



NASD Regulation, Inc.
1735 K Street, NW
Washington, DC 20006-1500

202-728-8000

April 7, 1998

VIA MESSENGER

Katherine A. England
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-98-31; Supervision of Correspondence**

Dear Ms. England:

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 WordPerfect 5.1 to facilitate production of the Federal Register release.

If you have any questions, please contact Mary Revell, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8203; e-mail revellm@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden S. Adkins
Vice President and General Counsel

Attachment

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 National Association of Securities Dealers, Inc. ("NASD" or "Association") Rules 3010 and 3110 to implement the effective date of recently-approved amendments to these rules. The amendments allow firms to develop flexible procedure for the review of correspondence with the public.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The NASD Regulation Board of Directors approved a proposed rule change to amend NASD Rules 3010 and 3110 and authorized the filing of the rule change with the SEC at its meeting on March 14, 1997. The Nasdaq Stock Market was provided with 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 April 10, 1997. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(2) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to the NASD Conduct Rules without recourse to the membership for approval.

The original Rule Filing specified an effective date of 45 days after SEC approval of the proposed rule change. However, subsequent to approval of the proposed rule change, several member firms submitted comment letters raising concerns regarding issues raised by SEC approval of an amendment to the proposed rule change. As a result, NASD Regulation postponed the effective date of the proposed rule to address member concerns. Implementing a new effective date is consistent with prior authorizations.

(b) Questions regarding this rule filing may be directed to Mary Revell, Associate General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-8203.

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

(a) **Purpose**

A proposed rule change to amend NASD Rules 3010 and 3110 was filed with the SEC on April 11, 1997 in File No. SR-NASD-97-24. The purpose of the amendments was to allow firms to develop flexible procedures for the review of correspondence with the public. In that filing, the NASD stated that it would make the proposed rule change effective within 45 days of Commission approval. Amendment No. 1, containing a draft Notice to Members to be issued following approval of the proposed rule change, was filed with the SEC on December 1, 1997. The Notice to Members described the new rules and provided guidance to NASD members on the implementation of the new rules. The SEC approved the proposed rule change and Amendment No. 1 to the proposed rule change on December 31,

1997.¹ Notice to Members 98-11 announced approval of the proposed rule change and stated that the amendments to Rules 3010 and 3110 would be effective on February 15, 1998.

Subsequent to approval of the proposed rule change by the SEC, several commenters filed letters with the SEC raising issues regarding Amendment No. 1 to the proposed rule change and its accompanying Notice to Members.² NASD Regulation, believing that the letters raise important issues that should be fully addressed before the effectiveness of the rule change, filed proposed rule change SR-NASD-98-10 to postpone the effective date of the amendments to Rules 3010 and 3110 approved in Release No. 39510.³

The concerns raised by the commenters include issues concerning the effect of the rules on the review of incoming correspondence and the scope of the obligation of member firms to control the use of electronic communications systems that registered persons use to communicate with their customers. After considering these issues, NASD Regulation

¹ See Securities Exchange Act Release No. 39510 (December 31, 1997), 63 FR 1131 (January 8, 1998) ("Release No. 39510").

² See letters from Carl B. Wilkerson, American Council of Life Insurance, to Jonathan G. Katz, Secretary, SEC, dated January 9, 1998 and January 29, 1998; Beverly A. Byre, BenefitsCorp Equities, Inc., to Jonathan G. Katz, Secretary, SEC, dated January 26, 1998; Michael S. Martin, The Equitable Life Assurance Society of the United States, to Jonathan G. Katz, SEC, dated January 29, 1998; Janet G. McCallen, International Association for Financial Planning, to Jonathan G. Katz, Secretary, SEC, dated February 13, 1998; W. Thomas Boulter, Jefferson Pilot Financial, to Jonathan G. Katz, Secretary, SEC, dated January 28, 1998; Leonard M. Bakal, Metropolitan Life Insurance Company and MetLife Securities, Inc., to Jonathan G. Katz, Secretary, SEC, dated January 28, 1998; Michael L. Kerley, MML Investors Services, Inc. to Secretary, SEC, dated January 26, 1998; Mark D. Johnson, The National Association of Life Underwriters, to Jonathan G. Katz, Secretary, SEC, dated February 5, 1998; Theodore Mathas, NYLIFE Securities, to Jonathan G. Katz, Secretary, SEC, dated January 16, 1998 and January 29, 1998; Beverly A. Byrne, One Orchard Equities, Inc., to Jonathan G. Katz, Secretary, SEC, dated January 26, 1998; Dodie Kent, Pruco Securities Corporation, to Jonathan G. Katz, Secretary, SEC, dated January 29, 1998; and James T. Bruce, Wiley, Rein & Fielding, on behalf of the Electronic Messaging Association, to Jonathan G. Katz, SEC, dated January 30, 1998.

³ The proposed rule change became effective on filing. See Release No. 34-39665 (February 13, 1998), 63 FR 9032 (February 23, 1998).

proposes to implement the amendments to Rules 3010 and 3110 approved in Release No. 39510 immediately, including the requirements set forth in Notice to Members 98-11, with the exception of the provision in the Notice stating that members must 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 proposes to delay the effective date of this provision until **July 7, 1998**. Extension of the effective date for this provision will allow NASD Regulation a further opportunity to consider comments on this issue. Prior to this effective date, however, members will be required to review and report customer complaints as required by Rule 3070(a)(2); keep and preserve all written customer complaints as required by Rule 3110(d); and establish procedures for the review of incoming and outgoing written and electronic correspondence consistent with new Rules 3010(d)(1) and (2).

