

Patrice M. Gliniecki
Vice President and
Deputy General Counsel

VIA MESSENGER

June 28, 2001

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

Re: **File No. SR-NASD-00-39 Amendment to Schedule A of the NASD By-Laws for the Timely Filing of Reports, and Amendments to IM-9216; Amendment No. 3**

Dear Ms. England:

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 19b-4 thereunder, NASD Regulation, Inc. ("NASD Regulation" or "Association") is submitting Amendment No. 3 to the above-numbered rule filing. The purpose of this amendment is to respond to comments made by Securities and Exchange Commission ("SEC") staff regarding the proposed rule change. NASD Regulation is revising the rule filing concerning certain provisions for the expansion of the Association's minor rule violation plan. Amendment No. 3 does not make any change to the rule filing with regard to Schedule A of the National Association of Securities Dealers, Inc. ("NASD") By-Laws.

Background

On June 20, 2000, NASD Regulation filed a proposed rule change with the SEC to amend Schedule A of the NASD By-Laws to establish fees for the untimely filing by members of certain reports and to expand the list of violations contained in NASD Interpretive Material ("IM") 9216 that would be appropriate for disposition under a plan established pursuant to SEC Exchange Act Rule 19d-1(c)(2).

Specifically, NASD Regulation proposes to establish administrative fees under Schedule A of the NASD By-Laws for the untimely filing by members of certain reports. Initially, the late fees would be limited to the late filing of reports filed pursuant to SEC Exchange Act Rule 17a-5. In addition, NASD Regulation proposes to expand the Association's plan that contains a list of

rules as identified in IM-9216 where fines may be assessed to members or individuals for minor violations of rules. The expansion of the plan would include certain membership, conduct, marketplace, and financial responsibility rules, as well as Municipal Securities Rulemaking Board ("MSRB") rules. These proposed changes were in response to a request from the membership for alternative mechanisms to achieve regulatory compliance in an effective and efficient manner. The proposed rule filing was issued as Securities Exchange Act Release No. 43330 on September 22, 2000,¹ and was published in the *Federal Register* for public comments.² The comment period announced in the *Federal Register* expired on October 20, 2000. No comments were received.

Proposed Minor Rule Violation Plan Provisions

The following are the proposed changes to the Association's minor rule violation plan that are being made in response to comments from SEC staff. As noted above, NASD Regulation is not modifying in this amendment the portion of the proposed rule change concerning Schedule A of the NASD By-Laws.

Continuing Education – NASD Rule 1120

As originally filed, the proposed rule change would allow NASD Regulation staff to issue minor violations to a firm that has not fully complied with the continuing education requirements of NASD Rule 1120. In response to SEC staff concerns, NASD Regulation is amending the proposed rule change to limit NASD Regulation's authority to issue minor violations to firms that are not in compliance with the Firm Element of NASD Rule 1120.³ Member firm violations of the Regulatory Element of NASD Rule 1120 will not be eligible for consideration as minor violations of the rule.

In evaluating a violation of the Firm Element of NASD Rule 1120, the staff considers the length of time that the firm failed to fully comply with the rule; the number of registered persons

¹ Securities Exchange Act Release No. 43330 incorporated Amendments No. 1 and No. 2. Amendment No. 1 provided clarifying language to assist in describing the requirements under Rule 1120 and technical, non-substantive changes to other provisions of the original proposal. Amendment No. 2 provided a technical, non-substantive change to the original proposal.

² 65 FR 58585 (September 29, 2000).

³ The Firm Element of the continuing education requirements of Rule 1120(b) states that a member firm must: (1) annually evaluate and prioritize its training needs; (2) develop a written training plan based on that analysis; (3) implement the plan in accordance with the evaluation and written plan; and (4) maintain records documenting the content of the program and completion of the program by covered registered persons. Rule 1120(b) further requires that the training plan be appropriate for the business of the firm and include the specific subject matters required by the rule.

affected; the experience of the registered representatives in the securities industry and with the financial products marketed by the firm; and the nature of the firm's business. The staff also considers whether the firm corrected any deficiencies promptly after receiving notice from the staff and whether the firm was the subject of prior formal or informal disciplinary action. In general, a minor violation of the rule would be considered for non-technical violations of the rule where, for instance, the firm has made a good faith effort to comply with the rule's requirements, provided training to all or substantially all of its registered representatives, has no prior formal or informal action in this area, and has corrected any deficiencies promptly after being contacted by the staff.

