

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 NASD consents, the Commission will:

A. by order approve such proposed rule change, as amended, or

B. institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 File No. SR-NASD-2003-57 and should be submitted by June 25, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

J. Lynn Taylor,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47930; File No. SR-NASD-2003-66]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc. To Rebate Certain Past Primex Auction System Logon Charges for Certain Participants

May 27, 2003.

On April 2, 2003, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to rebate certain past Primex Auction System ("Primex") logon charges for certain participants. Specifically, Nasdaq proposes to modify NASD Rule 7010(r) to enable Nasdaq to waive all Primex logon charges for the period of August 2002 through November 2002 for participants who, in connection with their participation in Primex during that period, were customers of the Brass Service Bureau and Order Management System ("Brass").

The proposed rule change was published for comment in the **Federal Register** on April 24, 2003.³ The Commission received no comments on the proposal.

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.⁴ Specifically, the Commission finds that the proposed rule change promotes the objectives of Section 15A(b)(5) of the Act⁵ which requires that the rules of the association provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities. The Commission believes that the proposed waiver of certain Primex logon charges for the named period is equitable because Primex participants, who are users of Brass, were unable to route orders to Primex and were therefore

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 47692 (April 17, 2003), 68 FR 20197 (April 24, 2003).

⁴ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁵ 15 U.S.C. 78o-3(b)(5).

effectively unable to use the full range of Primex services.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁶ that the proposed rule change (SR-NASD-2003-66) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 03-13944 Filed 6-3-03; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47925; File No. SR-NASD-98-80]

Self-Regulatory Organizations; Order Granting Approval to the Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 3, 4, and 5 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. to Establish a Two-Year Pilot Program Relating to the Issuance of Temporary Cease and Desist Orders

May 23, 2003.

On October 28, 1998, the National Association of Securities Dealers, Inc. ("NASD"), filed with the Securities and Exchange Commission ("SEC" or "Commission"), a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder.² Under its proposal, NASD establishes procedures to enable it to issue temporary cease and desist orders. The proposed rule change and Amendment No. 1³ to the proposal were published for comment in the **Federal Register** on December 30, 1998.⁴ The Commission received five comment letters on the proposal.⁵ On May 17, 1999, August 19,

⁶ 15 U.S.C. 78s(b)(2).

⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The first amendment to the proposal included changes to the evidentiary standard and the tenure of a temporary cease and desist order. See Letter from Alden S. Adkins, Senior Vice President and General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated December 15, 1998 ("Amendment No. 1").

⁴ Securities Exchange Act Release No. 40826 (December 22, 1998), 63 FR 71984. On December 22, 1998, the NASD submitted a written extension of time for the public comment period as Amendment No. 2. The amendment is not subject to notice and comment. See Letter from Alden S. Adkins, Senior Vice President and General Counsel, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated December 21, 1998.

⁵ See Letters to Jonathan G. Katz, Secretary,

¹⁹ 17 CFR 200.30-3(a)(12).

2002, and April 15, 2003, the NASD filed Amendment Nos. 3, 4 and 5 respectively.⁶ The Commission is approving the proposed rule change, and is publishing notice of, and granting accelerated approval to, Amendment Nos. 3, 4, and 5 to the proposed rule change.

I. Description of the Proposal

NASD is proposing to establish, for a two-year period, procedures to enable NASD to issue temporary cease and desist orders. The proposal also would provide NASD with the authority to issue permanent cease and desist orders. Furthermore, the proposed rule change would grant NASD authority to initiate non-summary proceedings when temporary or permanent cease and desist orders are violated.

