

2002, and April 15, 2003, the NASD filed Amendment Nos. 3, 4 and 5 respectively.⁶ The Commission is approving the proposed rule change, and is publishing notice of, and granting accelerated approval to, Amendment Nos. 3, 4, and 5 to the proposed rule change.

I. Description of the Proposal

NASD is proposing to establish, for a two-year period, procedures to enable NASD to issue temporary cease and desist orders. The proposal also would provide NASD with the authority to issue permanent cease and desist orders. Furthermore, the proposed rule change would grant NASD authority to initiate non-summary proceedings when temporary or permanent cease and desist orders are violated.

1. Due Process Procedures

NASD recognizes that temporary cease and desist orders are powerful measures that should be used very cautiously. Consequently, the NASD

states that it has designed the rules to ensure that the proceedings are used to address only the most serious types of misconduct and that the interests of respondents are protected. For example, to ensure that temporary cease and desist proceedings are used appropriately and that the decision to initiate a proceeding is made only at the highest staff levels, the proposed rules require the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs to issue written authorization before NASD Department of Enforcement ("Enforcement") or the Department of Market Regulation ("Market Regulation") can institute a temporary cease and desist proceeding.

In addition, NASD has proposed limiting use of this tool to what it views as the most serious offenses. Under the proposal, a temporary cease and desist proceeding can be initiated only with respect to alleged violations of certain sections of the securities laws and certain NASD rules.⁷

Moreover, the proposed rules are based upon the rules that govern NASD disciplinary proceedings, with certain modifications made to reflect that temporary cease and desist proceedings are expedited proceedings. The NASD believes, therefore, that the proposed rules provide respondents with many procedural protections.

In addition, once the initiation of a temporary cease and desist proceeding has been authorized, Enforcement or Market Regulation must file a notice with the Office of Hearing Officers and serve the respondent with a copy of the notice. The notice must set forth the rule or statutory provision the respondent is alleged to have violated, must include a declaration of facts that specifies the acts or omissions that constitute the alleged violation,⁸ and must include a proposed order that contains the required elements of a

temporary cease and desist order.⁹ In addition, if Enforcement or Market Regulation has not already issued a complaint under NASD Rule 9211 against the respondent relating to the subject matter of the temporary cease and desist proceeding and alleging violations of the rule or statutory provisions specified in the notice initiating the temporary cease and desist proceeding, Enforcement or Market Regulation must serve the complaint with the notice initiating the temporary cease and desist proceeding.

Further, a hearing to determine whether a temporary cease and desist order should be issued must be held within 15 days after service of the notice (unless a Hearing Officer or Hearing Panelist is recused or disqualified or the parties agree to extend the 15-day period for good cause shown),¹⁰ and the respondent must be served with notice of the date, time, and location of the hearing not later than seven days before the hearing, unless the Hearing Officer orders otherwise.¹¹

Each hearing panel would be appointed by NASD's Chief Hearing Officer, and would be comprised of a hearing officer and two panelists. The two panelists would be selected from a roster of candidates that is comprised of current or former members of the National Adjudicatory Council, NASD Board of Governors, or NASD Regulation Board of Directors, and at least one panelist would have to be an associated person. A hearing officer, who is an attorney and an employee of NASD, would preside over each proceeding and would have the authority to do all things necessary and appropriate to discharge his or her duties as set forth in NASD Rule 9235.

The proposed rules also set a specific standard that must be met before a hearing panel can issue an order. A hearing panel must find by a preponderance of the evidence that the alleged violation has occurred, which is the same evidentiary standard used in the underlying disciplinary proceeding. The hearing panel also must find that the violative conduct or the continuation thereof is likely to result in significant dissipation or conversion of assets or other significant harm to investors before completion of the disciplinary proceeding under the Rule 9200 and 9300 Series. The NASD states that this standard is designed to ensure

Commission, from: Dan Jamieson, dated December 29, 1998 ("Jamieson Letter"); Sam Scott Miller, Orrick, Herrington & Sutcliffe, dated February 9, 1999 ("Orrick Letter"); Peter C. Hildreth, President, North American Securities Administrators Association, Inc., dated March 2, 1999 ("NASAA Letter"); Barbara M.G. Lynn, Chair, Section of Litigation, and James H. Cheek III, Chair, Section of Business Law, Ad Hoc Task Force of the American Bar Association's Sections of Litigation and Business Law, dated March 8, 1999 ("ABA Sections Letter"); and Lee B. Spencer, Chairman, Federal Regulation Committee, R. Gerald Baker, Chairman, Self Regulation & Supervisory Practices Committee, and James Tricarico, President, Compliance & Legal Division, Securities Industry Association, dated March 5, 1999 ("SIA Letter").

⁶ See Letters to Katherine A. England, Assistant Director, Division, Commission, from Alden S. Adkins, Sr. Vice President and General Counsel, NASD Regulation, dated May 14, 1999 ("Amendment No. 3"), from Patrice M. Gliniecki, Vice President and Deputy General Counsel, NASD, dated August 16, 2002 ("Amendment No. 4"), and from Sarah J. Williams, Associate General Counsel, NASD, dated April 14, 2003 ("Amendment No. 5"). In Amendment No. 3, the NASD responded to comments and clarified the context in which the NASD would seek a permanent cease and desist order. In Amendment No. 4, the NASD (i) proposed that the rule change operate for a two-year period, unless extended or permanently adopted before the expiration of the two-year period; (ii) extended the minimum amount of time between service of notice of a hearing and the hearing from four to seven days; (iii) supplemented the discussion of the applicability of Section 19(d) of the Act to a temporary cease and desist order; (iv) made certain technical changes to the rule language to conform the proposal to current NASD practices; and (v) made further non-substantive changes to the discussion of the proposed rule change. In Amendment No. 5, the NASD responded to comments and clarified the discussion of Rule 9850 in which a respondent may seek to have a temporary cease and desist order modified, set aside, limited or suspended and how a respondent may seek to challenge the order, and, in recognition of the U.S. Court of Appeals for the District of Columbia's denial of reconsideration of the SEC's decision against KPMG, LLP, the NASD provided clarifying discussion of the context in which a permanent cease and desist order would be sought.

⁷ The sections and rules are specified in proposed NASD Rule 9810(a) and are limited to alleged violations of Section 10(b) of the Act and Rule 10b-5 thereunder; Rules 15c-1 through 15c-9 under the Act; or NASD Rules 2110, 2120, or 2330. The alleged violations of NASD rules for which a temporary cease and desist proceeding can be initiated are further limited. For NASD Rule 2110, which governs standards of commercial honor and just and equitable principles of trade, the alleged violations are limited to violations of Section 17(a) of the Securities Act of 1933 or circumstances involving unauthorized trading or misuse or conversion of customer assets. For NASD Rule 2330, which governs members' use of customers' securities or funds, the alleged violations for which a temporary cease and desist proceeding can be initiated are limited to circumstances involving misuse or conversion of customer assets.

⁸ The declaration of facts must be signed by a person with knowledge of the facts contained in the declaration.

⁹ The required elements of a temporary cease and desist order are set forth in proposed Rule 9840(b).

¹⁰ See Proposed Rule 9830(a).

¹¹ See Amendment No. 4.