

September 16, 1999

Richard C. Strasser  
Assistant Director  
Division of Market Regulation  
Securities and Exchange Commission  
450 Fifth Street, N.W  
Washington, D.C. 20549  
Mail Stop 10-1

Re: **File No. SR-NASD-99-46** - Chief Compliance Officer Registration

Dear Mr. Strasser:

Pursuant to Rule 19b-4, enclosed herewith is the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Mary M. Dunbar, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8252; e-mail [dunbarm@nasd.com](mailto:dunbarm@nasd.com). The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden S. Adkins  
Senior Vice President and  
General Counsel

Enclosure

File No. SR-NASD-99-46  
Consists of 111 Pages

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C.

---

Form 19b-4

Proposed Rule Change

by

**NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.**

Pursuant to Rule 19b-4 under the  
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 ("Act"), NASD Regulation, Inc. ("NASD Regulation") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend Rule 1022 of the National Association of Securities Dealers, Inc. ("NASD" or "Association") to require the registration of chief compliance officers. Below is the text of the proposed rule change.

Proposed new language is underlined; proposed deletions are in brackets.

**1022. Categories of Principal Registration**

(a) General Securities Principal

(1) Each person associated with a member who is included within the definition of principal in Rule 1021, and each person designated as a Chief Compliance Officer on Schedule A of Form BD, shall be required to register with the Association as a General Securities Principal and shall pass an appropriate Qualification Examination before such registration may become effective unless his activities are so limited as to qualify him for one or more of the limited categories of principal registration specified hereafter. A person whose activities in the investment banking or securities business are so limited is not, however, precluded from attempting to become qualified for registration as a General Securities Principal, and if qualified, may become so registered. Each person seeking to register and qualify as a General Securities Principal must, prior to or concurrent with such registration, become registered, pursuant to the Rule 1030 Series, either as a General Securities Representative or as a Limited Representative-Corporate Securities.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation at its meeting on July 28, 1999, which authorized the filing of the rule change with the SEC. The Nasdaq Stock Market has been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on July 29, 1999. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(2) of Article VI of the By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

(b) Questions regarding this rule filing may be directed to Mary M. Dunbar, Associate General Counsel, NASD Regulation, Inc. Office of General Counsel, at (202) 728-8252.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

The purpose of the proposed rule change is to require the chief compliance officer designated on Schedule A of a member's Form BD to be registered as a principal.

Some chief compliance officers may already be registered as a principal due to other NASD rule requirements. For example, Rule 3010(a)(8) requires each member to designate and specifically identify to the NASD one or more principals who are required to review the member's supervisory system, procedures, and inspections implemented by the member and take appropriate action reasonably designed to achieve the member's compliance with applicable

securities laws and regulations. For some members, the chief compliance officer is one of these designated principals. For other members, the chief compliance officer may already be registered as a principal because he or she is an officer of the member or otherwise engaged in the member's investment banking or securities business in a manner that requires principal registration under Rule 1021.

However, some chief compliance officers may not be registered. Rule 1021(a), which sets forth the requirements for principal registration, states that a member "may" make or maintain an application for principal registration for certain personnel, including compliance personnel. The negative implication of this provision is that compliance personnel are not required to be registered, but rather that a member may choose whether to register an individual with compliance responsibilities. Some members have chosen not to register any compliance personnel.

NASD Regulation believes that the chief compliance officer of a member, as designated on Schedule A of the Form BD, should be registered as a principal. This position generally entails directing the advice that is provided to both registered representatives and other principals about compliance issues and devising compliance systems and procedures for the firm as a whole. As such, the individual performing this function should be able to demonstrate his or her knowledge through a qualifications examination and be subject to continuing education requirements.

Under the proposed rule change, the chief compliance officer must be registered as a Series 24 General Securities Principal, unless the member's activities are limited to particular areas of the investment banking or securities business. In that case, the individual may apply for a limited principal registration. For example, if a member sells only mutual funds, the chief

compliance officer of that member may apply for registration as either a Series 26 Limited Principal—Investment Company and Variable Contracts Products or a Series 24 General Securities Principal. Acceptable limited principal categories for a chief compliance officer are the Series 4 (Registered Options Principal), 26 (Limited Principal Investment Company and Variable Contracts Products), 39 (Limited Principal Direct Participation Programs), and 73 (Government Securities Principal), if the activities of the chief compliance officer's firm are limited to these areas.

