

Notice to Members

FEBRUARY 2003

SUGGESTED ROUTING

Legal & Compliance
Senior Management

KEY TOPICS

Consultative Committees
District Committees
Enforcement Actions
Market Regulation Committee

INFORMATIONAL

NASD Establishes Consultative Committees

Executive Summary

NASD regulatory staff believes that greater industry input into its investigatory process would be particularly valuable in responding to emerging regulatory issues, particularly given the technological and marketplace developments that have taken place over the past few years. To provide staff with a resource for obtaining the benefits of industry expertise during the course of an investigation, NASD has established Consultative Committees, on a pilot basis. NASD also has developed procedures for the operation of these committees that provide staff with flexibility to obtain information from industry representatives without compromising the staff's autonomy in performing its regulatory obligations.

Questions/Further Information

Questions concerning this *Notice to Members* may be directed to Jeffrey S. Holik, Senior Vice President, Member Regulation, at (202) 728-8387, or Katherine A. Malfa, Vice President, Enforcement, at (202) 974-2853.

Background

During the course of an investigation, NASD staff may encounter situations where industry expertise would be a useful resource. Such situations may arise, for example, as the result of new or complex securities products, technological developments, or industry practices. In these instances, NASD staff could benefit from industry experience to provide information on the background, operation, or scope of these products, developments or practices so

03-10

that the staff can heighten its understanding regarding the extent to which the product, development, or practice raises regulatory concern. NASD believes consultation with industry representatives for this purpose produces more informed regulation.

It is critical that consultations by NASD staff with industry representatives do not impinge on the staff's independence and autonomy in deciding whether and how to investigate or prosecute any particular matter. To ensure that the staff has the ability to obtain information on industry practices and developments in connection with an investigation without raising concerns about the staff's independence, NASD has established, on a pilot basis, Consultative Committees that will be available to the staff as a source of industry-related information. NASD also has developed guidelines concerning the operation of these committees to ensure that the committees are consulted and provide services in an appropriate manner.¹

Consultative Committees

NASD has established one Consultative Committee for each NASD region that will be responsible for providing information to NASD staff on issues arising out of investigations. Each Consultative Committee will be composed of former District Committee members from the Committees in their region. Former District Committee 10 members and former Market Regulation Committee industry members together will be treated as representatives of one region for these purposes and will comprise one Consultative Committee.²

Former District Committee members eligible to serve on Consultative Committees are those who have just

completed their third year of a three-year term and are not being reappointed to the District Committee. These representatives will be invited to serve two-year terms on the Consultative Committee for their region, and may continue to participate beyond the two years as necessary to complete the consultation process on a matter that was pending before the two-year term expired. Each Consultative Committee will range in size from approximately six to nine members during the first year of operation, and contain between approximately twelve and eighteen members thereafter.

Consultative Committee members will be required to sign, at the beginning of their term, an agreement that contains provisions regarding confidentiality and conflicts of interest. In addition, members will be advised at each meeting of the confidential nature of the matters presented to them. Members also will be reminded at each meeting that their function is strictly advisory and they will have no role in determining whether a regulatory proceeding will be initiated in any matter. Further, staff will be advised that there are no circumstances in which it may ask Consultative Committee members whether NASD should initiate a proceeding.

NASD has adopted internal procedures to ensure that this program does not impinge upon the independence of NASD staff and to coordinate this program with NASD's other regulatory operations. For example, NASD staff will be permitted to seek information from a Consultative Committee only when authorized to do so by a District Director or the Executive Vice President from Market Regulation or Enforcement (or their designees). Further, if the appropriate staff authorizes a consultation with a Consultative

Committee, the staff will maintain careful records of the consultation with the Consultative Committee and will provide this information to the relevant departments of NASD. These procedures maintain the staff's independence and ensure that the Consultative Committees will not influence inappropriately determinations to bring disciplinary actions. The procedures also ensure that the staff responsible for assigning hearing panelists to disciplinary matters is aware of those potential panelists who may be recused from a particular matter because they participated in a Consultative Committee meeting where the matter was discussed.

Endnotes

- 1 In response to a report issued by the SEC in 1996 pursuant to Section 21(a) of the Securities Exchange Act of 1934 (Section 21(a) Report), NASD undertook, among other things, to provide for the autonomy and independence of its staff with respect to disciplinary matters where the commercial interests of NASD's members could be inappropriately asserted. See Undertaking No. 4, Section 21(a) Report. The internal procedures established for the operation of Consultative Committees are consistent with the undertakings and principles of independence articulated in the Section 21(a) Report.
- 2 Information and documents concerning NASD staff discussions with members of the District Committees and Market Regulation Committee are exempt from discovery in NASD disciplinary proceedings pursuant to Rule 9251(b)(1) of the NASD Code of Procedure.

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