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September 15, 2006

NASD Regulation, Inc.
1735 K Street N.W.
Washington, D.C. 20006-0106
Attention: Ms. Barbara Z. Sweeney

Re: NASD Notice to Members 06-31

The Bond Market Association and the Securities Industry Association (the "Associations")[1] are pleased to provide these comments on Notice to Members 06-31, issued by NASD Regulation, Inc. ("NASD Regulation"), concerning regulatory relief that might be necessary in a pandemic to enable securities firms to continue doing business. The Associations appreciate the willingness of the NASD Regulation to do this kind of strategic thinking about the effects of a pandemic.

We are also sending copies of this letter to the Securities and Exchange Commission and to other interested regulators. Some of the relief that would be necessary in a pandemic is relief from regulations promulgated by the SEC and other regulators, and we have not limited ourselves in this letter to a discussion of NASD rules.

The Associations and their members have regular programs to plan for business continuity in the event of a variety of interruptions. Before the industry began thinking about a pandemic, most business continuity planning involved disruptions, such as floods, electrical blackouts and terrorism, that would primarily affect broker-dealers' buildings and systems. A pandemic is different because it would leave the firms' buildings and systems intact, but could affect the health of firms' employees, as well as those of its customers. Because the nature and severity of a pandemic will depend upon

[1] The Bond Market Association represents brokers, dealers and asset managers who underwrite, trade and invest in all kinds of debt securities. The Securities Industry Association brings together the shared interests of approximately 600 securities firms to accomplish common goals. The Bond Market Association and the Securities Industry Association expect to consolidate into a new trade organization, Securities Industry and Financial Markets Association, in November 2006.

the particular pathogen that causes it, and because it is difficult to predict the effects of a health emergency on the markets and firms' operations, any pandemic planning is by nature imprecise. A pandemic will therefore require a great deal of flexibility and ingenuity on the part of both the firms and the regulators.

This comment letter reflects current thinking about how firms would operate in a pandemic. Section I discusses the need for a multi-regulator process for granting relief. Section II proposes a trigger for the commencement of relief. Section III notes the need for forbearance with respect to many time frames. Section IV focuses on nine different categories of regulatory relief that may be necessary to give broker-dealers the flexibility to operate during a period when a large number of employees are not in their regular work space, either because they are sick, caring for others, or afraid to come into the office, and some employees may be able to work from non-regular locations.. Annex 1 contains the Associations' assumptions about the course of the pandemic and how various market sectors might be affected. Annex 2 contains a description of different methods firms might use conduct their operations in a pandemic. The nature of the regulatory relief firms will need to conduct business in a pandemic will depend upon the method or methods in which they choose to operate. It is likely, however, that regulatory relief will be necessary no matter which method of operation a broker-dealer chooses, if only because the number of absentees means that transactions will be more difficult to settle in a timely manner and almost everything will take more time to complete.

I. The Process for Granting Relief.

The Associations believe that the financial services regulators should jointly agree to a process for granting regulatory relief in a variety of business emergencies, including pandemics. Many of our member firms are subject to the jurisdiction of multiple regulators, including not only the NASD and the Securities and Exchange Commission, but also the New York Stock Exchange, the Treasury Department (with respect to U.S. Government Securities), the Municipal Securities Rulemaking Board, and the Commodities Futures Trading Commission, as well as state regulators and non-U.S. regulators. Bank-affiliated broker-dealers are also subject to the jurisdiction of the bank regulators. Consequently, obtaining relief from only one regulator may not enable a broker-dealer to modify its practices and yet comply with all applicable rules. We therefore urge all financial market regulators to consult with each other on regulatory relief and to provide coordinated relief that is both protective of investors and also enables brokers and dealers to continue to provide liquidity to the markets and financial services to their customers. In this letter, we mention some rules of other regulators that should also be the subject of relief.

We also believe that the process for granting ad hoc relief should be clarified, so that market participants will know what is required. It is unlikely that industry participants have foreseen, as part of the comment process on the NASD's Notice to Members, all of the areas in which regulatory relief will be necessary. Consequently, it will be necessary for firms (or trade associations on behalf of member firms) to apply for relief in the midst of an emergency. It will speed that process and help financial firms to continue in business without assuming undesirable regulatory risk if the regulators publish guidelines setting forth the requirements for regulatory relief applications,[2] the criteria for determining whether to grant relief, and a process in which all relevant regulators could consult, making it more likely that different regulators will provide consistent regulatory relief.

The Associations believe that a multi-regulator Statement of General Principles would include the following principles: Regulatory relief should be uniform across federal, state and international regulators. Regulatory relief should acknowledge differences between markets, products and customers, e.g. between exchange and OTC markets, between "cash" and derivative products; and between retail and institutional customers. Finally, one of the aims of regulatory relief should be removing impediments that would hinder dealers from providing liquidity and stability to the markets at a time when investors may wish to sell securities and imbalances in supply and demand create market volatility.