NASD Regulation proposes to make effective immediately that portion of the Notice to Members that states that members’ supervisory policies and procedures must:

prohibit registered representatives and other employees’ use of electronic correspondence to the public unless such communications are subject to supervisory and review procedures developed by the firm. For example, NASD Regulation would expect members to prohibit correspondence with customers from employees’ home computers or through third party systems unless the firm is capable of monitoring such communications.

In response to comments received regarding this provision in the Notice, NASD Regulation wishes to point out that the Notice to Members does not establish any new obligation that is

not already encompassed by Rule 3010's requirement that firms supervise the activities of their associated persons and registered representatives to ensure compliance with applicable securities laws and regulations and NASD rules and merely provides guidance to members on how they can comply with Rule 3010. Furthermore, the Notice to Members does not prohibit the use of such systems or dictate the use of a particular system. The Notice only points out that firms should prohibit correspondence with customers through electronic communication systems unless the firm is capable of supervising the communications. In developing procedures for the review of correspondence, each firm must determine how it will review different types of correspondence, including electronic correspondence. If the firm determines that it can subject correspondence to customers through electronic communication systems to appropriate supervision and review, the firm can allow employees to correspond with customers through such systems.

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

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

Not applicable.

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

The rule change is effective upon filing pursuant to Section 19(b)(3)(A)(i) of the Act and Section (e) of Rule 19b-4 promulgated thereunder in that it constitutes a stated policy, practice, or interpretation with respect to the meaning of an existing rule.

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. 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
Vice President and General Counsel

Date: April 7, 1998

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-98-31)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Supervision of Correspondence

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 , 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. NASD Regulation has designated this proposal as one constituting a stated policy, practice, or interpretation with respect to the meaning of an existing rule under § 19(b)(3)(A)(i) of the Act, which renders the rule effective upon the Commission's receipt of this filing. 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 National Association of Securities Dealers, Inc. ("NASD" or "Association") Rules 3010 and 3110 to implement the effective date of recently-approved amendments to these rules.

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**

A proposed rule change to amend NASD Rules 3010 and 3110 was filed with the SEC on April 11, 1997 in File No. SR-NASD-97-24. The purpose of the amendments was to allow firms to develop flexible procedures for the review of correspondence with the public. In that filing, the NASD stated that it would make the proposed rule change effective within 45 days of Commission approval. Amendment No. 1, containing a draft Notice to Members to be issued following approval of the proposed rule change, was filed with the SEC on December 1, 1997. The Notice to Members described the new rules and provided guidance to NASD members on the implementation of the new rules. The SEC approved the proposed rule change and Amendment No. 1 to the proposed rule change on December 31, 1997.¹ Notice to Members 98-11 announced approval of the proposed rule change and stated that the amendments to Rules 3010 and 3110 would be effective on February 15, 1998.

Subsequent to approval of the proposed rule change by the SEC, several commenters filed letters with the SEC raising issues regarding Amendment No. 1 to the proposed rule change and its accompanying Notice to Members.² NASD Regulation, believing that the

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letters raise important issues that should be fully addressed before the effectiveness of the rule change, filed proposed rule change SR-NASD-98-10 to postpone the effective date of the amendments to Rules 3010 and 3110 approved in Release No. 39510.³

The concerns raised by the commenters include issues concerning the effect of the rules on the review of incoming correspondence and the scope of the obligation of member firms to control the use of electronic communications systems that registered persons use to communicate with their customers. After considering these issues, NASD Regulation proposes to implement the amendments to Rules 3010 and 3110 approved in Release No. 39510 immediately, including the requirements set forth in Notice to Members 98-11, with the exception of the provision in the Notice stating that members must 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 proposes to delay the effective date of this provision until **July 7, 1998**. Extension of the effective date for this provision will allow NASD Regulation a further opportunity to consider comments on this issue. Prior to this effective date, however, members will be

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required to review and report customer complaints as required by Rule 3070(a)(2); keep and preserve all written customer complaints as required by Rule 3110(d); and establish procedures for the review of incoming and outgoing written and electronic correspondence consistent with new Rules 3010(d)(1) and (2).

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prohibit registered representatives and other employees' use of electronic correspondence to the public unless such communications are subject to supervisory and review procedures developed by the firm. For example, NASD Regulation would expect members to prohibit correspondence with customers from employees' home computers or through third party systems unless the firm is capable of monitoring such communications.

In response to comments received regarding this provision in the Notice, NASD Regulation wishes to point out that the Notice to Members does not establish any new obligation that is not already encompassed by Rule 3010's requirement that firms supervise the activities of their associated persons and registered representatives to ensure compliance with applicable securities laws and regulations and NASD rules and merely provides guidance to members on how they can comply with Rule 3010. Furthermore, the Notice to Members does not prohibit the use of such systems or dictate the use of a particular system. The Notice only points out that firms should prohibit correspondence with customers through electronic communication systems unless the firm is capable of supervising the communications. In developing procedures for the review of correspondence, each firm must determine how it will review

different types of correspondence, including electronic correspondence. If the firm determines that it can subject correspondence to customers through electronic communication systems to appropriate supervision and review, the firm can allow employees to correspond with customers through such systems.

(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. The NASD believes that implementing the effective date of the new rules with the exception of the requirement to review all incoming non-electronic correspondence is consistent with these requirements.

(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

Written comments were neither solicited nor received.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(i) of the Act and subparagraph (e) of Rule 19b-4 thereunder in that it constitutes a stated policy, practice, or interpretation with respect to the meaning of an existing rule.

At any time within 60 days of the filing of a rule change pursuant to Section 19(b)(3)(A) of the Act, the Commission may summarily abrogate the rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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