

August 16, 2002

VIA COURIER

Ms. Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-98-80; Amendment No. 4** - Establishing Procedures to Enable NASD to Issue Temporary Cease and Desist Orders

Dear Ms. England:

NASD hereby submits Amendment No. 4 to the above-numbered rule filing. In response to discussions with the staff at the SEC, NASD hereby amends the proposed rule filing as described below. The attached Exhibit 1 reflecting these amendments replaces, in its entirety, the one filed on December 15, 1998. Also attached, as Exhibit 4, is a comparison of the text of the proposed rule language, as amended by Amendments Nos. 1 through 3, with the text of the proposed rule language, as amended in this Amendment No. 4.

Background

NASD has proposed to add a new rule to the NASD Code of Procedure that authorizes the NASD Department of Enforcement (“Department of Enforcement”) staff, after obtaining the approval of the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs, to initiate temporary cease and desist proceedings with respect to the rule violations that pose the most serious and immediate investor protection concerns.¹ The proceedings would allow the Department of Enforcement, after notice

¹ As the result of a recent restructuring of NASD, the President of NASD Regulation now holds the title of President of NASD Regulatory Policy and Oversight. The Chief Operating Officer of NASD Regulation now has the title of Executive Vice President for NASD Regulatory Policy and Programs. NASD is amending the proposed rule change, as described below, to reflect the organizational changes.

and opportunity for a hearing, to order a member or individual to stop engaging in activity that violates certain securities laws or rules. Orders could remain in place until regular disciplinary proceedings are completed. It is expected that temporary cease and desist proceedings would only be used in the most serious cases. Further, the rules would permit an accelerated proceeding to impose sanctions for violations of temporary or permanent cease and desist orders.

In June 1998, NASD issued Notice to Members 98-42 to solicit comment on proposed temporary cease and desist rules that differed in a number of respects from the proposal ultimately filed with the Commission. The comment period closed on July 31, 1998. NASD received thirteen comment letters. The staff modified the proposal in response to the comment letters in many significant respects, including: limiting markup violations for which temporary cease and desist orders can be pursued to those violations involving fraudulent markups; requiring that hearing panels find by a preponderance of the evidence that violations occurred; requiring that the disciplinary action underlying temporary cease and desist orders be conducted on an expedited basis; limiting the duration of temporary cease and desist orders; requiring that members or associated persons being charged with violations of temporary or permanent cease and desists orders be notified of the specific provisions of orders alleged to have been violated and that notifications be accompanied by specific facts supporting the alleged violations; and specifying that temporary cease and desist orders are final and immediately effective decisions of the NASD that can be appealed to the SEC under Section 19 of the Securities Exchange Act of 1934 (the "Act").

On December 22, 1998, the Commission published NASD's proposed rule change for public comment.² The Commission received five comment letters concerning the proposed rule change. On May 14, 1999, NASD responded to the comment letters received by the SEC and amended the proposed rule change to clarify its intended use of permanent cease and desist orders.

Amendment No. 4

Pursuant to discussions with the SEC staff, NASD hereby amends the proposed rule change as indicated below. For your convenience, attached as Exhibit 4 is the text of the proposed rule change with redlined additions and deletions to reflect the amendments described in this Amendment No. 4. We have also attached a new Exhibit 1 that includes the text of the proposed rule change, redlined to reflect the proposed modifications to existing NASD rules pursuant to the proposed rule change. Unless otherwise indicated, proposed additions are underlined and proposed deletions are bracketed.

1. Implementing Proposal as a Pilot Program

In recognition of the new and powerful nature of temporary cease and desist orders ("TCDOs") as enforcement tools, the proposed rule change required the NASD staff to report to the Board of Directors of NASD Regulation within two years after the effective date of the rules

² Release No. 34-40826, 63 Fed. Reg. 71984 (December 22, 1998).

concerning the staff's experience with the rules, and obtain the Board's authorization to continue to exercise authority under the rules. As a more effective mechanism to evaluate the use of the proposed rule change, NASD hereby amends the proposed rule change to provide that it will operate as a two-year pilot program. At the end of the two-year period, the pilot program will terminate unless NASD seeks and obtains SEC approval to extend or permanently adopt the proposal. In evaluating whether to seek extension or approval of the proposed rule change, NASD will review its experiences with the proposed rule change during the two-year period of the pilot program.

Accordingly, NASD amends paragraph (ix) of Exhibit 1 as follows:

(ix) [Report to Board of Directors

NASD Regulation recognizes that temporary cease and desist orders are new and powerful enforcement tools. Therefore, NASD Regulation staff is required to report to the Board of Directors of NASD Regulation ("Board"), within two years after the effective date of the rules (if the rules are approved by the SEC), on the staff's experience with the rules and obtain the Board's authorization to continue to exercise authority under the rules. This report will enable the Board to assess whether the authority is being exercised as it had envisioned.]

Two-Year Trial Period for Proposed Rule Change

NASD recognizes that temporary cease and desist orders are new and powerful enforcement tools. Therefore, NASD staff believes the proposed rule change should be adopted on a trial basis for a two-year period. At the expiration of the two-year period, NASD will review its experience with temporary cease and desist orders, and if it believes the proposed rule change should be extended or adopted on a permanent basis, NASD will file a proposed rule change with the Commission seeking extension or adoption. Such proposed rule change will describe the staff's experience with the rule and its basis for seeking extension or adoption.

In addition, NASD amends the language of the proposed Rule 9800 as follows:

9800. TEMPORARY CEASE AND DESIST ORDERS

(The entire Rule 9800 Series, and related amendments adopted by SR-NASD-98-80 to Rule 8301, IM-8310-2, Rules 9513, 9120, 9241, 9290, 9311, 9312, 9360, 9511 shall expire on (insert date that is two years after SEC approval of SR-NASD-98-80), unless extended or permanently adopted by NASD pursuant to SEC approval at or before such date.)

2. Technical Changes to Conform Proposed Rule Change to Current NASD Practices

a. Reflecting Organizational Changes at NASD

As the result of recent organizational changes at NASD, the President of NASD Regulation now has the title of President of NASD Regulatory Policy and Oversight. The Chief Operating Officer of NASD Regulation now holds the title of Executive Vice President for NASD Regulatory Policy and Programs. Accordingly, NASD hereby amends the following provisions of the proposed rule change:

- Second sentence of Rule 9513(a): Association staff may initiate a proceeding authorized under Rule 9511(a)(2)(D), after receiving written authorization from the President of NASD Regulatory Policy and Oversight or [Chief Operating Officer of NASD Regulation] the Executive Vice President for NASD Regulatory Policy and Programs, by issuing a written notice to the member or associated person.

- First sentence of proposed Rule 9810(a): With the prior written authorization of the President of NASD Regulatory Policy and Oversight [or Chief Operating Officer of NASD Regulation, Inc.] or the Executive Vice President for NASD Regulatory Policy and Programs, the Department of Enforcement or Department of Market Regulation may initiate a temporary cease and desist proceeding with respect to alleged violations of Section 10(b) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5 thereunder; ...

- Second sentence of proposed Rule 9860: The President [or Chief Operating Officer of NASD Regulation, Inc.] of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs must authorize the initiation of any such proceeding in writing.

Similarly, conforming changes have been made to the discussions in Exhibit 1 to reflect the changes in title described above.

In addition, NASD has undertaken to adopt a new corporate structure and is seeking the merger of NASD Regulation, Inc. and NASD Dispute Resolution, Inc. into NASD, with the merger becoming effective upon the Commission's authorization of the operation of Nasdaq other than as a facility of NASD.³ To underscore this new corporate structure and renewed regulatory focus, NASD generally does not refer to itself using its full corporate name, "the Association" or "the NASD." Instead NASD uses "NASD" unless otherwise appropriate for corporate or regulatory reasons. Accordingly, references to "NASD Regulation" and "the Association" have been replaced throughout the text of the proposed rule change and the revised Exhibit 1 with "NASD."

³ See File No. SR-NASD-2002-104 (Notice of Proposed Rule Change Relating to NASD Reorganization).

b. Specifying the Department of Market Regulation as a Party to TCDO Proceedings

Prior to August 1, 2000, the definition of “Department of Enforcement” under the Rule 9000 Series reflected that the Department of Market Regulation (“Market Regulation”) had delegated authority to represent NASD in disciplinary matters. On August 1, 2000, the SEC approved an NASD rule change to reflect the role of Market Regulation throughout the Rule 9000 Series.⁴ NASD hereby amends the proposed rule change to make it consistent with the August 2000 amendments described above by adding “or Department of Market Regulation” after “Department of Enforcement” where “Department of Enforcement” appears in proposed Rules 9810, 9820(a), 9830(b) and 9830(h).

c. Reflecting that the Office of Hearing Officers Performs Certain Administrative Duties in Connection with TCDOs

Rules 9830(b), 9840(d) and 9850 of the proposed rule change provide that the Hearing Officer shall serve the notice of hearing, the decision, and the order in a TCDO proceeding. Because these functions are technically performed by the Office of Hearing Officers and not the Hearing Officer individually, NASD hereby amends the proposed rule language of Rules 9830(b), 9840(d) and 9850 to provide that the Office of Hearing Officers, and not the Hearing Officer, will serve the notice of hearing, decision and order in a TCDO proceeding.

