



August 24, 2004

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Release No. 34-50105; File No. SR-NASD-2003-176 -- Comment on Amendment No. 2 to Proposed Chief Executive Officer Certification Requirement

Dear Mr. Katz:

The Securities Industry Association¹ and the SIA Compliance and Legal Division² (collectively, the "SIA") appreciate the opportunity to provide comments in response to the referenced amendments, which propose new NASD Rule 3013 and accompanying interpretative material ("Rule Proposal"). Among other things, the Rule Proposal would require (i) each member to designate a principal to serve as a Chief Compliance Officer ("CCO"); and (ii) the Chief Executive Officer ("CEO") 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 detailed in our prior two comment letters,³ SIA supports a rule amendment that would require, on an industry-wide basis, meaningful and joint consideration by the CEO (or equivalent

¹ The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 790,600 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated \$213 billion in domestic revenue and an estimated \$283 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)

² The Compliance and Legal Division's members are primarily compliance and legal personnel associated with Securities Industry Association member firms. Among its purposes are enhancement of the integrity and reputation of the securities industry through compliance and legal education and improved communication with industry regulatory bodies.

³ Joint SIA and The Bond Market Association comment letters, dated July 18, 2003, to NASD, Re: NASD NTM 03-29; and dated February 6, 2004, to SEC, Re: Release 48981; File No. SR-NASD-2003-176.

officer) and the CCO (among others) of the firms' supervisory procedures, policies, compliance programs and initiatives. Indeed, many firms already have embedded within their business models effective processes tailored to their size, structure and activities that facilitate the type of regular and substantive interaction sought by the Rule Proposal. The NASD's proposal is consistent with seeking to enhance investor protection, as well as public trust and confidence in the markets, by ensuring that this interaction between CEOs and CCOs is universal throughout the industry.

SIA therefore supports the proposed amendment to Rule 3013, and commends the NASD staff for their willingness to work with the industry so that compliance is given the highest priority by the members' senior executive officers. SIA also thanks NASD for its efforts to distinguish the role of Compliance professionals from that of supervisors with business line responsibility. This distinction serves to enhance the independence of the Compliance function and reinforce the supervisory responsibility of the designated principals who manage the business of each member firm.

Interpretive Material 3013 (the "IM") contains language describing the obligations and functions of the CCO that appropriately emphasizes the role of other employees, both inside and outside the Compliance department, in fulfilling many important compliance functions. However, as discussed during a meeting with NASD staff on August 17, 2004, there is other language in the IM that inadvertently may create confusion about the proper role of the CCO versus other control functions within the firm. On this point, as is more particularly set forth below, we request clarification with regard to the IM language referencing "compliance functions" and "compliance policies."

Clarification as to "Compliance Functions"

In describing the obligations of the CCO as the primary advisor on the member firm's overall "compliance processes," the IM identifies several areas of "expertise" attributable to the CCO, including expertise in the process of:

- gaining an understanding of the products, services or line functions that need to be the subject of written compliance policies and written supervisory procedures;
- identifying the relevant rules, regulations, laws and standards of conduct pertaining to such products, services or line functions based on experience and/or consultation with those persons who have technical expertise in such areas of the member's business;
- developing, or advising other business persons charged with the obligation to develop, policies and procedures that are reasonably designed to achieve compliance with those relevant rules, regulations, laws and standards of conduct;
- evidencing the supervision by the line managers who are responsible for the execution of compliance policies; and
- developing programs to test compliance with the member's policies and procedures.

While SIA agrees that the CCO is a primary advisor to the firm on its overall compliance scheme and the application of specific rules, policies and procedures, we are concerned that, as currently written, the IM may not adequately take into account member firms' varying organizational structures and allocations of compliance functions. Specifically, we seek clarification with respect to the following italicized language of the IM:

The chief compliance officer and other compliance officers that report to the chief compliance officer (as described in the sentence that immediately follows) *shall perform the*

compliance functions contemplated by this Interpretive Material and paragraphs 3 and 4 of the certification. Nothing in the IM is intended to limit or discourage the responsibility or participation of other employees within and without the member's compliance department in any aspect of the members' compliance programs and processes, including those matters discussed in the Interpretive Material. However, it is understood that the CCO, and where applicable, the most senior compliance officers having primary compliance responsibility for each of the member's business segments, will retain responsibility for the compliance functions contemplated by this Interpretive Material and paragraphs 3 and 4 of the certification." (Release, p. 46604).

