

Proposed Rule Change by National Association of Securities Dealers  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial <input checked="" type="checkbox"/>	Amendment <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) <input checked="" type="checkbox"/>	Section 19(b)(3)(A) <input type="checkbox"/>	Section 19(b)(3)(B) <input type="checkbox"/>
			Rule		
			<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**  
Provide a brief description of the proposed rule change (limit 250 characters).

The proposed rule change will amend NASD Rule 3011 and adopt new related interpretive material, specifically IM-3011-1 and IM-3011-2.

**Contact Information**  
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.


First Name	<input type="text" value="Brant"/>	Last Name	<input type="text" value="Brown"/>
Title	<input type="text" value="Counsel"/>		
E-mail	<input type="text" value="brant.brown@nasd.com"/>		
Telephone	<input type="text" value="(202) 728-6927"/>	Fax	<input type="text" value="(202) 728-8034"/>

**Signature**  
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date	<input type="text" value="05/23/2005"/>
By	<input type="text" value="Patrice Gliniecki"/>
	(Name)
	<input type="text" value="Senior Vice President and Deputy General Counsel"/>
	(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.



SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

**Form 19b-4 Information**

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change**

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

**1. Text of Proposed Rule Change**

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend NASD Rule 3011 and adopt new related interpretive material (“IM”), specifically IM-3011-1 and IM-3011-2. Proposed amendments to Rule 3011 would require each member to conduct the independent test of its anti-money laundering program on an annual basis, with the exception of certain types of firms, which would be allowed to test every two years. Proposed IM-3011-1 would clarify the persons not considered to be independent for purposes of Rule 3011(c), and therefore not eligible to conduct the test. Proposed IM-3011-2 would require a member to review and update, if necessary, the accuracy of the member’s anti-money laundering compliance person information on a quarterly basis. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

\* \* \* \* \*

**3011. Anti-Money Laundering Compliance Program**

On or before April 24, 2002, each member shall develop and implement a written anti-money laundering program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*), and the implementing regulations promulgated thereunder by the Department of the Treasury. Each [member organization's] member’s anti-money laundering program must

be approved, in writing, by a member of senior management. The anti-money laundering programs required by this Rule shall, at a minimum,

(a) Establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder;

(b) Establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder;

(c) Provide for annual (on a calendar-year basis) independent testing for compliance to be conducted by member personnel or by a qualified outside party, unless the member does not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts (e.g., engages solely in proprietary trading or conducts business only with other broker-dealers), in which case such “independent testing” is required every two years (on a calendar-year basis);

(d) Designate[,] and identify to NASD (by name, title, mailing address, e-mail address, telephone number, and facsimile number) an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program (such individual or individuals must be an associated person of the member) and provide prompt notification to NASD regarding any change in such designation(s); and

(e) Provide ongoing training for appropriate personnel.

\* \* \* \* \*

**IM-3011-1. Independent Testing Requirements**

(a) All members should undertake more frequent testing than required if circumstances warrant.

(b) Independent testing, pursuant to Rule 3011(c), must be conducted by a designated person with a working knowledge of applicable requirements under the Bank Secrecy Act and its implementing regulations.

(c) Independent testing may not be conducted by:

(1) a person who performs the functions being tested,

(2) the designated anti-money laundering compliance person, or

(3) a person who reports to a person described in either (1) or (2) above,

except that a member may allow the test to be conducted by a person who reports to a person described in (1) or (2) above if all four of the following conditions are met:

(A) the member has no other qualified internal personnel to conduct the test;

(B) the member establishes written policies and procedures to address conflicts that may arise from allowing the test to be conducted by a person who reports to the person(s) whose activities he or she is testing (e.g., anti-retaliation procedures);

(C) to the extent possible, the person conducting the test reports the results of the test to a person at the member who is senior to the persons described in (1) or (2) above; and

(D) the member must document its rationale, which must be reasonable, for determining that it has no other alternative than to comply in the manner set forth in the exception to this paragraph (3). In addition, if the person does not report the results consistent with (C) above, the member must document a reasonable explanation for not doing so.

\* \* \* \* \*

**IM-3011-2. Review of Anti-Money Laundering Compliance Person Information**

Each member must review and, if necessary, update the information regarding its anti-money laundering compliance person designated pursuant to Rule 3011(d) within 17 business days after the end of each calendar quarter to ensure the information's accuracy.