II. Triggering of Relief.

We are aware that the regulators would like the certainty of a trigger identified by a neutral party, such as an announcement by health officials of the incidence of influenza, e.g. a 0.1% infection rate. However, it is likely that firms will want to implement their contingency plans before local health officials declare a health emergency, either because they wish to mitigate the risk of contagion to their employees, or because employee willingness to come to the office is affected by news reports of the spread of the pandemic. Particularly as a result of the fear factor, we believe the need for relief will be triggered by absenteeism rates, and not by infection rates. In addition, we believe the trigger should apply to all firms at once, rather than applying on a firm-by-firm or even a geographic basis. First, even if the pandemic took time to spread from one geographic region in the U.S. to another (e.g. from the East Coast to the Midwest or West Coast), any disruption in the markets and in trade settlements is likely to affect all firms simultaneously. Second, the unequal application of triggers based on illness or absenteeism rates at individual firms could put firms that had not reached the trigger level at a competitive disadvantage. We therefore believe the industry should develop a mechanism whereby, in a pandemic, either the Associations could collect statistics on absenteeism rates from a cross-section of member firms and provide them to NASD Regulation and other regulators, or the selected firms would report such figures directly to a central location.

Because we believe it likely that emergency conditions in a pandemic would last for 8 to 12 weeks, we believe any regulatory relief should have a term of no less than 8 weeks,

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[2] See, e.g. NASD's Series 9600 rules.

but be terminable if absenteeism rates drop below a certain level and extendable for good cause.

III. Time Frames and Error Rates in General.

With high rates of employee absenteeism, and many employees substituting for absent colleagues, it is likely to take much longer to do many things, and error rates are likely to be higher than usual, even if volume levels are also down. This comment letter identifies a number of time limits that the Association believes will be difficult to meet and should be extended. We have not attempted to identify every regulatory requirement with a time limit. We believe, however, that the NASD and other regulators should either grant general extensions of time or should instruct their examination and enforcement staffs to exercise forbearance in their after-the-fact reviews of over-worked front and back offices.

IV. Specific Categories of Regulatory Relief.

The following sections focus on relief in nine general areas: (1) registration of branches, (2) registration of personnel/continuing education, (3) supervision, (4) trading, (5) confirmations and customer account statements, (6) margin rules, (7) books and records, (8) financial statements, and (9) various operational issues, including reconciliations, buy-ins, broker-to-broker account transfers, and issues with respect to physical certificates.

1. **Registration of Branches**.

As noted in Notice to Members 06-31, NASD Regulation gave regulatory relief to member firms in the area of registrations of branch offices and personnel, during both 9/11 and Hurricane Katrina. Past relief has included suspending the requirement to submit branch office applications for new temporary offices established as a result of the event. Although the uniform definition of “branch office” adopted after Hurricane Katrina contains some helpful exclusions, additional relief would be desirable in a pandemic.

a. <u>Current exclusions</u>. The uniform definition of “branch office” excludes from the requirement to register as a branch office the following locations: (1) a non-sales location that provides customer service or back office functions, (2) a non-sales office that provides only proprietary trading or securities lending, (3) an associated person’s primary residence, as long as it is not held out to the public as a branch office, correspondence and communications with the public are subject to the member’s supervision, electronic communications (e.g. email) are transmitted through the member’s electronic system, all orders are entered through the employee’s designated branch office or an electronic system established by the member that is reviewable at the branch office, the member has a system for supervising sales activities, and the member maintains a list of those residence locations, (4) a location other than the primary residence, that is used for less than 30 business days in any calendar year for securities business, is not held out to the public as an office and which satisfies certain of the conditions set forth in the primary residence exemption, and (5) a temporary location used as part of a business continuity plan.

b. Need for additional relief. The exemption for an associated person's primary residence goes far in providing relief for the work-at-home solution. It is possible, however, that some locations where employees might want to work during a pandemic are not currently excluded from the definition of branch office, and would therefore require registration. For example, employees might want to use a secondary residence (e.g. one not located in an urban center where social distancing is more easily accomplished), or may want to move temporarily to be with family or friends. The limit in the uniform definition that a location other than the primary residence be used for less than 30 business days in any calendar year would be easily breached in a pandemic that has three waves, each lasting for 8 to 12 weeks. The 30-day limit also would seem to apply to "pod" locations, unless they are deemed to be part of the firm's business continuity plan. It is not clear whether temporary locations that are part of a business continuity plan must be listed in the plan or may be otherwise approved.

