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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-2002-108 - Business Continuity Plans and Emergency
Contact Information; Amendment No. 6 and Response to Comments on
Third Notice of Proposed Rulemaking**

Dear Ms. England:

NASD hereby submits its response to comment letters received by the Securities and Exchange Commission ("SEC" or "Commission") after the third publication of SR-NASD-2002-108 in the Federal Register on September 17, 2003.¹ The SEC received 13 comment letters.² Eight of these comment letters were almost identical.³ Following extensive discussion of the comment letters with staffs of the SEC and New York Stock Exchange ("NYSE"), NASD is making two amendments to the proposed rule change.

¹ Exchange Act Rel. No. 48503 (Sept. 17, 2003), 68 FR 55686 (Sept. 26, 2003).

² See Letter from Jack R. Handy, Jr., Financial Network Investment Corp. ("Financial Network") to Jonathan G. Katz, dated October 14, 2003; Letter from Patrick H. McEvoy, IFG Network Securities, Inc. ("IFG") to Jonathan G. Katz, undated; Letter from Ronald R. Barhorst, ING Financial Advisers, LLC ("ING") to Jonathan G. Katz, undated; Letter from Karl Lindberg, Locus Street Securities, Inc. ("Locus Street") to Jonathan G. Katz, undated; Letter from Patrick H. McEvoy, Multi-Financial Securities Corp. ("Multi-Financial") to Jonathan G. Katz, undated; Letter from Kevin P. Maas, PrimeVest Financial Services ("PrimeVest") to Jonathan G. Katz, dated October 14, 2003; Letter from Patrick H. McEvoy, Vestax Securities Corp. ("Vestax") to Jonathan G. Katz, undated; Letter from Barbara Stewart, Washington Square Securities, Inc. ("Washington Square") to Jonathan G. Katz, undated; Letter from Jerry W. Klawitter, Securities Industry Association ("SIA") to Jonathan G. Katz, dated October 16, 2003; Letter from Barry S. Augenbraun, "Raymond James Financial, Inc. ("Raymond James") to Jonathan G. Katz, dated October 16, 2003; Letter from Henry H. Hopkins and John R. Gilner, T. Rowe Price Investment Services, Inc. ("T. Rowe Price") to Jonathan G. Katz, dated October 16, 2003; Letter from Joseph H. Moglia, Ameritrade Holding Corporation ("Ameritrade") to Margaret H. McFarland, dated October 17, 2003; and Letter from W. Thomas Boulter, Jefferson Pilot Securities Corp. ("Jefferson Pilot") to Jonathan G. Katz, dated October 20, 2003.

³ See Letters from Financial Network, IFG, ING, Locus Street, Multi-Financial, PrimeVest, Vestax, and Washington Square. [hereinafter "Joint Commenters"]

Response to Comment Letters

I. Proposed Rule 3510

A. Requirement that Plans be Reasonably Designed to Enable Members to Meet their Obligations to their Customers

Proposed Rule 3510(a) requires that members create and maintain business continuity plans. In Amendment No. 3 to the proposed rule change, filed on February 19, 2003, NASD amended the proposed rule text to state that each member's plan must be "reasonably designed to enable the member to continue its business." The SEC staff and commenters, however, raised concerns that members could interpret this rule text to require members to continue their businesses in the event of a significant business disruption. Accordingly, following discussions with the SEC staff, NASD, in Amendment No. 4, amended the language of the proposed rule to provide that each member's plan be "reasonably designed to enable the member to meet its existing obligations to customers. In addition, such procedures must address the member's existing relationships with other broker-dealers and counter-parties." NASD further stated in Amendment No. 4 that it did not intend members to interpret this provision to require them to continue their businesses in the event of a significant business disruption.

