

January 4, 2002

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-2002-04** – Amendments to the Taping Rule

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find 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 Grace Yeh, Office of General Counsel, NASD Regulation, Inc., at (202) 728-6939; e-mail grace.yeh@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Patrice M. Gliniecki
Vice President
and Acting General Counsel

Enclosures

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

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”), is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend NASD Rule 3010(b)(2), also known as the “Taping Rule,” and NASD IM-8310-2. The proposed amendments to the Taping Rule generally would: (1) permit firms that become subject to the Taping Rule a one time opportunity to adjust their staffing levels to fall below the prescribed threshold levels and thus avoid application of the Rule; (2) revise the criteria by which firms become subject to the Taping Rule by not including certain short-term employees of disciplined firms into the calculations of the Taping Rule threshold levels; (3) expand the compliance deadline from 30 to 60 days for firms subject to the Taping Rule to install taping systems; (4) clarify the staff’s authority to grant exemptions from the Rule pursuant to the Rule 9600 Series only in exceptional cases; and (5) extend the taping requirements from two years to three years to eliminate conflicting time periods in the Taping Rule. In addition, NASD Regulation proposes amendments to NASD IM-8310-2 to permit, upon request, public disclosure of whether a particular firm is subject to the Taping Rule. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

3010. Supervision

(a) No Change.

(b)(2) Tape recording of conversations

~~(A)~~~~(i)~~ Each member that either is notified by NASD Regulation or otherwise has actual knowledge that it meets one of the criteria in paragraph (b)(2)~~(H)~~~~(viii)~~ relating to the employment history of its registered persons at a Disciplined Firm as defined in paragraph (b)(2)~~(J)~~~~(x)~~ shall establish, maintain, and enforce special written procedures for supervising the telemarketing activities of all of its registered persons.

~~(B)~~~~(ii)~~ The member must establish and implement the supervisory procedures required by this paragraph within [30] 60 days of receiving notice from NASD Regulation or obtaining actual knowledge that it is subject to the provisions of this paragraph.

A member that meets one of the criteria in paragraph (b)(2)(H) for the first time may reduce its staffing levels to fall below the threshold levels within 30 days after receiving notice from NASD Regulation pursuant to the provisions of paragraph (b)(2)(A) or obtaining actual knowledge that it is subject to the provisions of the paragraph, provided the firm promptly notifies the Department of Member Regulation, NASD Regulation, in writing of its becoming subject to the Rule. Once the member has reduced its staffing levels to fall below the threshold levels, it shall not rehire a person terminated to accomplish the staff reduction for a period of 180 days. On or prior to reducing staffing levels pursuant to this paragraph, a member must provide the Department of Member Regulation, NASD Regulation with written notice, identifying the terminated person(s).

(C)[(iii)] The procedures required by this paragraph shall include tape-recording all telephone conversations between the member's registered persons and both existing and potential customers.

(D)[(iv)] The member shall establish reasonable procedures for reviewing the tape recordings made pursuant to the requirements of this paragraph to ensure compliance with applicable securities laws and regulations and applicable rules of [this] the Association. The procedures must be appropriate for the member's business, size, structure, and customers.

(E)[(v)] All tape recordings made pursuant to the requirements of this paragraph shall be retained for a period of not less than three years from the date the tape was created, the first two years in an easily accessible place. Each member shall catalog the retained tapes by registered person and date.

(F)[(vi)] Such procedures shall be maintained for a period of [two] three years from the date that the member establishes and implements the procedures required by the provisions of this paragraph.

(G)[(vii)] By the 30th day of the month following the end of each calendar quarter, each member firm subject to the requirements of this paragraph shall submit to the Association a report on the member's supervision of the telemarketing activities of its registered persons.

(H)[(viii)] The following members shall be required to adopt special supervisory procedures over the telemarketing activities of their registered persons:

- A firm with at least five but fewer than ten registered persons, where 40% or more of its registered persons have been [employed by] associated with one or more Disciplined Firms in a registered capacity within the last three years;

- A firm with at least ten but fewer than twenty registered persons, where four or more of its registered persons have been [employed by] associated with one or more Disciplined Firms in a registered capacity within the last three years;

- A firm with at least twenty registered persons, where 20% or more of its registered persons have been [employed by] associated with one or more Disciplined Firms in a registered capacity within the last three years.