The current exemption for a person's primary residence requires that electronic communications (e.g. email) be transmitted through the member's electronic system. Member firms have indicated that this is their current intention. The Associations believe, however, that the regulators should consider whether they would give relief from this condition that would apply if the firm's system were unavailable, but non-firm systems, such as the employee's personal email account, were operational. Would it be sufficient in that case to require that copies of all correspondence sent from an employee's personal account be simultaneously sent either to the employee's office email account or to a designated compliance address?

c. Relief from registering certain temporary locations as an OSJ. Under NASD's Rule 3010(g), several activities must be conducted in an "office of supervisory jurisdiction," which must be a branch office. This includes (1) executing orders and/or market making; (2) structuring of public offerings or private placements; (3) final acceptance (approval) of new accounts on behalf of the member; (4) review and endorsement of customer orders, (5) final approval of advertising or sales literature for use by persons associated with the member, and (6) supervising the activities of persons associated with the member at one or more other branch offices of the member. To the extent such activities are being performed at an employee's home during a pandemic, the residence should not be required to be registered as a branch or an OSJ.

2. **Registration of Personnel/Fulfillment of Continuing Education Requirements**.

As noted in Notice to Members 06-31, NASD Regulation gave regulatory relief to member firms in the area of registrations and related areas during both 9/11 and

Hurricane Katrina. The relief included extra time for registration, extending testing windows, giving fee refunds for test no-shows or cancellations, and extra time for registered representatives to fulfill continuing education requirements. All such relief would be necessary in a pandemic. Employees who had previously signed up to take tests might be unwilling to appear at a testing location with numerous other people, or firm policies might prohibit employees from congregating with others.

a. Registration of Representatives. Under NASD Rule 1031, a representative cannot act without proper registration and without having passed the appropriate examinations. In the case of sales personnel, it is important that persons who are selling products to the public have the necessary knowledge of both the products and applicable regulations. It is possible, however, that in a pandemic, a firm may have sales staff who have a limited registration (i.e. government securities, investment companies and variable contracts, corporate securities, government securities or private offerings) they may wish to shift to other areas that need coverage. The Associations believe the regulators should consider waiving the registration and testing rules for such personnel. With absenteeism rates of 40%, such shifting may be necessary in order to provide adequate customer coverage. Given the emergency situation, it would not be practical to have the shifted employees registered and tested before they assume temporary new duties.

b. Registration of Principals. Under NASD Rule 1021, dealing with the registration of principals, there is a grace period following a change in duties that triggers the requirement to register as a principal. The elevation form must be submitted "upon elevation" and there is a grace period of 90 calendar days in which to take and pass the qualification exam for principals.[3] The Associations believe that the testing requirement should be waived in a pandemic if the temporary supervisor will not remain a supervisor after the emergency ends.[4] If the temporary supervisor wishes to remain a supervisor thereafter, the 90-day grace period should be extended, since each wave of a pandemic is expected to last longer than 90 days, and an employee pressed into service as a supervisor to replace a colleague who is ill or out of the office may be unwilling to appear at a testing location with numerous other people, or firm policies may prohibit employees from congregating with others. Moreover, such employees may be overworked during the emergency and not have time to study for the examination.

c. Amendments to registration forms. Just as a pandemic would affect new registrations, it would affect amendments to existing registrations. Therefore, there should be extensions of time for reporting items that would appear in amendments to Form U-4, including outside activities, submission of broker relocations, address changes, etc. In the case of Hurricane Katrina, the requirement to maintain updated Form

[3] The relevant New York Stock Exchange Rule contains no grace period for either registration or testing and NYSE appears to have no waiver authority. Thus a firm that did not register enough principals to be sufficient in a pandemic would have to shut down or be liable for failure to supervise. During the current process of harmonization of SRO rules, a grace period should be added to the NYSE rule.

[4] The NASD currently has the authority to waive the testing requirements. See Rule 1070.

U-4 information regarding office of employment address was temporarily suspended. Finally, the Associations believe firms will need extra time to file amendments to registrations forms with respect to customer complaints, disciplinary actions,[5] and other material events, because absenteeism levels may affect the persons who normally keep track of these events and file the reports. Consequently, the NASD should grant extra time for such filings and take the circumstances of the pandemic into account in determining whether such reports are "prompt" or whether the member "knew or should have known of the condition" within the meaning of Rule 3070.

d. Annual renewals. If a pandemic occurs during the annual renewal time for registrations, regulators should extend the renewal time, since we believe the compliance officers who normally perform renewals would likely be pressed into service for other compliance activities.

e. State registrations. We note that, if individuals work from home or firm locations where they do not regularly work, they may need additional state registrations. We urge the NASD to encourage state regulators to grant similar relief from state registration and testing requirements for employees whose office location is temporarily moved to another state during the pandemic.

f. Continuing education requirements. A pandemic would also interfere with continuing education requirements under NASD Rule 1120. Employees who are scheduled to take continuing education courses might be unable to attend the necessary sessions because they are busy with work or because their firm policies prohibit them from congregating in groups of other people. Consequently, extension of deadlines for completion of CLE requirements would be necessary. This should include an extension of the deadlines for the Firm Element, Regulatory Element, and/or Annual Compliance Training.