In the latest comments on the proposed rule change, Ameritrade and the Joint Commenters advocate returning to the language used in Amendment No. 3, which stated that each member's plan must be "reasonably designed to enable the member to continue its business." Ameritrade specifically argues that business continuity plans are intended for recovery from and resumption of business after a significant business disruption. While NASD understands the commenters' position that there is a difference between having a plan to continue business and actually executing such a plan, NASD declines to amend this provision. As the SEC stated in its policy statement on business continuity planning for trading markets:

The decision by a broker-dealer to risk capital or provide brokerage services on an ongoing basis is, in essence, a matter of business judgment. Given the competitive nature of the securities business, however, the Commission expects there to be incentives for broker-dealers to be prepared to participate in the markets following a wide-scale disruption as soon as the markets' trading facilities become available.⁴

To limit member confusion on whether the proposed rule requires a member to continue its business, NASD believes that an amendment to this provision is not warranted.

⁴ See Policy Statement for Trading Markets, Exchange Act Rel. No. 48545 (Sept. 25, 2003), 68 FR 56656 (Oct. 1, 2003).

B. Critical Business Constituents, Banks, and Counter-Parties

The proposal, as amended by Amendment No. 4, requires a member's business continuity plan to address "Critical business constituents, banks, and counter-parties." In Amendment No. 4, NASD amended "Business constituent, bank, and counter-party impact" to "Critical business constituents, banks, and counter-parties." In addressing this category, NASD stated that firms should have procedures that assess the impact that a significant business disruption has on business constituents (businesses with which a member firm has an ongoing commercial relationship in support of the member's operating activities), banks (lenders), and counter-parties (such as other broker/dealers or institutional customers). In addition, NASD stated that members should provide for alternative actions or arrangements with respect to their contractual relationships with business constituents, banks, and counter-parties upon the occurrence of a material business disruption to either party. NASD, however, recognized that certain business constituent, banking, and counter-party relationships may not be critical to a firm's business or operations, and therefore limited the requirement to critical business constituents, banks, and counter-parties. NASD also stated that members will be responsible for identifying those relationships that they deem critical for purposes of complying with the rule; NASD, however, will consider, based on its experience in working with the rule following the rule's adoption, whether to enumerate specific relationships that it views as critical to all members.

SIA contends that because of the elimination of the word "impact" in the proposed rule text, it is unclear "what the NASD rule envisions a firm addressing in this part of the plan." Although NASD believes that the proposed rule is clear that members' plans must address the impact that a significant business disruption on critical business constituents, banks, and counter-parties, NASD is amending the proposed rule 3510(c)(6) to state "Critical business constituent, bank, and counter-party impact."

In addition, the Joint Commenters are concerned that NASD did not define "critical business constituents, banks, and counter parties." As stated in Amendment No. 4, NASD, at this time, declines to define which business constituents, banks, and counter parties a member should consider critical to their own business. Members will be responsible for identifying those relationships that they deem critical for purposes of complying with the rule.

C. Prompt Access to Funds and Securities

Following discussions with the SEC and NYSE staffs, NASD, in Amendment No. 4, amended proposed Rule 3510(c) to require a plan to address how a member will assure customers' prompt access to their funds and securities in the event that the member determines it is unable to continue its business. If a member has customers, the member must detail the procedures it will employ to ensure customer access to funds and securities. The SEC, NYSE, and NASD believe that this new category helps to ensure

that, if a member is unable to continue its business following a significant business disruption, customers can access their funds or securities held through the member.

The SIA contends that NASD did not anticipate and discuss how this provision will interact with Securities Investor Protection Corporation ("SIPC") rules. The SIA believes that the lack of discussion in the rule filing exposes firms to competing compliance requirements. NASD, however, does not believe the provision conflicts with SIPC rules and did not intend for the proposed rule change to have any effect on a member's obligations under such rules. Proposed Rule 3510(c)(9) requires that each member address how it will assure customers' prompt access to their funds and securities in the event that the member determines it is unable to continue its business. While this provision is tied to the provision governing a member's obligations to its customers, the provision only requires a firm to address how it will assure such access. If a member believes that SIPC rules may affect its response to this subsection, the member should address SIPC rules in its plan. NASD further notes that members may not rely on SIPC membership, by itself, to satisfy their obligations under proposed Rule 3510(c)(9) because SIPC involvement in the liquidation of a broker/dealer is limited to SIPC's authority under the Securities Investor Protection Act of 1970.

