

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51434; File No. SR-NASD-2005-033)

March 24, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change Relating to Taping Rule “Opt Out” and Exemption Provisions

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 March 22, 2005, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. 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 is filing a proposed rule change to amend paragraph (L) of NASD Rule 3010(b)(2) (“Taping Rule” or “Rule”) to (1) require member firms that are seeking an exemption from the Rule to submit their exemption requests to NASD within 30 days of receiving notice from NASD or obtaining actual knowledge that they are subject to the provisions of the Rule and (2) clarify that firms that trigger application of the Taping Rule for the first time can elect to either avail themselves of the one-time “opt out provision” or seek an exemption from the Rule, but they may not seek both options. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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3010. Supervision

- (a) No Change.
- (b) Written Procedures

- (1) No Change.
- (2) Tape recording of conversations

(A) 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) relating to the employment history of its registered persons at a Disciplined Firm as defined in paragraph (b)(2)(J) shall establish, maintain, and enforce special written procedures for supervising the telemarketing activities of all of its registered persons.

(B) The member must establish and implement the supervisory procedures required by this paragraph within 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) No Change.

(D) 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 [the Association] NASD. The procedures must be appropriate for the member's business, size, structure, and customers.

(E) through (F) No Change.

(G) 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] NASD a report on the member's supervision of the telemarketing activities of its registered persons.

(H) No Change.

(I) For purposes of this Rule, the term "registered person" means any person registered with [the Association] NASD 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) through (K) No Change.

(L) Pursuant to the Rule 9600 Series, [the Association] NASD 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. A member seeking an exemption must file a written application pursuant to the Rule 9600 Series within 30 days after receiving notice from NASD or obtaining actual knowledge that it meets one of the criteria in paragraph (b)(2)(H). A member that meets one of the criteria in paragraph (b)(2)(H) for the first time may elect to reduce its staffing levels pursuant to the provisions of paragraph (b)(2)(B) or, alternatively, to seek an exemption pursuant to paragraph (b)(2)(L), as appropriate; such a member may not seek relief from the Rule by both reducing its staffing levels pursuant to paragraph (b)(2)(B) and requesting an exemption.

(3) through (4) No Change.

(c) through (g) No Change.

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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

According to the NASD, the Taping Rule, which has been in effect since 1998, is designed to ensure that members with a significant number of registered persons that previously were employed by firms that have been expelled from membership or have had their registration revoked for sales practice violations (“Disciplined Firms”) have proper supervisory procedures in place relating to telemarketing activities to prevent fraudulent and improper sales practices or other customer harm.

Under the Rule, member firms that hire a specified number of registered persons from Disciplined Firms must establish, maintain, and enforce special written procedures for supervising the telemarketing activities of all their registered persons. Such procedures must include tape-recording all telephone conversations between such firms’ registered persons and both existing and potential customers. The Rule provides firms up to 60 days from the date they receive notice from NASD or obtain actual knowledge that they are subject to the provisions of the Rule to establish and implement the required supervisory procedures, including installing taping systems. Such firms also are required to review the tape recordings, maintain appropriate records, and file quarterly reports with NASD.

The Taping Rule permits member firms that become subject to the Rule for the first time a one-time opportunity to adjust their staffing levels to fall below the prescribed threshold levels and thus avoid application of the Rule (often referred to as the “opt out

provision”). A firm that elects this one-time option must reduce its staffing levels to fall below the applicable threshold levels within 30 days after receiving notice from NASD or obtaining actual knowledge that it is subject to the provisions of the Rule. Once a firm has made the reductions, the firm is not permitted to rehire the terminated individuals for at least 180 days.

NASD also has the authority to grant exemptions from the Rule in “exceptional circumstances.” In reviewing exemption requests, NASD generally has required a firm to establish that it has alternative procedures to assure supervision at a level functionally equivalent to a taping system. The Rule currently is silent on the time frame for submitting an exemption request. However, because a firm has a total of 60 days from the date it receives notice from NASD or obtains actual knowledge that it is subject to the provisions of the Rule to implement the required supervisory procedures, a firm implicitly has that 60-day period to submit an exemption request. A firm that submits an exemption request is not required to establish and implement the required supervisory procedures, including the taping system (i.e., such requirements are “tolled”) while the staff is reviewing the request and during the course of any subsequent appeals to NASD’s National Adjudicatory Council (“NAC”).

