Notice to Members

MARCH 2005

SUGGESTED ROUTING

Executive Representatives
Legal & Compliance
Senior Management
Registered Representatives

KEY TOPICS

NASD Sanction Guidelines
Institutional Sales Material and Correspondence
Telemarketing
Research Analysts and ResearchReports

GUIDANCE

Sanction Guidelines

NASD Adopts New *Sanction Guidelines;* **Effective Date: March 15, 2005**

Executive Summary

This *Notice* advises NASD members of modifications to the NASD *Sanction Guidelines* (Guidelines). NASD is adopting four new guidelines to provide recommended sanctions for violations of Rules 2211 (Institutional Sales Material), 2212 (Telemarketing), and 2711 (Research Analysts and Research Reports). Additionally, NASD is amending the guideline for violations related to communications with the public to indicate that the current sanction guideline also applies to violations of the content standards contained in Rule 2211. The new guidelines are effective as of **March 15, 2005**, and apply to all actions as of that date, including pending disciplinary cases.

The new guidelines for violations of Rules 2211 (Institutional Sales Material), 2212 (Telemarketing), and 2711 (Research Analysts and Research Reports), and the revised guidelines for violations related to communications with the public can be read in their entirety in attachment A to this *Notice*. The new and revised guidelines are also available on NASD's Web site (*www.nasd.com*).

Questions/Further Information

Questions concerning this *Notice* may be directed to Carla Carloni, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-7019.

Discussion

NASD initially published the Guidelines in 1993 to promote consistency and uniformity in the imposition of sanctions in disciplinary matters. Over the years, NASD has revised and updated the Guidelines and has adopted new individual guidelines in order to reflect changes in and additions to NASD's rules. Adjudicators rely on the Guidelines to determine appropriately remedial sanctions in disciplinary actions. NASD's Departments of Enforcement and Market Regulation and the defense bar also rely on the Guidelines in negotiating settlements in disciplinary matters. NASD therefore endeavors to maintain up-to-date and inclusive Guidelines that are designed to address a wide variety of potential violations of NASD's rules.

2211 – Institutional Sales Material and Correspondence

On May 9, 2003, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 2210 (Communications with the Public) and the creation of NASD Rule 2211 (Institutional Sales Material and Correspondence) as part of NASD's effort to modernize and clarify NASD's rules regarding member communications with the public. Rule 2211 is a separate rule applicable only to institutional sales material and correspondence. Rule 2211 subjects institutional sales material to supervision and review requirements, establishes standards for recordkeeping related to institutional sales material, and subjects institutional sales material and correspondence to content standards contained in Rule 2210. NASD separated Rule 2211 from the more general rule regarding member communications with the public (Rule 2210) in order to facilitate members' ability to determine how the advertising rules apply specifically to communications regarding institutional sales material and correspondence.

The new sanction guideline for violations of Rule 2211 is divided into two categories of violation: (1) the failure to establish and maintain written procedures in compliance with Rule 2211(b); and (2) the failure to comply with the record-keeping requirements contained in Rule 2211(b). Additionally, NASD amended the guideline for communications with the public (Rule 2210) to indicate that the current sanction guideline for violations related to communications with the public also now applies to violations of the content standards contained in Rule 2211(d).

Rule 2212 – Telemarketing[1]

In 2003, the Federal Trade Commission (FTC) and the Federal Communications Commission (FCC) established requirements for sellers and telemarketers to participate in a national do-not-call registry. In January 2004, the SEC approved amendments to NASD's revised Rule 2212, which applies only to telephone solicitations, provides time-of-day restrictions on solicitation calls, requires member firms to maintain firm-specific do-not-call lists, and prohibits member firms from making telephone solicitation calls to any person who registers his or her phone number on the national do-not-call registry.

The new sanction guideline for violations of Rule 2212 is divided into two categories of violation: (1) the failure to comply with time-of-day restrictions or do-not-call lists; and (2) the failure to establish and maintain procedures to comply with the do-not-call and time-of-day requirements in subpart (a) of the rule.

Rule 2711 – Research Analysts and Research Reports

The SEC approved Rule 2711 on May 10, 2002, and approved important amendments to Rule 2711 on July 29, 2003. Rule 2711 provides specific guidance for member firms regarding the regulation of the relationship between the research and investment banking departments. The rule establishes disclosure requirements for research reports and public appearances by research analysts and imposes time restrictions on the publishing of research reports and research analysts' public appearances. Rule 2711 also imposes restrictions on the personal trading of research analysts; research analysts' communications with target companies; research analysts' compensation; and other conduct related to member firms' research activities.

