



Securities Industry Association

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January 6, 2003

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, D.C. 20006-1500

**Re: NASD Notice to Members 02-74 – Comment on Proposed Public
Information Review Initiative**

Dear Ms. Sweeney:

The Securities Industry Association (“SIA”)¹ is pleased to offer comment in response to the referenced Notice to Members (“*Notice*”), which seeks input from interested parties on a broad range of issues relating to information the NASD makes public. According to the *Notice*, NASD is considering various changes, both substantive and technological, to the existing NASD public disclosure framework. Among these are significant expansions to the type of information it currently makes available through its Public Disclosure Program (“PD Program”).

I. Introduction

SIA commends NASD for undertaking this comprehensive review of the information it collects, develops and makes available to the general public. We too share the view that the existing system, which has served the public well for over a decade, will stand to benefit from many of the technological enhancements under consideration. In particular, SIA supports consolidation and reconfiguration of the existing disclosure information into a single, more “user-friendly” website. We agree that this modification,

¹ The Securities Industry Association brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. Collectively they employ more than 495,000 individuals, representing 97 percent of total employment in securities brokers and dealers. The U.S. securities industry manages the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2001, the industry generated \$280 billion in U.S. revenue and \$383 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)

along with the proposed improvements to the existing Internet application to provide for ease of use and expeditious delivery of information, will benefit investors. SIA, therefore, applauds NASD's efforts to update, streamline and simplify the existing technology underlying the public disclosure system.

SIA also commends NASD for undertaking to provide more comprehensive and constructive disclosures. SIA has long espoused the principles of fair and accurate disclosure to the investing public. Such disclosures, particularly those that relate to the individuals or firms with whom investors are contemplating doing business, are vital to the industry's ongoing commitment to strengthening public trust and confidence in our capital markets. As NASD correctly notes, however, the key challenge presented by this initiative is to ensure that any changes to the existing disclosure system are reasonable, well balanced and do not needlessly jeopardize the legitimate privacy interests at stake.

Unfortunately, many of the substantive expansions enumerated in the *Notice* fall short in several significant respects. In particular, we believe that the proposed expansions to the PD Program do not strike a fair balance between the need for quality disclosure on the one hand and legitimate privacy interests on the other. As detailed below, SIA has several concerns with the proposed expansions relating to CRD form filing information, individual licensing examination results, Form U-5 information and comparative data. Also problematic are the suggested "safeguards" purportedly designed to promote timely reporting of disclosure information by member firms and associated persons.

Though some will argue that increased public disclosure is better disclosure, we believe this to be a faulty premise. Certainly, we agree, as Justice Brandeis said, that "sunlight is the best disinfectant," but there are limits to the benefit of any policy tool, including one as sacrosanct as disclosure. Burying investors in the type of information contemplated within the *Notice*, however, does not help the investor or the thousands of honest men and women who work in this industry. What purpose does it serve to have innocent individuals explain and defend their records perpetually, or worse, lose business, because of unfounded allegations, outdated historical information, or erroneous filings that have since been removed from the PD Program?

As the *Notice* candidly acknowledges, "NASD currently provides an unparalleled amount of information about firms, markets and regulation to the public." To the best of our knowledge, no other profession must contend with the amount and type of public disclosure both under consideration and currently available about securities professionals: not physicians, lawyers, or accountants -- all of whom hold positions of public trust at least as important as that occupied by stockbrokers.

If implemented, NASD's proposed expansions would place within the public domain a trove of personal information about securities professionals, without regard for who is seeking the information or for what purpose the information is being sought.

Moreover, because current reporting requirements sweep in unsubstantiated and unproven allegations, irrespective of how frivolous or facially incorrect, we believe the PD Program will become flooded with irrelevant and confusing information. Indeed, we fear that these proposed expansions, coupled with the modifications to the Internet application,² will encourage fishing expeditions into private and potentially sensitive personal records of associated persons by anyone with Internet access – irrespective of motive or an existing business relationship.

Our concerns about the serious erosion of the privacy rights of securities professionals are heightened further still when we view the proposed expansions outlined in the *Notice* against the backdrop of NASD's recent curtailment of the expungement remedy. Notwithstanding strenuous industry objection, NASD submitted a rule filing that severely constrains the rights of associated persons to have meritless claims removed from their CRD records pursuant to an arbitration award. While we do not seek to recommence the debate over the wisdom or fairness of that development here, it is both appropriate and necessary to consider carefully how the recent contraction of the expungement remedy and the proposed changes to the PD Program will interact. We believe that these tandem changes will create a disclosure system that unfairly places securities professionals under the harsh glare of a universally accessible, 24-hour electronic bulletin board that indiscriminately records and displays sales practice complaints made against them – no matter how frivolous or unfounded – with little or no ability on their part to remove the stain of a baseless claim. Clearly, the effect of such a system would be unfair and unjust and we respectfully urge the NASD to reconsider its proposal.

