

MEMO# 11072

June 24, 1999

NASD NOTICE TO MEMBERS ON SUPERVISORY RESPONSIBILITIES

1 NASD Notice to Members 99-45 (June 1999). 2 The Notice adds that this responsibility does not preclude a member from implementing a supervisory system designed by another party. However, if a member chooses to implement such a system, it must make its own determination that the system implemented is current and is reasonably designed to achieve compliance with the securities laws. [11072] June 24, 1999 TO: COMPLIANCE ADVISORY COMMITTEE No. 24-99 SEC RULES MEMBERS No. 42-99 RE: NASD NOTICE TO MEMBERS ON SUPERVISORY RESPONSIBILITIES

The National Association of Securities Dealers, Inc. ("NASD") recently issued a Notice to Members (attached) providing guidance on supervisory responsibilities.¹ In particular, the Notice focuses on those sections of NASD Conduct Rule 3010 that require members to establish a supervisory system and develop and maintain written supervisory procedures. I. Supervisory System and Written Procedures - Rule 3010(a) and (b) The Notice states that regardless of its size or complexity, each member must adopt and implement a supervisory system that is tailored specifically to the member's business and that addresses the activities of all its registered representatives and associated persons. Supervisory procedures must be in writing and must be reasonably designed to achieve compliance with applicable securities laws and rules. The Notice emphasizes that the ultimate responsibility for supervision rests with the member.² The Notice also lists factors that should be considered in a member's analysis of the types of business it conducts, how the firm is organized and operated, and that a member should take into consideration when establishing the framework of its supervisory system. Once a member has designed its supervisory system, Rule 3010(b) requires the member to memorialize the system in writing and implement and enforce these written procedures. The member must keep a record of each associated person who has supervisory responsibilities and the date each person was assigned those responsibilities. This must include the titles, registration status, and locations of the supervisory personnel. The written procedures also must include the business line and applicable securities laws for which each supervisor is responsible and must be updated to properly reflect any necessary changes to the supervisory system. II. Minimum Requirements of a Supervisory System - Rule 3010(a) The NASD has identified certain elements that must be included in every member's supervisory system, including: A. Designating Principals Responsible for Supervision - Rule 3010(a)(2) Rule 3010(a)(2) requires that a member assign responsibility for each type of business that the member conducts to one or more principals. This requirement is limited to those types of businesses that require registration as a broker/dealer. The Rule also requires that principals be appropriately registered and vested with the authority to carry out the supervision for

which they are responsible. B. Designating Offices of Supervisory Jurisdiction - Rule 3010(a)(3) The Notice states that certain types of activities are sufficiently vested with regulatory significance that the locations where members conduct these types of activities require special recognition and attention. These locations or offices are known as offices of supervisory jurisdiction ("OSJ"). Paragraph (g)(1) of the Rule lists the types of activities that have been identified by the NASD as requiring significant supervisory attention. A member must designate as an OSJ any office that conducts any of the functions listed in that section of the Rule. A member also must designate any other office as an OSJ, if that designation is necessary to enable the member to fulfill its supervisory obligations. C. Assigning Supervisors for Registered Representatives and Designating OSJ/Non-OSJ Branch Supervisors - Rule 3010(a)(5) and (a)(4) Rule 3010(a)(5) requires that each registered person be assigned to at least one supervisor, even if the person to be supervised is a registered representative or a registered principal, or that the registered person is part of the senior management of the member. Rule 3010(a)(4) requires members to assign each OSJ at least one principal with the authority to carry out the supervisory responsibilities conducted at the OSJ. Each branch office that is not designated as an OSJ also must have at least one supervisor assigned to it. D. Determining Qualifications of Supervisory Personnel - Rule 3010(a)(6) Rule 3010(a)(6) sets the standard for determining the qualifications of supervisors. The Rule requires that members make reasonable efforts to determine that all supervisory personnel are qualified to fulfill their assigned responsibilities. At a minimum, the supervisor must be properly licensed to conduct the assigned responsibilities. E. Annual Compliance Meeting - Rule 3010(a)(7) Rule 3010(a)(7) requires that each registered representative participate, at least once each year, in an interview or meeting at which compliance matters relevant to the particular representative are discussed. The Notice states that these meetings can be held with representatives individually or with a group of representatives, and can be held at a central or regional location or at the member's place of business. F. Review of Supervisory System - Rule 3010(a)(8) Rule 3010(a)(8) requires that at least one principal be designated to review the firm's supervisory system, procedures, and internal inspections. If more than one principal is designated, it must be clear which areas of the supervisory system each has been assigned to review. III. Internal Inspections - Rule 3010(c) The Notice states that it is important that members not only review their supervisory systems and procedures to ensure that they are current and adequate, but also conduct inspections to determine whether the systems and procedures are being followed. Paragraph (c) of the Rule, therefore, requires members to annually review the businesses they conduct, and sets forth the standard for this review. The Rule also requires that each office of a member be reviewed. The Notice states that the frequency of this review will depend on several factors, including whether an office is designated as an OSJ. At a minimum, an OSJ must be reviewed every year, as opposed to branch offices, which are required to be reviewed in accordance with a stated cycle. In determining the inspection cycle for a branch office, a member must consider the nature and complexity of the securities activity for which the branch office is responsible, as well as the volume of business conducted at the office and the number of associated persons assigned to the office. Ari Burstein Assistant Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11072. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

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