For purposes of the calculations required in subparagraph (H), firms should not include registered persons who:

(1) have been registered for an aggregate total of 90 days or less with one or more Disciplined Firms within the past three years; and

(2) do not have a disciplinary history as defined in IM-1011-1.

~~(I)~~[(ix)] For purposes of this Rule, the term “registered person” means any person registered with the Association as a representative, principal, or assistant representative pursuant to the Rule 1020, 1030, 1040, and 1110 Series or pursuant to Municipal Securities Rulemaking Board (“MSRB”) Rule G-3.

~~(J)~~[(x)] For purposes of this Rule, the term "disciplined firm" means a member that, in connection with sales practices involving the offer, purchase, or

sale of any security, has been expelled from membership or participation in any securities industry self-regulatory organization or is subject to an order of the Securities and Exchange Commission revoking its registration as a broker/dealer.

(K)[(xi)] Pursuant to the Rule 9600 Series, the Association may in exceptional circumstances, taking into consideration all relevant factors, exempt any member unconditionally or on specified terms and conditions from the requirements of this paragraph [upon satisfactory showing that the member's supervisory procedures ensure compliance with applicable securities laws and regulations and applicable rules of the Association].

* * * * *

IM-8310-2. Release of Disciplinary [Information] and Other Information Through the Public Disclosure Program

(a) In response to a written inquiry, electronic inquiry, or telephonic inquiry via a toll-free telephone listing, the Association shall release certain information contained in the Central Registration Depository regarding a current or former member, an associated person, or a person who was associated with a member within the preceding two years, through the Public Disclosure Program. Such information shall include:

- (1) the person's employment history and other business experience required to be reported on Form U-4;
- (2) currently approved registrations for the member or associated person;
- (3) the main office, legal status, and type of business engaged in by the member; and

(4) an event or proceeding—

(A) required to be reported under Item 23 on Form U-4;

(B) required to be reported under Item 11 on Form BD; or

(C) reported on Form U-6.

The Association also shall make available through the Public Disclosure Program certain arbitration decisions against a member involving a securities or commodities dispute with a public customer. In addition, the Association shall make available in response to telephonic inquiries via the Public Disclosure Program's toll-free telephone listing whether a particular member is subject to the provisions of Rule 3010(b)(2). The Association shall not release through the Public Disclosure Program social security numbers, residential history information, or physical description information, or information that the Association is otherwise prohibited from releasing under Federal law.

(b) through (l) No Change.

* * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation at its meeting on April 25, 2001, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have 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 proposed rule change at its meeting on April 26, 2001. 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.

The NASD will announce the effective date of the proposed rule change in a Notice to Members to be published approximately 60 days following the date of Commission approval. The effective date of the proposed rule change will be 30 days following the later of (1) the issuance of such Notice to Members or (2) the completion of the NASD system changes required to make the calculations under the proposal (anticipated to be completed on July 29, 2002).

(b) Questions regarding this rule filing may be directed to Grace Yeh, Assistant General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-6939.

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

(a) Purpose

The Taping Rule, which was adopted in 1998, is designed to ensure that members with a large number of registered persons from firms that have been expelled from membership or have had their registration revoked ("Disciplined Firms") have proper supervisory procedures over telemarketing activities to prevent fraudulent and improper sales practices or other customer harm. Under the Rule, firms that hire a significant number of employees from Disciplined Firms must establish, maintain, and enforce special written procedures for supervising the telemarketing activities of all their registered persons. In

addition, such firms are required to install taping systems to record all telephone conversations between all of their registered persons and both existing and potential customers, review the tape recordings, and file quarterly reports with NASD Regulation.

Based upon staff's experience with the Taping Rule and input from the National Adjudicatory Council and NASD Regulation Committees, the staff proposes several amendments to the Rule. Generally, the proposed amendments are intended to refine the application of the Taping Rule and to provide additional flexibility to assist member firms in meeting their compliance obligations under the Rule.

1. Establishment Of A 30-Day Staff Adjustment Period

NASD Regulation is concerned that some firms may inadvertently or unintentionally become subject to the Taping Rule due, for example, to sudden turnover among registered persons or other events beyond the firm's control. As a means to address these types of occurrences, NASD Regulation is proposing to provide all firms that trigger application of the Taping Rule (for the first time) a one-time opportunity to obtain relief from the Taping Rule requirements by adjusting their staffing levels.

