

August 7, 2003

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: File No. SR-NASD-2002-162 – Proposed Supervisory Control Amendments –
Amendment No. 2

Dear Ms. England:

NASD hereby submits Amendment No. 2 to SR-NASD-2002-162 (the “rule filing”) proposing that the following changes should be made to the rule filing.¹

1. Proposed Rule 3012(a)(2)(A) beginning on pages seven and thirty-four should be revised to read as follows (new language is underlined and deleted text is [bracketed]):

(A) procedures that are reasonably designed to review and supervise the customer account activity conducted by the member’s branch office managers, sales managers, regional or district sales managers, or any person performing a similar supervisory function [by a person]. A person who is senior to the producing manager must perform such supervisory reviews. However, if a member does not conduct a public business, or has a capital requirement of \$5,000 or less, or employs 10 or fewer representatives, and its business is conducted in a manner necessitated by a limitation of resources that includes fewer than two layers of supervisory personnel, a person in another office who is in the same or similar position to the producing manager may conduct the supervisory reviews, provided that the person in the same or similar position does not have supervisory responsibility over the activity being reviewed, reports to his supervisor his supervision and review of the producing manager, and has not performed a review of the producing manager in the last two years;

¹ The changes made in Amendment No. 2 to the rule filing assume that the changes made in Amendment No. 1 have been approved and therefore, are not indicated in this Amendment. Only current changes to the language made pursuant to this Amendment are shown.

2. Rule 3110 beginning on pages nine and thirty-seven should be revised to read as follows (new language is underlined and deleted text is [bracketed]):

(a) through (b)[c] No change.

(c) Customer Account Information

(1) through (3) No change.

(4) For purposes of this Rule [and], Rule 2310, and Rule 2510 the term “institutional account” shall mean the account of:

(A) through (C) No change.

3. The paragraph in the section setting forth the purpose of Proposed Rule 3012 beginning on pages seventeen and forty-four that begins with the sentence “NASD agrees with commenters concerns and is amending proposed Rule 3012 to eliminate the requirement that persons conducting testing and verification procedures be ‘independent’” should be deleted in its entirety and the following new paragraphs inserted:

NASD agrees with commenters’ concerns and is amending proposed Rule 3012 to eliminate the requirement that persons establishing, maintaining, and enforcing supervisory control policies and procedures be “independent.” The proposed rule now will require that a member designate and specifically identify to NASD one or more principals who will establish, maintain, and enforce supervisory control procedures that will test and verify that the members’ supervisory procedures are sufficient and create additional or amend supervisory procedures where the need is identified by such testing and verification. Of course, NASD expects that the designated principals will test and verify the adequacy of the supervisory control procedures in a manner that is independent of a member’s countervailing business considerations.

Importantly, as stated in proposed Rule 3012, these policies and procedures must include procedures that are reasonably designed to review and supervise the customer account activity conducted by the member’s branch office managers, sales managers, regional or district sales managers, or any person performing a similar supervisory function. Proposed Rule 3012 provides that a person who is senior to the producing manager must perform these supervisory reviews; however, if a member does not conduct a public business, or has a capital requirement of \$5,000 or less, or employs ten or fewer representatives, and its business is conducted in a manner necessitated by a limitation of resources that includes fewer than two layers of supervisory personnel, a person in another office who is in the same or similar position to the producing manager may conduct the supervisory review, provided that the person does not have supervisory responsibility over the activity being reviewed, reports to his supervisor his supervision and review of the producing manager, and has not performed a review of the producing manager in the last two years.

The supervisory policies and procedures required under proposed Rule 3012 also must include procedures reasonably designed to provide heightened supervision over the

activities of each producing manager who is responsible for generating 20% or more of the income of the producing manager's supervisor. The proposed rule does not mandate the contents of such heightened supervisory procedures, in recognition of the fact that such procedures will vary depending on the business models and needs of each particular member. In establishing such heightened supervisory procedures, however, members should consider such elements as unannounced supervisory reviews, an increased number of supervisory reviews by different reviewers within a certain period, a broader scope of activities reviewed, and/or having one or more principals approve the supervisory review of such producing managers. These examples are meant to illustrate the type of procedures a member may want to include in its heightened supervisory procedures and are not meant to be an exclusive or exhaustive list of heightened supervisory procedures a member may need to put in place. NASD believes that proposed Rule 3012, as amended herein, should allow members sufficient flexibility to create the supervisory control procedures mandated by the rule without creating undue burdens and costs.

4. Immediately after the paragraph in the section setting forth the purpose of Proposed Rule 3012 on pages eighteen and forty-five that ends with the sentence "NASD, however, believes that it is reasonable and appropriate that regulatory oversight in the sensitive areas designated in proposed Rule 3012 extend to institutional account activity" the following paragraph should be inserted:

NASD is retaining Rule 3012's originally proposed provision that any member in compliance with substantially similar requirements of the New York Stock Exchange, Inc. ("NYSE") shall be deemed to be in compliance with Rule 3012. NASD believes that this provision helps promote consistency between NASD's and the NYSE's supervisory control requirements.