1. Due Process Procedures

NASD recognizes that temporary cease and desist orders are powerful measures that should be used very cautiously. Consequently, the NASD

Commission, from: Dan Jamieson, dated December 29, 1998 ("Jamieson Letter"); Sam Scott Miller, Orrick, Herrington & Sutcliffe, dated February 9, 1999 ("Orrick Letter"); Peter C. Hildreth, President, North American Securities Administrators Association, Inc., dated March 2, 1999 ("NASAA Letter"); Barbara M.G. Lynn, Chair, Section of Litigation, and James H. Cheek III, Chair, Section of Business Law, Ad Hoc Task Force of the American Bar Association's Sections of Litigation and Business Law, dated March 8, 1999 ("ABA Sections Letter"); and Lee B. Spencer, Chairman, Federal Regulation Committee, R. Gerald Baker, Chairman, Self Regulation & Supervisory Practices Committee, and James Tricarico, President, Compliance & Legal Division, Securities Industry Association, dated March 5, 1999 ("SIA Letter").

⁶ See Letters to Katherine A. England, Assistant Director, Division, Commission, from Alden S. Adkins, Sr. Vice President and General Counsel, NASD Regulation, dated May 14, 1999 ("Amendment No. 3"), from Patrice M. Gliniecki, Vice President and Deputy General Counsel, NASD, dated August 16, 2002 ("Amendment No. 4"), and from Sarah J. Williams, Associate General Counsel, NASD, dated April 14, 2003 ("Amendment No. 5"). In Amendment No. 3, the NASD responded to comments and clarified the context in which the NASD would seek a permanent cease and desist order. In Amendment No. 4, the NASD (i) proposed that the rule change operate for a two-year period, unless extended or permanently adopted before the expiration of the two-year period; (ii) extended the minimum amount of time between service of notice of a hearing and the hearing from four to seven days; (iii) supplemented the discussion of the applicability of Section 19(d) of the Act to a temporary cease and desist order; (iv) made certain technical changes to the rule language to conform the proposal to current NASD practices; and (v) made further non-substantive changes to the discussion of the proposed rule change. In Amendment No. 5, the NASD responded to comments and clarified the discussion of Rule 9850 in which a respondent may seek to have a temporary cease and desist order modified, set aside, limited or suspended and how a respondent may seek to challenge the order, and, in recognition of the U.S. Court of Appeals for the District of Columbia's denial of reconsideration of the SEC's decision against KPMG, LLP, the NASD provided clarifying discussion of the context in which a permanent cease and desist order would be sought.

states that it has designed the rules 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 Programs 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.

In addition, NASD has proposed limiting use of this tool to what it views as the most serious offenses. Under the proposal, 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.⁷

Moreover, 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 NASD believes, therefore, that the proposed rules provide respondents with many procedural protections.

In addition, once the initiation of a temporary cease and desist proceeding has been authorized, 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, must include a declaration of facts that specifies the acts or omissions that constitute the alleged violation,⁸ and must include a proposed order that contains the required elements of a

⁷ 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 just and equitable principles of trade, the alleged violations are limited to violations of Section 17(a) of the Securities Act of 1933 or circumstances involving unauthorized trading or misuse or conversion of customer assets. For NASD 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.

⁸ The declaration of facts must be signed by a person with knowledge of the facts contained in the declaration.

temporary cease and desist order.⁹ In addition, if Enforcement or Market Regulation has not already issued a complaint under NASD 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 the complaint with the notice initiating the temporary cease and desist proceeding.

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),¹⁰ 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, unless the Hearing Officer orders otherwise.¹¹

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 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 duties as set forth in NASD Rule 9235.

The proposed rules also set a specific standard that must be met before a hearing panel can issue 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 before completion of the disciplinary proceeding under the Rule 9200 and 9300 Series. The NASD states that this standard is designed to ensure

⁹ The required elements of a temporary cease and desist order are set forth in proposed Rule 9840(b).

¹⁰ See Proposed Rule 9830(a).

¹¹ See Amendment No. 4.

that a temporary cease and desist order cannot be issued for technical violations of rules; it 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.

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 a 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. 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 conducting business with customers.

2. 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.

