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A legal update from Dechert's Financial Services Group

SEC Approves Changes to NASD and NYSE Supervision and Related Rules

The SEC has approved a series of rules and rule amendments of the NASD and the New York Stock Exchange, Inc. ("NYSE") that are designed to strengthen the supervisory and supervisory control procedures of member firms. Effective December 17, 2004 for NYSE member firms, and January 31, 2005 for NASD member firms, the new rules and rule amendments broadly will require broker-dealer members of these self-regulatory organizations ("SROs") to:

- Develop and enforce a system of supervisory control policies and procedures that cause the firm to test and verify that its supervisory procedures are reasonably designed to achieve compliance with applicable federal securities laws and applicable SRO rules;
- Comply with new, detailed amendments to existing rules that require office inspections to be conducted by independent persons and include, among other things, testing and verification of supervisory policies and procedures;
- Place account names or designations on the memorandum for each transaction before customer orders are executed, and comply with new rules governing the process for changing account names and designations;
- Limit the time period that a member may hold customer mail; and
- Comply with new limitations on time and price discretionary authority.¹

Both SROs proposed these rules and rule amendments in late 2002 in response to the *Gruttaduria* case, which involved a branch manager's misappropriation of approximately \$40 million in customer funds.² This legal update discusses the new rules and rule amendments and their impact on the supervisory systems of member firms.

Background and History

The Gruttaduria Case

Frank D. Gruttaduria was a former branch manager of the Cleveland, Ohio office of a major broker-dealer. He previously had served in senior managerial roles with SG Cowen Securities Corp and its predecessor, Cowen & Co., and several other broker-dealers.

In a January 11, 2002 letter to the Federal Bureau of Investigation, Gruttaduria admitted that he had "caused misappropriation [of client assets] through various methods which resulted in other violations" over the course of a 15-year period.³ Later investigations by the Securities and Exchange Commission and the Federal

2004) (NASD). NASD amended the proposal three times to address commentators' concerns.

² See *In re Frank D. Gruttaduria*, SEC Lit. Release No. 17590 (June 27, 2002).

³ *Id.*

Bureau of Investigation revealed the vast extent of Gruttaduria's illegal conduct. Immediately prior to his written *mea culpa*, the last falsified account statements that Gruttaduria had sent to clients showed that their accounts were worth over \$285 million, when the actual statements for those accounts showed an aggregate balance of less than \$2 million. An SEC's complaint against one of Gruttaduria's describes the magnitude of Gruttaduria's fraud:

Since 1987, Gruttaduria had been defrauding dozens of customers through various means. He lied to some of those customers about purchases and sales of securities in their accounts and the performance of those accounts, often telling these customers that their accounts contained a wide variety of holdings worth millions of dollars when, in fact, the accounts contained only a few thousand dollars. He falsely told some customers that he used the funds that they deposited into their accounts to buy securities when, in fact, he misappropriated those funds. In a few instances, Gruttaduria induced customers to give him funds to open an account and simply misappropriated the funds. Gruttaduria also told a number of customers from whom he did not misappropriate funds or securities that their accounts were more valuable than the accounts actually were. When those customers sought to withdraw the inflated amounts, Gruttaduria misappropriated funds from other customer accounts to satisfy those withdrawal requests.

Although the scope of Gruttaduria's illegal activity was troubling enough, what made the case even more frustrating was that apparently no broker-dealer, SRO, or government regulator uncovered Gruttaduria's illicit activity. Gruttaduria's fraud, sustained over a period of at least 15 years, apparently was discovered only after he "blew the whistle" on himself, leaving regulators and SROs wondering whether Gruttaduria could have continued his activities for many more years without detection.⁴

⁴ Once regulators and law enforcement became aware of Gruttaduria's activities, they moved against him and his then-current and former employers with alacrity. The SEC immediately filed fraud charges against Gruttaduria and the U.S. District Court for the Northern District of Ohio granted a permanent injunction against him. See *SEC v. Frank D. Gruttaduria*, SEC Lit. Release No. 17369 (Feb. 21, 2002); *SEC v. Frank D. Gruttaduria*, SEC Lit. Release No.