In addition, NASD amends proposed Rule 9840(b)(4) to provide that a TCDO issued by a Hearing Panel will include the date and hour the order was *issued*, and not the date and time the order was served, since the Hearing Panel will not know the hour of service at the time it issues the order.

d. Updating Proposed Rule Language to Reflect Changes in NASD Rules that Were Approved by the SEC in Rule Filings Unrelated to the Proposed Rule Change

Since the proposed rule change was initially filed in 1998, NASD rules have undergone a series of revisions. As a result, NASD is revising the proposed rule change to reflect the current text of the NASD Manual. Exhibit 1 has been updated accordingly to reflect the changes, and the comparison of the proposed rule change to Amendment No. 4 (Exhibit 4 hereof) is footnoted to detail the relevant modifications to existing NASD rules that have occurred since the proposed rule change was initially filed.

e. Allowing Time Periods in the Proposed Rule Change Concerning the TCDO Hearing to be Extended for Good Cause Shown Where the Parties Consent

Rule 9830(a) of the proposed rule change provides that the TCDO hearing shall be held within 15 days after service of the notice initiating the hearing. Rule 9840(a) requires the Hearing Panel to issue its decision on whether to impose temporary cease and desist order no later than ten days after receipt of the hearing transcript. Rule 9850 requires the Hearing Panel to respond

⁴ Release No. 43102 (August 1, 2000), 65 Fed. Reg. 48266 (August 7, 2000).

to a request to modify, set aside, lift or suspend a TCDO within ten days after receipt of the request.

The time frames set out in each of these provisions provides no flexibility for extension of the required deadlines, even in instances in which all parties agree that there is good reason to extend those dates. NASD hereby amends the provisions of Rule 9830(a), 9840(a) and 9850 to provide that with the consent of the parties for good cause shown, the Hearing Officer may extend the time required by the proposed rule change concerning the date on which the hearing is held, the date on which the decision must be issued, and the date on which the Hearing Panel must respond to a request to modify, set aside, lift or suspend a TCDO.

f. Clarifying Process of Issuing Complaints Served in Disciplinary Proceedings

NASD hereby amends proposed Rule 9810(c) to clarify that complaints served in disciplinary proceedings underlying a TCDO proceeding must be filed with the Office of Hearing Officers by adding the words “and file” between the words “the Department of Enforcement or the Department of Market Regulation shall serve” and the words “such a complaint.”

g. Defining the “Record” for Purposes of Proposed Rule 9830(g)

NASD hereby amends the first sentence of proposed Rule 9830(g) as follows to more accurately encompass items that may become part of the record:

The record shall consist of the notice initiating the proceeding, the declaration, and the proposed order described in Rule 9810(b); the transcript of the hearing; [and] all evidence considered by the Hearing Panel; and any other document or item accepted into the record by the Hearing Officer or the Hearing Panel.

h. Miscellaneous Corrections

NASD Rule 8310 was mistakenly designated as NASD Rule 8301 in the proposed rule change. Accordingly, NASD hereby amends the designation of the NASD rule entitled “Sanctions for Violation of the Rules,” changing it from “8301” to “8310.”

The first sentence of proposed Rule 9810(a) refers to the “Securities and Exchange Act of 1934.” NASD hereby amends proposed Rule 9810(a) to delete the word “and” from the phrase.

NASD hereby amends the last sentence of proposed Rule 9870 to insert the word “the” between the words “effectiveness of” and “temporary cease and desist order.”

3. Providing Seven Days Notice of Date of Hearing Instead of Four Days Notice

Rule 9830(b) of the proposed rule change provides that the Office of Hearing Officers (see discussion in paragraph 2(b) above) will serve notice of the date, time and place of the TCDO hearing not later than four days before the hearing. To address concerns raised by the SEC staff that this time period may give inadequate notice of the hearing, NASD hereby amends the proposed rule change to provide that the notice of the hearing be served no later than seven days before the hearing. NASD believes that seven days notice provides the Respondent with adequate notice of the specific date and time of the TCDO hearing, while providing the Office of Hearing Officers with adequate time to locate current or former Governors, Directors or National Adjudicatory Council members (as required by the proposed rule change) who are available to participate on the panel. Accordingly, the first sentence of proposed Rule 9830(b) is amended to replace the word “four” with the word “seven.”

4. Supplementing Discussion of Applicability of Section 19(d) of the Exchange Act to TCDOs

For the reasons set forth in the proposed rule change, NASD believes that TCDOs are subject to Commission review under Section 19(d) of the Act. NASD hereby amends the proposed rule change by adding the following language at the end of the last paragraph of item (vii) of Exhibit 1 to reflect a recent SEC order that is relevant to this issue:

NASD’s view that temporary cease and desist orders are subject to Commission review under Section 19(d) of the Act is further supported by the Commission’s Order Accepting Jurisdiction issued *In the Matter of the Application of Martin Lee Eng*, Release No. 42962 (June 20, 2000). In its Order, the Commission found that it had jurisdiction to review the NASD’s imposition of a letter of caution in a disciplinary action because the letter of caution constituted a “sanction” under Section 19(d). The Commission based its finding of jurisdiction on the fact that the letter of caution resulted from a finding in a formal NASD disciplinary proceeding that the respondent violated an NASD rule, and the letter of caution had been reported to the CRD.

NASD believes that, by analogy to the SEC Order’s in the *Eng* matter, a disciplinary proceeding imposing a temporary cease and desist order constitutes a final disciplinary sanction for purposes of Section 19(d) because it is based on a finding of violation of NASD rules or the Act where the temporary cease and desist order is made public and reported to the CRD.

5. Withdrawing Discussion Comparing NASD’s Proposal to the Authority of the SEC to Issue Temporary Cease and Desist Orders

In response to concerns raised by the SEC staff about discussions in the proposed rule change comparing the SEC’s authority to issue temporary cease and desist orders with the authority NASD now seeks in the proposed rule change, NASD deletes the following text and accompanying footnotes from page 17, second paragraph of the Exhibit 1 of the proposed rule change submitted on December 15, 1998:

[The proposed rules are based upon and closely mirror the SEC rules pertaining to temporary cease and desist orders, but with increased procedural protections in some respects. For example, the SEC rules permit a temporary cease and desist order to be entered against a person without prior notice and an opportunity for a hearing. Such *ex parte* proceedings are not permitted under the rules proposed by the NASD. In addition, under the rules the NASD is proposing, a temporary cease and desist proceeding can be initiated only with respect to alleged violations of certain sections of the securities laws and certain NASD rules. The SEC rules have no such limitation.]

If you have any questions, please call Sarah J. Williams, NASD Regulatory Policy and Oversight, Office of the General Counsel, at (202) 728-8083; e-mail sarah.williams@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Patrice M. Gliniecki
Vice President and
Deputy General Counsel

Attachment

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD- 98-80)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Issuing Temporary Cease and Desist Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on , the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission"), and amended on December 15, 1998, December 21, 1998, December 21, 1998 and [date],¹ the proposed rule change as described in Items I, II, and III below. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD is proposing to establish, for a two-year period, procedures to enable NASD to issue temporary cease and desist orders. The proposed rule change also would grant NASD authority to initiate non-summary proceedings when temporary or permanent cease and desist orders are violated. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

¹ On December 15, 1998, NASD filed Amendment No. 1 to SR-98-80 replacing Exhibit No. 1 of the original rule filing. On December 21, 1998, NASD filed Amendment No. 2 extending the public comment period of the proposed rule change. On May 14, 1999, NASD filed Amendment No. 3 responding to comments received by the Commission on the proposed rule change and adding discussion to the proposed rule change concerning permanent cease and desist orders. NASD filed Amendment No. 4 to the proposed rule change on [date] (1) providing that the proposed rule change will operate for a two-year period, unless extended or permanently adopted prior to the expiration of the two-year period; (2) making technical changes to conform the proposed rule change to modifications made to existing NASD rules unrelated to the proposed rule change; (3) modifying the proposed rule language to conform to existing NASD procedures; and (4) replacing Exhibit 1 in its entirety.

8300. Sanctions

8310. Sanctions for Violation of the Rules

(a) Imposition of Sanction

After compliance with the Rule 9000 Series, the Association may impose one or more of the following sanctions on a member or person associated with a member for each violation of the federal securities laws, rules or regulations thereunder, the rules of the Municipal Securities Rulemaking Board, or Rules of the Association, or may impose one or more of the following sanctions on a member or person associated with a member for any neglect or refusal to comply with an order, direction, or decision issued under the Rules of the Association:

(5) suspend or bar a member or person associated with a member from association with all members; [or]

(6) [impose any other fitting sanction.]impose a temporary or permanent cease and desist order against a member or a person associated with a member; or

(7) impose any other fitting sanction.

IM-8310-2. Release of Disciplinary Information

(d)(1) The Association shall release to the public information with respect to any disciplinary decision issued pursuant to the Rule 9000 Series imposing a suspension, cancellation or expulsion of a member; or suspension or revocation of the registration of a person associated with a member; or suspension or barring of a member or person

associated with a member from association with all members; or imposition of monetary sanctions of \$10,000 or more upon a member or person associated with a member; or containing an allegation of a violation of a Designated Rule; and may also release such information with respect to any disciplinary decision or group of decisions that involve a significant policy or enforcement determination where the release of information is deemed by the President of NASD Regulation, Inc. to be in the public interest. The Association also may release to the public information with respect to any disciplinary decision issued pursuant to the Rule 8220 Series imposing a suspension or cancellation of the member or a suspension of the association of a person with a member, unless the National Adjudicatory Council determines otherwise. The National Adjudicatory Council may, in its discretion, determine to waive the requirement to release information with respect to a disciplinary decision under those extraordinary circumstances where the release of such information would violate fundamental notions of fairness or work an injustice. NASD also shall release to the public information with respect to any temporary cease and desist order issued pursuant to the Rule 9800 Series. The Association may release to the public information on any final, litigated, disciplinary decision issued pursuant to the Rule 8220 or Rule 9000 Series, not specifically enumerated in this paragraph, regardless of sanctions imposed, so long as the names of the parties and other identifying information is redacted.

