

Special NASD Notice to Members 98-63

NASD Alerts Members About SEC Rule Amendment Requiring Broker/Dealers To File Year 2000 Reports And Releases Year 2000 Survey Results

Suggested Routing

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Executive Summary

On July 2, 1998, the Securities and Exchange Commission (SEC or Commission) amended SEC Rule 17a-5 to require broker/dealers to complete reports regarding their readiness and activities to prepare their businesses to address Year 2000 challenges and risks. The Rule amendment was published in the *Federal Register*—63 FR 37667 on July 13, 1998. Complete Rule information is also available on the SEC Web Site (www.sec.gov). This *Notice* discusses the specifics of the SEC's Year 2000 amendment.

Furthermore, this *Notice* highlights survey results from the National Association of Securities Dealers, Inc. (NASD®) December 1997 Year 2000 Compliance Survey. The purpose of that survey was to assist the NASD in determining the status of its members' Year 2000 initiatives, and to ensure that member firms are moving forward in making their businesses and systems Year 2000 compliant. As of June 30, 1998, 99.9 percent of the membership had responded to the survey.

Questions or comments regarding this *Notice* may be directed to Lyn Kelly, NASD Year 2000 Program Director, via the Program Office toll-free number, (888) 227-1330, or via e-mail at y2k@nasd.com. Also, visit the NASD Web Site (www.nasd.com) and NASD Regulation, Inc. (NASD RegulationSM) Web Site (www.nasdr.com) for further Year 2000 information.

SEC Year 2000 Amendment

The amendment to SEC Rule 17a-5 requires all NASD members with FOCUS capital requirements on or after December 31, 1997 of \$5,000 or greater to file two reports with the SEC and the firm's designated examining authority (DEA). **The first report is due to the SEC and DEA**

on or before August 31, 1998. The second report is due April 30, 1999.

The SEC states that these reports will increase broker/dealer awareness to take specific steps now to prepare for the Year 2000; facilitate coordination with self-regulatory organizations of industry-wide testing, implementation, and contingency planning; supplement the Commission's examination module for Year 2000 issues and identify potential Year 2000 problems; and provide information regarding the securities industry's preparedness for the Year 2000. The reports will be available to the public and will enable broker/dealer counterparties and others to assess the risks of doing business with a broker/dealer that may not be Year 2000 compliant.

Summary Details For Report Submission

Each NASD member firm with a \$5,000 or greater net capital requirement is required to file reports to the SEC and DEA at specified times regarding its efforts to address Year 2000 problems. **Important Note:** Member firms that fail to provide required Year 2000 reports will be subject to disciplinary action for violation of NASD Rule 8210.

Each report contains two parts. Part I must be completed by all NASD members with a \$5,000 or greater net capital requirement. Part I is a check-box format. Part II, which requires narrative answers, must be completed in addition to Part I if the NASD member firm has a \$100,000 or greater net capital requirement. SEC Form BD-Y2K and detailed filing instructions are enclosed with this *Notice*.

Generally, the report requires each NASD member firm to discuss the steps it has taken to address Year 2000 problems. Each member,

among other things, is required to: 1) indicate whether its board of directors, or similar body, has approved and funded written Year 2000 remediation plans that address all mission-critical computer systems; 2) describe its Year 2000 staffing efforts; 3) discuss its progress on each stage of preparation for the Year 2000; 4) indicate if it has written contingency plans to deal with Year 2000 problems that may occur; and 5) identify what levels of management are responsible for Year 2000 remediation efforts.

Attestation Comment Period

The SEC is reopening the comment period with respect to its proposal that would have required broker/dealers to engage an independent public accountant to attest to specific assertions in these reports. **The SEC should receive comments on or before 30 days after the Rule amendment was published in the *Federal Register* (July 13, 1998) or August 12, 1998.**

Comment letters should refer to File No. S7-7-98 and be submitted in triplicate to:

**Jonathan G. Katz, Secretary
Securities and Exchange
Commission
450 Fifth Street, NW
Washington DC 20549**

Comments may also be submitted electronically to the following e-mail address: rule-comments@sec.gov. File No. S7-7-98 should be included on the subject line if e-mail is used.

Report Submission Question & Answer Sessions With The SEC

In response to the challenge presented by the coming millennium change, the NASD has been communicating to NASD members about

the Year 2000 issue on a regular basis. The NASD Regulation Year 2000 Program has, and will continue to, developed publications and workshops to help prepare and educate members on how to address the problem and to make members aware of their responsibility to analyze the readiness of their own business and computer systems, as well as other services and computer systems that each member relies upon.

In order to facilitate complete and accurate report submission, the NASD and SEC will be offering free question and answer sessions to assist members with their individual reports mandated by the recent SEC Year 2000 rule amendment. Two-hour long sessions have been scheduled for the following cities:

City	Date
Chicago	July 31
Dallas	Aug. 3
New York City	Aug. 3
Kansas City	Aug. 4
Atlanta	Aug. 5
Boston	Aug. 5
Los Angeles	Aug. 10
New York City	Aug. 10
Denver	Aug. 11
San Francisco	Aug. 12
Seattle	Aug. 13

Call the NASD Year 2000 Program Office at (888) 227-1330 for details and to make a reservation. Details on these sessions are available on the NASD Regulation Web Site Year 2000 Web Page (www.nasdr.com).

Books And Records Advisory

The SEC advises that a broker/dealer with Year 2000 computer problems may be deemed not to have accurate and current records and be in violation of SEC Rule 17a-3. Also, any broker/dealer that fails to make and keep current books and records would be required to notify the SEC under SEC Rule 17a-11.

NASD Survey Results

In December 1997, the NASD published *Special Notice to Members 97-96* requiring NASD member firms to complete a Year 2000 Compliance Survey. The purpose of the survey was to assist in determining the status of NASD members' Year 2000 initiatives, and to ensure that member firms are on a course to make their businesses and systems Year 2000 compliant. The NASD Year 2000 Program Office will be performing risk-based analysis using information gathered on member firms' Year 2000 readiness from the NASD survey; information from SEC Rule 17a-5 amendment reports due August 31, 1998, and April 30, 1999; and NASD analyst discussions with members.

The SEC requested a report from the NASD summarizing results from the member survey to use in preparation of the June SEC "Report to the Congress on the Readiness of the United States Securities Industry and Public Companies to Meet the Information Processing Challenges of the Year 2000." This report is available on the SEC Web Site at www.sec.gov. It presents the SEC staff's findings as to the current state of readiness, their position with respect to corporate disclosure as it relates to the Year 2000 issue, actions they intend to continue to take to reduce the risk associated with the Year 2000 problem, and the staff's plans to meet future reporting requirements. An SEC representative will discuss the SEC's report to Congress in an article appearing in the September issue of the NASD's *Regulatory & Compliance Alert*.

Survey Processing And Definitions

The initial survey was mailed to the NASD Executive Representative contact at each member firm. The mailing list for active NASD members contained approximately 5,500 firms as of December 15, 1997. The survey was sent as an *NASD Special Notice To Members* on December 17, 1997.

The survey was designed so that responses could be provided in a check-box format or by filling in blank spaces. If a firm did not complete a section, the response was considered to be "blank" rather than "not applicable." If the response was "blank," the data for that question is not included in the NASD's reporting of the total of firms responding to that question.

As of June 30, 1998, the NASD received responses from 99.9 percent or 5,160 member firms. Member firms are categorized based on self-reported classifications contained in the FOCUS Schedule 1 Filing in 1997. Based on the filing data,

NASD membership is composed of 62 percent "Introducing," 9 percent "Clearing," and 29 percent "Other Firms." Other Firms include Limited Partnerships (DPP), Insurance Companies, Investment Companies, Mergers and Acquisitions Companies, and other firms not specifically designated as Introducing or Clearing. A graphic breakdown of the results appear on the following pages.

Update On SEC Staff Legal Bulletin No. 5

The SEC will release an interpretive memo to the *Staff Legal Bulletin No. 5* describing the results of a recent analysis of company 10Q disclosure reports on Year 2000. The *Bulletin*, originally issued on October 8, 1997, and revised on January 12, 1998, reminds public operating companies, investment advisers, and investment companies to consider their disclosure obligations relating to anticipated costs, problems, and uncertainties associated with the Year 2000 issue. At a recent Securities Industry Association (SIA) meeting, the SEC discussed general

findings of their recent analysis. They found that public organizations are not adequately disclosing the potential risk Year 2000 poses to their organizations. They also found that the percentage of companies disclosing in the financial industry is less than in other sectors. As a result of this, they are enlisting the NASD, SIA, and other exchanges to help them communicate the importance of disclosure to the public issuers.

