

INFORMATIONAL

Minor Violations Of Rules And Late Fees

SEC Approves Proposed Additions To The List Of Rules Appropriate For Disposition As Minor Violations Of Rules And For The Establishment Of Late Fees For Certain Filings And Reports

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Senior Management

KEY TOPICS

- Minor Rule Violation Plan
- Schedule A of the NASD By-Laws

Executive Summary

On July 3, 2001, the Securities and Exchange Commission (SEC) approved rule changes proposed by the National Association of Securities Dealers, Inc. (NASD®) that afford the NASD more flexibility in responding to certain technical or minor violations of NASD rules.¹ The NASD is expanding upon the list of rule violations that can be resolved through its Minor Rule Violation Plan (MRVP) and is establishing late fees for certain filings and reports.

The amendments become effective on September 10, 2001. The text of the amendments is attached (see Attachment A).

Questions concerning this *Notice* may be directed to the Legal Division, Enforcement, NASD Regulation, Inc., at (202) 974-2800, Legal Section, Market Regulation, NASD Regulation, Inc., at (240) 386-5139; or Office of General Counsel, NASD Regulation, Inc., at (202) 728-8071.

Late Fees

The NASD is amending Schedule A of its By-Laws to impose late filing fees for certain filings and reports. The late fees will be assessed on a per-day basis for a period of not more than 10 business days. The fees are administrative rather than disciplinary in nature and should help to deter violations of certain NASD filing requirements. The NASD staff may institute disciplinary proceedings where the late filing is serious.

In those instances where a member knows it is unable to meet a filing deadline, the member may request an extension no later than three days prior to the

deadline. Extensions only will be granted for delays outside of the control of the member, e.g., technical difficulties, third-party contractor delays, and auditor delays.

The NASD will send notice of the late fee to the member after a document has been correctly filed, or after 10 business days from the filing deadline. When the notice has been sent, any accrued late fees will be automatically deducted from the member's Central Registration Depository (CRD) Account.

Initially, the designated filings and reports for the imposition of late fees will be limited to untimely filings pursuant to Rule 17a-5 under the Securities Exchange Act of 1934 (Exchange Act), monthly and quarterly FOCUS reports, and annual audit reports. Inaccurate or incomplete filings will not be deemed filed. The NASD may seek to amend this list from time to time as appropriate.

Minor Violations Of Rules

In 1984, the SEC adopted amendments to Exchange Act Rule 19d-1(c) 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, the NASD established a MRVP.³ NASD Rule 9216(b) authorizes the NASD to impose a fine of \$2,500 or less on any member or associated person for a minor violation of certain specified rules as identified in IM-9216.⁴

The number and seriousness of the violations, as well as the previous disciplinary history of the respondent, will be reviewed to determine if a matter is appropriate for disposition

pursuant to the MRVP and to determine the amount of the fine. Once the NASD has brought a minor violation of a rule against an individual or member firm, the NASD 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.

The purpose of the MRVP is to provide for a meaningful sanction for the minor or technical 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 alternative means by which to deter violations of rules while maintaining procedural rights for disciplined persons.

Inclusion of a rule in the NASD's MRVP does not mean it is an unimportant rule; rather, a minor or technical violation of the rule may be appropriate for disposition under the MRVP.⁵ The NASD retains the discretion to bring full disciplinary proceedings for any violation of a rule included in the MRVP, including situations where: (1) a violation is more than technical, minor, or inadvertent; (2) there is a history or pattern of repeat violations; or (3) a violation significantly impacts investors or impairs the ability of the NASD to regulate the market.

Description Of Additions To The MRVP

The NASD stated when it established the MRVP that it would revisit the list of eligible rule violations from time to time. As discussed above, the NASD now is expanding the list of eligible rule violations. The following is a discussion of rule violations that

are being added to the MRVP.