D. Disclosure Provision

In Amendment No. 4, NASD amended the proposed rule text to require each member to disclose to its customers how its business continuity plan addresses the possibility of a future significant business disruption and how the member plans to respond to events of varying scope. In addressing the events of varying scope, NASD believes that each member should: (1) provide specific scenarios of varying severity (e.g., a firm-only business disruption, a disruption to a single building, a disruption to a business district, a city-wide business disruption, and a regional disruption); (2) state whether it plans to continue business during that scenario, and, if so, its planned recovery time; and (3) provide general information on its intended response. The disclosure must, at a minimum, be made in writing to customers at account opening, posted on the member's Internet Web site (if the member maintains a Web site), and mailed to customers upon request. NASD stated that this requirement will enable investors to make an educated decision about whether to place their funds and securities at the specific member based on the firm's business continuity planning and also will deter members from creating plans that do not adequately address contingency planning.

The Joint Commenters, Raymond James, and Jefferson Pilot believe that the disclosure provision, as proposed, is unduly burdensome and would be extremely costly. NASD recognizes that this provision places an additional cost on members, but following further discussions with the SEC and NYSE staffs, NASD continues to believe that this requirement is necessary to enable customers to make an educated decision about whether to place their funds and securities at a specific broker/dealer. The provision also will encourage members to create adequate plans.

Ameritrade, in turn, raises concerns about disclosing potentially confidential and proprietary information. The proposed rule, however, only requires a member to summarize the manner in which its plan addresses the possibility of significant business disruptions and to disclose the member's planned responses to significant business disruptions. For example, members would need to disclose the existence of back-up facilities and arrangements. Members, however, would not need to disclose such factors as: the specific location of any back-up facilities; any proprietary information contained in the plan; and the parties with whom the member has back-up arrangements.

Ameritrade also raises concerns regarding potential liability if a firm were to change its plan's response to an event. In this regard, NASD notes that members may include in their business continuity plans cautionary language to the effect that such plans are subject to modification, that updated plans will be promptly posted on the member's Web site, and that customers may alternatively obtain updated plans by requesting a written copy of the plan by mail.

II. Proposed Rule 3520

A. Emergency Contact Information

Proposed Rule 3520 requires members to provide NASD with emergency contact information and to update any information upon the occurrence of a material change. Among other things, the proposed rule requires members to designate two emergency contact persons that NASD may contact in the event of a significant business disruption. Each emergency contact person must be a registered principal and a member of senior management.

The SIA asserted that the discussion of the proposed rule states that the executive representative should have the authority to make potentially time sensitive decisions on behalf of the firm. The SIA believes that this language may elevate the responsibilities of the member's executive representative and conflict with the member's structure and procedures. In Amendment No. 4, however, NASD stated only that it "believes it is essential that the emergency contact persons be members of senior management with the authority, experience, and knowledge to make potentially critical and time-sensitive decisions regarding the firm." NASD further noted that the requirement that a contact person be a member of senior management and a registered principal is consistent with other NASD rules, including designation of a member's executive representative. NASD in no way sought to alter the scope of authority of a member's executive representative to make these types of decisions.

B. Review and Update of Emergency Contact Information

Proposed Rule 3520(b), as amended by Amendment No. 1, requires each member to promptly update its emergency contact information in the event of any material change. In Amendment No. 4, NASD added a requirement that each member must review and, if necessary, update its emergency contact information within 17 business days after the end of each calendar quarter, which is consistent with the quarterly FOCUS reporting schedule. Under this provision, the member's executive representative must review and update the firm's emergency contact information. Finally, each member must have adequate controls and procedures to ensure that only the executive representative may perform the review and update of this information.

