 - **Notice requirements**

(i.e. annual offer of ADV to advisory clients per Rule 204-3(c)(1))
 - **Customer verification of books and records information**
 - **Access to markets**

Additional Services Provided by Clearing Firms

- ◆ However, one must be aware of guidance provided in NYSE Rule 382, supplementary material .10, which states:
 - “ To the extent that a particular function is allocated to one of the parties, the other parties to the agreement shall supply to the responsible organization all data in its possession pertinent to the proper performance and supervision of that function. The agreement shall include an acknowledgement by each relevant party of this obligation.”
- ◆ What that means in practice is: *if you do it for me, I need to give you the data to do it correctly, and vice versa.*
 - **Example – Trades done by money managers direct with clearing firm.**

Amendments to Prime Brokerage No-Action Letter

- ◆ Investment Advisers – individual customer accounts
- ◆ Order marking discrepancies
- ◆ Long Sales
- ◆ Short Sales

Amendments to Rule 412(f)

- ◆ Bulk transfers may be effected without a TIF subject to the following:
 - The transfer involves a large number of accounts
 - Circumstances necessitating transfer is outside of delivery firms ordinary course of business.
 - Delivery and receiving firm must agree to transfer in writing.

Amendments to Rule 412(f)

- Delivering firm must give notice of transfer via negative consent to include:
 - Circumstances necessitating such transfers
 - Language that customer has the right to object
 - Information on how customer can transfer to another B/D.
 - Provision whereby customer has adequate time to respond to negative consent.

Amendments to Rule 412(f)

- Disclosure of previously established costs on customer resulting from transfer.
- Statement regarding delivering/receiving firm compliance with Reg S-P.

Amendments to NYSE Rule 409 and NASD Rule 2340

- ◆ SIPA Issues
- ◆ Members must include a legend on customer statements advising customers to promptly report inaccuracies or discrepancies as follows:
 - Because of possible unauthorized trading, no referral to account executive but, a different address and phone number for such communication.

Amendments to NYSE Rule 409 and NASD Rule 2340

- If a/c is subject to CA under Rule 382 the customer must be advised to send notice to both introducing and clearing firm.
- Any oral communications with either firm should be reconfirmed in writing.
- ◆ Members must advise each customer in writing upon a/c opening and at least annually thereafter that they may obtain SIPC information and provide website address or phone number of SIPC. Permitted to be allocated under the CA.

Clearing Agreements – NASD Rule 3230(a)



- ◆ All clearing agreements shall specify the respective functions and responsibilities of each party to the agreement and shall, at a minimum, specify the responsibilities of each party with respect to each of the following matters:
 - Opening, approving and monitoring customer accounts;
 - Extension of credit;
 - Maintenance of books and records;
 - Receipt and delivery of funds and securities;

Clearing Agreements – NASD Rule 3230(a) (cont.)

- Safeguarding of funds and securities;
- Confirmations and statements;
- Acceptance of orders and execution of transactions
- Whether customers are considered customers of the clearing member for purposes of financial responsibilities rules; and
- Responsibility to send customers notification of the clearing firm and clearing agreement. (Rule 3230(g))

Clearing Arrangements

- ◆ Additional things to consider and include in the Clearing Agreement:
 - Capital requirements
 - Proprietary assets of introducing firm maintained at clearing firm
 - Check writing and local cashiering, and supervisory responsibilities
 - Risk Management of introducing firm's business activities and financial position
 - Clearing deposit
 - AML and CIP responsibilities
 - Execution of orders and transactions
 - Commissions received by clearing firm for transactions of introducing firm customer accounts
 - Maintenance of books and records
 - All other services to be provided
 - Cost and fees
 - Termination of clearing agreement and return of clearing deposit

Data Conversion Working Group

- ◆ Subgroup of SIFMA Clearing Firms Committee.
- ◆ Objective: provide secure facility for exchange of data (passing of conversion files) between CFs; increase accuracy and delivery time.
- ◆ Project organized into three phases.

Data Conversion Working Group

- ◆ Phase 1: CFs to use NSCC as hub to facilitate exchange of account information.
- ◆ Phase 2: Development of standardized data formats.
- ◆ SEC Release No. 34-55259: Approval of NSCC rule change creating the Account Information Transmission Service (“AIT”).
- ◆ Phase 3: Transfer of Assets.