\* \* \* \* \*

(b) Not applicable.

(c) Not applicable.

**2. Procedures of the Self-Regulatory Organization**

The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on November 12, 2003, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The Board of Governors of NASD had an opportunity to review the proposed rule change at its meeting on November 13, 2003. No other action by NASD is necessary for the filing of the proposed rule change. Sections 1(a)(ii) and (iii) of Article VII of the NASD By-Laws permit the Board of Governors of NASD to adopt NASD

Rules and issue interpretations of rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be not more than 30 days following publication of the Notice to Members announcing Commission approval.

**3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

(a) Purpose

Section 352 of the USA PATRIOT Act of 2001 (“PATRIOT Act”)<sup>1</sup> requires all financial institutions, including broker-dealers, to develop and implement anti-money laundering (“AML”) programs. Consistent with Section 352 of the PATRIOT Act, NASD Rule 3011 requires that each member develop and implement a written AML program and specifies the minimum requirements for those programs.

Independent Testing

One of the AML program requirements is that firms independently test their AML programs. Testing allows a member to review and assess the adequacy of the firm’s AML program and the firm’s degree of compliance with its written procedures. Test results alert members to any deficiencies in their AML program, thereby allowing them to take appropriate corrective action or disciplinary action as the situation may warrant. The independent test report also is an important tool for regulators during their examinations of firms for AML compliance to, among other things, ensure that the firms

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<sup>1</sup> Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001).

are following up with corrective action when such tests discover AML program deficiencies.

#### Frequency of Testing

Neither the PATRIOT Act nor Rule 3011 specifies the frequency of independent testing, and members have asked NASD for guidance on this issue. Given the important role that testing plays in a firm ensuring that its AML program is effective in preventing money laundering activities from occurring at or through the firm and, in order to assure that member AML programs are serving their regulatory purposes, the proposed rule change would require in most instances that firms test their AML programs at least annually (on a calendar-year basis). Certain firms, however, because of their business models and activities may be able to test on a less frequent basis. Therefore, the proposed rule change would allow members that do not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts to test at least once every two years (on a calendar-year basis), rather than on an annual basis. Examples of these types of firms may include firms that engage solely in proprietary trading or that conduct business only with other broker-dealers. In either case, the proposed rule change establishes a minimum requirement, and members should undertake more frequent testing than required if circumstances warrant.

#### Establishing Independence

Rule 3011(c) allows the independent testing of a firm's AML program to be conducted by either member personnel or by a qualified outside party. Some firms may find it more cost effective to use appropriately trained firm personnel. In this regard,



members have asked for guidance on how to sufficiently maintain the independence of any internal personnel conducting the test. The proposed rule change would require the person conducting the independent test to have a working knowledge of the applicable Bank Secrecy Act requirements and related implementing regulations. The proposed rule change further clarifies that, to ensure sufficient separation of functions for independence purposes, the testing cannot be conducted by the AML compliance person(s) designated in Rule 3011, by any person who performs the AML functions being tested, or by any person who reports to any of these persons.

Recognizing that these limitations may effectively prevent a small firm from using appropriate internal personnel to conduct the tests, the proposed rule change would allow tests to be conducted by persons who report to either the AML compliance person or persons performing AML functions if (1) the member has no other qualified personnel to conduct the test; (2) the member establishes written policies and procedures to address potential conflicts that can arise from allowing the test to be conducted by a person in the reporting chain (*e.g.*, anti-retaliation procedures); (3) to the extent possible, the results of the test are reported to someone senior to the person to whom the test conductor reports; and (4) the member documents its rationale, which must be reasonable, for determining that it has no other alternative than to comply in this manner.<sup>2</sup> In addition, if the person does not report the results to a person senior to the AML compliance person or persons

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<sup>2</sup> For example, assume that all of a small firm's employees, even those who do not perform any AML functions, report to the firm's AML compliance person who is also the sole compliance officer of the firm. The member could elect to use qualified internal personnel who do not perform AML functions to conduct the independent test, even though they report to the AML compliance officer,

performing AML functions, the member must document a reasonable explanation for not doing so.

Consistent with SEC and NASD recordkeeping requirements, the member would need to retain a copy of the documented rationale, which would be reviewed by NASD examiners to assess whether the member's rationale reasonably supports its determination.