By requiring chief compliance officers to be registered, NASD Regulation is not creating a presumption that they are supervising the member's securities or investment banking business or otherwise are control persons. Some chief compliance officers are completely segregated from a member's supervisory structure. As in the past, NASD Regulation will determine whether a person is acting as a supervisor or control person by looking at the responsibilities and functions he performs for the member, not simply his title.

To avoid imposing duplicative examination requirements on dual NASD-New York Stock Exchange (NYSE) members, NASD Regulation has determined that for purposes of chief compliance officer registration, it will accept the NYSE's Series 14 Compliance Official examination in lieu of any of the NASD principal examinations noted above. For example, if a person had passed the NYSE Series 14, and after the effective date of the rule, accepted a chief compliance officer position with an NASD member, then the person would not be required to take the Series 24 examination.

NASD Regulation proposes to make the rule change effective on January 31, 2000. NASD Regulation will apply the rule change prospectively only. Therefore, any person listed as a chief compliance officer on a Form BD before that date will not be required to take any

examination, register, or participate in continuing education in order to serve in that position for his current or a future firm. If a person grandfathered under this provision wishes to serve as a principal for any other function, he must be appropriately qualified and register. The grandfather provision applies only to the chief compliance officer position. Any person who is listed as the chief compliance officer on the Form BD for the first time on or after January 31, 2000, will be required to apply for registration, pass the required examinations, and participate in continuing education.

Finally, NASD Regulation wishes to clarify an interpretive position related to the new chief compliance officer registration requirement. In Notice to Members 99-49, NASD Regulation stated that a general counsel of a member is not required to be registered unless he sits on the member's board of directors or otherwise participates in the management of the member's securities or investment banking business.<sup>1</sup> NASD Regulation has determined that this interpretation will continue to apply after the effective date of the rule even if a registered chief compliance officer reports directly to the general counsel, i.e., the general counsel has the power to hire and fire and direct the activities of the chief compliance officer. NASD Regulation does not believe that it is necessary at this time to impose a general registration requirement on general counsels, or to require them to be registered simply because registered persons may report to them.

---

<sup>1</sup> The Notice further explained that an employee of a member who sits on its board of directors is generally presumed to be involved in the day-to-day management of the member's business and therefore is required to be registered as a principal. If the general counsel or corporate secretary is not a director but has management-level responsibilities for supervising any aspect of the member's investment banking or securities business, then he would have to be registered as a principal. Management responsibilities in this context would include serving as a voting member of the firm's executive, management, or operations committees. A general counsel may participate in such committees' activities without triggering a registration requirement if he only provides counsel to the committee and does not vote.

(b) Statutory Basis

NASD Regulation 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 the Association'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 Regulation believes that adding this registration requirement will help protect investors and the public interest by ensuring that chief compliance officers can demonstrate their knowledgeable about compliance matters and stay up-to-date with industry requirements through continuing education.

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

NASD Regulation 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, as amended.

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

The proposed rule change was published for comment in NASD Notice to Members 99-51. Sixty-one comments were received in response to the Notice. A copy of the Notice to Members is attached as Exhibit 2. A list of commenters and copies of the comment letters received in response to the Notice are attached as Exhibit 3.

Thirty-seven commenters favored registration of chief compliance officers<sup>2</sup> and 14 were opposed.<sup>3</sup> Some of the commenters who opposed the proposed rule change stated that it is not necessary for chief compliance officers to demonstrate their knowledge through examinations because they could not obtain the position unless they were competent and/or that the expenses associated with registration would be burdensome.<sup>4</sup> One commenter stated that continuing education programs are already available to compliance personnel.<sup>5</sup> Another commenter stated that the rule would create a presumption that the chief compliance officer is a control person.<sup>6</sup>

NASD Regulation does not believe that the incremental effort required for a chief compliance officer to pass examinations to demonstrate his knowledge would be burdensome. As noted above, some chief compliance officers already are registered as principals, so no additional requirement is being imposed on them. Also, NASD Regulation does not believe that the cost associated with registering at most one more person for each member is unduly burdensome. Furthermore, required annual continuing education programs will assist the chief

