
NASD Sanction Guidelines

NASD Revises Sanction Guidelines

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.

- Executive Representatives
- Legal & Compliance
- Registered Representatives
- Senior Management

KEY TOPICS

- Disciplinary Proceedings
- Sanctions
- Settlements

Executive Summary

The National Adjudicatory Council (NAC) has revised the National Association of Securities Dealers, Inc. (NASD®) Sanction Guidelines (Guidelines). The various bodies that adjudicate disciplinary matters use the Guidelines to determine appropriately remedial sanctions. NASD Regulation, Inc., staff and respondents also use the Guidelines to craft settlements in disciplinary matters. The NAC revised the introductory section, amended individual guidelines, and added several new guidelines. As with prior versions of the Guidelines, in this edition, the NAC does not prescribe fixed sanctions for particular violations. Rather, the NAC encourages adjudicators to exercise discretion and consider the unique facts and circumstances of each particular case.

The revised Sanction Guidelines supersede guidelines previously published by the NAC and referenced in prior *NASD Notices to Members*. The revised Sanction Guidelines are effective as of April 10, 2001, and apply to all actions as of that date, including pending disciplinary actions.

The revised Sanction Guidelines will be available on the NASD Regulation Web Site (www.nasdr.com). The Sanction Guidelines will also be available, within the next two months, for purchase in hard-copy format for \$35 by calling NASD MediaSource at (240) 386-4200.

Questions/Further Information

Questions concerning this *Notice* may be directed to Carla Carloni, Associate General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8019.

Background And Discussion

At the NAC's February 2000 meeting, the NAC appointed a Sanction Guidelines Subcommittee to revisit some of the general policies expressed in the Sanction Guidelines, amend existing guidelines, and add new guidelines as needed. The NAC recently approved the Sanction Guidelines Subcommittee's proposed amendments.

Changes To The Introductory Section

The NAC's revisions include several changes to the introductory section.¹

- The NAC revised the discussion of the remedial nature of disciplinary sanctions in General Principle One. The revised language advises adjudicators that they may consider firm size in connection with determining appropriately remedial sanctions, with a view toward ensuring that sanctions are not punitive. New footnote one lists factors that adjudicators may consider in connection with assessing firm size. New footnote two addresses whether firm size should be considered in cases involving fraudulent misconduct.
- The NAC revised General Principle Three, which advises adjudicators to tailor sanctions to the misconduct at issue. The revised language suggests that, in certain cases, the imposition of tape-recording requirements may be an appropriately remedial sanction.
- The NAC revised the current definition of "financial benefit" in General Principle Six (Disgorgement).²

- General Principle Eight, which discusses an adjudicator's consideration of ability to pay when raised by a respondent, has been amended to incorporate information from *NASD Notice to Members 99-86* (Imposition and Collection of Monetary Sanctions).
- The NAC amended Principal Consideration No. 11 to indicate that the harm resulting from a respondent's misconduct may include harm to the firm with which an individual respondent is or was associated.
- The subsection entitled "Applicability" now clarifies for users of the Sanction Guidelines the many means by which the NAC may amend and/or supplement the Sanction Guidelines.³
- The NAC added a new subsection entitled "Censures" to the introductory section. This subsection incorporates into the Guidelines the substance of the NAC's policy on the imposition of censures announced by the NAC in *NASD Notice to Members 99-91* (Imposition of Censures).
- The NAC added a new subsection entitled "Monetary Sanctions – Imposition and Collection of Monetary Sanctions." This subsection incorporates into the Guidelines the monetary sanctions policy announced by the NAC in *NASD Notice to Members 99-86* (Imposition and Collection of Monetary Sanctions).
- The subsection entitled "Suspensions, Bars, and Expulsions," dealing with suspensions and statutory disqualifications, was amended. The current introductory section acknowledges that

the Guidelines generally recommend the imposition of suspensions of not more than two years. The NAC added an explanation that the NASD's rules allow for the imposition of lengthier suspensions and that adjudicators therefore have discretion to impose lengthier suspensions, notwithstanding the general recommendation in the Guidelines to impose suspensions that do not exceed two years.

- With respect to statutory disqualifications, the NAC added proposed footnote 10, which references the Securities and Exchange Commission's (SEC's) 1994 release regarding the permanent nature of bars.

The NAC also made other minor revisions throughout the introductory section.

