

SPECIAL NASD NOTICE TO MEMBERS 97-55

New Membership Application Rules, New Code Of Procedure, And Other New Disciplinary Rules

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- ☐ Mutual Fund
- ☒ Operations
- ☐ Options
- ☒ Registration
- ☐ Research
- ☐ Syndicate
- ☐ Systems
- ☐ Trading
- ☒ Training

Executive Summary

On April 18, 1997, the National Association of Securities Dealers, Inc. (NASD[®]) proposed to the Securities and Exchange Commission (SEC or Commission) SR-NASD-97-28, a rule filing containing proposed rules relating to membership application procedures; disciplinary proceedings; and procedures used to determine eligibility questions, impose limitations on the operations of members, impose summary suspensions, non-summary suspensions, cancellations, or bars, and adjudicate denials of access (Rules).¹ The Commission approved the Rules on August 7, 1997.²

Questions

Questions should be directed to:

Membership Application Procedures

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Procedures In Rule 9400 Series- Rule 9500 Series

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Case Authorization Process In Code Of Procedure

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Membership Application Procedures

The NASD is amending the membership application procedures so that all initial membership application decisions are made by the Department of Member Regulation rather than a District Committee. In addition, the new Rules set forth more detailed information on the standards for admission and contain specific guidelines for determining when an admission decision must be issued. The new Rules also address applications by a current member to obtain approval of a change in ownership, control, or operations, or a change in a business restriction agreement. The new Rules are set forth in the new Rule 1010 Series.

Rules Regarding Investigations And Sanctions

The NASD is making changes to the procedures used in NASD investigations and examinations to clarify the NASD's authority to require members and their associated persons to testify under oath or affirmation and provide other information. The NASD is also revising a procedure for suspending members or their associated persons who fail to provide the NASD with requested infor-

mation. Such changes are set forth in the amended Rule 8000 Series.

Disciplinary Procedures In Code Of Procedure

The NASD is amending the procedures applicable to disciplinary proceedings described in the Code of Procedure to provide for, among other things:

- Staff-authorized complaints;
- Staff Hearing Officers presiding over disciplinary proceedings;
- New Rules relating to discovery, *ex parte* prohibitions and motions practice;
- Hearing Panels chaired by staff Hearing Officers;
- “Trial-level” decisions issued by Hearing Panels, rather than by District Committees; and
- Appeals of disciplinary decisions by NASD staff as well as by Respondents.

The new Rules setting forth these changes to the Code of Procedure are the new Rule 9100 Series, the new Rule 9200 Series, and the new Rule 9300 Series. The new Rule 9100 Series sets forth Rules of general applicability not only to disciplinary proceedings described in the new Rule 9200 Series and the new Rule 9300 Series, but also to the procedures set forth in the new Rule 9400 Series and the new Rule 9500 Series described below.

Procedures Regarding Eligibility, Limitations On Operations, Summary And Non-Summary Suspensions, Cancellations, Bars, And Denials Of Access

The NASD is amending the procedures relating to eligibility, limita-

tions on operations, summary and non-summary suspensions, cancellations, bars, and denials of access to provide greater detail regarding the procedural rights of a participant in a proceeding and to conform such proceedings to the current corporate structure. These amended Rules are set forth in the new Rule 9400 Series and the new Rule 9500 Series.

The new Rules set forth sweeping changes in several areas of concern to members, their associated persons, and the investing public. For a complete understanding of the new Rules, the NASD urges members and their associated persons to read the Rules and the description of such Rules in the SEC releases in the *Federal Register* cited in note 1 and note 2.

Effectiveness Of The New Procedures

The Commission approved SR-NASD-97-28 on August 7, 1997, and made the new Rules effective upon approval, except as indicated below.

Membership Admission Rules

The new Rule 1010 Series, the membership admission Rules, will take effect on August 7, 1997. Thus, if a membership application is received by the NASD before August 7, 1997, the application will be considered under the old procedures. However, if a membership application is received by the NASD on or after August 7, 1997, the new Rule 1010 Series will apply to the application process.

