

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50221; File No. SR-NASD-2004-121)

August 19, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 by the National Association of Securities Dealers, Inc. to Include Failures to Submit Timely Amendments to Form U5 in its Minor Rule Violation Plan

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 11, 2004, the National Association of Securities Dealers, Inc. ("NASD") 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. On August 17, 2004, NASD filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On August 19, 2004, NASD filed Amendment No. 2 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

NASD proposes to amend NASD Interpretative Material 9216 ("IM-9216") (Violations

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Shirley H. Weiss, Associate General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission (August 16, 2004) ("Amendment No. 1"). In Amendment No. 1, NASD alphabetically rearranged the contents of Exhibit 3 to the proposed rule change. Exhibit 3 included comment letters NASD received from its members with respect to the proposed rule change.

<sup>4</sup> See letter from Shirley H. Weiss, Associate General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission (August 19, 2004) ("Amendment No. 2"). In Amendment No. 2, NASD made technical corrections to conform the proposed rule text with the rule text of current IM-9216.

Appropriate for Disposition Under the Plan Pursuant to SEC Rule 19d-1(c)(2)) to expand the list of violations eligible for disposition under NASD's Minor Rule Violation Plan ("MRVP") to include failure to submit timely amendments to Form U5, as required by Article V, Section 3(a) of the NASD By-Laws. The proposed rule filing also changes "U-4" to "U4," to be consistent with the most recent amendments to that form. The text of the proposed rule change is available at the principal office of NASD and the Commission's Public Reference Room.<sup>5</sup>

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 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 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

In 1984, the Commission adopted amendments to Rule 19d-1(c) under the Act<sup>6</sup> to allow a self-regulatory organization to adopt, with Commission approval, plans for the disposition of minor violations of the rules of such self-regulatory organization.<sup>7</sup> In 1993, pursuant to Commission Rule 19d-1(c), NASD established the MRVP for the disposition of minor violations

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<sup>5</sup> On February 10, 2004, NASD proposed additional amendments to the MRVP. See SR-NASD-2004-025. NASD has stated that it would amend the rule text set forth in this proposed rule change in the event the Commission approves SR-NASD-2004-025 before approval of this proposed rule change.

<sup>6</sup> 17 CFR 240.19d-1(c).

of certain NASD rules.<sup>8</sup> In 2001, the Commission approved significant amendments to the MRVP<sup>9</sup> and, in February 2004, NASD proposed additional amendments to the MRVP.<sup>10</sup>

According to NASD, the MRVP provides for meaningful sanctions for minor or technical violations of certain NASD rules when the initiation of a NASD disciplinary proceeding through the NASD formal complaint process would be more costly and time-consuming than would be warranted. NASD represents that inclusion of an NASD rule in the MRVP does not mean that such rule is unimportant; rather, a minor or technical violation of such rule may be appropriate for disposition under the MRVP. NASD retains the discretion to bring full disciplinary proceedings for a minor or technical violation of such rule.

NASD Rule 9216(b) authorizes NASD to impose a fine of \$2,500 or less on any member or associated person of a member for a violation of NASD rules specified in IM-9216. NASD staff reviews the number and seriousness of the violation, as well as the previous disciplinary history of the violator, to determine if a matter is appropriate for disposition under the MRVP, and, if appropriate for disposition under the MRVP, to determine the amount of the fine. Once NASD has fined an individual or a member firm for a minor or technical violation pursuant to the MRVP, NASD may, at its discretion, issue progressively higher fines for all subsequent minor or technical violations of NASD rules specified in IM-9216 within the next 24-month

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<sup>7</sup> See Exchange Act Release No. 21013 (June 1, 1984), 49 FR 23828 (June 8, 1984).

<sup>8</sup> See NASD Rule 9216(b). See also Exchange Act Release No. 32076 (March 31, 1993), 58 FR 18291 (April 8, 1993); and Notice to Members 93-42 (SEC Approves NASD's Minor Rule Violation Plan) (July 1993).

<sup>9</sup> See Exchange Act Release No. 44512 (July 3, 2001), 66 FR 36812 (July 13, 2001).

<sup>10</sup> See SR-NASD-2004-025.

period or initiate more formal disciplinary proceedings.<sup>11</sup>

NASD proposes to amend the MRVP to include the failure to submit timely amendments to Form U5, as required by Article V, Section 3(a) of the NASD By-Laws. NASD represents that the inclusion of the failure to timely submit amendments to Form U5 would be consistent with the current MRVP, which includes failure to timely submit amendments to Form U4, as required by Article V, Section 2(c) of the NASD By-Laws, and failure to timely submit amendments to Form BD, as required by Article IV, Section 1(c) of the NASD By-Laws. NASD believes that expanding the MRVP to include violations of the failure to timely submit amendments to Form U5 would give NASD's Department of Enforcement the same flexibility to resolve such violations, as violations with respect to the failure to submit timely amendments to the Form U4 and/or Form BD. In addition, NASD believes that the addition of this violation to the MRVP would provide NASD staff with the ability to impose a meaningful sanction for violations that warrant more than a Letter of Caution but do not necessarily rise to a level meriting a full disciplinary proceeding.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>12</sup> which requires, among other things, that NASD 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. Further, NASD

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<sup>11</sup> See Notice to Members 04-19 (NASD Releases Minor Rule Violation Plan (MRVP) Guidelines) (March 2004) (providing interested parties with guidance concerning the application of the MRVP to each of the rules under the Plan, as specified in NASD IM-9216 and identifying the factors to be considered in determining whether to dispose of an action under the MRVP and discussing the appropriate levels for fines).

believes that the proposed rule change is consistent with Section 15A(b)(7) of the Act<sup>13</sup> in that the proposed rule change provides for the appropriate discipline for violation of NASD rules. Also, NASD believes the proposed rule change is consistent with Section 15A(b)(8) of the Act<sup>14</sup> in that the proposed rule change provides a fair procedure for the disciplining of NASD members and associated persons.

B. Self-Regulatory Organization's Statement of Burden on Competition

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

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

In March 2004, NASD published Notice to Members 04-23 requesting comment on amending the MRVP to include failure to submit timely amendments to Form U5 and adopting a rule to create an inactive disclosure review registration status. Five of the seven commenters commented on the proposed amendment to the MRVP, and all five commenters supported the proposal.<sup>15</sup> In particular, one commenter suggested that the amount of fines for late Form U5 filings should be based on the percentage of assets under management to encourage compliance. NASD notes that the MRVP is restricted to fines of \$2,500 or less. Additionally, NASD notes that, rather than relying on a formula to impose sanctions pursuant to the MRVP, NASD considers the facts and circumstances of each case in determining appropriate sanctions. Moreover, NASD notes that it retains the discretion to bring against a violator full disciplinary

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<sup>12</sup> 15 U.S.C. 78o-3(b)(6).

<sup>13</sup> 15 U.S.C. 78o-3(b)(7).

<sup>14</sup> 15 U.S.C. 78o-3(b)(8).

<sup>15</sup> Two commenters addressed the "inactive disclosure," but did not address the MRVP.

action, which may involve higher monetary sanctions, when the facts and circumstances of the violation warrant a formal complaint.

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 NASD consents, the Commission will:

- (A) by order approve the 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, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2004-121 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-121. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2004-121 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).