NASD Notice to Members 98-39

NASD Revises Sanction Guidelines

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| Senior Management |
|----------------------------|
| Advertising |
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| Corporate Finance |
| Executive Representatives |
| Government Securities |
| Institutional |
| Insurance |
| Internal Audit |
| Legal & Compliance |
| Municipal |
| Mutual Fund |
| Operations |
| Options |
| Registered Representatives |
| Registration |
| Research |
| Syndicate |
| Systems |
| Trading |
| Training |

Executive Summary

The National Association of Securities Dealers, Inc. (NASD®) has revised the NASD Sanction Guidelines (Guidelines), which are used by the various bodies that adjudicate disciplinary matters (Adjudicators) to determine appropriate remedial sanctions. The National Business Conduct Committee (NBCC)¹ originally published the Guidelines in 1993 and periodically revised them to promote consistency and uniformity in the imposition of sanctions in disciplinary matters. The Guidelines contain an introductory section that explains the purpose of NASD disciplinary sanctions and sets forth certain generally applicable principles and considerations for determining appropriately remedial sanctions. The Guidelines also specify the range of monetary (e.g., fines and restitution orders) and non-monetary (e.g., bars, suspensions, and expulsions) sanctions generally applicable for violations at issue. The recommended ranges are not absolute. In applying the Guidelines, Adjudicators must exercise judgment and discretion in determining remedial sanctions and may impose sanctions that fall outside of the recommended ranges, or impose no sanction at all, depending on the unique facts of each case.

Questions concerning the Guidelines may be directed to Carla J. Carloni, Assistant General Counsel, NASD Regulation, Inc., at (202) 728-8019.

In addition to the copy of the Guidelines mailed with the print version of this *Notice*, copies of the Guidelines are available for purchase at \$35 each (\$10 each for employees of NASD member firms) by contacting NASD MediaSourceSM at (301) 590-6142. The Guidelines also are available on NASD Regulation's Web Site at *www.nasdr.com*.

Background

In 1997 the NBCC appointed a Sanction Guidelines Subcommittee (Subcommittee) to review and revise the Guidelines. The Subcommittee included representative District Business Conduct and Market Regulation Committee members, staff members from every NASD District, Market Regulation, Enforcement, and other departments of NASD RegulationSM, and current and former NBCC, National Adjudicatory Council (NAC), and NASD Board of Governors members. The Subcommittee recommended, and the NBCC approved, the attached Guidelines for publication.

The overall approach of the Guidelines is to set forth principal considerations in determining sanctions and ranges of monetary and non-monetary sanctions generally applicable to specific violations while leaving Adjudicators free to impose sanctions outside the recommended ranges in appropriate circumstances. The Guidelines include a revised introductory section, several new guidelines, and revisions to all existing guidelines.

The NASD believes that the Guidelines will enhance NASD Regulation's regulatory function by providing Adjudicators with guidance for determining appropriate remedial sanctions in disciplinary matters.

The Guidelines supersede guidelines previously published by the NASD and referenced in prior *NASD Notices to Members*. The Guidelines are effective as of May 15, 1998, and apply to all actions as of that date, including pending disciplinary cases.

Changes In Presentation

The presentation of the Guidelines has been revised with a view toward making the Guidelines more "user friendly." The Guidelines are

Variable Contracts

arranged according to the following 11 subject matter groupings:

- Activity Away From Associated Person's Member Firm
- Arbitration
- Distributions of Securities
- Financial and Operational Practices
- Impeding Regulatory Investigations
- Improper Use of Funds/Forgery
- Qualification and Membership
- Quality of Markets
- Reporting/Provision of Information
- Sales Practices
- Supervision

The Guidelines also include an alphabetical index that will allow users to locate any individual guideline by name.

Introductory Section

The introductory section, which now includes general principles applicable to every case and a list of principal considerations, provides users of the Guidelines with a comprehensive overview of appropriate methods for implementing the Guidelines. The revised introductory section also explains NASD Regulation's regulatory mission and the NASD's purpose in adopting the Guidelines. The NASD believes that the revised introductory section is a necessary component of the revised Guidelines and that it will prove useful to all Guidelines users.