---

<sup>2</sup> Letters from A.G. Edwards & Sons, Inc. ("A.G. Edwards"); American Equity Capital, Inc. ("American Equity"); Atlantic Capital Management, LLC ("Atlantic"); BMS International ("BMS"); Burke, Christensen & Lewis Securities, Inc. ("Burke, Christensen"); California Association of Independent Broker-Dealers ("CAIBD"); Centennial Securities Co. ("Centennial"); Consolidated Financial Investments, Inc. ("Consolidated Financial"); Corporate Network Brokerage Services, Inc. ("Corporate Network"); Melissa Crockett ("Crockett"); Davenport & Company, LLC ("Davenport"); Dreyfus Brokerage Services ("Dreyfus"); Robert A. Eder, Sr. ("Eder"); FAS Wealth Management Services, Inc. ("FAS Wealth Management"); Fulcrum Financial Advisors, Inc. ("Fulcrum"); H.C. Wainwright & Co., Inc.; Jackson Securities, Inc. ("Jackson"); John Hancock Mutual Life Insurance Company ("John Hancock"); Lynn Junkin ("Junkin"); Betty Kabanek; Don Katz ("Katz"); Keystone Brokerage, Inc. ("Keystone"); Andrew J. Lenza ("Lenza"); Liberty Funds Distributor, Inc. ("Liberty Funds"); Lincoln Investment Planning, Inc. ("Lincoln Investment"); Larry Lowman ("Lowman"); Mid-Florida Equities, Inc. ("Mid-Florida Equities"); MidSouth Capital Incorporated ("MidSouth Capital"); mmlcarthurlafon@dstsystems.com; MML Investors Services, Inc. ("MML"); Nalico Equity; Linda K. Parker ("Parker"); Regions Investment Company, Inc. ("Regions"); Althea Roberts ("Roberts"); SIA Self-Regulation and Supervisory Practices Committee ("SIA Committee"); Tradition, Inc. ("Tradition"); and Unified Management Corporation ("Unified Management").

<sup>3</sup> Letters from Branch Cabell & Co., Inc. ("Branch Cabell"); Charles Schwab & Co., Inc. ("Schwab"); Mark Geregach ("Geregach"); George T. Goldman; Mark Horin ("Horin"); Knight Securities, L.P. ("Knight Securities"); Eric D. Koval ("Koval"); lizakahn@aol.com; Joel Martin McTague ("McTague"); Orrick, Herrington & Sutcliffe, LLP; Princeton Equity Securities, Inc.; St. Bernard Financial Services, Inc.; John Tubman; and Robert Woeber ("Woeber").

<sup>4</sup> Letters from Branch Cabell; Horin; Koval; Schwab; and Woeber.

<sup>5</sup> Letter from Geregach.

<sup>6</sup> Letter from Knight Securities.

compliance officer in staying current with regulatory requirements and developments. Finally, as stated above, NASD Regulation will not presume that a chief compliance officer is a supervisor or control person just by virtue of his title.

Twenty-six commenters favored using the Series 24 General Securities Principal registration category (or a limited principal category as appropriate);<sup>7</sup> three commenters were opposed.<sup>8</sup> Only eight commenters favored the creation of a new examination,<sup>9</sup> while 14 commenters opposed it.<sup>10</sup> NASD Regulation determined not to create a new examination because it believes that the Series 24 is suitable for testing knowledge of compliance matters, some chief compliance officers have already taken and passed it, and the development costs associated with a new examination would have to be passed along to members.

Nine commenters favored accepting the NYSE Series 14 in lieu of the Series 24.<sup>11</sup> NASD Regulation agrees with these commenters and will accept the NYSE examination for purposes of chief compliance officer registration.

Most commenters did not address the issue of whether a general counsel who supervises a registered chief compliance officer should be registered. However, nine commenters specifically favored requiring such a general counsel to be registered,<sup>12</sup> while eight were opposed.<sup>13</sup> Only

---

<sup>7</sup> Letters from A.G. Edwards; Atlantic; BMS; Consolidated Financial; Corporate Network; Crockett; Eder; FAS Wealth Management; Fulcrum; Jackson; John Hancock; Junkin; Keystone; Lenza; Liberty Funds; Lincoln Investment; Lowman; Mid-Florida Equities; MidSouth Capital; mlmcarthurlafon@dstsystems.com; MML; Parker; Regions; SIA Committee; Tradition; and Unified Management.

<sup>8</sup> Letters from American Equity; Burke, Christensen; and CAIBD.

