

of the securities industry, especially in the area of microcap securities fraud, only NASAA generally supported the proposal. The remaining commenters expressed a number of concerns regarding certain provisions of the proposed rule change. The comments submitted to the Commission, and the NASD's response to the comments, are summarized by issue below.

### 1. Consistent with the Act

NASAA stated its belief that the proposed rule change would be consistent with the provisions of the Act relating to member enforcement, promotion of fair practices and appropriate disciplinary actions by an SRO against its members.<sup>20</sup> Three commenters disagreed, questioning the existence of statutory authority for a grant of temporary cease and desist power to NASD.<sup>21</sup> Two of these commenters argued that this authority falls outside the definition of the term "sanction" under Section 15A of the Act,<sup>22</sup> with one of these commenters contending that temporary cease and desist orders are quasi-judicial powers primarily intended to preserve the status quo pending a formal decision, not sanctions.

NASD responded that several provisions of the Act provide SROs with the authority to issue temporary cease and desist orders. Section 15A(b)(2) of the Act, among other things, requires that an association of brokers and dealers have the capacity to be able to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its members with the Act, the rules and regulations thereunder, and the rules of the association. In addition, Section 15A(b)(6) of the Act requires that the rules of an association 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. Finally, section 15A(b)(7) of the Act permits an association to sanction its members and persons associated with members through the imposition of any "fitting sanction," and Section 15A(b)(8) of the Act, among other things, requires that the rules of an association, in general, provide a fair procedure for disciplining members and persons associated with members. The NASD contends, therefore, that the proposed rules are

consistent with NASD's obligations under Section 15A(b)(2), (6), (7) and (8) of the Act because temporary cease and desist orders are fitting sanctions designed to stop violative conduct that is likely to cause significant dissipation or conversion of assets or other significant harm to investors.

### 2. Justification for Temporary Cease and Desist Powers

The Commission specifically requested public comment on whether the NASD has sufficiently justified the need for temporary cease and desist powers. NASAA responded that the exponential growth of the securities markets and in the number of participants, particularly in the area of microcap securities, justifies the need for regulators to utilize all of the enforcement tools available, including the authority to issue a temporary cease and desist order.<sup>23</sup> Three commenters contend, however, that the NASD has not sufficiently justified the need for the extraordinary power to issue temporary cease and desist orders.<sup>24</sup> One commenter noted that no other SRO has ever requested temporary cease and desist authority and the Commission has used its cease and desist authority only once in eight years, thereby casting doubt on its usefulness as an enforcement tool.<sup>25</sup> Two commenters questioned why the NASD could not refer any matter for which a temporary cease and desist order may be appropriate, along with the supporting documentation required to be recited in the notice and underlying complaint, to the Commission or appropriate state regulator.<sup>26</sup>

In response, the NASD stated that there is a clear need for an additional tool to stop members' or associated persons' misconduct where NASD believes significant dissipation or conversion of assets or other significant harm to investors is likely to occur before a disciplinary proceeding under NASD Rules 9100-9300 is concluded. The NASD notes that, under its current rules, it takes a minimum of four months to complete a disciplinary proceeding. Without a temporary cease and desist rule, NASD believes it has no immediate remedy to order cessation of egregious, ongoing violative conduct.

With respect to its current authority, the NASD notes that it can summarily suspend a member or associated person only in the limited situations that are

described in Section 15A(h)(3) of the Act, which do not include the types of situations NASD is attempting to address with the temporary cease and desist rules. Similarly, the NASD's non-summary suspension rules<sup>27</sup> are designed to limit or stop a member's or associated person's ability to conduct business, whereas temporary cease and desist orders are designed to stop ongoing, violative conduct while an underlying disciplinary proceeding is being litigated.

With respect to referring cases to the SEC or a state regulatory authority for prosecution where an emergency exists, NASD responds that its experience demonstrates that this is not a viable alternative to the proposed rule. Even though NASD, the SEC and other regulators have made great strides in coordinating their respective enforcement efforts, this is not a substitute for temporary cease and desist authority. The NASD believes that there are situations where it is in the best position to take immediate action, based on its preexisting investigation and access to case-specific information. In such situations, having to refer the case to another regulatory authority might result in unacceptable delay and would not be an efficient use of NASD's or other regulators' resources.

### 3. Scope of Predicate Violations

The Commission specifically requested public comment on whether the scope of possible violations should be narrowed. NASAA responded that the scope of predicate violations should not be limited beyond the current restrictions in the proposed rule change because all of the possible violations raise concerns of fraudulent or manipulative conduct or the need for preservation of investor assets and funds.<sup>28</sup>

Three commenters believe, however, that the predicate rule violations are overly broad. Two of these commenters argued that the predicate violations are broad enough to encompass virtually any alleged violation of securities laws and rules because the proposed violations include basic anti-fraud and manipulation provisions.<sup>29</sup> One of the commenters argued that, if the purpose is primarily to protect against potential customer losses, the predicate violations should be limited to alleged violations involving microcap securities.<sup>30</sup> In particular, this commenter felt that many alleged cases of unauthorized

<sup>20</sup> See 15 U.S.C. 78o-3(b)(2), (6) and (7). See NASAA Letter, p. 2.

<sup>21</sup> See Jamieson Letter, p. 1, Orrick Letter, p. 5, and SIA Letter, p. 2.

<sup>22</sup> See Orrick Letter, p. 5, and SIA Letter, p. 2.

<sup>23</sup> See NASAA Letter, p. 3.

<sup>24</sup> See ABA Sections Letter, pgs. 6-7, Orrick Letter, p. 3, SIA Letter, p. 1.

<sup>25</sup> See ABA Sections Letter, p. 2.

<sup>26</sup> See Orrick Letter, p. 3, and SIA Letter, p. 2.

<sup>27</sup> NASD Rules 9511(a)(2) and 9513.

<sup>28</sup> See NASAA Letter, p. 2.

<sup>29</sup> See SIA Letter, p. 3 and Orrick Letter, p. 3.

<sup>30</sup> See ABA Sections Letter, pgs. 7-8.