Regulatory Response

In direct response to Gruttaduria's illegal acts, in late 2002 the NASD and NYSE filed with the SEC proposed rules and rule amendments relating to the establishment, maintenance and testing of internal controls and supervision of member firms, the approved versions of which are the subject of this client update.⁵ After considering numerous comments concerning, among other things, the impact of the rules and rule amendments on smaller firms, and the desire to maintain parity in the SROs' rulemaking, the NASD and NYSE filed several amendments to the proposals over the course of the next two years.⁶ The SEC approved the NASD's and NYSE's rules and rule amendments on June 17, 2004, and set a compliance date of December 17, 2004.⁷ On September 30, 2004, the SEC granted accelerated approval to additional changes to the NASD's new supervisory controls' rule, discussed herein, that more closely conform the NASD's rules to those of the NYSE.⁸

Although the new supervisory and supervisory control rules and rule amendments were proposed in response to the *Gruttaduria* case, they also are consistent with the SEC's and SROs' recent efforts to enhance and promote a "culture of compliance" by regulated financial institutions.⁹ The SEC recently implemented new rules requiring investment companies and investment advisers to implement comprehensive, risk-

17418 (March 18, 2002). Gruttaduria also pled guilty to federal mail fraud, wire fraud, identity theft and securities law charges, for which he currently is serving a seven-year sentence.

⁵ See SEC Release No. 34-46858 (Nov. 20, 2002) (Rule Filing and Amendment No. 1 of the NYSE); SEC Release No. 34-46859 (Nov. 20, 2002) (Rule Filing of the NASD).

⁶ See SEC Release No. 34-48298 (Aug. 7, 2003) (Amendments No. 1 and 2 of the NASD); SEC Release No. 34-48299 (Aug. 7, 2003) (Amendments No. 2 and 3 of the NYSE).

⁷ See SEC Release No. 34-49882 (June 17, 2004) (NYSE); SEC Release No. 34-49883 (June 17, 2004) (NASD).

⁸ See SEC Release No. 34-50477 (Sept. 30, 2004).

⁹ See Lori A. Richards, Remarks at NRS Annual Spring Compliance Conference (Apr. 14, 2004) (noting that the SEC staff has "dedicated [itself] to being more proactive, to identifying high risk conduct and taking steps to mitigate or eliminate it, before it can blow up and investors are harmed").

based compliance programs and to designate a chief compliance officer.¹⁰ More recently, the NASD implemented a new rule that required chief executive officers of firms to make a formal annual certification regarding the functioning of the firm's compliance program.¹¹ The new supervisory and supervisory control rules and rule amendments, discussed herein, are an integral part of the SEC's enhanced compliance-program driven regulatory regime.

For ease of reference, this update discusses the new and amended NASD rules, with appropriate cross-references to the similar amended rules of the NYSE.

New Supervisory Control Rules

General Requirement

New NASD Rule 3012 requires member firms to designate and specifically identify to the NASD one or more principals charged with establishing, maintaining and enforcing a system of "supervisory control policies and procedures" that:

- test and verify that a member's supervisory procedures are reasonably designed with respect to achieve compliance with the federal securities laws and NASD rules by the member, its registered representatives and associated persons; and
- create additional or amended supervisory procedures where a need for such procedures is identified by such testing.¹²

¹⁰ Compliance Programs of Investment Companies and Investment Advisers, SEC Release No. IA-2204 (Dec. 17, 2003).

¹¹ See SEC Release No. 34-50347 (Sept. 10, 2004); see also SEC Approves NASD CEO Compliance Certification Rule, Dechert Legal Update 2004-28 (Oct. 2004); *Notice to Members* 04-79 (Nov. 2004). That *Notice to Members* states that members must designate and identify to NASD on Schedule A of Form BD a principal to serve as chief compliance officer by October 1, 2004. A member's CEO must execute the certification within one year after the effective date, and annually thereafter.