3. **Supervision**.

Much current supervision is done using face-to-face contact before and during the conduct of business, as well as after-the-fact review of transactions. Traders or salespeople who have questions about whether a trade is appropriate, or who have a trade outside the scope of their authority may check in advance with their manager. Similarly, many firms have compliance hotlines where traders or salesmen can consult a compliance person. After the close of business, the Operations Department produces trade reports, which generally are distributed by the opening of business the following day, and which contain information about the trade. The firm's system usually highlights trades that fall outside established parameters.

[5] In a pandemic, it would be important to build extra time into the process of securities arbitrations. It will be difficult to schedule witnesses and arbitrators, who may be reluctant to leave their own houses.

During a pandemic, member firms will still be able to utilize after-the-fact trade reports and other electronic reports to ensure that activity is appropriately supervised and monitored, even when the supervisors and the persons they supervise are operating in different and non-regular locations. Firms have indicated they are likely to implement additional controls for monitoring the work of employees who require supervision, including sales and trading employees. An example of such additional supervision is a centralized command center to facilitate communication between sales and trading business units and their supervisors. In addition, many firms expect to be able to utilize a modified version of their compliance hotlines.

Under current rules, a Financial and Operations Principal must be responsible for the supervision of individuals who are involved in the actual maintenance of the member's financial books and records. The Associations would appreciate confirmation that this supervision may be done remotely if the member firms believe remote supervision provides adequate supervision.[6]

Firms may need to deviate from the firm's written procedures and written supervisory procedures on numerous issues. They may need to provide for more ad hoc procedures for amending their supervisory procedures than would normally be the case. After Hurricane Katrina the NASD allowed firms to deviate from standard operating procedures due to the relocation of branch offices. For example, procedures that required written letters of authorization to move funds or route a check to a third party address were waived.

During a pandemic, the time periods for conducting normal supervisory reviews should be extended, since the personnel who perform such reviews are likely to be needed to help the firm in its day-to-day activities. Similarly, if the pandemic occurs during the time when a firm otherwise would be conducting its annual compliance inspections, and either travel is restricted or the firm’s compliance personnel are engaged in other activities, the regulators should provide an extension of time for completion of the inspection requirement. The same considerations will apply to the compliance discussion.

4. **Trading**.

a. <u>The 3-quote rule</u>. As the NASD has noted, during 9/11, the NASD suspended the 3 quote rule in recognition of the overtaxed communications system. The Associations believe that such a suspension would be necessary in a pandemic. Firms’ trading activities are sure to be affected by high absenteeism rates for their own employees, as well as by absenteeism rates at market making/dealing firms and by what likely will be high volatility of market prices. Firms subject to the three-quote

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[6] Compare NYSE Information Memo 06-30 (Some of the areas of potential regulatory relief currently under consideration by NYSE Regulation Inc. include delays in real-time supervision where technology monitoring is feasible).

requirements of Rule 2320(g) should be required to seek but not obtain quotations from three dealers (or all dealers if there are fewer than three).

b. Marketplace rules. Although firms recognize the importance of observing the marketplace rules of the SEC and SROs, they have questions about the practical application of a number of such rules, including the rules governing market-makers, in a pandemic. Can the firm suspend its market-making operations not as a result of market factors, but because of insufficient staff to maintain continued controlled operations? If a firm withdraws from market-making, must it wait 30 days before re-entering the market?

c. Cross-border trading issues. Fixed income firms, in particular, are affected by cross-border trading issues. If the pandemic affects a firm's U.S. trading desk but the firm's non-U.S. trading desks can handle some or all of the activity, the Associations believe that broker-dealers should be allowed to "pass the book" to non-U.S. locations. This should certainly apply to proprietary trading, including hedging the firm's positions. The Associations also believe it should apply to trades with institutional customers that are input into the U.S. systems for booking to the U.S. broker-dealer's account. In our opinion, as long as the U.S. firm stands behind the trade, then allowing this passing of the book maintains customer protection. This passing of the book would require the suspension of the need for a Series 17 for the foreign trader. The Associations believe that foreign traders would be registered and tested in accordance with the requirements of the foreign jurisdiction. In addition, it would require an exemption from the rules applicable to dual employees. It also might require relief from the NASD's "parking" rule if passing of the book required transfer of the securities to the foreign firm, rather than "transfer" of the foreign traders and salespeople to the U.S. firm.