In particular, NASD Regulation proposes to permit firms, within 30 days after receiving the notice that they are subject to the Taping Rule or obtaining actual knowledge that they are subject to the Rule (and have promptly notified the Department of Member Regulation that they are subject to the Rule), to reduce their staffing levels to fall below the threshold levels contained in paragraph (b)(2)(viii) of the Taping Rule and thus avoid application of the Taping Rule. Under the proposed rule change, firms would not be permitted to hire additional registered representatives to fall below the stated thresholds but

rather would be required to reduce their number of registered representatives from Disciplined Firms. Once a firm has made the reductions, the firm would not be permitted to rehire the terminated individuals for a period of at least 180 days. Under the proposed rule change, firms may elect, but are not required, to make reductions to their staffing levels. If a firm chooses not to make the adjustment, then it will be required to comply with the Taping Rule requirements.

A firm would be permitted to adjust its staffing levels only when it becomes subject to the Taping Rule for the first time. If the firm re-triggers the Taping Rule at any point in the future, then the firm automatically would become subject to its provisions. While a new entity resulting from a restructuring (by a merger, acquisition, or otherwise) would be allowed to make a staff adjustment to avoid application of the Taping Rule even if one of the participating members in the restructuring had previously adjusted its staff level pursuant to the proposed rule change, this would not be the case for an entity that was restructured in an effort to avoid compliance with the Rule.

2. Revision Of The Criteria By Which Firms Become Subject To The Taping Rule

NASD Regulation is proposing to revise the criteria for determining whether a firm is subject to the Taping Rule by excluding from the firm's calculations registered persons who were associated with a Disciplined Firm for only a short period of time. Specifically, registered persons who were registered with one or more Disciplined Firms for 90 days or less within the last three years and who have no relevant disciplinary history may be excluded from the calculations required under the Rule of registered persons from Disciplined Firms.

NASD Regulation believes that the proposed rule change is consistent with the intent of the Taping Rule. The proposed rule change recognizes that persons registered with Disciplined Firms for a short period of time (i.e., an aggregate total of 90 days or less) are far less likely to have acquired the “bad habits” from the Disciplined Firms that the Taping Rule seeks to redress. Moreover, it is anticipated that these individuals will receive the proper training and supervision at their new firms. To provide greater assurance that these short-term employees have not acquired the “bad habits” of concern or do not otherwise raise the concerns that the Rule is designed to address, the proposed rule change also requires that such short-term employees have no disciplinary history as defined in NASD IM-1011-1.

In addition, the proposed rule change would clarify that the calculation of registered representatives from Disciplined Firms includes independent contractors previously registered with a Disciplined Firm. NASD Regulation proposes to make a technical amendment to the current rule language by substituting “associated with one or more Disciplined Firms in a registered capacity” for “employed by one or more Disciplined Firms” in subparagraph (b)(2)(viii) of the Taping Rule.

3. Expansion Of The Compliance Deadline From 30 To 60 Days

Under the current Taping Rule, firms are obligated to implement the special supervisory procedures, including the installation of taping systems within 30 days of receiving notice from the NASD (or obtaining actual knowledge) that they are subject to the Taping Rule. Most of the firms that have become subject to the Taping Rule have requested extensions of time to complete the installation of a taping system. In light of these requests and the staff’s understanding that firms typically require greater than 30 days to install an

appropriate taping system, the proposed rule change would extend the time for firms to install the taping system from 30 days to 60 days. Based on the staff's experience, 60 days should provide adequate time for firms to install the taping systems and would alleviate the need for firms to request extensions of time.

4. Clarification Of The Exemptive Relief Authority

Currently, paragraph (b)(2)(xi) of the Taping Rule permits member firms that become subject to the Taping Rule to apply for exemptive relief under the Rule 9600 Series "upon satisfactory showing that the member's supervisory procedures ensure compliance with applicable securities laws and regulations and applicable rules of the Association." In reviewing exemptive requests, NASD Regulation generally has required a firm to establish that it has alternative procedures to assure supervision at a level functionally equivalent to a taping system. Notwithstanding this high standard, the staff has received a substantial number of applications for exemptive relief, all but one of which have been denied.