¹² NASD Rule 3012(a)(1); see NYSE Rule 342(a) (requiring each office, department or business activity of members and member organizations to be under the supervision and control of the member or member organization). The NYSE interprets Rule 342(a) as requiring "supervision," i.e., "the ongoing, day-to-day review of each business activity, pursuant to reasonably designed systems and procedures, to ensure overall compliance with applicable

At least once annually, the principal(s) designated under Rule 3012 must submit a report to senior management that details the firm's supervisory control policies and procedures, summarizes the results of testing and identifies significant exceptions, and discusses additional or amended procedures implemented in response to such testing.¹³

In the *Notice to Members*, NASD stated that it "expects that the designated principals will test and verify the adequacy of the supervisory control procedures in a manner that is independent of any business considerations that are countervailing to full compliance with applicable securities laws and regulations and NASD rules."¹⁴

Independent Review of Producing Manner

Each firm's supervisory control policies and procedures must include procedures that are reasonably designed to review and supervise, on a day-to-day basis, the customer account activity of each branch office manager, sales manager, regional or district sales manager, or any person performing similar supervisory function (each a "producing manager").¹⁵ This review must be conducted by a person or persons who are senior to, or "otherwise independent" of, the producing manager.¹⁶ The NASD notes that a person is considered to be a producing manager even if the amount of

NYSE rules and the federal securities laws," and "control," i.e., "the development of these systems and procedures, and ... independent oversight and testing of them to measure and maintain their effectiveness." *Amendments to Rules 342, 401, 408 and 410 Relating to Supervision and Internal Controls*, NYSE Information Memo 04-38 (July 26, 2004) [hereinafter "NYSE Information Memo 04-38"]. See also NYSE Rule 342.23 (requiring the development of internal controls over business activities and independent testing of same).

¹³ *Id.*; see also NYSE Rule 342.30.

¹⁴ *Supervisory Controls: SEC Approves New Rules and Rule Amendments Concerning Supervision and Supervisory Controls*, *Notice to Members* 04-71, at p. 827 (Oct. 2004) [hereinafter "Notice to Members" or "NTM 04-71"].

¹⁵ NASD Rule 3012(a)(2)(A); see NYSE Rule 342.19 (similar new rule of the NYSE).

¹⁶ The NASD repealed Rule 3010(a)(8)'s requirement that firms identify principals who will review the member's supervisory system and procedure, noting that the rule would duplicate efforts required by new Rule 3012. See also NYSE Rule 342.19(a).

customer-account activity he or she conducts is *de minimis*.¹⁷

To be considered “otherwise independent” of the producing manager, the person performing the review:

- must be located at a different office than the producing manager;
- must not have supervisory authority over any of the activity under review, including not being directly compensated in whole or in part, as a result of such activity; and
- must alternate such review responsibility with another person at least once every two years.¹⁸

The NASD has cited several factors that should be considered in determining whether a person is *senior* to a producing manager. A person may be considered “senior” to a producing manager if the person “does not report to the producing manager, . . . [his or her] compensation is not determined in whole or in part by the producing manager, and . . . [he or she] is not in the same chain of authority” of the producing manager, so long as that person has the authority “to oversee, direct and correct” the producing manager’s activities and is authorized to take all necessary remedial actions, including terminating the producing manager if necessary.¹⁹

In response to numerous comments expressing concern that the rule may be too burdensome on smaller firms, NASD amended its original proposal so that the final rule provides relief to firms unable to reasonably comply with these independence requirements.²⁰ If, because of

¹⁷ See NTM 04-71, *supra* note 14, at 827.

¹⁸ NYSE Rule 342.19(a) also provides that, if the senior or otherwise independent person designated to review of producing manager:

receives an override or other income derived from that [manager’s] customer activity that represents more than 10% of the designated person’s gross income derived from the member or member organization over a rolling twelve-month period, the member or member organization must establish alternate senior or otherwise independent supervision of that [producing manager] to be conducted by a qualified person ... other than the designated person receiving the income.

