

small branch offices.<sup>11</sup> One commenter suggested that the proposed rule change be adopted in the form of "principles for effective supervision" or "best practices" that could be tailored to various business models rather than rules that would apply to all firms.<sup>12</sup>

NASD does not agree that the proposed rule change should be adopted in the form of "principles or best practices." NASD believes that the degree of authority carried by the proposed rules is necessary to encourage the conduct intended by the rule changes. However, as discussed in detail below, NASD agrees that greater flexibility is needed in certain respects to account for variations in members' business models.

i. *Comments on Proposed NASD Rule 3012 (Supervisory Controls) and Proposed Changes.* As originally proposed, NASD Rule 3012 requires that each member establish supervisory control procedures that (a) test and verify that the member's supervisory procedures are reasonably designed to comply with the federal securities laws and regulations and NASD rules and (b) amend the supervisory procedures where testing and verification identifies the need to do so. NASD Rule 3012 also requires that the supervisory control procedures be performed by persons who are "independent" from those activities being tested and verified and the persons who directly supervise those activities.

In addition, NASD Rule 3012 requires that written policies and procedures to administer the supervisory controls specifically address transmittals of funds between accounts, changes of customers' addresses, and changes in customers' investment objectives. These designated policies and procedures must include a means or method of customer confirmation, notification, or follow-up that can be documented.

Many commenters requested clarification regarding who would be sufficiently "independent" to perform the supervisory control procedures required under proposed NASD Rule

3012.<sup>13</sup> A large number of commenters contended that restricting senior supervisory personnel from performing and/or overseeing the review of a firm's supervisory control procedures could compromise the quality of the review. The commenters stated that the alternative approach of assigning someone from another division of the firm, such as Marketing or Operations, to perform the review could result in a supervisory review that is less sensitive to compliance requirements.<sup>14</sup> At least

<sup>13</sup> 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); Midland National Life Insurance, P.M. Phalen, Assistant Vice President (12/17/02); MML Investors Services, Inc., Michael L. Kerley, VP/Chief Legal Officer (12/17/02); Mutual Service Corp., Dennis S. Kaminski, EVP/CAO (12/18/02); MWA Financial Services, Robert M. Roth, President (12/18/02); Princi 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); United Planners' Financial Services of America, 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).

<sup>14</sup> 21st Century Financial Services, Inc., Charles Mazziotti, President (12/17/02); AIG Advisor Group, Inc., Bridget M. Gaughan, EVP (12/30/02); Brookstreet Securities Corporation, Stanley C. Brooks, President, CEO (12/4/02); Cambridge Investment Research, Inc., Terry L. Lister, General Counsel (12/20/02); CUNA Brokerage Services, Inc., Marcia L. Martin, President (12/19/02); Duerr Financial Corporation, William Partin, President (11/27/02); Eagle One Investments, LLC, Steven J. Svoboda, President (12/16/02); Financial Network Investment Corp., Jack R. Handy, Jr., President (12/13/02); Financial Northeastern Companies, Dominick Del Duca, CCO (12/12/02); First Allied Securities, Inc., Adam Antoniadis, President/COO (12/18/02); First Heartland Capital, Inc., Julius J. Anderson, Vice President (12/27/02); FMN Capital Corporation, David W. Schofield, Director of Operations and Compliance (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); Iron Street Securities Inc., Robert L. Hamman, President (12/24/02); JKR & Company, Inc., J. Kemp Richardson, President (12/10/02); John Hancock Financial Services, Inc., Robert H. Watts, SVP/CCO, (12/17/02) & Another Letter (1/16/03) (additional comments); Kyson & Co., Kao Sheng Lin, President (11/25/02); Lesko Securities, Inc.,

one commenter stated that the "independence" requirement in NASD Rule 3012 appears to refer to someone outside of the firm.<sup>15</sup>

NASD agrees with commenters' concerns and is amending proposed NYSE Rule 3012 to eliminate the requirement that persons establishing, maintaining, and enforcing supervisory control policies and procedures be "independent." The proposed rule now will require that a member designate and specifically identify to NASD one or more principals who will establish, maintain, and enforce supervisory control procedures that will test and verify that the members' supervisory procedures are sufficient and create additional or amend supervisory procedures where the need is identified by such testing and verification. Of course, NASD expects that the designated principals will test and verify the adequacy of the supervisory control procedures in a manner that is independent of a member's countervailing business considerations.

Importantly, as stated in proposed NYSE Rule 3012, these policies and procedures must include procedures that are reasonably designed to review and supervise the customer account activity conducted by the member's branch office managers, sales managers,

Charles Lesko, Jr., President (12/18/02); Liberty Life Securities, LLC, John T. Treece, President (1/15/03); Locust Street Securities, Inc., Jacqueline C. Conley, VP, Compliance (12/13/02); Main Street Securities, LLC, David L. Meckenstock, VP/CCO (12/13/02); Monitor Capital, Inc., Hsiao-wen, President (11/25/02); Multi-Financial Securities Corp., Patrick H. McEvoy, President/CEO (12/16/02); Mutual Securities, Inc., William L. Sabol, President (11/26/02); Mutual Service Corp., Dennis S. Kaminski, EVP/CAO (12/18/02); MWA Financial Services, Robert M. Roth, President (12/18/02); National Planning Corporation, M. Shawn Dreffin, President (12/2/02); Pacific West Securities, Inc., Philip A. Pizelo, President (1/14/03); PrimeVest Financial Services, Inc., Kevin P. Maas, VP, Director of Compliance (no date); Princi Financial Services Corp., Minoo Spellerberg, Compliance Officer (12/16/02); Quest Securities, Inc., Robert J. Schoen, President (11/22/02); Rhodes Securities, Inc., Sandra T. Masek, EVP/COO (12/17/02); Rhodes Securities, Inc., Sandra T. Masek, EVP/COO (12/17/02); Securities America, Inc., Bryan R. Hill, President (12/16/02); The Leaders Group, Inc., Z. Jane Riley, Compliance Officer (12/13/02); 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); 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); Wharton Equity Corp., Malcom A. Morrison, President (1/10/03); World Group Securities, Inc., Leesa M. Easley, Chief Legal Officer (12/19/02); World Trade Financial Corporation, Rod P. Michel, President (12/31/02).

<sup>15</sup> See Woodbury Financial Services, Inc., Michael G. Brennan, Associate Counsel/Assistant Secretary (12/18/02).

<sup>11</sup> Associated Securities Corp., Neal K. Nakagiri, President/CEO (12/19/02); AXA Advisors, John M. Lefferts, President (12/18/02); Mutual Service Corp., Dennis S. Kaminski, EVP/CAO (12/18/02); Pacific Select Distributors, Inc., John L. Dixon, President (12/18/02); Securities Industry Association, Self-Regulation and Supervisory Practices Group, Christopher R. Franke, Chairman—Self-Regulation and Supervisory Practices Committee (12/18/02); Woodbury Financial Services, Inc., Michael G. Brennan, Associate Counsel/Assistant Secretary (12/18/02).

<sup>12</sup> 1st Global, Inc., Stephen Batman, CEO (12/18/02); Securities Industry Association, Self-Regulation and Supervisory Practices Group, Christopher R. Franke, Chairman—Self-Regulation and Supervisory Practices Committee (12/18/02).