

Notice to Members

MARCH 2004

INFORMATIONAL

SUGGESTED ROUTING

Executive Representatives
Legal & Compliance
Registered Representatives
Senior Management

KEY TOPICS

Deterrence of Future Misconduct
NASD Sanction Guidelines

Sanction Guidelines

NASD Revises *NASD Sanction Guidelines*

Executive Summary

This *Notice* advises NASD members of modifications to the *NASD Sanction Guidelines* (Guidelines). NASD is modifying General Principles Nos. 1 and 3 of the Guidelines to emphasize its commitment to imposing sanctions in disciplinary actions that are designed to modify the behavior of respondents and to deter future misconduct in the securities industry. The modifications also clarify that NASD may—in egregious cases—suspend or bar a firm from engaging in one or more areas of business. The changes are effective as of March 15, 2004, and apply to all actions as of that date, including pending disciplinary cases.

General Principle No. 1 and General Principle No. 3, as modified, may be read in their entirety in Attachment A to this *Notice*. The revised General Principles also will be available on the NASD Web Site (www.nasdr.com).

Questions/Further Information

Questions concerning this *Notice* may be directed to Carla Carloni, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8019.

Discussion

NASD initially published the Guidelines in 1993 to promote consistency and uniformity in the imposition of sanctions in disciplinary matters. The Guidelines are divided into three main sections—the General Principles, the Principal Considerations, and the individual guidelines that address specific types of misconduct. The General Principles contain policy considerations that NASD’s adjudicatory bodies (Adjudicators) should factor into every sanction determination. The Principal Considerations focus on the severity of a violation by listing potentially aggravating and mitigating factors that may apply to all violations. The individual guidelines contain additional violation-specific aggravating and mitigating factors and recommended sanction ranges for particular violations. Adjudicators rely on the Guidelines to determine appropriately remedial sanctions in disciplinary actions. NASD’s Departments of Enforcement and Market Regulation and the defense bar also rely on the Guidelines in negotiating settlements in disciplinary matters.

These amendments revise the discussion in the General Principles section of the Guidelines to emphasize to Adjudicators that sanctions should be significant enough to promote the prevention of future misconduct. The amendments to General Principle No. 1 and General Principle No. 3 highlight NASD’s ability to (1) impose fines that are not limited by the harm caused to customers, but rather are significant enough to modify the behavior of the respondent firm; and (2) suspend or bar a firm in egregious cases from engaging in a particular line of business related to the misconduct at issue.

Under NASD’s By-Laws, Adjudicators already possess the authority to impose sanctions designed to deter future misconduct either by the imposition of monetary sanctions or the limitation of business activities. The amendments emphasize NASD’s ability to achieve deterrence through the imposition of sanctions and clarify that NASD, in crafting appropriately remedial sanctions, intends to focus significant attention on preventing the recurrence of misconduct. Furthermore, the amendments will remind Adjudicators to consider the scope and severity of the misconduct and the financial resources of the respondent when crafting sanctions to avoid imposing sanctions that member firms may view as a cost of doing business and that do not deter future misconduct.

Effective Date

General Principle No. 1 and General Principle No. 3, as modified, supersede General Principle No. 1 and General Principle No. 3 published by NASD in 2001 and referenced in prior *NASD Notices to Members*. The changes are effective as of March 15, 2004, and apply to all actions as of that date, including pending disciplinary cases.

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ATTACHMENT A

Additions are underlined; deletions are in brackets.

General Principles Applicable to all Sanctions Determinations

1. Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry. The overall purposes of NASD[Regulation]'s disciplinary process and NASD [Regulation]'s responsibility in imposing sanctions are to remediate misconduct by preventing the recurrence of misconduct, improving overall standards in the industry, and [and to] protecting the investing public. Toward this end, Adjudicators should design sanctions that are significant enough to prevent and discourage future misconduct by a respondent, to deter others from engaging in similar misconduct, and to modify and improve [overall]business [standards]practices. [in the securities industry. Adjudicators should balance the concepts of remediation and deterrence by imposing sanctions that both effectively address the violative conduct and are of sufficient moment to discourage and prevent future violations and to improve overall standards.] Depending on the seriousness of the violations, Adjudicators should impose sanctions that are significant enough to ensure effective deterrence. When necessary to achieve this goal, Adjudicators should impose sanctions that exceed the range recommended in the applicable guideline.