Rules Regarding Investigations And Sanctions

The amendments to the Rule 8000 Series will take effect on August 7, 1997.

The Code Of Procedure

The Code of Procedure, as amended (the new Rule 9100 Series through the new Rule 9300 Series), will apply to disciplinary proceedings as follows.

a) Complaints, Offers Of Settlement

If a complaint is authorized prior to August 7, 1997, a Respondent may not seek to obtain reconsideration of whether the complaint should have been authorized under the new Code. Otherwise, the application of the new Code to a complaint and the disciplinary proceeding following is established by determining two facts: when the complaint is authorized and when NASD staff first attempted service of the complaint.

Old Code

In a disciplinary proceeding involving only one Respondent named in the complaint, the Respondent is subject to the old Code, including those provisions relating to offers of settlement, if the complaint is authorized and the first attempted service occurs prior to August 7, 1997.³ First attempted service means the complaint is mailed by NASD staff or delivered by NASD staff to a courier for transmission by the courier. In a multi-Respondent disciplinary proceeding, all of the Respondents named in the complaint will be subject to the old Code, including those provisions relating to offers of settlement, if the complaint is authorized and, as to at least one Respondent, the first attempted service occurs prior to August 7, 1997.⁴

New Code

In a disciplinary proceeding involving only one named Respondent, the Respondent is subject to the new Code if the complaint is authorized before August 7, 1997, but the first attempted service occurs on or after

August 7, 1997. In a disciplinary proceeding in which multiple Respondents are named in the complaint, all Respondents are subject to the new Code if the complaint is authorized before August 7, 1997, but NASD staff does not make the first attempted service of the complaint as to any of the named Respondents until on or after August 7, 1997. Finally, in any case in which the complaint is authorized on or after August 7, 1997, the Respondent will be subject to the provisions of the new Code.

b) AWCs, MRVs

The application of the new Code to a letter of acceptance, waiver, and consent (AWC) or a minor rule violation plan letter (MRV) is based on when a member or an associated person executes an AWC or a MRV. Thus, if a member or an associated person executes an AWC or a MRV before August 7, 1997, the AWC or MRV will be subject to review and acceptance under the old Code. However, if a member or an associated person is engaged in negotiations about the terms of an AWC or MRV and the AWC or MRV is not executed until August 7, 1997, or later, it will be subject to review and acceptance under the new Code.

c) Appeals, Reviews

The Rule 9300 Series of the new Code will apply to any appeal, call for review, or review of a decision rendered under new Rule 9268 and new Rule 9269 if the decision is: (a) served on a Respondent on or after August 7, 1997, and (b) appealed, called for review, or reviewed. By doing so, all of the new appellate and review procedural enhancements, with one exception, will apply to a completed "trial-level" proceeding that is appealed, subject to a call for review, or reviewed on or after the effective date of the new Code. The

one exception is the right of the Department of Enforcement to appeal or cross-appeal a case, which will not apply. This provision in the new Rule 9300 Series will not apply to any disciplinary proceeding unless the disciplinary proceeding is based upon a complaint authorized on or after August 7, 1997.

d) A 14-Calendar Day "Opt-In" Period

In SR-NASD-97-28, the NASD proposed that in certain cases a Respondent to a disciplinary proceeding that would be administered under the old Code be allowed to opt in to the new Code. 62 F. R. 25229-25230. The NASD continues to believe that it is appropriate and desirable to have a period during which a Respondent subject to the old Code may opt to have the proceeding administered under the new Code, even though the Commission made the new Rules effective upon approval. Thus, a Respondent who is named in a complaint that is authorized prior to August 7, 1997, may opt to have the disciplinary proceeding go forward under the new Code if the first attempted service of the complaint upon the Respondent occurred not earlier than 14 calendar days before August 7, 1997, *i.e.*, July 24, 1997. A Respondent must notify NASD staff in writing of its request to have the disciplinary proceeding administered under the new Code prior to or on the date the Respondent's answer is due. As noted in a previous submission to the Commission, the NASD believes that in a disciplinary proceeding involving more than one Respondent, all Respondents must so opt in order for the new Code to apply. NASD staff shall specifically notify a Respondent who has the option to opt in of the existence of this right and the limitations on this right.

