Shirley H. Weiss
Associate General Counsel

Direct: (202) 728-8844
Fax: (202) 728-8264

May 10, 2001

VIA MESSENGER

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Room 6184, Mail Stop 6-9
Washington, D.C. 20549

Re: File No. SR-NASD-99-46; Proposed Rule Change and Amendment No. 3 to Rule 1022(a), Chief Compliance Officer Registration

Dear Mr. Katz:

The National Association of Securities Dealers, Inc. ("NASD" or "Association") hereby: (1) responds to the comment letter received by the Commission in response to the publication in the *Federal Register* of Notice of Filing of SR-NASD-99-46;[1] and (2) amends the above-referenced rule filing as described below and as reflected in the proposed rule language attached as Exhibit 1. The filing of this Amendment No. 3 clarifies that a Chief Compliance Officer ("CCO") for a member whose business is limited to the solicitation, purchase and/or sale of government securities may register as a government securities principal.

Issues Raised in Comment Letter

The Commission received one comment letter on the proposed rule change from Knight Trading Group, Inc. and its subsidiaries, Knight Securities, L.P. and Knight Capital Markets, Inc. (hereinafter referred to as "Knight"). Knight objects to the fact that, under the proposed rule change, the general counsel of a member firm who is also serving as the firm's chief compliance officer will be required to register with the NASD as a general securities principal. Knight contends that this registration requirement could constitute an unnecessary and impermissible interference with the attorney-client relationship and could compel a lawyer to violate his duty to

[1] Release No. 34-43765 (Dec. 21, 2000); 66 F.R. 830 (Jan. 4, 2001). The public comment period announced in the Federal Register expired on January 25, 2001.

keep client confidences through the threat of enforcement and disciplinary actions against the attorney for failing to respond to NASD Regulation requests for information or failing to supervise associated persons. Knight further contends that the proposed rule change is unnecessary because the parties subject to the new rules are already subject to NASD and other regulatory oversight. Knight also contends that registration is unnecessary for chief compliance officers who are also general counsels because such individuals would not have obtained such positions unless they were competent.[2]

NASD Regulation responded to similar objections to the proposed registration requirement in its rule filing. First, the purpose of the rule change, as stated in the rule filing, is to require chief compliance officers "to demonstrate [their] knowledge through a qualifications examination and be subject to continuing education requirements." A law degree does not necessarily ensure knowledge of the securities laws or the requisite level of competence to serve as a chief compliance officer. It is NASD Regulation's position that all chief compliance officers should be required to register in the appropriate principal capacity and, unless grandfathered, to take the appropriate qualifying examination.

With respect to Knight's concerns regarding the attorney-client relationship, NASD Regulation's Code of Procedure does not include a specific provision regarding the attorney-client privilege and the work-product doctrine. The NASD has an important obligation to detect and address violations of its rules and the federal securities laws and the rules and regulations thereunder, and member firms are obligated to cooperate in such efforts. The attorney-client privilege and the work-product doctrine are recognized in practice, provided that each is validly asserted. In the context of the obligations and statutory responsibilities of a self-regulatory organization ("SRO") and a member's agreement to abide by the rules of the SRO, the existence of such privileges does not limit the obligation of a member to comply with duties imposed by the SRO or shield a member from such obligations. It is incumbent upon a firm that employs an attorney who serves the firm both as legal counsel and chief compliance officer to provide for the appropriate separation of functions.

NASD Regulation also notes that the proposed rule change does not change the current requirement that any individual, including a firm's general counsel, who is involved in the day-to-day management of the firm's business or who has management-level responsibilities for supervising any aspect of the member's investment banking or securities business is required to be registered as a principal. NASD Regulation determines whether an individual is involved in the

---

[2] Knight previously noted similar objections in response to NASD Notice to Members 99-51 in a letter dated July 16, 1999.

management of a member firm on a case-by-case basis, regardless of whether the concerned individual is also the firm's general counsel. As described in Notice to Members 99-49 (providing interpretive guidance on registration requirements), a firm's general counsel who solely provides legal advice and does not participate in the management of the member is not required to register in a principal capacity. In addition, a member's general counsel may advise the firm's executive, management, or operations committees and avoid triggering the registration requirement if he or she only provides counsel and does not vote.[3]

The proposed registration requirement does not create the presumption that a chief compliance officer has supervisory responsibilities or is otherwise a control person. As in the past, and as clearly stated in the rule filing, NASD Regulation will hold a chief compliance officer responsible for supervision only where supervision is his or her responsibility. Many chief compliance officers are already registered as principals. NASD Regulation does not presume that these individuals have supervisory responsibility just by virtue of their title. NASD Regulation will continue to determine whether a chief compliance officer is acting in a supervisory capacity based on the actual responsibilities and functions that the chief compliance officer performs for the firm.

NASD Regulation is of the view that the proposed rule changes will serve to protect the investing public by requiring all chief compliance officers, unless grandfathered, to take and pass the appropriate qualifying principal examination.