Similarly, if foreign traders are in the midst of a pandemic emergency and wish to "pass the book" to colleagues in the U.S., we believe the regulators should determine how to treat those trades – that is, will the U.S. regulators apply U.S. rules to the trades, if the foreign firm retains liability for the trade and the foreign regulators approve?

d. Delays in executing orders. High rates of absenteeism for trade support staff may cause delay in executing orders. The Associations believe the regulators and their examiners should apply a standard of reasonable promptness under the circumstances.

e. Information barriers. If a firm uses the "multiple firm sites" method of operation, it may be difficult for the firm to maintain the same type of information barriers that they normally use. Similarly, if the firm decides to shift personnel who normally operate on the "private" side of the information barrier to the "public" side of the barrier, they may be deemed to be in possession of material non-public information. The NASD provided relief from any violations of the requirements for information barriers in the case of Hurricane Katrina, and such relief would be desirable in a pandemic.

f. SRO Trade Reporting System Outages We understand that regulators consider trade reporting and transparency to be key to continued operation in an emergency. We are not requesting any regulatory relief with respect to trade reporting at this time, since such reporting is automated and therefore should not be affected by absenteeism rates. We note, however, that, when the CTCI MW system for TRACE reporting went down in the summer of 2006, the NASD required firms to submit paper trade reports. Most broker-dealers with large trade volumes (in terms of number of trades) are no longer equipped to do paper filings and are unlikely to have the necessary personnel to do paper filings in the midst of a pandemic. Consequently, if the NASD or its vendors have system problems in a pandemic, we urge that any work-arounds be designed to minimize the extra burden that might be placed on member firms.

5. **Confirmations and Customer Account Statements**.

Confirmations are required by SEC Rule 10b-10. NASD Rule 2340 requires general securities members, at least once a calendar quarter, to send a customer account statement containing certain required information to each customer whose account had a security position, money balance or account activity during the period since the last such statement.[7]

NASD Regulation gave regulatory relief to member firms in the area of confirmations and customer account statements during Hurricane Katrina. It allowed members to accumulate confirmations, customer account statements and other communications or notices and send them to the customer within 90 days. The Associations do not believe that confirmations of trades with institutional customers would be a problem, because most confirmations with such customers are effected electronically, often through the Depository Trust Company's systems. A small proportion of trades with retail customers are also confirmed electronically; however, retail customers as a rule generally are more comfortable with paper confirmations. During a time when there is a 40% absenteeism rate, it may be difficult to keep up with a manpower-intensive activity, such as processing paper confirmations. For customers with email or fax machines, firms could provide confirmations electronically in the interim.

6. **Margin rules**.

With reduced numbers of employees at both institutional investors and broker-dealers it may take longer to do everything, particularly if volumes do not drop to a level where they can be handled by a reduced operations staff. Consequently, the level of fails may increase. In general, the Associations do not believe that customer settlement cycles should be extended, since the systems of many customers and their custodians are programmed to comply with current settlement cycles. If a customer is temporarily unable to pay for a security that has been delivered to the broker/dealer on its behalf, the Associations believe that, to enable the trade to settle, it may make more sense for

[7] Under the Series 9600 rules, the NASD may except any member from the provisions of this Rule.

broker-dealers to extend credit to the customer in accordance with their own policies and procedures than to allow the trade to fail. However, as a result of reduced staffing levels, the broker-dealer may not be able to contact clients regarding margin calls. Therefore, there should be an extension in the number of days to make margin calls. In addition, the time for making an overdue trade/extension request should be extended. As noted in NASD Notice to Members 05-57, the NASD granted margin extensions on a case-by-case basis for customers affected by Hurricane Katrina. The Associations urge that a blanket exemption be granted. See also the discussion of buy-ins of failed-to-receive securities below. Finally, the Associations believe firms should be granted a grace period before the application of net capital charges resulting from fails.

A number of these issues arise under the rules of the Fed, the SEC and the NYSE. We hope the regulators will work together to provide sensible uniform relief.

7. **Books and records**.

During a pandemic event, the regulators should extend the time to comply with the "prompt delivery" requirement for books and records during a regulatory inquiry. Such extensions were granted during 9/11. See, e.g. "The New Normal: Changes in Self-Regulation and the Securities Industry in the Wake of the 9/11 Tragedy," Remarks of Mary Schapiro at Fordham Law School, November 13, 2001 ("We granted blanket extensions on regulatory requests for information, and expanded them further, as appropriate for hard-hit firms.")

8. **Financial Statements; FOCUS Reports, Customer Reserve Account Calculation.**

Audited Financial Statements and 10-K reports for many broker-dealers are due during flu season. These are dependent upon outside auditors completing their work in a timely manner. The SEC should grant a delay if these deadlines cannot be met due to the inability of the external auditors to complete their work on time.

