

would severely reduce the number of principals eligible to conduct branch exams and would put enormous pressure on home office exam personnel to conduct more office inspections.<sup>20</sup> Commenters suggested that if home office exam personnel had to conduct more office inspections, the audit cycle would have to be extended to multiple-year durations and the quality of the audits would decline.<sup>21</sup>

<sup>20</sup> 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); 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, Director of Compliance (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, 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).

<sup>21</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); Clark/Bardes Financial Services, Inc., Kevin Ballou, President (3/17/03); 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); 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); First Heartland Capital, Inc., Julius J. Anderson, Vice President; (12/27/02); FMN Capital Corporation, David W. Schofield, Director of Operations (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

In response to commenters' concerns, NASD is amending Rule 3010 to replace the proposed "independence" requirement with a prohibition that an office inspection cannot be conducted by a branch office manager or any person within that office who has supervisory responsibilities or by any individual who is supervised by such person(s). In addition, members must establish heightened inspection procedures in situations where the person conducting the inspection either works in an office supervised by the branch office manager's supervisor or reports to the branch office manager's supervisor *and* the branch office manager generates 20% or more of the supervisor's income. The proposed rule does not mandate the contents of such heightened inspection 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 inspection procedures, however, members should consider such elements as unannounced office inspections, increased frequency of inspections, a broader scope of activities inspected, and/or having one or more principals review and approve the office's inspections. These examples are meant to illustrate the type of

Securities Inc., Robert L. Hamman, President (12/24/02); JKR & Company, Inc., J. Kemp Richardson, President (12/10/02); Kyson & Co., Kao Sheng Lin, President (11/25/02); Lesko Securities, Inc., 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 Dreffein, 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); Princor 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); Securities America, Inc., Bryan R. Hill, President (12/16/02); The Leaders Group, Inc., Z. Jane Riley, Compliance Officer and/CEO (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).

procedures a member may want to include in its heightened inspection procedures and are not meant to be an exclusive or exhaustive list of heightened inspection procedures a member may need to put in place. NASD believes that this proposed rule change should allow members sufficient flexibility to assign personnel to conduct office inspections without creating undue burdens and costs.

Because NASD has removed the "independence" requirement regarding inspections conducted pursuant to NASD Rule 3010(c), NASD is removing the provision in NASD Rule 3010(c) that would have allowed members to seek an exemption from the independence requirement in NASD Rule 3010(c) subject to specified terms and conditions. NASD is also removing NASD Rule 3010(c) from the list of rules in NASD Rule 9610(a) from which a member can seek an exemption.

Many commenters argued that the current supervisory system, which allows Office of Supervisory Jurisdiction ("OSJ") managers to conduct office inspections of branch and satellite offices should be retained because it was both effective and cost efficient.<sup>22</sup> Commenters noted that OSJ managers are the most familiar with registered representatives and activities located at particular offices, and therefore, are the most qualified to perform the periodic inspections. In addition, OSJ managers' auditing of branch and satellite offices serves to reinforce their accountability for the registered representatives' actions.<sup>23</sup>

As stated previously, the proposed change to NASD Rule 3010 has eliminated the proposed "independence" requirement with a prohibition that an office inspection cannot be conducted by a branch office manager or any person within that office who has supervisory responsibilities or by any individual who is supervised by such person(s). This structure allows OSJ managers to conduct office inspections in any location where the OSJ manager is senior to the office's branch manager. In addition, NASD is amending NASD Rule 3010 to codify previous NASD guidance that non-supervisory branch offices be inspected every three years and that all non-branch locations be inspected periodically.<sup>24</sup>

iii. *Comments on Changes to NASD Rule 2510 (Discretionary Accounts) and Proposed Changes.* As originally

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> See NASD Notice to Members 98-38 (May 1998); NASD Notice to Members 99-45 (June 1999).