3. 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.¹² 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, if a respondent believes the underlying disciplinary proceeding is not being conducted on an expedited basis, the respondent may seek to have the order modified, set aside, limited or suspended under proposed Rule 9850.¹³

Further, the respondent may seek to challenge a temporary cease and desist order by filing an application for review with the SEC pursuant to Section 19 of the Act.¹⁴ A respondent's application to challenge an order, however, will not stay the effectiveness of the order, unless otherwise ordered by the Commission.¹⁵

4. Enforcement of Cease and Desist Orders

The proposed rule change provides the 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,¹⁶ 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. NASD believes that this provision ensures that decisions that can have a significant impact on a respondent are made only at the highest staff level.

In addition, 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

¹² The Hearing Panel issuing the decision in the underlying disciplinary proceeding, however, may issue a permanent cease and desist order as part of any sanctions imposed pursuant to the underlying disciplinary proceeding. NASD will not stay the effectiveness of a permanent cease and desist order if the respondent appeals the decision in the underlying disciplinary proceeding.

¹³ See Amendment No. 5.

¹⁴ Section 19 of the Act provides for the appeal of final disciplinary sanctions imposed by self-regulatory organizations ("SROs").

¹⁵ See Amendment No. 5.

¹⁶ 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.

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.

5. Two-Year Trial Period for Proposed Rule Change

NASD recognizes that temporary cease and desist orders are new and powerful enforcement tools. Therefore, NASD believes the proposed rule change should be adopted on a trial basis, for a two-year period.¹⁷ 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 an extension or adoption. The proposed rule change will describe the staff's experience with the rule and its basis for seeking extension or adoption.

6. 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.¹⁸

II. Summary of Comments

The Commission received five comment letters on the proposed rule change.¹⁹ While all of the commenters applauded the NASD's objective of effective enforcement and fair regulation

¹⁷ See Amendment No. 4.

¹⁸ See Amendment No. 3. Cf. *In Re KPMG*, Exchange Act Release No. 43862 (Jan. 12, 2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002), where the SEC indicated that in determining whether a cease and desist order is appropriate, it would consider factors that provide some showing of risk of future violation, although such showing need not be as great as that required for the imposition of an injunction. The NASD staff states that nothing in this proposed rule change is intended to impose any standards on NASD staff in exercising its prosecutorial discretion in any particular matter, nor is it intended to require that Hearing Officers find that the standards advocated by the SEC in the *KPMG* litigation described above are met in imposing a permanent cease and desist order. See Amendment No. 5.

¹⁹ See *supra* note 5.

of the securities industry, especially in the area of microcap securities fraud, only NASAA generally supported the proposal. The remaining commenters expressed a number of concerns regarding certain provisions of the proposed rule change. The comments submitted to the Commission, and the NASD's response to the comments, are summarized by issue below.

1. Consistent with the Act

NASAA stated its belief that the proposed rule change would be consistent with the provisions of the Act relating to member enforcement, promotion of fair practices and appropriate disciplinary actions by an SRO against its members.²⁰ Three commenters disagreed, questioning the existence of statutory authority for a grant of temporary cease and desist power to NASD.²¹ Two of these commenters argued that this authority falls outside the definition of the term "sanction" under Section 15A of the Act,²² with one of these commenters contending that temporary cease and desist orders are quasi-judicial powers primarily intended to preserve the status quo pending a formal decision, not sanctions.

NASD responded that several provisions of the Act provide SROs 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) of the Act 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. Finally, section 15A(b)(7) of the Act permits an association to sanction its members and persons associated with members through the imposition of any "fitting sanction," and Section 15A(b)(8) of the Act, 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 NASD contends, therefore, that the proposed rules are

consistent with NASD's obligations under Section 15A(b)(2), (6), (7) and (8) of the Act 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.

