



October 7, 2003

Mr. Derek Linden  
Executive Vice President, Registration and Disclosure  
NASD  
9509 Key West Avenue  
Rockville, Maryland 20850

Dear Derek:

On behalf of the Ad Hoc Public Disclosure Working Group<sup>1</sup> of the Securities Industry Association ("SIA"), we thank you for hosting last week's meeting to discuss NASD's latest plans to expand its Public Disclosure Program. We appreciate your willingness to keep us apprised of new developments and your interest in hearing our concerns.

During our meeting, you indicated that NASD expects to file a rule proposal with the Securities Exchange Commission ("SEC") in the next few weeks for formal rulemaking. While we expect to submit comments to the SEC at the appropriate time, we think it useful to memorialize some of the major concerns we raised at the meeting. Specifically, we want to reiterate our beliefs that raw data comparisons can be confusing or misleading, that nominal settlements should not be used to trigger disclosure of archived information and that three unadjudicated complaints over a ten-year period is too low a threshold to trigger disclosure of archived information.

I. Comparative information is only useful if the comparisons that are drawn are valid ones.

SIA respects NASD's interest in placing CRD information "in context" by including comparative statistics against which a particular broker's or firm's record may be measured. Indeed, as previously stated, SIA believes that truly comparative information could be a useful complement to existing disclosures. We, however, are extremely concerned that raw data comparisons can paint an inaccurate picture and may serve only to confuse or potentially mislead the general public.

Three examples better illustrate this point. First, comparing complaint information on licensed individuals is tricky at best. You indicated that only a very small percentage of CRD licensed persons have any complaints, and an even smaller number have three or more complaints. Under this scenario, it would be considered highly unusual for a broker to have complaints in his or her file.

---

<sup>1</sup> This group consists of members representing several SIA Committees, including State Regulation and Legislation, Arbitration, Self Regulation, and various supervisory practices committees. Also at the meeting was Mario Di Trapani, who is the President of the Association of Registration Management ("ARM").

SIA, however, believes that NASD's numbers underestimate the likelihood of brokers having complaints filed against them. We understand that NASD relies upon Uniform form U-4 or U-5 information among others. This information, however, captures a universe of all CRD licensed persons, including many people who are not involved in retail sales activities. It is unfair to compare the complaint records of persons involved in retail sales against the complaint records of those registered individuals who have limited, if any, dealings with the general public. Registered individuals engaged in back office operations, institutional sales, banking, research, product personnel or other non-retail capacities are unlikely to have complaints.

As we discussed, a more useful comparison is one that looks at a retail broker's complaint record as compared to the universe of other retail brokers. It is the group's general belief that approximately twenty-five to thirty percent of persons involved in retail sales at their firms have one or more complaints in their file. We appreciate your willingness to work with Mario Di Trapani to get more information on this issue, and we strongly encourage you to delay dissemination of comparative complaint information to the public unless the narrower retail sales comparison can be made.

Even that, however, does not provide a completely accurate picture, as a raw percentage does not take into account such things as number of clients and years of service. For example, one could argue that a retail broker servicing 600 clients with two complaints has a lower complaint percentage - and perhaps a better track record - than a retail broker with 20 clients and one complaint. A raw percentage also fails to distinguish retail brokers who deal in high-risk products from brokers whose business is limited to low risk or conservative investments.

Second, comparing years of experience also has some pitfalls. A person licensed but doing back office work for seven years and retail sales for one year will be listed as having eight years of experience. A potential client who places a high value on years of experience may choose this broker over one with five years of retail sales experience, despite the fact that the latter broker's experience is more relevant.

Finally, NASD's discussion draft suggests that investors will be able to compare information between securities firms. Once again, raw data is grossly inadequate when making such comparisons. Firm size, business mix, and products sold all need to be taken into account if the investor is to truly get "a more complete, accurate and balanced picture." It is unclear how or if NASD plans to do this, although experience with INSITE raises concerns about whether some of these important distinctions can be made.

II. Nominal settlements should drop off the public disclosure system after two years and should not be used to trigger disclosure of archived information.

Under the current public disclosure program, settlements of less than \$10,000 drop off the public disclosure system after two years. SIA believes that the \$10,000 figure is too low and should be raised to reflect current economic conditions. We nonetheless applaud the principle behind this policy, which is that small settlements are not necessarily a reflection of the merits of the

plaintiff's case. As you well know, firms often settle cases for purely business reasons, particularly those involving relatively small amounts in dispute. Moreover, decisions to settle are generally made by securities firms and not by the specific brokers involved. The fact that the settlement drops off the broker's public disclosure record after two years makes the settlement decision more palatable to all.