Notifications Pursuant to NASD Rule 4619(d)

As originally filed, the proposed rule change also would allow NASD Regulation staff to issue minor violations to firms that do not file in a timely manner notifications pursuant to NASD Rule 4619(d). For purposes of background, SEC Regulation M requires market makers to notify the NASD in advance of their intention to engage in passive market making or when they seek an excused withdrawal from making a market in a security. Regulation M allows the NASD to prescribe the form of the notification, which is set forth in NASD Rule 4619.⁴ Specifically, NASD Rule 4619(d) requires a member to file an Underwriting Activity Report no later than close of business the day before the member wishes to have its quotations identified as those of a passive market maker or intends to withdraw its quotations.

In light of SEC staff comments concerning the Association's authority to issue a violation for a minor violation of the rule, NASD Regulation is only proposing use of the authority for Rule 4619(d) similar to the minor rule violation authority granted to the New York Stock Exchange ("NYSE") for its Rule 392, "Notification Requirements for Offerings of Listed Securities."⁵ NYSE Rule 392 sets forth the form and time frame for filings with the NYSE pursuant to Regulation M. NASD Regulation proposes that untimely notifications filed pursuant to NASD Rule 4619(d) may be appropriate for disposition as a minor violation, where, for instance, a member inadvertently misses the filing deadline but files the notification the following day before the commencement of trading and no customer harm has occurred. Notifications intentionally filed late would not be appropriate for disposition as a minor violation of the rule.

⁴ 17 CFR 242.103(b)(6).

⁵ Securities Exchange Act Release No. 40138 (June 26, 1998).

Synchronization of Business Clocks Pursuant to NASD Rule 6953

In response to concerns raised by SEC staff, NASD Regulation is amending the proposed rule change to delete NASD Rule 6953, "Synchronization of Member Business Clocks," from the proposed rule expansion of NASD IM-9216.

SEC Exchange Act Rule 17a-11

In response to concerns raised by SEC staff, NASD Regulation is amending the proposed rule change to delete SEC Exchange Act Rule 17a-11, "Notification Provisions for Brokers and Dealers," concerning the filing of net capital reports from the proposed rule expansion of NASD IM-9216.

Payment of Annual Fees Under MSRB Rule A-14

The proposed rule change would permit NASD Regulation staff to issue minor violations to member firms that do not pay in a timely manner the annual fee due to the MSRB pursuant to MSRB Rule A-14. In response to concerns raised by SEC staff, NASD Regulation wants to clarify that in the event NASD Regulation staff were to issue a minor violation to a firm for failure to pay the annual fee in a timely manner, the firm would remain obliged to pay the annual fee to the MSRB. Firms would not be permitted to pay the minor violation fine in lieu of paying the annual fee to the MSRB.

Purpose Section

NASD Regulation would like to amend the statement made in the "Purpose" section of the proposed rule change filed with the SEC concerning the proposed fine levels that can be assessed for minor violations of rules. As originally filed, the proposed rule change would have increased fines for minor violations of rules by member firms not to exceed \$5,000, to correspond to the NYSE fine level for member organizations. After further consideration of this issue, NASD Regulation has decided to retain the current fine levels for minor violations of rules by member firms. The change should be made in the second paragraph of the section entitled, "Minor Rule Violation Plan." The statement, "The Association intends to assess fines not to exceed \$2,500 for violations by individuals and not to exceed \$5,000 for violations by member firms." should be changed to read, "The Association intends to assess fines not to exceed \$2,500 for violations by individuals or member firms."

In addition, NASD Regulation also would like to clarify the statements in the "Purpose" section of the proposed rule change under the heading, "MSRB Rules G-12 and G-14 – Failure to

Report Transactions or Inaccurate Reporting of Transactions." This language is replacing the language originally filed with the SEC to clarify the types of information to be used by NASD Regulation staff to determine when a minor violation of MSRB Rules G-12 and G-14 is found. The entire section should be replaced with the following language:

MSRB Rules G-12 and G-14 - Failure to Report Transactions or Inaccurate Reporting of Transactions. The Association believes that failure to report transactions may be appropriate for disposition as a minor violation of the rules. Similarly, inaccurate or untimely transaction reporting or information transmittal under these rules also may be appropriate for disposition as a minor violation of the rules. The NASD uses certain information to determine a member's compliance with MSRB Rule G-14 reporting requirements and related MSRB Rule G-12 requirements concerning clearance and settlement. With respect to determining a member's compliance with inter-dealer only trades, NASD Regulation uses as one factor, the "T-Input Percentage." The T-Input Percentage is an indicator compiled by the National Securities Clearing Corporation, Inc. which provides information on the accuracy and timely submission of reports on inter-dealer municipal securities transactions.

Other indicators used to determine a member's compliance with MSRB Rules G-14 and G-12 for both inter-dealer and customer municipal securities transactions include, among other things: 1) the accuracy of the effecting broker symbol; 2) the accuracy or the reporting of time of trade; 3) the number of canceled and/or amended transactions; and 4) the number of late-trade submissions.

