

## Conduct Rules

### 3000. RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS, EMPLOYEES, AND OTHERS" EMPLOYEES

#### 3010. Supervision

##### (a) Supervisory System

Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of this Association. Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

- (1) The establishment and maintenance of written procedures as required by paragraphs (b) and (c) of this Rule.
- (2) The designation, where applicable, of an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker/dealer is required.
- (3) The designation as an office of supervisory jurisdiction (OSJ) of each location that meets the definition contained in paragraph (g) of this Rule. Each member shall also designate such other OSJs as it determines to be necessary in order to supervise its registered representatives and associated persons in accordance with the standards set forth in this Rule, taking into consideration the following factors:
  - (A) whether registered persons at the location engage in retail sales or other activities involving regular contact with public customers;
  - (B) whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from, such location;
  - (C) whether the location is geographically distant from another OSJ of the firm;
  - (D) whether the member's registered persons are geographically dispersed; and
  - (E) whether the securities activities at such location are diverse and/or complex.
- (4) The designation of one or more appropriately registered principals in each OSJ, including the main office, and one or more appropriately registered representatives or principals in each non-OSJ branch office with authority to carry out the supervisory responsibilities assigned to that office by the member.
- (5) The assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities.
- (6) Reasonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities.
- (7) The participation of each registered representative, either individually or collectively, no less than annually, in an interview or meeting conducted by persons designated by the member at which compliance matters relevant to the activities of the representative(s) are discussed. Such interview or meeting may occur in conjunction with the discussion of other matters and may be conducted at a central or regional location or at the representative's(') place of business.
- (8) Each member shall designate and specifically identify to the Association one or more principals who shall review the supervisory system, procedures, and inspections implemented by the member as required by this Rule and take or recommend to senior management appropriate action reasonably designed to achieve the member's compliance with applicable securities laws and regulations, and with the Rules of this Association.

##### (b) Written Procedures

- (1) Each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably

designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of this Association.

(2) Tape recording of conversations

(A) Each member that either is notified by NASD Regulation or otherwise has actual knowledge that it meets one of the criteria in paragraph (b)(2)(H) relating to the employment history of its registered persons at a Disciplined Firm as defined in paragraph (b)(2)(J) shall establish, maintain, and enforce special written procedures for supervising the telemarketing activities of all of its registered persons.

(B) The member must establish and implement the supervisory procedures required by this paragraph within 60 days of receiving notice from NASD Regulation or obtaining actual knowledge that it is subject to the provisions of this paragraph.

A member that meets one of the criteria in paragraph (b)(2)(H) for the first time may reduce its staffing levels to fall below the threshold levels within 30 days after receiving notice from NASD Regulation pursuant to the provisions of paragraph (b)(2)(A) or obtaining actual knowledge that it is subject to the provisions of the paragraph, provided the firm promptly notifies the Department of Member Regulation, NASD Regulation, in writing of its becoming subject to the Rule. Once the member has reduced its staffing levels to fall below the threshold levels, it shall not rehire a person terminated to accomplish the staff reduction for a period of 180 days. On or prior to reducing staffing levels pursuant to this paragraph, a member must provide the Department of Member Regulation, NASD Regulation with written notice, identifying the terminated person(s).

(C) The procedures required by this paragraph shall include tape-recording all telephone conversations between the member's registered persons and both existing and potential customers.

(D) The member shall establish reasonable procedures for reviewing the tape recordings made pursuant to the requirements of this paragraph to ensure compliance with applicable securities laws and regulations and applicable rules of the Association. The procedures must be appropriate for the member's business, size, structure, and customers.

(E) All tape recordings made pursuant to the requirements of this paragraph shall be retained for a period of not less than three years from the date the tape was created, the first two years in an easily accessible place. Each member shall catalog the retained tapes by registered person and date.

(F) Such procedures shall be maintained for a period of three years from the date that the member establishes and implements the procedures required by the provisions of this paragraph.

(G) By the 30th day of the month following the end of each calendar quarter, each member firm subject to the requirements of this paragraph shall submit to the Association a report on the member's supervision of the telemarketing activities of its registered persons.

(H) The following members shall be required to adopt special supervisory procedures over the telemarketing activities of their registered persons:

- A firm with at least five but fewer than ten registered persons, where 40% or more of its registered persons have been associated with one or more Disciplined Firms in a registered capacity within the last three years;
- A firm with at least ten but fewer than twenty registered persons, where four or more of its registered persons have been associated with one or more Disciplined Firms in a registered capacity within the last three years;
- A firm with at least twenty registered persons, where 20% or more of its registered persons have been associated with one or more Disciplined Firms in a registered capacity within the last three years.