NASD adopted two new guidelines to address violations of Rule 2711. One guideline recommends sanctions for violations regarding the limitations on the relationships between the research departments and investment banking departments, the relationships between research analysts and subject companies, and the manner of compensation for research analysts. The second guideline addresses violations in two categories. In the first category, the guideline provides recommended sanctions for failing to comply with restrictions on personal trading by research analysts. In the second category, the guideline provides recommended sanctions for failing to comply with restrictions on publishing research reports; restrictions on the public appearances of research analysts; and disclosure requirements for research reports and public appearances.

Effective Date

The amendments to the current sanction guideline for violations related to communications with the public and the new guidelines for violations of Rules 2211 (Institutional Sales Material), 2212 (Telemarketing), and 2711 (Research Analysts and Research Reports) are effective as of **March 15, 2005**, and apply to all actions as of that date, including pending disciplinary cases.

Endnote

1 On May 9, 2003, the SEC approved the renumbering of NASD's former telemarketing rule (Rule 2211) to Rule 2212. On January 12, 2004, the SEC approved significant amendments to Rule 2212. NASD's current telemarketing guideline references NASD's former Rule 2211 and was adopted prior to NASD's enactment of Rule 2212. NASD's new telemarketing guideline addresses violations of Rule 2212, as amended, and supersedes NASD's current telemarketing guideline.

ATTACHMENT A

(Additions are underlined)

Communications with the Public—Late Filing; Failing to File[1]; Failing to Comply with Rule Standards or Use of Misleading Communications[2]

NASD Conduct Rules 2210, <u>2211(d),</u> and 2220[3]

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar, or Other Sanctions
See Principal Considerations in Introductory Section		
Failure to File	***Failure to File***	***Failure to File***
1. Whether failure to file was inadvertent. 2. Whether communications with the public were circulated widely without having been filed with the Advertising Regulation Department. 3. Whether an individual respondent failed to notify a supervisor of a communication with the public.	Fine of $1,000 to $15,000.	In egregious cases, consider imposing, for a definite period, a "pre-use" filing requirement to obtain an NASD Regulation staff "no objection" letter on proposed communications with the public. Also consider suspending the responsible individual in any or all capacities for up to five business days.
Late Filing	***Late Filing***	***Late Filing***
1. Whether late filing was inadvertent. 2. Whether communications with the public were circulated widely before having been filed with the Advertising Regulation Department. 3. Number of days late.	Fine of $1,000 to $10,000.	In egregious cases, consider imposing, for a definite period, a "pre-use" filing requirement to obtain an NASD Regulation staff "no objection" letter on proposed communications with the public. Also consider suspending the responsible individual in any or all capacities for up to 10 business days.

1 Failing to file includes instances in which a respondent files with NASD Regulation staff a communication with the public in response to a notice from NASD Regulation staff that a necessary filing had not been made.

2 This guideline is appropriate for disciplinary actions that name as respondents member firms that have violated NASD rules or associated persons who have circumvented the firm's procedures or violated the NASD's rules.

3 This guideline also is appropriate for violations of MSRB Rule G-21.

Communications with the Public Continued

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar, or Other Sanctions
See Principal Considerations in Introductory Section	***Failure to Comply/Misleading***	***Failure to Comply/Misleading***
Failure to Comply with Rule Standards 1. Whether violative communications with the public were circulated widely.	***Failure to Comply with Rule Standards*** Fine of $1,000 to $20,000.	***Failure to Comply with Rule Standards*** In egregious cases, consider suspending the firm with respect to any or all activities or functions for up to one year and thereafter imposing, for a definite period, a "pre-use" filing requirement to obtain an NASD Regulation staff "no objection" letter on proposed communications with the public. Also consider suspending the responsible person in any or all capacities for up to 60 days.
	Use of Misleading Communications with the Public Fine of $10,000 to $100,000.	***Use of Misleading Communications with the Public*** In cases involving inadvertent use of misleading communications, consider suspending firm with respect to any or all activities or functions for up to six months and thereafter imposing, for a definite period, a "pre-use" filing requirement to obtain an NASD Regulation staff "no objection" letter on proposed communications with the public. In cases involving intentional or reckless use of misleading communications with the public, consider suspending the firm with respect to any or all activities or functions for up to two years.[4] Also consider suspending the responsible person in any or all capacities for up to two years. In cases involving numerous acts of intentional or reckless misconduct over an extended period of time, consider suspending the firm with respect to any or all activities or functions for up to two years, suspending the responsible person in any or all capacities for up to two years, expelling the firm, and/or barring the responsible individual.