¹⁹ *Id.*

²⁰ See SEC Release No. 34-49883 (June 17, 2004) (order approving proposed rule change and, *inter alia*, notice of

limitations in a firm’s size or resources, there is no person senior to or otherwise independent of a producing manager, then the reviews may be conducted by a principal who is sufficiently knowledgeable of the firm’s supervisory control procedures provided that it otherwise complies with the rules to the extent practicable.²¹ Member firms that avail themselves of this exception must document, as part of its supervisory control procedures, the factors considered when concluding that full compliance is not possible, and must discuss in their supervisory procedures how the review process otherwise complies with the rules to the fullest possible extent.²² In the *Notice to Members*, the NASD stresses that this “limited size and resources” exception is designed for firms that genuinely require this relief, and that the NASD expects firms that are able to comply with the independence requirements - in whole or in part - to do so. Says the NASD, “[f]irms that either construct their business models specifically to take advantage of the ‘limited size and resources’ exception or that have the size and resources to comply with the general requirement [but do not do so] ... will be in violation of Rule 3012.”²³

Heightened Supervision Requirements

Rule 3012 requires enhanced supervision of producing managers who are responsible for generating at least 20% of the revenue of the business which is supervised by the producing manager’s supervisor.²⁴ For the

filing and order granting accelerated approval of
Amendment No. 3).

²¹ See NASD Rule 3012(a)(2)(A)(ii); see also NYSE Rule 342.19(b) (similar rule of the NYSE).

²² See NASD Rule 3012(a)(2)(A)(iii); see also NYSE Rule 342.19(c) (similar rule of the NYSE).

²³ NTM 04-71, *supra* note 14, at 830. In approving the NASD’s rules, the SEC specified that the NASD must notify the SEC of all NASD members that avail themselves of the “limited size and resources” exception. Accordingly, the NASD also has filed a proposed rule change with the SEC that will require members to notify the NASD about whether they are availing themselves of this exception.

²⁴ See NASD Rule 3012(a)(2)(C). Firms must calculate the 20% threshold on a rolling, 12-month basis. As originally proposed by the NASD, the rule would have required enhanced supervision of each producing manager responsible for generating at least 20% of the income of the business units supervised by the manager’s supervisor. See SEC Release No. 34-46859 (Nov. 20, 2002). As amended, the final rule requires supervision of each producing manager responsible for generating at

purpose of determining the 20% threshold, firms must include all revenue generated by or credited to the producing manager or the producing manager's office, irrespective of whether the firm has a different internal process for allocating revenue. In the *Notice to Members*, the NASD stated that it regards the "20 percent threshold as a trigger for determining when a member must put in place heightened supervisory procedures," but notes that "a member may need to employ heightened supervision based on other facts and circumstances."²⁵

The "heightened supervision" of these producing managers must include implementing supervisory procedures that are "designed to avoid conflicts of interest that serve to undermine complete and effective supervision because of the economic, commercial or financial interests that the supervisor holds in the associated persons and businesses being supervised."²⁶ Examples of such "heightened" supervisory procedures may include, without limitation, the following:

- unannounced supervisory reviews;
- increasing the frequency of supervisory reviews by different reviewers within a certain time period;
- broadening the scope of activities reviewed; and
- having one or more principals approve the supervisory review of such producing manager.²⁷

In an effort to promote consistency between the NASD's and NYSE's supervisory control requirements, the rule provides that any NASD member that complies with substantially similar requirements of the NYSE shall be deemed to be in compliance with NASD Rule 3012.²⁸

Supervision of Customer Account Activity

Each firm's supervisory control policies and procedures must include procedures for heightened review of

least 20% of the revenue of the business units supervised by the manager's supervisor.

²⁵ NTM 04-71, *supra* note 14, at 828.

²⁶ NASD Rule 3012(a)(2)(C).

²⁷ NTM 04-71, *supra* note 14, at 829.

²⁸ NASD Rule 3012(b).

customer-account activity.²⁹ Policies and procedures must, at a minimum, be reasonably designed to review and monitor the following:

- All transmittals of funds and securities:
 - from customers and third-party accounts (e.g., a transmittal that would result in a change of beneficial ownership of securities or funds);
 - from customer accounts to outside entities, such as other securities firms or financial institutions;
 - from customer accounts to locations other than the customer's primary residence, including to post-office boxes and alternate addresses; and
 - between customers and registered representatives;
 - Changes of customer's address, including procedures to validate change of address; and
 - Changes in customer investment objectives, including validation of such charges.³⁰

These policies and procedures must include "a means of customer confirmation, notification, or follow-up that can be documented."