For purposes of the calculations required in subparagraph (H), firms should not include registered persons who:

- (1) have been registered for an aggregate total of 90 days or less with one or more Disciplined Firms within the past three years; and
- (2) do not have a disciplinary history.

(I) For purposes of this Rule, the term "registered person" means any person registered with the Association as a representative, principal, or assistant representative pursuant to the Rule 1020, 1030, 1040, and 1110 Series or

pursuant to Municipal Securities Rulemaking Board ("MSRB") Rule G-3.

(J) For purposes of this Rule, the term "disciplined firm" means either a member that, in connection with sales practices involving the offer, purchase, or sale of any security, has been expelled from membership or participation in any securities industry self-regulatory organization or is subject to an order of the Securities and Exchange Commission revoking its registration as a broker/dealer; or a futures commission merchant or introducing broker that has been formally charged by either the Commodity Futures Trading Commission or a registered futures association with deceptive telemarketing practices or promotional material relating to security futures, those charges have been resolved, and the futures commission merchant or introducing broker has been closed down and permanently barred from the futures industry as a result of those charges; or a futures commission merchant or introducing broker that, in connection with sales practices involving the offer, purchase, or sale of security futures is subject to an order of the Securities and Exchange Commission revoking its registration as a broker or dealer.

(K) For purposes of this Rule, the term "disciplinary history" means a finding of a violation by a registered person in the past five years by the Securities and Exchange Commission, a self-regulatory organization, or a foreign financial regulatory authority of one or more of the provisions (or comparable foreign provision) listed in IM-1011-1 or rules or regulations thereunder.

(L) Pursuant to the Rule 9600 Series, the Association may in exceptional circumstances, taking into consideration all relevant factors, exempt any member unconditionally or on specified terms and conditions from the requirements of this paragraph upon a satisfactory showing that the member's supervisory procedures ensure compliance with applicable securities laws and regulations and applicable rules of the Association.

(3) The member's written supervisory procedures shall set forth the supervisory system established by the member pursuant to paragraph (a) above, and shall include the titles, registration status and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and the Rules of this Association. The member shall maintain on an internal record the names of all persons who are designated as supervisory personnel and the dates for which such designation is or was effective. Such record shall be preserved by the member for a period of not less than three years, the first two years in an easily accessible place.

(4) A copy of a member's written supervisory procedures, or the relevant portions thereof, shall be kept and maintained in each OSJ and at each location where supervisory activities are conducted on behalf of the member. Each member shall amend its written supervisory procedures as appropriate within a reasonable time after changes occur in applicable securities laws and regulations, including the Rules of this Association, and as changes occur in its supervisory system, and each member shall be responsible for communicating amendments through its organization.

### **(c) Internal Inspections**

Each member shall conduct a review, at least annually, of the businesses in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with the Rules of this Association. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction. Each branch office of the member shall be inspected according to a cycle which shall be set forth in the firm's written supervisory and inspection procedures. In establishing such cycle, the firm shall give consideration to the nature and complexity of the securities activities for which the location is responsible, the volume of business done, and the number of associated persons assigned to the location. Each member shall retain a written record of the dates upon which each review and inspection is conducted.

### **(d) Review of Transactions and Correspondence**

#### **(1) Supervision of Registered Representatives**

Each member shall establish procedures for the review and endorsement by a registered principal in writing, on an internal record, of all transactions and for the review by a registered principal of incoming and outgoing written and electronic correspondence of its registered representatives with the public relating to the investment banking or securities business of such member. Such procedures should be in writing and be designed to reasonably supervise each registered representative. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available to the Association upon request.

#### **(2) Review of Correspondence**

Each member shall develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing written (i.e., non-electronic) and electronic correspondence with the public relating to its investment banking or securities business, including procedures to review incoming, written correspondence directed to registered representatives and related to the member's investment banking or securities business to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with firm procedures. Where such procedures for the review of correspondence do not require review of all correspondence prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing correspondence, documentation of such education and training, and surveillance and follow-up to ensure that such procedures are implemented and adhered to.

### (3) Retention of Correspondence

Each member shall retain correspondence of registered representatives relating to its investment banking or securities business in accordance with Rule 3110. The names of the persons who prepared outgoing correspondence and who reviewed the correspondence shall be ascertainable from the retained records and the retained records shall be readily available to the Association, upon request.

### **(e) Qualifications Investigated**

Each member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications, and experience of any person prior to making such a certification in the application of such person for registration with this Association. Where an applicant for registration has previously been registered with the Association, the member shall review a copy of the Uniform Termination Notice of Securities Industry Registration (Form U-5) filed with the Association by such person's most recent previous NASD member employer, together with any amendments thereto that may have been filed pursuant to Article V, Section 3 of the Association's By-Laws. The member shall review the Form U-5 as required by this Rule no later than sixty (60) days following the filing of the application for registration or demonstrate to the Association that it has made reasonable efforts to comply with the requirement. In conducting its review of the Form U-5 and any amendments thereto, a member shall take such action as may be deemed appropriate.