When applying these principles and crafting appropriately remedial sanctions, Adjudicators also should consider firm size¹ with a view toward ensuring that the sanctions imposed are not punitive but are sufficiently remedial to achieve deterrence.² (Also see General Principle No. 8 regarding ability to pay.)

3. Adjudicators should tailor sanctions to respond to the misconduct at issue. [Since s]Sanctions in disciplinary proceedings are intended to be remedial and to prevent the recurrence of misconduct.,]Adjudicators therefore should impose sanctions tailored to address the misconduct involved in each particular case. Section 15A of the Securities Exchange Act of 1934 and NASD Procedural Rule 8310 provide that NASD [Regulation] may enforce compliance

with its rules by: limitation or modification of a respondent's business activities, functions, and operations; fine; censure; suspension (of an individual from functioning in any or all capacities, or of a firm from engaging in any or all activities or functions, for a defined period or contingent on the performance of a particular act); bar (permanent expulsion of an individual from associating with a firm in any or all capacities); expulsion (of a firm from NASD membership and, consequently, from the securities industry); or any other fitting sanction.

To address the misconduct effectively in any given case, Adjudicators may design sanctions other than those specified in these guidelines. [To remediate misconduct in a particular case, f]For example, to achieve deterrence and remediate misconduct, Adjudicators may impose sanctions that: (a) require a respondent firm to retain a qualified independent consultant to design and/or implement procedures for improved future compliance with regulatory requirements; (b) suspend or bar a respondent firm from engaging in a particular line of business; (c) require an individual or member firm respondent, prior to conducting future business, to disclose certain information to new and/or existing clients, including disclosure of disciplinary history; (d[c]) require a respondent firm to implement heightened supervision of certain individuals or departments in the firm; (e[d]) require an individual or member firm respondent to obtain an NASD [Regulation]staff letter stating that a proposed communication with the public is consistent with NASD [Regulation]standards prior to disseminating the communication to the public; (f[e]) limit the number of securities in which a respondent firm may make a market; [or](g[f]) limit the activities of a respondent firm[. In addition, in appropriate cases, such as those involving pervasive, firm-wide misconduct and/or repeated violations, Adjudicators may] or (h) require a respondent firm to institute tape recording procedures. This list is illustrative, not exhaustive, and is included to provide examples of the types of sanctions that Adjudicators may design to address specific misconduct and to achieve deterrence. Adjudicators may craft other sanctions specifically designed to prevent the recurrence of misconduct.

The recommended ranges in these guidelines are not absolute. The guidelines suggest, but do not mandate, the range and types of sanctions to be applied. Depending on the facts and circumstances of a case, Adjudicators may determine that no remedial purpose is served by imposing a sanction within the range recommended in the applicable guideline, i.e., that a sanction below the recommended range, or no sanction at all, is appropriate. Conversely, Adjudicators may determine that egregious misconduct requires the imposition of sanctions above or otherwise outside of the recommended range. For instance, in an egregious case, Adjudicators may consider barring an individual respondent and/or expelling a respondent member firm, regardless of whether the individual guidelines applicable to the case recommend a bar and/or expulsion or other less severe sanctions. Adjudicators must always exercise judgment and discretion and consider appropriate aggravating and mitigating factors in determining remedial sanctions in each case. In addition, whether the sanctions are within or outside of the recommended range, Adjudicators must identify the basis for the sanctions imposed.

Endnotes

- 1 Factors to consider in connection with assessing firm size are: the financial resources of the firm; the nature of the firm's business; the number of individuals associated with the firm; the level of trading activity at the firm; other entities that the firm controls, is controlled by, or is under common control with; and the firm's contractual relationships (such as introducing broker/clearing firm relationships). This list is included for illustrative purposes and is not exhaustive. Other factors also may be considered in connection with assessing firm size.
- 2 Adjudicators may consider firm size in connection with the imposition of sanctions with respect to rule violations involving negligence. With respect to violations involving fraudulent, willful and/or reckless misconduct, Adjudicators should consider whether, given the totality of the circumstances involved, it is appropriate to consider firm size and may determine that, given the egregious nature of the fraudulent activity, firm size will not be considered in connection with sanctions.