5. The paragraph in the section setting forth the purpose of the amendments to Rule 3010 beginning on pages eighteen and forty-five that begins with the sentence "As originally proposed, the changes to Rule 3010 require that office inspections be conducted by a person who is 'independent' from the activities being performed at the office and the people providing supervision to that office" should be deleted in its entirety and the following new paragraphs inserted:

As originally proposed, the changes to Rule 3010 require that office inspections be conducted by a person who is "independent" from the activities being performed at the office and the people providing supervision to that office. In addition, office inspections must include, without limitation, the testing and verification of the member's supervisory policies and procedures in the areas of: safeguarding of customer funds and securities; maintaining books and records; supervision of customer accounts serviced by branch office managers; transmittal of funds between customers and registered representatives and between customers and third parties; validation of customer address changes; and validation of changes in customer account information.

6. The paragraph in the section setting forth the purpose of the amendments to Rule 3010 beginning on pages twenty-one and forty-eight that begins with the sentence "In response to commenters' concerns, NASD is amending Rule 3010 to replace the proposed 'independence'

requirement with a prohibition that an office inspection cannot be conducted by a branch manager or any person within that office who has supervisory responsibilities or by any individual who is supervised by such person(s)” should be deleted in its entirety and the following new paragraph inserted:

In response to commenters’ concerns, NASD is amending Rule 3010 to replace the proposed "independence" requirement with a prohibition that an office inspection cannot be conducted by a branch office manager or any person within that office who has supervisory responsibilities or by any individual who is supervised by such person(s). In addition, members must establish heightened inspection procedures in situations where the person conducting the inspection either works in an office supervised by the branch office manager’s supervisor or reports to the branch office manager’s supervisor and the branch office manager generates 20% or more of the supervisor’s income. The proposed rule does not mandate the contents of such heightened inspection procedures, in recognition of the fact that such procedures will vary depending on the business models and needs of each particular member. In establishing such heightened inspection procedures, however, members should consider such elements as unannounced office inspections, increased frequency of inspections, a broader scope of activities inspected, and/or having one or more principals review and approve the office’s inspections. These examples are meant to illustrate the type of procedures a member may want to include in its heightened inspection procedures and are not meant to be an exclusive or exhaustive list of heightened inspection procedures a member may need to put in place. NASD believes that this proposed rule change should allow members sufficient flexibility to assign personnel to conduct office inspections without creating undue burdens and costs.

7. The last sentence in the paragraph in the section setting forth the purpose of the amendments to Rule 3110 beginning on pages twenty-five and fifty-two that begins with the sentence “NASD does not believe that the new account designation change recordkeeping requirement should be unduly complicated or burdensome for members” should be amended as follows (new language is underlined and deleted language is [bracketed]):

It also [coincides] promotes consistency with Rule 3110’s existing mandate that members’ recordkeeping format, medium, and retention periods comply with SEC Rule 17a-4 requirements.

8. On pages twenty-five and fifty-two, immediately after the segment in the purpose section entitled “(vi) Comments on Rule 3110 (Books and Records),” the following new segment should be inserted:

(vii) Comments on IM-3110 (Customer Account Information)

As originally proposed, changes to IM-3110 would permit a member, upon a customer's written instructions, to hold mail for a customer who will not be at his or her usual address for the period of his or her absence, but not to exceed (A) two months if the member is advised that the customer will be on vacation or traveling or (B) three months if the customer is going abroad.

At least one commenter stated that a member would have to impose additional recordkeeping and administrative controls to avoid lost or misplaced mail in situations where a customer that travels frequently looks to a member to provide custody of his or her mail.² If a member provides this service to its customers, NASD understands that the member may have to put in place additional procedures to comply with the limitations set forth in this rule. However, the rule will help to ensure that members that do hold mail for customers who are away from their usual addresses, do so only pursuant to the customers' written instructions and for a specified, relatively short period of time. Thus, there is a reduced likelihood of risk that customers would not receive account statements or other account documentation at their usual addresses. In addition, the rule will help to ensure that customers provide the firms with which they do business current address information, insofar as a firm will not be permitted to hold mail indefinitely.

9. Segments (vii) and (viii) of the purpose section that begin on pages twenty-five and fifty-two should be renumbered (viii) and (ix), respectively.

Very truly yours,

Patrice M. Gliniecki
Senior Vice President and
Deputy General Counsel

² John Hancock Financial Services, Inc., Robert H. Watts, SVP/CCO, (12/17/02) & Additional Comments (1/16/03).