Every member firm relies upon external organizations for continued successful business operation. Whether a firm relies on services from utility companies or other business service providers, their Year 2000 readiness impacts the member firm. Because of this, it is imperative that every member firm check the disclosure statements of public companies with which it deals. And, if the member firm is a public company, it should be providing full disclosure on its own Year 2000 readiness. Members should also examine disclosure statements made by the issuers they trade.

NASD Year 2000 Member Survey Results

(January 31, 1998 - June 30, 1998)

SURVEY RESPONDENTS

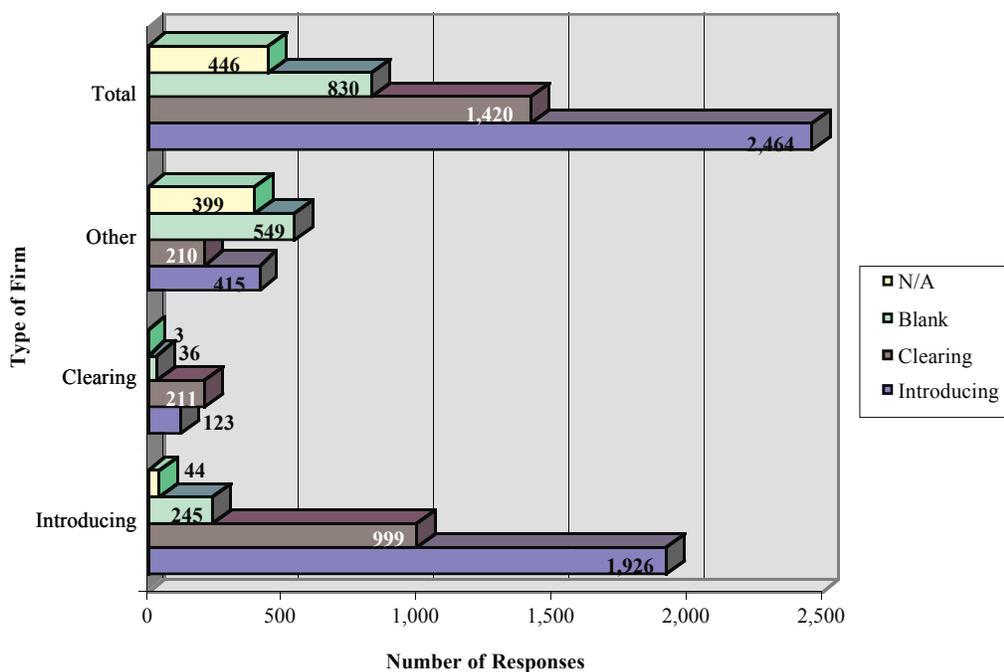
A representation of firm classification and survey response percentages is shown here:

Classification	NASD Members	Percent of Total	Joint NYSE Members	NASD Members Designated (DM)	NASD (DM) Survey Responses Received	Percent NASD (DM) Responses Received
Introducing	3,365	62%	145	3,220	3,214	99.8%
Clearing	505	9%	132	373	373	100.0%
Others	1,573	29%	0	1,573	1,573	100.0%
Total	5,443	100%	277	5,166	5,160	99.9%

SURVEY RESPONSES

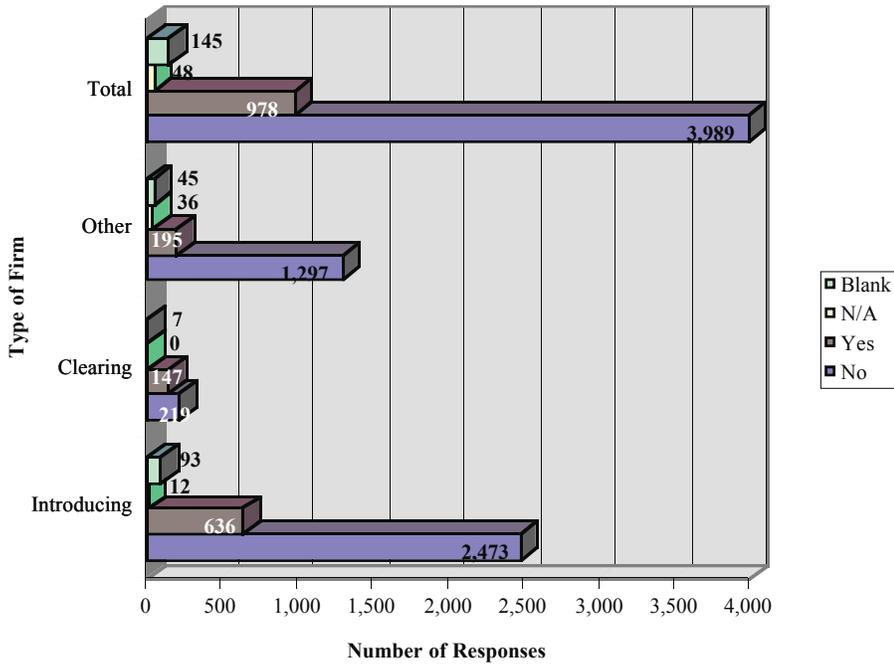
Question #1 - Is your firm an introducing or clearing firm?

Eighty-four percent (84%) of the firms surveyed responded to this question.



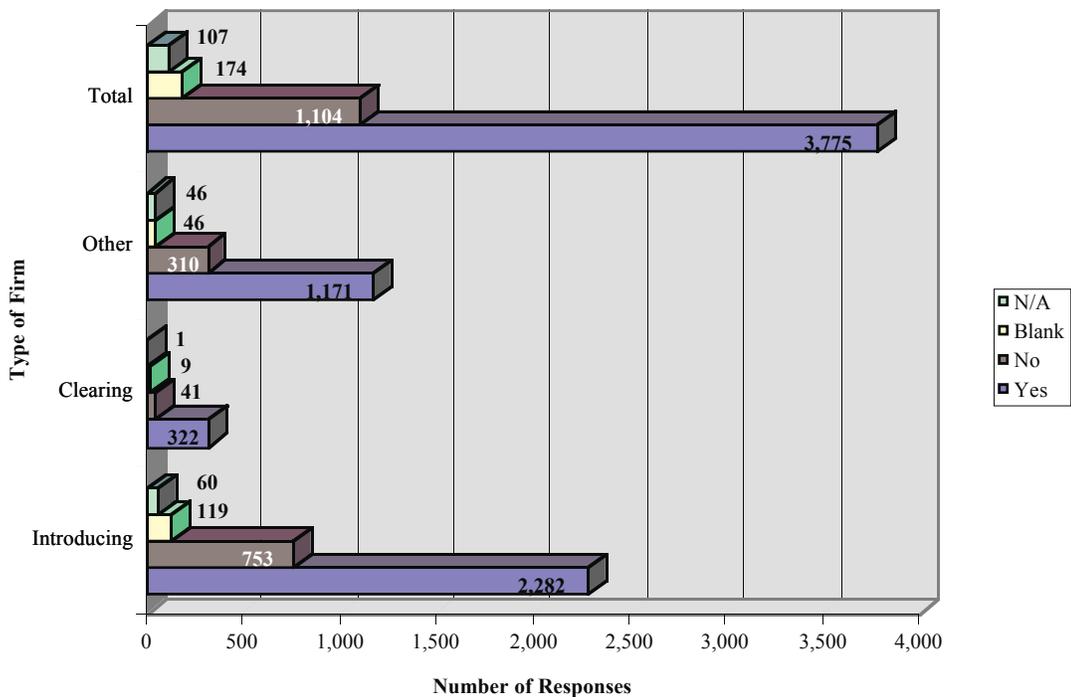
Question #2 - Does your firm use a service bureau for computer processing?

Ninety-seven percent (97%) of the firms surveyed responded to this question.