Amendments to Office Inspection Rules

Mandatory Inspection Cycles

The SEC also approved significant, detailed amendments to existing rules governing the inspection of branch offices and unregistered locations. Rule 3010(c)(1) codifies the existing obligation of firms to inspect offices of supervisory jurisdiction and supervisory branch offices on at least an annual basis.³¹

²⁹ See NASD Rule 3012(a)(2)(B).

³⁰ If a firm is not engaged in any of these activities, then the firm's supervisory control policies and procedures must note that the firm is not engaged in these activities and that the supervisory control policies and procedures must be amended before a member may engage in them. See *id.*; see also NYSE Rule 401(b) (similar rule of the NYSE).

³¹ See NASD Rule 3010(c)(1)(A); see also NASD Rule 3010(g)(1) (definition of "office of supervisory jurisdiction"); NASD Rule 3010(g)(2) (definition of "branch

It also requires firms to inspect all non-supervisory branch offices at least once every three years.³² The rule directs firms, however, to consider when it might be appropriate to conduct more frequent inspection of non-supervisory branch offices. Firms must consider several factors, including:

- The nature and complexity of a branch office's securities activities;
- The branch office's volume of business; and
- The number of associated persons assigned to the branch office.³³

In an effort to accommodate firms that inspect non-supervisory branch offices on a more frequent basis, but target only certain areas of an office's activities during an examination (e.g., sweep reviews of books-and-records compliance by all branch offices), Amended Rule 3010(c) provides firms with flexibility to design inspection programs for non-supervisory branch offices, so long as certain substantive areas (discussed in Section III.B, below) are inspected at least once every three years.³⁴ Each firm's written supervisory and inspection procedures must set forth:

- the firm's non-supervisory branch office inspection cycle;
- an explanation of the factors used to determine the frequency of the inspection cycle; and
- if the firm chooses to conduct more frequent examinations, the process used to ensure that each of the substantive areas addressed in Section III.B, below, are inspected.

office"). Rule 3010(c) already had required member firms to inspect offices of supervisory jurisdiction on at least an annual basis. Moreover, the NASD previously had stated that any office that supervises one or more unregistered offices (i.e., a supervisory branch office) should be inspected on at least an annual basis. See *NASD Provides Guidance on Supervisory Responsibilities, Notice to Members 99-45*, at p. 300 (June 1999). Both the NASD and NYSE have submitted rule filings to the SEC proposing to adopt a definition of "branch office" that is similar in all material respects. See Release No. 34-48897 (Dec. 9, 2003) (notice of rule filing).

³² NASD Rule 3010(c)(1)(B).

³³ *Id.*

³⁴ *Id.*

Amended Rule 3010(c) also requires firms to inspect non-branch locations "on a regular periodic schedule."³⁵ Each firm must document, as part of its written supervisory and inspection procedures, an explanation of how the firm determined the frequency of its examination schedule. In establishing the schedule, firms should consider the nature and complexity of the securities activities for which each non-branch location is responsible, and the frequency of customer contact at the non-branch location. In the *Notice to Members*, the NASD reminds member firms to review carefully the activities of non-branch offices to ensure that they are not operating *ipso facto* as a branch office.³⁶

Independent Office Inspections

Amended Rule 3010(c) prohibits office: inspections from being performed by

- the branch office manager;
- any person within the office who has supervisory responsibilities; or
- any individual who is directly or indirectly supervised by such person(s).³⁷

³⁵ NASD Rule 3010(c)(1)(C).