- *Article IV of NASD By-Laws—Failure to timely submit amendments to Form BD.* Members are required, pursuant to Article IV, Section 1(c) of the NASD By-Laws, to ensure that their membership applications are kept current at all times through amendments to Form BD. The failure to amend Form BD in a timely manner may be considered a minor violation.
- *Article V of NASD By-Laws—Failure to timely submit amendments to Form U-4.* Article V, Section 2(c) of the NASD By-Laws requires that applications for the registration of registered representatives and associated persons must be kept current at all times through amendments to Form U-4. The failure to amend Form U-4 in a timely manner may be considered a minor violation.
- *Rule 1120—Failure to comply with the Firm Element of the Continuing Education Requirements.* In evaluating whether a violation of the Firm Element of NASD Rule 1120 may be considered a minor violation, the staff will look at the length of time that the firm failed to fully comply with the rule; the number of registered persons affected; the experience of the registered representatives in the securities industry with the financial products marketed by the firm; and the nature of the firm's business. The staff also will consider whether the firm promptly corrected any deficiencies after receiving notice from the staff and whether the firm was the subject of prior formal or informal disciplinary actions. In general, a minor violation of the Rule would be considered for non-technical violations of the rule where the firm has made a good faith effort to comply with the Rule's requirements, has provided training to all or substantially all of its registered representatives, has no prior formal or informal action in this area, and has promptly corrected any deficiencies after being contacted by the staff. Violations of the Regulatory Element of NASD Rule 1120 will not be considered a minor violation.
- *Rule 3010(b)—Failure to timely file reports pursuant to the Taping Rule.* NASD Rule 3010(b)(2)(vii) requires members subject to the taping requirements of the Rule to file quarterly reports that detail the member's supervision of the telemarketing activities of its registered persons. A report not filed in a timely manner may be considered a minor violation.
- *Rule 3070—Failure to timely file reports.* NASD Rule 3070 requires member firms to file a report with the NASD when any of 10 specified events occur. In addition, member firms are required to collect and report statistical and summary information regarding customer complaints by the 15th of the month following the calendar quarter in which the member receives the customer complaints. A report not filed in a timely manner may be considered a minor violation.
- *Rule 4619(d)—Failure to timely file reports pursuant to SEC Regulation M.* NASD Rule 4619(d) requires member firms to file certain notifications with the NASD to comply with SEC Regulation M,⁶ SEC

Rules 101,⁷ 103,⁸ and 104⁹ (i.e., notification of withdrawal of quotations and identification of quotations as those of a passive market maker). Specifically, NASD Rule 4619(d) requires a member to file an Underwriting Activity Report no later than close of business the day before the member wishes to have its quotations identified as those of a passive market maker or intends to withdraw its quotations.

An untimely notification filed pursuant to NASD Rule 4619(d) may be considered a minor violation, where, for instance, a member inadvertently misses the filing deadline but files the notification the following day before the commencement of trading and no customer harm has occurred.

- *Rules 4632, 4642, 4652, 6240, 6420, 6550, 6620, and 6720—Transaction reporting in equity, convertible debt, and high yield securities.* The NASD's trade reporting Rules require member firms to submit reports of transactions in equity, convertible debt, and high yield securities. The Rules concern trade reporting in certain Nasdaq securities, listed securities (commonly known as the "third market"), over-the-counter (OTC) equity securities, non-Nasdaq securities, and high yield securities. The failure to properly report such transaction data may be considered a minor violation.
- *Rules 6130 and 6170—Transaction reporting to the Automated Confirmation Transaction Service (ACT).* NASD Rules 6130 and 6170 require member firms to

submit reports of transactions in "ACT Eligible Securities"¹⁰ to ACT. The failure to submit required transaction reports to ACT may be considered a minor violation.

- *Rules 6954 and 6955—Failure to submit data in accordance with the Order Audit Trail System (OATS).* The OATS Rules impose obligations on member firms to record in electronic form and to report to the NASD items of information with respect to orders they receive to effect transactions in equity securities traded in The Nasdaq Stock Market. The OATS Rules require that each member receiving an order relating to equity securities traded in The Nasdaq Stock Market must capture specific information and electronically transmit this information to OATS. The failure to submit data in accordance with the OATS Rules may be considered a minor violation.

For example, minor violations of the rules may include instances where a firm files information with missing or inaccurate data elements but the information does not significantly limit the usefulness of the Order Audit Trail. However, omissions and errors that should have been detected by a firm through its monitoring of the data made available by the NASD on the OATS Web Site may not be appropriate for disposition as minor violations.

- *Rule 11870—Failure to abide by Customer Account Transfer Contracts.* NASD Rule 11870 requires members to follow certain procedures for the transfer or closing-out of customer accounts. The Rule

requires members to validate or object to a customer account transfer within three days of receipt of the transfer notice. Members must complete the transfer within three days of validation.¹¹ The failure to validate or object to the transfer within the stated time or failure to properly transfer a customer account within the stated period may be considered a minor violation.