Based on its experience administering exemptive requests, the staff believes that the exemption provisions should be explicitly drafted to be available in "exceptional circumstances" only. The staff believes that clearly articulating a high standard for an exemption will save firms and the staff the time and expense involved in the vast majority of unmeritorious exemption applications the staff has reviewed to date. Further, the additional flexibility created by the proposed rule change, particularly the one-time ability to reduce staffing levels to avoid application of the Rule, should significantly reduce any need to seek an exemption.

5. Increase Duration Of The Special Supervisory Requirements

The proposed rule change would extend the time period for which firms must maintain taping systems from two years to three years. NASD Regulation believes that this proposed change will reduce confusion concerning the application of the Taping Rule. Currently, the Taping Rule requires firms to install the taping systems for a period of two years; however, the Taping Rule also requires firms to look back three years for the employment history of their registered representatives to calculate the threshold levels under paragraph (b)(2)(viii) of the Taping Rule. Equalizing these two time periods to three years would eliminate the confusion and would alleviate any problems in the calculations for the Taping Rule thresholds.

In addition, the proposed rule change would clarify that the period for which firms are required to maintain the taping system begins from the date that the member establishes its special supervisory procedures and implements the taping system. The proposed rule change further would clarify in paragraph (b)(2)(ii) of the Taping Rule that a firm is required to both establish and implement the taping system within the time period set forth in such paragraph.

Publication of the Identity of Firms Subject to the Taping Rule

Since the inception of the Taping Rule, the staff has received requests from regulators, consumer groups, and investor representatives, to make the identity of firms subject to the Taping Rule publicly available. After careful consideration of the issue, NASD Regulation believes that public disclosure of the identity of firms subject to the Taping Rule in circumstances where information is being sought regarding a particular firm is appropriate and consistent with the objectives of the Taping Rule. As a result, the proposed rule change

would enable investors and the general public to ascertain, upon request, whether an identified firm is subject to the Taping Rule.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that the proposed rule change provides firms with more flexibility to comply with the Rule while still requiring firms that hire a significant number of registered persons from Disciplined Firms to adopt enhanced supervisory procedures to protect investors and prevent fraudulent and manipulative sales practices.

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

The proposed rule change was published for comment in NASD Notice to Members 01-38 (June 2001). Sixteen comments were received in response to the Notice. A copy of the Notice to Members is attached as Exhibit 2. Copies of the comment letters received in response to the Notice, and a brief summary of those comments, are attached as Exhibits 3

and 4. Of the 16 comment letters received, 12 were in favor of the proposed rule change and 4 were opposed.

6. Extension of Time Period for Commission Action

NASD Regulation does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

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.
2. NASD Notice to Members 01-38 (June 2001).
3. Comments received in response to NASD Notice to Members 01-38 (June 2001).
4. Summary of comments received.

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: _____
Patrice M. Gliniecki, Vice President and
Acting General Counsel

Date: January 4, 2002

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2002-04)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Amendments to Rule 3010(b)(2) and IM-8310-2

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , the National Association of Securities Dealers, Inc. (“NASD”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as 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 NASD Rule 3010(b)(2), also known as the “Taping Rule,” and NASD IM-8310-2. The proposed amendments to the Taping Rule generally would: (1) permit firms that become subject to the Taping Rule a one time opportunity to adjust their staffing levels to fall below the prescribed threshold levels and thus avoid application of the Rule; (2) revise the criteria by which firms become subject to

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR § 240.19b-4.

the Taping Rule by not including certain short-term employees of disciplined firms into the calculations of the Taping Rule threshold levels; (3) expand the compliance deadline from 30 to 60 days for firms subject to the Taping Rule to install taping systems; (4) clarify the staff's authority to grant exemptions from the Rule pursuant to the Rule 9600 Series only in exceptional cases; and (5) extend the taping requirements from two years to three years to eliminate conflicting time periods in the Taping Rule. In addition, NASD Regulation proposes amendments to NASD IM-8310-2 to permit, upon request, public disclosure of whether a particular firm is subject to the Taping Rule. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

3010. Supervision

(a) No Change.

(b)(2) Tape recording of conversations

(A)[(i)] Each member that either is notified by NASD Regulation or otherwise has actual knowledge that it meets one of the criteria in paragraph (b)(2)(H)[(viii)] relating to the employment history of its registered persons at a Disciplined Firm as defined in paragraph (b)(2)(J)[(x)] shall establish, maintain, and enforce special written procedures for supervising the telemarketing activities of all of its registered persons.