CODE OF PROCEDURE

9100. Application and Purpose

9120. Definitions

(x) “Party”

With respect to a particular proceeding, the term “Party” means:

(1) in the Rule 9200 Series, [and] the Rule 9300 Series, and the Rule 9800 Series,
the Department of Enforcement or the Department of Market Regulation or a
Respondent;

9200. DISCIPLINARY PROCEEDINGS

9240. Pre-Hearing Conference and Submission

9241. Pre-Hearing Conference

(c) Subjects to be Discussed

At a pre-hearing conference, the Hearing Officer shall schedule an expedited proceeding as required by Rule 9290, and may consider and take action with respect to any or all of the following:

9290. Expedited Disciplinary Proceedings

For any disciplinary proceeding, the subject matter of which also is subject to a temporary cease and desist proceeding initiated pursuant to Rule 9810 or a temporary cease and desist order, hearings shall be held and decisions shall be rendered at the earliest possible time. An expedited

hearing schedule shall be determined at a pre-hearing conference held in accordance with Rule 9241.

9300. REVIEW OF DISCIPLINARY PROCEEDING BY NATIONAL ADJUDICATORY COUNCIL AND NASD BOARD; APPLICATION FOR COMMISSION REVIEW

9310. Appeal to or Review by National Adjudicatory Council

9311. Appeal by Any Party; Cross-Appeal

(b) Effect

An appeal to the National Adjudicatory Council from a decision issued pursuant to Rule 9268 or Rule 9269 shall operate as a stay of that decision until the National Adjudicatory Council issues a decision pursuant to Rule 9349 or, in cases called for discretionary review by the NASD Board, until a decision is issued pursuant to Rule 9351. Any such appeal, however, will not stay a decision, or that part of a decision, that imposes a permanent cease and desist order.

9312. Review Proceeding Initiated By National Adjudicatory Council

(b) Effect

Institution of review by a member of the National Adjudicatory Council on his or her own motion, a member of the Review Subcommittee on his or her own motion, or the General Counsel, on his or her own motion, shall operate as a stay of a final decision issued pursuant to Rule 9268 or Rule 9269 as to all Parties subject to the notice of review, until the National Adjudicatory Council issues a decision pursuant to Rule 9349, or, in cases called for discretionary review by the NASD Board, until a decision is issued pursuant to Rule 9351. Institution of any

such review, however, will not stay a decision, or that part of a decision, that imposes a permanent cease and desist order.

9360. Effectiveness of Sanctions

Unless otherwise provided in the decision issued under Rule 9349 or Rule 9351, a sanction (other than a bar, [or] an expulsion, or a permanent cease and desist order) specified in a decision constituting final disciplinary action of the Association for purposes of SEC Rule 19d-1(c)(1) shall become effective on a date to be determined by Association staff. A bar, [or] an expulsion, or a permanent cease and desist order shall become effective upon service of the decision constituting final disciplinary action of the Association, unless otherwise specified therein. The Association shall serve the decision on a Respondent by courier, facsimile or other means reasonably likely to obtain prompt service when the sanction is a bar, [or] an expulsion, or a permanent cease and desist order.

9500. OTHER PROCEEDINGS

9510. Summary and Non-Summary Proceedings

9511. Purpose and Computation of Time

(a) Purpose

The Rule 9510 Series sets forth procedures for: (1) summary proceedings authorized by Section 15A(h)(3) of the Act; and (2) non-summary proceedings to impose (A) a suspension or cancellation for failure to comply with an arbitration award or a settlement agreement related to an arbitration or mediation pursuant to Article VI, Section 3 of the NASD By-Laws; (B) a suspension or cancellation of a member, or a limitation or prohibition on any member, associated person, or other person with respect to access to services offered by the Association or a member

thereof, if the Association determines that such member or person does not meet the qualification requirements or other prerequisites for such access or such member or person cannot be permitted to continue to have such access with safety to investors, creditors, members, or the Association; [or] (C) an advertising pre-use filing requirement; or (D) suspend or cancel the membership of a member or the registration of a person for failure to comply with a permanent cease and desist order entered pursuant to a decision issued under the Rule 9200 Series or Rule 9300 Series or a temporary cease and desist order entered pursuant to a decision issued under the Rule 9800 Series.

9513. Initiation of Non-Summary Proceeding

(a) Notice

Association staff may initiate a proceeding authorized under Rule 9511(a)(2)(A) or (B), by issuing a written notice to the member, associated person, or other person. NASD staff may initiate a proceeding authorized under Rule 9511(a)(2)(D), after receiving written authorization from the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs, by issuing a written notice to the member or associated person. The notice shall specify the grounds for and effective date of the cancellation, suspension, bar, limitation, or prohibition and shall state that the member, associated person, or other person may file a written request for a hearing under Rule 9514. In addition, if the proceeding is authorized under Rule 9511(a)(2)(D), the notice shall specifically identify the provision of the permanent or temporary cease and desist order that is alleged to have been violated, and shall

contain a statement of facts specifying the alleged violation. The notice shall be served by facsimile or overnight commercial courier.

(b) Effective Date

For any cancellation or suspension pursuant to Rule 9511(a)(2)(A), the effective date shall be at least 15 days after service of the notice on the member or associated person. For any action pursuant to Rule 9511(a)(2)(B) or (D), the effective date shall be at least seven days after service of the notice on the member or person, except that the effective date for a notice of a limitation or prohibition on access to services offered by the Association or a member thereof with respect to services to which the member, associated person, or other person does not have access shall be upon receipt of the notice.

9800. TEMPORARY CEASE AND DESIST ORDERS

(The entire Rule 9800 Series, and related amendments adopted by SR-NASD-98-80 to Rule 8310, IM-8310-2(d)(1), 9120(x), 9241(c), 9290, 9311(b), 9312(b), 9360, 9511(a), 9513(a) and 9513(b) shall expire on (insert date that is two years after date of publication of Notice to Members announcing approval of SR-NASD-98-80), unless extended or permanently adopted by NASD pursuant to SEC approval at or before such date.)

9810. Initiation of Proceeding

(a) Department of Enforcement or Department of Market Regulation

With the prior written authorization of the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs, the Department of Enforcement or the Department of Market Regulation may initiate a temporary cease and desist proceeding with respect to alleged violations of Section 10(b) of the Securities

Exchange Act of 1934 and SEC Rule 10b-5 thereunder; SEC Rules 15g-1 through 15g-9; NASD Rule 2110 (if the alleged violation is unauthorized trading, or misuse or conversion of customer assets, or based on violations of Section 17(a) of the Securities Act of 1933); NASD Rule 2120; or NASD Rule 2330 (if the alleged violation is misuse or conversion of customer assets). The Department of Enforcement shall initiate the proceeding by serving a notice on a member or associated person (hereinafter "Respondent") and filing a copy thereof with the Office of Hearing Officers. The Department of Enforcement or the Department of Market Regulation shall serve the notice by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Department of Enforcement or the Department of Market Regulation shall send an additional copy of the notice by overnight commercial courier. The notice shall be effective upon service.

(b) Contents of Notice

The notice shall set forth the rule or statutory provision that the Respondent is alleged to have violated and that the Department of Enforcement or the Department of Market Regulation is seeking to have the Respondent ordered to cease violating. The notice also shall state whether the Department of Enforcement or the Department of Market Regulation is requesting the Respondent to be required to take action or to refrain from taking action. The notice shall be accompanied by:

- (1) a declaration of facts, signed by a person with knowledge of the facts contained therein, that specifies the acts or omissions that constitute the alleged violation;
and

(2) a proposed order that contains the required elements of a temporary cease and desist order (except the date and hour of the order's issuance), which are set forth in Rule 9840(b).

(c) Filing of Underlying Complaint

If the Department of Enforcement or the Department of Market Regulation has not issued a complaint under Rule 9211 against the Respondent relating to the subject matter of the temporary cease and desist proceeding and alleging violations of the rule or statutory provision specified in the notice described in paragraph (b), the Department of Enforcement or the Department of Market Regulation shall serve and file such a complaint with the notice initiating the temporary cease and desist proceeding.

9820. Appointment of Hearing Officer and Hearing Panel

(a) As soon as practicable after the Department of Enforcement or the Department of Market Regulation files a copy of the notice initiating a temporary cease and desist proceeding with the Office of Hearing Officers, the Chief Hearing Officer shall assign a Hearing Officer to preside over the temporary cease and desist proceeding. The Chief Hearing Officer shall appoint two Panelists to serve on a Hearing Panel with the Hearing Officer. The Panelists shall be current or former Governors, Directors, or National Adjudicatory Council members, and at least one Panelist shall be an associated person.

(b) If at any time a Hearing Officer or Hearing Panelist determines that he or she has a conflict of interest or bias or circumstances otherwise exist where his or her fairness might reasonably be questioned, or if a Party files a motion to disqualify a Hearing Officer or Hearing

Panelist, the recusal and disqualification proceeding shall be conducted in accordance with Rules 9233 and 9234, except that:

(1) a motion seeking disqualification of a Hearing Officer or Hearing Panelist must be filed no later than 5 days after the later of the events described in paragraph (b) of Rules 9233 and 9234; and

(2) the Chief Hearing Officer shall appoint a replacement Panelist using the criteria set forth in paragraph (a) of this Rule.

9830. Hearing

(a) When Held

The hearing shall be held not later than 15 days after service of the notice and filing initiating the temporary cease and desist proceeding, unless otherwise extended by the Hearing Officer with the consent of the Parties for good cause shown. If a Hearing Officer or Hearing Panelist is recused or disqualified, the hearing shall be held not later than five days after a replacement Hearing Officer or Hearing Panelist is appointed.

(b) Service of Notice of Hearing

The Office of Hearing Officers shall serve a notice of date, time, and place of the hearing on the Department of Enforcement or the Department of Market Regulation and the Respondent not later than seven days before the hearing, unless otherwise ordered by the Hearing Officer. Service shall be made by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Office of Hearing Officers shall send an additional copy of the notice by overnight commercial courier. The notice shall be effective upon service.

(c) Authority of Hearing Officer

The Hearing Officer shall have authority to do all things necessary and appropriate to discharge his or her duties as set forth under Rule 9235.

(d) Witnesses

A person who is subject to the jurisdiction of NASD shall testify under oath or affirmation. The oath or affirmation shall be administered by a court reporter or a notary public.

