

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Executive Representatives
Legal & Compliance
Registered Representatives
Senior Management

KEY TOPICS

Article V, Section 2 of the NASD By-Laws
Article V, Section 3(a) of the NASD By-Laws
Central Registration Depository
(CRD® or Web CRD)
IM-9216
Inactive Disclosure Review
Registration Status
Minor Rule Violation Plan (MRVP)
Rule 9216(b)

REQUEST FOR COMMENT

Minor Rule Violation Plan and Inactive Disclosure Review Registration Status

NASD Seeks Comment On (1) Amending its Minor Rule Violation Plan (MRVP) to Include Failure Timely to Submit Amendments to the Uniform Termination Notice for Securities Industry Registration (Form U5); and (2) Adopting a Rule to Create an Inactive Disclosure Review Registration Status; **Comment Period Expires April 19, 2004**

Executive Summary

In July 2002, an NASD task force (the Public Information Review or PIR Task Force) initiated a comprehensive review of disciplinary and other information that NASD makes public, including the information released under NASD Interpretive Material 8310-2 (IM-8310-2). NASD is requesting comment from its members and other interested parties on two of the PIR Task Force's recommendations: (1) expanding the coverage of NASD's MRVP to include the failure to amend the Uniform Termination Notice for Securities Industry Registration (Form U5) in a timely manner; and (2) creating an "Inactive Disclosure Review" (Inactive DR) registration status that would require a registered individual to cease all activities requiring registration and prohibit that individual from functioning in any capacity requiring registration until the member either reports or updates a disclosure item on a Uniform Application for Securities Industry Registration or Transfer (Form U4) or provides the disclosure documentation requested for that individual. These proposals are part of a multi-pronged effort to help ensure that members make required disclosures on all Uniform Forms in a timely manner.¹

Action Requested

NASD encourages all interested parties to comment on these two proposals. Comments must be received by April 19, 2004. Members and interested persons can submit their comments using the following methods:

- ▶ mailing in the checklist (Attachment A)
- ▶ mailing in written comments
- ▶ e-mailing written comments to pubcom@nasd.com
- ▶ submitting comments using the online form at the NASD Web Site (www.nasdr.com)

If you decide to submit comments using both the checklist and one of the other methods listed above, please indicate that in your submissions. The checklist and/or hard copy comments should be mailed to:

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, N.W.
Washington, D.C. 20006-1500

Important Notes: The only comments that will be considered are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the NASD Web Site. Generally, comments will be posted on the NASD Web Site one week after the end of the comment period. See *Notice to Members 03-73*.

Before becoming effective, a rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the NASD Board, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.

Questions/Further Information

As noted above, hard copy comments should be mailed to Barbara Z. Sweeney. Questions concerning this *Notice* may be directed to Victoria M. Pawelski, Assistant Chief Counsel and Assistant Director, Registration and Disclosure, at (240) 386-4803; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

MRVP

In 1984, the SEC adopted amendments to Rule 19d-1(c) under the Securities Exchange Act of 1934 (Exchange Act) to allow self-regulatory organizations to adopt, with SEC approval, plans for the disposition of minor violations of rules.² In 1993, pursuant to this Rule, NASD established an MRVP.³ The purpose of the MRVP is to provide for a meaningful sanction for the violation of a rule when the initiation of a disciplinary proceeding through the formal complaint process would be more costly and time-consuming than would be warranted. The MRVP provides an efficient means by which to deter violations of rules while maintaining procedural rights for disciplined persons. NASD's MRVP currently is described in Rule 9216(b), which authorizes NASD to impose a fine of \$2,500 or less on any member or associated person for a minor violation of the rules identified in NASD Interpretive Material 9216 (IM-9216).⁴

Notwithstanding the inclusion of a particular violation in IM-9216, NASD staff retains full discretion to institute disciplinary proceedings based on all of the facts and circumstances. NASD staff reviews the number and seriousness of the violations, as well as the previous disciplinary history of the respondent to determine if a matter is appropriate for disposition under the MRVP and to determine the amount of the fine. Further, once NASD has issued an MRVP letter against an individual or member firm, it may, at its discretion, issue progressively higher fines for all subsequent minor violations of rules within the next 24-month period or initiate more formal disciplinary proceedings. Minor rule violations currently are not reportable on an individual's Form U4 or U5 or a member firm's Form BD and, accordingly, do not appear on their respective Central Registration Depository (CRD) records.⁵

Among other things, the current MRVP includes failure timely to submit amendments to the Form U4, as required by Article V, Section 2(c) of the NASD By-Laws, and failure timely to submit amendments to the Form BD, as required by Article IV, Section 1(c) of the NASD By-Laws. NASD proposes to amend its MRVP to include failure timely to submit amendments to the Form U5, as required by Article V, Section 3(a) of the NASD By-Laws. Sanctions imposed pursuant to the proposed amendment to the MRVP would be in addition to late fees that currently may be imposed for late filings, including the recently adopted amendment to Schedule A of the NASD By-Laws, which provides for a \$10 per day late fee up to a maximum charge of \$300 for submitting late disclosure filings.