Proposed Amendment

The language of the proposed rule change provides that a chief compliance officer for a member whose business is limited to the activities described in Rule 1022(d)(1)(A) or (e)(2) may register as a Limited Principal-Direct Participation Programs or Limited Principal-Investment Company and Variable Products, respectively. The "Purpose" section of the rule filing (SEC Release No. 34-43765), however, states that a chief compliance officer may also satisfy the proposed principal registration requirement by registering as a Series 4 (Registered Options Principal) and Series 73 (Government Securities Principal).

NASD Regulation proposes to amend the rule filing to add that a chief compliance officer for a member whose business is limited to the solicitation, purchase and/or sale of "government securities," as described in Rule 1032(g), may satisfy the proposed principal registration

---

[3] See Notice to Members 99-49 (requesting comment on requiring chief compliance officers to be registered).

requirement by registering as a Government Securities Principal. Since there is no qualifying examination for a Government Securities Principal, a chief compliance officer for a member whose activities are limited to the solicitation, purchase and/or sale of government securities, need only register as such.

Amendments to the "Purpose" Section of the Proposed Rule Change

NASD Regulation is of the view that registration as a Registered Options Principal will not satisfy the proposed registration requirement. NASD Regulation therefore requests that the reference to "Series 4 (Registered Options Principal)" in the "Purpose" section of Release No. 34-43765 be deleted in the SEC's approval order.

NASD Regulation also proposes that the following language be added to the "Purpose" Section:

The proposed rule change will permit a person who has been designated as a Chief Compliance officer on Schedule A of Form BD for at least two years immediately prior to the effective date of the proposed rule change, and who has not been subject within the last ten years to a statutory disqualification or any designated disciplinary action, to register in the appropriate principal capacity, but to be exempt from the requirement to pass the appropriate Qualification Examination. Chief Compliance Officers who have been employed by more than one firm during the two years immediately prior to the effective date of the proposed rule change who otherwise meet the requirements for grandfathering may meet the two-year requirement for grandfathering, provided that their employment as a Chief Compliance Officer has been continuous for those two years. Individuals who have served as Chief Compliance Officers for both general securities firms and limited purpose firms for the two years immediately preceding the effective date of this proposed rule change should contact NASD Regulation's Membership Department to determine whether they qualify for the grandfathering provision or, in the alternative, whether they may be eligible for a waiver of the applicable examination requirement pursuant to Rule 1070(e).

* * *

If you have any questions, please contact Shirley H. Weiss, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8844; e-mail Shirley.Weiss@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Shirley H. Weiss

cc: Jack P. Drogin
Sonia A. Patton
Rebekah C. Liu

EXHIBIT 1

LIST OF COMMENTERS ON PROPOSED CHIEF COMPLIANCE OFFICER REGISTRATION

1. Knight Trading Group (January 30, 2001)

EXHIBIT 2

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

1022. Categories of Principal Registration

(a) General Securities Principal

(1) Each person associated with a member who is included within the definition of principal in Rule 1021, and each person designated as a Chief Compliance Officer on Schedule A of Form BD, shall be required to register with the Association as a General Securities Principal and shall pass an appropriate Qualification Examination before such registration may become effective unless [his] such person's activities are so limited as to qualify [him] such person for one or more of the limited categories of principal registration specified hereafter. A person whose activities in the investment banking or securities business are so limited is not, however, precluded from attempting to become qualified for registration as a General Securities Principal, and if qualified, may become so registered. Each person seeking to register and qualify as a General Securities Principal must, prior to or concurrent with such registration, become registered, pursuant to the Rule 1030 Series, either as a General Securities Representative or as a Limited Representative-Corporate Securities. A person who has been designated as a Chief Compliance Officer on Schedule A of Form BD for at least two years immediately prior to [insert effective date of proposed rule change] and who has not been subject within the last ten years to any statutory disqualification as defined in Section 3(a)(39) of the Act; a

suspension; or the imposition of a fine of $5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding shall be required to register as a General Securities Principal, but shall be exempt from the requirement to pass the appropriate Qualification Examination. If such person has acted as a Chief Compliance Officer for a member whose business is limited to the solicitation, purchase and/or sale of "government securities," as that term is defined in Section 3(a)(42)(A) of the Act, or the activities described in Rule 1022(d)(1)(A) or Rule 1022(e)(2), he or she shall be exempt from the requirement to pass the appropriate Qualification Examination only if he or she registers as a Government Securities Principal, or a Limited Principal pursuant to Rules 1022(d) or Rule 1022(e), as the case may be, and restricts his or her activities as required by such registration category. A Chief Compliance Officer who is subject to the Qualification Examination requirement shall be allowed a period of 90 calendar days following [insert effective date of proposed rule change] within which to pass the appropriate Qualification Examination for Principals.

(a)(2) through **(a)(6)** No change

(b) through **(g)** No change

* * *