³⁶ See NTM 04-71, *supra* note 14, at 833 (observing that "Rule 3010 considers a non-branch location to be a branch office if it is responsible for supervising the activities of persons associated with a firm at one or more of the firm's non-branch locations"). The *Notice to Members* also addresses so called "locations of convenience" (e.g., a branch office of a bank affiliated with a member firm, etc.), which by definition are excluded from the definition of "branch office." The NASD has determined to require locations of convenience to be inspected on the cycle for non-branch offices, noting that "[i]f locations of convenience were excluded from the inspection requirement, it could be possible for an associated person to clandestinely conduct business at that location on a more routine basis, and perhaps to arrange to keep records of any business conducted at the location that the associated person would not want revealed to the member firm." *Id.*

³⁷ See NASD Rule 3010(c)(3). New amendments to the Interpretation Handbook regarding NYSE Rule 342 also require that persons who conduct a member organization's annual branch office inspection must be independent of the direct supervision or control of the branch office. The NYSE believes that "an independent, and therefore objective, perspective is best maintained by a person who has no interest in a branch's 'bottom line' and is outside of the branch's supervisory structure." See NYSE Information Memo 04-38.

Like Rule 3012, however, Amended Rule 3010(c) includes a “limited size and resources” exception for persons conducting office inspections. If, because of limitations in a firm’s size or resources, the firm cannot comply with this independence limitation, then the firm may have a principal “who has the requisite knowledge to conduct an office inspection” perform the office inspections.³⁸ Member firms that avail themselves of this exception must document, as part of the office inspection reports, the factors considered when concluding that “it is so limited in size and resources that it has no other alternative to comply in this manner.”³⁹ Like it did with respect to Rule 3012, the NASD directs firms to construe this exception narrowly, and warns that firms that either construct their business models specifically to take advantage of the ‘limited size and resources’ exception, or that have the size and resources to comply with the independence requirements, but do not do so, will be in violation of Rule 3010.⁴⁰

Content of Inspections and Requirements for Inspection Reports

Amended Rule 3010(c) sets forth certain areas that must be tested and verified according to the inspection cycle set forth above, and to reduce the results of each inspection to a written report. Many of the areas identified for testing and verification are to be addressed in the firm’s supervisory control policies and procedures adopted pursuant to Rule 3012.⁴¹ The report must address the results of testing and verification of policies and procedures, including supervisory policies and procedures, in at least the following areas:

- safeguarding customer funds and securities;
- maintaining books and records;
- supervising customer accounts services by branch office managers;
- transmitting funds between customers and registered representatives and between customers and third parties;

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ See NTM 04-81, *supra* note 14, at 835.

⁴¹ See NASD Rule 3012(a)(2)(B).

- validating customer address changes; and
- validating changes in customer account information.⁴²

Heightened Inspection Requirements

Like Rule 3012, Amended Rule 3010(c) requires firms to have procedures reasonably designed to provide heightened office inspections if:

- the person conducting the inspection reports to the branch office manager’s supervisor or works in an office supervised by the branch manager’s supervisor; and
- the branch office manager generates 20% or more of the revenue of the business units supervised by the branch office manager’s supervisor.⁴³

For the purpose of determining the 20% threshold, firms must include all revenue generated by or credited to the branch office or branch office manager shall be attributed as revenue generated by the business units supervised by the branch office manager’s supervisor, irrespective of whether the firm has a different internal process for allocating revenue. In the *Notice to Members*, the NASD stated that it regards the “20 percent threshold as a trigger for determining when a member must put in place heightened inspection procedures,” but notes that “a member may need to employ heightened office inspection procedures based on other facts and circumstances.”⁴⁴

The “heightened inspection” required by Amended Rule 3010(c) that are “designed to avoid conflicts of interest that serve to undermine complete and effective supervision because of the economic, commercial or financial interests that the supervisor holds in the

⁴² NASD Rule 3010(c)(2). If a firm is not engaged in any of these activities, then the firm’s must identify those activities in which it is not engaged in the written inspection report and document in the report that the firm must implement supervisory policies and procedures for such activities before engaging in such activities. See *id.*; see also Interpretation of NYSE Rule 342 (similar requirements).

⁴³ See *id.* Similar to Rule 3012, firms seeking to comply with Amended Rule 3010(c) must calculate the 20% threshold on a rolling, 12-month basis.

