

March 19, 1999

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D. C. 20549
Mail Stop 10-1

Re: **File No. SR-NASD-99-15;**
Suspension of NAC Call For Review of Membership Decisions

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed herewith is the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Mary Dunbar, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8252; e-mail dunbarm@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden S. Adkins
Senior Vice President and General Counsel

Enclosure

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 ("Act"), NASD Regulation, Inc. ("NASD Regulation") is filing with the Securities and Exchange Commission ("Commission") a proposed rule change to NASD Rule 1015, which eliminates procedures for members of the National Adjudicatory Council to call for review membership decisions until June 1, 1999. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

1015. Review by National Adjudicatory Council

(a) Initiation of Review by Applicant

[(1) Request by Applicant]

Within 25 days after service of a decision under Rule 1014, 1017, or 1018, an Applicant may file a written request for review with the National Adjudicatory Council. A request for review shall state with specificity why the Applicant believes that the Department's decision is inconsistent with the membership standards set forth in Rule 1014, or otherwise should be set aside, and state whether a hearing is requested. The Applicant simultaneously shall send by first-class mail a copy of the request to the district office where the Applicant filed its membership application.

[(2) Notice by National Adjudicatory Council]

A decision issued under Rule 1014, 1017, or 1018 shall be subject to a call for review by any member of the National Adjudicatory Council or the Review Subcommittee defined in Rule 9120 within 30 days after service of the decision. If the National Adjudicatory Council calls a decision for review, a written notice of review shall be served promptly on the Applicant by first-class mail. The written notice of review

shall state the specific grounds for the review and whether a hearing is directed. If a decision is called for review by any member of the National Adjudicatory Council or the Review Subcommittee, the decision shall be reviewed by the National Adjudicatory Council. The National Adjudicatory Council simultaneously shall send by first-class mail a copy of the notice to the district office where the Applicant filed its membership application.]

(b) Transmission of Documents

Within ten days after receipt of a request for [or notice of] review, the Department shall:

(1) transmit to the National Adjudicatory Council copies of all documents that were considered in connection with the Department's decision and an index to the documents; and

(2) serve on the Applicant a copy of such documents (other than those documents originally submitted by Applicant) and a copy of the index.

(c) Membership Application Docket

The Department shall promptly record in the Association's membership application docket each request for [or notice of] review filed with the National Adjudicatory Council under this Rule and each material subsequent event, filing, and change in the status of a membership proceeding.

(d) Appointment of Subcommittee

No change.

(e) Powers of Subcommittee

If a hearing is requested [or directed], the Subcommittee shall conduct the hearing. If a hearing is not requested, the Subcommittee may serve a notice directing that a hearing be held. If

a hearing is not requested or directed, the Subcommittee shall conduct its review on the basis of the record developed before the Department and any written submissions made by the Applicant or the Department in connection with the request for review.

(f) Hearing

(1) Notice

If a hearing is requested or directed, the hearing shall be held within 45 days after the receipt of the request [or service of the notice] by the National Adjudicatory Council or service of the notice by the Subcommittee. The National Adjudicatory Council shall send written notice of the date and time of the hearing to the Applicant by facsimile or commercial courier not later than 14 days before the hearing.

(2) - (5)

No change.

(g) - (i)

No change.

2. Procedures of the Self-Regulatory Organization

(a) The NASD Regulation Board of Directors approved the proposed rule change at its October 7, 1998, meeting, and authorized the filing of the rule change with the Commission. The Nasdaq Stock Market Inc. has been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the rule change at its meeting on October 8, 1998. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits

the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD Regulation proposes to make the proposed rule change effective upon Commission approval and for the proposed rule change to remain effective until June 1, 1999.

