

establishment, maintenance, and testing of internal controls as well as several supervisory issues. Included are amendments to NYSE Rule 342 ("Offices—Approval, Supervision and Control") and its Interpretation, NYSE Rule 401 ("Business Conduct"), NYSE Rule 408 ("Discretionary Power in Customers' Accounts"), and NYSE Rule 410 ("Records of Orders").

The text of the proposed rule change is set forth below. Proposed new language is in *italics*; proposed deletions are in brackets.

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#### **Offices—Approval, Supervision and Control**

Rule 342. (a) through (e) unchanged. Supplementary Material:

.10 through .18 unchanged.

.19 *Supervision of Managers.—Members and member organizations must develop and implement written policies and procedures reasonably designed to independently review and supervise customer account activity conducted by each Branch Office Manager, Sales Manager, Regional/District Sales Manager, or by any person performing a similar supervisory function. Such supervisory reviews must be performed by a qualified person pursuant to Rule 342.13 who is senior to the Manager under review.*

.20 through .22 unchanged.

.23 *Internal Controls.—Pursuant to paragraphs (a) and (b) of this Rule, members and member organizations must develop and maintain adequate controls over each of its business activities. Such controls must provide for the establishment of procedures for independent verification and testing of those business activities. An ongoing analysis, based upon appropriate criteria, may be employed to assess and prioritize those business activities requiring independent verification and testing. A review of each member's or member organization's efforts with respect to internal controls, including a summary of tests conducted and significant exceptions identified, must be included in the Annual Report required by .30 of this Rule.*

*The independent verification and testing procedures shall not apply to members and member organizations that do not conduct a public business, or that have a capital requirement of \$5,000 or less, or that employ 10 or fewer registered representatives.*

(See also Rule 401(b))

.30 *Annual Report.—By April 1 of each year, each member not associated with a member organization and each member organization shall prepare, and each member organization shall submit*

to its chief executive officer or managing partner, a report on the member's or member organization's supervision and compliance effort during the preceding year. The report shall include:

(a) A tabulation of the reports pertaining to customer complaints and internal investigations made to the Exchange during the preceding year pursuant to Rules 351(d) and (e)(ii).

(b) Identification and analysis of significant compliance problems, plans for future systems or procedures to prevent and detect violations and problems, and an assessment of the preceding year's efforts of this nature, and

(c) Discussion of the preceding year's compliance efforts, new procedures, educational programs, etc. in each of the following areas:

- (i) Antifraud and trading practices,
- (ii) Investment banking activities,
- (iii) Sales practices,
- (iv) Books and records,
- (v) Finance and operations, [and]
- (vi) Supervision[.], and
- (vii) Internal controls.

If any of these areas do not apply to the member or member organization, the report should so state.

#### **Business Conduct**

Rule 401. (a) Every member, allied member and member organization shall at all times adhere to the principles of good business practice in the conduct of his or its business affairs.

(b) *Each member and member organization shall maintain written policies and procedures, administered pursuant to the internal control requirements prescribed under Rule 342.23, specifically with respect to the following activities:*

(1) *Transmittals of funds (e.g., wires, checks, etc.) or securities:*

(i) *from customer accounts to third party accounts (i.e., a transmittal that would result in a change of beneficial ownership);*

(ii) *from customer accounts to outside entities (e.g., banks, investment companies, etc.);*

(iii) *from customer accounts to locations other than a customer's primary residence (e.g., post office box, "in care of" accounts, alternate address, etc.); and*

(iv) *between customers and registered representatives (including the hand-delivery of checks).*

(2) *Customer changes of address.*

(3) *Customer changes of investment objectives.*

*The policies and procedures required under (b)(1), (b)(2), and (b)(3) above must include a means/method of customer confirmation, notification, or follow-up that can be documented.*

#### **Discretionary Power in Customers' Accounts**

Rule 408

(a) through (c) unchanged.

(d) The provisions of this rule shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a specified security shall be executed. *The authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent a specific, written, contrary indication signed and dated by the customer. This limitation shall not apply to time and price discretion exercised by Floor brokers pursuant to valid Good-Till-Cancelled instructions issued on a "not-held" basis. Any exercise of time and price discretion must be reflected on the order ticket.*

#### **Records of Orders**

Rule 410. (a) Every member or [his] member organization *must* [shall] preserve for at least three years the first two years in an easily accessible place, a record of:

[Transmitted to Floor]

(1) Every order transmitted directly or indirectly by such member or organization to the Floor, which record shall include the name and amount of the security, the terms of the order, the time when it was so transmitted, and the time at which a report of execution was received.

Carried to the Floor]

[(2)] (1) every order received by such member or member organization, either orally or in writing, [and carried by such member to the Floor,] which record *must* [shall] include the name and amount of the security, the terms of the order, the time when it was so received and the time at [as] which a report of execution was received.

[Entered Off Hours]

[(3)] (2) every order entered by such member or member organization into the Off-Hours Trading Facility (as Rule 900 (Off-Hours Trading: Applicability and Definitions) defines that term), which record *must* [shall] include the name and amount of the security, the terms of the order, the time when it was so entered, and the time at which a report of execution was received.

[Cancellation]

[(4)] (3) the time of the entry of every cancellation of an order covered by (1)[,] and (2) [and (3)] above.

[By Accounts] *Changes In Account Name or Designation*

Before any order covered by (1)[,] or (2) [or (3)] above is executed, there *must*