With a reduced workforce, it may be more difficult for the employees who put together the information for the firm's FOCUS report and reserve account calculation to obtain the necessary information and make the required calculations. The Associations believe the SEC should grant extensions of time for filing. For example, during 9/11, the SEC determined that the 11th, 12th, 13th and 14th of September, 2001 (when many firms in lower Manhattan did not have access to their office premises, and employees were working from home or back-up sites) would not be counted as business days for purposes of FOCUS reporting.

9. **Various Operational Issues.**

a. Comparison; Reconciliations; Buy-ins. Under the SEC's net capital and customer reserve calculations, aged fails and unresolved reconciliation differences with accounts or clearing corporations or depositories can result in deductions when computing net capital under Rule 15c3-1 and can affect the amount of cash and/or qualified securities required to be maintained in a "Special Reserve Bank Account for the Exclusive Benefit of Customers" under Exhibit A to Rule 15c3-3.

As noted above with respect to fails to receive, as a result of reduced numbers of employees at both institutional investors and broker-dealers it may take longer to do everything, particularly if volumes do not drop to a level where they can be handled by a reduced operations staff. Consequently, the level of fails may increase. If a customer purchase fails to settle because the expected security is not delivered, the Associations believe there should be an increase in the 45-day time period before the buy-in requirement applies. It is likely that settlement failures will be related to processing delays. Requiring a buy-in will unnecessarily increase trade volume and thereby spread the problem to the receiving firm.

b. Broker to Broker Account Transfers. It is possible that customers will want to move their accounts during a pandemic. This could be to a broker-dealer whose officers are closer to the customer's residence or to broker-dealer that the customer believes is better equipped to operate during the pandemic. The Associations believe there should be an extension of the time to initiate the process to transfer an account (currently required within 3 days of receipt of the transfer request). Similarly there should be an extension in the time to validate ACAT out transfers, the time to send residual balances, and the time to honor or reject transfer claims. We note that New York Stock Exchange, in interpreting what constitutes "prompt access" to customer funds under its Rule 446(c)(10) when the broker-dealer is discontinuing business during an emergency, defines it as "a reasonable time depending on the scope and severity of the significant business disruption." See NYSE Information Memo 05-80 (October 13, 2005). We believe the same standard should apply to account transfers.

c. Delivery, Receipt, Transfer and Vaulting of Physical Certificates. There are a variety of time frames in SEC Rules 15c3-3 and 17a-13 involving possession and control of securities. During a pandemic, there are likely to be delays in accomplishing the required tasks. It should be understood that those delays qualify as "temporary lags as the result of "normal business operations." There should also be an extension of the time for an "independent party" to do a quarterly securities count. Although the securities count is particularly important during a time of great market turmoil, it will be difficult to complete in the midst of a pandemic.

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The Associations appreciate this opportunity to share their views with NASD Regulation and with the regulators copied on this letter. We would be happy to continue the dialogue on pandemic preparedness between our member firms and the regulators that we began this summer. Questions may be directed to Marjorie E. Gross of The Bond Market Association at mgross@bondmarkets.com or 646.637.9204 or Howard Sprow of the Securities Industry Association at hsprow@sia.com or 212.618.0548.

Sincerely,

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Annex 1

Assumptions about the Pandemic and its Effect on Various Markets

A. The Pandemic

The Pandemic. This letter uses the assumptions about a pandemic currently used by the Centers for Disease Control, i.e. a pandemic will come in three waves lasting 8 to 12 weeks each, for a total of up to 18 months. Because air travel is pervasive, it is possible that, even if governments are quick to impose quarantines and travel restrictions, a pandemic may affect multiple financial centers roughly simultaneously.

While the pandemic may result from any number of agents that affect employee health, we have used influenza as our model for planning purposes. We also assume that there is an insufficient supply of anti-viral drugs, or that the available anti-virals are ineffective against the strain of virus causing the pandemic.

Employee Absenteeism. It is difficult to predict the employee absenteeism rate. For planning purposes, we have assumed that the rate at the height of the pandemic will be 40%. We also assume that the absenteeism rate will increase and then decrease as the pandemic waves wax and wane. Although some of the workers who are absent will be available to work from home, others will not, because they are sick or are serving as caregivers.

The absenteeism rate will be affected by many factors, including the following:

- In population centers like New York where employees commute to work using public transportation, the fear of contagion is likely to be greater than in locations where employees regularly drive to work alone. In population centers, the absenteeism rate is likely to become significant before the percentage of flu incidence would justify it. For example, we believe absenteeism is likely to spike when cases of influenza are confirmed anywhere in North or South America, because of the fear that it will spread quickly.

- If local municipal officials suspend elementary schools, parents without regular day care arrangements may need to stay home to care for their children.

- If the hospital system becomes overwhelmed, then families are likely to become the primary care-givers. This, too, could encourage employees to stay home even if they themselves are healthy.