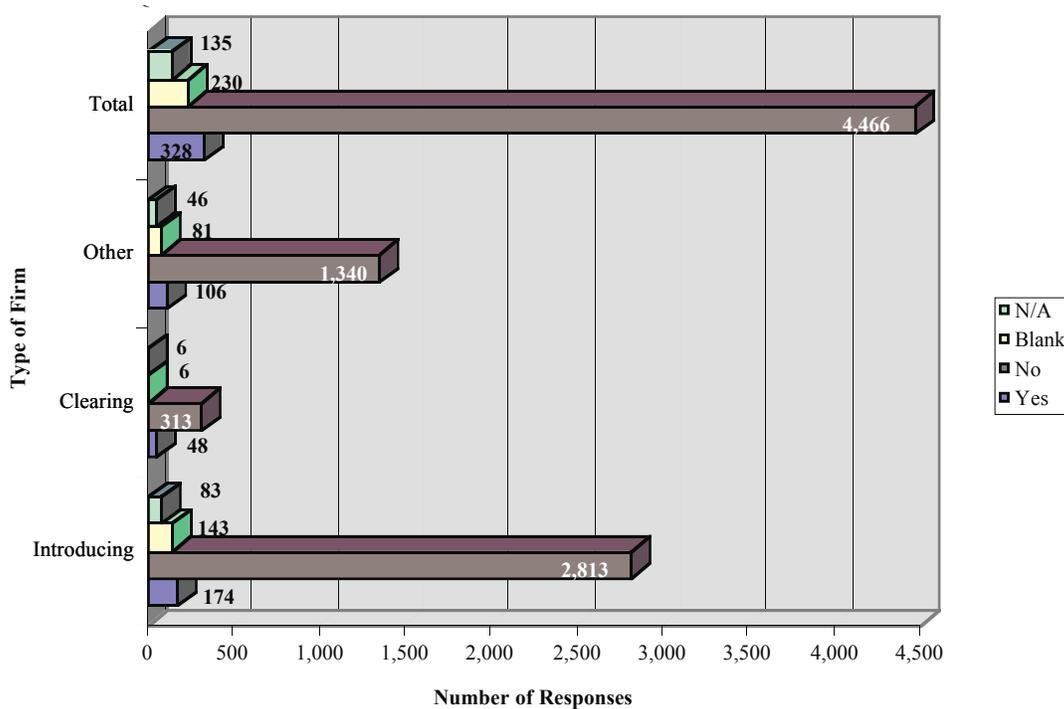


Question #3 - Has your firm prepared a Year 2000 Plan?

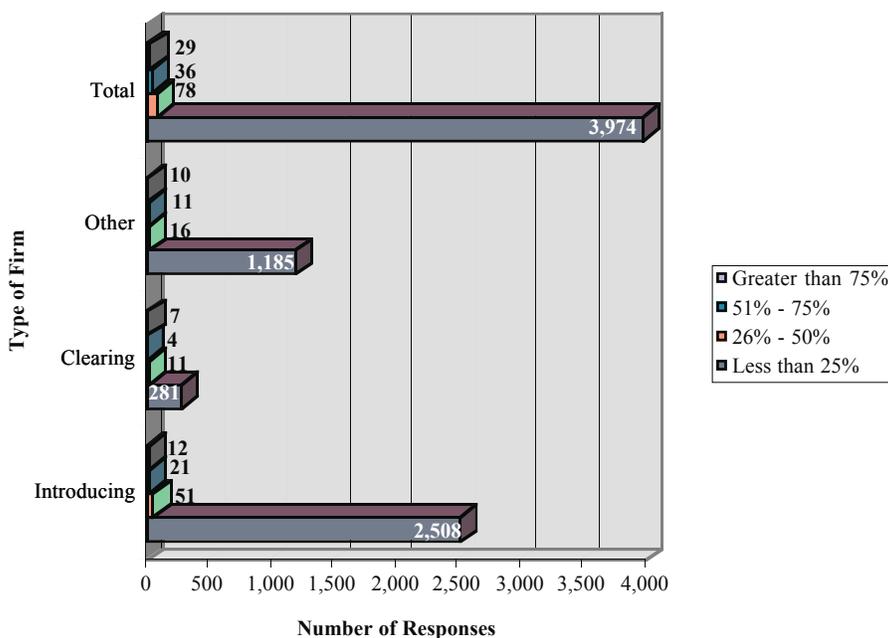
Ninety-seven percent (97%) of the firms surveyed responded to this question.



Question #4a. - Is this a full-time position for your Year 2000 Project Coordinator?
 Ninety-six percent (96%) of the firms surveyed responded to this question.

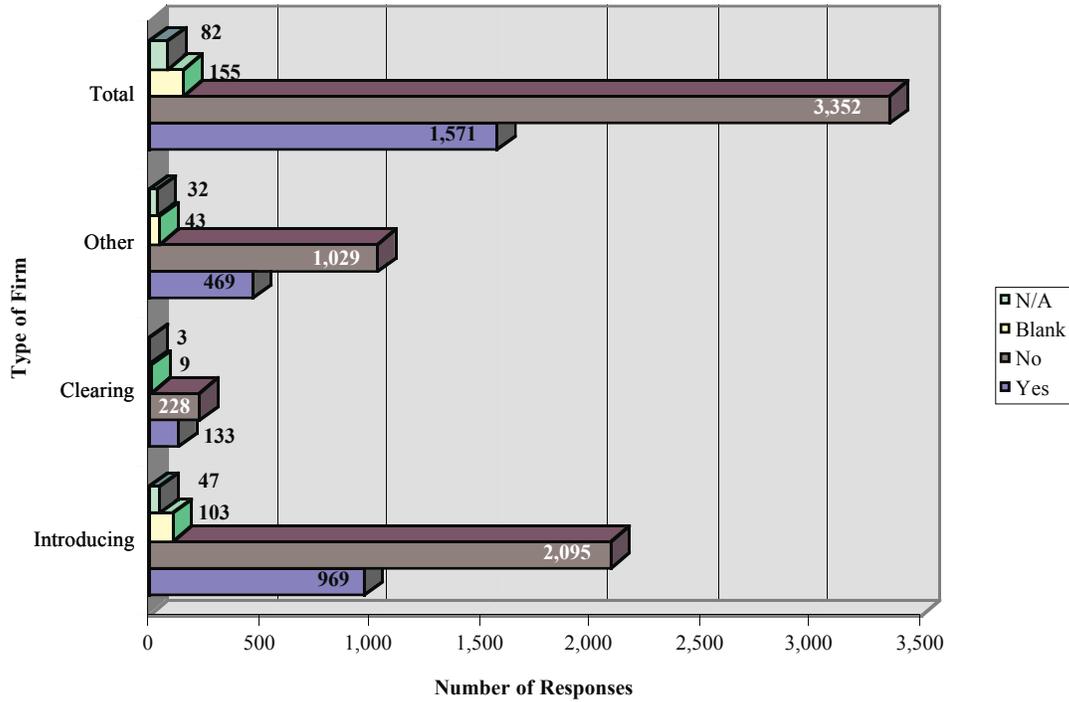


Question #4b. - If this is not a full-time position, what percentage of time is spent on the Year 2000 Project?
 Eighty percent (80%) of the firms surveyed responded to this question.



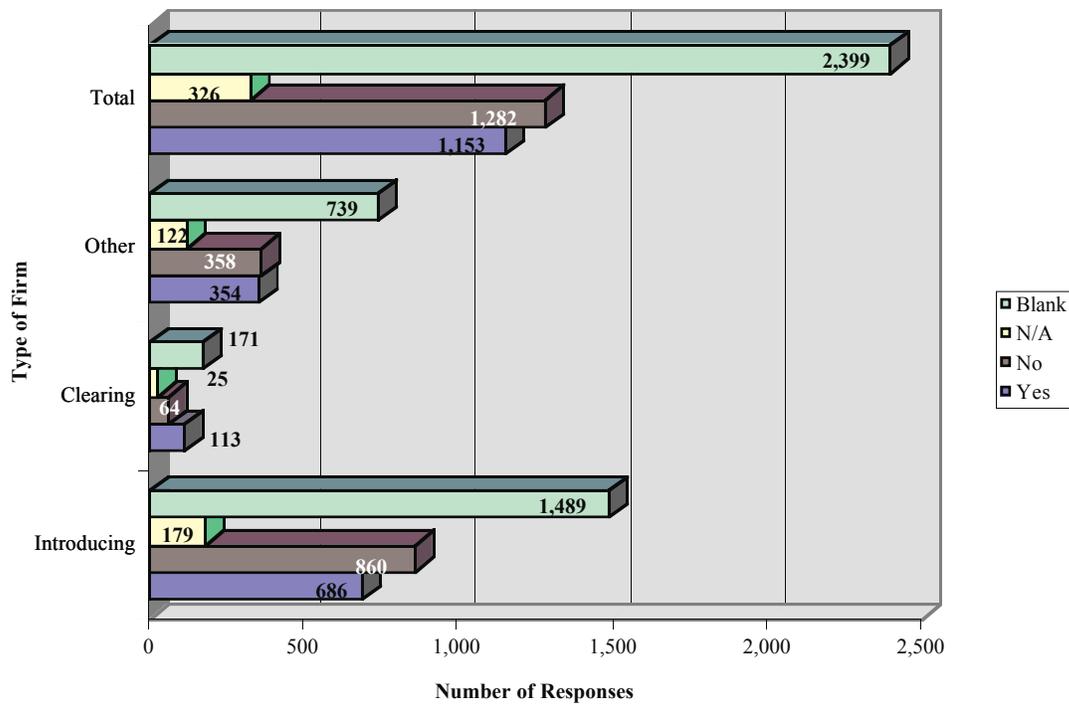
Question #5 - Does your firm plan to use an outside consultant?

