Special Notice to Members

OCTOBER 2003

INFORMATIONAL

Sanction Guidelines

NASD Revises *NASD Sanction Guidelines*

SUGGESTED ROUTING

Executive Representatives
Legal & Compliance
Registered Representatives
Senior Management

KEY TOPICS

NASD Sanction Guidelines
Rule 3030
Outside Business Activities
Rule 3040
Selling Away
Recidivists

Executive Summary

The *NASD Sanction Guidelines* (Guidelines) are used by the various bodies that adjudicate disciplinary matters (Adjudicators) in determining appropriately remedial sanctions. NASD staff and respondents also may use these Guidelines in crafting settlements. The Guidelines were initially published in 1993 and have been periodically revised to promote consistency and uniformity in the imposition of sanctions in disciplinary matters. The Guidelines contain an introductory section that explains the purpose of NASD disciplinary sanctions and sets forth certain generally applicable principles and considerations for determining appropriately remedial sanctions. The Guidelines also specify the range of monetary and non-monetary sanctions generally used for particular violations.

This *Notice* advises NASD members and Adjudicators of modifications to: (1) *General Principles Applicable To All Sanction Determinations* regarding the concept of progressive discipline (General Principle No. 2); (2) the *Outside Business Activities - Failure to Comply With Rule Requirements* Guideline; and (3) the *Selling Away (Private Securities Transactions)* Guideline. These Guidelines and General Principle No. 2, as modified, supersede the *Outside Business Activities - Failure to Comply With Rule Requirements* and *Selling Away (Private Securities Transactions)* Guidelines and General Principle No. 2 previously published by NASD and referenced in prior *Notices to Members*. The changes are effective as of December 1, 2003, and apply to all actions as of that date, including pending disciplinary cases.

These Guidelines and General Principle No. 2, as modified, may be read in their entirety in Attachment A to this *Notice*. The revised Guidelines and General Principle No. 2 also will be available on the NASD Web Site (*www.nasdr.com*).

Questions/Further Information

Questions concerning this *Notice* may be directed to the Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8071.

Discussion

General Principle No. 2

The Guidelines advise that *General Principles Applicable to All Sanction Determinations* should be considered in connection with the imposition of sanctions in all cases. General Principle No. 2 addresses the concept of deterring future misconduct by imposing progressively escalating sanctions on respondents who have engaged in past misconduct. Although registered persons with significant histories of disciplinary events constitute a small minority of industry participants, the potential negative impact of these few individuals on public investors may be significant.

The changes to General Principle No. 2 reaffirm for Adjudicators that sanctions for recidivists should be more severe. General Principle No. 2 now clarifies, however, that more severe sanctions for recidivists need not remain within the range recommended in a particular guideline but can increase to a level beyond those recommended in a guideline. General Principle No. 2 also advises Adjudicators that progressively escalating sanctions for recidivists can include barring registered persons and expelling firms. Moreover, General Principle No. 2 advises Adjudicators always to consider a respondent's disciplinary history in determining sanctions.

Outside Business Activities - Failure To Comply With Rule Requirements (NASD Conduct Rules 2110 and 3030)

Rule 3030 requires registered persons to give their employer member firms prompt written notice of any business activity, other than a passive investment, that is outside the scope of their relationship with their firms. Private securities transactions are not covered by from this requirement and, instead, are subject to the requirements of Rule 3040.

NASD has modified the principal considerations in the *Outside Business Activities* Guideline to emphasize to Adjudicators the importance of determining whether:

- the outside activity involved customers of the firm;
- the registered person's marketing and sale of the product or service could have created the impression that the employing member firm had approved the product or service;
- the registered person misled his or her employer member firm about the existence of the outside activity or otherwise concealed the activity from the firm; and
- the outside business activity caused injury to customers of the firm.

