April 17, 2002

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

Re: **File No. SR-NASD-2002-24** – NASD Proposed Rule 3011 Anti-Money Laundering Compliance Programs; Response to Comment Letters

Dear Ms. England:

NASD Regulation, Inc. ("NASD Regulation") hereby responds to the comment letters received by the Securities and Exchange Commission ("Commission" or "SEC") in response to the publication in the *Federal Register* of Notice of Filing of SR-NASD-2002-24.[1] Proposed Rule 3011 prescribes the minimum standards for each member firm's anti-money laundering compliance program required by Section 352 of the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 ("Money Laundering Act").

The Commission received four comment letters in response to the *Federal Register* publication of SR-NASD-2002-24.[2] The comments submitted to the Commission are summarized by issue below.

(a) General Exemptions

Two commenters requested that certain broker/dealers be exempt from the requirements of proposed Rule 3011. Mosaic recommended exemptions for

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[1] Securities Exchange Act Release No. 45457, File No. SR-NASD-2002-24 (February 19, 2002), 67 Fed. Reg. 8565 (February 25, 2002). The public comment period announced in the *Federal Register* expired on March 18, 2002.

[2] Letter from Mosaic Funds Distributor, LLC, to Jonathan G. Katz, SEC, dated March 11, 2002 ("Mosaic"); Letter from Securities Industry Association to Jonathan G. Katz, SEC, dated March 18, 2002 ("SIA"); Letter from Investment Company Institute to Jonathan G. Katz, SEC, dated March 18, 2002 ("ICI"); Letter from Schulte Roth & Zabel LLP to Jonathan G. Katz, SEC, dated March 18, 2002 ("Schulte").

broker/dealers that do not receive customer funds or open or hold customer accounts and that agree to establish compliance programs prior to engaging in such customer activities. Schulte stated that broker/dealers that do not deal with customers in what Schulte characterizes as a traditional sense and do not engage in certain typical broker/dealer activities, such as purchasing or selling securities as principal from or to customers, should be exempt from the proposed rule.[3] Both commenters expressed concerns that broker/dealers that do not deal with customers, because they do not have access to customer funds or accounts or because they do not have their own customers, will not be able to implement an effective compliance program designed to detect potential money laundering by customers through a financial institution.

NASD Regulation would like to emphasize that the requirement to establish an anti-money laundering compliance program is a mandate of federal law. Section 352 of the Money Laundering Act requires that *all* financial institutions, including broker/dealers, establish these compliance programs. While Section 352 requires the Secretary of the Department of Treasury ("Treasury") to issue regulations by April 24, 2002 that address the applicability of the statutory requirements to different types of financial institutions, Section 352 does not grant authority to the NASD or other self-regulatory organizations to exempt any types or classes of broker/dealers from the statutory requirements. While all broker/dealers are required to have anti-money laundering programs in place by April 24, the obligation to develop such a program is not a "one-size-fits-all" requirement, and each firm should tailor its program to fit its business model and the money laundering risks it poses. Accordingly, anti-money laundering programs at firms that have no customers and handle no funds will probably be targeted at potential employee misconduct and counterparty awareness.[4]

(b) Activities Exemption

ICI requested that proposed Rule 3011 exempt a NASD member with respect to its activities as principal underwriter of mutual fund securities where the fund complex being underwritten had established compliance programs that meet the requirements of Section 352 of the Money Laundering Act. ICI noted that this exemption would prevent duplicative programs and eliminate "piecemeal" anti-money laundering compliance

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[3] Schulte provided several examples of the types of broker/dealers that should be exempt from the proposed rule, including joint back-office broker/dealers and broker/dealers that only engage in stock lending activities with other broker/dealers.

[4] Principal underwriters to mutual funds would be expected to have similarly targeted procedures once the firms have assured themselves that the investment adviser or transfer agent within the fund complex had established and implemented a sufficient anti-money laundering program.

examinations. ICI further believed that exempting these activities would be consistent with Congressional intent that each firm tailor its program to fit its business.