As noted in our earlier letters, depending upon a member firm's size, organizational structure and type of business, both Compliance Department reporting lines and the allocation of compliance-type functions can vary. Consequently, it is not uncommon for professionals outside a Compliance Department, both non-business line and business line, to have responsibility for some or all of the functions to which the IM refers. For example, in many firms the CCO reports to the General Counsel, who might therefore serve as the senior adviser to the CEO on compliance as well as legal matters. Also, as a matter of practice, oversight of a firm's activities relating to the firm's financial controls and compliance with regulatory financial reporting requirements usually reside with the broker-dealer's Controller, Chief Financial Officer or Treasurer and may be reviewed by the Internal Audit Department. Similarly, a member firm's systems and procedures for assuring compliance with margin regulations and the clearance and settlement process is typically the responsibility of the firm's Chief Operations Officer.

SRO rules recognize these distinctions and establish regulatory responsibilities and a qualification examination for a member firm's Financial and Operations Principal ("FINOP") that are separate from those prescribed for Chief Compliance Officers. In such cases, the COO and the FINOP have separate reporting lines from the CCO, while the CCO and the Compliance Department retain responsibility for sales, trading, research and investment banking practices in the "front office." Indeed, SROs including NASD regularly conduct financial and operational examinations that are separate from sales practice examinations and trading and market making examinations and typically may not involve the Compliance Department. By suggesting that "compliance functions" described in the IM are to be "performed" or "retained" exclusively by the Compliance officers, the IM may obfuscate the different allocations of various compliance functions already permitted under existing SRO rules requiring the implementation of supervisory systems.

SIA therefore recommends that NASD clarify that where some of the duties and functions ascribed to the CCO and other senior compliance officers are delegated by senior management to others in the member firm (such as the General Counsel, Internal Audit, Operations, Finance), those parties will retain responsibility in those areas for the compliance functions contemplated by the IM. This, of course, would not impact the CCO's responsibility to advise the CEO with regard to whether the firm has in place the processes contemplated by the certification.

Clarification as to "Compliance Policies"

We also suggest that NASD replace the term "compliance policies" in the proposed Rule and IM with "policies and procedures reasonably designed to achieve compliance with applicable securities laws." This alternative tracks existing language in 3010(a) and the Securities Exchange Act, as well as avoids suggesting that "compliance policies" and related procedures are solely the responsibility of the Compliance Department. In fact, and consistent with well-established supervisory principles and SRO rules, it is the supervisors in the business who are responsible for

enforcing all firm policies and procedures related to the member firm's securities or investment banking activities with respect to the personnel subject to their supervision.

Conclusion

We thank you for the opportunity to provide comments on this significant rule filing. We reiterate our support for the proposed rule as amended, as well as our belief that the clarifications we suggest above are necessary to make the Rule Proposal succeed in fully accomplishing the important policy objectives advanced by NASD. SIA therefore encourages NASD to clarify the language of the IM, which we believe is fundamental to a proper understanding of the role of Compliance, in the form of a technical amendment to the Rule Proposal. We understand that NASD staff does not believe that any further amendments are warranted at this time but has offered in the alternative to issue clarifying guidance in the form of Questions and Answers (Q&A) once the filing has been approved. Should it be ultimately determined that further modification to the IM is unnecessary, then SIA respectfully requests that NASD issue the Q&A as expeditiously as possible, preferably by year-end, and that the Q&A be undertaken with industry input.

If you have any question, please feel free to contact any of the undersigned or SIA Vice President and Associate General Counsel, Amal Aly at (212) 618-0568.

Sincerely,

John Polanin, Jr.
Chairman
SIA Self-Regulation and Supervisory Practices
Committee

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