February 5, 2004

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: File No. SR-NASD-2003-176 – Proposed Rule: Chief Compliance Officer Annual Certification (the "Proposed Rule")

Dear Mr. Katz:

This comment letter, in response to the above-referenced Proposed Rule, is submitted on behalf of the National Society of Compliance Professionals, Inc. ("NSCP")

NSCP is the largest organization of securities industry professionals devoted exclusively to compliance. Since its founding in 1987, it has grown to over 1,250 members. The constituency from which its membership is drawn is unique. While compliance and legal personnel from the largest brokerage and investment management firms are counted among its ranks, the membership is more diverse than those of other similar non-profit organizations. NSCP's membership is drawn from traditional broker-dealers, investment advisers, bank and insurance affiliated firms, as well as the Law, Accounting and Consulting firms that serve them.

The NSCP appreciates the opportunity to comment on the revised proposed regulation, insofar as it concerns the proposed Chief Compliance Officer ("CCO") certification. Under the present formulation, the certification has been reframed to address the adequacy of the processes to establish and maintain policies and procedures designed to effect compliance, and the procedures in place to test them. While this is an improvement over the version that our prior (July 9, 2003) comment letter addressed, it does not resolve the fundamental issues we raised. We reiterate our view that it would be more prudent to delay the consideration of the imposition of a CCO certification until the effectiveness of other new and recent measures can be evaluated. The rationale, which is set out in detail in our earlier comment letter, is that the benefit of the certification is highly questionable and unlikely to improve upon the benefits already in play from other new and recent measures. The compliance costs of the CCO certification are, on the other hand, prohibitively high. Indeed, we believe the process will adversely impact both the influence of compliance officers as well as the breadth of the compliance function.

Our earlier letter, which is provided as an attachment, reviewed the role of compliance officers, and how the wide variation in the degree of their influence and the scope of their activity in different firms would make a generic certification problematic. In fact, the process would encourage compliance officers to narrowly define both their own roles and the reach of the various compliance regulations they seek to have their firms address. The ability of compliance officers to endorse novel approaches to new business or regulatory challenges would be compromised by a certification process that would only

aggravate an already unfortunate tendency for compliance personnel to be included as targets in civil litigation. We also pointed out that the large variance of what the compliance function is, from firm to firm, would preclude even the kind of uniform assessment that a CFO certification, subject to broadly employed financial standards, would offer. We need to avoid new regulations that would reduce the efficacy of the compliance function for such dubious value.

For all of these reasons, our initial comment letter applies equally to the current proposal regarding a CCO certification. However, then, as now, there are other parts of the proposal, such as the identification of the Chief Compliance Officer, that are constructive and which we support. We believe, for example, that strengthening an annual reporting process, and furthering the interaction between executive management and the Chief Compliance Officer (who may not be part of executive management) are positive steps and we fully endorse them. Similarly, the requirement that firms specifically establish the responsibility and accountability of supervisors for various parts of their businesses reflects the kind of pointed and effective measures that help the industry better effect compliance, and we similarly enthusiastically endorse those aspects of the regulatory framework.

Conclusion

We appreciate your consideration of our comments and recommendations. While we agree that strengthening the annual reporting process and furthering the interaction between executive management and the Chief Compliance Officer are positive steps, we believe that the CCO certification requirement would not be productive. We further believe that in the very least, it would be more prudent to delay the consideration of the imposition of a CCO certification until the NASD's experience with other new and recent measures can be evaluated.

Sincerely,

The National Society of Compliance Professionals, Inc.

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July 9, 2003

Via US Postal Overnight and Email Delivery

Ms. Barbara Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Re: Comments on Proposed Amendments to NASD Rule 3010; Proposed IM-3010-1; and Notice to Members 03-29 – Certification by Chief Executive Officer and Chief Compliance Officer

Dear Ms. Sweeney:

The National Society of Compliance Professionals ("NSCP") appreciates the opportunity to comment on the rule proposed by the National Association of Securities Dealers, Inc. ("NASD") that would require NASD member firms to designate a chief compliance officer ("CCO") who, jointly with the member firm's Chief Executive Officer ("CEO"), would be required to certify annually that the member has in place adequate compliance and supervisory policies and procedures (the "Proposed Rule").