Where an applicant for registration has been previously registered with a registered futures association ("RFA") member that is or has been registered as a broker/dealer pursuant to Section 15(b)(11) of the Act ("notice-registered broker/dealer") with the SEC to trade security futures, the member shall review a copy of the Notice of Termination of Associated Person (Form 8-T) filed with the RFA by such person's most recent previous RFA member employer, together with any amendments thereto. The member shall review the Form 8-T as required by this Rule no later than sixty (60) days following the filing of the application for registration or demonstrate to the Association that it has made reasonable efforts to comply with the requirement. In conducting its review of a Form 8-T and any amendments, a member shall take such action as may be deemed appropriate.

### **(f) Applicant's Responsibility**

Any applicant for registration who receives a request for a copy of his or her Form U-5 from a member pursuant to this Rule shall provide such copy to the member within two (2) business days of the request if the Form U-5 has been provided to such person by his or her former employer. If a former employer has failed to provide the Form U-5 to the applicant for registration, such person shall promptly request the Form U-5, and shall provide it to the requesting member within two (2) business days of receipt thereof. The applicant shall promptly provide any subsequent amendments to a Form U-5 he or she receives to the requesting member.

### **(g) Definitions**

(1) "Office of Supervisory Jurisdiction" means any office of a member at which any one or more of the following functions take place:

- (A) order execution and/or market making;
- (B) structuring of public offerings or private placements;
- (C) maintaining custody of customers' funds and/or securities;
- (D) final acceptance (approval) of new accounts on behalf of the member;
- (E) review and endorsement of customer orders, pursuant to paragraph (d) above;

(F) final approval of advertising or sales literature for use by persons associated with the member, pursuant to Rule 2210(b)(1); or

(G) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

(2) "Branch Office" means any location identified by any means to the public or customers as a location at which the member conducts an investment banking or securities business, excluding:

(A) any location identified in a telephone directory line listing or on a business card or letterhead, which listing, card, or letterhead also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly supervised;

(B) any location referred to in a member advertisement, as this term is defined in Rule 2210, by its local telephone number and/or local post office box provided that such reference may not contain the address of the non-branch location and, further, that such reference also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch location are directly supervised; or

(C) any location identified by address in a member's sales literature, as this term is defined in Rule 2210, provided that the sales literature also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly supervised.

(D) any location where a person conducts business on behalf of the member occasionally and exclusively by appointment for the convenience of customers, so long as each customer is provided with the address and telephone number of the branch office or OSJ of the firm from which the person conducting business at the non-branch location is directly supervised.

(3) A member may substitute a central office address and telephone number for the supervisory branch office or OSJ locations referred to in paragraph (g)(2) above provided it can demonstrate to the Association's District Office having jurisdiction over the member that it has in place a significant and geographically dispersed supervisory system appropriate to its business and that any investor complaint received at the central site is provided to and resolved in conjunction with the office or offices with responsibility over the non-branch business location involved in the complaint.

[Amended eff. June 12, 1989; Apr. 30, 1992; amended by SR-NASD-97-41 eff. Sept. 4, 1997; amended by SR-NASD-97-24 eff. Feb. 15, 1998; amended by SR-NASD-98-10 postponed eff. date; amended by SR-NASD-98-31 eff. Apr. 7, 1998, postponed eff. date of provision in Notice to Members 98-11; amended by SR-NASD-98-45 postponed eff. date of provision in Notice to Members 98-11; amended by SR-NASD-97-69 eff. Aug. 17, 1998; amended by SR-NASD-98-86 eff. Nov. 19, 1998; amended by SR-NASD-98-52 eff. March 15, 1999; amended by SR-NASD-99-28 eff. Aug. 16, 1999; amended by SR-NASD-2002-04 eff. Oct. 14, 2002; amended by SR-NASD-2002-40 eff. Oct. 15, 2002.]

Selected Notices to Members: 86-65, 88-84, 89-34, 89-57, 92-18, 96-33, 96-59, 96-82, 98-11, 98-52, 99-03.

#### **Selected SEC Decisions**

**Juan Carlos Schidlowski, SEC Rel. No. 34-23347 (1986).**

**Wedbush Securities, Inc. (f/k/a Wedbush Noble, Cooke, Inc.), SEC Rel. No. 34-25504 (1988).**

**Seco Securities, Inc. and Stanley Richards, SEC Rel. No. 34-26054 (1988).**