B. The Markets.

While it is difficult to predict what would be happening in the markets, the firms' planning is based on the following assumptions:

- General. Many institutional investors have a regular stream of income that must be reinvested. Their programs for investment and reinvestment in high-quality instruments are pre-programmed, and, if they are experiencing high rates of absenteeism in their front and back offices, there will be a reluctance to change normal investment patterns. Institutional investors are likely to increase the percentage of their investments portfolios allocation to cash and money market instruments. Consequently, the pandemic is likely to affect the funding of longer-term, riskier and more exotic instruments.

  We believe that one result of increased absenteeism rates will be a tendency of both investors and dealers to want to process fewer trade tickets, meaning fewer and larger trades.

- U.S. Treasuries. We believe, based on earlier market disruptions including 9/11, that there would be a flight to quality. Consequently, there would be increased demand for U.S. Treasury securities, particularly at the short end of the maturity scale. It is possible that refundings would not be greatly affected, since many investors will be willing to roll over their investments and settlement will not be dependent on receiving the sales proceeds of other investments. However, new issues may be more problematical, especially where there is a short period between the auction and its settlement date, and there is less time to cure a failed delivery of the purchase price of the new securities.

- Money Market Instruments. We believe that there would be high demand for money market instruments, including bank CDs, repos and commercial paper, both by the usual investors in short-term securities, and by investors who normally invest in longer-term bonds but who decide to place the proceeds of maturing long-term investments into shorter-term instruments while they examine the longer-term effects of the pandemic.

- High Grade Short- and Medium-Term Debt Securities. The effect of a pandemic on high quality short- and medium-term debt securities will depend on many factors, including the nature of the issuer (banks and finance companies versus operating companies), the credit rating of the issuer, the perceived effect of the pandemic on the creditworthiness of the issuer (drug companies versus companies that depend on tourism), whether the offering is public or private, whether underwriters are willing to underwrite the securities (which may depend on their ability to accomplish due diligence), and whether potential purchasers believe they are fairly priced.

- Equity Primary Markets. We believe activity in the equity primary markets will fall in a pandemic, both because customers will not want to devote the attention necessary to analyze new issues and because underwriters will not want to make large capital commitments during the period of the pandemic. The same is likely to be true for Merger & Acquisitions.

- Equity Secondary Markets. In times of crisis, investors often sell equity securities in favor of "safer" investments. Some observers have speculated that, when investors believe a pandemic is imminent, there may be a shifting of portfolio allocations from equities to fixed income. There could also be shifts within the equity market from stocks of companies likely to be adversely affected by the pandemic to other stocks. There might also be a shift from growth stock and small cap stocks into dividend-paying stocks. These shifts could occur within a short period of time, after which markets would be fairly stable. If this occurred, there would be a spike in volume in the early days of the crisis, which would disappear thereafter.

- Retail Investors. Many broker-dealers handle their retail investor customers who have assets below a certain threshold through a service center or call center. Retail customers often place trades through the broker's electronic trading system. Since the routing technology is usually hard-wired, member firms believe they would continue to service customers at their call centers, using social distancing (e.g. seating workers in every other seat) and frequent cleaning with disinfectant. High net worth individuals are generally served through individual financial advisers. Some firms who service high net worth individuals and others with individual financial consultants may be adopting a work-at-home strategy, with financial consultants taking orders by telephone.

Annex 2

Methods for Conducting Financial Services Business During a Pandemic

There is no one "best practice" for continuing a financial services business in a pandemic. There are likely to be six principal methods of doing business (described more fully below):

- Work-in-the-office.
- Work-at-home.
- Work-at-multiple-firm-sites (in jurisdictions near the office).
- Work-at-non-firm-sites.
- Shift-work-to-other-firm-locations (in jurisdictions not near the office).
- Service-level agreements with other broker-dealers.

Work-in-the-office**.** In this method, work will be conducted at the regular office location. The Associations assume that, even at the height of a pandemic, 60% of firm employees will continue to come into the office. Firms have prepared a variety of measures to promote a safe work environment in order to reassure employees who come to work that their risk of exposure is being managed effectively. These include educational programs with respect to employee hygiene, medical screening of persons who enter the workplace, cleansing of the workplace, personal protective gear, and implementation of social distancing.

Because of the high rate of absenteeism, and because it is likely that certain businesses would be suspended or greatly reduced in a pandemic, it is likely that firms would shift work from departments with lower work loads to departments whose workflow is the same or greater than normal. Even if the number of transactions during the period of the pandemic were greatly reduced, we believe that it would take longer to perform many necessary operations and there would be more errors and failed trades.

Work-at-home. In this method, employees whose work can be done at home would have the option of working at home. Many firms with institutional business have enabled a significant number of their employees to work from home while connected to the firm's systems, including managers of all types, traders, sales people and support staff, such as legal, compliance and even some operations personnel. Some firms with largely retail businesses have not thought it desirable or feasible to enable employees to work from home, particularly those that depend on a call center structure for handling customer relationships. However, some retail firms that use a business model with designated financial consultants have enabled their consultants to work from home in an emergency.