- *SEC Rule 11Ac1-4—Failure to properly display limit orders.* SEC Rule 11Ac1-4¹² requires, subject to certain exceptions, a registered broker or dealer acting as an OTC market maker to "immediately" display qualifying customer limit orders in its published quotes. The failure to immediately display qualifying limit orders pursuant to Rule 11Ac1-4 may be considered a minor violation.
- *SEC Rule 11Ac1-1(c)(5)—Failure to properly update published quotations in certain Electronic Communication Networks (ECNs).* SEC Rule 11Ac1-1(c)(5)¹³ requires an OTC market maker to update its published quotations to reflect qualifying priced orders that it enters into a specific type of ECN. The failure to display such priced orders may be considered a minor violation.
- *SEC Rule 17a-5—Failure to timely file FOCUS reports.* SEC Rule 17a-5 requires broker/dealers to submit certain financial information on a monthly, quarterly, and annual basis, known as FOCUS reports.¹⁴ The failure to file FOCUS reports in a timely manner may be considered a minor violation.

- *Municipal Securities Rulemaking Board (MSRB) Rule A-14—Failure to timely pay annual fee.* MSRB Rule A-14 requires each broker, dealer, and municipal securities dealer to pay an annual fee to the MSRB in each fiscal year in which the broker, dealer, and municipal securities dealer conducts municipal securities activities. The MSRB must receive the fee no later than October 31 of the fiscal year in which the fee is due. The failure to pay the annual fee in a timely manner may be considered a minor violation. Any fines imposed pursuant to the MRVP would be in addition to the annual fee owed to the MSRB.
- *MSRB Rules G-12 and G-14—Failure to Report Transactions or Inaccurate Reporting of Transactions.* The NASD uses certain information to determine a member's compliance with MSRB Rule G-14 reporting requirements and related MSRB Rule G-12 requirements concerning clearance and settlement. With respect to determining a member's compliance with inter-dealer only trades, the NASD uses as one factor, the "T-Input Percentage." The T-Input Percentage is an indicator compiled by the National Securities Clearing Corporation, Inc., which provides information on the accuracy and timely submission of reports on inter-dealer municipal securities transactions. Other indicators used to determine a member's compliance with MSRB Rules G-14 and G-12 for both inter-dealer and customer municipal securities transactions include, among other things: 1) the accuracy of the effecting

broker symbol; 2) the accuracy or the reporting of time of trade; 3) the number of canceled and/or amended transactions; and 4) the number of late-trade submissions.

The failure by a member firm to submit transaction reports or the filing of inaccurate or untimely transaction reports pursuant to MSRB Rules G-12 and G-14 may be considered minor violations.

- *MSRB Rule G-36—Failure to timely submit reports.* MSRB Rule G-36 concerns the delivery of Official Statements, Advance Refunding Documents and Forms G-36(OS) and G-36(ARD) to the MSRB. MSRB Rule G-36, in part, requires the sending—within certain specified time frames—of two copies of certain issuer documents to the MSRB. Failure to file Form G-36(OS) or G-36(ARD) within the published time frames may be considered a minor violation.
- *MSRB Rule G-37—Failure to timely submit reports for political contributions and MSRB Rule G-38—Failure to timely submit reports detailing consultant activities.* MSRB Rules G-37 and G-38 require, in part, the disclosure on MSRB Form G-37/38, of certain political contributions, solicitation of municipal securities business, and the use of consultants by municipal securities dealers. Due dates for these required disclosures are January 31, April 30, July 31, and October 31. The late filing of these reports may be considered a minor violation. In addition, form filings which are incomplete or inaccurate, or inaccurate record keeping

as required under MSRB Rules G-37 and G-38, may also be considered minor violations.

Endnotes

- 1 See Exchange Act Rel. No. 44512 (July 3, 2001), 66 Fed. Reg. 36812 (July 13, 2001) (File No. SR-NASD-00-39) ("SEC Approval Order").
- 2 See Exchange Act Rel. No. 21013 (June 1, 1984), 49 Fed. Reg. 23833 (June 8, 1984).
- 3 See Exchange Act Rel. No. 32076 (Mar. 31, 1993), 58 Fed. Reg. 18291 (Apr. 8, 1993) (SR-NASD-93-06). See also *Notice to Members 93-42* (July 1993) (SEC Approves NASD's Minor Rule Violation Plan).
- 4 Generally, the disposition of disciplinary matters brought by NASD staff pursuant to the NASD Rule 9000 Series must be reported to the SEC as "final disciplinary actions" pursuant to SEC Rule 19d-1. Disciplinary actions disposed of pursuant to NASD Rule 9216(b) will not be considered "final" pursuant to Exchange Act Rule 19d-1(c)(2) and may be reported to the SEC by the NASD in quarterly or periodic summary reports. In addition, matters brought pursuant to NASD Rule 9216(b) may not be required to be reported on Form BD, or Forms U-4 and U-5. For a discussion of the imposition of censures by the NASD, see *Notice to Members 99-59*.
- 5 The SEC Approval Order states, "In approving this proposal, the Commission in no way minimizes the importance of compliance with these rules, and all other rules subject to the imposition of fines under the NASD's [MRVP]. The Commission believes that the violation of any self-regulatory organization's rules, as well as Commission rules, is a serious matter. However, in an effort to provide the NASD with greater flexibility in addressing certain violations, the MRVP provides a reasonable means to address rule violations that do not rise to the level of requiring formal disciplinary proceedings."
- 6 17 CFR 242.
- 7 17 CFR 242.101.
- 8 17 CFR 242.103.
- 9 17 CFR 242.104.
- 10 NASD Rule 6110(a).
- 11 NASD Rule 11870 was amended to provide that the total post-validation transfer period be reduced from four days to three days. See Exchange Act Rel. No. 43635 (Nov. 29, 2000), 65 Fed. Reg. 75990 (Dec. 5, 2000) (File No. SR-NASD-00-68).
- 12 17 CFR 240.11Ac1-4.
- 13 17 CFR 240.11Ac1-1(c)(5).
- 14 17 CFR 240.17a-5.

