

application to the Office of General Counsel of NASD [Regulation].

(b) through (c) No Change.

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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 original 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

a. *Background.* On November 4, 2002, NASD filed with the Commission proposed rule change SR-NASD-2002-162. The rule change proposed new NASD Rule 3012 to require members to develop general and specific supervisory control procedures that independently test and verify and modify, where necessary, the members' supervisory procedures. In addition, the rule change proposed amendments to: (1) NASD Rule 3010(c) to require that office inspections be conducted by independent persons and include, at a minimum, the testing and verification of certain supervisory procedures;⁶ (2) NASD Rule 3110 to expand upon a members' supervisory and recordkeeping requirements with respect to changes in customer account name or designation in connection with order executions; (3) NASD IM-3110 to provide guidance regarding when a member may hold mail for a customer who will be absent for a period of time; (4) NASD Rule 2510(d) to clarify the

time limit on time-and-price discretionary authority; and (5) NASD Rule 9610 to incorporate into NASD Procedural Rules the ability of members to request an exemption from amended NASD Rule 3010(c).

The Commission received 72 comment letters in response to the **Federal Register** publication of SR-NASD-2002-162.⁷ The comments submitted to the Commission are summarized and responded to by issue below. Additional proposed rule changes are also discussed below.

b. *General Comments on the Rule Change.* Many commenters stated that the effective enforcement of existing supervisory rules should be sufficient to protect investors.⁸ These commenters frequently added that they viewed the proposed rules as an overreaction to the Gruttadauria case, which involved a producing branch manager who misappropriated millions of dollars in customer funds over a 15-year period. The commenters stated that the Gruttadauria case was not a result of inadequate supervisory systems but, instead, was a case of a single individual intent on defrauding customers.⁹

⁷ List of comment letters has been prepared as Exhibit 2. Exhibit 2 is available in the Commission's Public Reference Room.

⁸ 1st Global, Inc., Stephen Batman, CEO (12/18/02); AIG Advisor Group, Inc., Bridget M. Gaughan, EVP (12/30/02); Cambridge Investment Research, Inc., Terry L. Lister, General Counsel (12/20/02); Charles Schwab & Co., Inc., Selwyn J. Noteliovitz, SVP (2/25/03); Clark/Bardes Financial Services, Inc., Kevin Ballou, President (3/17/03); Commonwealth Financial Network, Peter T. Wheeler, President (12/17/02); CUNA Brokerage Services, Inc., Marcia L. Martin, President (12/19/02); FFP Securities, Inc., Craig A. Junkins, President/CEO (12/18/02); First Allied Securities, Inc., Adam Antoniadis, President/COO (12/18/02); Invest Financial Corporation, Lynn R. Niedermeier, President/CEO (12/17/02); Investment Centers of America, Inc., Greg Gunderson, President (12/16/02); Lesko Securities, Inc., Charles Lesko, Jr., President (12/18/02); Mutual Service Corp., Dennis S. Kaminski, EVP/CAO (12/18/02); MWA Financial Services, Robert M. Roth, President (12/18/02); Princor Financial Services Corp., Minoo Spellerberg, Compliance Officer (12/16/02); Rhodes Securities, Inc., Sandra T. Masek, EVP/COO (12/17/02); Securities America, Inc., Bryan R. Hill, President (12/16/02); Securities Industry Association, Self-Regulation and Supervisory Practices Group, Christopher R. Franke, Chairman—Self-Regulation and Supervisory Practices Committee (12/18/02); Transamerica Financial Advisors, Inc., Sandy Brown, President/COO (12/16/02); United Planners' Financial Services of America, Thomas H. Oliver, President, CEO, (12/13/02); USAllianz Securities, Inc., Michael D. Burns, CCO (12/16/02); Waterstone Financial Group, Inc., Thomas A. Hopkins, Chairman, (12/16/02); World Group Securities, Inc., Leesa M. Easley, Chief Legal Officer (12/19/02).

⁹ *Id.*; see also Associated Securities Corp., Neal K. Nakagiri, President/CEO (12/19/02); AXA Advisors, John M. Lefferts, President (12/18/02); Cadaret, Grant & Co., Arthur F. Grant, President (12/17/02); Commonwealth Financial Network, Peter T.