Ninety-seven percent (97%) of the firms surveyed responded to this question.



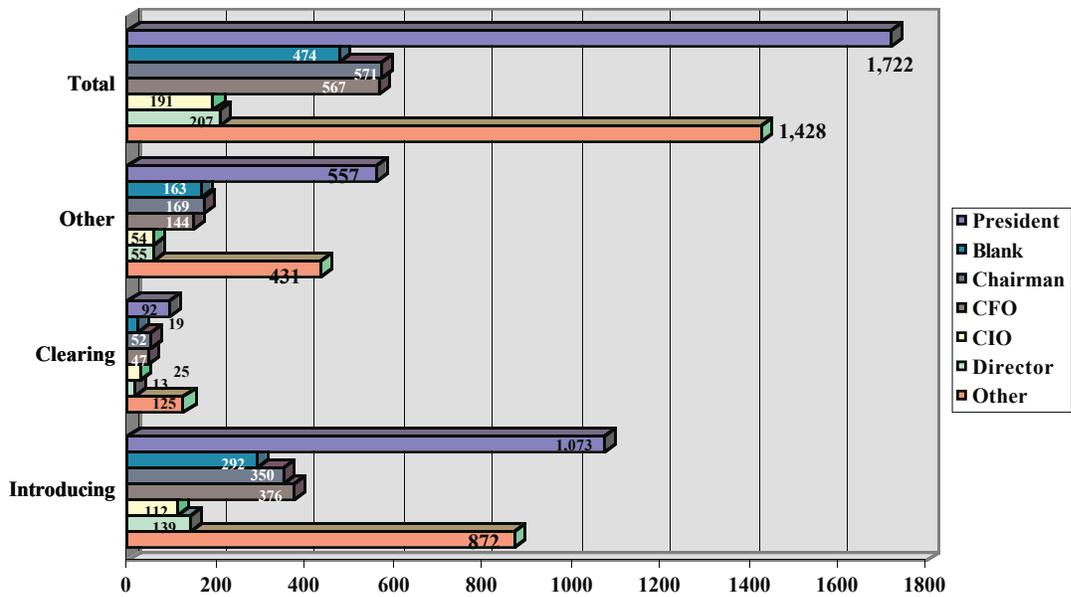
Question #5a. - If you are using an outside consultant, has the consultant been retained?

Fifty-four percent (54%) of the firms surveyed responded to this question.



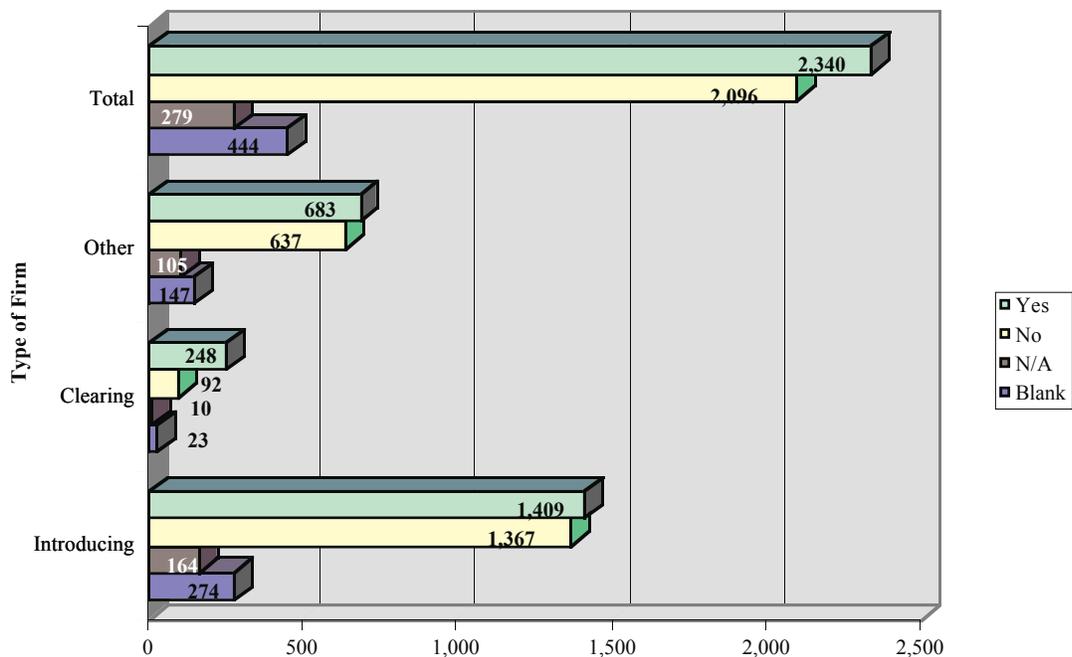
Question #6 - At what level of corporate management is your Year 2000 Project sponsored?

Ninety-one percent (91%) of the firms surveyed responded to this question.

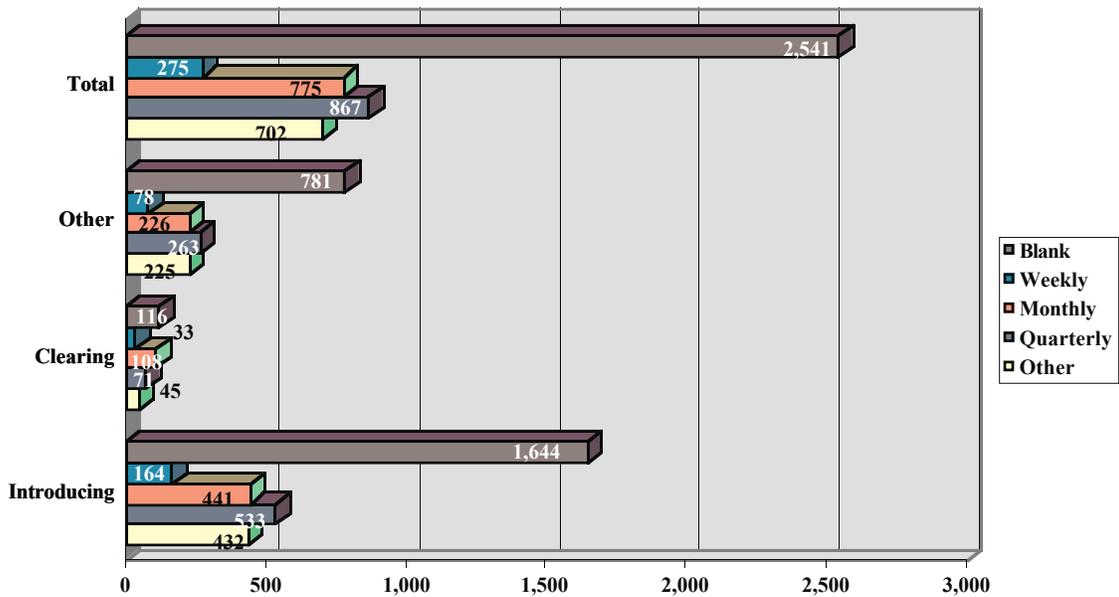


Question #7 - Are progress reports provided to the project sponsor and management?