(b) Questions regarding this rule filing may be directed to Mary M. Dunbar, Assistant General Counsel, NASD Regulation, at (202) 728-8252.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

(a) Purpose

The purpose of the proposed rule change is to eliminate the National Adjudicatory Council's ("NAC's") authority under Rule 1015 to call for review membership decisions until June 1, 1999. Currently, Rule 1015(a)(2) provides that a membership decision rendered by the Department of Member Regulation shall be subject to a call for review by the NAC. After considering several ways to exercise this authority, NASD Regulation has determined, based on its experience to date with the Rule, to eliminate NAC review of membership decisions from the date of approval by the Commission until June 1, 1999, for the reasons set forth below.

In August 1997, the SEC approved substantial revisions to the Rule 1010 Series¹ to conform the rules to the requirements of the SEC's August 8, 1996, Order with respect to the NASD ("Order").² One of the main changes required by the Order was a transfer of authority to render decisions on membership applications from the district business conduct committees to NASD Regulation staff, subject to appeals by applicants to the National Business Conduct Committee ("NBCC"), the NAC's predecessor.

¹ Securities Exchange Act Release No. 38908 (Aug. 7, 1997); 62 FR 43385 (Aug. 13, 1997).

² Securities Exchange Act Release No. 37538 (Aug. 8, 1996).

During consideration of the revisions to the Rule 1010 Series in 1997, the NBCC requested that a call for review provision for the NBCC be included in the Rule 1010 Series so that members would have a mechanism to provide input on membership decisions. The NBCC was not particularly concerned with decisions to deny or restrict an applicant because such applicants would have a strong incentive to appeal if they believed that the rules had been inconsistently applied. The NBCC was primarily concerned about decisions to grant an application without restriction. The successful applicant would have no basis or incentive to appeal such a decision, and the NBCC was concerned that there would not be a mechanism to review such a decision if a review appeared to be warranted. Thus, NASD Regulation submitted a proposed rule change including the call for review authority in November 1997³ and the Commission approved it in December 1997.⁴

Since receiving Commission approval, NASD Regulation has encountered significant practical problems in implementing this call for review authority. Approximately 1,100 membership decisions – including new member application decisions under Rule 1014, decisions to modify or remove a business restriction under Rule 1017, and decisions on continuing member applications under Rule 1018 – have been issued under the new membership rules as of November 30, 1998. NASD Regulation staff has tried several procedures to implement the call for review authority for these decisions, but does not believe that any of these procedures has been particularly effective. Reading the decisions, without more, has not proven to be useful. This is particularly true for decisions that grant a membership application without restriction because they do not contain a rationale; they simply state that the applicant has met all applicable standards. The staff also has found that decisions that deny or restrict an applicant appear to be

³ Securities Exchange Act Release No. 39350 (Nov. 21, 1997); 62 FR 64000 (Dec. 3, 1997).

well-supported by their rationale; in most districts, the district director (often a vice-president) reviews such decisions before issuing them. Unlike a call for review of a regular disciplinary decision under the Rule 9000 Series, there is no hearing panel vote that might indicate a close or difficult issue. The staff also believes that it would be duplicative of district staff work and inefficient to review every record in its entirety to determine if it supports the decision.

The staff also contemplated limiting the number of staff decisions to be considered for a call for review by focusing the process on certain categories of decisions, such as only new member application decisions or certain types of business expansions. The staff determined, however, that such a procedure might be perceived as biased against those firms that fell within the selected category.

Only one decision has been called for review by the NAC. This decision involved a new issue about the appropriate use of unadjudicated violations and an interpretation of an SEC order against an applicant. The staff believes that the issues raised in this call for review could have been resolved by consultation with the Office of General Counsel ("OGC") prior to the issuance of the district decision and by the issuance of guidelines to district staff on the appropriate consideration of unadjudicated matters in rendering a decision on a membership application.

After discussing the matter with staff, members, and practitioners, NASD Regulation has concluded that it is not possible yet to implement a fair and effective call for review mechanism for all Rule 1010 Series decisions. In view of this determination, the NAC and the Board agreed that NASD Regulation should eliminate the NAC's call for review authority temporarily until NASD Regulation has more fully reviewed the Rule 1010 Series in its entirety, including the role of the NAC in that process.