(e) Additional Information

At any time during its consideration, the Hearing Panel may direct a Party to submit additional information. Any additional information submitted shall be provided to all Parties at least one day before the Hearing Panel renders its decision.

(f) Transcript

The hearing shall be recorded by a court reporter and a written transcript thereof shall be prepared. A transcript of the hearing shall be available to the Parties for purchase from the court reporter at prescribed rates. A witness may purchase a copy of the transcript of his or her own testimony from the court reporter at prescribed rates. Proposed corrections to the transcript may be submitted by affidavit to the Hearing Panel within a reasonable time determined by the Hearing Panel. Upon notice to all the Parties to the proceeding, the Hearing Panel may order corrections to the transcript as requested or sua sponte.

(g) Record and Evidence Not Admitted

The record shall consist of the notice initiating the proceeding, the declaration, and the proposed order described in Rule 9810(b); the transcript of the hearing; all evidence considered by the Hearing Panel; and any other document or item accepted into the record by the Hearing

Officer or the Hearing Panel. The Office of Hearing Officers shall be the custodian of the record. Proffered evidence that is not accepted into the record by the Hearing Panel shall be retained by the custodian of the record until the date when the NASD's decision becomes final or, if applicable, upon the conclusion of any review by the Commission or the federal courts.

(h) Failure to Appear at Hearing

If a Respondent fails to appear at a hearing for which it has notice, the allegations in the notice and accompanying declaration may be deemed admitted, and the Hearing Panel may issue a temporary cease and desist order without further proceedings. If the Department of Enforcement or Department of Market Regulation fails to appear at a hearing for which it has notice, the Hearing Panel may order that the temporary cease and desist proceeding be dismissed.

9840. Issuance of Temporary Cease and Desist Order by Hearing Panel

(a) Basis for Issuance

The Hearing Panel shall issue a written decision stating whether a temporary cease and desist order shall be imposed. The Hearing Panel shall issue the decision not later than ten days after receipt of the hearing transcript, unless otherwise extended by the Hearing Officer with the consent of the Parties for good cause shown. A temporary cease and desist order shall be imposed if the Hearing Panel finds:

- (1) by a preponderance of the evidence that the alleged violation specified in the notice has occurred; and
- (2) that the violative conduct or continuation thereof is likely to result in significant dissipation or conversion of assets or other significant harm to investors prior

to the completion of the underlying disciplinary proceeding under the Rule 9200 and 9300 Series.

(b) Content, Scope, and Form of Order

A temporary cease and desist order shall:

(1) be limited to ordering a Respondent to cease and desist from violating a specific rule or statutory provision, and, where applicable, to ordering a Respondent to cease and desist from dissipating or converting assets or causing other harm to investors;

(2) set forth the alleged violation and the significant dissipation or conversion of assets or other significant harm to investors that is likely to result without the issuance of an order;

(3) describe in reasonable detail the act or acts the Respondent is to take or refrain from taking; and

(4) include the date and hour of its issuance.

(c) Duration of Order

A temporary cease and desist order shall remain effective and enforceable until the issuance of a decision under Rule 9268 or Rule 9269.

(d) Service

The Office of Hearing Officers shall serve the Hearing Panel's decision and any temporary cease and desist order by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Office of Hearing Officers shall send an additional copy of the Hearing Panel's decision and any temporary cease and desist order by overnight commercial courier. The temporary cease and desist order shall be effective upon service.

9850. Review by Hearing Panel

At any time after the Office of Hearing Officers serves the Respondent with a temporary cease and desist order, a Party may apply to the Hearing Panel to have the order modified, set aside, limited, or suspended. The application shall set forth with specificity the facts that support the request. The Hearing Panel shall respond to the request in writing within ten days after receipt of the request, unless otherwise extended by the Hearing Officer with the consent of the Parties for good cause shown. The Hearing Panel's response shall be served on the Respondent via personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Office of Hearing Officers shall send an additional copy of the temporary cease and desist order by overnight commercial courier. The filing of an application under this Rule shall not stay the effectiveness of the temporary cease and desist order.

9860. Violation of TCDO

A Respondent who violates a temporary cease and desist order imposed under this Rule Series may have its association or membership suspended or canceled under the Rule 9510 Series. The President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs must authorize the initiation of any such proceeding in writing.

9870. Application to Commission for Review

Temporary cease and desist orders imposed pursuant to this Rule Series constitute final and immediately effective disciplinary sanctions by NASD. The right to have any action under this Rule Series reviewed by the Commission is governed by Section 19 of the Exchange Act.

The filing of an application for review shall not stay the effectiveness of the temporary cease and desist order, unless the Commission otherwise orders.

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

(i) Background

In 1997, the SEC approved a proposed rule change filed by NASD that, among other things, removed from NASD's rules the provision that granted NASD the authority to conduct Expedited Remedial Proceedings.² These rules were intended to provide NASD with a mechanism to take appropriate remedial action against an NASD member or an associated person if the member or associated person had engaged and there was a reasonable likelihood that the member or person would again engage in securities law violations.³ Unfortunately, the rules did not serve their intended purpose. In the proposed rule change removing these rules,⁴ NASD

² See Securities Exchange Act Rel. No. 38908 (Aug. 8, 1997).

³ Under the rules, NASD was authorized to suspend, limit, or condition a broker-dealer's membership or suspend, limit, or condition a person's association with a broker-dealer.

⁴ See SR-NASD-97-28

stated that it would file a proposed rule change in the future that would propose a different approach to expedited remedial proceedings. This proposal contains the alternative approach.

(ii) NASD Notice to Members 98-42

NASD issued a Notice to Member in June 1998 to solicit comment on proposed temporary cease and desist rules that differed in a number of respects from the proposal contained in this filing. The comment period closed on July 31, 1998.⁵ NASD received 13 comment letters in response.⁶ While three commentators expressed support for NASD's overall goal of effective regulation of the securities markets, none of the commentators voiced support the proposal. The commentators generally stated that NASD had not justified the need for the rules, and, if adopted, the rules lacked sufficient procedural protections for proposed respondents (hereinafter referred to as "Respondents"). One commentator questioned whether the Act provides self-regulatory organizations with the authority to issue temporary cease and desist orders. As discussed in greater detail later, NASD believes that the Act does provide it with the authority, and that the proposed rules are both necessary and fair. The staff has carefully reviewed all comments and, as a result, modified the proposal in many significant respects. These changes will:

- limit markup violations for which temporary cease and desist orders can be pursued to those violations involving *fraudulent* markups;

⁵ See NASD Notice to Members 98-42 (June 1998).

⁶ mlimoges@pimfinancial.com (June 18, 1998); Choice Investments, Inc. (June 19, 1998); Dan Jamieson (June 19, 1998); Cutter & Company (June 24, 1998); Wulff, Hansen & Co. (June 22, 1998); Combined Research & Trading, Inc. (June 22, 1998); A.G. Edwards & Sons, Inc. (June 26, 1998); Dortch Securities & Investments, Inc. (July 10, 1998); Whale Securities Co., L.P. (July 17, 1998); Orrick, Herrington & Sutcliffe LLP (July 17, 1998); Securities Industry Association, Compliance and Legal Division (August 5, 1998); Securities Industry Association, Federal Regulation Committee and Self-Regulation and Supervisory Practices Committee (August 17, 1998); and American Bar Association, Sections of Litigation and Business Law (August 18, 1998).

- require that a hearing panel find *by a preponderance of the evidence* that a violation occurred;
- require that the disciplinary action underlying a temporary cease and desist order be conducted on an expedited basis;
- limit the duration of a temporary cease and desist order;
- require that a member or associated person being charged with violating a temporary or permanent cease and desist order be notified of the specific provision of the order alleged to have been violated and that the notification be accompanied by specific facts supporting the alleged violation; and
- specify that temporary cease and desist orders are final and immediately effective decisions of NASD that can be appealed to the SEC under Section 19 of the Exchange Act.

(iii) Need for Temporary Cease and Desist Authority

NASD believes there is a clear need for an additional tool to stop members' or associated persons' misconduct that causes significant dissipation of or conversion of assets or other significant harm to investors while a disciplinary action is pending.⁷ While NASD litigates disciplinary actions involving small capitalization securities, for example, investors may continue to lose substantial sums. Without a temporary cease and desist rule, NASD has no immediate remedy to order cessation of egregious, ongoing violative conduct.

Several commentators believe that NASD's regular disciplinary proceedings provide sufficient measures to combat the violative conduct that concerns NASD. NASD disagrees.

⁷ While this need often is expressed in the context of microcap fraud, it is not necessarily so limited. Temporary cease and desist orders could be used to address fraudulent conduct in any market.

Temporary cease and desist orders would be pursued in cases where NASD believes significant dissipation or conversion of assets or other significant harm to investors is likely to occur *before* a disciplinary proceeding under NASD Rules 9100-9300 is concluded. In addition, under the NASD's current rules, it would take a minimum of four months to complete a disciplinary proceeding. This scenario assumes that the action is not settled and that each aspect of the proceeding occurs without delay. NASD's experience with microcap fraud is that investor losses tend to occur quickly, over very short periods of time.

One commentator suggested that NASD could use its summary suspension authority to address egregious cases of fraud, while another commentator suggested that NASD could use its non-summary suspension authority in such circumstances. NASD, and any other self-regulatory organization, can summarily suspend a member or associated person only in the limited situations that are described in Section 15A(h)(3) of the Act, which do not include the types of situations NASD is attempting to address with the temporary cease and desist rules. The NASD's non-summary suspension rules⁸ also can be used only in limited situations that do not include the types of situations that NASD is attempting to address. For example, NASD can, after notice and opportunity for a hearing, suspend or cancel the membership of a member or the registration of a person for failure to pay fees, dues, assessments or other charges, or for failure to comply with an arbitration award or settlement agreement. In addition, the non-summary suspension rules and temporary cease and desist rules are designed for different purposes. Non-summary suspension proceedings are designed to limit or stop a member's or associated person's ability to conduct

⁸ NASD Rules 9511(a)(2) and 9513.

business, whereas temporary cease and desist orders are designed to stop ongoing, violative conduct while an underlying disciplinary proceeding is being litigated.

