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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. 1 and Response to Comments**

Dear Ms. England:

NASD hereby submits Amendment No. 1 to SR-NASD-2002-108 (the “rule filing”). NASD stated in the original rule filing that it only received 17 comment letters in response to *Notice to Members* 02-23 (April 2002). As we discussed with SEC staff, NASD identified 15 additional comment letters that were not included or summarized in the rule filing. NASD is submitting this amendment to include and summarize the 15 new comment letters (“NtM Comment Letters”).¹ The comment letters are attached as Exhibit A. In addition, the SEC received three comment letters in response to the Federal Register notice announcing the proposed rule (“Federal Register Comment Letters”).² The Federal Register Comment Letters are attached as Exhibit B.

¹ New NtM Comment Letters were received from: Brian Bouda, Federated Securities Corp. (“Federated”); Bruce R. Bent, The Reserve Funds (“The Reserve Funds”); Roberta Kilkenny, Citicorp Investment Services (“Citicorp”); Cheryl Cook-Schneider, Edward D. Jones & Co., LP (“Edward Jones”); Luisa de Samame Spear, Morgan, Lewis, Githens & Ahn, Inc. (“Morgan”); Jack M. Pullara, Pricewaterhouse Coopers (“Pricewaterhouse”); Mark Beloyan, Beloyan Investment Securities, Inc. (“Beloyan”); Sheryl Brownhill, Raymond James & Associates, Inc. (“Raymond James”); Bradley R. Skarie, Lincoln National Life; Andrea Vadas Evacho, E.E. Powell & Co., Inc. (“E.E. Powell”); Robert Cervoni, Weeden & Co. (“Weeden”); Pierre-Antoine Boulat, TradingScreen (“TradingScreen”); Larry Quinn, BSC Securities, LC (“BSC”); Sarah O’Connor, First Tennessee Securities Corp. (“First Tennessee”); Joel McTague, Redgrave & Turner, LLP (“Redgrave & Turner”).

² Federal Register Comment Letters were received from the Securities Industry Association and the Bond Market Association (“SIA/BMA”), Investment Company Institute (“ICI”), and Edward D. Jones.

Summary of and Response to Comment Letters

A. Business Continuity Plan Requirement

Proposed Rule 3510(a) requires members to create and maintain business continuity plans. Of the 15 new NtM comment letters, 10 supported this requirement. In total, 24 of the 32 NtM comment letters supported the requirement that firms create and maintain business continuity plans. Of those in opposition, one member commented that NASD should only strongly urge members to have business continuity plans, but should not mandate it.³ Another member suggested NASD should only offer guidelines.⁴ One member thought the rule will be too costly for small members firms.⁵ Finally, a member stated that the rule is not necessary because September 11, 2001 was a “financial non-event.”⁶ Notwithstanding these suggestions, for the reasons stated in this rule filing, NASD continues to believe that members should be required to have business continuity plans. To address the cost impact to small firms, NASD reiterates its statement in the Federal Register rule proposal that NASD will issue guidance in this area and is preparing a template for use by small firms to assist with the creation of business continuity plans.

B. Categories of a Member's Business Continuity Plan

Proposed Rule 3510(c) states that the “requirements of a business continuity plan are flexible and may be tailored to the size and needs of a member.” The rule requires that each plan must, at a minimum, address eight key categories. These categories are: (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) business constituent, bank and counter-party impact; (7) regulatory reporting; and (8) communications with regulators.

Four new NtM commenters stated that the categories were over-inclusive.⁷ In total, nine of 24 NtM commenters believed that the categories were over-inclusive. One member believed that the term “financial and operational assessments” was unclear and that it was duplicative of mission critical systems.⁸ Another member stated that plans

³ See NtM Comment Letter from BSC Securities.

⁴ See NtM Comment Letter from Lincoln National Life.

⁵ See NtM Comment Letter from Beloyan.

⁶ See NtM Comment Letter from The Reserve Fund.

⁷ See NtM Comment Letters from Federated, E.E. Powell, Weeden, and BSC Securities.

⁸ See NtM Comment Letter from Federated.

should not address “minimums” but should require a member's plan to protect a member's customers in their ability to receive their cash or securities within a reasonable period and for the firm to carry out its fundamental accounting and reporting functions.⁹

In contrast, four new NtM commenters concluded that the categories were under-inclusive.¹⁰ In total, six out of 22 NtM commenters believed that the categories were under-inclusive. One larger member firm believed that contingency sites should be included.¹¹ Another firm believed that the rule should require a category for emergency contact information for employees.¹² One member suggested adding the following categories: (1) alternate workspace requirements; (2) crisis management plans and procedures; (3) communications with local police, fire, and other governmental agencies; and (4) security over recovered operations and facilities.¹³ Another member suggested that, in general, plans of small member firms should be more comprehensive.¹⁴

NASD believes that the categories required of a member's business continuity plan should be broad and flexible to allow members to tailor their plans to their particular business and operations. A requirement to maintain a contingency site would likely be costly for many small member firms, without commensurate benefit. The staff, however, believes that if a member has a contingency site, it should be referenced throughout its business continuity plan. A member with a contingency site could not adequately address its contingency planning for mission critical systems without referring to its contingency site.