Changes To Existing Guidelines

In all, the NAC revised 29 individual guidelines. Of these, the NAC revised only the disgorgement footnote discussed in footnote two in 15 guidelines.⁴ The remaining 14 guidelines contain more extensive revisions.⁵ Notable revisions to these 14 guidelines include:

- revising the non-monetary sanction sections of the churning, selling away, suitability, and unauthorized trading guidelines to ensure consistency in the recommended sanctions;
- revising the selling away guideline to clarify that whether an investment or enterprise is successful should not necessarily mitigate the significance of the sanctions imposed, and to revising and supplementing the principal

considerations listed in the guideline;

- revising the guideline for conversion or improper use of funds or securities to note that, in accordance with the NASD's Monetary Sanctions Policy (see *NASD Notice to Members 99-86*), adjudicators generally should not impose a fine if an individual is barred in a case involving conversion;
- revising the principal considerations listed in the guideline for the exercise of discretion without written authority;
- revising the Forms U-4/U-5 guideline to clarify that it applies to violations involving both the filing of initial forms and the filing of amendments thereto;
- revising the guideline for outside business activities to allow for more significant sanctions (consistent with sanctions for selling away violations) in cases involving egregious violations, particularly those in which the outside activities involve financial products;
- revising the registration guideline to indicate that an adjudicator may consider imposing a suspension against an individual respondent in all cases, including non-egregious cases;
- revising the monetary sanction section of the short sales guideline to suggest that, if a short-selling customer is not subject to NASD jurisdiction, in certain cases, it may be appropriate to add the short-selling customer's transaction profit to the fine of the executing member or associated person;

- revising the principal considerations listed in the guideline for trade reporting;
and
- revising the unauthorized trading guideline to incorporate the NAC's views as expressed in *Daniel S. Hellen*, Complaint No. C3A970031 (NAC June 15, 1999).

The NAC also made other minor revisions to these and other individual guidelines. ⁶

New Guidelines

The NAC added nine new guidelines to address violations in the following areas:

- intimidation/coordination;
- best execution;
- registration of branch offices;
- the Corporate Financing Rule;
- customer account transfer contracts;
- day trading appropriateness;
- margin requirements/ Regulation T;
- order audit trail systems;
and
- the Taping Rule.

The NAC believes that its revisions will enhance NASD Regulation's regulatory function by providing adjudicators with better guidance for determining appropriately remedial sanctions in disciplinary matters.

Endnotes

- 1 The introductory section includes the Overview, General Principles, Principal Considerations, and other sections involving technical matters.
- 2 The NAC also revised the standard disgorgement footnote currently contained in 25 individual guidelines. In the current publication, a footnote included throughout the Guidelines states:

As set forth in General Principle No. 6, Adjudicators should increase the recommended fine amount by adding the amount of a respondent's financial benefit. In this instance, the factors to be considered in the calculation of financial benefit should include . . .

The factors recommended in the individual guidelines for consideration in connection with the assessment of financial benefit did not vary significantly. In the revised Sanction Guidelines, the NAC deleted the second sentence from all of the disgorgement footnotes contained in the individual guidelines and, instead, expanded the definition of "financial benefit" contained in General Principle Six.

- 3 In order to ensure that all users of the NASD Sanction Guidelines are aware of the NAC's post-publication amendments to the Guidelines, whether by *NASD Notice to Members* or NAC decision, the NASD Regulation Web Site will now include a listing of all NAC decisions, *NASD Notices to Members*, or other public documents that amend or supplement the Sanction Guidelines.
- 4 The only revision contained in the following individual guidelines is an amendment to the disgorgement footnote:
 - Engaging in Prohibited Municipal Securities Business;
 - Free-Riding and Withholding Violations;
 - Unregistered Securities - Sales of;
 - Continuing Education - Regulatory Element;
 - Disqualified Person Associating with Firm Prior to Approval; Firm Allowing Disqualified Person to Associate Prior to Approval;

- Member Agreement Violations;
 - Misrepresentations or Material Omissions of Fact;
 - Registration Violations;
 - Options Exercise and Position Limits;
 - SOES Rules;
 - Telemarketing;
 - Trades Executed During a Trading Halt;
 - Reportable Events Under Conduct Rule 3070;
 - Guaranteeing A Customer Against Loss;
and
 - Trading Ahead of Research Reports.
- 5 The following guidelines contain amendments other than or in addition to the NAC's revision of the disgorgement footnote:
 - Automated Submission of Trading Data;
 - Churning or Excessive Trading;
 - Conversion or Improper Use of Funds or Securities;
 - Discretion Without Written Authority;
 - Disqualified Persons — Failure to Supervise;
 - Forms U-4/U-5;
 - Outside Business Activities;
 - Penny Stock Rules;
 - Registration Violations;
 - Selling Away;
 - Short Sale Rule;
 - Suitability;
 - Trade Reporting;
and
 - Unauthorized Trading.
 - 6 Consistent with the NAC's practice in the current version of the Guidelines, the NAC added references to applicable Municipal Securities Rulemaking Board Rules to certain of the existing individual guidelines.

© 2001, National Association of Securities Dealers, Inc. (NASD). All rights reserved. Notices to Members attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.