

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52727; File No. SR-NASD-2005-121)

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amendments to Rule 3012, Rule 3013, and IM-3013

November 3, 2005

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 14, 2005, 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, and II below, which Items have been prepared by NASD. NASD has designated the proposed rule change as constituting a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon receipt of this filing by the Commission. 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 3012 (Supervisory Control System), Rule 3013 (Annual Certification of Compliance and Supervisory Processes), and IM-3013 (Annual Compliance and Supervision Certification) to allow members, by no later

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)

⁴ 17 CFR 240.19b-4.

than April 1, 2006, to submit the initial annual report required by Rule 3012 and to execute the initial annual certification required by Rule 3013 and IM-3013. Below is the text of the proposed rule change. Proposed new language is in underlined.

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3012. Supervisory Control System

(a) General Requirements

(1) Each member shall designate and specifically identify to NASD one or more principals who shall establish, maintain, and enforce a system of supervisory control policies and procedures that (A) test and verify that the member's supervisory procedures are reasonably designed with respect to the activities of the member and its registered representatives and associated persons, to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules and (B) create additional or amend supervisory procedures where the need is identified by such testing and verification. The designated principal or principals must submit to the member's senior management no less than annually, a report⁵ detailing each member's system of supervisory controls, the summary of the test results and significant identified exceptions, and any

⁵ Rule 3012 became effective on January 31, 2005, which would require a member's first Rule 3012 report to be submitted by no later than January 31, 2006 and at least annually thereafter; however, a member may elect to submit its first Rule 3012 report by no later than April 1, 2006. Importantly, a member's first Rule 3012 report must encompass the period from January 31, 2005 (the effective date of Rule 3012) up to the submission date (or a reasonable period of time immediately preceding the submission date). Each ensuing Rule 3012 report may not be for a period greater than 12 months from the date of the preceding Rule 3012 report (but may be for a shorter time period if a member elects to prepare a report more frequently than annually).

additional or amended supervisory procedures created in response to the test results.

(2) No change.

(b) Dual Member No change.

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Rule 3013. Annual Certification of Compliance and Supervisory Processes

(a) Designation of Chief Compliance Officer No change.

(b) Annual Certification

Each member shall have its chief executive officer (or equivalent officer) certify annually,⁶ as set forth in IM-3013, that the member has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules and federal securities laws and regulations, and that the chief executive officer has conducted one or more meetings with the chief compliance officer in the preceding 12 months to discuss such processes.

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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

⁶ Rule 3013 and IM-3013 became effective on December 1, 2004, which would require a member's first certification to be executed by December 1, 2005 and annually thereafter; however, a member may elect to execute its first certification by no later than April 1, 2006 and annually thereafter.

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

Rule 3013 requires that each member's chief executive officer ("CEO"), or other equivalent officer, certify annually according to the terms set forth in IM-3013 that the member has in place processes to establish, maintain, review, test and modify its written supervisory procedures. The first annual certification is currently due by December 1, 2005.⁷ Before a CEO can complete the annual certification requirement, IM-3013 requires, among other things, that the CEO, chief compliance officer ("CCO"), and any other necessary officers review a report that evidences the member's processes.

Rule 3012(a)(1) requires, among other things, that each member submit to its senior management no less than annually a report detailing its supervisory controls system that will test and verify the adequacy of its supervisory procedures, the summary of the test results, and any additional or amended supervisory procedures created in response to the test results. Currently, members must complete and submit the report by January 31, 2006 and at least annually thereafter.⁸

Since the adoption of these rules, NASD has received a number of inquiries from members regarding whether the reports required by Rule 3012 and IM-3013 could be

⁷ Each ensuing annual certification must be effected no later than on the anniversary date of the previous year's certification. *See* IM-3013, n.1.

⁸ See Notice to Members 04-71 (October 2004) (announcing, among other things, the effective date of January 31, 2005); *see also* Transcript of December 16, 2004 Call-in Workshop ("Transcript") reminding members that Rule 3012 Report is due within one year of the January 31, 2005 effective date and at least annually thereafter. The Transcript is available at www.nasd.com/SupervisoryControl.

combined. Although NASD has advised members that they may combine the Rule 3012 report with the report required by IM-3013 as long as all of the required elements of the respective reports are addressed and clearly identified, members have indicated that it would be difficult to combine the reports since the first annual certification required by Rule 3013 must be executed by December 1, 2005 (and thus the related report must be prepared in advance of, but reasonably close in time to, such execution), while the Rule 3012 report is not required to be submitted until January 31, 2006.