The Guideline recommends that Adjudicators consider suspensions for up to 30 days in cases where the outside business activities do not involve aggravating conduct and suspensions of up to one year where there is aggravating conduct. In egregious cases, the Guideline recommends considering a longer suspension or a bar. Adjudicators should also consider other factors as described in the *Principal Considerations* for the *Outside Business Activities* Guideline and the *General Principles Applicable to All Guidelines*.

Selling Away (Private Securities Transactions) (NASD Conduct Rules 2110 and 3040)

Rule 3040 sets forth the reporting requirements for registered persons who wish to participate in any manner in a private securities transaction (*i.e.*, sell securities away from their firm). NASD has modified the *Selling Away* Guideline to give firms and Adjudicators guidance on the methodology to be used in determining sanctions and the factors that will be considered in determining the seriousness of the violation when the associated person has been found to have failed to comply with the requirements of Rule 3040.

The Guideline advises Adjudicators that the first step is to assess the extent of the selling away, including the dollar amount of sales, the number of customers, and the length of time over which the selling away occurred. Following this assessment, Adjudicators are advised to consider other factors as described in the *Principal Considerations* for the *Selling Away* Guideline and the *General Principles Applicable to All Guidelines*. The Guideline reminds Adjudicators that the presence of one or more mitigating or aggravating factors may either raise or lower sanctions.

With slight modifications, the five *Principal Considerations* in the previous Guideline have been kept in the revised *Selling Away* Guideline. To help Adjudicators determine appropriate sanctions, the revised Guideline adds eight new *Principal Considerations*. These include:

- a quantitative analysis of the dollar volume of sales, the number of customers, and the length of time over which the selling away activity occurred;
- whether the product sold away has been found to involve a violation of federal or state securities laws or federal, state or SRO rules;
- whether the selling away resulted in injury to the investing public;
- the extent of the respondent's involvement in the selling away, *i.e.*, whether the respondent referred customers or sold the product directly to customers and whether the respondent recruited other registered individuals to sell the product; and
- whether the respondent misled his or her employer about the existence of the selling away activity or otherwise concealed the selling away activity from the firm.

Effective Date

These Guidelines and General Principle No. 2, as modified, supersede the *Selling Away* and *Outside Business Activities* Guidelines and General Principle No. 2 published by NASD in 2002 and referenced in prior NASD *Notices to Members*. The changes are effective as of December 1, 2003, and apply to all actions as of that date, including pending disciplinary cases.

NASD Sanction Guildlines

1. Activity Away From Associated Person's Member Firm

Outside Business Activities—Failure To Comply With Rule Requirements

NASD Conduct Rules 2110 And 3030

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar or Other Sanction
See Principal Considerations in Introductory Section 1. Whether the outside activity involved customers of the firm. 2. Whether the outside activity resulted directly or indirectly in injury to customers of the firm and, if so, the nature and extent of the injury. 3. The duration of the outside activity, the number of customers, and the dollar volume of sales. 4. Whether the respondent's marketing and sale of the product or service could have created the impression that the employer (member firm) had approved the product or service. 5. Whether the respondent misled his or her employer member firm about the existence of the outside activity or otherwise concealed the activity from the firm.	Fine of \$2,500 to \$50,000.[1]	When the outside business activities do not involve aggravating conduct, consider suspending respondent for up to 30 business days. When the outside business activities involve aggravating conduct, consider a longer suspension of up to one year. In egregious cases, including those involving a substantial volume of activity or significant injury to customers of the firm, consider a longer suspension or a bar.

1 As set forth in General Principle No. 6, Adjudicators may increase the recommended fine amount by adding the amount of a respondent's financial benefit.