NASD does not believe the Rule should be amended to include the added categories suggested by the comment letters. Even though proposed Rule 3510 only places minimums on a member's business continuity plan, the rule should not be interpreted to prevent members from addressing additional areas of concern. NASD also believes that “financial and operational assessments” is not duplicative of mission critical systems. “Financial and operational assessments” is a planning component that

⁹ See NtM Comment Letter from Weeden.

¹⁰ See NtM Comment Letters from Citicorp, Morgan Lewis, Pricewaterhouse, and Redgrave & Turner.

¹¹ See NtM Comment Letter from Citicorp.

¹² See NtM Comment Letter from Morgan Lewis.

¹³ See NtM Comment Letter from Pricewaterhouse.

¹⁴ See NtM Comment Letter from Redgrave & Turner.

requires written procedures to address changes in operational, financial and credit-risk exposures. In contrast, “mission critical systems” only addresses the processing of securities transactions and the maintenance of customer accounts.

A Federal Register commenter believed that Rule 3510 should specifically state that a member must only address each of the eight listed categories “to the extent applicable.”¹⁵ In the proposing release, NASD stated that “each member's business continuity plan will only be required to address the eight listed categories . . . to the extent applicable and necessary.” NASD believes that this approach is preferable because a member should be required to state that a category does not apply to its firm. Including the phrase “to the extent applicable” in the rule language might mislead members into believing that if they do not carry customer accounts or perform a specific function, they do not have to address the category or system at all. For example, if a firm does not carry customer accounts or if books and records are kept at its clearing firm, the member's plan should address this point.

C. Definition of Mission Critical Systems

NASD has defined the category of “mission critical systems” as “any system that is necessary, depending on the nature of a member’s business, to ensure prompt and accurate processing of securities transactions, including, but not limited to, order taking, order entry, execution, comparison, allocation, clearance and settlement of securities transactions, the maintenance of customer accounts, access to customer accounts and the delivery of funds and securities.” Two of 10 new NtM commenters believed that the definition of mission critical system was not adequate.¹⁶ A member commented that its firm would just shut down its operations for a period of time in the event of a significant business disruption.¹⁷ As a result, they argue that addressing mission critical systems would not be necessary for this firm. One firm broadly suggested that accounting should be addressed in the definition of “mission critical systems.”¹⁸ First, NASD believes that a firm completely closing down its operations during a business disruption may not serve the purpose of business continuity. The purpose of proposed Rule 3510 is for members to be able to continue necessary business operations, not cease operations. Second, NASD believes that accounting for transactions is implicit in proposed Rule 3510 because the rule does not alter a member's obligation to comply with SEC and NASD books and records requirements. Accounting for transactions is also implicit in the category of “financial and operational assessments” and the term

¹⁵ See Federal Register Comment Letter from ICI.

¹⁶ See NtM Comment Letter from Weeden, and TradingScreen.

¹⁷ See NtM Comment Letter from Weedem.

¹⁸ See NtM Comment Letter from TradingScreen.

“maintenance of customer accounts,” which is part of the definition of “mission critical systems.”

D. Requirement to Update Business Continuity Plans

Proposed Rule 3510(b) requires that each member conduct an annual review of its business continuity plan to determine whether any modifications are necessary in light of changes to the member’s operations, structure, business or location. Six out of 13 new NtM commenters believed that a yearly review of business continuity plans was inadequate.¹⁹ In total, nine out of 27 NtM commenters believed that the yearly review requirement was inadequate. Although commenters cited different events that should trigger an update of a business continuity plan, most commenters who dissented believed that plans should be updated more frequently.

NASD believes that an annual review of the plan is necessary, but is amending its rule to reflect significant member and industry comment. NASD is amending the proposal to require that “Each member must update its plan in the event of any material change to the member's operations, structure, business or location. Each member also must conduct an annual review of its plan to determine whether any modifications are necessary in light of changes to the member's operations, structure, business or location.” This added language emphasizes that members must promptly update their business continuity plans whenever there is a material change in a member's operations, structure, business or location that affects the information set forth in the business continuity plan. This requirement is in addition to the yearly review requirement.

E. Repository Service and Filing Requirement

In *Notice to Members* 02-23 (April 2002), NASD solicited comment on whether members believed that firms should be required to file their business continuity plans with NASD. Only four of 12 new NtM commenters believed that members should be required to file their plans.²⁰ In total, only eight of 27 NtM commenters supported such a requirement. In the original rule filing, Rule 3510 did not impose a filing requirement. Based upon the comment letters, NASD will not impose a filing requirement.

While NASD will not impose a filing requirement for members’ business continuity plans, NASD intends to offer an optional repository service for members’ plans. Eight of 12 new NtM commenters supported a repository service for members’

¹⁹ See NtM Comment Letters from Citicorp, Edward Jones, Morgan Lewis, Pricewaterhouse, Raymond James, and Redgrave & Turner.

²⁰ See NtM Comment Letters from Citicorp, Morgan Lewis, Pricewaterhouse, and First Tennessee.

plans.²¹ In total, 16 out of 27 NtM commenters supported the creation of a repository service. Accordingly, NASD will provide this service to members at a reasonable fee.