NASD engaged in extensive discussions with the New York Stock Exchange, Inc. ("NYSE") to coordinate this proposed rule change regarding independent testing of AML compliance programs. To the extent possible, NASD and the NYSE have tried to develop consistent approaches with variations where necessary to account for the differences in NASD and NYSE membership, namely, differences in firm size, types of businesses conducted, and overall business models.

AML Compliance Person – Review and Update of Contact Information

Paragraph (d) of Rule 3011 requires that each member designate and identify to NASD the member's AML compliance person(s) and notify NASD of any changes to the compliance person(s)' contact information. NASD requires this information to, among other things, facilitate the efforts of the Financial Crimes Enforcement Network, pursuant to Section 314(a) of the PATRIOT Act and its implementing regulations, in requesting information from financial institutions about persons suspected of engaging in money laundering or terrorist activities.

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provided all of the conditions set forth in proposed IM-3011-1(c)(3) have been met.

Given the important role of the AML compliance person in ensuring effective communication for purposes of identifying money-laundering and terrorist financing activities, NASD believes that members should review and update the AML compliance person information periodically to ensure its accuracy. As such, the proposed rule change would require that each member conduct a review and update, if necessary, of its AML compliance person information within 17 business days after the end of each calendar quarter.<sup>3</sup> Quarterly reviews and updates are consistent with NYSE requirements.<sup>4</sup>

The proposed rule change also would clarify that the AML compliance person must be an associated person of the member.

As noted in Section 2 of this filing, NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be not more than 30 days

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<sup>3</sup> This proposed schedule is consistent with a member's quarterly FOCUS reporting schedule, as well as with a member's business continuity plan requirement to review and update emergency contact information on a quarterly basis (see NASD Rule 3520(b)). Similarly, the proposed schedule is consistent with the requirement to review and update a member's Executive Representative designation and contact information (see NASD Rule 1150) and to designate a person to receive notifications relating to continuing education, and the need to review and update such designation and contact information (see NASD Rule 1120(a)(7)). When members file their FOCUS reports each quarter, they are reminded of the need to review and update this information on the NASD Contact System.

<sup>4</sup> In Information Memo Number 02-41 (Aug. 30, 2002), the NYSE stated that its members should review and/or update on a quarterly basis (*i.e.*, March, June, September, and December) the information furnished on its Electronic Filing Platform, including information regarding the member's or member organization's AML compliance person.

following publication of the Notice to Members announcing Commission approval.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change is designed to accomplish these ends by requiring members to conduct periodic tests of their AML compliance programs, preserve the independence of their testing personnel, and ensure the accuracy of their AML compliance person information.

**4. Self-Regulatory Organization's Statement on Burden on Competition**

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

**5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

Written comments were neither solicited nor received.

**6. Extension of Time Period for Commission Action**

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

**7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

Not applicable.

**8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

Not applicable.

**9. Exhibits**

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

**EXHIBIT 1**

**SECURITIES AND EXCHANGE COMMISSION**

(Release No. 34- ; File No. SR-NASD-2005-066)

**SELF-REGULATORY ORGANIZATIONS**

Proposed Rule Change by National Association of Securities Dealers, Inc.  
Relating to Amendments to NASD Rule 3011 and the Adoption of New Related  
Interpretive Material

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on , the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

NASD is proposing to amend NASD Rule 3011 and adopt new related interpretive material (“IM”), to (1) require each member to conduct the independent test of its anti-money laundering program on an annual basis, with the exception of certain types of firms, which would be allowed to test every two years; (2) clarify the persons not considered to be independent for purposes of Rule 3011(c), and therefore not eligible to

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

conduct the test; and (3) require a member to review and update, if necessary, the accuracy of the member's anti-money laundering compliance person information on a quarterly basis. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

\* \* \* \* \*

### **3011. Anti-Money Laundering Compliance Program**

On or before April 24, 2002, each member shall develop and implement a written anti-money laundering program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*), and the implementing regulations promulgated thereunder by the Department of the Treasury. Each [member organization's] member's anti-money laundering program must be approved, in writing, by a member of senior management. The anti-money laundering programs required by this Rule shall, at a minimum,

(a) Establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder;

(b) Establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder;

(c) Provide for annual (on a calendar-year basis) independent testing for compliance to be conducted by member personnel or by a qualified outside party, unless the member does not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts (e.g., engages

solely in proprietary trading or conducts business only with other broker-dealers), in which case such “independent testing” is required every two years (on a calendar-year basis);

(d) Designate[,] and identify to NASD (by name, title, mailing address, e-mail address, telephone number, and facsimile number) an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program (such individual or individuals must be an associated person of the member) and provide prompt notification to NASD regarding any change in such designation(s); and

(e) Provide ongoing training for appropriate personnel.