⁴ Securities Exchange Act Release No. 39470 (Dec. 19, 1997); 62 FR 67927 (Dec. 30, 1997).

At the time that NASD Regulation determined that the call for review authority should be temporarily eliminated, it was in the process of forming a Membership Admission Review Committee ("MARC"). The purpose of the MARC is to review membership application rules and procedures to see if they can be streamlined while still protecting investors. The MARC is composed of five NASD member representatives who are familiar with the membership application process and supported by NASD Regulation staff who have participated in the development or implementation of the membership rules and procedures.⁵ The call for review issue has been added to the MARC's agenda. The MARC has begun meeting and intends to report its findings to the NAC and the NASD Regulation Board in 1999.

NASD Regulation proposes to make the proposed rule change effective upon approval by the Commission and remain effective until June 1, 1999.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(8) of the Act, which requires, among other things, that the Association's rules must be designed to provide fair procedures for the denial of membership to any person seeking membership therein. The proposed rule change would not result in any change to an applicant's ability to seek NAC review of a membership decision and thus in no way prejudices applicants' rights under the NASD Rules.

⁵ Committee members include Faith Colish, New York, New York; Linda Lerner, All-Tech Investment Group, Montvale, New Jersey; Brian Shea, Pershing, Jersey City, New Jersey; Theodore Urban, Ferris, Baker, Watts, Washington, D.C.; Richard Woltman, Spelman & Co., San Diego, California. NASD Regulation staff includes Alden S. Adkins, Senior Vice President and General Counsel; Eugene Bleier, Associate District Director for District 10; Mary M. Dunbar, Assistant General Counsel; Jeffrey S. Holik, Director of Regulation Policy, Department of Member Regulation; Daniel M. Sibears, Vice President and Deputy Director, Department of Member Regulation; Mark J. Tomlin, Supervisor of Examiners for District 8.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY: _____
Alden S. Adkins, Senior Vice President and General Counsel

Date: March 19, 1999

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-99-15)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by NASD Regulation, Inc. Relating to National Adjudicatory Council Call For Review of Membership Decisions

On March 19, 1999, NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), and Rule 19b-4 thereunder. The proposed rule change is described in Items I, II, and III below, which Items have been prepared by NASD Regulation. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Regulation is proposing to amend Rule 1015 to eliminate temporarily the authority of the National Adjudicatory Council to call for review membership decisions issued by district staff. Proposed new language is underlined; proposed deletions are in brackets.

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD Regulation included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD Regulation has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

(1) Purpose

The purpose of the proposed rule change is to eliminate the National Adjudicatory Council's ("NAC's") authority under Rule 1015 to call for review membership decisions until June 1, 1999. Currently, Rule 1015(a)(2) provides that a membership decision rendered by the Department of Member Regulation shall be subject to a call for review by the NAC. After considering several ways to exercise this authority, NASD Regulation has determined, based on its experience to date with the Rule, to eliminate NAC review of membership decisions from the date of approval by the Commission until June 1, 1999, for the reasons set forth below.

In August 1997, the SEC approved substantial revisions to the Rule 1010 Series¹ to conform the rules to the requirements of the SEC's August 8, 1996, Order with respect to the NASD ("Order").² One of the main changes required by the Order was a transfer of authority to render decisions on membership applications from the district business conduct committees to NASD Regulation staff, subject to appeals by applicants to the National Business Conduct Committee ("NBCC"), the NAC's predecessor.

During consideration of the revisions to the Rule 1010 Series in 1997, the NBCC requested that a call for review provision for the NBCC be included in the Rule 1010 Series so that members would have a mechanism to provide input on membership decisions. The NBCC was not particularly concerned with decisions to deny or restrict an applicant because such applicants would have a strong incentive to appeal if they believed that the rules had been inconsistently applied. The NBCC was primarily concerned about decisions to grant an

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application without restriction. The successful applicant would have no basis or incentive to appeal such a decision, and the NBCC was concerned that there would not be a mechanism to review such a decision if a review appeared to be warranted. Thus, NASD Regulation submitted a proposed rule change including the call for review authority in November 1997³ and the Commission approved it in December 1997.⁴