Finally, we note that while we attempt to cover as many issues as possible in this letter, we do not view our comments as all-inclusive. Rather, they are intended to be the starting point of an evolving regulatory dialogue with the NASD as it moves forward with this initiative. Indeed, because the *Notice* lacks specificity about many of the proposed expansions, we urge the NASD to provide interested parties with further opportunity to review and comment upon each specific expansion once NASD has further considered and formulated the underlying details.

II. CRD Data and Other Form Filing Information

Among the most troubling aspects of the proposed expansions to the current public disclosure framework are those relating to the CRD data and form filing information. Specifically, NASD proposes to disseminate through the PD Program individual broker examination information, historical form filing information and Form

² The *Notice* contemplates expanding the PD Program to provide on-line for the first time “disclosure” type information, such as customer sales practice complaints and related litigation or arbitration.

U-5 information. We address each of these proposals separately below. We begin, however, with a brief review of the function and purpose of the CRD and PD Program.

A. The CRD System and PD Program

As noted above, the CRD database contains an “unparalleled” amount of information about member firms and their associated persons, unmatched by any other professional or commercial licensing system. This information is derived predominantly from data filed by broker-dealers, individuals and securities regulators through the Uniform Forms.³ With respect to individuals, CRD contains not only registration and licensing information, but a host of personal data as well, including information about residential history; education and employment experience; regulatory and disciplinary history; criminal arrests and convictions; and personal financial information, such as personal bankruptcies, judgments and liens. CRD also contains information about customer-initiated complaints, related arbitrations and judicial proceedings.

With respect to customer complaints, the Uniform Forms require firms and associated persons to report alleged sales practice violations without regard to the apparent degree of seriousness, the veracity of the claim or its outcome. Consequently, the CRD system is replete with customer complaints that are without any factual or legal basis.⁴

In recognition of the far-reaching ramifications of the reporting requirements, as well as due process and privacy concerns, the CRD system itself permits varying degrees of access to this information, depending on who is requesting the information and for what purpose. Securities regulators, therefore, have the broadest range of access, while other parties, including member firms,⁵ are provided only with specific subsets of that information. NASD’s PD Program is the vehicle by which members of the general public access this subset of information.

³ The uniform forms include the Form U-4 (the Uniform Application for Securities Industry Registration), the Form U-5 (the Uniform Termination Notice for Securities Industry Registration), the Form U-6 (the Uniform Disciplinary Action Reporting Form), the Form BD (Uniform Application for Broker-Dealer), and the Form BDW (the Uniform Request for Broker-Dealer Withdrawal).

⁴ SIA has long questioned the equity and value of a regulatory disclosure system that mandates the reporting of unproven and unsubstantiated allegations. Fundamental principles of fairness and due process mandate that individuals be not subject to wrongful consequences stemming from incorrect data contained within the CRD that is subsequently disseminated through the public disclosure program. The problem with the proposal, of course, is that the more information NASD intends to disseminate publicly, the greater the risk of potential harm to associated persons.

⁵ For example, member firms conducting pre-employment screening cannot access CRD information about a potential candidate absent the candidate’s express written consent.

Established in 1988, the PD Program was created with a goal of helping investors make informed decisions about the individuals and firms with whom they were contemplating doing business. Consequently, the PD Program provides investors with certain information about the professional background, regulatory and litigation history of NASD members and their associated persons, as well as allegations made against those parties.⁶

In determining what subset of CRD information is made public, the central premise underlying the PD Program has always been -- and should remain -- fair and *informative* disclosure that adequately balances investors' access to relevant information against the privacy rights of associated persons. For this reason, the PD Program traditionally has excluded certain types of potentially inflammatory or outdated information. For instance, although the CRD system collects verbal and written customer-initiated complaints reported during the lifetime of the registered person, the PD Program omits what is commonly referred to as "stale" customer complaints -- that is, complaints more than 24 months old that were neither settled nor pursued in arbitration or litigation. Similarly, NASD currently does not release certain historical financial information for individuals, such as *satisfied* personal judgments or liens, or bankruptcies initiated over ten years ago.