<sup>9</sup> Letters from A.G. Edwards; Burke, Christensen; CAIBD; Centennial; Fulcrum; Lenza; Mid-Florida Equities; and Lisa Roth.

<sup>10</sup> Letters from American Equity; Corporate Network; Eder; H.C. Wainwright & Co., Inc. ("H.C. Wainwright"); John Hancock; Katz; Liberty Funds; Lowman; MidSouth Capital; mlmcarthurlafon@dstsystems.com; MML; Parker; Regions; and SIA Committee.

<sup>11</sup> Letters from A.G. Edwards; Corporate Network; Davenport; Dreyfus; H.C. Wainwright; John Hancock; Roberts; Schwab; and SIA Committee.

<sup>12</sup> Letters from A.G. Edwards; Crockett; Davenport; Eder; Keystone; MidSouth Capital; MML; NBC Capital Markets Group, Inc.; and Tradition.

one of the commenters in favor of general counsel registration offered a rationale for their position, i.e., that a law degree does not ensure knowledge of securities laws and that a general counsel who supervises a chief compliance officer is in effect the chief compliance officer himself.<sup>14</sup> While NASD Regulation agrees with the first reason, it disagrees with the second. The fact that a chief compliance officer reports to another officer such as the general counsel does not make that officer the "effective" chief compliance officer. Commenters opposed to requiring a general counsel to register stated that a registration requirement could lead firms to restructure reporting lines, undermine the independence of the general counsel, and improperly interfere with the practice of law.<sup>15</sup> NASD Regulation does not believe that a compelling reason has been offered at this time to impose a general registration requirement on general counsels who supervise chief compliance officers.

Six commenters were opposed to grandfathering current chief compliance officers, i.e., applying the proposed rule change prospectively only.<sup>16</sup> NASD Regulation disagrees with these commenters. As noted previously, the NASD rules to date have not explicitly required chief compliance officer registration, and it would be unnecessarily burdensome to apply the new requirement immediately to persons currently serving in this position. Therefore, NASD Regulation determined to impose the requirement prospectively only.

#### 6. Extension of Time Period for Commission Action

NASD Regulation does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

---

<sup>13</sup> Letters from Investment Company Institute ("ICI"); John Hancock; Knight Securities; Lenza; Liberty Funds; McTague; Nationwide Life Insurance Company; Syndicated Capital.

<sup>14</sup> Letter from Davenport.

<sup>15</sup> Letters from ICI, Knight Securities, e.g.

<sup>16</sup> Letters from A.G. Edwards; Crockett; Fulcrum; MidSouth Capital; Parker; and SIA Committee.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.
2. NASD Notice to Members 99-51.
3. Comments received in response to NASD Notice to Members 99-51.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY: \_\_\_\_\_  
Alden S. Adkins, Senior Vice President and  
General Counsel

Date: September 16, 1999

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- ; File No. SR-NASD-99-46)  
September 16, 1999

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Registration of Chief Compliance Officers

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on September \_\_, 1999, NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Regulation is proposing to amend Rule 1022(a) of the National Association of Securities Dealers, Inc. ("NASD" or "Association") to require the registration of chief compliance officers. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

**1022. Categories of Principal Registration**

(a) General Securities Principal

(1) Each person associated with a member who is included within the definition of principal in Rule 1021, and each person designated as a Chief Compliance Officer on Schedule A of Form BD, shall be required to register with the Association as a General Securities Principal and shall pass an appropriate Qualification Examination before such

registration may become effective unless his activities are so limited as to qualify him for one or more of the limited categories of principal registration specified hereafter. A person whose activities in the investment banking or securities business are so limited is not, however, precluded from attempting to become qualified for registration as a General Securities Principal, and if qualified, may become so registered. Each person seeking to register and qualify as a General Securities Principal must, prior to or concurrent with such registration, become registered, pursuant to the Rule 1030 Series, either as a General Securities Representative or as a Limited Representative-Corporate Securities.

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD Regulation included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD Regulation has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

The purpose of the proposed rule change is to require the chief compliance officer designated on Schedule A of a member's Form BD to be registered as a principal.

Some chief compliance officers may already be registered as a principal due to other NASD rule requirements. For example, Rule 3010(a)(8) requires each member to designate and specifically identify to the NASD one or more principals who are required to review the

member's supervisory system, procedures, and inspections implemented by the member and take appropriate action reasonably designed to achieve the member's compliance with applicable securities laws and regulations. For some members, the chief compliance officer is one of these designated principals. For other members, the chief compliance officer may already be registered as a principal because he or she is an officer of the member or otherwise engaged in the member's investment banking or securities business in a manner that requires principal registration under Rule 1021.

However, some chief compliance officers may not be registered. Rule 1021(a), which sets forth the requirements for principal registration, states that a member "may" make or maintain an application for principal registration for certain personnel, including compliance personnel. The negative implication of this provision is that compliance personnel are not required to be registered, but rather that a member may choose whether to register an individual with compliance responsibilities. Some members have chosen not to register any compliance personnel.

NASD Regulation believes that the chief compliance officer of a member, as designated on Schedule A of the Form BD, should be registered as a principal. This position generally entails directing the advice that is provided to both registered representatives and other principals about compliance issues and devising compliance systems and procedures for the firm as a whole. As such, the individual performing this function should be able to demonstrate his or her knowledge through a qualifications examination and be subject to continuing education requirements.

Under the proposed rule change, the chief compliance officer must be registered as a Series 24 General Securities Principal, unless the member's activities are limited to particular

areas of the investment banking or securities business. In that case, the individual may apply for a limited principal registration. For example, if a member sells only mutual funds, the chief compliance officer of that member may apply for registration as either a Series 26 Limited Principal—Investment Company and Variable Contracts Products or a Series 24 General Securities Principal. Acceptable limited principal categories for a chief compliance officer are the Series 4 (Registered Options Principal), 26 (Limited Principal Investment Company and Variable Contracts Products), 39 (Limited Principal Direct Participation Programs), and 73 (Government Securities Principal), if the activities of the chief compliance officer's firm are limited to these areas.

By requiring chief compliance officers to be registered, NASD Regulation is not creating a presumption that they are supervising the member's securities or investment banking business or otherwise are control persons. Some chief compliance officers are completely segregated from a member's supervisory structure. As in the past, NASD Regulation will determine whether a person is acting as a supervisor or control person by looking at the responsibilities and functions he performs for the member, not simply his title.

To avoid imposing duplicative examination requirements on dual NASD-New York Stock Exchange (NYSE) members, NASD Regulation has determined that for purposes of chief compliance officer registration, it will accept the NYSE's Series 14 Compliance Official examination in lieu of any of the NASD principal examinations noted above. For example, if a person had passed the NYSE Series 14, and after the effective date of the rule, accepted a chief compliance officer position with an NASD member, then the person would not be required to take the Series 24 examination.

NASD Regulation proposes to make the rule change effective on January 31, 2000.

NASD Regulation will apply the rule change prospectively only. Therefore, any person listed as a chief compliance officer on a Form BD before that date will not be required to take any examination, register, or participate in continuing education in order to serve in that position for his current or a future firm. If a person grandfathered under this provision wishes to serve as a principal for any other function, he must be appropriately qualified and register. The grandfather provision applies only to the chief compliance officer position. Any person who is listed as the chief compliance officer on the Form BD for the first time on or after January 31, 2000, will be required to apply for registration, pass the required examinations, and participate in continuing education.

Finally, NASD Regulation wishes to clarify an interpretive position related to the new chief compliance officer registration requirement. In Notice to Members 99-49, NASD Regulation stated that a general counsel of a member is not required to be registered unless he sits on the member's board of directors or otherwise participates in the management of the member's securities or investment banking business.<sup>1</sup> NASD Regulation has determined that this interpretation will continue to apply after the effective date of the rule even if a registered chief compliance officer reports directly to the general counsel, i.e., the general counsel has the

---

<sup>1</sup> The Notice further explained that an employee of a member who sits on its board of directors is generally presumed to be involved in the day-to-day management of the member's business and therefore is required to be registered as a principal. If the general counsel or corporate secretary is not a director but has management-level responsibilities for supervising any aspect of the member's investment banking or securities business, then he would have to be registered as a principal. Management responsibilities in this context would include serving as a voting member of the firm's executive, management, or operations committees. A general counsel may participate in such committees' activities without triggering a registration requirement if he only provides counsel to the committee and does not vote.

power to hire and fire and direct the activities of the chief compliance officer. NASD Regulation does not believe that it is necessary at this time to impose a general registration requirement on general counsels, or to require them to be registered simply because registered persons may report to them.

