

relief in arbitration proceedings and thus this is a cognizable factor in membership decisions. The proposed rule change would more explicitly make this part of the membership decisional criteria.

4. Burden of Proof

NASD has seen instances where an applicant (both new member and change of ownership/control) has a disciplinary history of some concern that falls short of a statutory disqualification. Many of these cases involve applications from closely held firms where, even if the broker/dealer establishes heightened supervisory procedures, the influence of the control person on the small broker/dealer may overcome the supervisory structures. Rule 1014(a)(3) requires NASD to determine whether an applicant and its associated persons "are capable of complying with" federal securities laws and the rules of NASD. A variety of specific events, including past and current disciplinary actions and customer claims, are among the considerations referenced in the rule.

To further enhance NASD's authority under Rule 1014(a) to consider the impact of an applicant's past behavior, the proposed rule change would create a rebuttable presumption that the application should be denied when any of the events enumerated in Rule 1014(a)(3)(A) and (C) through (E) are present. An Applicant may overcome the presumption by demonstrating to the Department that it can meet each of the standards in Rule 1014(a). In determining whether an Applicant has overcome the presumption, NASD staff will consider the Applicant's submission in light of the specific standards of Rule 1014(a), the public interest, protection of investors, and NASD's responsibility to provide a fair procedure in accordance with its membership rules. The rebuttable presumption would not create new standards for admission, but would merely clarify that applicants with certain regulatory history must affirmatively demonstrate that they should be allowed admission.

5. Applicability of Rule to Non-Natural Persons

The proposed rule change would amend Rule 1011 to amend the definition of "Associated Person" to, among other things, include a reference to non-natural controlling persons in light of the fact that NASD's current definition of "associated persons" does not encompass non-natural persons. The amended definition would apply to the entire Rule 1010 Series and provide for

consistency in the membership application process. NASD may consider in the future whether to expand the definition of "associated persons" more generally to include non-natural persons.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁷ which require, among other things, that NASD's rules 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 improve its ability to detect and prevent conduct that can be harmful to public investors.

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

The proposed rule change was published for comment in NASD Notice to Members 02-54 (August 2002). Seven comments were received in response to the Notice.⁸ Of the seven comment letters received, six were in favor of the proposed rule change and the seventh, while not opposed to the proposed rule change, expressed concerns that the proposed rule change would not be able to accomplish its objectives. The commenter expressed doubts about NASD's ability to monitor asset transfers and further believed that the amendments may be unnecessary as a plaintiff's attorney often had other means to recover judgments.⁹ A summary of the comments received is set forth below.

Review of Material Transfer of Member's Assets

Five of the commenters supported the proposal to require firms to submit an

application prior to the transfer of a material amount of the member's assets or prior to the transfer of any asset, business or line of operation that generates revenues comprising a material portion of the selling member's earnings.¹⁰ While supporting the proposal, one commenter noted that the proposed rule change should only apply to full service firms with specified minimum revenues, and not to advisory firms that do not handle customer accounts, cash or have retail customers.¹¹ While not opposing the proposal, another commenter questioned whether NASD would be able to monitor these types of asset transfers and noted that requiring reviews of these types of transactions might force a firm into liquidation.¹²

All six commenters who responded to the question of whether materiality should be more clearly defined agreed that the Rules should include a more specific definition of materiality.¹³ One commenter stated that a more specific plain English standard would help prevent confusion and errors.¹⁴ A second commenter suggested a minimum of 15% and a maximum of 25% standard.¹⁵ A third commenter noted that while a more specific standard would help ensure compliance, a standard that is too specific might make it easier for people to circumvent the rule. This same commenter also suggested that the definition of materiality include a time component as well as a percentage component to address concerns of "piecemeal" transfers (e.g., X% or greater if no other transfer has occurred within the last Y years or X/Y% if any such transfer has occurred within the last Y years).¹⁶ As described in Item II A of this Notice, in response to the comments received, NASD has revised

¹⁰ See comment letters from Anonymous, dated September 18, 2002; Anderson Corporate Finance, LLC, dated August 28, 2002; Canaccord Capital Corporation, USA, dated September 20, 2002; Kirk Securities Corporation, dated September 17, 2002; and Rhodes Securities, Inc., dated September 16, 2002.

¹¹ See comment letter from Anonymous, dated September 13, 2002.

¹² See comment letter from Associated Securities Corp., dated September 11, 2002.

¹³ See comment letters from Anonymous, dated September 13, 2002; Anonymous, dated September 18, 2002; Anderson Corporate Finance, LLC, dated August 28, 2002; Canaccord Capital Corporation, USA, dated September 20, 2002; Kirk Securities Corporation, dated September 17, 2002; and Rhodes Securities, Inc., dated September 16, 2002.

¹⁴ See comment letter from Canaccord Capital Corporation, USA, dated September 20, 2002.

¹⁵ See comment letter from Kirk Securities Corporation, dated September 17, 2002.

¹⁶ See comment letter from Anderson Corporate Finance, LLC, dated August 28, 2002.

⁷ 15 U.S.C. 78o-3(b)(6).

⁸ See comment letters from Anonymous, dated September 13, 2002; Anonymous, dated September 18, 2002; Anderson Corporate Finance, LLC, dated August 28, 2002; Associated Securities Corp., dated September 11, 2002; Canaccord Capital Corporation, USA, dated September 20, 2002; Kirk Securities Corporation, dated September 17, 2002; and Rhodes Securities, Inc. dated September 16, 2002.

⁹ See comment letter from Associated Securities Corp., dated September 11, 2002.