The Proposed Rule is of considerable interest to the NSCP and its members. The NSCP is the largest organization of securities industry professionals devoted exclusively to compliance issues, effective supervision, and oversight. The principal purpose of NSCP is to enhance compliance in the securities industry, including firms' compliance efforts and programs and to further the education and professionalism of the individuals implementing those efforts. An essential mission of the NSCP is to instill in its members the importance of developing and implementing sound compliance programs.

Since its founding in 1987, the NSCP has grown to over 1,250 members, and the breadth of the constituency from which its membership is drawn is unique. The NSCP membership is drawn principally from traditional broker-dealers, investment advisers, bank and insurance affiliated firms, as well as the law firms, accounting firms, and consultants that serve them. The vast majority of NSCP members are compliance and legal personnel, and the broker-dealer members of the NSCP span a wide spectrum of firms, from the largest brokerage firms to those operations with only a handful of employees or independent contractor representatives. The diversity of our membership allows the NSCP to represent a large variety of perspectives in the brokerage industry.

The NSCP strongly supports the NASD's efforts to enhance and strengthen compliance programs at broker-dealers, but nevertheless is concerned about the Proposed Rule's requirement for CCO certification. In particular, the NSCP is concerned that the Proposed Rule would alter the CCO's roles and responsibilities within a broker-dealer in ways that would be detrimental and could expose CCOs to new, unwarranted, and fundamentally unfair personal liability. The NSCP respectfully suggests that other measures are more likely to achieve the stated objective of improving compliance efforts at broker-dealers without the undesirable consequences of the Proposed Rule.

I. Certification Requirements Are Intended to Increase Personal Liability: Compliance Professionals Should Not Be Subjected to Greater Personal Liability

The CEOs and Chief Financial Officers ("CFOs") of public companies have been required to certify to the accuracy of their company's public filings since the adoption of the Sarbanes-Oxley Act last year. The purpose of these certification requirements is precisely to expand the personal liability of CEOs and CFOs for false filings. In particular, the certification requirement was triggered by the Congressional testimony of Jeffery Skilling, Enron's former CEO, who repeatedly claimed that he was uninvolved with and unaware of improper transactions at Enron. Thus, the:

> purpose of the new management certification requirement is to prevent CEOs and CFOs from using this defense in private securities litigation or SEC enforcement proceedings to defeat liability on *scienter* grounds – in other words, to require that the CEO and CFO become sufficiently personally involved in the preparation of SEC annual and quarterly reports that their personal liability under the securities laws for material misstatements or materially misleading statements can be readily established once the materiality of the defective statement is proved. A related purpose is to seek to restore investor confidence in those reports through greater management accountability.[1]

In the highly litigious world of broker-dealer regulation, there is no comparable case to be made for increasing the personal liability of compliance professionals who, based on the record, are already trying to improve compliance in their firms. They are already frequently named in complaints unjustifiably in a reflexive manner. Creating another path of liability through certification is unwise. This additional vehicle for personal liability of compliance professionals is unwarranted and does not improve the quality of compliance at broker-dealers.

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[1] *The Sarbanes-Oxley Deskbook* at 4-5, Bostelman (P.L.I. 2003).

Compliance professionals are different from CEOs and CFOs in numerous respects, all of which militate against an expansion of the personal liability of CCOs:

1. Compliance professionals are typically not part of senior management and, thus, lack the power to control the operations of their firms. They may lack sufficient authority or responsibility, or may even be unable to gather sufficient information, to permit them to evaluate compliance efforts in certain areas. CEOs and CFOs are empowered to control their companies and thus are more appropriate targets for certifications that increase personal liability. CCOs work to ensure that proper procedures are in place and make recommendations to management as to the application of the procedures and the results of reviews where procedures are either not being followed, or are being violated. If management chooses, in the exercise of business judgment, not to follow these recommendations, CCOs generally lack the authority to force management to adopt the recommendations.