Since receiving Commission approval, NASD Regulation has encountered significant practical problems in implementing this call for review authority. Approximately 1,100 membership decisions – including new member application decisions under Rule 1014, decisions to modify or remove a business restriction under Rule 1017, and decisions on continuing member applications under Rule 1018 – have been issued under the new membership rules as of November 30, 1998. NASD Regulation staff has tried several procedures to implement the call for review authority for these decisions, but does not believe that any of these procedures has been particularly effective. Reading the decisions, without more, has not proven to be useful. This is particularly true for decisions that grant a membership application without restriction because they do not contain a rationale; they simply state that the applicant has met all applicable standards. The staff also has found that decisions that deny or restrict an applicant appear to be well-supported by their rationale; in most districts, the district director (often a vice-president) reviews such decisions before issuing them. Unlike a call for review of a regular disciplinary decision under the Rule 9000 Series, there is no hearing panel vote that might indicate a close or difficult issue. The staff also believes that it would be duplicative of district staff work and inefficient to review every record in its entirety to determine if it supports the decision.

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The staff also contemplated limiting the number of staff decisions to be considered for a call for review by focusing the process on certain categories of decisions, such as only new member application decisions or certain types of business expansions. The staff determined, however, that such a procedure might be perceived as biased against those firms that fell within the selected category.

Only one decision has been called for review by the NAC. This decision involved a new issue about the appropriate use of unadjudicated violations and an interpretation of an SEC order against an applicant. The staff believes that the issues raised in this call for review could have been resolved by consultation with the Office of General Counsel ("OGC") prior to the issuance of the district decision and by the issuance of guidelines to district staff on the appropriate consideration of unadjudicated matters in rendering a decision on a membership application.

After discussing the matter with staff, members, and practitioners, NASD Regulation has concluded that it is not possible yet to implement a fair and effective call for review mechanism for all Rule 1010 Series decisions. In view of this determination, the NAC and the Board agreed that NASD Regulation should eliminate the NAC's call for review authority temporarily until NASD Regulation has more fully reviewed the Rule 1010 Series in its entirety, including the role of the NAC in that process.

At the time that NASD Regulation determined that the call for review authority should be temporarily eliminated, it was in the process of forming a Membership Admission Review Committee ("MARC"). The purpose of the MARC is to review membership application rules and procedures to see if they can be streamlined while still protecting investors. The MARC is composed of five NASD member representatives who are familiar with the membership application process and supported by NASD Regulation staff who have participated in the

development or implementation of the membership rules and procedures.⁵ The call for review issue has been added to the MARC's agenda. The MARC has begun meeting and intends to report its findings to the NAC and the NASD Regulation Board in 1999.

NASD Regulation proposes to make the proposed rule change effective upon approval by the Commission and remain effective until June 1, 1999.

(2) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(8) of the Act, which requires, among other things, that the Association's rules must be designed to provide fair procedures for the denial of membership to any person seeking membership therein. The proposed rule change would not result in any change to an applicant's ability to seek NAC review of a membership decision and thus in no way prejudices applicants' rights under the NASD Rules.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

⁵ Committee members include Faith Colish, New York, New York; Linda Lerner, All-Tech Investment Group, Montvale, New Jersey; Brian Shea, Pershing, Jersey City, New Jersey; Theodore Urban, Ferris, Baker, Watts, Washington, D.C.; Richard Woltman, Spelman & Co., San Diego, California. NASD Regulation staff includes Alden S. Adkins, Senior Vice President and General Counsel; Eugene Bleier, Associate District Director for District 10; Mary M. Dunbar, Assistant General Counsel; Jeffrey S. Holik, Director of Regulation Policy, Department of Member Regulation; Daniel M. Sibears, Vice President and Deputy Director, Department of Member Regulation; Mark J. Tomlin, Supervisor of Examiners for District 8.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will by order approve such proposed rule change, or institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of NASD Regulation. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary