

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51994; File No. SR-NASD-2004-025)

July 7, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendments No. 1 and 2 Thereto to Amend NASD's 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 February 10, 2004, 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. On March 17, 2005, NASD filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On June 27, 2005, 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 is proposing to amend NASD Interpretative Material 9216 ("IM-9216") ("Violations 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"). The text of the rule change is available on NASD's Web site (<http://www.nasd.com>), at NASD's principal office, and at the Commission's Public Reference Room.

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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> Amendment No. 1 replaced the original filing in its entirety.

<sup>4</sup> Amendment No. 2 replaced Amendment No. 1 in its entirety.

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, as amended, and discussed any comments it received on the proposal. 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

Background

In 1984, the Commission adopted amendments to Rule 19d-1(c) under the Act<sup>5</sup> that allow self-regulatory organizations to adopt, with Commission approval, plans for the disposition of minor violations of rules.<sup>6</sup> In 1993, pursuant to Rule 19d-1(c), NASD established its MRVP.<sup>7</sup> In 2001, the Commission approved significant amendments to NASD's MRVP.<sup>8</sup> In addition, in 2004, the Commission approved an amendment to NASD's MRVP to include failure to timely submit amendments to the Form U5 ("Uniform Termination Notice for Securities Industry Registration").<sup>9</sup>

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<sup>5</sup> 17 CFR 240.19d-1(c).

<sup>6</sup> See Securities Exchange Act Release No. 21013 (June 1, 1984), 49 FR 23828 (June 8, 1984).

<sup>7</sup> See Securities Exchange Act Release No. 32383 (May 28, 1993), 58 FR 31768 (June 4, 1993) (SR-NASD-93-6). See also NASD Rule 9216(b) and Notice to Members 93-42 (July 1993).

<sup>8</sup> See Securities Exchange Act Release No. 44512 (July 3, 2001), 66 FR 36812 (July 13, 2001) (SR-NASD-00-39).

<sup>9</sup> See Securities Exchange Act Release No. 50466 (September 24, 2004), 69 FR 58568 (September 30, 2004) (SR-NASD-2004-121).

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 any of the rules specified in NASD IM-9216. NASD staff reviews the number and seriousness of the violations, as well as the previous disciplinary history of the respondent, to determine if a matter is appropriate for disposition under the MRVP and to determine the amount of the fine. Once NASD has brought an MRVP action against an individual or member firm, NASD may, at its discretion, issue progressively higher fines for all subsequent minor rule violations within the next 24-month period or initiate more formal disciplinary proceedings.

NASD states that the purpose of the MRVP is to provide a meaningful sanction for the minor or technical violation of a rule when the initiation of a disciplinary proceeding through the formal complaint process would be more costly and time-consuming than would be warranted. NASD further states that the inclusion of a rule in NASD's MRVP does not mean that it is unimportant; rather, a minor or technical violation of the rule may be appropriate for disposition under the MRVP. Moreover, NASD states that it retains the discretion to bring full disciplinary proceedings if violations of such rule occur.

### Discussion

NASD proposes to amend its MRVP to make the following changes:

- Transaction Reporting and Audit Trail Requirements in Equity and Debt Securities

NASD proposes to combine in one entry all of the rule violations eligible for disposition under the MRVP that relate to transaction reporting and audit trail requirements in equity and debt securities. As proposed, this entry would include violations of transaction reporting and audit trail requirements related to (1) the Nasdaq Market Center; (2) NASD's Trade Reporting

and Comparison Service ("TRACS");<sup>10</sup> and (3) Trade Reporting and Compliance Engine ("TRACE").

To effectuate this, NASD proposes to eliminate the separate minor rule violation pertaining to NASD Rules 6130 and NASD 6170 (transaction reporting to the Automated Confirmation Transaction Service) and add those rules to this consolidated entry. NASD further proposes to add to the MRVP, and this consolidated entry, violations of NASD Rules 4632A, 5430, 6130A, and 6170A, which relate to TRACS requirements.<sup>11</sup> Currently, NASD's MRVP includes transaction reporting for various systems, including the Nasdaq Market Center. NASD believes that including violations of ADF transaction reporting requirements in the MRVP is consistent with the current provisions for minor rule violations of transaction reporting requirements in equity securities.

NASD also proposes to eliminate the reference in the MRVP to a violation of the Fixed Income Pricing System ("FIPS"), NASD Rule 6240, and replace it with a violation of NASD Rule 6230, the TRACE transaction reporting rule.<sup>12</sup> In adopting the TRACE rules in 2001, NASD eliminated FIPS, which required members to report trades for 50 high-yield debt securities. Because the TRACE system replaced and expanded upon FIPS, NASD proposes to amend its MRVP to replace the FIPS violation with a violation of the TRACE system transaction reporting requirement and also combine it into this single entry.