Procedures Regarding Eligibility, Limitations On Operations, Summary And Non-Summary Suspensions, Cancellations, Bars, And Denials Of Access

The new Rule 9400 Series through the new Rule 9500 Series will take effect on August 7, 1997. If a proceeding is initiated before August 7, 1997, the proceeding will be administered under the old provisions relating to the proceeding. If a proceeding is initiated on or after August 7, 1997, the proceeding will be administered under the new Rules.

The Case Authorization Process Investigations

Investigations under the new Code will be handled in essentially the same manner as such matters were performed previously. Previously, staff of the Departments of Member Regulation and Enforcement investigated matters arising in NASD's District Offices. These matters resulted from a variety of sources, including routine or cause examinations of member firms, review of customer complaints, registered representatives' terminations for cause filed on Form U-5, inquiries from the public, or referrals from regulators. The staff of the Departments of Member Regulation and Enforcement will continue to investigate such matters and obtain the evidence to support allegations of violations of the NASD rules, the rules of the Municipal Securities Rulemaking Board (MSRB), or the federal securities laws. These matters will also be reviewed by an attorney in the District Office who is a member of the Department of Enforcement. As before, the attorney will work with the Member Regulation staff to ensure that there is sufficient evidence to support proposed charges.

Staff of the Department of Enforcement in Washington, D.C. and the

Department of Market Regulation will continue to investigate matters that arise from a variety of sources. Staff in each of these departments also will work with attorneys to ensure that there is sufficient evidence to support allegations of violation.

At the conclusion of an investigation, the staff will determine whether formal action is appropriate. In certain cases, the staff may determine that formal disciplinary action is not warranted, but informal cautionary action is appropriate. In such instances, the staff may issue a Letter of Caution and may also require individuals and representatives of a member firm to attend a meeting, which the staff has referred to as a "Compliance Conference." These informal actions will not be subject to review by the Case Authorization Unit (CAU) described below.

When the staff notifies a Respondent that a recommendation of formal disciplinary charges is being considered, the potential Respondent generally will have an opportunity to either settle the matter through the appropriate pre-complaint procedure, or, if the Respondent chooses, submit a written statement explaining why such charges should not be brought. These statements are commonly referred to as "Wells Submissions,"⁵ and will be provided to the CAU, and, in appropriate cases, the Office of Disciplinary Policy (ODP), along with the staff's recommendation to file a disciplinary action.⁶ Potential Respondents will have one opportunity to submit a "Wells-type" statement and all appropriate arguments should be addressed at that time.

Case Authorization

Beginning August 7, 1997, the effective date of the new Code, all District cases will be authorized by the new CAU, which has been formed in the Department of Enforcement. After

the staff has completed its investigation and the matter has been reviewed at the District level by both the attorney responsible for the case and the District Director, the recommendation to bring a formal disciplinary action will be forwarded to the CAU. This unit will review the matter, obtain any additional information necessary to evaluate its basis, and consult with other offices, if appropriate. The Department of Enforcement has developed a computer system to systematically track the progress of matters being reviewed by the CAU.

The newly formed ODP will assist in the development of overall disciplinary policy for the organization. On behalf of the Office of the President of NASD Regulation, Inc. (NASD RegulationSM) ODP will review and approve all recommendations by District Offices to file significant or complex formal actions raising important regulatory or policy issues. ODP review will be concurrent, and in coordination, with CAU review. The ODP also will provide an objective review and approval of cases that are investigated by the Department of Enforcement in Washington D.C., as well as those that relate to "quality of market" issues. The review and approval of these cases will be performed in a manner similar to that described for the District Office cases, except that ODP will serve as the primary reviewer. The Department of Enforcement, however, will be the authorizing entity within NASD Regulation.

