

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-54051; File No. SR-NASD-2006-070]

**Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change To Amend the Safe Harbor for Business Expansions**

June 27, 2006.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) <sup>1</sup> and Rule 19b-4 thereunder, <sup>2</sup> notice is hereby given that on June 2, 2006, the National Association of Securities Dealers, Inc. (“NASD”) 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 by NASD. 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 amend NASD Interpretative Material 1011-1 (Safe Harbors for Business Expansions) (“NASD IM-1011-1”) to limit the types of violations of NASD Rule 2110 (Standards of Commercial Honor and Principles of Trade) that would result in a member being ineligible to use the safe harbor for business expansions and to make certain technical changes. Below is the text of the proposed rule change. Proposed new language is *in italics*; proposed deletions are in [brackets]. IM-1011-1. Safe Harbor[s] for Business Expansions

This interpretive material concerns the types of business expansions that will not require a member to submit a Rule 1017 application to obtain NASD’s [Regulation’s] approval of the expansion. This safe harbor applies to: (1) Firms that do not have a membership agreement, and (2) firms that have a membership agreement that does not contain a restriction on the factors listed below.

The safe harbor is not available to a member that has a membership agreement that contains a specific restriction as to one or more of the factors listed below. In that case, the agreement takes precedence because NASD [Regulation] has determined that a particular restriction should apply as to one or more of the factors, and NASD [Regulation] has issued a decision with a rationale for that restriction. Similarly, the safe harbor also does not apply if the member has a membership agreement that permits expansion beyond the limits set forth below (e.g., an Applicant requests and obtains approval for ten registered representatives in the first six months with an additional ten registered representatives in the next year); in such case, [the Department] NASD has specifically considered the firm’s expansion plans and approved them.

The safe harbor is not available to any member that has disciplinary history. For purposes of this Interpretation, “disciplinary history” means a finding of a violation by the member or a principal of the member in the past five years by the Securities and Exchange Commission, a self-regulatory organization, or a foreign financial regulatory authority of one or more of the following provisions (or a

comparable foreign provision) or rules or regulations thereunder: *violations of the types enumerated in Section[s] 15(b)(4)(E) [and 15(c)] of the Securities Exchange Act of 1934; Section 15(c) of the Securities Exchange Act of 1934; Section 17(a) of the Securities Act of 1933; SEC Rules 10b-5 and 15g-1 through 15g-9; NASD Rules 2110 (only if the finding of a violation is for unauthorized trading, churning, conversion, material misrepresentations or omissions to a customer, front-running, trading ahead of research reports or excessive markups), 2120, 2310, 2330, 2440, 3010 (failure to supervise only), 3310, and 3330; and MSRB Rules G-19, G-30, and G-37(b) & (c).*

For those firms to which the safe harbor is available, the following types of expansions are presumed not to be a material change in business operations and therefore do not require a Rule 1017 application. For any expansion beyond these limits, a member should contact its district office prior to implementing the change to determine whether the proposed expansion requires an application under Rule 1017. Expansions in each area are measured on a rolling 12-month basis; members are required to keep records of increases in personnel, offices, and markets to determine whether they are within the safe harbor.

“Associated Persons involved in sales” includes all Associated Persons, whether or not registered, who are involved in sales activities with public customers, including sales assistants and cold callers, but excludes clerical, back office, and trading personnel who are not involved in sales activities.

Number of Associated Persons Involved in Sales	Safe Harbor—Increase Permitted Within One Year Period Without Rule 1017 Application
1-10 .....	10 persons.
11 or more .....	10 persons or a 30 percent increase, whichever is greater.
Number of Offices (registered or unregistered):	
1-5 .....	3 offices.
6 or more .....	3 offices or a 30 percent increase, whichever is greater.
Number of Markets Made:	
1-10 .....	10 markets.
11 or more .....	10 markets or a 30 percent increase, whichever is greater.

\* \* \* \* \*

**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.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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

1. Purpose

NASD Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations) requires that a member submit an application to NASD for approval prior to, among other things, making a "material change in business operations," which is defined in NASD Rule 1011.<sup>3</sup> NASD IM-1011-1 creates a safe harbor for certain types of expansions that are presumed not to be a "material change in business operations" and therefore do not require NASD approval.<sup>4</sup> This provides members with greater certainty regarding which expansions require approval and eliminates unnecessary applications for approval of business changes.