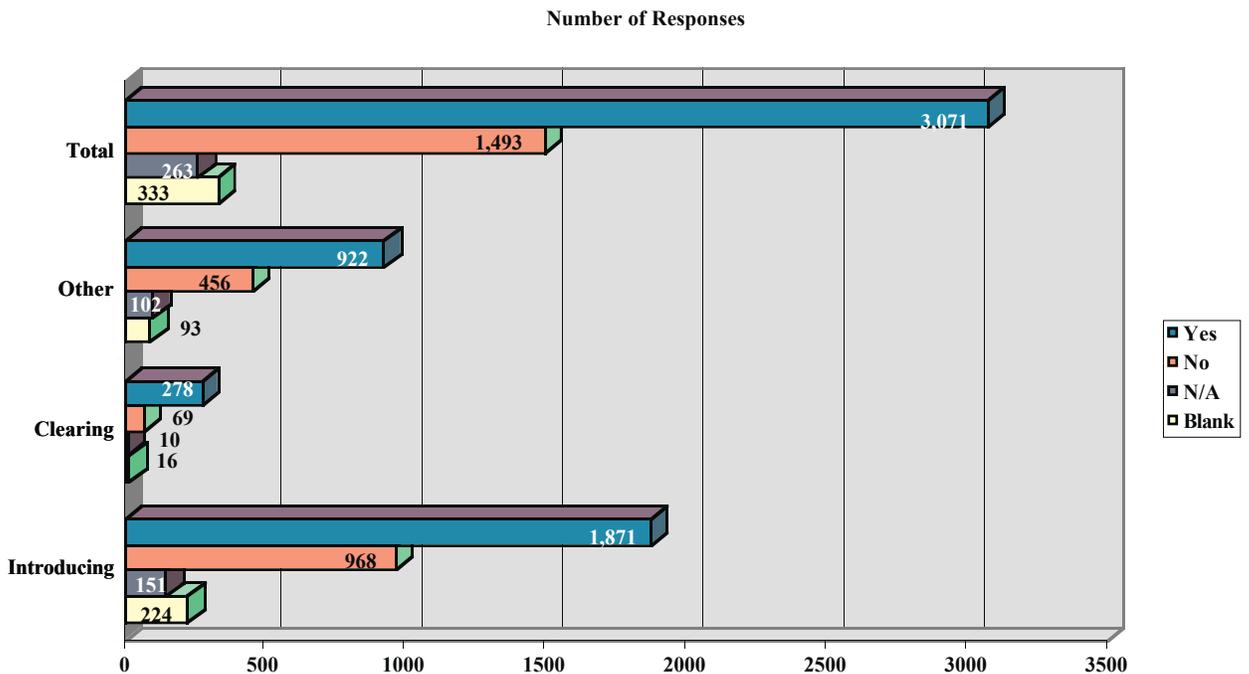
Ninety-one percent (91%) of the firms surveyed responded to this question.



Question #7a. - If progress reports are provided, how frequently?
 Fifty-one percent (51%) of the firms surveyed responded to this question.

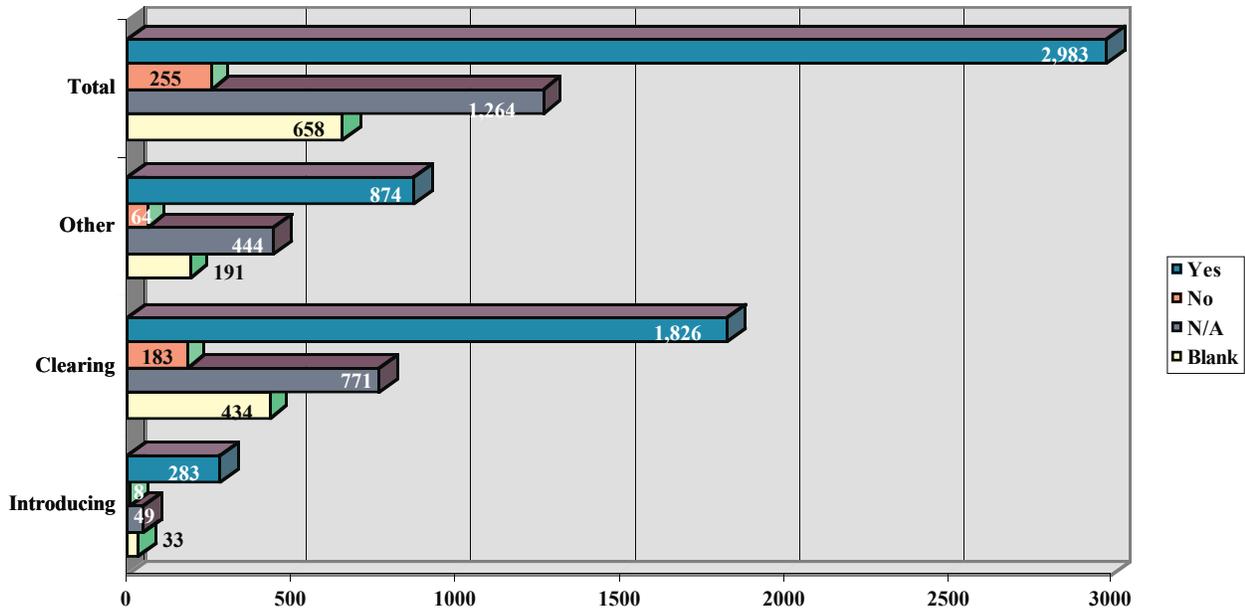


Question #8 - Does your firm's Year 2000 Project include an assessment phase to measure the scope and risk of the Year 2000 problem at your firm?
 Ninety-four percent (94%) of the firms surveyed responded to this question.



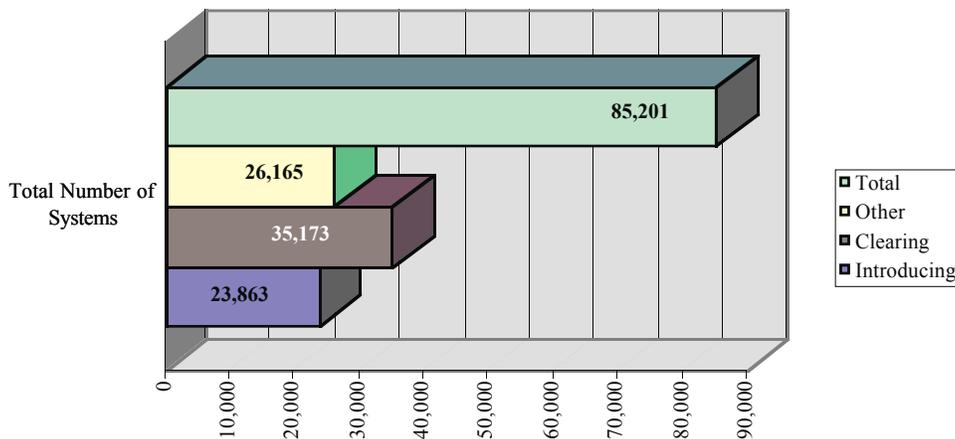
**Question #9 - Does the assessment phase include:
A. An inventory of all technology systems?**

Eighty-seven percent (87%) of the firms surveyed responded to this question.



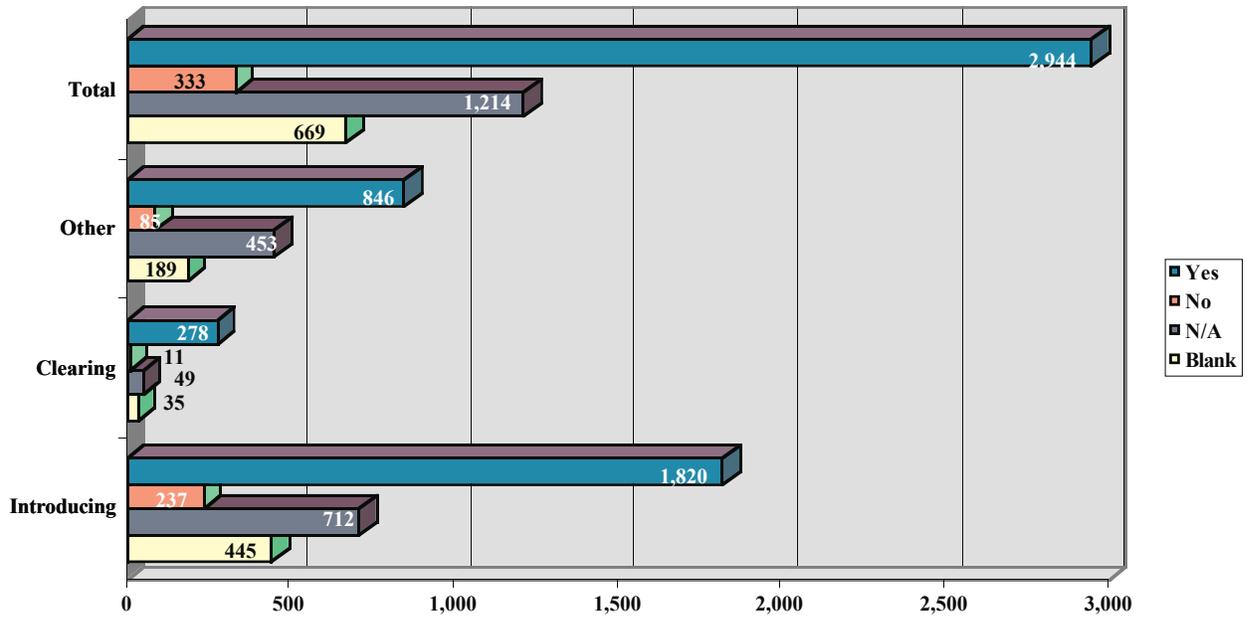
B. If an inventory is included, how many systems have been identified?