2. Justification for Temporary Cease and Desist Powers

The Commission specifically requested public comment on whether the NASD has sufficiently justified the need for temporary cease and desist powers. NASAA responded that the exponential growth of the securities markets and in the number of participants, particularly in the area of microcap securities, justifies the need for regulators to utilize all of the enforcement tools available, including the authority to issue a temporary cease and desist order.²³ Three commenters contend, however, that the NASD has not sufficiently justified the need for the extraordinary power to issue temporary cease and desist orders.²⁴ One commenter noted that no other SRO has ever requested temporary cease and desist authority and the Commission has used its cease and desist authority only once in eight years, thereby casting doubt on its usefulness as an enforcement tool.²⁵ Two commenters questioned why the NASD could not refer any matter for which a temporary cease and desist order may be appropriate, along with the supporting documentation required to be recited in the notice and underlying complaint, to the Commission or appropriate state regulator.²⁶

In response, the NASD stated that there is a clear need for an additional tool to stop members' or associated persons' misconduct 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. The NASD notes that, under its current rules, it takes a minimum of four months to complete a disciplinary proceeding. Without a temporary cease and desist rule, NASD believes it has no immediate remedy to order cessation of egregious, ongoing violative conduct.

With respect to its current authority, the NASD notes that it 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. Similarly, the NASD's non-summary suspension rules²⁷ are designed to limit or stop a member's or associated person's ability to conduct business, whereas temporary cease and desist orders are designed to stop ongoing, violative conduct while an underlying disciplinary proceeding is being litigated.

With respect to referring cases to the SEC or a state regulatory authority for prosecution where an emergency exists, NASD responds that its 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. The NASD believes that there are situations where it is in the best position to take immediate action, based on its preexisting investigation and access to case-specific information. In such situations, having to refer the case to another regulatory authority might result in unacceptable delay and would not be an efficient use of NASD's or other regulators' resources.

3. Scope of Predicate Violations

The Commission specifically requested public comment on whether the scope of possible violations should be narrowed. NASAA responded that the scope of predicate violations should not be limited beyond the current restrictions in the proposed rule change because all of the possible violations raise concerns of fraudulent or manipulative conduct or the need for preservation of investor assets and funds.²⁸

Three commenters believe, however, that the predicate rule violations are overly broad. Two of these commenters argued that the predicate violations are broad enough to encompass virtually any alleged violation of securities laws and rules because the proposed violations include basic anti-fraud and manipulation provisions.²⁹ One of the commenters argued that, if the purpose is primarily to protect against potential customer losses, the predicate violations should be limited to alleged violations involving microcap securities.³⁰ In particular, this commenter felt that many alleged cases of unauthorized

²⁰ See 15 U.S.C. 78o-3(b)(2), (6) and (7). See NASAA Letter, p. 2.

²¹ See Jamieson Letter, p. 1, Orrick Letter, p. 5, and SIA Letter, p. 2.

²² See Orrick Letter, p. 5, and SIA Letter, p. 2.

²³ See NASAA Letter, p. 3.

²⁴ See ABA Sections Letter, pgs. 6-7, Orrick Letter, p. 3, SIA Letter, p. 1.

²⁵ See ABA Sections Letter, p. 2.

²⁶ See Orrick Letter, p. 3, and SIA Letter, p. 2.

²⁷ NASD Rules 9511(a)(2) and 9513.

²⁸ See NASAA Letter, p. 2.

²⁹ See SIA Letter, p. 3 and Orrick Letter, p. 3.

³⁰ See ABA Sections Letter, pgs. 7-8.

trading and fraudulent markups are inappropriate for temporary cease and desist proceedings.

In response, the NASD noted that the proposal does not permit it to seek a temporary cease and desist order for any securities law violation because Rule 10b-5 under the Act requires a showing of fraud. In addition, the NASD believes the proposed rule only addresses the forms of misconduct most likely to result in rapid dissipation of investor funds, such as unauthorized trading and charging fraudulent, excessive markups.