In addition, some commentators believe that NASD could refer cases to the SEC or a state regulatory authority for prosecution where an emergency exists. NASD's experience demonstrates that this is not a viable alternative to the proposed rule. Even though NASD, the SEC and other regulators have made great strides in coordinating their respective enforcement efforts, this is not a substitute for temporary cease and desist authority. There are situations where NASD is in the best position to take immediate action, based on its preexisting investigation and access to case-specific information. In such situations, the prospect of having to refer the case to another regulatory authority may result in unacceptable delay and would not be an efficient use of NASD's or other regulators' resources.

(iv) Authority for Issuing Temporary Cease and Desist Orders

NASD believes that relevant provisions of the Act provide self regulatory organizations with the authority to issue temporary cease and desist orders. Section 15A(b)(2) of the Act, among other things, requires that an association of brokers and dealers have the capacity to be able to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its members with the Act, the rules and regulations thereunder, and the rules of the association. In addition, Section 15A(b)(6) requires that the rules of an association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Section 15A(b)(7) permits an association to sanction its members and persons associated with members in many different ways, including through the imposition of any "fitting sanction," and Section 15A(b)(8),

among other things, requires that the rules of an association, in general, provide a fair procedure for disciplining members and persons associated with members. The proposed rules are consistent with NASD's obligations under Section 15A(b)(2), (6), (7) and (8) because temporary cease and desist orders are fitting sanctions designed to stop violative conduct that is likely to cause significant dissipation or conversion of assets or other significant harm to investors, subject to the specific procedures contained in the rules.

(v) Due Process Protections

NASD recognizes that temporary cease and desist orders are powerful measures that should be used very cautiously. Consequently, the rules have been designed to ensure that the proceedings are used to address only the most serious types of misconduct and that the interests of Respondents are protected. For example, to ensure that temporary cease and desist proceedings are used appropriately and that the decision to initiate a proceeding is made only at the highest staff levels, the proposed rules require the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs⁹ to issue written authorization before NASD Department of Enforcement ("Enforcement") or the Department of Market Regulation ("Market Regulation") can institute a temporary cease and desist proceeding. Two commentators stated that the President or Executive Vice President should be required to follow specific guidelines or meet a specific standard before authorizing a temporary cease and desist proceeding. NASD believes that such guidelines or standard already exists. NASD believes it is implicit that the President or Executive Vice President must be

⁹ As the result of organizational changes at NASD, the position of President of NASD Regulation has been renamed as President of NASD Regulatory Policy and Oversight. The position of Chief Operating Officer of NASD Regulation is now Executive Vice President for NASD Regulatory Policy and Programs. This Exhibit 1 refers to those new titles.

convinced by a preponderance of the evidence that the alleged violation has occurred, and the violative conduct or the continuation thereof is likely to result in significant dissipation or conversion of assets or other significant harm to investors prior to completion of the disciplinary proceeding under the Rule 9200 and 9300 Series. This is the standard that guides the hearing panel in determining whether to issue a temporary cease and desist order.

In addition, NASD has proposed limiting use of this tool to only the most serious offenses. A temporary cease and desist proceeding can be initiated only with respect to alleged violations of certain sections of the securities laws and certain NASD rules.¹⁰ In addition, the alleged violations of NASD rules for which a temporary cease and desist proceeding can be initiated are further limited to circumstances involving fraud, unauthorized trading, misuse or conversion of customer assets, or markups.

In the Notice to Members, NASD proposed pursuing temporary cease and desist orders in cases in which Enforcement alleged that the markups were *excessive* and in violation of Rule 2110. Two commentators believed it would be inappropriate to pursue a temporary cease and desist order for excessive markups because of the degree of uncertainty involved in determining appropriate markups. In response to the comments, NASD has modified the proposal to permit temporary cease and desist orders only in cases in which it is alleged that the markups are

¹⁰ The sections and rules are specified in proposed NASD Rule 9810(a) and are limited to alleged violations of Section 10(b) of the Act and Rule 10b-5 thereunder; Rules 15g-1 through 15g-9 under the Act; or NASD Rules 2110, 2120, or 2330. The alleged violations of NASD rules for which a temporary cease and desist proceeding can be initiated are further limited. For NASD Rule 2110, which governs standards of commercial honor and principles of trade, the alleged violations are limited to circumstances involving alleged violations of Section 17(a) of Securities Act of 1933, or circumstances involving unauthorized trading or misuse or conversion of customer assets. For Rule 2330, which governs members' use of customers' securities or funds, the alleged violations for which a temporary cease and desist proceeding can be initiated are limited to circumstances involving misuse or conversion of customer assets.

fraudulent under Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, or NASD Rule 2120.

The proposed rules are based upon the rules that govern NASD disciplinary proceedings, with certain modifications made to reflect that temporary cease and desist proceedings are expedited proceedings. The proposed rules therefore provide Respondents with many procedural protections.

In addition, once the President of NASD Regulatory Policy and Oversight or Executive Vice President for NASD Regulatory Policy and Programs has provided written authorization to initiate a temporary cease and desist proceeding, Enforcement or Market Regulation must file a notice with the Office of Hearing Officers and serve the Respondent with a copy of the notice. The notice must set forth the rule or statutory provision the Respondent is alleged to have violated, include a declaration of facts that specifies the acts or omissions that constitute the alleged violation,¹¹ and must contain a proposed order that contains the required elements of a temporary cease and desist order.¹² In addition, if Enforcement or Market Regulation has not already issued a complaint under Rule 9211 against the Respondent relating to the subject matter of the temporary cease and desist proceeding and alleging violations of the rule or statutory provisions specified in the notice initiating the temporary cease and desist proceeding, Enforcement or Market Regulation must serve such a complaint with the notice initiating the temporary cease and desist proceeding.

¹¹ The declaration of facts must be signed by a person with knowledge of the facts contained in the declaration. Such persons may include NASD staff.

¹² The required elements of a temporary cease and desist order are set forth in proposed Rule 9840(b).

Further, a hearing to determine whether a temporary cease and desist order should be issued must be held within 15 days after service of the notice (unless a Hearing Officer or Hearing Panelist is recused or disqualified or the parties agree to extend the 15-day period for good cause shown),¹³ and the Respondent must be served with notice of the date, time, and location of the hearing not later than seven days before the hearing,¹⁴ unless the Hearing Officer orders otherwise. One commentator believes that requiring the hearing to be held within 15 days after service of the notice does not provide a Respondent with sufficient time to prepare for the hearing, and, by way of comparison, notes that the Securities Act of 1933 and the Act require that hearings in SEC temporary cease and desist proceedings be held no earlier than 30 days nor later than 60 days after service of the notice. NASD believes that conducting the hearing within 15 days after service of the notice is appropriate because its rules would require the notice initiating the proceeding to have sufficient detail of the alleged violation.¹⁵ In addition, these proceedings are designed to occur on an expedited basis so as to stop ongoing violative conduct that is likely to cause significant dissipation or conversion of assets or other significant harm to investors before the underlying disciplinary is concluded.

Each hearing panel would be appointed by NASD's Chief Hearing Officer, and would be comprised of a hearing officer and two panelists. The two panelists would be selected from a roster of candidates that is comprised of current or former members of the National Adjudicatory Council, NASD Board of Governors, or NASD Regulation Board of Directors, and at least one panelist would have to be an associated person. A hearing officer, who is an attorney and an

¹³ See Proposed Rule 9830(a).

¹⁴ A four day notice requirement should provide the Respondent with sufficient notice of the hearing.

¹⁵ See Proposed Rule 9810(b).

employee of NASD, would preside over each proceeding and would have the authority to do all things necessary and appropriate to discharge his or her own duties as set forth in Rule 9235.

One commentator suggested that the same hearing panel that issued the temporary cease and desist order be assigned to hear the disciplinary proceeding. NASD agrees that this is desirable whenever possible. The class of persons eligible to serve on a temporary cease and desist hearing panel, however, is more limited than the class eligible to serve on disciplinary hearing panels. NASD would attempt to use the same panels whenever possible.

The proposed rules also set a specific standard that must be met before a hearing panel can issue such an order. A hearing panel must find *by a preponderance of the evidence* that the alleged violation has occurred, which is the same evidentiary standard used in the underlying disciplinary proceeding. The hearing panel also must find that the violative conduct or the continuation thereof is likely to result in *significant* dissipation or conversion of assets or other *significant* harm to investors *prior* to completion of the disciplinary proceeding under the Rule 9200 and 9300 Series. This standard is designed to ensure that a temporary cease and desist order cannot be issued for technical violations of rules, but can be issued only if the violative conduct or the continuation thereof is likely to result in significant dissipation or conversion of assets or other significant harm to investors before completion of the underlying disciplinary proceeding.

Several commentators believe that the hearing panels should be required to find a likelihood of success on the merits and irreparable harm to investors, and should explicitly consider the effect of the order on the Respondent. While NASD believes that the "likelihood of success" standard is an inappropriate standard in the context of the other required showings,

NASD does agree that there should be an express evidentiary standard in the rule. Thus, in response to the commentators' concerns, the proposed rules require that there be a preponderance of evidence of a violation of one of the specified rules before an order can be issued. The preponderance of evidence test would be in addition to the requirement that the alleged violative conduct or the continuation thereof be likely to result in significant dissipation or conversion of assets or other significant harm to investors.