Based upon an evaluation of these factors, NASD Regulation believes that the failure by a member firm to submit transaction reports or the filing of inaccurate or untimely transaction reports pursuant to MSRB Rules G-12 and G-14 may, in instances of minor or technical violations of the rules, be appropriate for disposition as minor violations. Significant non-compliance with the requirements of MSRB Rules G-12 and G-14 could warrant more formal disciplinary proceedings by the Association. Subsequent non-compliance using these criteria may warrant the filing of a formal complaint.

Amended Rule Language

As noted above, NASD Regulation is herein revising the proposed rule language. The attached proposed rule language has been marked to show revisions as filed with the SEC and as modified by Amendments No. 1 and No. 2. The proposed additions of Amendment No. 3 are underlined; proposed deletions of Amendment No. 3 are in brackets.

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If you have any questions, please contact Greg Dean, Office of General Counsel, NASD Regulation, Inc. at (202) 728-8159; e-mail gregory.dean@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Patrice M. Gliniecki

cc: Joseph P. Morra, Special Counsel, SEC

TEXT OF PROPOSED RULE CHANGE

Amendment No. 3 to SR-NASD-00-39
(Additions are underlined; deletions are bracketed.)

Schedule A to the NASD By-Laws

Assessments and fees pursuant to the provisions of Article VI of the By-Laws of the NASD shall be determined on the following basis:

* * *

Section 2-Fees

(a) through (k) No Change.

(1) (1) Unless a specific temporary extension of time has been granted, there shall be imposed upon each member required to file reports, as designated by this paragraph, a fee of \$100 for each day that such report is not timely filed. The fee will be assessed for a period not to exceed 10 business days. Requests for such extension of time must be submitted to the Association at least three business days prior to the due date; and

(2) Any report filed pursuant to this Rule containing material inaccuracies or filed incompletely shall be deemed not to have been filed until a corrected copy of the report has been resubmitted.

(3) List of Designated Reports:

(A) SEC Rule 17a-5 -Monthly and quarterly FOCUS reports and annual audit reports.

* * *

IM-9216. Violations Appropriate for Disposition Under Plan Pursuant to SEC Rule 19d-1(c)(2)

-Rule 2210(b) and (c) and Rule 2220(b) and (c) - Failure to have advertisements and sales literature approved by a principal prior to use; failure to maintain separate files of advertisements and sales literature containing required information; and failure to file advertisements with the Association within the required time limits.

-Rule 3360 -Failure to timely file reports of short positions on Form NS-1.

-Rule 3110 -Failure to keep and preserve books, accounts, records, memoranda, and correspondence in conformance with all applicable laws, rules, regulations and statements of policy promulgated thereunder, and with the Rules of the Association.

-Rule 8211, Rule 8212, and Rule 8213 -Failure to submit trading data as requested.

-Article IV of the NASD By-Laws -Failure to timely submit amendments to Form BD.

- Article V of the NASD By-Laws -Failure to timely submit amendments to Form U-4.
- Rule 1120 -Failure to comply with the Firm Element of the continuing education requirements.
- Rule 3010(b) -Failure to timely file reports pursuant to the Taping Rule.
- Rule 3070 -Failure to timely file reports.
- Rule 4619(d) -Failure to timely file notifications pursuant to SEC Regulation M.
- Rules 4632, 4642, 4652, 6240, 6420, 6550, 6620, And 6720 -Transaction reporting in equity, convertible debt, and high yield securities.
- Rules 6130 and 6170 -Transaction reporting to the Automated Confirmation Transaction Service ("ACT").
- [-Rule 6953 -Synchronization of member business clocks.]
- Rules 6954 and 6955 -Failure to submit data in accordance with the Order Audit Trail System ("OATS").
- Rule 11870 -Failure to abide by Customer Account Transfer Contracts.
- SEC Exchange Act Rule 11Ac1-4 -Failure to properly display limit orders.
- SEC Exchange Act Rule 11Ac1-1(c)(5) -Failure to properly update published quotations in certain Electronic Communication Networks ("ECN's").
- SEC Exchange Act Rule 17a-5 -Failure to timely file FOCUS reports.
- [-SEC Exchange Act Rule 17a-11 -Failure to timely file net capital reports.]
- MSRB Rule A-14 -Failure to timely pay annual fee.
- MSRB Rule G-12 -Failure to abide by uniform practice rules.
- MSRB Rule G-14 -Failure to submit reports.
- MSRB Rule G-36 -Failure to timely submit reports.
- MSRB Rule G-37 -Failure to timely submit reports for political contributions.
- MSRB Rule G-38 -Failure to timely submit reports detailing consultant activities.