The Joint Commenters, Ameritrade, and T. Rowe Price believe that the ability to update emergency contact information should not be restricted to the executive representative and that the executive representative should be able to delegate this duty. NASD agrees with the commenters and is amending proposed rule 3520(b) to state that the executive representative, or his or her designee, which must be in writing, must conduct the review or update.

III. Effective Date of Rules

In Amendment Nos. 4 and 5, NASD announced that clearing firms must establish business continuity plans, as required by proposed Rule 3510, within 120 days of the publication of the SEC order announcing the approval of the rule filing and that introducing firms must establish business continuity plans, as required by proposed Rule 3510, within 150 days of the publication of the SEC order announcing the approval of the rule filing. All members (both introducing and clearing firms) must designate emergency contact persons and provide NASD with their contact information, as required by proposed Rule 3520, within 60 days of publication of the SEC approval order.

The SIA believes that these implementation dates for proposed rule 3510 are too aggressive and that NASD should follow the SEC's implementation dates for trading markets.⁵ In this regard, in a policy statement, the SEC announced that self-regulatory organizations operating trading markets and electronic communication networks ("ECNs") should implement plans for the resumption of trading by the end of 2004. NASD, however, does not believe that this comparison is appropriate. The SEC's policy statement requires trading markets and ECNs to have plans that enable them to resume trading operations by the next business day in response to a wide-scale business disruption. NASD's proposed rule only requires members to create and maintain business continuity plans that are reasonably designed to meet the firms' obligations to their customers and that address certain enumerated areas. NASD believes that the

⁵ See Policy Statement for Trading Markets, Exchange Act Rel. No. 48545 (Sept. 25, 2003), 68 FR 56656 (Oct. 1, 2003).

proposed effective dates are reasonable given the scope of the proposed rule change and declines to amend these effective dates.

Text of Amendment

Below is the text of the current amendment to the proposed rule text published in the Federal Register on March 10, 2003. Proposed new language is underlined; proposed deletions are in brackets.

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3500. EMERGENCY PREPAREDNESS

3510. Business Continuity Plans

(a) - (b) No Change

(c) The elements that comprise a business continuity plan are flexible and may be tailored to the size and needs of a member. Each plan, however, must at a minimum, address:

- (1) Data back-up and recovery (hard copy and electronic);
- (2) All mission critical systems;
- (3) Financial and operational assessments;
- (4) Alternate communications between customers and the member;
- (5) Alternate communications between the member and its employees;
- (6) Critical business constituent[s], bank[s], and counter-party[ies]

impact;

- (7) Regulatory reporting;
- (8) Communications with regulators; and
- (9) How the member will assure customers' prompt access to their funds

and securities in the event that the member determines that it is unable to continue its business.

Each member must address the above-listed categories to the extent applicable and necessary. If any of the above-listed categories is not applicable, the member's business continuity plan need not address the category. The member's business continuity plan, however, must document the rationale for not including such category in its plan. If a member relies on another entity for any one of the above-listed categories or any mission critical system, the member's business continuity plan must address this relationship.

(d) – (f) No Change

3520. Emergency Contact Information

(a) No Change

(b) Each member must promptly update its emergency contact information, via such electronic or other means as NASD may require, in the event of any material change. Each member must review and, if necessary, update its emergency contact information, including designation of two emergency contact persons, within 17 business days after the end of each calendar quarter to ensure the information's accuracy. The member's Executive Representative, or his or her designee, which must be in writing, must conduct such review and any update. Furthermore, members must have adequate controls and procedures to ensure that only the Executive Representative, or his or her written designee, may perform the review and update.

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If you have any questions concerning this submission, please contact me at (202) 728-6927; e-mail brian.woldow@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

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