Eighty-seven percent (87%) of the firms surveyed responded to this question.



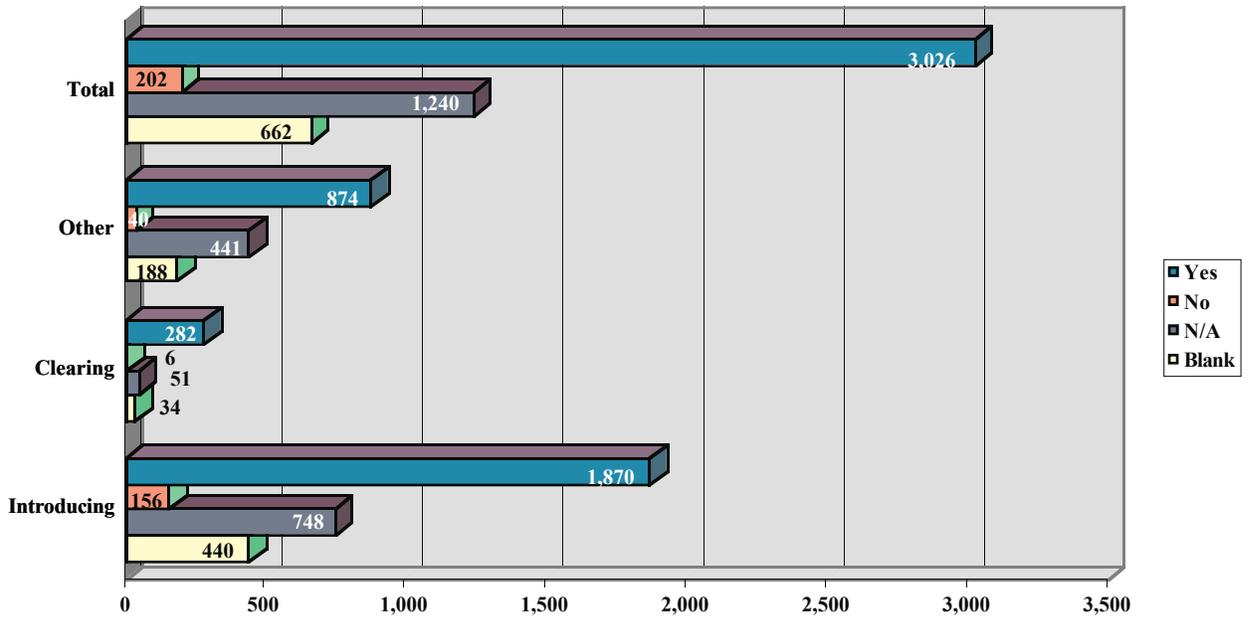
C. An analysis of all-third party vendor software and hardware products?

Eighty-seven percent (87%) of the firms surveyed responded to this question.



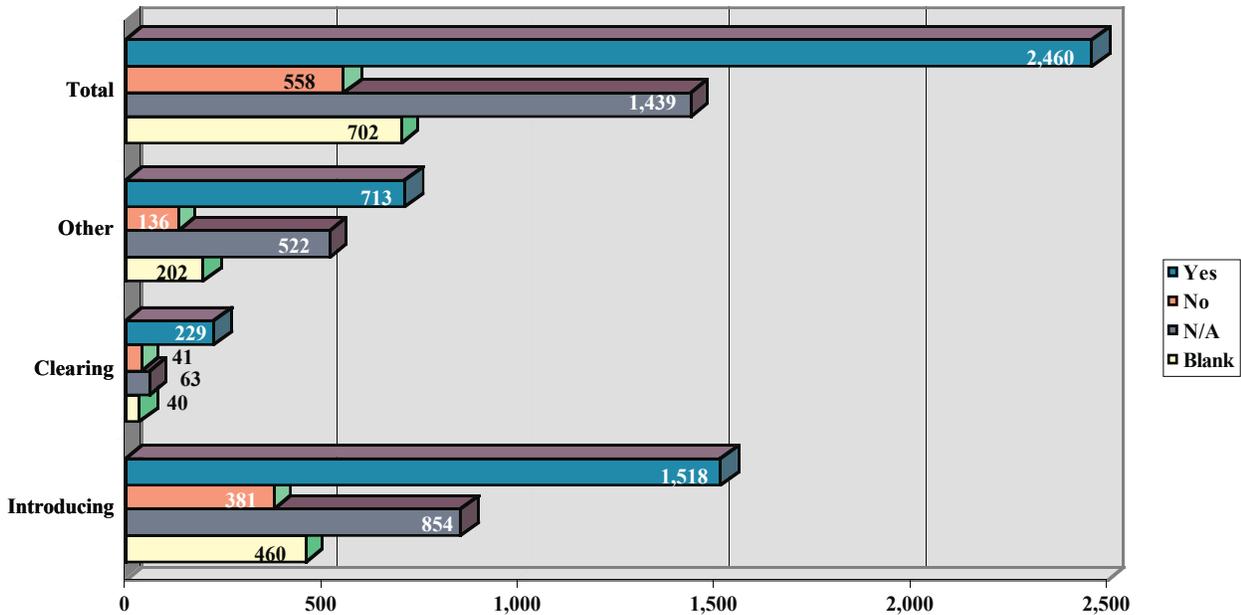
D. An analysis of all internal systems?

Eighty-seven percent (87%) of the firms surveyed responded to this question.



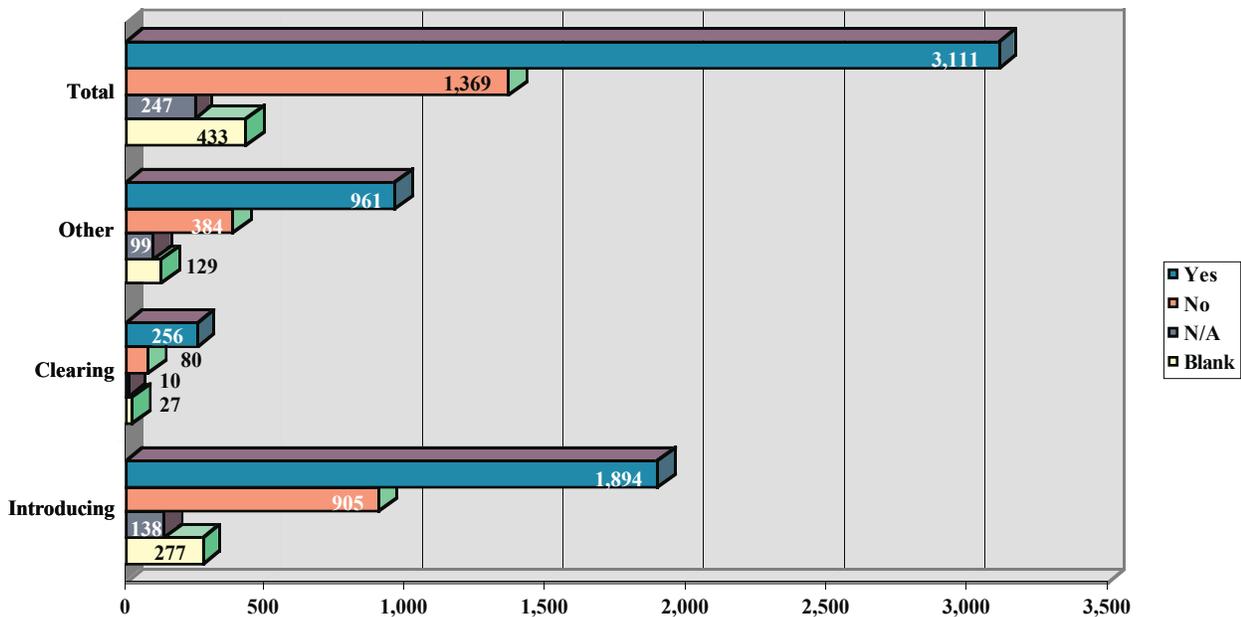
E. An analysis of facilities and communication systems?