New Guideline

Institutional Sales Material—Failing to Establish and Maintain Written Procedures in Compliance with Rule Standards; Failing to Comply with Rule Standards Regarding Recordkeeping

NASD Conduct Rule 2211

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar, or Other Sanctions
See Principal Considerations In Introductory Section.		
Failure to Establish and Maintain Written Procedures in Compliance with Rule 2211(b) 1. Whether deficiencies enabled violations to occur and escape detection. 2. Nature, extent, and character of underlying misconduct, if any.	***Failure to Establish and Maintain Written Procedures in Compliance with Rule 2211(b)*** Fine of $5,000 to $20,000.	***Failure to Establish and Maintain Written Procedures in Compliance with Rule 2211(b)*** In egregious cases, consider suspending the responsible individual(s) in any or all capacities for up to one year. In egregious cases, also consider imposing a pre-use filing requirement for institutional sales material and suspending the firm with respect to any or all activities or functions for up to 30 business days or until the firm's written procedures are amended to conform to the requirements of Rule 2211(b).
Failure to Comply with Record-Keeping Requirements of Rule 2211(b) 1. Nature and materiality of inaccurate or missing information.	***Failure to Comply with Record-Keeping Requirements of Rule 2211(b)*** Fine of $1,000 to $20,000. In egregious cases, consider a higher fine.	***Failure to Comply with Record-Keeping Requirements of Rule 2211(b)*** In egregious cases, consider suspending the responsible individual for up to two years and consider suspending the firm in any or all activities or functions for up to 30 days.

New Guideline (supersedes current telemarketing guideline)

Telemarketing—Failing to Comply with Time-of-Day Restrictions and Do-Not-Call Lists; Failing to Establish and Maintain Procedures to Comply with Rule 2212(a)

NASD Conduct Rule 2212

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar, or Other Sanctions
See Principal Considerations In Introductory Section.		
Failure to Comply with Time-of-Day Restrictions or Do-Not-Call Lists 1. Whether violations were widespread within the firm. 2. Number of calls that violated restrictions. 3. Whether there are patterns of abuses relating to when telephone calls are placed or to the repeated contacting of persons who have previously requested to be placed on a do-not-call list. 4. Whether firm made reasonable efforts to establish an effective call-blocking system for any members of the public requesting to be placed on a do-not-call list.	***Failure to Comply with Time-of-Day Restrictions or Do-Not-Call Lists*** Fine of $5,000 to $25,000.	***Failure to Comply with Time-of-Day Restrictions or Do-Not-Call Lists*** Consider suspending responsible individual for up to 30 business days. In egregious cases, consider suspending the responsible individual in any or all capacities for up to two years. Also, consider suspending the firm with respect to any or all activities or functions, including telemarketing activities, for up to one year.

Telemarketing continued

NASD Conduct Rule 2212

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar, or Other Sanctions
Failure to Establish and Maintain Procedures to Comply with Rule 2212(a) 1. Nature and extent of underlying misconduct that resulted from the deficient procedures, if any. 2. Whether firm made reasonable efforts to establish an effective call-blocking system for any members of the public requesting to be placed on a do-not-call list. 3. Whether there are patterns of abuses relating to when telephone calls are placed or to the repeated contacting of persons who have previously requested to be placed on a do-not-call list.	***Failure to Establish and Maintain Procedures to Comply with Rule 2212(a)*** Fine of $5,000 to $50,000. In egregious cases, consider a higher fine.	***Failure to Establish and Maintain Procedures to Comply with Rule 2212(a)*** Consider suspending responsible individual in any or all capacities for up to 30 business days. Consider limiting activities of appropriate branch office or department for up to 30 business days. In egregious cases, consider suspending the responsible individual for up to two years. In egregious cases, also consider limiting activities of appropriate branch office or department for more than 30 days or suspending the firm in any or all activities or functions, including telemarketing activities, for up to one year.