Selling Away (Private Securities Transactions)

NASD Conduct Rules 2110 And 3040

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar or Other Sanction
See Principal Considerations in Introductory Section	*Associated Person*	*Associated Person*
1. The dollar volume of sales. 2. The number of customers. 3. The length of time over which the selling away activity occurred. 4. Whether the product sold away has been found to involve a violation of federal or state securities laws or federal, state or SRO rules. 5. Whether the respondent had a proprietary or beneficial interest in, or was otherwise affiliated with, the selling enterprise or issuer and, if so, whether respondent disclosed this information to his or her customers. 6. Whether respondent attempted to create the impression that his or her employer (member firm) sanctioned the activity, for example, by using the employer's premises, facilities, name, and/or goodwill for the selling away activity or by selling a product similar to the products that the employer (member firm) sells. 7. Whether the respondent's selling away activity resulted, either directly or indirectly, in injury to the investing public and, if so, the nature and extent of the injury.	Fine of $5,000 to $50,000.[1]	The first step in determining sanctions is to assess the extent of the selling away, including the dollar amount of sales, the number of customers, and the length of time over which the selling away occurred. Adjudicators should consider the following range of sanctions based on the dollar amount of sales: • Up to $100,000 in sales: 10 business days to 3 months • $100,000 to $500,000: 3 to 6 months • $500,000 to $1,000,000: 6 to 12 months • Over $1,000,000: 12 months to a bar Following this assessment, Adjudicators should consider other factors as described in the Principal Considerations for this Guideline and the General Principles applicable to all Guidelines. The presence of one or more mitigating or aggravating factors may either raise or lower the above-described sanctions.

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar or Other Sanction
See Principal Considerations in Introductory Section	*Member Firm*	*Member Firm*
8. Whether respondent sold away to customers of his or her employer (member firm). 9. Whether respondent provided his or her employer firm with verbal notice of the details of the proposed transaction and, if so, the firm's verbal or written response, if any. 10. Whether respondent sold away after being instructed by his or her firm not to sell the type of the product involved or to discontinue selling the specific product involved in the case. 11. Whether respondent participated in the sale by referring customers or selling the product directly to customers. 12. Whether respondent recruited other registered individuals to sell the product. 13. Whether respondent misled his or her employer (member firm) about the existence of the selling away activity or otherwise concealed the selling away activity from the firm.	Where member firm receives written notice of a private securities transaction, but fails to provide written notice of approval, disapproval, or acknowledgment, fine of $2,500 to $10,000.[2]	Where member firm receives written notice of a private securities transaction, but fails to provide written notice of approval, disapproval, or acknowledgment, consider suspending responsible supervisory personnel in any or all capacities for up to two years.

1 As provided for in General Principle No. 6, Adjudicators should increase the recommended fine amount by adding the amount of a respondent's financial benefit.

2 If the allegations involve a member's failure to supervise the selling away activity, then Adjudicators should also consider the Supervision-Failure To Supervise guideline.

General Principles Applicable To All Sanction Determinations

2. Disciplinary Sanctions Should Be More Severe For Recidivists.

An important objective of the disciplinary process is to deter and prevent future misconduct by imposing progressively escalating sanctions on recidivists beyond those outlined in these guidelines, up to and including barring registered persons and expelling firms. Adjudicators should always consider a respondent's disciplinary history in determining sanctions. Adjudicators should consider imposing more severe sanctions when a respondent's disciplinary history includes (a) past misconduct similar to that at issue; or (b) past misconduct that evidences disregard for regulatory requirements, investor protection, or commercial integrity. Even if a respondent has no history of relevant misconduct, however, the misconduct at issue may be so serious as to justify sanctions beyond the range contemplated in the guidelines, i.e., an isolated act of egregious misconduct could justify sanctions significantly above or different from those recommended in the guidelines.

Certain regulatory incidents are not relevant to the determination of sanctions. Arbitration proceedings, whether pending, settled, or litigated to conclusion, are not "disciplinary" actions. Similarly, pending investigations or the existence of ongoing regulatory proceedings prior to a final decision are not relevant.

In certain cases, particularly those involving quality-of-markets issues, these guidelines recommend increasingly severe monetary sanctions for second and subsequent disciplinary actions. This escalation is consistent with the concept that repeated acts of misconduct call for increasingly severe sanctions.