While NASD understands industry concerns that regulators not overreact to one case of violative conduct, NASD does not view the proposed rule change as a reaction to any particular legal or regulatory event. Rather, NASD believes that the proposed rule change is designed to enhance the current rules and examination efforts by specifically requiring members to establish adequate supervisory control systems. NASD also believes that the proposed rule change will strengthen its ability to fulfill its ongoing obligation to protect investors.

A majority of the commenters also suggested that implementing the proposed rule change would require firms to hire a large number of additional personnel to conduct the supervisory activities required by the proposed rules, thereby placing a significant financial burden on firms.¹⁰ Many commenters believed that this cost would destroy the business model of independent contractors located in

Wheeler, President (12/17/02); Equity Services, Inc., Gregory D. Teese, VP (12/18/02); Linsco/Private Ledger, Corp., James F. McGuire, SVP & CCO (1/16/03); National Society of Compliance Professionals, Inc., Joan Hinchman, Executive Director, President & CEO (1/8/03); Pacific Select Distributors, Inc., John L. Dixon, President (12/18/02).

¹⁰ 1st Global, Inc., Stephen Batman, CEO (12/18/02); AIG Advisor Group, Inc., Bridget M. Gaughan, EVP (12/30/02); American Express Financial Advisors, Inc., Beth E. Weimer, VP & CCO (1/17/03); Cambridge Investment Research, Inc., Terry L. Lister, General Counsel (12/20/02); Clark/Bardes Financial Services, Inc., Kevin Ballou, President (3/17/03); CUNA Brokerage Services, Inc., Marcia L. Martin, President (12/19/02); Equity Services, Inc., Gregory D. Teese, VP (12/18/02); FFP Securities, Inc., Craig A. Junkins, President/CEO (12/18/02); Financial Network Investment Corp., Jack R. Handy, Jr., President (12/13/02); First Allied Securities, Inc., Adam Antoniadis, President/COO (12/18/02); IFG Network Securities, Inc., R. Jack Conley, President/CEO (12/18/02); Invest Financial Corporation, Lynn R. Niedermeier, President/CEO (12/17/02); Investment Centers of America, Inc., Greg Gunderson, President (12/16/02); John Hancock Financial Services, Inc., Robert H. Watts, SVP/CCO, (12/17/02) & Another Letter (1/16/03) (additional comments); Lesko Securities, Inc., Charles Lesko, Jr., President (12/18/02); Linsco/Private Ledger, Corp., James F. McGuire, SVP & CCO (1/16/03); Locust Street Securities, Inc., Jacqueline C. Conley, VP, Compliance (12/13/02); Multi-Financial Securities Corp., Patrick H. McEvoy, President/CEO (12/16/02); Mutual Service Corp., Dennis S. Kaminski, EVP/CAO (12/18/02); MWA Financial Services, Robert M. Roth, President (12/18/02); PrimeVest Financial Services, Inc., Kevin P. Maas, VP, (No Date on Letter); Princor Financial Services Corp., Minoo Spellerberg, Compliance Officer (12/16/02); Rhodes Securities, Inc., Sandra T. Masek, EVP/COO (12/17/02); Securities America, Inc., Bryan R. Hill, President (12/16/02); Transamerica Financial Advisors, Inc., Sandy Brown, President/COO (12/16/02); United Planners' Financial Services of America, CEO (12/13/02); USAllianz Securities, Inc., Michael D. Burns, CCO (12/16/02); Vestax Securities Corp., R. Jack Conley, President/CEO (12/17/02); Washington Square Securities, Inc., Tom K. Rippberger, VP/CCO (No Date on Letter); Waterstone Financial Group, Inc., Thomas A. Hopkins, Chairman, (12/16/02).

⁶ NASD has filed with the Commission a separate proposed rule change to Rule 3010(g)(2) that addresses other situations where a location of a member may be considered a "branch office" and affects only the content of what is now being renumbered as paragraph (2)(A) of Rule 3010(g). See SR-NASD-2003-104. If the SEC approves the proposed rule change in No. SR-NASD-2003-104 prior to approving the rule change proposed in this filing, NASD will file an amendment to this proposal updating the rule language in the new Rule 3010(g)(2). Alternatively, if the SEC approves the proposed rule change in this rule filing prior to approving the proposed rule change in SR-NASD-2003-104, NASD will file an amendment to SR-NASD-2003-104 reflecting the changes set forth in this filing.