New Guideline

Research Analysts and Research Reports—Failing to Comply with Rule Requirements Regarding (1) Relationships Between Research Department and Investment Banking Department; (2) Compensation for Research Analysts; and (3) Relationships Between Research Analysts and Subject Companies[1]

NASD Conduct Rule 2711(b), 2711(c), 2711(d), 2711(e), 2711(j)

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar, or Other Sanctions
See Principal Considerations In Introductory Section. 1. Whether misconduct resulted from negligence or intentional/reckless behavior. 2. Whether misconduct also resulted in publication of research reports that omitted material information or contained misleading information. 3. Whether evidence suggested systemic problems or widespread abuse at the firm.	***Negligent Misconduct*** Fine of $5,000 to $100,000. ***Intentional/Reckless Misconduct*** Fine of $10,000 to $200,000. In egregious cases, consider a larger fine.	***Negligent Misconduct*** Consider suspending the responsible individual(s) in any or all capacities for up to 30 business days. ***Intentional/Reckless Misconduct*** **Responsible Individual** – Suspend responsible individual(s) in any or all capacities for a period of 30 business days to two years. In egregious cases, suspend individual(s) for a longer period or bar individual(s). **Firm** – Consider suspending firm's research activities for a period of one month to two years. Consider requiring firm to retain an independent consultant to review and make recommendations regarding the adequacy of the firm's supervisory procedures regarding research activities. In cases involving violative relationships between a firm's research department and investment banking department, consider suspending the firm's investment banking activities for a period of three months to two years. In egregious cases, suspend firm in any or all activities or functions for up to two years or expel the firm.

1 For violations of Rule 2711(i) Supervisory Procedures, Adjudicators should refer to the guideline for Supervision – Failure to Supervise.

New Guideline

Research Analysts and Research Reports—Failing to Comply with Rule Requirements Regarding (1) Restrictions on Publishing Research Reports and Public Appearances of Research Analysts; (2) Restrictions on Personal Trading of Research Analysts; and (3) Disclosure Requirements for Research Reports and Public Appearances of Research Analysts[1]

NASD Conduct Rule 2711(f), 2711(g), 2711(h)

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar, or Other Sanctions
For all violations ***See Principal Considerations In Introductory Section.*** 1. Whether misconduct resulted from negligence or intentional/reckless behavior. 2. Whether misconduct also resulted in publication of research reports that omitted material information or contained misleading information. 3. Whether evidence suggested systemic problems or widespread abuse in the firm.	***Failure to Comply with Restrictions on Personal Trading of Research Analysts (Rule 2711(g))*** Fine of $5,000 to $50,000.[2] In egregious cases, consider a higher fine.	***Failure to Comply with Restrictions on Personal Trading of Research Analysts (Rule 2711(g))*** Suspend individual in any or all capacities for a period of 10 business days to one year. In egregious cases, consider a longer suspension or a bar.

1 For violations of Rule 2711(i) Supervisory Procedures, Adjudicators should refer to the guideline for Supervision – Failure to Supervise.

2 As set forth in General Principle No. 6, Adjudicators may increase the fine amount by adding the amount of the respondent's financial benefit.

Research Analysts and Research Reports continued

NASD Conduct Rule 2711(f), 2711(g), 2711(h)

	Monetary Sanction	Suspension, Bar, or Other Sanctions
	Failure to Comply with Restrictions on Publishing Research Reports, Restrictions on Public Appearances of Research Analysts, and Disclosure Requirements for Research Reports and Public Appearances (Rule 2711 (f) and (h))	***Failure to Comply with Restrictions on Publishing Research Reports, Restrictions on Public Appearances of Research Analysts, and Disclosure Requirements for Research Reports and Public Appearances (Rule 2711 (f) and (h))***
	Negligent Misconduct	***Negligent Misconduct***
	Fine of $5,000 to $100,000.	Responsible Individual – Consider suspending responsible individual(s) in any or all capacities for up to 60 business days.
	Intentional/Reckless Misconduct	***Intentional/Reckless Misconduct***
	Fine of $10,000 to $200,000. In egregious cases, consider a larger fine.	Responsible Individual – Suspend responsible individual(s) in any or all capacities for a period of 60 business days to two years. In egregious cases, suspend individual(s) for a longer period or bar individual(s). Firm – Consider suspending firm's research activities for a period of one month to two years. Consider requiring firm to retain an independent consultant to review and make recommendations regarding the adequacy of the firm's supervisory procedures regarding research activities. Consider requiring firm, for a period of six months to two years, to certify monthly that a general securities principal has conducted a pre-distribution review of all research reports. In egregious cases, suspend firm in any or all activities or functions for up to two years or expel the firm.