NASD tolls the Taping Rule’s requirements during the exemption appeal process primarily due to the significant costs involved with installing a taping system and the possibility that the staff or NAC will grant the exemption. At the same time, it has been NASD’s experience that firms often wait until the 60th day (or shortly before) to request the exemption, which, assuming the exemption is not granted, only further prolongs the establishment and implementation of the required supervisory procedures.

To reduce these possible delays in implementation of the Taping Rule requirements, NASD is proposing to amend NASD Rule 3010(b)(2)(L) to require firms that are seeking an exemption from the provisions of the Rule to submit their exemption requests to NASD within 30 days of receiving notice from NASD or obtaining actual knowledge that they are subject to the provisions of the Rule. NASD believes that specifying a time frame for submitting an exemption request is consistent with the investor protection concerns that the Rule is intended to address, in particular given that the requirement to establish and implement the appropriate supervisory procedures is tolled upon the submission of an exemption request. Moreover, based on NASD's experience, 30 days would provide ample time for firms to decide whether to seek an exemption and to submit their requests to NASD.

Some firms also have inquired whether they could elect to use the "opt out" while simultaneously seeking an exemption, with the goal being that the firm would be granted an exemption and be able to immediately rehire the persons whose employment was terminated as part of the "opt out" (rather than waiting the requisite 180 days). It is NASD's belief, however, that firms should not be able to pursue these two alternatives simultaneously. NASD believes that a core purpose of the "opt out provision" is to provide relief to those firms that may have inadvertently or unintentionally become subject to the Taping Rule for the first time due, for example, to sudden turnover among registered persons or other events beyond the firm's control. In contrast, exemptions, which are granted only in "exceptional circumstances," are for those situations where the firm has demonstrated that it has supervisory procedures that are equivalent to a taping system or is otherwise in a truly unique situation. NASD believes it would be

inconsistent with the purposes of these two provisions to permit a firm to pursue both options with NASD, either simultaneously or one after the other. For instance, NASD believes that it would be inconsistent with the purposes of these provisions for a firm that chooses to submit an exemption request pursuant to NASD Rule 3010(b)(2)(L) and is denied the exemption to then employ the NASD Rule 3010(b)(2)(B) “opt out” as its second option.

Therefore, NASD also is proposing to amend NASD Rule 3010(b)(2)(L) to clarify that firms that trigger application of the Taping Rule for the first time must elect to either avail themselves of the one-time “opt out provision” (i.e., make the staff adjustment to fall below the thresholds of the Rule) or seek an exemption from the Rule, but they may not elect to do both. Accordingly, under the proposed rule change, firms that become subject to the Taping Rule for the first time would have 30 days to decide on one option and may pursue only that option.

Finally, NASD no longer refers to itself or its subsidiary, NASD Regulation, Inc., using its full corporate name, “the Association,” “the NASD,” or “NASD Regulation.” Instead, NASD uses the name “NASD” unless otherwise appropriate for corporate or regulatory reasons. Accordingly, the proposed rule change replaces, as a technical change, several references to “Association” and “NASD Regulation” in NASD Rule 3010(b)(2) with the name “NASD.”

NASD will announce the effective date of the proposed rule change in a Notice to Members (“NtM”) to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the NtM announcing Commission approval.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,³ 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. NASD believes that the proposed rule change will ensure that members with a significant number of registered persons from Disciplined Firms have proper supervisory procedures over telemarketing activities to prevent fraudulent and improper sales practices or other customer harm, and will ensure that members use the “opt out” and exemption provisions in a manner that is consistent with the intent of the Rule.

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

NASD 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.

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:

³ 15 U.S.C. 78o-3(b)(6).

- (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, 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. Please include File Number SR-NASD-2005-033 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-2005-033. 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 Room. 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 the File Number SR-NASD-2005-033 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.⁴

Margaret H. McFarland
Deputy Secretary

⁴ 17 CFR 200.30-3(a)(12).