Eighty-six percent (86%) of the firms surveyed responded to this question.



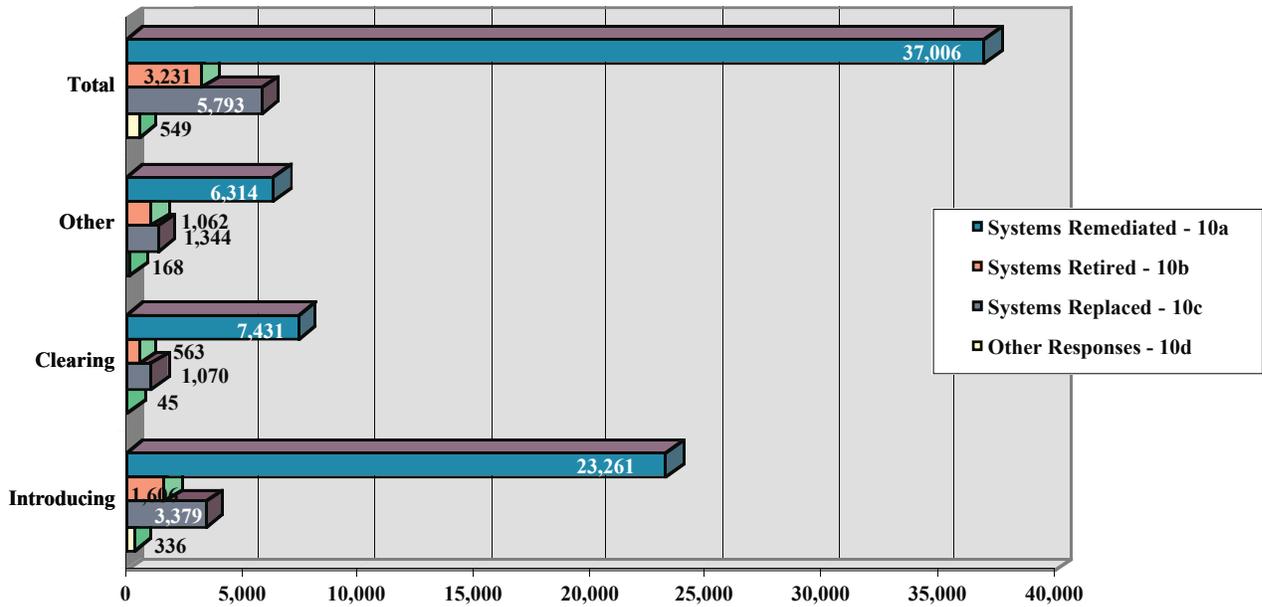
Question #10 - Has your firm determined the corrective action necessary to ensure the technology systems will be Year 2000 compliant?

Ninety-two percent (92%) of the firms surveyed responded to this question.



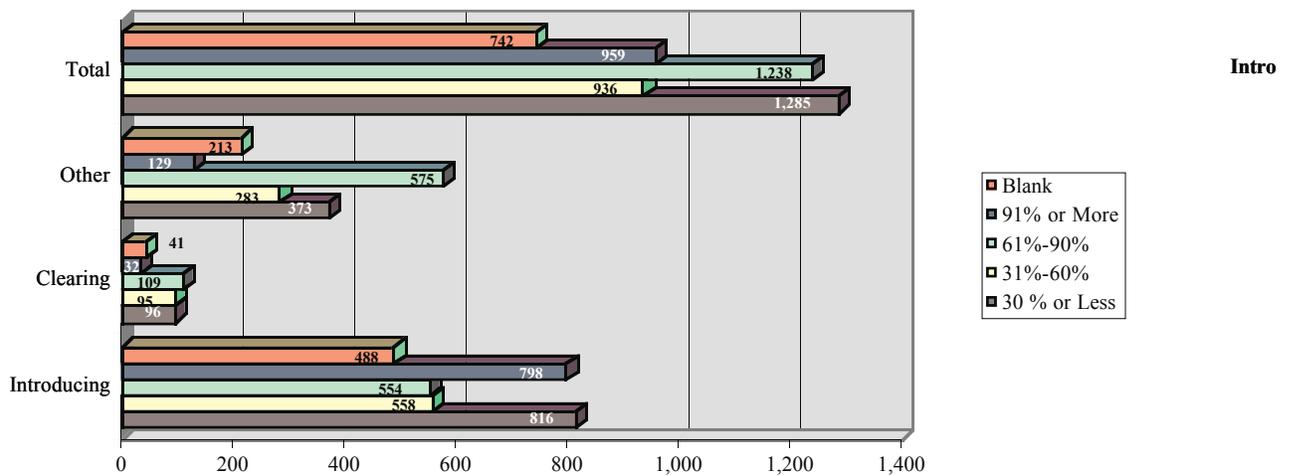
Question #10 (A-D) - If corrective action has been determined, how many systems will be (A) Remediated, (B) Retired, (C) Replaced and (D) Other?

Ninety-nine percent (99%) of the firms surveyed responded to this question.



Question #11 - What is the completion status of your firm's Year 2000 Project?

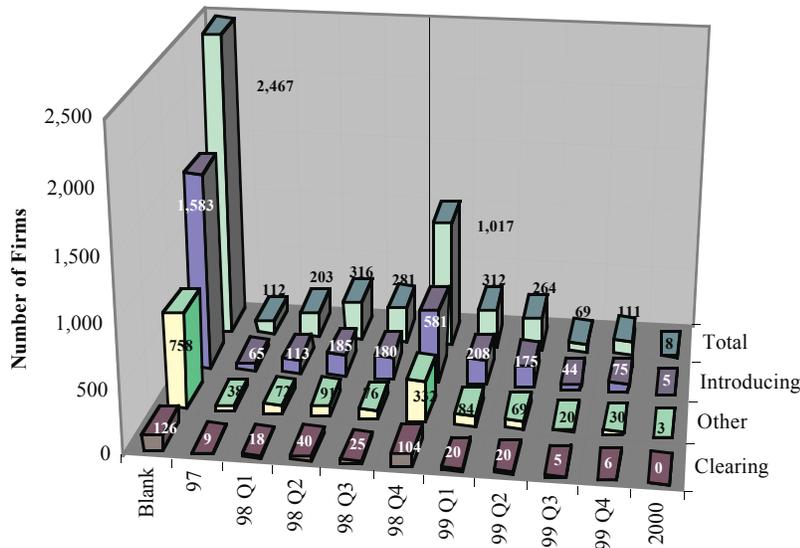
Eighty-six percent (86%) of the firms surveyed responded to this question.



Question #12 - When is your firm scheduled to complete the following major milestones:

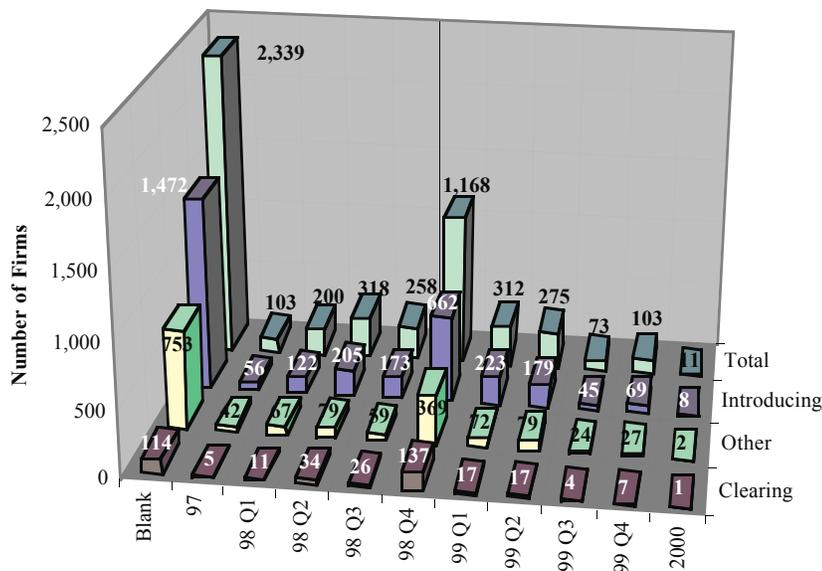
A. Remediation of firm systems.

Fifty-two percent (52%) of the firms surveyed responded to this question.