NASD believes that an irreparable harm standard would frustrate its attempt to stop ongoing fraudulent activity. Under such a standard, as long as a member could show that it is solvent and *at the time* could pay any potential arbitration or mediation awards while the disciplinary action is proceeding, NASD could be unable to stop the ongoing fraudulent activity until the completion of the regular disciplinary proceeding. Too often, the member's financial condition significantly changes after the conclusion of the disciplinary proceeding. Indeed, in a number of recent cases, the member firm filed for bankruptcy or went into SIPC liquidation during or immediately after the completion of an NASD disciplinary action. Finally, NASD believes that once it has been shown that the violative conduct or the continuation thereof is likely to result in significant dissipation or conversion of assets or other significant harm to investors, the potential harm to the Respondent if an order is issued is overshadowed by the harm that is likely to occur if the order is not issued.

A hearing panel must issue a written decision within ten days of receiving the transcript of the hearing, unless otherwise extended by the Hearing Officer with the consent of the Parties upon a showing of good cause. If a hearing panel decides that a temporary cease and desist order should be issued, the order must direct the Respondent to cease and desist from violating specific

rule or statutory provisions, and, where applicable, to cease and desist from dissipating or converting assets or causing other harm to investors. The order also must set forth the alleged violation and the significant dissipation or conversion of assets or other significant harm to investors that is likely to result without the issuance of the order, and it must describe in reasonable detail the act or acts the Respondent is to take or refrain from taking.¹⁶ A temporary cease and desist order issued to stop unauthorized trading, for example, would order a Respondent to cease and desist from violating NASD Rule 2110 by directing the Respondent to stop the practice of executing unauthorized trades for customers' accounts. The order would not instruct the Respondent to cease and desist from conducting business with customers.

(vi) Publicizing Issuance of a Temporary Cease and Desist Order

If a hearing panel issues a temporary cease and desist order, NASD would publicize the issuance of the order, just as it publicizes the issuance of decisions in disciplinary proceedings that result in significant sanctions. Accordingly, the proposed rule change modifies IM- 8310-2 to permit the release of this information. When issuance of a temporary cease and desist order is made public, if applicable, a statement would accompany the public release indicating that the decision could still be appealed to the SEC or that the appeal is pending.

(vii) Duration of Temporary Cease and Desist Orders

Once a temporary cease and desist order has been issued, it will remain in effect until a decision is issued in the underlying disciplinary proceeding.¹⁷ Because a temporary cease and

¹⁶ The order also must include the date and hour of its issuance.

¹⁷ The Hearing Panel issuing the decision in the underlying disciplinary proceeding, however, may issue a permanent cease and desist order as part of the sanctions, if any, imposed pursuant to the underlying disciplinary proceeding. The effectiveness of a permanent cease and desist order would not be stayed if the Respondent appeals the decision in the underlying disciplinary proceeding.

desist order would, unless modified, remain in effect until the underlying disciplinary proceeding concludes, two commentators suggested that, in any disciplinary proceeding for which a temporary cease and desist order has been issued, the disciplinary proceeding should be conducted on an expedited basis. NASD agrees with this suggestion and has proposed Rule 9290, which would require that in any disciplinary proceeding for which a temporary cease and desist order has been issued every hearing shall be held and every decision shall be rendered at the earliest possible time.

In addition, a Respondent is provided the opportunity to challenge a temporary cease and desist order, pursuant to proposed Rule 9850, if it believes the underlying disciplinary proceeding is not being conducted on an expedited basis. If a Respondent can prove by a preponderance of the evidence that the underlying disciplinary proceeding is not being conducted on an expedited basis due to bad faith conduct by NASD, the hearing panel that issued the temporary cease and desist order can modify, set aside, limit, or suspend the order as it believes is appropriate. If a challenge on such a basis is pursued by a Respondent, the hearing panel's consideration would be limited to determining whether the underlying disciplinary proceeding was not being conducted on an expedited basis due to the bad faith conduct of NASD.

The proposed rules provide Respondents with several opportunities to challenge a temporary cease and desist order. A Respondent may apply to the hearing panel, pursuant to proposed Rule 9850, to have the order modified, set aside, limited, or suspended, or the Respondent may challenge the order by filing an application for review with the SEC pursuant to

Section 19 of the Exchange Act.¹⁸ A Respondent challenging an order, however, will not stay the effectiveness of the order, unless otherwise ordered by the Commission.

Two commentators raised a concern about the ability of a Respondent to appeal decisions issuing temporary cease and desist orders to the SEC because it was unclear whether temporary cease and desist orders are final disciplinary decisions of NASD. NASD believes temporary cease and desist orders should be considered final and immediately effective decisions of NASD and therefore should be able to be appealed to the SEC as soon as the orders are issued. A temporary cease and desist order is issued after notice and an opportunity for a hearing and upon a finding by a preponderance of the evidence that a violation of a statutory provision or rule has occurred. The temporary cease and desist order is an “other fitting sanction” under Section 15A(b)(7) of the Act because the order directs a Respondent to cease from violating a rule, to cease specified violative conduct, and, as appropriate, to cease and desist from dissipating or converting assets. In addition, a temporary cease and desist order is immediately effective and enforceable, and a Respondent that violates the terms of a temporary cease and desist order can have its membership or registration suspended or canceled.

NASD’s view that temporary cease and desist orders are subject to Commission review under Section 19(d) of the Act is further supported by the Commission’s Order Accepting Jurisdiction issued *In the Matter of the Application of Martin Lee Eng*, Release No. 42962 (June 20, 2000). In its Order, the Commission found that it had jurisdiction to review NASD’s imposition of a letter of caution in a disciplinary action because the letter of caution constituted a “sanction” under Section 19(d). The Commission based its finding of jurisdiction on the fact that

¹⁸ Section 19 of the Exchange Act provides for the appeal of final disciplinary sanctions imposed by self-regulatory organizations.

the letter of caution resulted from a finding in a formal NASD disciplinary proceeding that the respondent violated an NASD rule, and the letter of caution had been reported to the CRD.

NASD believes that, by analogy to the SEC Order's in the *Eng* matter, a disciplinary proceeding imposing a temporary cease and desist order constitutes a final disciplinary sanction for purposes of Section 19(d) because it is based on a finding of violation of NASD rules or the Act where the temporary cease and desist order is made public and reported to the CRD.

(viii) Enforcement of Cease and Desist Orders

In order for temporary cease and desist orders, or permanent cease and desist orders issued pursuant to disciplinary proceedings conducted under the Rule 9200 Series or Rule 9300 Series, to have their full effect it is necessary to have a mechanism to enforce such orders and to be able to sanction members or associated persons that violate the orders. Consequently, the proposed rule change seeks to provide NASD with the authority to suspend or cancel a Respondent's membership or association if it is found, after a proceeding pursuant to the Rule 9510 Series,¹⁹ that a Respondent violated a temporary cease and desist order or a permanent cease and desist order. The proposed rule change provides that a proceeding to suspend or cancel a Respondent's association or membership for violating an order cannot be initiated unless it is authorized in writing by the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs.²⁰ This provision ensures that

¹⁹ The Rule 9510 Series sets forth the procedures for summary and non-summary suspension, cancellation, bar, limitation, or prohibition. Pursuant to the proposed amendment to Rule 9511, the sanctions for a violation of a temporary or permanent cease and desist order are limited to suspension or cancellation of the membership of a member or the registration of a person.

²⁰ See Proposed Rule 9860.

decisions that can have a significant impact on a Respondent are made only at the highest staff level.

In addition, under the proposed rules, in any proceeding initiated pursuant to the Rule 9510 Series to sanction a member or associated person for violating a temporary or permanent cease and desist order, NASD would be required to specifically identify in the notice initiating the proceeding the provision of the temporary or permanent cease and desist order that is alleged to have been violated, and the notice must contain a statement of facts specifying the alleged violation. These provisions were included in response to a suggestion by a commentator.

(ix) Two-Year Trial Period for Proposed Rule Change

NASD recognizes that temporary cease and desist orders are new and powerful enforcement tools. Therefore, NASD staff believes the proposed rule change should be adopted on a trial basis ,for a two-year period. At the expiration of the two-year period, NASD will review its experience with temporary cease and desist orders, and if it believes the proposed rule change should be extended or adopted on a permanent basis, NASD will file a proposed rule change with the Commission seeking extension or adoption. Such proposed rule change will describe the staff's experience with the rule and its basis for seeking extension or adoption.

(x) Context in Which Permanent Cease and Desist Orders will be Sought

NASD staff does not anticipate seeking permanent cease and desist orders on a routine basis. Factors that NASD staff will consider in determining whether a permanent cease and desist order is appropriate include whether the party's violation was isolated or part of a pattern,

whether the violation was flagrant and deliberate or merely technical in nature, and whether the party's business will present opportunities to engage in future violative conduct.²¹

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(2) of the Act, which requires, among other things, that an association of brokers and dealers have the capacity to be able to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its members with the Act, the rules and regulations thereunder, and the rules of the association. In addition, NASD believes the proposed rule change is consistent with the provisions of Sections 15A(b)(6), which require that the rules of an association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD also believes the proposal is consistent with the provisions of Sections 15A(b)(7) and (8). Paragraph (b)(7) permits the sanctioning of members and associated person by several means, including by imposing fitting sanctions, and paragraph (b)(8) requires that the rules of an association, in general, provide a fair procedure for disciplining members and persons associated with members. NASD believes that the relevant provisions of the Act provide it with authority to issue temporary cease and desist orders. NASD also believes the proposed rules are consistent with NASD's obligations under Sections 15A(b)(2), (6), (7), and (8) because temporary cease and desist orders are fitting sanctions designed to stop violative conduct that is

²¹ Although courts have considered these factors in evaluating the likelihood of future violations, *see SEC v. Steadman*, 967 F.2d 636, 647-48 (D.C. Cir. 1992). NASD does not propose requiring Hearing Officers to find a substantial likelihood of future violations before issuing cease and desist orders. NASD is only stating that these are factors that the staff of NASD will consider in determining whether to seek a permanent cease and desist order.

likely to cause significant dissipation or conversion of assets or other significant harm to investors, subject to the specific procedures contained in the rules.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in NASD Notice to Members 98-42 (June 1998). Thirteen comments were received in response to the Notice. While three comment letters expressed support for NASD's overall goal of effective regulation of the securities markets, none of the comment letters voiced support for the proposed rule change.