After review and approval by the CAU, and, in appropriate cases, ODP, the Department of Enforcement will authorize the matter. After a case has been authorized, the appropriate office will issue the complaint and file the complaint with the Office of Hearing Officers. All offers of settlement supported by the staff will be reviewed in the same manner

as described above for filing cases. AWCs and MRVs may be negotiated with the staff prior to, and subject to, approval by the Department of Enforcement, and, in appropriate cases, ODP, and acceptance by the National Business Conduct Committee (NBCC).

This centralized review of disciplinary proceedings is intended to provide an objective review of the case by those not directly involved in the investigation and ensure a level of consistency among the many disciplinary actions that are filed each year.

This is a brief summary of the new Rules approved by the Commission. Members, associated persons, and their counsel should refer to the specific Rules for a complete understanding of the Rules and to assure compliance with their terms. The full text of the approved Rules is attached to this *Notice* as it is published on the NASD Regulation Web Site, www.nasdr.com, "Members Check Here," and then under the caption, "Notices to Members." The full text of the new Rules is also available from NASD MediaSource, at (301) 590-6142.

Endnotes

¹ SR-NASD-97-28, filed April 18, 1997, Rel. No. 34-38545 (April 24, 1997), 62 F.R. 25226 (May 8, 1997); SR-NASD-97-28, Amendment No. 1, filed April 23, 1997; SR-NASD-97-28, Amendment No. 2, filed July 10, 1997, Rel. No. 34-38831 (July 11, 1997), 62 F.R. 38156 (July 16, 1997); SR-NASD-97-28, Amendment No. 3, filed July 11, 1997; SR-NASD-97-28, Amendment No. 4, filed July 21, 1997; and SR-NASD-97-28, Amendment No. 5, filed August 4, 1997. In Amendment No. 2, the NASD also proposed Rules relating to requests for exemptive relief, which are the Rule 9600 Series. The Rule 9600 Series will be addressed in a separate *Notice to Members*. The amendments that do not contain a *Federal Register* citation

were not published. Terms that are defined in the rule filing are capitalized in this *Notice*.

² Rel. No. 34-38908 (August 7, 1997). The Commission also approved proposed amendments to the Rule 8000 Series, Rule 0120, and Rule 0121, and proposed Rule IM-2210-4. The NASD withdrew the part of SR-NASD-97-28 relating to the restated certificates of incorporation of NASD, NASD Regulation and Nasdaq, Inc. (Nasdaq[®]), the By-Laws of NASD, NASD Regulation, and Nasdaq, and the Plan of Allocation and Delegation of Functions By NASD to Subsidiaries (Delegation Plan) (collectively, the “Seven Corporate Documents”). The Seven Corporate Documents, as amended to reflect the corporate restructuring recently approved by the NASD Board of Governors, will be resubmitted in a separate rule filing.

³ The appeal or review of such disciplinary proceeding may be subject to the new Code if the disciplinary proceeding is subsequently appealed to the NBCC or the NBCC subjects the disciplinary proceeding to a review, as described in greater detail below.

⁴ See note 3, *supra*.

⁵ This term has been used at the SEC following the issuance of the release *Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations*, Rel. No. 33-5310 (September 27, 1972). This release addressed recommendations of the Advisory Committee on Enforcement Policies, which was known as the “Wells Committee.” The recommendations included the discretionary practice of permitting persons to present a statement to

the Commission. See William R. McLucas, *et al.*, *An Overview of Various Procedural Considerations Associated with the Securities and Exchange Commission’s Investigative Process*, 45 Bus. Law. 625, 689 (1990).

⁶ In most cases, potential Respondents will be given the opportunity to make such a submission; however, there may be instances where the staff determines it inappropriate to do so. This process is discretionary with the staff and is not a right or policy. The failure to allow for the submission of a “Wells-type” statement has no effect on the staff’s ability or authority to file a disciplinary action against a member or an associated person.

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