

NSCP

NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS INC.

HOTLINE MEMO

January 2005

The HotLine Memo provides NSCP members with brief synopses of regulatory initiatives applicable to securities compliance. As only some detail is provided herein, members to whom certain items are of special interest may e-mail hotline@nscp.org for additional details. When e-mailing, please specify the reference number that appears in brackets at the end of each reported item. All NSCP reference numbers are available via e-mail.

GENERAL INTEREST

SEC Issues Temporary Rule on Certain Broker-Dealers Deemed Not to be IAs

The SEC has adopted a temporary rule addressing the application of the Investment Advisers Act of 1940 to broker-dealers offering certain types of brokerage programs. Under the rule, a broker-dealer providing nondiscretionary advice that is solely incidental to its brokerage services is excepted from the Investment Advisers Act regardless of whether it charges an asset-based or fixed fee (rather than commissions, mark-ups, or mark-downs) for its services. The temporary rule also provides that broker-dealers are not subject to the Investment Advisers Act solely because they offer full-service brokerage and discount brokerage services, including execution-only brokerage, for reduced commission rates. The temporary rule will expire on April 15, 2005. The SEC notes that this release contemplates issues that extend beyond those originally covered in the initial proposing release, and has re-proposed the rule in the full context of what is “solely incidental” to brokerage (see below). [Rel. Nos. 34-50979; IA-2339]

In the companion “re-proposal” release, the SEC proposes a rule that would, among other things, state that exercising investment discretion is not solely incidental to brokerage business, and thus, a broker-dealer providing discretionary advice would be deemed to be an investment adviser under the Investment Advisers Act. In addition, under the rule, broker-dealers would not be subject to the Investment Advisers Act solely because they offer full-service brokerage and discount brokerage services, including electronic brokerage, for reduced commission rates. Finally, the Commission is proposing to issue a statement of interpretive position that would clarify when certain broker-dealer advisory services, including financial planning, are solely incidental to brokerage business. [Rel. Nos. 34-50980; IA-2340]

SELF-REGULATORY ORGANIZATIONS

NASD Amends Telemarketing Rule

The NASD has proposed to amend NASD Rule 2212 to require a member that seeks to qualify for the safe harbor set forth in that rule to, among other things, use a process to prevent telephone solicitations to any telephone number in a version of the national do-not-call registry obtained from the administrator of the registry no more than thirty-one (31) days (formerly three months) prior to the date any call is made. This proposed amendment in the number of days is consistent with recent amendments to the FCC's and FTC's do-not-call rules.

In July 2003, the SEC requested that NASD amend its telemarketing rules to require NASD members to participate in the national do-not-call registry. Because broker-dealers are subject to the FCC's do-not-call rules, the NASD modeled its rules after the FCC's and codified these do-not-call requirements in NASD Rule 2212, with minor modifications tailoring the rules to broker-dealer activities and the securities industry. The SEC approved these rules in January 2004. [Rel. No. 34-51023]

NASD Makes Minor, Conforming Rule Text Change

The NASD has filed a rule change, effective immediately, amending NASD Rule 3360 to change references from "SEC Rule 3b-3" to "SEC Rule 200," thereby conforming the rule language in Rule 3360 in light of the SEC's new short sale regulation, Regulation SHO. [Rel. No. 34-51025]

NYSE Proposes Minor Rule Changes on Member Certificates, Fines

The NYSE has proposed to delete the requirement in NYSE Rule 343(d) to return certificates of membership upon termination of customer offices or status as a member organization, and to rescind NYSE Rule 412(g), which currently allows the Exchange to impose fees of up to \$100 per securities account per day for violations of that rule (which mandates several time frames and procedures that must be followed when transferring customer accounts between member organizations). [Rel. No. 34-50942]

NYSE Makes Changes to Board, Panel Appointments

The NYSE has filed with the SEC a proposed rule change relating to amendments to Exchange Rules 633, 634, and 635 concerning appointments of members of the Board of Arbitration, appointments to the panels of securities and non-securities arbitrators, and the appointment of the Director of Arbitration of the Exchange.

NYSE Rule 633 currently provides that the Chairman of the NYSE Board appoints, subject to approval by the Board of Directors, a Board of Arbitration. The proposed amendment would eliminate the involvement of both the Chairman and the Board, and allow the

director of Arbitration to appoint a Board of Arbitration. According to the NYSE, Involvement of the Chairman and the Board of Directors in the process does not serve a valid regulatory purpose. The proposed amendment also would delete the references in the rule to the annual election of the Exchange, as the review of the members of the Board of Arbitration will be an ongoing process, and the Board will no longer be involved.