   CCOs cannot, typically, hire and fire non-compliance personnel or control the day-to-day operations of the firm. Decisions about the firm's business are typically made by management, not CCOs. Correspondingly, the SRO disciplinary approach has been to prosecute compliance officers only insofar as they have actually engaged in supervisory activity. This prudent judgment would be effectively compromised by the proposed certification.

2. Compliance professionals seldom, if ever, profit personally from misconduct at their firms, whereas CEOs and CFOs typically have their compensation more directly tied to firm profits, and thus are more likely to actually profit personally from their firm's misdeeds. Developing a system that will impose personal liability on professionals who neither control improper conduct nor are likely to profit from it is merely punitive, without creating any effective deterrent to violative activity.

3. While evidence exists that from time to time some CEOs and CFOs have attempted to evade responsibility for their misconduct, virtually no such evidence exists against compliance professionals. As stated earlier, in the highly litigious world of broker-dealer regulation, the case has not been made for increasing the personal liability of professionals who, based on the record, are already trying to improve their firms.

4. Unlike CEOs and CFOs, CCOs have responsibilities that vary widely from firm to firm. An increased personal liability will reduce and undercut any broad independent compliance role which many firms need in light of the current regulatory environment. The Proposed Rule could change the nature of the compliance role by motivating firms and their CCOs to define it more narrowly, and thus less likely to impart exposure. This

result would be exactly contrary to the stated goals of the proposed amendment.

II. The Absence of Clearly Defined Standards for Effective Compliance Renders the Proposed Certifications by CCOs Unreasonable

The Proposed Rule attempts to address the concern that CCO certification will increase CCO personal liability, but the purported protection against personal liability is unlikely to be effective. In particular, the Notice to Members that accompanies the Proposed Rule states "that no liability under the proposed rule or other NASD rule will attach to the signatories of the certification, provided there was a reasonable basis to certify at the time of execution."

This statement illustrates a fundamental defect in the Proposed Rule – since there are no clearly accepted standards for evaluating the "adequacy" of compliance systems, there is no delineation of specific parameters to ascertain whether a "reasonable basis" existed at the time of the certification for evaluating whether a CCO's review of the "adequacy" of those systems was "reasonable." Similarly, the proposed rule creates a profound incentive for the CCO to be less creative in approaching compliance, since efforts which improve the firm's compliance may also expand the apparent certification responsibility.

In contrast, financial reporting is governed by a complex body of standards created by the accounting profession and elaborated by professional organizations and the SEC. Non-financial reporting by public companies is governed by the complex standards established by law with interpretive guidance from both the SEC and the courts. No such body of clearly defined standards exists for compliance systems. Nor is there a professional or regulatory organization that interprets and clearly defines when compliance systems are "adequate."

In the absence of well defined duties and standards for evaluating a system of compliance, there is no clear standard for evaluating whether the review of the "adequacy" of those systems is "reasonable." Stated differently, an honest CCO has no clear standard of reference to determine whether compliance systems at a firm are "adequate" and, therefore, whether a review of the "adequacy" of those systems is "reasonable."

III. The Proposed Certifications Could Actually Diminish the Effectiveness of CCOs

Since standards of effective compliance are still evolving, it is important to permit CCOs to experiment and to permit them the freedom to work to constantly adjust and improve their firm's compliance systems. The Proposed Rule would interfere with this process by forcing CCOs to commit to the "adequacy" of their firm's compliance systems. Once this commitment is made in a filed certification, it will be difficult for CCOs to recommend changes in compliance systems without appearing to admit that past systems were inadequate. This will tend to freeze the evolution of compliance systems, which is an undesirable result since the effectiveness of different compliance systems is still being tested through trial and error. The CCO and the firm will be strongly biased to

be conservative and unduly narrowly focused in meeting new regulatory standards, because there can be no "trial and error" without some "errors."