(B)[(ii)] The member must establish and implement the supervisory procedures required by this paragraph within [30] 60 days of receiving notice from NASD Regulation or obtaining actual knowledge that it is subject to the provisions of this paragraph.

A member that meets one of the criteria in paragraph (b)(2)(H) for the first time may reduce its staffing levels to fall below the threshold levels within 30 days after receiving notice from NASD Regulation pursuant to the provisions of paragraph (b)(2)(A) or obtaining actual knowledge that it is subject to the provisions of the paragraph, provided the firm promptly notifies the Department of Member Regulation, NASD Regulation, in writing of its becoming subject to the Rule. Once the member has reduced its staffing levels to fall below the threshold levels, it shall not rehire a person terminated to accomplish the staff reduction for a period of 180 days. On or prior to reducing staffing levels pursuant to this paragraph, a member must provide the Department of Member Regulation, NASD Regulation with written notice, identifying the terminated person(s).

(C)[(iii)] The procedures required by this paragraph shall include tape-recording all telephone conversations between the member's registered persons and both existing and potential customers.

(D)[(iv)] The member shall establish reasonable procedures for reviewing the tape recordings made pursuant to the requirements of this paragraph to ensure compliance with applicable securities laws and regulations and applicable rules of [this] the Association. The procedures must be appropriate for the member's business, size, structure, and customers.

(E)[(v)] All tape recordings made pursuant to the requirements of this paragraph shall be retained for a period of not less than three years from the date

the tape was created, the first two years in an easily accessible place. Each member shall catalog the retained tapes by registered person and date.

(E)[(vi)] Such procedures shall be maintained for a period of [two] three years from the date that the member establishes and implements the procedures required by the provisions of this paragraph.

(G)[(vii)] By the 30th day of the month following the end of each calendar quarter, each member firm subject to the requirements of this paragraph shall submit to the Association a report on the member's supervision of the telemarketing activities of its registered persons.

(H)[(viii)] The following members shall be required to adopt special supervisory procedures over the telemarketing activities of their registered persons:

- A firm with at least five but fewer than ten registered persons, where 40% or more of its registered persons have been [employed by] associated with one or more Disciplined Firms in a registered capacity within the last three years;
- A firm with at least ten but fewer than twenty registered persons, where four or more of its registered persons have been [employed by] associated with one or more Disciplined Firms in a registered capacity within the last three years;
- A firm with at least twenty registered persons, where 20% or more of its registered persons have been [employed by] associated with one or more Disciplined Firms in a registered capacity within the last three years.

For purposes of the calculations required in subparagraph (H), firms should not include registered persons who:

(1) have been registered for an aggregate total of 90 days or less with one or more Disciplined Firms within the past three years; and

(2) do not have a disciplinary history as defined in IM-1011-1.

~~(I)~~~~(ix)~~ For purposes of this Rule, the term “registered person” means any person registered with the Association as a representative, principal, or assistant representative pursuant to the Rule 1020, 1030, 1040, and 1110 Series or pursuant to Municipal Securities Rulemaking Board (“MSRB”) Rule G-3.

~~(J)~~~~(x)~~ For purposes of this Rule, the term "disciplined firm" means a member that, in connection with sales practices involving the offer, purchase, or sale of any security, has been expelled from membership or participation in any securities industry self-regulatory organization or is subject to an order of the Securities and Exchange Commission revoking its registration as a broker/dealer.

~~(K)~~~~(xi)~~ Pursuant to the Rule 9600 Series, the Association may in exceptional circumstances, taking into consideration all relevant factors, exempt any member unconditionally or on specified terms and conditions from the requirements of this paragraph [upon satisfactory showing that the member’s supervisory procedures ensure compliance with applicable securities laws and regulations and applicable rules of the Association].

* * * * *

IM-8310-2. Release of Disciplinary [Information] and Other Information Through the Public Disclosure Program

(a) In response to a written inquiry, electronic inquiry, or telephonic inquiry via a toll-free telephone listing, the Association shall release certain information contained in the Central Registration Depository regarding a current or former member, an associated person, or a person who was associated with a member within the preceding two years, through the Public Disclosure Program. Such information shall include:

- (1) the person's employment history and other business experience required to be reported on Form U-4;
- (2) currently approved registrations for the member or associated person;
- (3) the main office, legal status, and type of business engaged in by the member; and
- (4) an event or proceeding—
 - (A) required to be reported under Item 23 on Form U-4;
 - (B) required to be reported under Item 11 on Form BD; or
 - (C) reported on Form U-6.