The more important revisions and additions in the introductory section include:

- Discussion of remedial nature of disciplinary sanctions and concept of progressive discipline designed to deter future misconduct. The revised introductory section explains the intended purpose of NASD disciplinary sanctions and defines relevant disciplinary history as it applies to determining sanctions.
- Discussion of tailoring sanctions to address the specific misconduct at issue. The revised introductory section provides an illustrative list of sanctions that may be appropriate in certain instances to address specific types of misconduct and indicates that Adjudicators may find it necessary, in any given case, to impose sanctions outside the ranges recommended in the Guidelines or to impose no sanctions at all.
- Discussion of the concept of aggregation of violations. The revised introductory section delineates the factors that should be considered in determining whether to aggregate violations for purposes of instituting formal actions.
- Discussion of orders of restitution, orders of rescission, and fining away ill-gotten gains. The revised introductory section recommends that, when an identifiable customer has suffered a quantifiable loss. Adjudicators should consider ordering restitution. The introductory section also suggests that Adjudicators order that amounts not paid in restitution (because, after reasonable efforts, a customer cannot be located) be paid into the appropriate state escheat fund. The introductory section also suggests that, where appropriate, Adjudicators consider requiring orders of rescission and/or including as part of a disciplinary fine the amount of the respondent's ill-gotten gains.

 Discussion of orders of requalification. The revised introductory section now recommends that, where appropriate, Adjudicators require respondents to requalify in any or all capacities.

New Guidelines

The Guidelines include new guidelines specifically designed to address violations in the following areas:

- Confidentiality Agreements (settling with customers in exchange for customer agreements not to cooperate with regulatory authorities);
- Forms U-4 and U-5 (late filling, failing to file, filling false, misleading, or inaccurate forms or amendments);
- MSRB Rule G-36 (late filing or failing to file offering documents with the Municipal Securities Rulemaking Board);
- Regulation M Reports (late filing, failing to file, filing false or misleading reports);
- Reportable Events Under NASD Rule 3070 (late reporting, failing to report, filing false, inaccurate or misleading reports);
- Supervisory Procedures (deficient written supervisory procedures);
- Telemarketing Violations; and
- Trading Ahead of Research Reports.

Revisions To Individual Guidelines

The NBCC reviewed the Guidelines by subject matter classification in order to ensure uniformity among guidelines that address similar types of violations. This review allowed for important adjustments in recommended fine levels in the guidelines for cheating, churning, conversion, forgery, guaranteeing a customer against loss, unauthorized trading, and others. It also allowed for adjustments in suspension recommendations for guidelines that address financial and operational violations and violations related to impeding regulatory investigations. Where appropriate, the guidelines that deal with reporting violations were expanded to address not only failures to report, but also late reporting and reporting inaccurate and/or misleading information.

Major specific changes to individual guidelines include:

 Increasing the high end of fine ranges for the guidelines on forgery, conversion, and cheating to \$100,000;

- Increasing the high end of fine ranges for the guidelines on unauthorized trading and churning to \$75,000;
- Introducing the concept of a daily escalator into the recommended fine amount for egregious cases of failing to honor arbitration awards;
- Expanding recommended suspensions for egregious cases of backing away from suspensions as market makers only to suspensions in any or all capacities;
- Increasing the high end of fine ranges for the guidelines on net capital violations and violations involving outside business activities to \$50,000; and

 Increasing the high end of the fine range for the guideline on pricing violations to \$100,000 (plus the gross amount of the excessive markups, markdowns, or excessive commissions if restitution is not ordered), and adding a recommendation to consider a suspension of up to 30 business days in nonegregious cases.

Endnote

¹ The NAC became the successor to the NBCC in January 1998. *See* Exchange Act Release No. 39470, December 19, 1997, 62 FR 67927 (December 30, 1997).

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