B. Historical Form Filing Information

Given the differing roles and intended audiences of the CRD system and PD Program, it is extremely disconcerting that NASD would offer to publicly disclose much of the information currently warehoused in the CRD system. In particular, we are deeply concerned over the modification that would disseminate the historical form filings submitted to the CRD system, as well as the information contained in the specific filings. As stated in the *Notice*, this expansion would encompass not only disclosure events reported in *error*, but previously reported information that is no longer reportable, either due to a change in the question or a "sunset" provision within the question.

SIA believes such an expansion is not only unwarranted, it is highly prejudicial and counterproductive to the stated goals of enhanced public disclosure. Simply stated, increased disclosure does not necessarily equate to better disclosure in this case. No legitimate purpose is served by thrusting into the public domain historical information previously withheld as irrelevant, outdated and factually incorrect. Indeed, given the scope of the existing reporting parameters and the array of data currently captured within the CRD system,⁷ we believe that disclosure of this type of information will inundate

⁶ NASD's PD Program is described in Interpretive Material 83210-2 of the NASD Rules ("the Interpretation").

⁷ It is worthy of mention that there is no limitations period after which unfounded accusations are automatically removed from the CRD system. Therefore, such accusations remain affixed to a registered person's permanent record unless and until expunged by court order.

investors with unhelpful and potentially misleading information. In the end, what is meant to improve investor protection will have the unintended consequence of diminishing the quality of the disclosure that will be provided to the public.

Equally compelling of course are the privacy interests of associated persons. Under the proposed historical filing expansions, the NASD would now release highly personal information previously recorded in the CRD system, irrespective of time lapsed or current status. For example, this change to the PD Program would now allow the general public to view historical financial information that is no longer applicable, such as personal judgments or liens originally reported to the CRD but subsequently satisfied. Also subject to public scrutiny is information relating to personal bankruptcy proceedings filed over a decade ago.

By disseminating historical information that no longer meets the existing Uniform Form reporting requirements, NASD also undermines both the spirit and letter of many of the questions that currently appear on these Forms -- questions that were the subject of careful deliberation and negotiation between NASD, the North American Securities Administrators Association ("NASAA"), and the industry. Having taken great care in developing questions that thoughtfully balance the competing disclosure and privacy interests, NASD has offered no reasonable justification for disregarding the current regime that is specifically designed to remove or make non-reportable on the Forms certain irrelevant or erroneous items.

As gatekeeper of the securities industry licensing database, NASD owes a duty of trust to the securities professionals who submit their personal information to the CRD system as a prerequisite to conducting business with the public. Therefore, it is incumbent upon NASD to manage the information contained within that database reasonably and responsibly. This means that NASD must take the necessary measures to safeguard against unnecessary disclosure and to ensure that the information it does release is relevant, accurate and respectful of the compelling privacy interests at stake. Given the current public and legislative concern for the privacy of personal information as reflected by the Gramm, Leach, Bliley Act, Regulation SP and the growing problem of identity theft, NASD's proposal is oddly out of step and ignores these important concerns.

We note that the NASD does not specify whether the proposed historical filing expansions will apply to information about persons formerly associated with a member firm. Currently, NASD releases information about persons who have been associated with an NASD member within the preceding two years. NASD adopted the two-year limitation period because it believed it inappropriate to continue public disclosure

indefinitely for individuals who choose to leave the securities industry.⁸ Moreover, a two-year period coincides with the period in which an individual can return to the industry without being required to re-qualify by examination. We urge NASD to continue this policy, which we believe achieves the necessary balance between the investor's interest to easily obtain information about a former associated person against that person's desire to privacy once he or she left the securities industry.

C. Individual Exam Information

SIA also finds problematic the proposed changes relating to individual licensing examination information. As stated in the *Notice*, NASD intends to publicize a registered person's examination results (pass or fail), the type of exams requested, as well as the number and type of examinations taken and not taken by a registered person. SIA objects to this proposed expansion on several grounds.

As a preliminary matter, we disagree with the proposition that public display of individual examination information (perhaps 5, 10 or 20 years old) will somehow advance the interests of investor protection. Absent full explanation of surrounding facts and circumstances, we believe that this type of disclosure at best will provide investors will a false sense of security. At worst, it will prove harmful to existing and prospective business relationships by unfairly calling into question a person's competence or ability based on standardized test scores that may have been recorded years ago.

Not only are examination results increasingly irrelevant as time goes by, disclosure of this type of information undermines the NASD's industry-wide Continuing Education Program,⁹ which is designed to ensure that registered persons undergo training and education on both general sales practice issues and topics specific to the particular services and products provided by them.