In addition, the Board of Directors of NASD Regulation reviewed the Notice and approved its publication. NASD's National Adjudicatory Council also approved issuing the Notice, and the Small Firm Advisory Board supported issuing the Notice, but took no formal position. In addition, a subcommittee of the Legal Advisory Board reviewed and unanimously supported issuing the Notice.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary

Below is the text of the proposed rule change as reflected in SR-NASD-98-80 (including Amendments Nos. 1 through 3 thereof), redlined to indicate changes to the proposed rule language as described in Amendment No. 4 to the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets. This Exhibit 4 also reflects changes to existing NASD rules that have occurred since the initial filing of SR-NASD-98-80 through rule changes unrelated to this proposed rule change. These changes are identified using *italics* with footnotes explanations.

8300. Sanctions

[8301] 8310. Sanctions for Violation of the Rules

(a) Imposition of Sanctions

After compliance with the Rule 9000 Series, the Association may impose one or more of the following sanctions on a member or person associated with a member for each violation of the federal securities laws, rules or regulations thereunder, the rules of the Municipal Securities Rulemaking Board, or Rules of the Association, or may impose one or more of the following sanctions on a member or person associated with a member for any neglect or refusal to comply with an order, direction, or decision issued under the Rules of the Association:

- (5) suspend or bar a member or person associated with a member from association with all members;
- (6) impose a temporary or permanent cease and desist order against a member or a person associated with a member; or
- (7) impose any other fitting sanction.

IM-8310-2. Release of Disciplinary Information

(d)(1) The Association shall release to the public information with respect to any disciplinary decision issued pursuant to the Rule 9000 Series imposing a suspension, cancellation or expulsion of a member; or suspension or revocation of the registration of a person associated with a member; or suspension or barring of a member or person associated with a member from association with all members; or imposition of monetary sanctions of \$10,000 or more upon a member or person associated with a member; or containing an allegation of a violation of a Designated Rule; and may also release such information with respect to any disciplinary decision or group of decisions that involve a significant policy or enforcement determination where the release of information is deemed by the President of NASD Regulation, Inc. to be in the public interest. The Association also may release to the public information with respect to any disciplinary decision issued pursuant to the Rule 8220 Series imposing a suspension or cancellation of the member or a suspension of the association of a person with a member, unless the National Adjudicatory Council determines otherwise. The National Adjudicatory Council may, in its discretion, determine to waive the requirement to release information with respect to a disciplinary decision under those extraordinary circumstances where the release of such information would violate fundamental notions of fairness or work an injustice. *The Association may release to the public information on any other final, litigated, disciplinary decision issued pursuant to the Rule 8220 Series or Rule 9000 Series, not specifically enumerated in this paragraph, regardless*

*of sanctions imposed, so long as the names of the parties and other identifying information is redacted.*¹ NASD [The Association] also shall release to the public information with respect to any temporary cease and desist order issued pursuant to the Rule 9800 Series.

*[(h) If a final decision of the Association is not appealed to the Commission, the sanctions specified in the decision (other than bars, expulsions, permanent cease and desist orders, and temporary cease and desist orders) shall become effective on a date established by the Association but not before the expiration of 30 days after the date of the decision. Bars, expulsions, permanent cease and desist orders, and temporary cease and desist orders, however, shall become effective upon issuance of the decision, unless the decision specifies otherwise. An appeal to the Commission of a decision that imposes a permanent cease and desist order or a temporary cease and desist order shall not stay the effectiveness of such orders, unless the Commission specifies otherwise.]*²

9000. CODE OF PROCEDURE

9100. Application and Purpose

9120. Definitions

¹ This sentence was added pursuant to SR-NASD-00-05, SEC Release No. 42783, 65 Fed. Reg. 32140 (May 22, 2000).

² This paragraph (h) was deleted pursuant to SR-NASD-99-76, SEC Release No. 43102, 65 Fed. Reg. 48266 (August 1, 2000).

(x) “Party”

With respect to a particular proceeding, the term “Party” means:

(1) in the Rule 9200 Series, the Rule 9300 Series, and the Rule 9800 Series, the Department of Enforcement or the Department of Market Regulation or a Respondent;

9200. DISCIPLINARY PROCEEDINGS

9240. Pre-Hearing Conference and Submission

9241. Pre-Hearing Conference

(c) Subjects to be Discussed

At a pre-hearing conference, the Hearing Officer shall schedule an expedited proceeding as required by Rule 9290, and may consider and take action with respect to any or all of the following:

9290. Expedited Disciplinary Proceedings

For any disciplinary proceeding, the subject matter of which also is subject to a temporary cease and desist proceeding initiated pursuant to Rule 9810 or a temporary cease and desist order, hearings shall be held and decisions shall be rendered at the earliest possible time. An expedited hearing schedule shall be determined at a pre-hearing conference held in accordance with Rule 9241.

9300. REVIEW OF DISCIPLINARY PROCEEDING BY NATIONAL ADJUDICATORY COUNCIL AND NASD BOARD; APPLICATION FOR COMMISSION REVIEW

9310. Appeal to or Review by National Adjudicatory Council

9311. Appeal by Any Party; Cross-Appeal

(b) Effect

An appeal to the National Adjudicatory Council from a decision issued pursuant to Rule 9268 or Rule 9269 shall operate as a stay of that decision until the National Adjudicatory Council issues a decision pursuant to Rule 9349 or, in cases called for discretionary review by the NASD Board, until a decision is issued pursuant to Rule 9351. Any such appeal, however, will not stay a decision, or that part of a decision, that imposes a permanent cease and desist order.

9312. Review Proceeding Initiated By National Adjudicatory Council

(b) Effect

Institution of review by a member of the National Adjudicatory Council on his or her own motion, a member of the Review Subcommittee on his or her own motion, or the General Counsel, on his or her own motion, shall operate as a stay of a final decision issued pursuant to Rule 9268 or Rule 9269 as to all Parties subject to the notice of review, until the National Adjudicatory Council issues a decision pursuant to Rule 9349, or, in cases called for discretionary review by the NASD Board, until a decision is issued pursuant to Rule 9351. Institution of any

such review, however, will not stay a decision, or that part of a decision, that imposes a permanent cease and desist order.

9360. Effectiveness of Sanctions

Unless otherwise provided in the decision issued under Rule 9349 or Rule 9351, a sanction (other than a bar, an expulsion, or a permanent cease and desist order) specified in a decision constituting final disciplinary action of the Association for purposes of SEC Rule 19d-1(c)(1) shall become effective *on a date to be determined by Association staff*.³ A bar, an expulsion, or a permanent cease and desist order shall become effective upon service of the decision constituting final disciplinary action of the Association⁴, unless otherwise specified therein. The Association shall *serve the decision on a Respondent by courier, facsimile or other means reasonably likely to obtain prompt service when the sanction is a bar or an expulsion*.⁵

9500. OTHER PROCEEDINGS

9510. Summary and Non-Summary Proceedings

9511. Purpose and Computation of Time

(a) Purpose

The Rule 9510 Series sets forth procedures for: (1) summary proceedings authorized by Section 15A(h)(3) of the Act; and (2) non-summary proceedings to impose (A) a suspension or

³ Pursuant to SR-NASD-99-76, SEC. Release No. 43102, 65 Fed. Reg. 48266 (August 1, 2000), the clause “30 days after the date of service of the decision constituting final disciplinary action” was replaced with the italicized rule language.

⁴ SR-NASD-99-76, *id.* at FN 3, deleted the clause “for purposes of SEC Rule 19d-1(c)(1)” after the word “Association.”

⁵ This language was changed from “take reasonable steps to obtain personal service of a Respondent when the sanction is a bar or an expulsion” pursuant to SR-NASD-98-58, Release No. 40854, 64 Fed. Reg. 918 (December 28, 1998).

cancellation for failure to comply with an arbitration award or a settlement agreement related to an arbitration or mediation pursuant to Article VI, Section 3 of the NASD By-Laws; (B) a suspension or cancellation of a member, or a limitation or prohibition on any member, associated person, or other person with respect to access to services offered by the Association or a member thereof, if the Association determines that such member or person does not meet the qualification requirements or other prerequisites for such access or such member or person cannot be permitted to continue to have such access with safety to investors, creditors, members, or the Association; (C) an advertising pre-use filing requirement; or (D) suspend or cancel the membership of a member or the registration of a person for failure to comply with a permanent cease and desist order entered pursuant to a decision issued under the Rule 9200 Series or Rule 9300 Series or a temporary cease and desist order entered pursuant to a decision issued under the Rule 9800 Series.

9513. Initiation of Non-Summary Proceeding

(a) Notice

Association staff may initiate a proceeding authorized under Rule 9511(a)(2)(A) or (B), by issuing a written notice to the member, associated person, or other person. Association staff may initiate a proceeding authorized under Rule 9511(a)(2)(D), after receiving written authorization from the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs [Chief Operating Officer of NASD Regulation], by issuing a written notice to the member or associated person. The notice shall specify the grounds for and effective date of the cancellation, suspension, bar, limitation, or prohibition and shall state that the member, associated person, or other person may file a written

request for a hearing under Rule 9514. In addition, if the proceeding is authorized under Rule 9511(a)(2)(D), the notice shall specifically identify the provision of the permanent or temporary cease and desist order that is alleged to have been violated, and shall contain a statement of facts specifying the alleged violation. The notice shall be served by facsimile or overnight commercial courier.