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### **IM-3011-1. Independent Testing Requirements**

(a) All members should undertake more frequent testing than required if circumstances warrant.

(b) Independent testing, pursuant to Rule 3011(c), must be conducted by a designated person with a working knowledge of applicable requirements under the Bank Secrecy Act and its implementing regulations.

(c) Independent testing may not be conducted by:

(1) a person who performs the functions being tested,

(2) the designated anti-money laundering compliance person, or

(3) a person who reports to a person described in either (1) or (2) above,

except that a member may allow the test to be conducted by a person who reports to a person described in (1) or (2) above if all four of the following conditions are



met:

(A) the member has no other qualified internal personnel to conduct the test;

(B) the member establishes written policies and procedures to address conflicts that may arise from allowing the test to be conducted by a person who reports to the person(s) whose activities he or she is testing (e.g., anti-retaliation procedures);

(C) to the extent possible, the person conducting the test reports the results of the test to a person at the member who is senior to the persons described in (1) or (2) above; and

(D) the member must document its rationale, which must be reasonable, for determining that it has no other alternative than to comply in the manner set forth in the exception to this paragraph (3). In addition, if the person does not report the results consistent with (C) above, the member must document a reasonable explanation for not doing so.

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**IM-3011-2. Review of Anti-Money Laundering Compliance Person Information**

Each member must review and, if necessary, update the information regarding its anti-money laundering compliance person designated pursuant to Rule 3011(d) within 17 business days after the end of each calendar quarter to ensure the information's accuracy.

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**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

**A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

1. Purpose

Section 352 of the USA PATRIOT Act of 2001 ("PATRIOT Act")<sup>3</sup> requires all financial institutions, including broker-dealers, to develop and implement anti-money laundering ("AML") programs. Consistent with Section 352 of the PATRIOT Act, NASD Rule 3011 requires that each member develop and implement a written AML program and specifies the minimum requirements for those programs.

Independent Testing

One of the AML program requirements is that firms independently test their AML programs. Testing allows a member to review and assess the adequacy of the firm's AML program and the firm's degree of compliance with its written procedures. Test results alert members to any deficiencies in their AML program, thereby allowing them to take appropriate corrective action or disciplinary action as the situation may warrant. The independent test report also is an important tool for regulators during their

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<sup>3</sup> Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001).

examinations of firms for AML compliance to, among other things, ensure that the firms are following up with corrective action when such tests discover AML program deficiencies.

#### Frequency of Testing

Neither the PATRIOT Act nor Rule 3011 specifies the frequency of independent testing, and members have asked NASD for guidance on this issue. Given the important role that testing plays in a firm ensuring that its AML program is effective in preventing money laundering activities from occurring at or through the firm and, in order to assure that member AML programs are serving their regulatory purposes, the proposed rule change would require in most instances that firms test their AML programs at least annually (on a calendar-year basis). Certain firms, however, because of their business models and activities may be able to test on a less frequent basis. Therefore, the proposed rule change would allow members that do not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts to test at least once every two years (on a calendar-year basis), rather than on an annual basis. Examples of these types of firms may include firms that engage solely in proprietary trading or that conduct business only with other broker-dealers. In either case, the proposed rule change establishes a minimum requirement, and members should undertake more frequent testing than required if circumstances warrant.

#### Establishing Independence

Rule 3011(c) allows the independent testing of a firm's AML program to be conducted by either member personnel or by a qualified outside party. Some firms may find it more cost effective to use appropriately trained firm personnel. In this regard,

members have asked for guidance on how to sufficiently maintain the independence of any internal personnel conducting the test. The proposed rule change would require the person conducting the independent test to have a working knowledge of the applicable Bank Secrecy Act requirements and related implementing regulations. The proposed rule change further clarifies that, to ensure sufficient separation of functions for independence purposes, the testing cannot be conducted by the AML compliance person(s) designated in Rule 3011, by any person who performs the AML functions being tested, or by any person who reports to any of these persons.