4. Due Process

While NASAA believes the proposed rule change contains sufficient safeguards to ensure adequate due process,³¹ Orrick contends that the timetable for a hearing on a temporary cease and desist order fails to give the respondent an adequate amount of time to prepare for the hearing.³² In response to Orrick's concerns, the NASD extended the minimum amount of time between service of notice of a hearing and the hearing date from four to seven days.³³

5. Standard for Issuance of a Temporary Cease and Desist Order

Two commenters believe that the "preponderance of evidence" standard, alone, is an inadequate basis for granting the extraordinary relief of a temporary cease and desist order.³⁴ These commenters contend that there should be a finding that investors will be irreparably harmed or that their chances of subsequent recovery will be damaged by the standard disciplinary process. One commenter further believes that, in cases that do not involve potential investor losses, there should be a finding that there is a substantial likelihood that respondents will engage in future violations. Another commenter contends that the standard for issuance of a temporary cease and desist order invites arbitrary imposition of orders based on subjective interpretation of the standard.³⁵

NASD responds that the "likelihood of success" standard is an inappropriate standard in the context of the other required showings, and 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 the disciplinary action is proceeding,

could pay any potential arbitration or mediation awards, NASD would be unable to stop the ongoing fraudulent activity until the completion of the regular disciplinary proceeding. The NASD notes that the member's financial condition often significantly changes after the conclusion of the disciplinary proceeding. 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.

6. Review of Temporary Cease and Desist Order

Two commenters noted that, unlike a temporary cease and desist order issued by the Commission, entry of a temporary cease and desist order issued by the NASD cannot be immediately appealed to a U.S. District Court. These 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.³⁶

NASD responded that it believes a temporary cease and desist order should be considered a final disciplinary sanction of NASD under Section 19(d) of the Act and, therefore, should be appealable to the SEC as soon as the order is 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 violating a rule, to cease specified violative conduct, and, as appropriate, to cease and desist dissipating or converting assets. In addition, NASD notes that a temporary cease and desist order is immediately effective and enforceable and, moreover, a respondent that violates the terms of a temporary cease and desist order can have its membership or registration suspended or canceled.³⁷

³⁶ See SIA Letter, p. 4, and Orrick Letter, p. 4.

³⁷ NASD believes that its 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). NASD states that the Commission found that

7. Permanent Cease and Desist Authority

One commenter strongly opposed the provision that allows the NASD to impose a permanent cease and desist order on the grounds that the industry and other interested parties had not been provided adequate notice of the provision.³⁸ This commenter further stated that the NASD has not articulated either a purpose or need for permanent cease and desist powers, a compelling justification for the authority, the circumstances in which a permanent cease and desist order would be sought, or the evidentiary standard for issuance.

The NASD responded that it did not highlight the issue of permanent cease and desist authority because it believes it already has the authority to issue them as an "other fitting sanction" under NASD Rule 8310. In response to the commenter's concerns, however, the NASD added language that it does not anticipate seeking permanent cease and desist orders on a routine basis, and listed the factors the NASD will consider in determining whether a permanent cease and desist order is appropriate.³⁹

8. Collateral Consequences

The Commission solicited comments on what impact, if any, the issuance of a temporary cease and desist order will have on other laws (other than the federal securities laws). Two commenters responded that the proposal did not contain any consideration of the potential collateral consequences of a temporary cease and desist order.⁴⁰ These commenters contend that the NASD should evaluate the potential collateral consequences of the issuance of a temporary cease and desist order and report the results before Commission approval of the proposed rule change.

NASD responded that it believes the use of temporary cease and desist authority will have limited collateral effects. The NASD reviewed the state securities laws and did not find any state statute that would mandate the denial, suspension, or revocation of a broker-dealer's registration based on the

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 NASD contends that 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 that the letter of caution had been reported to the Central Registration Depository ("CRD").

³⁸ See ABA Sections Letter, pgs. 17-19.

³⁹ See Amendment Nos. 3 and 5.

⁴⁰ See ABA Sections Letter, pgs. 14-15, and SIA Letter, pgs. 4-5.

³¹ See NASAA Letter, p. 2.

³² See Orrick Letter, p. 4.