Moreover, we question the utility and the fairness of allowing the general public to peer so closely into the lives of registered persons. Information relating to whether a

⁸ SEC approved in 2000 changes to NASD IM-8310 to allow NASD to release information about persons formally associated with a member for a two-year period following termination of their registration with the NASD.

⁹ NASD's Continuing Education Program is a mandatory two-part, industry wide program that is comprised of the Regulatory Element and the Firm Element. The Regulatory Element requires registered persons to complete a computer-based training program on the 2nd anniversary of their registration, and every three years thereafter on various topics, including those relating to sales practices, customer communications, compliance, ethics, and other subjects pertinent to conducting a securities business. The Firm Element requires broker-dealers to provide ongoing training, tailored specifically to the products and services they provide. Such training must be reviewed and updated at least annually, and must also focus specifically on supervisory training needs. Compliance with Regulatory Element and Firm Element requirements is evaluated as part of the on-site examinations that are conducted by the self-regulatory organizations.

person passed or failed an exam or chose to take a particular securities exam is inherently private and cannot be treated cavalierly.

In short, associated persons do not forswear their privacy rights and agree to public scrutiny of every aspect of their professional and personal lives upon entering the securities business. Rather, the rules of the road are reasonable disclosure of important and meaningful information that helps investors make informed decisions about the people with whom they want to enter into a business relationship. Disclosure of examination information serves no legitimate purpose and has the potential to do considerable harm to both business and reputation. In light of the forgoing, we cannot support this proposed expansion and respectfully request it be abandoned.

D. Form U-5 Information

NASD also proposes to disclose Form U-5 information (including date and reason for termination) immediately upon filing, rather than upon the registered person's re-registration with another firm. The *Notice* states that NASD does not intend to undertake any Form U-5 disclosures until it has modified the Form U-5. SIA strongly urges NASD to defer any action with regard to Form U-5 information until there is a nationwide uniform standard for qualified immunity to firms for good faith disclosures on the Form U-5.

With increased frequency, firms are faced with an untenable dilemma when fulfilling their Form U-5 reporting obligations. On the one hand, firms must satisfy their regulatory obligations to file a Form U-5 which calls for accurate disclosure of even suspected misconduct by a former employee. This reporting obligation extends to post-termination events, such as customer complaints or settlements that may not arise until well after the employee left the firm. Failure to complete the Form U-5 fully and accurately can lead to serious consequences for firms, including disciplinary sanctions and civil liability. On the other hand, including negative language in a Form U-5 increases the risk of a potential defamation claim.

An important proposed rule change by the NASD to strengthen investor protection has been pending before the SEC for several years now. Proposed new NASD Rule 1150 would establish a national, uniform standard of qualified immunity from arbitration proceedings filed against member firms with respect to statements they make on Forms U-4 and U-5. Keeping bad actors out of the securities industry is vital to public trust and confidence in the integrity of the securities markets, and ensuring that the information on Form U-5 is as complete and forthcoming as possible is an important ingredient in screening out undesirable individuals from securities employment.

This issue is important to broker-dealers as a matter of simple investor protection. Currently, employees who are terminated by firms for regulatory violations are able to use the threat of a defamation action as leverage to try to get the firm to dilute any

statement about possible regulatory violations committed by the terminated employee. Firms that ignore such pressure then face the litigation risk that an arbitration panel might not properly understand or apply the law of defamation.

SIA believes that developing an appropriate level of protection for U-5 statements is an important investor protection issue that should be resolved promptly. In this spirit, we have stated our support for the nationwide qualified immunity standard proposed by the NASD. SIA therefore reiterates its support for the nationwide qualified immunity standard, which we believe will help strike an appropriate balance between encouraging candid and accurate disclosure by member firms on the Form U-5 and allowing member firms to defend themselves against frivolous actions alleging that statements made on such Forms are defamatory. In light of the foregoing, we believe that NASD should postpone any action with regard to Form U-5 information until the SEC has approved a qualified immunity standard, at which time the NASD should provide the public with an opportunity to review and comment upon the proposed modifications.

III. Comparative Information

SIA also is concerned by NASD's proposal to place CRD information "in context" by including comparative statistics against which a particular broker's or firm's complaint record may be measured. NASD intends to compile and release various statistical information, such as total number of active brokers or firms, industry averages, as well as the average number of disclosure events by category for a particular broker or firm. While SIA recognizes that truly comparative information could be a useful complement to existing disclosures, we do not believe that offering this type of raw data, particularly in the area of customer complaints, is helpful. On the contrary, we think it will only serve to confuse or potentially mislead the general public.