The Proposed Rule also transforms the CCO into a "verifier," similar to an outside auditor or attorney rendering a legal opinion. NSCP is concerned that this "verifier" role will actually diminish the free flow of information between senior management and compliance professionals since the "verifier" may be unwilling to "verify" if problems are identified and questions are raised about the adequacy of procedures. The relationship between outside auditors, a classic "verifier," and public companies is unavoidably adversarial and a poor model for the type of communication and mutual trust that can enhance the effectiveness of compliance professionals. The NSCP is concerned that CCO certifications will reduce, rather than increase, open communication between CCOs and senior management.

In addition, absent a clear standard of reference, a CCO could repeatedly become a respondent or a witness in litigation/arbitration, being asked to justify the "reasonableness" of the determination that compliance systems are "adequate." This could ultimately be a very tedious, disruptive, and in a downward moving economy, frequent process that would keep the CCO away from the office and make it more difficult to achieve the stated objective of improving compliance efforts at broker-dealers. Further, it could lead a CCO to be far less aggressive in stating a view that a compliance procedure might be improved, for fear of thus elevating the standard against which the CCO is measured, or being seen to have inadequate historic compliance systems.

IV. The NSCP Supports the Requirements for Designation of a CCO and Recommends Further Study of the Practicality and Value of CEO Certification

The NSCP supports the proposal to require every NASD member to designate a chief compliance officer, although the NSCP notes that such designation is already required on Form BD. It is unclear that the Proposed Rule would alter current practices.

While our comments are directed to CCO certifications, we wish to make the observation that the approach for CEO certifications may be somewhat premature. The NASD should consider waiting to see the impact of new and proposed similar measures before imposing another (certification) requirement. In the last year, significant regulatory changes have occurred regarding the securities industry and other public companies, notably through Sarbanes Oxley and the proposed amendments to NASD 3010 and NYSE 472. Sarbanes Oxley calls for certifications for public companies, and the proposed amendments call for procedures which actively monitor whether supervisory procedures are effective and implemented. Each of these procedures has a cost and a benefit -- presumably each provides an extra measure of control, but each also inevitably diverts resources from the process by which firms are managed. Because the proposed amendments and the Sarbanes Oxley certifications are so new -- the amendments are not yet even in place -- we suggest that it would be prudent first to evaluate how these measures actually work before placing even more burdens on firms' supervisory and compliance systems. There will be time enough, after audits have taken place when the proposed amendments are implemented, to determine what more needs to be done.

There will also be, in the context of the audit experience, the prospect of putting in place more tailored procedures, insofar as they would be productive. Once a certification rule is in place, it is highly unlikely to be rescinded, and we will all lose the opportunity to use more effectively the resources the rule will consume. It is better to wait to evaluate the usefulness of such a rule, in light of how the new and pending rules actually impact brokers.

SUMMARY

For the reasons set forth above, NSCP opposes the CCO certification requirements, supports the designation of a CCO, and urges the NASD to consider further the CEO certification proposal. The NSCP shares the NASD's concerns about the quality of compliance efforts at member firms and supports innovations to improve those compliance efforts. In this regard, with so many innovations recently proposed and adopted, the NSCP encourages the NASD to establish a blue ribbon task force to study how member firms can enhance their compliance efforts. Such a blue ribbon task force could also review the efficacy of innovations that have already been implemented, so that the best innovations can be further exploited and the worst innovations can be quickly modified. The NSCP and its members would be happy to assist such a blue ribbon task force, the compliance enhancement project, in its efforts.

Very truly yours,

Joan Hinchman
Executive Director, President and CEO