NYSE Rule 634 currently provides that the Chairman of the NYSE Board appoints two standing panels (rosters) of arbitrators, one roster of securities arbitrators and one roster of non-securities arbitrators. In practice, arbitration department management routinely appoints new individuals to the rosters of arbitrators, subject to the oversight of the Vice President. This proposed change would conform the rule to current practice.

NYSE Rule 635 provides that the Chairman of the Board appoints the Director of Arbitration from the officers or employees of the Exchange. Pursuant to a recent restructuring at the Exchange, the Arbitration Department reports to the Chief Regulatory Officer (through the Vice President, Arbitration and Hearing Board). The proposed amendment provides that the Chief Regulatory Officer would designate the Director of Arbitration, which is subject to the approval of the Regulatory Oversight Committee. [Rel. No. 34-50939]

NYSE Rules Changed to Keep Parallel With SEC's Regulation SHO

The NYSE has filed a rule change with the SEC, effective immediately, amending Exchange Rules 440B ("Short Sales") and 440C ("Deliveries Against Short Sales"). Supplementary Material is included intended to conform Exchange rules to the requirements of recent Commission rule amendments regarding short sales, and the adoption of Regulation SHO (Regulation of Short Sales).

On June 23, 2004, the SEC adopted new Regulation SHO. This action rescinded Rules 3b-3 ("Definition of Short Sale") and 10a-2 ("Requirements for Covering Purchases"), under the Exchange Act, and replaced them with new Rules 200 ("Definition of Short Sale and Marking Requirements") and 203 ("Borrowing and Delivery Requirements"), to Regulation SHO. In addition, the Commission has amended Rule 10a-1 ("Short Sales") to conform to Regulation SHO.

Currently, Exchange Rule 440B includes the complete text of Rule 10a-1, under the Exchange Act, and Rules 440B and 440C set forth many sections of repealed Rules 3b-3 and 10a-2, under the Exchange Act, respectively. The proposed amendments to Rules 440B and 440C, including Supplementary Material, conform to the changes in Rule 10a-1 and recently adopted Regulation SHO, under the Exchange Act. The changes remove the text of SEA Rule 10a-1 from Exchange Rule 440B, and instead incorporate both SEA Rule 10a-1 and Regulation SHO by reference, as though they were fully set forth therein. The amendments to Exchange Rule 440B also include a revised Explanatory Note, which generally describes the recent changes to short sale regulation and implementation dates. [Rel. No. 34-50929]

MSRB Sets Standards for Dealer Advertisements of Municipal Fund Securities

The MSRB has proposed a rule change relating to advertisements of Municipal Fund Securities under MSRB Rule G-21, which establishes standards for dealer advertisements relating to municipal securities. The proposed rule change would establish specific requirements with respect to advertisements by brokers, dealers and municipal securities dealers relating to municipal fund securities.

The proposed rule change amends Rule G-21 to establish specific standards applicable solely to dealer advertisements of municipal fund securities. In particular, the proposed rule change incorporates advertising standards enunciated in a 2002 Notice¹ (with certain changes, outlined in the release). In addition, the proposed rule change includes specific requirements regarding the calculation and display of performance data for municipal fund securities in a manner consistent with Rule 482 adopted by the SEC in connection with the advertisement of mutual fund performance. The proposed rule change also includes general disclosure requirements regarding municipal fund securities that are similar in most respects to generalized disclosures currently required for mutual fund advertisements under SEC rules. [Rel. No. 34-50919]

1. See Rule G-21 Interpretation--Application of Fair Practice and Advertising Rules to Municipal Fund Securities, May 14, 2002.

Comment Period on SRO Ownership Extended

The SEC has extended the comment period for a release proposing to adopt new rules and amend existing rules under the Securities Exchange Act of 1934 relating to the fair administration, transparency, governance, and ownership of SROs. The original comment period would have expired on January 24, 2005; the new extended comment period will expire on March 8, 2005. The new deadline coincides with the comment period for the Concept Release Concerning Self-Regulation (at 69 FR 71256, Dec. 8, 2004). [Rel. No. 34-51019]