F. Business Constituent, Bank and Counter-party Impact

One of the categories that members' business continuity plans must address is "business constituent, bank, and counter-party impact." In both sets of comment letters (NtM and Federal Register), commenters asked for clarification of this category. Under this category, 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 on-going commercial relationship pertaining to the support of the member's operating activities), banks (lenders), and counter-parties (such as other broker/dealers or institutional customers). In addition, 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.

G. Category of Books and Records Back-Up and Recovery

One of the categories that members' business continuity plans must address is "books and records back-up and recovery (hard copy and electronic)." One commenter requested clarification of whether the rule creates a requirement that members have both hard copy and electronic books and records.²² While proposed Rule 3510 refers to the types of books and records that a firm might maintain, the rule does not mandate that members keep book and records (and back-up books and records) in both hard copy and electronic formats. To determine what records (and in what format) firms must retain documents, members should refer to SEC and NASD rules and interpretative materials specifically addressing record retention requirements, such as SEC Rule 17a-4 and NASD Rule 3110.

H. Application of Proposed Rule to Subsidiaries

In its original rule filing, NASD stated that it believes that a subsidiary member firm may satisfy its obligations under the proposed rule change by participating in a corporate-wide business continuity plan of a parent corporation that addresses its subsidiary member firms. As a result, a subsidiary member firm may rely on the corporate-wide business continuity plan of its parent corporation regardless of whether the parent corporation is a member or non-member. The original rule filing, however, stated that the parent corporation's business continuity plan must comply fully with

²¹ See NtM Comment Letters from Citicorp, Edward Jones, Morgan Lewis, Pricewaterhouse, E.E. Powell, TradingScreen, BSC Securities, First Tennessee, and Redgrave & Turner.

²² See Federal Register Comment Letter from SIA/BMA.

proposed NASD Rule 3510 and address all requirements under the proposed rule change. In addition, the parent and subsidiary corporations must both comply with NASD rules on record-keeping and supervision for purposes of proposed NASD Rule 3510. Finally, the parent corporation must grant NASD access to its business continuity plan upon request.

A Federal Register commenter believed that it is not appropriate to subject non-member firms to these NASD requirements nor is it necessary.²³ NASD, however, believes that if a member chooses to participate in a parent company's corporate-wide business continuity plan, the record-keeping of that plan and any supervision of the creation, execution, or updating of that plan must comply with NASD rules on record-keeping and supervision. Participating in a corporate-wide business continuity plan is merely an alternative and is intended to give firms greater flexibility in complying with the proposed rule.

I. Senior Management Approval

NASD is proposing to amend the text of Rule 3510 to include new subsection (d) to conform NASD's rule with the NYSE's proposed business continuity rule. NASD agrees with the requirement set forth in the NYSE proposal that a member of senior management and a registered principal should approve a member's business continuity plan, including any updates to the plan, to ensure that the creation and maintenance of any plan is reviewed and approved by persons with appropriate expertise and seniority. As a result of this new subsection, former subsection (d) is amended to subsection (e).

J. Emergency Contact Information

Proposed Rule 3520 requires members to provide NASD with emergency contact information and update any information upon the occurrence of a material change. A commenter suggested that NASD take a proactive role in gathering emergency contact information.²⁴ Again, as noted in the proposing release, NASD believes that this duty should lie with the member firm because the member will be best able to identify when a material change has taken place. NASD, however, is amending Proposed Rule 3520(b) to require members to promptly update any changes to their emergency contact information. In addition, NASD is eliminating the semi-annual update requirement from the rule text. Rather, to be consistent with other contact information required by NASD and periodic updates required by the NYSE, NASD will issue future guidance on a periodic update requirement. NASD also is amending proposed Rule 3520(a) to include the phrase “[a]mong other things” to emphasize that

²³ See Federal Register Comment Letter from ICI.

²⁴ See Federal Register Comment Letter from Edward Jones.

NASD is requiring other contact information in addition to designating an emergency contact person.

Text of Amendment

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

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3500. EMERGENCY PREPAREDNESS

3510. Business Continuity Plans

(a) No Change

(b) Each member must update its plan in the event of any material change to the member's operations, structure, business or location. Each member must also conduct an annual review of its business continuity plan to determine whether any modifications are necessary in light of changes to the member's operations, structure, business or location.

(c) No Change

(d) Members must designate a member of senior management to approve the plan and he or she shall be responsible for conducting the required annual review. The member of senior management must also be a registered principal.

[(d)](e) For purposes of this rule, the following terms shall have the meanings specified below:

(1) – (2) No Change

3520. Emergency Contact Information

(a) Each member shall report to NASD, via such electronic or other means as NASD may require, prescribed emergency contact information for the member. Among other things, [T]the emergency contact information for the member includes designation of two emergency contact persons. Each emergency contact person shall be a member of senior management and a registered principal of the member.

(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[, but at a minimum must review the information contained therein twice a year to ensure its accuracy].

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If you have any questions concerning this amendment, please contact the undersigned 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,

Brian J. Woldow