However, the safe harbor in NASD IM-1011-1 is not available to any member that, among other things, has a "disciplinary history" as defined in NASD IM-1011-1.<sup>5</sup> For purposes of NASD IM-1011-1, disciplinary history means a finding of a violation by a member or a principal of the member in the past five years by the SEC, a self-regulatory organization, or a foreign financial regulatory authority of one or more specified provisions (or comparable foreign provisions) or rules

or regulations thereunder,<sup>6</sup> including NASD Rule 2110.<sup>7</sup>

When a member or individual is charged with violating an NASD rule, NASD frequently charges a violation of NASD Rule 2110 as part of NASD's action (in both settled and litigated matters).<sup>8</sup> Thus, the inclusion of NASD Rule 2110 in NASD IM-1011-1, without any limitation, often results in members being ineligible to use the safe harbor if they (or any of their principals) have violated any other NASD rule, which was not the intended effect. Rather, the safe harbor specifically included a finite list of rules, the violation of which would preclude the member from using the safe harbor, and was not intended to capture violations of all NASD rules.

Accordingly, with respect to violations of NASD Rule 2110, NASD proposes amendments to NASD IM-1011-1 that would deem a member ineligible to use the safe harbor only where the finding of a violation of NASD Rule 2110 by the member or a principal of the member raises significant investor protection issues by involving unauthorized trading, churning, conversion, material misrepresentations or omissions to a customer, front-running, trading ahead of research reports or excessive markups.<sup>9</sup> Therefore, a member would not be eligible to rely on the safe harbor for material changes in business operations if the member or any of its principals have been found, within the past five years, to have violated NASD Rule 2110 in the context of one or more of these enumerated activities (or to

have violated any of the other rules specified in NASD IM-1011-1).

In addition, NASD proposes to make a technical correction to the rule text with respect to the inclusion of section 15(b)(4)(E) of the Act in the list of rules the violation of which would preclude a member from relying on the safe harbor under NASD IM-1011-1. Section 15(b)(4)(E) of the Act lists the willful violations that will result in the statutory disqualification of a broker or dealer under the Federal securities laws. A member or principal of a member is not able to violate this section *per se*. Accordingly, the proposed rule change clarifies that a member would be ineligible to use the safe harbor in the event that a member or any of its principals has been found to have engaged in one or more violations of the type specified in section 15(b)(4)(E) of the Act in the past five years.

NASD will announce the effective date of the proposed rule change in a *Notice to Members* to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the *Notice to Members* announcing Commission approval.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of section 15A of the Act,<sup>10</sup> in general, and with section 15A(b)(6) of the Act,<sup>11</sup> which requires, among other things, that NASD rules must 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 believes that limiting the types of violations of NASD Rule 2110 that constitute "disciplinary history" for purposes of NASD IM-1101-1 will allow additional firms to be able to rely on the safe harbor consistent with the original intent of the IM, while at the same time continuing to ensure investor protection by deeming a member ineligible to use the safe harbor where the violation of NASD Rule 2110 by the member or a principal presents significant investor protection issues.

*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.

<sup>3</sup> A "material change in business operations" is defined in NASD Rule 1011(i) and includes, but is not limited to: removing or modifying a membership agreement restriction; market making, underwriting, or acting as a dealer for the first time; and adding business activities that require a higher minimum net capital under SEC Rule 15c3-1.

<sup>4</sup> The safe harbor permits within a one year period (1) an increase of 10 persons if the firm has 10 or less associated persons in sales, or an increase of 10 persons or a 30 percent increase, whichever is greater, if the firm has 11 or more associated persons in sales; (2) an increase of 3 offices if the firm has 5 or less offices, or an increase of 3 offices or a 30 percent increase, whichever is greater, if the firm has 6 or more offices; and (3) an increase of 10 markets to be made if the firm makes 10 or less markets, or an increase of 10 markets or a 30 percent increase, whichever is greater, if the firm makes 11 or more markets.

<sup>5</sup> The safe harbor is also generally not available to members with membership agreements that contain certain restrictions on number of personnel, offices, and markets that may be made.

<sup>6</sup> The applicable provisions are sections 15(b)(4)(E) and 15(c) of the Securities Exchange Act of 1934; section 17(a) of the Securities Act of 1933; SEC Rules 10b-5 and 15g-1 through 15g-9; NASD Rules 2110, 2120 (Use of Manipulative, Deceptive or Other Fraudulent Devices), 2310 (Recommendations to Customers (Suitability)), 2330 (Customers' Securities or Funds), 2440 (Fair Prices and Commissions), 3010 (Supervision-failure to supervise only), 3310 (Publication of Transactions and Quotations), and 3330 (Payment Designed to Influence Market Prices, Other than Paid Advertising); and MSRB Rules G-19, G-30 and G-37(b) and (c).