(b) Statutory Basis

NASD Regulation 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 the Association'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 Regulation believes that adding this registration requirement will help protect investors and the public interest by ensuring that chief compliance officers can demonstrate their knowledgeable about compliance matters and stay up-to-date with industry requirements through continuing education.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation 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, as amended.

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

The proposed rule change was published for comment in NASD Notice to Members 99-51. Sixty-one comments were received in response to the Notice. A copy of the Notice to Members is attached as Exhibit 2. A list of commenters and copies of the comment letters received in response to the Notice are attached as Exhibit 3.

Thirty-seven commenters favored registration of chief compliance officers<sup>2</sup> and 14 were opposed.<sup>3</sup> Some of the commenters who opposed the proposed rule change stated that it is not necessary for chief compliance officers to demonstrate their knowledge through examinations because they could not obtain the position unless they were competent and/or that the expenses associated with registration would be burdensome.<sup>4</sup> One commenter stated that continuing education programs are already available to compliance personnel.<sup>5</sup> Another commenter stated that the rule would create a presumption that the chief compliance officer is a control person.<sup>6</sup>

NASD Regulation does not believe that the incremental effort required for a chief compliance officer to pass examinations to demonstrate his knowledge would be burdensome. As noted above, some chief compliance officers already are registered as principals, so no additional requirement is being imposed on them. Also, NASD Regulation does not believe that the cost associated with registering at most one more person for each member is undue

---

<sup>2</sup> Letters from A.G. Edwards & Sons, Inc. ("A.G. Edwards"); American Equity Capital, Inc. ("American Equity"); Atlantic Capital Management, LLC ("Atlantic"); BMS International ("BMS"); Burke, Christensen & Lewis Securities, Inc. ("Burke, Christensen"); California Association of Independent Broker-Dealers ("CAIBD"); Centennial Securities Co. ("Centennial"); Consolidated Financial Investments, Inc. ("Consolidated Financial"); Corporate Network Brokerage Services, Inc. ("Corporate Network"); Melissa Crockett ("Crockett"); Davenport & Company, LLC ("Davenport"); Dreyfus Brokerage Services ("Dreyfus"); Robert A. Eder, Sr. ("Eder"); FAS Wealth Management Services, Inc. ("FAS Wealth Management"); Fulcrum Financial Advisors, Inc. ("Fulcrum"); H.C. Wainwright & Co., Inc.; Jackson Securities, Inc. ("Jackson"); John Hancock Mutual Life Insurance Company ("John Hancock"); Lynn Junkin ("Junkin"); Betty Kabanek; Don Katz ("Katz"); Keystone Brokerage, Inc. ("Keystone"); Andrew J. Lenza ("Lenza"); Liberty Funds Distributor, Inc. ("Liberty Funds"); Lincoln Investment Planning, Inc. ("Lincoln Investment"); Larry Lowman ("Lowman"); Mid-Florida Equities, Inc. ("Mid-Florida Equities"); MidSouth Capital Incorporated ("MidSouth Capital"); mlmcarthurlafon@dstsystems.com; MML Investors Services, Inc. ("MML"); Nalico Equity; Linda K. Parker ("Parker"); Regions Investment Company, Inc. ("Regions"); Althea Roberts ("Roberts"); SIA Self-Regulation and Supervisory Practices Committee ("SIA Committee"); Tradition, Inc. ("Tradition"); and Unified Management Corporation ("Unified Management").

<sup>3</sup> Letters from Branch Cabell & Co., Inc. ("Branch Cabell"); Charles Schwab & Co., Inc. ("Schwab"); Mark Geregach ("Geregach"); George T. Goldman; Mark Horin ("Horin"); Knight Securities, L.P. ("Knight Securities"); Eric D. Koval ("Koval"); lizakahn@aol.com; Joel Martin McTague ("McTague"); Orrick, Herrington & Sutcliffe, LLP; Princeton Equity Securities, Inc.; St. Bernard Financial Services, Inc.; John Tubman; and Robert Woeber ("Woeber").

<sup>4</sup> Letters from Branch Cabell; Horin; Koval; Schwab; and Woeber.

<sup>5</sup> Letter from Geregach.