(b) Effective Date

For any cancellation or suspension pursuant to Rule 9511(a)(2)(A), the effective date shall be at least 15 days after service of the notice on the member or associated person. For any action pursuant to Rule 9511(a)(2)(B) or (D), the effective date shall be at least seven days after service of the notice on the member or person, except that the effective date for a notice of a limitation or prohibition on access to services offered by the Association or a member thereof with respect to services to which the member, associated person, or other person does not have access shall be upon receipt of the notice.

9800. TEMPORARY CEASE AND DESIST ORDERS

(The entire Rule 9800 Series, and related amendments adopted by SR-NASD-98-80 to Rule 8310, IM-8310-2(d)(1), 9120(x), 9241(c), 9290, 9311(b), 9312(b), 9360, 9511(a), 9513(a) and 9513(b) shall expire on (insert date that is two years after SEC approval of SR-NASD-98-80), unless extended or permanently approved by NASD before such date.)

9810. Initiation of Proceeding

(a) Department of Enforcement or Department of Market Regulation

With the prior written authorization of the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs [Chief

Operating Officer of NASD Regulation, Inc.], the Department of Enforcement or the Department of Market Regulation may initiate a temporary cease and desist proceeding with respect to alleged violations of Section 10(b) of the Securities [and] Exchange Act of 1934 and SEC Rule 10b-5 thereunder; SEC Rules 15g-1 through 15g-9; NASD Rule 2110 (if the alleged violation is unauthorized trading, or misuse or conversion of customer assets, or based on violations of Section 17(a) of the Securities Act of 1933); NASD Rule 2120; or NASD Rule 2330 (if the alleged violation is misuse or conversion of customer assets). The Department of Enforcement or the Department of Market Regulation shall initiate the proceeding by serving a notice on a member or associated person (hereinafter "Respondent") and filing a copy thereof with the Office of Hearing Officers. The Department of Enforcement or the Department of Market Regulation shall serve the notice by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Department of Enforcement or the Department of Market Regulation shall send an additional copy of the notice by overnight commercial courier. The notice shall be effective upon service.

(b) Contents of Notice

The notice shall set forth the rule or statutory provision that the Respondent is alleged to have violated and that the Department of Enforcement or the Department of Market Regulation is seeking to have the Respondent ordered to cease violating. The notice also shall state whether the Department of Enforcement or the Department of Market Regulation is requesting the Respondent to be required to take action or to refrain from taking action. The notice shall be accompanied by:

- (1) a declaration of facts, signed by a person with knowledge of the facts contained therein, that specifies the acts or omissions that constitute the alleged violation; and
- (2) a proposed order that contains the required elements of a temporary cease and desist order (except the date and hour of the order's issuance), which are set forth in Rule 9840(b).

(c) Filing of Underlying Complaint

If the Department of Enforcement or the Department of Market Regulation has not issued a complaint under Rule 9211 against the Respondent relating to the subject matter of the temporary cease and desist proceeding and alleging violations of the rule or statutory provision specified in the notice described in paragraph (b), the Department of Enforcement or the Department of Market Regulation shall serve and file such a complaint with the notice initiating the temporary cease and desist proceeding.

9820. Appointment of Hearing Officer and Hearing Panel

(a) As soon as practicable after the Department of Enforcement or the Department of Market Regulation files a copy of the notice initiating a temporary cease and desist proceeding with the Office of Hearing Officers, the Chief Hearing Officer shall assign a Hearing Officer to preside over the temporary cease and desist proceeding. The Chief Hearing Officer shall appoint two Panelists to serve on a Hearing Panel with the Hearing Officer. The Panelists shall be current or former Governors, Directors, or National Adjudicatory Council members, and at least one Panelist shall be an associated person.

(b) If at any time a Hearing Officer or Hearing Panelist determines that he or she has a conflict of interest or bias or circumstances otherwise exist where his or her fairness might reasonably be questioned, or if a Party files a motion to disqualify a Hearing Officer or Hearing Panelist, the recusal and disqualification proceeding shall be conducted in accordance with Rules 9233 and 9234, except that:

(1) a motion seeking disqualification of a Hearing Officer or Hearing Panelist must be filed no later than 5 days after the later of the events described in paragraph (b) of Rules 9233 and 9234; and

(2) the Chief Hearing Officer shall appoint a replacement Panelist using the criteria set forth in paragraph (a) of this Rule.

9830. Hearing

(a) When Held

The hearing shall be held not later than 15 days after service of the notice and filing initiating the temporary cease and desist proceeding, unless otherwise extended by the Hearing Officer with the consent of the Parties for good cause shown. If a Hearing Officer or Hearing Panelist is recused or disqualified, [in which case] the hearing shall be held not later than five days after a replacement Hearing Officer or Hearing Panelist is appointed.

(b) Service of Notice of Hearing

The Office of Hearing Officers shall serve a notice of date, time, and place of the hearing on the Department of Enforcement or the Department of Market Regulation and the Respondent not later than [four] seven days before the hearing, unless otherwise ordered by the Hearing Officer. Service shall be made by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Office of Hearing Officers shall send an additional copy of the notice by overnight commercial courier. The notice shall be effective upon service.

(c) Authority of Hearing Officer

The Hearing Officer shall have authority to do all things necessary and appropriate to discharge his or her duties as set forth under Rule 9235.

(d) Witnesses

A person who is subject to the jurisdiction of [the Association] NASD shall testify under oath or affirmation. The oath or affirmation shall be administered by a court reporter or a notary public.

(e) Additional Information

At any time during its consideration, the Hearing Panel may direct a Party to submit additional information. Any additional information submitted shall be provided to all Parties at least one day before the Hearing Panel renders its decision.

(f) Transcript

The hearing shall be recorded by a court reporter and a written transcript thereof shall be prepared. A transcript of the hearing shall be available to the Parties for purchase from the court reporter at prescribed rates. A witness may purchase a copy of the transcript of his or her own testimony from the court reporter at prescribed rates. Proposed corrections to the transcript may

be submitted by affidavit to the Hearing Panel within a reasonable time determined by the Hearing Panel. Upon notice to all the Parties to the proceeding, the Hearing Panel may order corrections to the transcript as requested or sua sponte.

(g) Record and Evidence Not Admitted

The record shall consist of the notice initiating the proceeding, the declaration, and the proposed order described in Rule 9810(b); the transcript of the hearing; [and] all evidence considered by the Hearing Panel; and any other document or item accepted into the record by the Hearing Officer or the Hearing Panel. The Office of Hearing Officers shall be the custodian of the record. Proffered evidence that is not accepted into the record by the Hearing Panel shall be retained by the custodian of the record until the date when the [Association's] NASD's decision becomes final or, if applicable, upon the conclusion of any review by the Commission or the federal courts.

(h) Failure to Appear at Hearing

If a Respondent fails to appear at a hearing for which it has notice, the allegations in the notice and accompanying declaration may be deemed admitted, and the Hearing Panel may issue a temporary cease and desist order without further proceedings. If the Department of Enforcement or Department of Market Regulation fails to appear at a hearing for which it has notice, the Hearing Panel may order that the temporary cease and desist proceeding be dismissed.

9840. Issuance of Temporary Cease and Desist Order by Hearing Panel

(a) Basis for Issuance

The Hearing Panel shall issue a written decision stating whether a temporary cease and desist order shall be imposed. The Hearing Panel shall issue the decision not later than ten days after receipt of the hearing transcript, unless otherwise extended by the Hearing Officer with the

consent of the Parties for good cause shown. A temporary cease and desist order shall be imposed if the Hearing Panel finds:

- (1) by a preponderance of the evidence that the alleged violation specified in the notice has occurred; and
- (2) that the violative conduct or continuation thereof is likely to result in significant dissipation or conversion of assets or other significant harm to investors prior to the completion of the underlying disciplinary proceeding under the Rule 9200 and 9300 Series.

(b) Content, Scope, and Form of Order

A temporary cease and desist order shall:

- (1) be limited to ordering a Respondent to cease and desist from violating a specific rule or statutory provision, and, where applicable, to ordering a Respondent to cease and desist from dissipating or converting assets or causing other harm to investors;
- (2) set forth the alleged violation and the significant dissipation or conversion of assets or other significant harm to investors that is likely to result without the issuance of an order;
- (3) describe in reasonable detail the act or acts the Respondent is to take or refrain from taking; and
- (4) include the date and hour of its [service] issuance.

(c) Duration of Order

A temporary cease and desist order shall remain effective and enforceable until the issuance of a decision under Rule 9268 or Rule 9269.

(d) Service

The Office of Hearing Officers shall serve the Hearing Panel's decision and any temporary cease and desist order by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Office of Hearing Officers shall send an additional copy of the Hearing Panel's decision and any temporary cease and desist order by overnight commercial courier. The temporary cease and desist order shall be effective upon service.

9850. Review by Hearing Panel

At any time after the Office of Hearing Officers serves the Respondent with a temporary cease and desist order, a Party may apply to the Hearing Panel to have the order modified, set aside, limited, or suspended. The application shall set forth with specificity the facts that support the request. The Hearing Panel shall respond to the request in writing within ten days after receipt of the request, unless otherwise extended by the Hearing Officer with the consent of the Parties for good cause shown. The Hearing Panel's response shall be served on the Respondent via personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Office of Hearing Officers shall send an additional copy of the temporary cease and desist order by overnight commercial courier. The filing of an application under this Rule shall not stay the effectiveness of the temporary cease and desist order.

9860. Violation of TCDO

A Respondent who violates a temporary cease and desist order imposed under this Rule Series may have its association or membership suspended or canceled under the Rule 9510 Series. The President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs [Chief Operating Officer of NASD Regulation, Inc.] must authorize the initiation of any such proceeding in writing.

9870. Application to Commission for Review

Temporary cease and desist orders issued pursuant to this Rule Series constitute final and immediately effective disciplinary sanctions imposed by NASD [the Association]. The right to have any action under this Rule Series reviewed by the Commission is governed by Section 19 of the Exchange Act. The filing of an application for review shall not stay the effectiveness of the temporary cease and desist order, unless the Commission otherwise orders.