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<sup>10</sup> TRACS is the trade reporting system for NASD's Alternative Display Facility ("ADF"). ADF is a quotation collection, trade comparison, and trade reporting facility developed by NASD in accordance with the Commission's SuperMontage Approval Order.

<sup>11</sup> NASD notes that NASD Rule 5430 governs both TRACS and the Nasdaq Market Center transaction reporting requirements.

<sup>12</sup> Prior to July 1, 2002, the NASD Rule 6200 Series pertained to FIPS, and NASD Rule 6240 governed transaction reporting in high-yield fixed income securities.

- Communications with the Public

NASD proposes to include in its MRVP violations of the standards applicable to member communications with the public. NASD's advertising rules (NASD Rules 2210, 2211, and 2220, and related Interpretive Materials) contain general and specific standards applicable to all member communications with the public. These standards prohibit incomplete, unbalanced, or unfair communications as well as exaggerated, unwarranted, or misleading statements or claims. The rules also enumerate specific standards for certain type of communications, including recommendations, hedge clauses, and projections. In addition, the rules set forth standards for the use and disclosure of the member's name.

Under the current MRVP, NASD may issue minor rule violations only for procedural violations of the advertising rules, such as a failure to have advertisements and sales literature approved by a principal prior to use or a failure to meet specified time limits for filing advertisements. It is NASD's experience, however, that, based on the facts and circumstances, certain content-related violations of these rules can warrant more than a Letter of Caution, yet not rise to a level requiring or meriting full disciplinary action. Accordingly, the proposed rule change would allow NASD to address these minor or technical violations of content-related advertising rules, which might include, for example only, a technical violation of the provisions on the use and disclosure of members' names. NASD, therefore, proposes to include in its MRVP violations of the standards applicable to member communications with the public.

- Contact Information

NASD proposes to expand the MRVP to include, as a general category, a member's failure to identify to NASD and keep current information regarding any contact person that a member must provide to NASD under any current or future NASD rule. For example, a

member's failure to provide or update emergency contact information under NASD Rule 3520 or failure to provide or update its executive representative designation and contact information as required by NASD Rule 1150 would be eligible for disposition as a minor rule violation under this category.<sup>13</sup>

- Other Changes

In addition, NASD proposes to change "the Association" to "NASD" in the minor rule violation provision relating to NASD Rule 3110<sup>14</sup> and change "ECN's" to "ECNs" in the minor rule violation provision relating to Rule 11Ac1-1(c)(5) under the Act.<sup>15</sup>

NASD would announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval, if the Commission approves this proposal. The effective date would be 30 days following publication of that Notice to Members.

## 2. Statutory Basis

NASD believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>16</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.

NASD believes that the proposed rule change, as amended, is consistent with Section 15A(b)(7)

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<sup>13</sup> See also NASD Rule 1120(a)(7) (requirement to provide continuing education regulatory element contact person). NASD notes that it generally has sought to achieve consistency regarding the frequency with which members must review and update contact information (namely, within 17 business days after the end of each calendar quarter).

<sup>14</sup> NASD no longer refers to itself or its subsidiary, NASD Regulation, Inc., using its full corporate name, "the Association," "the NASD," or "NASD Regulation, Inc." Instead, NASD uses "NASD" unless otherwise appropriate for corporate or regulatory reasons.

<sup>15</sup> 17 CFR 240.11Ac1-1(c)(5).

<sup>16</sup> 15 U.S.C. 78o-3(b)(6).

of the Act<sup>17</sup> in that it works to safeguard adequately the interests of investors while establishing fair and reasonable rules for members and persons associated with members. NASD also believes that the proposed rule change also is consistent with Section 15A(b)(8) of the Act<sup>18</sup> in that it furthers the statutory goals of providing a fair procedure for disciplining members and associated persons. NASD believes that the addition of these violations to the MRVP will provide NASD with the ability to impose a meaningful sanction for violations of the rules discussed herein that warrant more than a Letter of Caution but do not necessarily rise to a level meriting a full disciplinary proceeding.

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

NASD does not believe that the proposed rule change, as amended, 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 on Comments on the Proposed Rule Change Received from Members, Participants, or Others

NASD neither solicited nor received any comments.

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

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<sup>17</sup> 15 U.S.C. 78o-3(b)(7).

<sup>18</sup> 15 U.S.C. 78o-3(b)(8).

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, as amended, 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-2004-025 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File No. SR-NASD-2004-025. 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-2004-025 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>19</sup>

J. Lynn Taylor  
Assistant Secretary

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<sup>19</sup> 17 CFR 200.30-3(a)(12).