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ATTACHMENT A

SR-NASD-00-39, Text of Rule Language, as amended

(Note: New language is underlined.)

Schedule A to the NASD By-Laws

Assessments and fees pursuant to the provisions of Article VI of the By-Laws of the NASD shall be determined on the following basis:

Section 2-Fees

(a) through (k) No Change.

(l) (1) Unless a specific temporary extension of time has been granted, there shall be imposed upon each member required to file reports, as designated by this paragraph, a fee of \$100 for each day that such report is not timely filed. The fee will be assessed for a period not to exceed 10 business days. Requests for such extension of time must be submitted to the Association at least three business days prior to the due date; and

(2) Any report filed pursuant to this Rule containing material inaccuracies or filed incompletely shall be deemed not to have been filed until a corrected copy of the report has been resubmitted.

(3) List of Designated Reports:

(A) SEC Rule 17a-5 -Monthly and quarterly FOCUS reports and annual audit reports.

IM-9216. Violations Appropriate for Disposition Under Plan Pursuant to SEC Rule 19d-1(c)(2)

-Rule 2210(b) and (c) and Rule 2220(b) and (c) - Failure to have advertisements and sales literature approved by a principal prior to use; failure to maintain separate files of advertisements and sales literature containing required information; and failure to file advertisements with the Association within the required time limits.

-Rule 3360 -Failure to timely file reports of short positions on Form NS-1.

-Rule 3110 -Failure to keep and preserve books, accounts, records, memoranda, and correspondence in conformance with all applicable laws, rules, regulations and statements of policy promulgated thereunder, and with the Rules of the Association.

-Rule 8211, Rule 8212, and Rule 8213 -Failure to submit trading data as requested.

-Article IV of the NASD By-Laws -Failure to timely submit amendments to Form BD.

-Article V of the NASD By-Laws -Failure to timely submit amendments to Form U-4.

-Rule 1120 -Failure to comply with the Firm Element of the continuing education requirements.

- Rule 3010(b) -Failure to timely file reports pursuant to the Taping Rule.
- Rule 3070 -Failure to timely file reports.
- Rule 4619(d) -Failure to timely file notifications pursuant to SEC Regulation M.
- Rules 4632, 4642, 4652, 6240, 6420, 6550, 6620, And 6720 -Transaction reporting in equity, convertible debt, and high yield securities.
- Rules 6130 and 6170 -Transaction reporting to the Automated Confirmation Transaction Service ("ACT").
- Rules 6954 and 6955 -Failure to submit data in accordance with the Order Audit Trail System ("OATS").
- Rule 11870 -Failure to abide by Customer Account Transfer Contracts.
- SEC Exchange Act Rule 11Ac1-4 -Failure to properly display limit orders.
- SEC Exchange Act Rule 11Ac1-1(c)(5) -Failure to properly update published quotations in certain Electronic Communication Networks ("ECN's").
- SEC Exchange Act Rule 17a-5 -Failure to timely file FOCUS reports.
- MSRB Rule A-14 -Failure to timely pay annual fee.
- MSRB Rule G-12 -Failure to abide by uniform practice rules.
- MSRB Rule G-14 -Failure to submit reports.
- MSRB Rule G-36 -Failure to timely submit reports.
- MSRB Rule G-37 -Failure to timely submit reports for political contributions.
- MSRB Rule G-38 -Failure to timely submit reports detailing consultant activities.