The Association also shall make available through the Public Disclosure Program certain arbitration decisions against a member involving a securities or commodities dispute with a public customer. In addition, the Association shall make available in response to telephonic inquiries via the Public Disclosure Program's toll-free telephone listing whether a particular member is subject to the provisions of Rule 3010(b)(2). The Association shall not release through the Public Disclosure Program social security numbers, residential history

information, or physical description information, or information that the Association is otherwise prohibited from releasing under Federal law.

(b) through (l) No Change.

* * * *

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 Taping Rule, which was adopted in 1998, is designed to ensure that members with a large number of registered persons from firms that have been expelled from membership or have had their registration revoked ("Disciplined Firms") have proper supervisory procedures over telemarketing activities to prevent fraudulent and improper sales practices or other customer harm. Under the Rule, firms that hire a significant number of employees from Disciplined Firms must establish, maintain, and enforce special written procedures for supervising the telemarketing activities of all their registered persons. In addition, such firms are required to install taping systems to record all telephone conversations between all of their registered persons and both existing and potential customers, review the tape recordings, and file quarterly reports with NASD Regulation.

Based upon staff's experience with the Taping Rule and input from the National Adjudicatory Council and NASD Regulation Committees, the staff proposes several amendments to the Rule. Generally, the proposed amendments are intended to refine the application of the Taping Rule and to provide additional flexibility to assist member firms in meeting their compliance obligations under the Rule.

1. Establishment Of A 30-Day Staff Adjustment Period

NASD Regulation is concerned that some firms may inadvertently or unintentionally become subject to the Taping Rule due, for example, to sudden turnover among registered persons or other events beyond the firm's control. As a means to address these types of occurrences, NASD Regulation is proposing to provide all firms that trigger application of the Taping Rule (for the first time) a one-time opportunity to obtain relief from the Taping Rule requirements by adjusting their staffing levels.

In particular, NASD Regulation proposes to permit firms, within 30 days after receiving the notice that they are subject to the Taping Rule or obtaining actual knowledge that they are subject to the Rule (and have promptly notified the Department of Member Regulation that they are subject to the Rule), to reduce their staffing levels to fall below the threshold levels contained in paragraph (b)(2)(viii) of the Taping Rule and thus avoid application of the Taping Rule. Under the proposed rule change, firms would not be permitted to hire additional registered representatives to fall below the stated thresholds but rather would be required to reduce their number of registered representatives from Disciplined Firms. Once a firm has made the reductions, the firm would not be permitted to rehire the terminated individuals for a period of at least 180 days. Under the proposed rule

change, firms may elect, but are not required, to make reductions to their staffing levels. If a firm chooses not to make the adjustment, then it will be required to comply with the Taping Rule requirements.

A firm would be permitted to adjust its staffing levels only when it becomes subject to the Taping Rule for the first time. If the firm re-triggers the Taping Rule at any point in the future, then the firm automatically would become subject to its provisions. While a new entity resulting from a restructuring (by a merger, acquisition, or otherwise) would be allowed to make a staff adjustment to avoid application of the Taping Rule even if one of the participating members in the restructuring had previously adjusted its staff level pursuant to the proposed rule change, this would not be the case for an entity that was restructured in an effort to avoid compliance with the Rule.

2. Revision Of The Criteria By Which Firms Become Subject To The Taping Rule

NASD Regulation is proposing to revise the criteria for determining whether a firm is subject to the Taping Rule by excluding from the firm's calculations registered persons who were associated with a Disciplined Firm for only a short period of time. Specifically, registered persons who were registered with one or more Disciplined Firms for 90 days or less within the last three years and who have no relevant disciplinary history may be excluded from the calculations required under the Rule of registered persons from Disciplined Firms.

NASD Regulation believes that the proposed rule change is consistent with the intent of the Taping Rule. The proposed rule change recognizes that persons registered with Disciplined Firms for a short period of time (i.e., an aggregate total of 90 days or less) are far less likely to have acquired the “bad habits” from the Disciplined Firms that the Taping Rule

seeks to redress. Moreover, it is anticipated that these individuals will receive the proper training and supervision at their new firms. To provide greater assurance that these short-term employees have not acquired the “bad habits” of concern or do not otherwise raise the concerns that the Rule is designed to address, the proposed rule change also requires that such short-term employees have no disciplinary history as defined in NASD IM-1011-1.

In addition, the proposed rule change would clarify that the calculation of registered representatives from Disciplined Firms includes independent contractors previously registered with a Disciplined Firm. NASD Regulation proposes to make a technical amendment to the current rule language by substituting “associated with one or more Disciplined Firms in a registered capacity” for “employed by one or more Disciplined Firms” in subparagraph (b)(2)(viii) of the Taping Rule.

3. Expansion Of The Compliance Deadline From 30 To 60 Days

Under the current Taping Rule, firms are obligated to implement the special supervisory procedures, including the installation of taping systems within 30 days of receiving notice from the NASD (or obtaining actual knowledge) that they are subject to the Taping Rule. Most of the firms that have become subject to the Taping Rule have requested extensions of time to complete the installation of a taping system. In light of these requests and the staff’s understanding that firms typically require greater than 30 days to install an appropriate taping system, the proposed rule change would extend the time for firms to install the taping system from 30 days to 60 days. Based on the staff’s experience, 60 days should provide adequate time for firms to install the taping systems and would alleviate the need for firms to request extensions of time.

4. Clarification Of The Exemptive Relief Authority

Currently, paragraph (b)(2)(xi) of the Taping Rule permits member firms that become subject to the Taping Rule to apply for exemptive relief under the Rule 9600 Series “upon satisfactory showing that the member’s supervisory procedures ensure compliance with applicable securities laws and regulations and applicable rules of the Association.” In reviewing exemptive requests, NASD Regulation generally has required a firm to establish that it has alternative procedures to assure supervision at a level functionally equivalent to a taping system. Notwithstanding this high standard, the staff has received a substantial number of applications for exemptive relief, all but one of which have been denied.

Based on its experience administering exemptive requests, the staff believes that the exemption provisions should be explicitly drafted to be available in “exceptional circumstances” only. The staff believes that clearly articulating a high standard for an exemption will save firms and the staff the time and expense involved in the vast majority of unmeritorious exemption applications the staff has reviewed to date. Further, the additional flexibility created by the proposed rule change, particularly the one-time ability to reduce staffing levels to avoid application of the Rule, should significantly reduce any need to seek an exemption.

5. Increase Duration Of The Special Supervisory Requirements

The proposed rule change would extend the time period for which firms must maintain taping systems from two years to three years. NASD Regulation believes that this proposed change will reduce confusion concerning the application of the Taping Rule. Currently, the Taping Rule requires firms to install the taping systems for a period of two

years; however, the Taping Rule also requires firms to look back three years for the employment history of their registered representatives to calculate the threshold levels under paragraph (b)(2)(viii) of the Taping Rule. Equalizing these two time periods to three years would eliminate the confusion and would alleviate any problems in the calculations for the Taping Rule thresholds.

In addition, the proposed rule change would clarify that the period for which firms are required to maintain the taping system begins from the date that the member establishes its special supervisory procedures and implements the taping system. The proposed rule change further would clarify in paragraph (b)(2)(ii) of the Taping Rule that a firm is required to both establish and implement the taping system within the time period set forth in such paragraph.

Publication of the Identity of Firms Subject to the Taping Rule

Since the inception of the Taping Rule, the staff has received requests from regulators, consumer groups, and investor representatives, to make the identity of firms subject to the Taping Rule publicly available. After careful consideration of the issue, NASD Regulation believes that public disclosure of the identity of firms subject to the Taping Rule in circumstances where information is being sought regarding a particular firm is appropriate and consistent with the objectives of the Taping Rule. As a result, the proposed rule change would enable investors and the general public to ascertain, upon request, whether an identified firm is subject to the Taping Rule.

(2) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which require, among other things, that the

Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that the proposed rule change provides firms with more flexibility to comply with the Rule while still requiring firms that hire a significant number of registered persons from Disciplined Firms to adopt enhanced supervisory procedures to protect investors and prevent fraudulent and manipulative sales practices.

(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

The proposed rule change was published for comment in NASD Notice to Members 01-38 (June 2001). Sixteen comments were received in response to the Notice. Copies of the comment letters and a brief summary of the comments have been provided to the Commission. Of the 16 comment letters received, 12 were in favor of the proposed rule change and 4 were opposed.

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:

- (A) by order approve such proposed rule change, or
- (B) 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 the NASD. 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