

protection by promoting regular and meaningful interaction between senior management and compliance personnel to ensure that compliance is given the highest priority by a member's senior executive officers. Specifically, the proposed rule change would require (1) that each member designate a principal to serve as CCO and (2) the CEO and CCO to certify annually to having in place processes to establish, maintain, review, modify, and test policies and procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules and federal securities laws.

As to the former, NASD Rule 1022 currently requires a person designated as a CCO on Schedule A of Form BD to be registered as a General Securities Principal unless certain exceptions apply.³ However, the current rules do not require that a member so designate such a person. The proposed rule change would mandate that a member designate a CCO and identify that person on Schedule A of Form BD.

With respect to the certification, the proposed rule change also would require the CEO and CCO to certify annually that senior executive management has in place processes to (1) establish and maintain policies and procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules and federal securities laws; (2) modify such policies and procedures as business, regulatory and legislative changes and events dictate; and (3) test the effectiveness of such policies and procedures on a periodic basis, the timing of which is reasonably designed to ensure continuing compliance with NASD rules, MSRB rules and the federal securities laws. The proposed rule change further would require the CEO and CCO to certify that those processes are evidenced in a report that has been reviewed by those executing the certification, as well as the member's board of directors and audit committee.⁴ Notably, the processes, at a minimum, must include one or more meetings between the CEO and CCO to discuss and review the matters that are subject of the certification.

The proposed rule change also would create IM-3013, which sets forth the language of the certification and gives further guidance as to the requirements and limitations of the rule. For example, the interpretive material clarifies that

the person designated as CCO also may hold other positions within the member, including CEO, provided that individual can effectively discharge the CCO responsibilities while maintaining another position. Thus, resource-constrained members are not required to hire or designate a dedicated CCO. The proposed interpretive material also explains that the rule permits co-certifications by other compliance officers that report to the CCO, provided those individuals are senior compliance officers who have primary responsibility over a segment of the member's business operations.

The proposed interpretive material further recognizes that responsibility for discharging compliance policies and written supervisory procedures rests with business line supervisors. The proposed interpretive material clarifies that execution of the certification does not by itself establish a signatory as having such line supervisory responsibility.

The proposed interpretive material also sets forth the particulars regarding the report that must evidence a member's compliance processes. It states that the report must be produced prior to execution of the certification and reviewed by the CEO, CCO and such other officers as the member deems necessary. The report also must include the manner and frequency in which the processes are administered and identify those officers and supervisors with responsibility for such administration. The proposed interpretive material further explains that the report need not contain conclusions that result from following the specified processes, such as compliance deficiencies. Additionally, the proposed interpretive material states that the report may be combined with other reports required by a self-regulatory organization, provided the report is made annually, clearly indicates in the title that it contains the information required by Rule 3013, and that the entire report is provided in response to any regulatory request for all or part of the combined report.

Finally, with respect to review of the report, the proposed interpretive material clarifies that review by a member's board of directors and audit committee only applies to those members whose corporate governance structure have such or similar governing bodies and committees—it does not impose a requirement that members create them if they do not currently exist.

The proposal would complement and underscore the closely related obligations that currently exist under NASD rules that require each member to

designate principals who must review the member's supervisory systems and procedures and recommend to senior management appropriate action to ensure the systems are reasonably designed to achieve compliance with applicable rules and regulations.⁵ NASD believes the proposal provides an effective mechanism to compel substantial and purposeful interaction between senior management and compliance personnel, thereby enhancing the quality of members' supervisory and compliance systems. NASD further believes the rule change imposes the minimal additional burden on members that is necessary to achieve the proposal's purpose.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that that the proposed rule change is consistent with the provisions of the Act noted above in that it will enhance focus on members' compliance and supervision systems, thereby decreasing the likelihood of fraud and manipulative acts and increasing investor protection.

B. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

In June 2003, NASD issued Notice to Members 03-29, seeking comment on a different proposal with similar objectives. That proposal would have required each member to designate a CCO and further required that the CCO and CEO certify annually to the

⁵ See 3010(a)(8). NASD has filed with the Commission a proposed rule change that would incorporate the requirements of Rule 3010(a)(8) into new Rule 3012 and eliminate Rule 3010(a)(8) altogether. If the proposed rule change is approved, Rule 3012 would require members to designate one or more principals who will establish, maintain, and enforce a system of supervisory control policies and procedures that test and verify that the member's supervisory procedures are reasonably designed to achieve compliance with applicable securities laws and NASD rules and amend supervisory procedures where the need is identified. See SR-NASD-2002-162.

³ See Notice to Members 01-51 (August 2001).

⁴ Members that do not employ a board of directors or audit committee or other similar bodies in their governance and management would not be subject to this requirement.