

# Notice to Members

NOVEMBER 2005

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registered Representatives  
Senior Management  
Trading

## KEY TOPICS

IM-3013 (Annual Compliance and Supervision Certification)  
Supervision  
Supervisory Control Procedures  
Rule 3012 (Supervisory Control System)  
Rule 3013 (Annual Certification of Compliance and Supervisory Processes)

## GUIDANCE

### Supervisory Controls and Annual CEO Certification

Amendments Regarding Deadlines for Submission of Initial Annual Report under Rule 3012 and Execution of the Initial Annual Certification under Rule 3013 and IM-3013

#### Executive Summary

NASD has filed for immediate effectiveness amendments to NASD Rule 3012 (Supervisory Control System) and Rule 3013 (Annual Certification of Compliance and Supervisory Processes) to extend until April 1, 2006, the date by which members must submit their initial annual report required by Rule 3012 and execute their first annual certification pursuant to Rule 3013 and IM-3013.<sup>1</sup> The rule change became immediately effective on its **October 14, 2005** filing date.

The text of the amendments is set forth in Attachment A.

#### Questions/Further Information

Questions concerning this *Notice* may be directed to Patricia Albrecht, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8026.

#### Background

Since the approval of new Rules 3012 and 3013, NASD has received a number of inquiries from members regarding whether the reports required by Rule 3012 and IM-3013 may be combined. Although NASD has previously advised members that they may combine the two reports as long as all of the required elements of the respective reports are addressed and clearly identified, members have indicated that the initial compliance deadline of December 1, 2005 for Rule

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3013 makes that option impracticable. This is because the Rule 3013 report must be prepared in advance of the certification-*i.e.*, before December 1, 2005-while the initial Rule 3012 report is not required to be submitted until January 31, 2006.

In addition, members of both NASD and the New York Stock Exchange (NYSE) ("dual members") have inquired whether they can combine the reports required by Rule 3012 and IM-3013 with the Annual Report required by NYSE Rule 342.30, which is due by April 1 of each year. As support for their request, dual members have noted that the NYSE Rule 342.30 Annual Report mandates similar, though not identical, requirements to the Rule 3012 report. Dual members have also noted that IM-3013 specifically provides that the IM-3013 report may be combined with any other compliance or other similar report required by another self-regulatory organization.

## Discussion

In response to these inquiries, NASD has amended Rule 3012 and Rule 3013 to allow members to submit the initial annual report required by Rule 3012 and to execute the initial annual certification required by Rule 3013 and IM-3013 by no later than April 1, 2006. As a result, members will be able, if they so choose, to combine the Rule 3012 report with the report required by IM-3013. In addition, dual members will be able to combine either or both of these respective reports with the NYSE Rule 342.30 Annual Report. Accordingly, members will be able to avoid any undue duplication of resources when complying with these reporting requirements.

Members should be aware, however, that due to Rule 3012's January 31, 2005 effective date, any member choosing to rely on any date after January 31, 2005 through April 1, 2006 as the submission deadline for its initial Rule 3012 report will have to encompass the period from January 31, 2005 up to that submission date (or a reasonable period of time immediately preceding the submission date). Members should also be aware that the report required by IM-3013 that evidences the member's processes must be prepared and submitted to the member's board of directors and audit committee in advance of, but reasonably close in time to, the certification. The certification may be executed anytime up until April 1, 2006 and annually thereafter by the same date the member chooses for its initial certification.

## Endnote

1. Exchange Act Release No. 52727 (Nov. 3, 2005) (SR-NASD-2005-121).

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## ATTACHMENT A

New rule text is underlined; deleted rule text is bracketed.

### 3012. Supervisory Control System

#### (a) General Requirements

(1) Each member shall designate and specifically identify to NASD one or more principals who shall establish, maintain, and enforce a system of supervisory control policies and procedures that (A) test and verify that the member's supervisory procedures are reasonably designed with respect to the activities of the member and its registered representatives and associated persons, to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules and (B) create additional or amend supervisory procedures where the need is identified by such testing and verification. The designated principal or principals must submit to the member's senior management no less than annually, a report<sup>1</sup> detailing each member's system of supervisory controls, the summary of the test results and significant identified exceptions, and any additional or amended supervisory procedures created in response to the test results.

(2) No change.

#### (b) Dual Member No change.

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1. Rule 3012 became effective on January 31, 2005, which would require a member's first Rule 3012 report to be submitted by no later than January 31, 2006 and at least annually thereafter; however, a member may elect to submit its first Rule 3012 report by no later than April 1, 2006. Importantly, a member's first Rule 3012 report must encompass the period from January 31, 2005 (the effective date of Rule 3012) up to the submission date (or a reasonable period of time immediately preceding the submission date). Each ensuing Rule 3012 report may not be for a period greater than 12 months from the date of the preceding Rule 3012 report (but may be for a shorter time period if a member elects to prepare a report more frequently than annually).

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## Rule 3013. Annual Certification of Compliance and Supervisory Processes

(a) Designation of Chief Compliance Officer No change.

(b) Annual Certification

Each member shall have its chief executive officer (or equivalent officer) certify annually,<sup>1</sup> as set forth in IM-3013, that the member has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules and federal securities laws and regulations, and that the chief executive officer has conducted one or more meetings with the chief compliance officer in the preceding 12 months to discuss such processes.

1. Rule 3013 and IM-3013 became effective on December 1, 2004, which would require a member's first certification to be executed by December 1, 2005 and annually thereafter; however, a member may elect to execute its first certification by no later than April 1, 2006 and annually thereafter.