<sup>7</sup> NASD Rule 2110 requires that "a member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."

<sup>8</sup> See Joseph Abbondante, Securities Exchange Act Release No. 53066 (January 6, 2006) at 36 ("It is well settled that a violation of a rule promulgated by the SEC or by NASD also violates NASD Conduct Rule 2110.")

<sup>9</sup> The proposed limits on violations of NASD Rule 2110 mirror the limits on NASD Rule 2110 with respect to the public release of disciplinary complaints. See NASD IM-8310-2 (Release of Disciplinary and Other Information Through BrokerCheck) and the related *Notice to Members* 97-42 (July 1997).

<sup>10</sup> 15 U.S.C. 78o-3.

<sup>11</sup> 15 U.S.C. 78o3(b)(6).

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

Written comments were neither solicited nor received.

**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 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, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

*Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2006-070 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-070. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2006-070 and should be submitted on or before July 26, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

[FR Doc. E6-10434 Filed 7-3-06; 8:45 am]

BILLING CODE 8010-01-P

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-54053; File No. SR-NASD-2003-168]

**Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Amendment Nos. 4 and 5 to the Proposed Rule Change Relating to the Release of Information Through NASD BrokerCheck**

June 27, 2006.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 6, 2006 and June 22, 2006, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission") Amendment Nos. 4 and 5, respectively, to the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The proposed rule change, incorporating Amendment Nos. 1, 2, and 3, was published for comment in the **Federal Register** on June 30, 2005.<sup>3</sup> The Commission received eight comment letters in response to the Notice.<sup>4</sup> The Commission is publishing

this notice to solicit comments on the proposed rule change, as amended by Amendment Nos. 4 and 5, from interested persons.

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

In response to comments on the Notice, NASD proposes additional amendments to NASD Interpretive Material 8310-2 ("IM-8310-2")<sup>5</sup> regarding disclosures through NASD BrokerCheck.<sup>6</sup> The discussion section of this notice focuses on the changes made in Amendment Nos. 4 and 5.<sup>7</sup> The text of the proposed rule change, as amended by Amendment Nos. 4 and 5, is available on NASD's Web site (<http://www.nasd.com>), at NASD's principal office, and at the Commission's Public Reference Room.

**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, as amended, and discussed any comments it received on the proposed rule change, as amended. 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.

Ronald C. Long, Senior Vice President, Regulatory Policy and Administration, Wachovia Securities, LLC, dated July 18, 2005; Mario Di Trapani, President, Association of Registration Management, dated July 19, 2005 ("ARM Letter"); John S. Simmers, CEO, ING Advisors Network, dated July 19, 2005 ("ING Letter"); Coleman Wortham III, President and CEO, Davenport & Company LLC, dated July 20, 2005; Jill Gross, Director of Advocacy and Rosario M. Patane, Student Intern, Pace Investor Rights Project, dated July 21, 2005; and Ira Hammerman, Senior Vice President and General Counsel, Securities Industry Association, dated July 27, 2005 ("SIA Letter"). NASD submitted a response to comments on June 6, 2006. See letter from Richard E. Pullano, Associate Vice President & Chief Counsel, Registration and Disclosure, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated June 6, 2006 ("NASD Response to Comments"). The NASD Response to Comments is available on the Commission's Web site (<http://www.sec.gov/rules/sro.shtml>).

<sup>5</sup> NASD also proposes to make non-substantive technical changes to the proposed rule language, including the text of Interpretive Material 8310-3, in Amendment Nos. 4 and 5. In Amendment No. 5, NASD also clarifies that the implementation date for the proposed rule change would be no later than 90 days following Commission approval.

<sup>6</sup> In December 2003, NASD announced that its Public Disclosure Program would thereafter be known as "NASD BrokerCheck."

<sup>7</sup> For an explanation of the Notice, see Securities Exchange Act Release No. 51915, *supra* note 3.

<sup>12</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 51915 (June 23, 2005), 70 FR 37880 ("Notice").

<sup>4</sup> See letters from Barry Augenbraun, Senior Vice President and Corporate Secretary, Raymond James Financial, Inc., dated July 8, 2005; Joseph D. Fleming, Managing Director and Chief Compliance Officer, Piper Jaffray & Co., dated July 13, 2005;