⁴⁴ NTM 04-71, *supra* note 14, at 835-36.

associated persons and businesses being supervised.⁴⁵ Examples of such “heightened” inspection procedures may include, without limitation, the following:

- unannounced office inspections;
- increasing the frequency of inspections;
- broadening the scope of activities inspected; and
- having one or more principals review or approve the inspection.⁴⁶

Other Rule Changes

New Approval and Documentation Procedures for Changes in Account Name or Designation

The SEC also approved amendments to NASD Rule 3110, that account names or designations to be placed on the memorandum for each transaction before a customer order is executed.⁴⁷ Only a designated person, who must have already passed a qualifying principal examination appropriate to the business of the firm, may approve any changes in account names or designations. The designated person also must document the essential facts relied upon in approving the changes, and firms must maintain these records in a central location for a period of not less than three years. For the first two years, the documentation must be kept in an easily accessible place.⁴⁸

Term Limits for Holding Customer Mail

New amendments to NASD IM-3110(i) continue to permit a firm, upon a customer's written instructions, to hold mail for a customer who will not be at his or her

⁴⁵ NASD Rule 3012(a)(2)(C).

⁴⁶ NTM 04-71, *supra* note 14, at 836.

⁴⁷ NASD Rule 3110(d)

⁴⁸ The NYSE approved similar amendments in amendments to NYSE Rule 410. In addition, the amendments expand the recordkeeping requirements for the orders members receive. The Rule previously required that firms preserve records of certain information about every order transmitted or carried to the floor of the New York Stock Exchange. As amended, the Rule now requires firms to preserve records of that information for orders sent to all marketplaces.

usual address.⁴⁹ But the interpretative material now limits the time in which a firm may hold customer mail “for no longer than two months, if the customer is on vacation or traveling, or three months if the customer is going abroad.”⁵⁰ The revised interpretative materials is designed to reduce the “risk that customers would not receive account statements or other account documentation at their usual addresses.”⁵¹

Limitations on Time/Price Discretionary Authority

NASD Rule 2510(d) permits firms to exercise “time and price” discretion on orders for the purchase or sale of a definite amount of a specified security without prior written authorization from the customer.⁵² Amended Rule 2510(d) now limits this discretion by requiring orders to be executed on the day customers granted discretionary authority, “absent a specific, written contrary indication signed and dated by the customer.” This limitation does not apply to time and price discretion exercised for orders effected with or for an “institutional account,” as defined in Rule 3110(c)(4), pursuant to valid Good-to-Cancelled instructions issued on a “not held” basis. Any exercise of time and price discretion must be reflected on the order ticket.⁵³



This Legal Update was authored by Stuart Kaswell (+1.202.261.3314; stuart.kaswell@dechert.com) and Thomas C. Bogle (+1.202.261.3360; thomas.bogle@dechert.com).

⁴⁹ NASD IM-3110(i).

⁵⁰ NTM 04-71, *supra* note 14, at 837.

⁵¹ *Id.*

⁵² NASD Rule 2510(d).

⁵³ See also NYSE Rule 408(d) (similar rule of the NYSE). The NYSE notes that “the establishment of a specific time limitation eliminates uncertainty and establishes a reasonable control.” NYSE Information Memo 04-38.

Practice group contacts

For further information, contact the authors, one of the attorneys listed or any Dechert LLP attorney with whom you are in regular contact. Visit us at www.dechert.com/financialservices.

Stuart J. Kaswell

Washington, D.C.
+1.202.261.3314
stuart.kaswell@dechert.com

Jack W. Murphy

Washington, D.C.
+1.202.261.3303
jack.murphy@dechert.com

Jane A. Kanter

New York
+1.202.261.3302
jane.kanter@dechert.com

Elliott R. Curzon

Washington, D.C.
+1.202.261.3341
elliott.curzon@dechert.com

Kevin Hull

Newport Beach, CA
+1.949.442.6006
kevin.hull@dechert.com

Taylor A. Edwards

Washington, D.C.
1.202.261.3453
edwards.taylor@dechert.com

Thomas C. Bogle

Washington, D.C.
1.202.261.3360
thomas.bogle@dechert.com

Christine Wessel

Newport Beach, CA
1.949.422.6063
christine.wessel@dechert.com



www.dechert.com

U.S.

Boston
Charlotte
Harrisburg
Hartford
New York
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