

# NSCP

July 13, 2007

**VIA EMAIL: [pubcom@nasd.com](mailto:pubcom@nasd.com)**

Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
1735 K Street, NW  
Washington, D.C. 20006-1506

Re: *NtM 07-30 Joint Request for Comment  
Supervision of Electronic Communications*

Dear Ms. Sweeney:

This letter is submitted on behalf of the National Society of Compliance Professionals Inc. ("NSCP") in response to the joint solicitation for comments by the National Association of Securities Dealers, Inc. ("NASD) and New York Stock Exchange, Inc. ("NYSE") (the "SROs") with respect to a proposed Joint Guidance Regarding the Review and Supervision of Electronic Communications (the "Joint Guidance"). The purpose of this letter is to appraise the SROs of NSCP's strong support for the issuance of comprehensive, practical guidance in this complex and constantly evolving area and to suggest ways in which NSCP believes the guidance can more precisely address the obligations of the member firms.

## **NSCP and its Mission**

NSCP was formed in 1987 for the purpose of representing the interests of securities industry compliance professionals. NSCP is a non-profit membership association with more than 1700 members. Its members are drawn from the broker-dealer, investment adviser, and investment management communities, and from all sizes of firms. Its members include large wire houses, capital market firms, insurance and bank-affiliated firms and specialty firms. To our knowledge, NSCP is the largest organization of securities industry professionals in the United States devoted exclusively to compliance.

NSCP serves its members in very specific ways. First, it sponsors an annual national meeting, and annual regional meetings, at which the NSCP membership comes together for the

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Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
July 13, 2007  
Page 2 of 6

purpose of training and exchanging ideas and information regarding regulatory experiences and developments. These meetings are extremely well attended and provide NSCP members with an ability to hear directly from SEC Staff and Commissioners, and from SRO officials.

Second, NSCP supports its members by providing them with practical solutions to compliance issues. This service is made possible by the interchange of ideas and information that flow among the members at our meetings, through the work of established committees, and through various Board initiatives. Given the complexity of the federal securities laws and SRO rules and the fact that NSCP members are on the front lines of ensuring the correct administration of these regulations, our members are keenly interested in developing practical "best practices" for the compliance industry.

Third, NSCP alerts its members to important regulatory developments and comments on behalf of the membership when appropriate on certain of those developments. In sum, the organization's missions to support the professionalism of all securities industry compliance professionals is advanced on a day-to-day basis through the individual efforts of each NSCP member and through the collective efforts of the organization.

### **NSCP's Support for the SROs' Joint Guidance**

One of the most daunting day-to-day tasks facing NSCP members and the industry is the review and supervision of electronic communications. NSCP strongly supports the SROs' decision to provide Joint Guidance. Guidance to date has been provided primarily through *ad hoc* disciplinary proceedings. NASD and NYSE member firms have struggled to meet their regulatory obligations in what is essentially uncharted territory because of rapidly changing technology, burgeoning costs, and what many perceive as an unforgiving regulatory environment.

Thus, NSCP believes that the benefits of the Joint Guidance will be substantial. The NSCP suggests that minor, but important, revisions to the proposed Joint Guidance will enhance its utility and augment the common thread of supervision found throughout the SROs' Rules. There are three areas of common concern addressed by NSCP's comments: first, concern for a sharper delineation between supervisory obligations and the role of the chief compliance officer and compliance department personnel (collectively the "CCO") in the review of electronic communications; second, concern that the Joint Guidance does not explore to the extent appropriate the delegation of functions for electronic communication review; and finally, concern that the Joint Guidance does not adequately address burdens and costs that will flow from future increases in data capture having marginal or no value.

### **Delineation Between Supervisory Obligations And Compliance Department Role**

As noted above, NSCP has a concern that the Joint Guidance does not sufficiently delineate between supervisory obligations and the CCO's role in the electronic communications review process. It has long been a concern of the NSCP's members, the industry in general, and to some extent the SROs, that CCOs not be viewed, either from a practical or regulatory standpoint, as supervisory personnel, except with regard to their specific compliance department management role. Most firms have placed the obligations for the preparation of written policies and procedures with their respective CCOs.

With respect to electronic communications, the obligation to prepare procedures has significantly enhanced burdens, particularly in firms with lexicon-based systems utilized for screening electronic communications, and may carry unwarranted and unintended consequences. Thus, while the establishment of written policies and procedures regarding electronic communications would not appear necessarily to involve the development of the lexicon for such a system, NSCP suggests that the Joint Guidance more clearly delineate functions between the development of written supervisory procedures that prescribes methods of electronic communication review, including development of lexicon-based systems and/or random reviews, and the function of developing the lexicon itself and the selection process for random reviews. Such a supervision/compliance delineation is made quite clear, in limited circumstances, in the Joint Guidance's description of the appropriateness of re-review of e-mails: "Under limited circumstances, members should consider having their legal and/or compliance departments re-review e-mails that have already been reviewed by line supervisors and their delegates in certain situations." This type delineation is not present, however, with respect to statements regarding developments of lexicon-based reviews and random reviews. While the Joint Guidance generally leaves to the SROs' members the selection process, NSCP believes that it should be emphasized in the Joint Guidance that the selections are not compliance functions.

A second related area of concern is that firms have assigned, and under the Joint Guidance could be expected to assign, initial screening or pre-screening of electronic communications to the CCO despite the delineation noted above. Again, NSCP suggests that the Joint Guidance emphasize that initial screening and/or pre-screening should not be viewed as a compliance function and that placing this burden on the CCO could compromise a system dependent upon escalating levels of review where the firm does not have a legal department that could ultimately address issues internally with respect to questionable electronic communications captured by the review system.

Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
July 13, 2007  
Page 4 of 6

Because review and supervision of electronic communications is such a complex and evolving area, NSCP believes that significant emphases on the delineation between the supervisory and compliance functions are warranted and that the Joint Guidance should expressly recognize this delineation.

### **Delegation of Functions Related to Review of Electronic Communications**

The NSCP appreciates the recognition in the proposed Joint Guidance of the necessity and appropriateness of the delegation of functions related to the review of electronic communications. The delegation of review functions to non-registered personnel and/or third-party vendors is essential to the timely, cost-efficient and effective performance of the review and supervision of electronic communications. Without the ability to delegate review functions, supervisors in most member firms would undoubtedly be overwhelmed by the sheer volume of electronic communications to be reviewed under any reasonably constructed risk-based approach. Further, because of the pace of technological change and the growing sophistication and complexity of electronic communications, member firms must be able to rely on experts and specially trained personnel to provide essential and cost-effective assistance in developing reasonable and appropriate procedures to review electronic communications and also to carry out the review function.

In this regard, the NSCP has concern that the efficiencies and practical ability to conduct the efficient, reasonable and cost-effective review of electronic communications will be compromised or undermined by an overemphasis on the level of knowledge, experience and training required by the regulators for "all reviewers." The NSCP respectfully suggests that the proposed Joint Guidance more clearly and specifically consider and describe the level of knowledge, experience and training necessary to perform the review of electronic communications as part of the supervisory function. As currently drafted, the proposed Joint Guidance appears to require an unduly high and rigorous level of knowledge, experience and training for "all reviewers." If these requirements are too rigorous, the cost savings and efficiencies necessary to make the review of electronic communications workable will never be realized and the review and supervision of electronic communications will overwhelm the primary business and supervisory responsibility of member firms.

The proposed Joint Guidance makes clear that the supervision duty itself may not be delegated and that there must be procedures to escalate regulatory issues to the appropriate supervisor or other department in all events. Given this, the appropriate balance between the supervisory obligation and the efficiencies, and cost savings necessary to make the review and supervision of electronic communications realistically achievable, can be still be achieved

Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
July 13, 2007  
Page 5 of 6

without requiring that all reviewers meet such a high standard of knowledge, experience and training. NSCP respectfully suggests that more of the review function can and should be delegated to non-registered personnel, and even more importantly, to third-party vendors with more limited knowledge, experience and training than currently contemplated in the proposed Joint Guidance. Encouraging the use of third-party vendors will enhance economies of scale and lead to savings and more reasonable costs and burdens resulting from the new supervisory challenges raised by burgeoning electronic communication. Further, ongoing developments and advances in the tools and technologies available to firms and third-party vendors for the storage, culling, selection (whether random or lexicon-based) and review of electronic communications will help streamline the review and supervision process and still achieve the desired goal of reasonable and effective supervision of such communications.

#### **Concern about the Costs and Burdens That Member Firms Face and Will Continue to Face**

In addition to, and beyond the delegation issue discussed above, the NSCP respectfully suggests that the NASD and NYSE further consider and address in specific detail the likelihood that the number of electronic communications and the volume and size of data files that can be communicated electronically will continue to explode, and as a result, the cost and burdens that member firms will face in collecting, storing, reviewing and supervising electronic communications likewise will continue to mushroom. For these reasons, the ability to resort to and rely on technology and a wide array of selection and review techniques, including delegation, is essential to help contain the costs burdens imposed on member firms and still achieve policies and procedures that are reasonably designed to achieve compliance with applicable laws, rules and regulations.

Furthermore, these mounting costs and burdens will be multiplied to the extent that the review and supervision of internal electronic communications are required. In virtually all member firms, the number and size of internal communications dwarf the number and size of external communications with customers and others. Requiring the review and supervision of internal communications for purposes other than the most critical and specific will overwhelm any reasonably designed system and impose costs and burdens that far exceed the supervisory and compliance benefits that could or will be achieved. Therefore, the NSCP respectfully suggests that the NASD and NYSE revise and clarify the guidance provided as to the regulators' expectations and requirements for the review and supervision of internal electronic communications to make those expectations and requirements much more narrowly tailored to strike a more appropriate balance between reasonable and necessary supervisory obligations and additional cost and burden.

Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
July 13, 2007  
Page 6 of 6

## Conclusion

In sum, the NSCP greatly appreciates the SROs' efforts in preparing and proposing to issue Joint Guidance on the challenging and constantly evolving issues regarding the review and supervision of electronic communications. The NSCP believes that further consideration and clarification of certain issues will enhance the value and utility of the Joint Guidance for member firms and their compliance personnel. Specifically, the NSCP respectfully suggests that the Joint Guidance provide greater delineation between the respective roles of supervisory personnel and compliance personnel in the electronic communications review process. In addition, further consideration and clarification of the nature and extent of appropriate delegation of the review function, and greater flexibility in the knowledge, training and experience level of reviewers will serve to enhance the efficiency and cost-effectiveness of such review. Finally, in view of the fast-changing environment and literal explosion in the number and volume of electronic communications and attached data files, and the proliferation of internal electronic communications, the NSCP respectfully suggests that further consideration be given to guidance that will more directly address and assist member firms in managing the ever-mounting costs and burdens associated with the collection, storage, selection, review and supervision of electronic communications.

We hope that these comments are useful in the further refinement of the proposed Joint Guidance regarding the supervision of electronic communications. If and as appropriate, we would be pleased to discuss our views in more detail.

Very truly yours,



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Executive Director, President and CEO

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