

regional or district sales managers, or any person performing a similar supervisory function. Proposed NYSE Rule 3012 provides that a person who is senior to the producing manager must perform these supervisory reviews; however, if a member does not conduct a public business, or has a capital requirement of \$5,000 or less, or employs ten or fewer representatives, and its business is conducted in a manner necessitated by a limitation of resources that includes fewer than two layers of supervisory personnel, a person in another office who is in the same or similar position to the producing manager may conduct the supervisory review, provided that the person does not have supervisory responsibility over the activity being reviewed, reports to his supervisor his supervision and review of the producing manager, and has not performed a review of the producing manager in the last two years.

The supervisory policies and procedures required under proposed Rule 3012 also must include procedures reasonably designed to provide heightened supervision over the activities of each producing manager who is responsible for generating 20% or more of the income of the producing manager's supervisor. The proposed rule does not mandate the contents of such heightened supervisory procedures, in recognition of the fact that such procedures will vary depending on the business models and needs of each particular member. In establishing such heightened supervisory procedures, however, members should consider such elements as unannounced supervisory reviews, an increased number of supervisory reviews by different reviewers within a certain period, a broader scope of activities reviewed, and/or having one or more principals approve the supervisory review of such producing managers. These examples are meant to illustrate the type of procedures a member may want to include in its heightened supervisory procedures and are not meant to be an exclusive or exhaustive list of heightened supervisory procedures a member may need to put in place. NASD believes that proposed Rule 3012, as amended herein, should allow members sufficient flexibility to create the supervisory control procedures mandated by the rule without creating undue burdens and costs.

Several commenters mentioned that the requirements in proposed NASD Rule 3012 to test and verify a member's supervisory procedures and make any changes identified through the testing

and verification procedures appear to be substantially similar to NASD Rule 3010(a)(8), which requires a member to review the supervisory system and make any appropriate changes. Commenters stated that it would be redundant to require a member to conduct two separate, yet very similar, reviews of the member's supervisory procedures to determine if changes need to be made.¹⁶

NASD is aware of the similarity of the two supervisory review requirements. Accordingly, NASD is amending the proposed rule change to combine the two supervisory review requirements into proposed NASD Rule 3012 and eliminate NASD Rule 3010(a)(8) altogether.

One commenter stated that proposed NASD Rule 3012's requirement that specific supervisory controls be in place to address the transmittal of funds between accounts, changes of customers' addresses, and changes in customers' investment objectives should apply only to retail customer activity and not to institutional customer activity. An institutional exemption is sought because much of that business is done on a delivery-versus-payment or receipt-versus-payment basis or via prime brokerage arrangements that involve system and controls that are markedly different from retail account servicing.¹⁷ NASD, however, believes that it is reasonable and appropriate that regulatory oversight in the sensitive areas designated in proposed NASD Rule 3012 extend to institutional account activity.

NASD is retaining NASD Rule 3012's originally proposed provision that any member in compliance with substantially similar requirements of the New York Stock Exchange, Inc. ("NYSE") shall be deemed to be in compliance with NASD Rule 3012. NASD believes that this provision helps promote consistency between NASD's and the NYSE's supervisory control requirements.

¹⁶ Clark/Bardes Financial Services, Inc., Kevin Ballou, President (3/17/03); Financial Network Investment Corp., Jack R. Handy, Jr., President (12/13/02); Financial Northeastern Companies, Dominick Del Duca, CCO (12/12/02); IFG Network Securities, Inc., R. Jack Conley, President/CEO (12/18/02); Locust Street Securities, Inc., Jacqueline C. Conley, VP, Compliance (12/13/02); MML Investors Services, Inc., Michael L. Kerley, VP/Chief Legal Officer (12/17/02); Multi-Financial Securities Corp., Patrick H. McEvoy, President/CEO (12/16/02); PrimeVest Financial Services, Inc., Kevin P. Maas, VP, Director of Compliance (no date on letter); Vestax Securities Corp., R. Jack Conley, President/CEO (12/17/02); Washington Square Securities, Inc., Tom K. Rippberger, VP/CCO.

¹⁷ 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).

ii. *Comments on NASD Rule 3010 (Supervision) and Proposed Changes.* As originally proposed, the changes to NASD Rule 3010 require that office inspections be conducted by a person who is "independent" from the activities being performed at the office and the people providing supervision to that office. In addition, office inspections must include, without limitation, the testing and verification of the member's supervisory policies and procedures in the areas of: Safeguarding customer funds and securities; maintaining books and records; supervision of customer accounts serviced by branch office managers; transmittal of funds between customers and registered representatives and between customers and third parties; validation of customer address changes; and validation of changes in customer account information.

Many commenters requested clarification regarding who would be sufficiently "independent" to conduct the office inspections required in NASD Rule 3010.¹⁸ At least one commenter stated that the "independence" requirement in NASD Rule 3010 appears to refer to someone within the firm who does not receive compensation based on sales.¹⁹ Many commenters stated that the "independence" requirement in NASD Rule 3010(c)

¹⁸ 1st Global, Inc., Stephen Batman, CEO; 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, Thomas H. 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).

¹⁹ See Woodbury Financial Services, Inc., Michael G. Brennan, Associate Counsel/Assistant Secretary (12/18/02).