<sup>6</sup> Letter from Knight Securities.

burdensome. Furthermore, required annual continuing education programs will assist the chief compliance officer in staying current with regulatory requirements and developments. Finally, as stated above, NASD Regulation will not presume that a chief compliance officer is a supervisor or control person just by virtue of his title.

Twenty-six commenters favored using the Series 24 General Securities Principal registration category (or a limited principal category as appropriate);<sup>7</sup> three commenters were opposed.<sup>8</sup> Only eight commenters favored the creation of a new examination,<sup>9</sup> while 14 commenters opposed it.<sup>10</sup> NASD Regulation determined not to create a new examination because it believes that the Series 24 is suitable for testing knowledge of compliance matters, some chief compliance officers have already taken and passed it, and the development costs associated with a new examination would have to be passed along to members.

Nine commenters favored accepting the NYSE Series 14 in lieu of the Series 24.<sup>11</sup> NASD Regulation agrees with these commenters and will accept the NYSE examination for purposes of chief compliance officer registration.

Most commenters did not address the issue of whether a general counsel who supervises a registered chief compliance officer should be registered. However, nine commenters specifically

---

<sup>7</sup> Letters from A.G. Edwards; Atlantic; BMS; Consolidated Financial; Corporate Network; Crockett; Eder; FAS Wealth Management; Fulcrum; Jackson; John Hancock; Junkin; Keystone; Lenza; Liberty Funds; Lincoln Investment; Lowman; Mid-Florida Equities; MidSouth Capital; mlmcarthurlafon@dstsystems.com; MML; Parker; Regions; SIA Committee; Tradition; and Unified Management.

<sup>8</sup> Letters from American Equity; Burke, Christensen; and CAIBD.

<sup>9</sup> Letters from A.G. Edwards; Burke, Christensen; CAIBD; Centennial; Fulcrum; Lenza; Mid-Florida Equities; and Lisa Roth.

<sup>10</sup> Letters from American Equity; Corporate Network; Eder; H.C. Wainwright & Co., Inc. ("H.C. Wainwright"); John Hancock; Katz; Liberty Funds; Lowman; MidSouth Capital; mlmcarthurlafon@dstsystems.com; MML; Parker; Regions; and SIA Committee.

<sup>11</sup> Letters from A.G. Edwards; Corporate Network; Davenport; Dreyfus; H.C. Wainwright; John Hancock; Roberts; Schwab; and SIA Committee.

avored requiring such a general counsel to be registered,<sup>12</sup> while eight were opposed.<sup>13</sup> Only one of the commenters in favor of general counsel registration offered a rationale for their position, i.e., that a law degree does not ensure knowledge of securities laws and that a general counsel who supervises a chief compliance officer is in effect the chief compliance officer himself.<sup>14</sup> While NASD Regulation agrees with the first reason, it disagrees with the second. The fact that a chief compliance officer reports to another officer such as the general counsel does not make that officer the "effective" chief compliance officer. Commenters opposed to requiring a general counsel to register stated that a registration requirement could lead firms to restructure reporting lines, undermine the independence of the general counsel, and improperly interfere with the practice of law.<sup>15</sup> NASD Regulation does not believe that a compelling reason has been offered at this time to impose a general registration requirement on general counsels who supervise chief compliance officers.

Six commenters were opposed to grandfathering current chief compliance officers, i.e., applying the proposed rule change prospectively only.<sup>16</sup> NASD Regulation disagrees with these commenters. As noted previously, the NASD rules to date have not explicitly required chief compliance officer registration, and it would be unnecessarily burdensome to apply the new requirement immediately to persons currently serving in this position. Therefore, NASD Regulation determined to impose the requirement prospectively only.

---

<sup>12</sup> Letters from A.G. Edwards; Crockett; Davenport; Eder; Keystone; MidSouth Capital; MML; NBC Capital Markets Group, Inc.; and Tradition.

<sup>13</sup> Letters from Investment Company Institute ("ICI"); John Hancock; Knight Securities; Lenza; Liberty Funds; McTague; Nationwide Life Insurance Company; Syndicated Capital.

<sup>14</sup> Letter from Davenport.

<sup>15</sup> Letters from ICI, Knight Securities, e.g.

<sup>16</sup> Letters from A.G. Edwards; Crockett; Fulcrum; MidSouth Capital; Parker; and SIA Committee.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz  
Secretary