Recognizing that these limitations may effectively prevent a small firm from using appropriate internal personnel to conduct the tests, the proposed rule change would allow tests to be conducted by persons who report to either the AML compliance person or persons performing AML functions if (1) the member has no other qualified personnel to conduct the test; (2) the member establishes written policies and procedures to address potential conflicts that can arise from allowing the test to be conducted by a person in the reporting chain (*e.g.*, anti-retaliation procedures); (3) to the extent possible, the results of the test are reported to someone senior to the person to whom the test conductor reports; and (4) the member documents its rationale, which must be reasonable, for determining that it has no other alternative than to comply in this manner.<sup>4</sup> In addition, if the person does not report the results to a person senior to the AML compliance person or persons

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<sup>4</sup> For example, assume that all of a small firm's employees, even those who do not perform any AML functions, report to the firm's AML compliance person who is also the sole compliance officer of the firm. The member could elect to use qualified internal personnel who do not perform AML functions to conduct the independent test, even though they report to the AML compliance officer, provided all of the conditions set forth in proposed IM-3011-1(c)(3) have been met.

performing AML functions, the member must document a reasonable explanation for not doing so.

Consistent with SEC and NASD recordkeeping requirements, the member would need to retain a copy of the documented rationale, which would be reviewed by NASD examiners to assess whether the member's rationale reasonably supports its determination.

NASD engaged in extensive discussions with the New York Stock Exchange, Inc. ("NYSE") to coordinate this proposed rule change regarding independent testing of AML compliance programs. To the extent possible, NASD and the NYSE have tried to develop consistent approaches with variations where necessary to account for the differences in NASD and NYSE membership, namely, differences in firm size, types of businesses conducted, and overall business models.

#### AML Compliance Person – Review and Update of Contact Information

Paragraph (d) of Rule 3011 requires that each member designate and identify to NASD the member's AML compliance person(s) and notify NASD of any changes to the compliance person(s)' contact information. NASD requires this information to, among other things, facilitate the efforts of the Financial Crimes Enforcement Network, pursuant to Section 314(a) of the PATRIOT Act and its implementing regulations, in requesting information from financial institutions about persons suspected of engaging in money laundering or terrorist activities.

Given the important role of the AML compliance person in ensuring effective communication for purposes of identifying money-laundering and terrorist financing activities, NASD believes that members should review and update the AML compliance

person information periodically to ensure its accuracy. As such, the proposed rule change would require that each member conduct a review and update, if necessary, of its AML compliance person information within 17 business days after the end of each calendar quarter.<sup>5</sup> Quarterly reviews and updates are consistent with NYSE requirements.<sup>6</sup>

The proposed rule change also would clarify that the AML compliance person must be an associated person of the member. As noted in Section 2 of this filing, NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be not more than 30 days following publication of the Notice to Members announcing Commission approval.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD rules must

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<sup>5</sup> This proposed schedule is consistent with a member's quarterly FOCUS reporting schedule, as well as with a member's business continuity plan requirement to review and update emergency contact information on a quarterly basis (see NASD Rule 3520(b)). Similarly, the proposed schedule is consistent with the requirement to review and update a member's Executive Representative designation and contact information (see NASD Rule 1150) and to designate a person to receive notifications relating to continuing education, and the need to review and update such designation and contact information (see NASD Rule 1120(a)(7)). When members file their FOCUS reports each quarter, they are reminded of the need to review and update this information on the NASD Contact System.

<sup>6</sup> In Information Memo Number 02-41 (Aug. 30, 2002), the NYSE stated that its members should review and/or update on a quarterly basis (*i.e.*, March, June, September, and December) the information furnished on its Electronic Filing Platform, including information regarding the member's or member organization's AML compliance person.

be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change is designed to accomplish these ends by requiring members to conduct periodic tests of their AML compliance programs, preserve the independence of their testing personnel, and ensure the accuracy of their AML compliance person information.

**B. Self-Regulatory Organization's Statement on Burden on Competition**

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

**C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

Written comments were neither solicited nor received.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-066 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2005-066. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street,



NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NASD.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to the File Number SR-NASD-2005-066 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(12).