In the work-at-home option, some firms require that employees use firm-approved or firm-provided computer equipment. Others do not enforce such a requirement. Data communication in a work-at-home scenario is through the firm's systems, usually through an internet interface. In a few cases, firms have put firm trading turrets into the homes of traders. In other cases, firms use remote desktop access software, such as CITRIX and virtual private networks, to link employee's home computers to the firm's primary applications. Voice communication could be through a variety of equipment, including the employee's own telephone or a pc-based telephone which links the employee's home phone to the office telephone system.[8] Generally, communications methods must comply with the firm's data security and privacy standards. Work-at-home is attractive to employees who do not wish to subject themselves to contagion outside their homes. However, it depends on a large number of regulatory waivers. In addition, it depends upon the ability of telecommunications providers to handle the increased traffic. If telecommunications providers find it necessary to allocate various hours to particular types of users (e.g. schoolchildren taking classes over the internet and other critical industries as well as the financial services industry) it might be necessary for financial markets to change their hours of operation, which would have a knock-on effect on settlements. Even if hours of operation are not changed, employees working from home will not necessarily be using high speed connections and may suffer localized disruptions or congestion that slows operations of various systems and applications.

Some back office operations (including trade reconciliations) can be performed by persons working from home. Other back office operations (including communications with the clearing utilities) may not be capable of being performed from workers homes, because they must be performed from a terminal with the required digital certificates, and digital certificates may have been installed in employees' homes. They exist mainly at regular office locations and the firm's regular back-up site.

Work-at-multiple-firm-sites**.** There are many options under this method. One option is for a firm to divide various business units into multiple groups and disperse the groups to different work sites where the firm regularly operates. Another is to allow employees to work from an office location closer to the employee's home. The firm sites that might be used include the firm's regular sites and a regular back-up site that is not normally occupied by the firm but that is wired as an outpost of the firm. Especially for firms with substantial operations in New York City and a back-up site in within driving distance of New York City, the use of a regular back-up site to which employees with cars could drive, thus avoiding the need to use public transportation, is attractive. Use of multiple sites may increase available space for social distancing. In addition, where the firm disperses employees who perform the same function to different locations, it makes it more likely that, if the employees at one location were stricken in a pandemic, the employees at other location would not be simultaneously affected.

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[8] The Associations have a project to determine the feasibility of an industry directory that would help employees work effectively from remote locations by providing them with contact information and possibly communications functionality. It also would allow users to determine the individuals at other member firms currently responsible for various functions. Member firms have not yet determined that a new directory utility is necessary.

Work at regular firm locations eliminates certain operational problems, since work is performed using the firm's local area network and the firm's systems are readily available. However, it may exacerbate the effects of high rates of absenteeism, since people who normally work together and back each other up will be divided. Consequently, all of the issues that occur in the work-in-the-office scenario happen with even greater force in the work-at-multiple-firm-sites scenario.

Work at Non-firm-sites**.** In this method, groups of employees work together in a location that is not a normal firm location, e.g. a hotel room or the home of an employee where several employees who live nearby could work as a group. These sites are sometimes referred to as "pods." Some firms have regular back-up sites for a small number of employees, where the firm's systems can be accessed. These pods are located in areas where a substantial number of employees live. Pods were first developed as a business continuity mechanism after 9/11. They work particularly well in an emergency where the main office is unavailable. It remains to be seen whether employees will be equally comfortable with the "pod" concept in a health emergency, where social distancing is more important.

Shift Work to Other Firm Locations**.** If all financial centers are not affected simultaneously, firms will switch some functions to locations outside the jurisdiction where they are normally performed. For example, during 9/11, many firms switched their proprietary trading functions to their London offices and at least one firm sent a product team to its Chicago office to resume trading. The work shifted is most likely to be trading in U.S. securities through the firm's U.S. systems. The operational aspects of such trading would continue to be performed in the U.S., for a number of reasons. First, the computer terminals for clearance and settlement of both U.S. government securities cleared through the Federal Reserve Bank of New York and those for securities cleared through the Depository Trust and Clearing Corporation are located in firms' U.S. offices. Second, only the U.S. systems are programmed to accomplish U.S. tax reporting and U.S. regulatory reporting on customer trades. As discussed in the body of this letter, with regulatory relief, more could be shifted.

Service level agreements. Some small firms may have so few employees that they are unable to continue business as usual with a high absenteeism rate. While many of those firms may be engaged primarily in investment banking, and be able to cease doing business for a period of weeks, firms with customer accounts will need to make alternative arrangements. We believe some of them may want to enter into service level agreements with other firms to cover their customer base for a short period of time.