

sanctions. The Department of Member Regulation shall serve the order on the member by facsimile or overnight courier.

(b) through (c) No Change

(d) Decision

Within four days after the hearing, the Hearing Panel shall affirm, modify, or reverse the order issued under paragraph (a). The Office of Hearing Officers shall serve the decision on the member pursuant to Rules 9132 and 9134. The decision shall become effective upon service and shall constitute final action of [the Association] NASD.

9417. Additional [Limitations] *Restrictions*; Reduction or Removal of [Limitations] *Restrictions*

(a) Additional [Limitations] *Restrictions*

If a member continues to experience financial or operational difficulty specified in Rule 3130 or 3131, notwithstanding an effective notice or decision under the Rule 9410 Series, the Department of Member Regulation may impose additional [limitations] *restrictions* by issuing a notice under Rule 9412. The notice shall state that the member may apply for relief from the additional [limitations] *restrictions* by filing a written application for a hearing under Rule 9413 and that the procedures in Rules 9413 through 9416 shall be applicable. An application for a hearing also shall include a detailed statement of the member's objections to the additional [limitations] *restrictions*.

(b) Reduction or Removal of [Limitations] *Restrictions*

If the Department of Member Regulation determines that any [limitations] *restrictions* previously imposed under the Rule 9410 Series should be reduced or removed, the Department of Member Regulation shall serve a written notice on the member pursuant to Rules 9132 and 9134.

9418. Application to Commission for Review

The right to have any action taken by [the Association] NASD pursuant to this Rule Series reviewed by the Commission is governed by Section 19 of the Act. The filing of an application for review shall not stay the effectiveness of the action taken by [the Association] NASD, unless the Commission otherwise orders.

9419. Other Action Not Foreclosed

Action by [the Association] NASD under the Rule 9410 Series shall not

foreclose action by [the Association] NASD under any other Rule.

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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

#### Background

Currently, NASD can take expedited action against a member when its Department of Member Regulation has reason to believe that the member maintains inadequate capital levels given the scope and nature of the firm's business. However, NASD is currently limited to taking action with respect to only those firms that must maintain a minimum net capital of greater than \$50,000 and can only issue notices (and institute an expedited proceeding when these notices are contested) requiring that such firms either limit their business or not expand their business in order to maintain appropriate net capital levels. Further, NASD's current rules do not address the capacity of NASD to suspend a firm from business on an expedited basis when it fails to maintain minimum net capital.<sup>6</sup>

NASD believes that enhanced tools are required to enable it to better address any situation where a member is not satisfying applicable capital requirements. Accordingly, NASD proposes amendments to Rules 3130, 3131 and the Rule 9410 Series as described below. These amendments would (i) expand NASD's authority to take expedited action against all member firms with capital deficiencies, (ii) permit NASD to suspend a member

that operates for any period of time with inadequate net capital, and (iii) make non-substantive clarifications to the language of the rules. In addition, NASD proposes to delete subparagraph (g) of NASD Rule 9160 because the Department of Member Regulation staff does not participate as an adjudicator in a Rule 9410 decision.

### Current NASD Rules Regarding Members Experiencing Financial Difficulties

NASD Rules 3130 and 3131 regulate the activities of members that are (1) required to maintain net capital in excess of \$50,000; and (2) experiencing certain financial and/or operational deficiencies.<sup>7</sup> These rules provide that NASD may prescribe certain remedial courses of action for members experiencing financial or operational deficiencies, such as requiring them to limit their activities. NASD's Rule 9410 Series provides a procedural framework for actions taken under these provisions. Pursuant to the Rule 9410 Series, a member experiencing financial and operational difficulties as described in Rules 3130 and 3131 receives a notice of limitations describing the grounds for the notice, the effective date of the limitations described in the notice, and a fitting sanction that will be imposed if the member fails to comply with the limitations set forth in the notice. The member then has five days from the date of service of the notice to request a hearing. If a hearing is not requested, the limitations prescribed in the notice become effective at least seven days after the date of service of the notice. Following the hearing, if one is requested, any remedial action ordered by the Hearing Panel becomes effective. If a member does not comply with the limitations described in any effective notice or remedial action imposed by the Hearing Panel, NASD staff may order the sanction set forth in the notice or specified in the Hearing Panel decision against the member. The member has the opportunity to request a second hearing if such sanctions are ordered.

<sup>7</sup> Rule 15c3-1 under the Act requires that firms maintain certain specified levels of net capital. 17 CFR 240.15c3-1. Section 402.2 of the Treasury Department rules contains liquid capital requirements for government securities broker/dealers. 17 CFR 402.2. NASD represents that it does not set net capital requirements, but enforces these provisions as part of its regulatory function. However, NASD Rules 3130 and 3131 effectively allow NASD to require net capital and liquid capital requirements in excess of those respective capital requirements stated above.

<sup>6</sup> NASD Rule 9512 ("Summary Proceedings") is available to address severe financial or operational difficulties. However, because this procedure allows NASD to suspend a member before a hearing is held, and requires authorization from the Board of Governors, NASD represents that it is reserved for the most serious of circumstances and generally would be inappropriate to address most instances of net capital deficiencies.