The Money Laundering Act requires that all broker/dealers enact the appropriate anti-money laundering procedures. In establishing a compliance program, consistent with the information sharing provisions of the Money Laundering Act and the related proposed regulations, a broker/dealer certainly may coordinate its efforts by taking account of the program and procedures of other firms with which it does business. Regardless, each firm must have its own program designed to detect suspicious activity, and no broker/dealer is relieved of its obligations to comply with the requirements of Section 352 simply by relying on a compliance program implemented by a firm with which it does business or has a business relationship. Moreover, proposed Rule 3011 is the only anti-money laundering program rule currently directed at these broker/dealers. Once Treasury's planned rulemaking for mutual fund anti-money laundering compliance program is in effect and the study relating to the application of the Bank Secrecy Act ("BSA") to investment companies called for under Section 356 of the Money Laundering Act is concluded, NASD Regulation can address whether any adjustment to the proposed rule would be appropriate.

(c) Program Implementation

SIA expressed concerns that the proposed rule's requirement to "establish and implement" compliance programs by April 24, 2002 exceeds the scope of Section 352 of the Money Laundering Act, which requires financial institutions to establish compliance programs by April 24, 2002. NASD Regulation believes that proposed Rule 3011 is consistent with Section 352 and just and equitable principles of trade. NASD Regulation is not suggesting that all aspects of a firm's compliance program necessarily be fully operational by April 24. However, NASD Regulation believes that in addition to putting in place written procedures, a firm must have taken meaningful steps by April 24 to carry out the procedures to the extent possible.

For example, while NASD Regulation does not anticipate that all firms will have fully trained their employees in all areas of anti-money laundering compliance by April 24, it does expect firms to have identified the manner in which they expect to train relevant employees and, at a minimum, either to have started to conduct such training programs or to have clear written procedures in place that evidence the firm's commitment promptly to provide such training. NASD Regulation also anticipates that, as further discussed below, firms will be regularly updating their training programs to cover additional anti-money laundering compliance requirements, as Treasury puts into place additional final rules and regulations in this area.

(d) Bank Secrecy Act Requirements

SIA and ICI requested that the proposed rule clarify that the compliance programs required by April 24, 2002 only need to address the BSA requirements that are in effect by that date. SIA noted that firms would need to update their programs as new BSA rules and requirements become final. NASD Regulation agrees that a member's compliance program is not fixed and must continuously evolve to take into account new BSA requirements as they are adopted.

NASD Regulation believes that the proposed rule language does not require a firm's compliance program to take into account those BSA requirements that are not in effect by April 24, 2002. Rather, the proposed rule would require that the program "achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder." As written, it is not necessary to comply with those provisions of the BSA that are not yet in effect (or regulations that are proposed but not yet adopted thereunder). NASD Regulation, however, encourages all firms, to the extent practicable, voluntarily to comply with those provisions of the BSA not yet in effect as of April 24, rather than waiting for mandatory compliance deadlines.

(e) Suspicious Activity Reports (SARs)

Proposed Rule 3011 requires the compliance programs to establish and implement procedures to allow for the reasonable detection and reporting of suspicious transactions required under 31 U.S.C. 5318(g) and its implementing regulations. The SIA noted that the broker/dealer SAR reporting requirement will not be in effect until 180 days after Treasury issues final rules. As discussed above, NASD Regulation recognizes that an anti-money laundering program only needs to achieve compliance with BSA requirements that are in effect.

However, NASD Regulation believes that the identification and reporting of suspicious activities are an integral part of any anti-money laundering program. As noted in Notice to Members 89-12, a failure to report suspicious transactions can be construed as aiding and abetting money laundering violations, subjecting the member firm to civil and criminal liability. While Treasury's proposed suspicious activity reporting rules applicable to broker/dealers do not become effective until 180 days after Treasury issues the final rules, broker/dealers should consider filing SARs voluntarily prior to the effective date of the regulations. Broker/dealers' procedures will need to be augmented to provide a process for reporting such transactions pursuant to SARs consistent with the final Treasury rule once the final rule becomes effective.

(f) Extension of Compliance Date

SIA expressed concerns that due to operational disruptions as a result of the September 11th events or lack of resources, some firms may not meet the April 24 compliance deadline. SIA requested that the proposed rule allow for exemptions of the compliance date under appropriate circumstances. The April 24, 2002 deadline is established in Section 352 of the Money Laundering Act. The Money Laundering Act does not grant NASD Regulation or any other securities self-regulatory organization withauthority to grant exemptions or extensions of time for compliance.

If you have any questions, please feel free to contact, Grace Yeh, Office of General Counsel, NASD Regulation, Inc., at (202) 728-6939.

Very truly yours,

Patrice M. Gliniecki
Vice President
and Acting General Counsel

cc: Joseph Morra