NASD's proposed change to provide archived settlement information if a broker has two additional reportable actions significantly and unfairly changes the rules of the game. The reality is firms simply may not have settled and brokers may not have acquiesced to such settlements had the current proposal been a possibility.

NASD should also consider that such a policy change creates a disincentive for brokers and firms to settle complaints. If the settling of a complaint results in unsubstantiated or nuisance complaints resurfacing, firms will likely deny claims that they might have otherwise offered to settle. Clearly, this would not be in the public's interest. Moreover, the current proposal could lead to potential abuses by both plaintiffs' bars and may tempt brokers to make settlements in the field with clients or suppress a client complaint altogether.

We strongly urge NASD to reconsider making settlements part of the triggering mechanism for archived information. At a minimum, if and when this policy change is instituted, it should not apply retroactively. In other words, settlements prior to your target implementation date of 2005 should not be used to trigger disclosure of archived information.

III. Three complaints over a ten-year period is too low a threshold to trigger disclosure of archived information.

SIA strongly favors NASD's current policy of dropping customer complaints that have not been adjudicated or pursued from the public disclosure system after two years. SIA believes that such a policy recognizes that it is unfair to permanently taint a broker's record based on mere allegations that clients may have raised in the heat of the moment and that they ultimately chose not to pursue.

SIA recognizes that NASD wants to modify that policy to make archived complaints available if such complaints help to suggest a potential pattern or practice of improper conduct by a broker. We, however, believe that three complaints over ten or more years is too low a threshold to trigger disclosure of archived information. This is particularly true given that reporting obligations are triggered even if a customer's allegations are clearly without merit. For example, a broker would have to report receiving a sales practice complaint even if he or she did not service the customer's account at the time of the alleged misconduct. A customer letter alleging a sales practice violation that has absolutely no validity or is not pursued should not be given much weight and certainly should not be given the same credence as a regulatory disclosure.

Moreover, we question why three is the dispositive number. A specific cut-off fails to take into account the seriousness of the allegation. Three insignificant complaints is certainly better than two bad complaints, yet only the broker with the three complaints over ten years would have his or her archived information disclosed.

SIA would strongly encourage NASD to raise substantially the triggering threshold. The information you garner from Mario Di Trapani may help you to set a more reasonable trigger.

#### IV. Other concerns

While most of our meeting time was focused on comparative and archived information, we did raise in a more limited way several other issues. First, we remain concerned about the display of information. Sometimes how something is displayed is as important as what is displayed. For example, currently a complaint and a subsequent proceeding resolving the issue are not necessarily linked, which is confusing to the investor. We appreciate your willingness to work closely with us to ensure that information is not only displayed but is displayed in an appropriate and useful way.

Second, we have potential issues with amending the minor rule violation plan to include late filing of required registration information. In some states, a violation of an NASD rule is considered a violation of the state's unethical business practice rule, which subjects the violator to separate and often times substantial fines. We would want to ensure that a minor rule violation was imposed only in egregious cases. We'd also seek clarification that fines and violations would not be imposed for late filing of anything other than so-called Question 14 items.

In addition, as pointed out at our meeting, most of the information requiring disclosure on Form U4 can only be reported if the registered representative notifies the firm of the event (e.g., arrests, bankruptcies, judgments, liens, etc.). Firms should not be held accountable for reporting those incidences that they do not know exist. Likewise, a firm should not be forced to pay a financial penalty with the expectation that it will somehow collect the fine from its employee. While we can understand that the NASD wants to ensure compliance with its reporting requirements, we believe that industry already takes reasonable steps to accomplish this objective.<sup>2</sup>

Third, we'd like further clarification on how NASD would implement inactive disclosure review status. This is a heavy-handed enforcement tool that should be imposed only in the most extreme circumstances. We would want some reassurance that inactive status was instated only after substantial notice had been given to the firm's Compliance Department, and there had been appropriate opportunities to remedy any deficiencies.

---

<sup>2</sup> Typically, when a firm learns of an incident involving an employee that should have been disclosed on Form U4, the firm will, on a case-by-case basis, evaluate the reason for non-disclosure and the seriousness of the event. Often times, the employee was unaware that a particular incident required disclosure and is given a caution. Other times, the employee knew or should have known that the incident was reportable and is terminated from employment.

Finally, on a more mundane level, we have some concerns about what Form U5 disclosure information would be disclosed and how NASD would reflect the fact that an exam had been waived.

Once again we appreciate the opportunity to provide both oral and written feedback to NASD's discussion draft. We look forward to working with you in the future as this program continues to develop.

Sincerely,

Kim Chamberlain  
Vice President & Counsel  
State Government Affairs

Cc: Douglas Shulman  
Chip Jones  
Rick Pullano