



National Association of Securities Dealers Conduct Rules 3010 (Supervision) and 3110 (Books and Records)

NASD 3010: The NASD requires that member firms establish and maintain a system to "supervise" the activities of each registered representative, including transactions and correspondence with the public. In addition, NASD 3110 requires that member firms implement a retention program ("Books and Records") for all correspondence involving registered representatives.

WHO IS AFFECTED BY NASD 3010 AND 3110?

Primarily broker-dealers, registered representatives, and those individuals that trade securities or act as brokers for traders are subject to the regulations. Organizationally, these include: banks, securities firms, stock brokerage firms, and financial institutions that deal in the trading of securities of any type that are governed by the SEC. These include any entities that fall under the jurisdiction of the National Association of Securities Dealers (NASD) as well.

WHAT ARE THE REQUIREMENTS OF NASD 3010 AND 3110?

For brokerage firms, specific rules surrounding supervision, records retention, non-rewriteable storage, and ease of retrieval and viewing are highlighted by SEC 17a-3 and 17a-4. In addition, NASD 3010 requires the creation of policies for supervisory review of broker email, and for education of brokers on regulatory issues. NASD 3110 specifies the retention of customer records and transaction data in a reviewable format and in an easily accessible place. In June 2003, NASD also said that all IMs sent to clients and employees by brokers and dealers have to be preserved for at least three years. Also in the proposed amendment, NASD wanted to appoint a CCO. NASD filed the proposed rule change with the Commission (1) to amend NASD Rule 3010(g)(2) to revise the definition of the term "branch office"; and (2) to adopt IM-3010-1 to provide guidance on factors to be considered by a member firm in conducting internal inspections of offices.

Note: 3rd Party Rule Clarification

On February 5, 1997, the Commission amended Rule 17a-4 to allow broker dealers to employ, under certain conditions, electronic storage media to maintain its records. The Electronic Storage Media Release requires a broker-dealer that employs micrographic or electronic storage media to be ready at all times to immediately provide a facsimile enlargement upon request by the Commission or its representatives. It also requires a broker-dealer that exclusively uses electronic storage media to fulfill one or all of its record preservation requirements to contract with a third party download provider that will file undertakings with the broker-dealer's designated examining authority indicating that the download provider will furnish promptly to the Commission, its designees or representatives, the information necessary to download information kept on the broker-dealer's electronic storage media.

In essence, **data does NOT have to be stored in the hands of a 3rd party** – the broker dealer or financial institution's email archiving provider just needs to know how to get the data so the NASD can access it themselves.

WHEN ARE NASD 3010 AND 3110 EFFECTIVE?

Amended in December 1997, February 1998, and November 1998. NASD 3010 and 3110 are currently active.

WHAT ARE THE PENALTIES FOR NASD 3010 AND 3110?

Criteria for compliance are strict and penalties for violation are severe. NASD oversees and regulates all trading on NASDAQ and in the OTC markets, as well as trades in New York Stock Exchange- and Amex-listed securities reported to NASDAQ. NASD also regulates trading on the corporate and municipal bond markets. In the case of corporate bonds, NASD operates the Trade Reporting and Compliance Engine (TRACE), on which virtually all corporate bond transactions are reported to the public within 15 minutes of execution. In 2003, NASD set records for the number of new disciplinary actions filed (1,410) and the number of individuals suspended or expelled from the industry (827). NASD also collected more than \$33 million in fines.

"At NASD, we don't simply wait for violations to occur. We are committed to looking ahead, trying to foresee and prevent problems before they can harm investors." – NASD website, <http://www.nasd.com> Example of recent fining: On May 19 2005, NASD announced today that Hilary L. Shane, a hedge fund manager formerly registered with First New York Securities, L.L.C. (FNY), has been permanently barred from associating with any NASD registered firm and will pay more than \$1.45 million to settle NASD and Securities and Exchange Commission (SEC) charges of fraud and insider trading. The charges arise from Shane's purchase and sale of shares in a PIPE transaction.

HOW DO FIRMS COMPLY WITH NASD 3010 AND 3110?

The following are simplified requirements for NASD 3010 and 3110. Firms must enact policies or implement technologies to:

- Develop supervisory procedures for public correspondence
- Monitor and ensure policies are implemented and effective. Consider necessary revisions
- Provide training to appropriate employees on policies governing correspondence, update as policies change
- Maintain records documenting how and when employees are educated and trained
- Specify firm's policies and procedures for supervisory review of different types of correspondence, the minimum frequency of the reviews for each type, and recommendations to customers
- Identify how supervisory reviews are conducted and documented; what types of correspondence will be pre- or postreviewed; and the organizational position(s) responsible for review of the different types of correspondence
- Consider the nature and extent of training provided registered representatives and other employees, as well as their experience in using communications media
- Review the compliant and disciplinary history of registered representatives and other employees
- Provide that all customer complaints are reported to the NASD in compliance with Rule 3070(c)
- Preserve records in accordance with NASD rules and with SEC Rule 17a-3