Inactive Disclosure Review Registration Status

Currently, when a member fails after repeated requests to report or update a disclosure item on a Form U4 on behalf of a registered person or to provide adequate disclosure documentation in response to NASD staff requests, the registered person continues to have an "Approved" registration status and may continue to function as a registered person, notwithstanding that his or her Form U4 may not be current or complete. To address this situation, the PIR Task Force recommended that NASD implement an "Inactive Disclosure Review" registration status (also referred to as Inactive DR) that would place the registration of a person whose firm has failed to meet a Form U4 reporting requirement, or to provide requested disclosure documentation, in an inactive status and, as a result, such person would be prohibited from engaging in sales or other activities that require registration until the reporting deficiency is cured or information request is met.

Article V, Section 2(c) of the NASD By-Laws requires every application for registration filed with NASD to be kept current at all times by supplementary amendments. Amendments to Forms U4 must be filed not later than 30 days after learning of facts or circumstances giving rise to a reporting obligation. If the amendment being filed involves a statutory disqualification as defined in Exchange Act Sections 3(a)(39) and 15(b)(4), it must be filed not later than 10 days after the disqualification occurs.

Under the proposed rule, failure to make a timely report would initiate the Inactive DR process. The member would receive notice from NASD staff that it has 30 days to comply with a request by NASD staff to report a disclosure event, update a previously reported disclosure event, or provide documentation of a potential or actual disclosure event as requested. Staff would continue its current policy of exercising discretion to grant extensions of time in exceptional cases or accept, in lieu of required documentation, correspondence that provides NASD staff with an adequate explanation as to why compliance with a request is not feasible within that time frame (e.g., difficulty in obtaining court documents despite good faith efforts). If a member fails to comply with a request (or provide an adequate explanation as to why compliance is not feasible) within 30 days, NASD staff would send the member a final notice giving the member an additional 10 days to comply.

If the member fails to comply within the additional 10 days, the registered person would be placed in an inactive status.⁶ Members will also receive notice when an individual becomes inactive. Any person whose registration has been deemed inactive under the proposed rule will be required to cease all activities as a registered person and will be prohibited from performing any duties and functioning in any capacity requiring registration until such time as the employing member either updates the person's Form U4 as required or provides the requested documentation to NASD staff. NASD would administratively terminate an individual whose registration has been inactive for two years.

The proposed Inactive Disclosure Review registration status is part of a multi-pronged effort by NASD to help ensure that firms timely update Forms U4 and U5, as required by the NASD By-Laws. The proposed 30-day and additional 10-day notice provisions are designed to give firms adequate notice and time to resolve or cure any deficiencies before the person at issue is deemed inactive. NASD staff also plans to provide members with information about this process on the NASD Web Site. Although the proposed rule will address only the registration status of the registered person, the noncompliant member also will be subject to imposition of late filing fees and potential disciplinary action, as appropriate, based on the facts and circumstances presented.

Endnotes

- 1 This effort includes the newly established late disclosure fee, which was another recommendation of the PIR Task Force. See Exchange Act Rel. No. 49224 (Feb. 11, 2004), 69 Fed. Reg. 7833 (Feb. 19, 2004) (File No. SR-NASD-2003-192). See also *Notice to Members 04-09* (March 2004).
- 2 See Exchange Act Rel. No. 21013 (June 1, 1984), 49 Fed. Reg. 23833 (June 8, 1984).
- 3 See Exchange Act Rel. No. 44512 (July 3, 2001), 66 Fed. Reg. 36812 (July 13, 2001) (File No. SR-NASD-00-39).
- 4 NASD recently filed a rule change to expand the MRVP by adding six additional violations. The proposed additions are: (1) violation of the Intermarket Trading System (ITS) trade-through rule; (2) violation of the locked and crossed markets rule; (3) violation of the Trade Reporting and Compliance Engine (TRACE) system transaction reporting requirement; (4) violation of the Alternate Display Facility (ADF) transaction reporting requirement; (5) violation of the standards applicable to communications with the public; and (6) failure to provide or update firm contact information as required by NASD rules. See SR-NASD-2004-25 (Feb. 10, 2004). NASD also recently issued guidance concerning the application of NASD's MRVP to each of the rules specified in the MRVP. See *Notice to Members 04-19* (March 2004).
- 5 Firms and individuals should consult with their own legal counsel as needed to determine whether any particular matter must be reported on Forms BD, U4, or U5.
- 6 The Inactive DR status would be similar to the existing Continuing Education (CE) Inactive status (Rule 1120) and the Fingerprint Inactive status (Rule 1140).

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ATTACHMENT A

Request For Comment Checklist

(1) MRVP

Should NASD amend IM-9216 (MRVP) to include failure timely to submit amendments to the Form U5 (as required by Article V, Section 3(a) of the NASD By-Laws), to be consistent with existing provisions regarding the failure timely to submit amendments to Forms U4 and BD?

(1) Inactive Disclosure Review

(a) Should NASD adopt a rule creating an Inactive Disclosure Review registration status for registered persons whose employing member fails timely to report or update a disclosure item on behalf of the registered person and/or fails to provide requested documentation to NASD staff (and fails to provide adequate justification for failing to make such report)?

(b) If so, do the proposed 30-day and supplemental 10-day notice provisions provide adequate time for members to report matters or otherwise resolve deficiencies?

(c) Do you have any additional comments or suggestions?