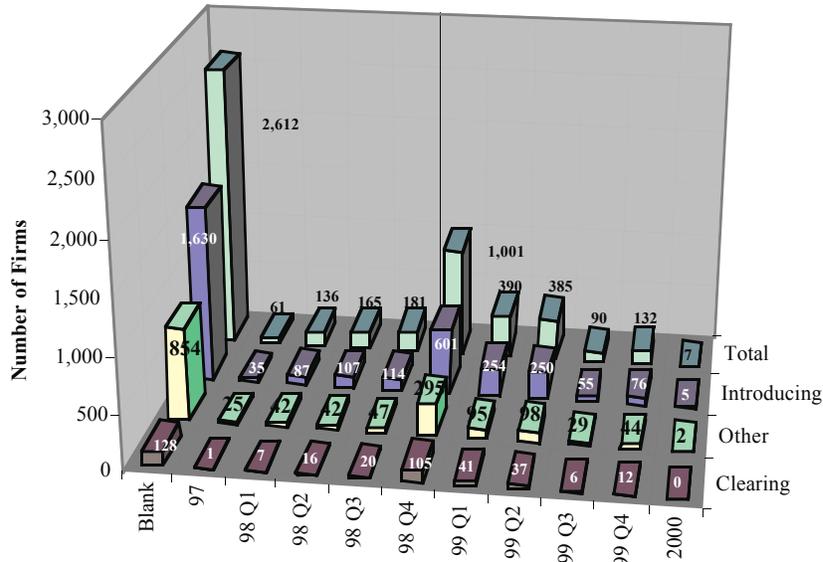
B. Verification that other systems used by the firm are Year 2000 compliant.

Fifty-five percent (55%) of the firms surveyed responded to this question.



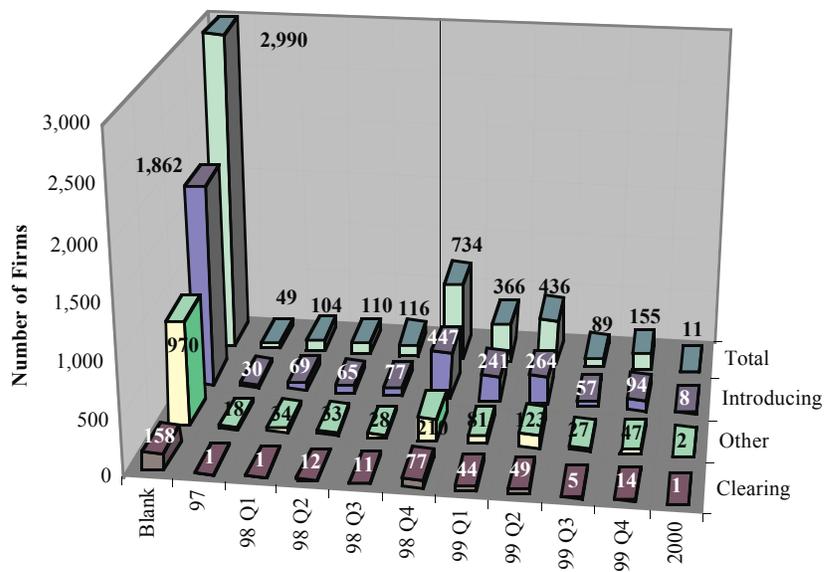
C. Testing of firm and other systems with other party systems.

Forty-nine percent (49%) of the firms surveyed responded to this question.

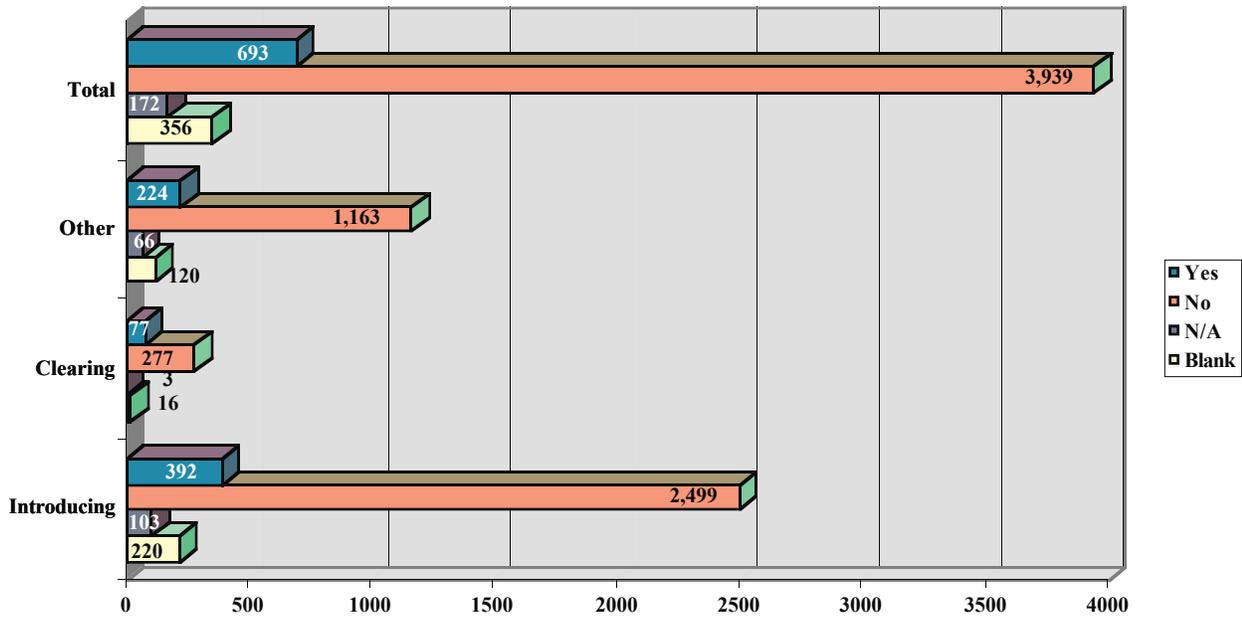


D. Industry-wide testing of firm and other systems.

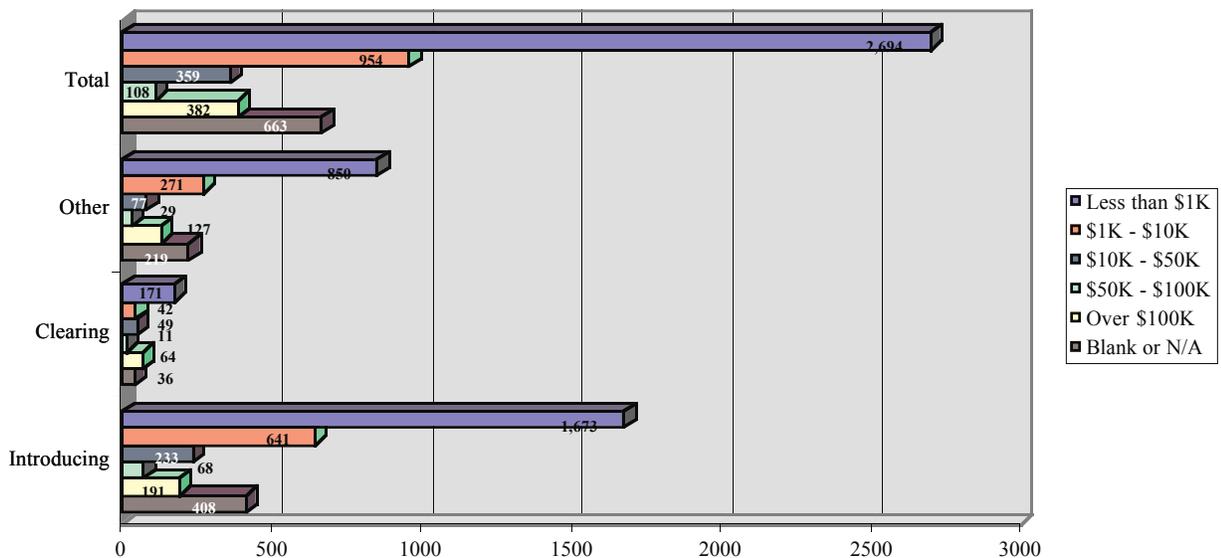
Forty-two percent (42%) of the firms surveyed responded to this question.



Question #13 - Has your firm dedicated a separate budget for your Year 2000 project?
 Ninety-three percent (93%) of the firms surveyed responded to this question.



Question #14 - What is the estimated total cost of your firm's Year 2000 Project?
 Eighty-seven percent (87%) of the firms surveyed responded to this question.



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