³³ See Amendment No. 4.

³⁴ See ABA Sections Letter, p. 9, and Orrick Letter, p. 4.

³⁵ See SIA Letter, p. 4.

imposition of a cease and desist order by the NASD.⁴¹ In addition, the NASD does not believe that respondents will be collaterally estopped from contesting issues in customer disputes because arbitrators are not required to apply the same legal standards as the courts. Finally, the NASD stated that it would work with other regulators in coordinating the use of the cease and desist authority as an enforcement tool to help prevent regulators from “piling” sanctions on respondents.

III. Discussion

The Commission finds that the proposed rule change is consistent with the provisions of Section 15A(b)⁴² of the Act, in general, and furthers the objectives of Section 15A(b)(6),⁴³ in particular, in that it is 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.⁴⁴ The Commission believes that the proposed rule change will protect investors and the public interest by improving the NASD's capability to prevent fraudulent and manipulative acts and practices, such as unauthorized trading in a customer's account.

The Commission further finds that the proposed rule change is a “fitting sanction” under Section 15A(b)(7) of the Act. One commenter's argument that temporary cease and desist orders are “quasi-judicial powers primarily intended to preserve the status quo” and are “not designed to function as sanctions” is not accurate in this context. For the Commission to issue a temporary cease and desist order under Section 21C of the Act, it must only find that an alleged or threatened violation specified in the permanent cease-and-desist complaint is likely to result in significant dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest before completion of the permanent cease-and-desist proceeding. Thus, unlike a NASD issued temporary cease and desist order, the Commission does not have to find an actual violation before issuing a temporary cease and desist order.

The NASD's proposal requires the NASD to prove its case by finding an actual violation by a preponderance of the evidence; in other words, there is a

ruling on the merits. Accordingly, the imposition of a temporary cease and desist order can be a “sanction” for the finding of wrongdoing under Section 15A(b)(7) of the Act.

The Commission further finds that the proposed rule change is consistent with Section 15A(b)(8) of the Act in that it provides for a fair procedure for disciplining members and persons associated with members. Temporary cease and desist proceedings are designed to occur on an expedited basis to help stop ongoing violations that are likely to result in a significant dissipation or conversion of assets or other significant harm to investors. In response to a commenter's concerns that there was inadequate time to prepare for a hearing, however, the NASD extended the minimum amount of time between service of notice of a hearing and the hearing date from four to seven days. This should give respondents sufficient time to prepare a response to the NASD's detailed allegations set forth in the notice.

Commenters also believe that the “preponderance of evidence” standard, alone, is an inadequate basis for granting a temporary cease and desist order. The preponderance of the evidence standard, however, is consistent with the standard in civil actions generally, including Commission actions.⁴⁵

With respect to the ability of the NASD to impose a permanent cease and desist order, the NASD has articulated the factors it will consider before imposing an order. The Commission notes in *In Re KPMG* that, in determining whether a cease and desist order is appropriate, it would consider factors that provide some showing of risk of future violation, although such showing need not be as great as that required for the imposition of an injunction.⁴⁶

IV. Accelerated Approval of Amendment Nos. 3, 4 and 5

The Commission finds good cause for approving Amendment Nos. 3, 4 and 5 prior to the thirtieth day after publication in the **Federal Register**. The Commission believes that NASD has responded adequately to commenters' concerns and suggestions by incorporating certain commenters' recommendations into the proposed rule language and discussion in Amendment Nos. 3, 4 and 5, and by explaining why it was not incorporating

