

NASD Notice to Members 99-03

SEC Approves Rule Amendments Requiring Review Of Incoming, Written Correspondence; Effective March 15, 1999

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Executive Representatives
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
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- Variable Contracts

Executive Summary

On November 30, 1998, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD[®]) Rule 3010, requiring firms to review incoming, written correspondence to identify customer complaints and funds and to ensure they are properly handled. The rule amendments will be effective on March 15, 1999. This amendment revises rule changes that became effective on April 7, 1998. The text of the amended Rule and the *Federal Register* version of the SEC release are attached. This *Notice to Members* is being issued to provide guidance on how to implement this rule.

Questions concerning this *Notice* should be directed to Lawrence Kosciulek, Assistant Director, Advertising/Investment Companies Regulation, NASD Regulation, Inc. (NASD RegulationSM), at (202) 728-8329; or Mary N. Revell, Associate General Counsel, Office of General Counsel, NASD Regulation at (202) 728-8203.

Background

In December 1997, the SEC approved rule amendments that were designed to allow firms to develop flexible supervisory procedures for the review of correspondence with the public. The amendments were intended to recognize the growing use of correspondence sent and received in electronic format (*i.e.*, e-mail and facsimile) while still providing for effective supervision. *Notice to Members 98-11*, issued in January 1998, provided guidance to firms on how to implement these rules. Subsequent to SEC approval of the amendments, but before the amended rules went into effect, the SEC received 14 comment letters objecting to certain provisions in the new rules, primarily from members in the insurance industry. The commenters primarily

objected to a provision in *Notice to Members 98-11*, which states that firms will be required to review all incoming correspondence received in non-electronic format directed to registered representatives and related to a member's investment banking or securities business. NASD Regulation added this provision to *Notice to Members 98-11* to address two regulatory concerns raised by the SEC: (1) ensuring that firms capture all customer complaints; and (2) safeguarding customer funds.

The commenters stated that it will be very difficult or impossible for a registered principal to conduct a pre-distribution review of all incoming, non-electronic correspondence, particularly correspondence received by registered representatives in small, one- or two-person offices. In response to these concerns, the effective date of the requirement to review all incoming, non-electronic correspondence was delayed to allow NASD Regulation time to develop an alternative, workable procedure for the review of incoming, non-electronic correspondence that addresses the regulatory concerns about preventing misappropriation of customer funds and diversion of customer complaints. The rule amendments and all other provisions in the *Notice* became effective on April 7, 1998.

Amended Rule

NASD Regulation has received SEC approval of amendments to Rule 3010 (*see* Securities Exchange Act Release No. 40723 (November 30, 1998), 63 FR 67496 (December 7, 1998), attached). Rule 3010(d)(2) requires each member to develop written policies and procedures for review of correspondence with the public relating to its investment banking or securities business tailored to its structure and the nature and size of its business and customers. The

rule has been amended to state that these procedures must also include the review of incoming, written correspondence directed to registered representatives and related to the member's investment banking or securities business to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with firm procedures.

The method used for conducting reviews of incoming, written correspondence to identify customer complaints and funds may vary depending on the firm's office structure. Where the office structure permits review of all correspondence, members should designate a registered representative or an associated person to open and review correspondence prior to use or distribution to identify customer complaints and funds. The designated person must not be supervised or under the control of the registered person whose correspondence is opened and reviewed. Unregistered persons who have received sufficient training to enable them to identify complaints and checks would be permitted to review correspondence.

It is the understanding and view of NASD Regulation that member firms possess the legal capacity to insist that mail addressed to their offices be deemed to be related to their business, even if marked to the attention of a particular associated person, if they advise associated persons that personal correspondence should not be received at the firm. Members are reminded that SEC Rule 17a-4(b)(4) requires that "originals of all communications received . . . by such member, broker or dealer, relating to its business as such . . ." must be preserved for not less than three years.

Where the office structure does not permit the review of correspondence prior to use or distribution, the firm

would have to employ alternative procedures reasonably designed to assure adequate handling of complaints and checks. Procedures that could be adopted include the following:

- forwarding opened incoming, written correspondence related to the firm's investment banking or securities business to an Office of Supervisory Jurisdiction or a branch manager for review on a weekly basis;
- maintenance of a separate log for all checks received and securities products sold, which is forwarded to the supervising branch on a weekly basis;
- communication to clients that they can contact the broker/dealer directly for any matter, including the filing of a complaint, and provides them with an address and telephone number of a central office of the broker/dealer for this purpose; and
- branch examination verification that the procedures are being followed.

Regardless of the method used for initial review of incoming, written correspondence, as with other types of correspondence, Rule 3010(d)(1) would still require review by a registered principal of some of each registered representative's correspondence with the public relating to the member's investment banking or securities business.

Notice to Members 98-11

As stated above, *Notice to Members 98-11* stated that firms would be required to review all incoming correspondence received in non-electronic format directed to registered representatives and related to a member's investment banking or securities business. That requirement is no longer applicable and has been superseded by the amendment

to Rule 3010(d)(2) and the guidance provided in this *Notice*.

Text Of Amendments

(Note: New text is underlined; deletions are bracketed.)

Rule 3010. Supervision

(a) - (c) No change

(d) Review of Transactions and Correspondence

(1) No change

(2) Review of correspondence. Each member shall develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing written (i.e., non-electronic) and electronic correspondence with the public relating to its investment banking or securities business, including procedures to review incoming, written correspondence directed to registered representatives and related to the member's investment banking or securities business to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with firm procedures. Where such procedures for the review of correspondence do not require [pre-use] review of all correspondence prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing correspondence; documentation of such education and training; and surveillance and follow-up to ensure that such procedures are implemented and adhered to.

(3) No change

(e) - (g) No change

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