In addition, dual members have inquired whether they can combine the reports required by Rule 3012 and IM-3013 with the Annual Report required by NYSE Rule 342.30, which is due by April 1st of each year. As support for their request, dual members have noted that the NYSE Rule 342.30 Annual Report mandates similar, though not identical, requirements as the Rule 3012 report. Dual members have also noted that IM-3013 specifically provides that the IM-3013 report may be combined with any other compliance or other similar report required by another self-regulatory organization. Dual members assert that being able to complete one report instead of being required to complete three reports that could cover overlapping topics and issues would prevent the duplication of significant resources. However, because of the disparate dates by which the three reports must be completed, the dual members have indicated that it would be nearly impossible to combine the reports.⁹

⁹ It should be noted that Rule 3012(b) provides that any dual member electing to comply with the substantially similar requirements of the NYSE shall be deemed in compliance with the provisions of Rule 3012. A dual member must comply with all of the NYSE's substantially similar requirements to be considered in compliance with Rule 3012. Accordingly, any dual member electing to comply with the substantially similar requirements of the NYSE would comply with Rule 3012's reporting requirement by completing the NYSE Rule 342.30 Annual Report. The member, however, would still be required to complete the report required by IM-3013 prior to the initial certification date required by Rule 3013 and IM-3013.

Accordingly, NASD is filing this proposed rule change to address those issues. Specifically, the proposed rule change will amend Rule 3012 to provide that a member may submit its initial Rule 3012 report by no later than April 1, 2006. The proposed rule change explains that due to Rule 3012's January 31, 2005 effective date, a member choosing to rely on any date after January 31, 2005 through April 1, 2006 as the submission deadline for its initial Rule 3012 report will have to encompass the period from January 31, 2004 up to that submission date (or a reasonable period of time immediately preceding the submission date). Each ensuing Rule 3012 report must encompass the 12 months following the previous Rule 3012 report (or such shorter time period if a member elects to prepare a report more frequently than annually).

Additionally, the proposed rule change will amend Rule 3013 and IM-3013 to provide that a member may execute its first annual certification by no later than April 1, 2006 and annually thereafter. A member should keep in mind that the report required by IM-3013 that evidences the member's processes must be prepared in advance of, but reasonably close in time to, April 1, 2006.

As a result of these proposed changes members will be able, if they so choose, to combine the respective reports, provided the single report clearly identifies and addresses all of the requirements set forth in Rule 3012, Rule 3013 and IM-3013. The proposed rule change will also allow dual members to comply with the respective reporting requirements of Rule 3012, Rule 3013, IM-3013, and NYSE Rule 342.30 without undue duplication of effort.

NASD has filed the proposed rule change for immediate effectiveness and has requested that the Commission waive the 5-day pre-filing requirement and the 30-day

period for the proposed rule change to become operative, in order to allow NASD members to have as much time as possible to adjust their procedures to the new submission dates for the initial Rule 3012 report and the initial certification required by Rule 3013 and IM-3013. The effective date and the implementation date will be the date of filing, October 14, 2005.

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 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 synchronizing the date of the report required by Rule 3012 and the date of execution of the certification required by Rule 3013 and IM-3013 will reasonably serve to minimize duplication of effort on the part of members, while still ensuring the protection of investors.

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

The foregoing proposed rule change is subject to Section 19(b)(3)(A)(iii) of the

Act¹⁰ and Rule 19b-4(f)(6) thereunder¹¹ because the proposal (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the self-regulatory organization has given the Commission notice of its intent to file the proposed rule change, along with a brief description of the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

NASD has requested that the Commission waive the five-day pre-filing requirement and the 30-day operative delay so that the proposed rule change will become immediately effective upon filing. The Commission believes that waiving the five-day pre-filing provision and the 30-day operative delay is consistent with the protection of investors and the public interest.¹² Waiving the pre-filing requirement and accelerating the operative date will merely permit the immediate implementation of changes that will allow firms to more efficiently discharge their reporting obligations. For these reasons, the Commission designates the proposed rule change as effective and operative immediately.

¹⁰ 15 U.S.C. 78s(b)(3)(A)(iii).

¹¹ 17 CFR 240.19b-4(f)(6).

¹² For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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. Please include File Number SR-NASD-2005-121 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-121. 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, 100 F Street, NE, 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-2005-121 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.¹³

Jonathan G. Katz
Secretary

¹³ 17 CFR 200.30-3(a)(12).