others. Further, the Commission notes that there were no language changes to the rule in Amendment Nos. 3 and 5, and the only substantive changes to the rule language in Amendment No. 4 are the implementation of the proposal relating to the temporary cease and desist orders as a two-year pilot program and the extension of the minimum amount of time between the notice of the hearing and the hearing date. Both of these changes were made in response to commenters' concerns. Thus, the substance of the proposed rule change was provided in the Notice and has been the subject of a full comment period. Accordingly, the Commission believes that there is good cause, consistent with Section 19(b) of the Act,⁴⁷ to approve Amendment Nos. 3, 4 and 5 to the proposal on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 3, 4 and 5, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 at the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-98-80 and should be submitted by June 25, 2003.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NASD-98-80) as amended by Amendment No. 1 be, and it hereby is, approved, and that Amendment Nos. 3, 4 and 5 to the proposed rule change be, and they hereby are, approved on an accelerated basis. With respect to the NASD's authority to issue a temporary cease and desist order, it is hereby approved on an accelerated basis as a two-year pilot

⁴¹ See Amendment No. 3.

⁴² 15 U.S.C. 78o-3(b).

⁴³ 15 U.S.C. 78o-3(b)(6).

⁴⁴ In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴⁵ See *Steadman v. Securities and Exchange Commission*, 450 U.S. 91 (1981); *Seaton v. Securities and Exchange Commission*, 670 F.2d 309 (D.C. Cir. 1982).

⁴⁶ See also footnote 18.

⁴⁷ 15 U.S.C. 78f(b) and 78s(b).

program. The NASD will publish a Notice to Members announcing the effectiveness of the temporary cease and desist order pilot. The pilot will expire two years after the date of publication of Notice to Members.⁴⁸

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴⁹

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47935; File No. SR-NSCC-2003-07]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating To Balance Order Transaction Data Reporting and Other Technical Corrections

May 28, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on April 10, 2003, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The purpose of the proposed rule change is to modify NSCC Procedure V to allow NSCC to report Balance Order transaction data on the Consolidated Trade Summary delivered to participants. The proposed rule change will also correct errors in NSCC Procedure VII.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NSCC 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. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.²

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

As part of NSCC's straight through processing development efforts, NSCC is revising its Continuous Net Settlement and Balance Order processing. As part of this initiative, NSCC has decided to modify the manner in which it reports Balance Order transaction data to participants in order to make such information more readily available in a more efficient and cost effective manner. Starting on July 25, 2003, Balance Order information will be reported on the Consolidated Trade Summary.

The proposed modification to Procedure V, "Balance Order Accounting Operation," implements this change. In addition, the proposed rule change clarifies that the Consolidated Trade Summary is issued on each day that is a settlement day. The proposed rule change further corrects erroneous cross references and a typographical error in Procedure VII, section E, subsections 4(a) and (b), respectively.

The proposed rule change is consistent with Section 17A(b)(3)(F) of the Act³ and the rules and regulations thereunder because it will enable NSCC to report Balance Order transaction data to its participants in an easier, more cost efficient manner thereby facilitating the prompt and accurate clearance and settlement of securities transactions.

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

NSCC does not believe that the proposed rule change will have an impact on or impose a burden on competition.

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

No written comments relating to the proposed rule change have been solicited or received. NSCC consulted with the Securities Industry Association's Straight Through Processing Subcommittee in developing the reporting modifications. NSCC

advised participants of the proposed modifications in Important Notice A 5482, P&S 5052 (September 25, 2002). NSCC will notify the Commission of any written comments received by NSCC.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change will take effect on July 25, 2003, pursuant to Section 19(b)(3)(A)(iii) of the Act⁴ and Rule 19b-4(f)(4)⁵ thereunder because the proposed rule effects a change in an existing service of NSCC which neither (1) adversely affects the safeguarding of securities or funds in NSCC's custody or control or for which NSCC is responsible nor (2) significantly affects the rights or obligations of NSCC or persons using the service. At any time within sixty days of the filing of such rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-NSCC-2003-07. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 Section, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of

⁴⁸ See Amendment No. 4.

⁴⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² The Commission has modified the text of the summaries prepared by NSCC.

³ 15 U.S.C. 78q(b)(3)(F).

⁴ 15 U.S.C. 78s(b)(3)(A)(iii).

⁵ 17 CFR 240.19b-4(f)(4).