As with the proposed historical CRD information, here too the difficulty lies with the CRD system itself, which captures allegations of sales practice violations, irrespective of how old, frivolous, or facially incorrect. Since NASD will simply mine the data from the CRD system, we are concerned that the resulting statistical picture could be extremely skewed depending upon the individual facts and circumstances of each complaint. Consider, for example, a broker who, through no fault of his own, gets named in a number of complaints as a result of a product failure. Or, the broker who has the misfortune to have his client list mined by an overly aggressive claimants' lawyer who is engaged in unprofessional champerty. A simplistic statistical comparison would paint an unfairly negative picture of both brokers, neither of whom has a public forum to correct the resulting misimpression. Moreover, depending on the size of the branch office, or even the firm, the potential for overstating the number of reportable events can be significant, thereby unfairly prejudicing firms that are diligent in their reporting obligations. For these reasons, we cannot support this proposed modification as well.

IV. Additional Safeguards

In addition to the substantive expansions detailed above, SIA also has several concerns regarding the various “safeguards” enumerated within the *Notice*, which NASD claims will improve the integrity of the CRD data. These include, among other things, creation of a new registration status called “Inactive Disclosure Review,” and construction of a public NASD web page for attorneys and investors.

A. “Inactive Disclosure Review” Status

NASD proposes to create a new registration status, which would automatically render a person’s registration inactive whenever a member of the NASD staff concluded that such person failed to (i) meet a reporting requirement or (ii) respond timely to a staff request for disclosure or related information. Once a person’s registration status is deemed “Inactive Disclosure Review,” that person would be prohibited from conducting any sales or other regulated activity until he or she satisfied the reporting obligation or responded to the staff’s request.

This proposal is seriously flawed on several fronts. First, this new registration status is both heavy handed and unnecessary in light of NASD's proposed imposition of automatic fines on late Form U-4 or U-5 filings. Second, we are deeply troubled that NASD would consider *automatically* rendering a person’s registration inactive – and thereby deprive them of their livelihood – without more thought to the types of safeguards needed to ensure proper notice and review. For example, an inadvertent late Form U-4 or U-5 filing (or, just as likely, a mistake by a NASD staff member) could easily result in a broker unwittingly conducting securities transactions without a license. This in turn raises the corollary risk of investors asserting rescission claims of otherwise valid transactions under state Blue Sky laws. Third, given the ongoing debate between NASD and registration personnel surrounding what constitutes a new reportable event, we find this proposal to be unreasonable and extremely unfair. Finally, contrary to NASD’s assertion that the proposed modifications are not intended to “increase member firms’ compliance and reporting obligations,” this new status would present a significant challenge to registration and compliance departments, who will have to closely monitor this new registration status. Indeed, we think that this new status, coupled with the proposed attorney website, is a Pandora’s box that is likely to do more harm than good. In the end, both NASD and member firms will be required to build an infrastructure to track, review and investigate, not only those reportable events of which they become aware in the normal course of business, but inaccurate allegations by confused investors or their counsel that a particular claim should have been reported on the Uniform Forms.

B. NASD Web Page for Attorneys and Investors

Equally problematic is the proposed website through which "investors, attorneys or others can report instances where they believe a particular disclosure event that is required to be reported . . . has not been reported." SIA believes such a website is not only ripe for abuse, it will force firms and the NASD to respond to inaccurate claims by confused investors who mistakenly believe that claims or complaints should have been, but were not, reported on the PD Program. As stated above, this will require firms to expend significant administrative and economic resources to ensure that a proper infrastructure is in place to monitor, review and respond to these claims. We are also concerned that the website will unwittingly invite customers to recast their complaints for strategic purposes (*i.e.*, in order to inflict maximum damage on an associated person's CRD record) rather than simply reporting their alleged complaint. In light of the foregoing, we cannot support either proposal at this time, but would be willing to work with the NASD to reach a workable solution that advances the objectives of these proposed modifications.

V. E-Mail Notification of Public Disclosure Report Updates

NASD also solicits comment on whether it should add a functionality to the PD Program that would allow any user of the PD Program to request an e-mail update of "significant changes" that occur to the information previously provided to the user through the PD Program. SIA agrees in principle to a mechanism that provides meaningful information updates, but several of the implementation details need further refinement. For example, the *Notice* does not identify what constitutes a "significant change." Often a single occurrence will result in multiple disclosures on the Uniform Forms. Therefore, it is unclear if NASD intends to provide separate and potentially redundant notifications stemming from a single event. In addition, it is unclear at what point the e-mail notification will be sent and whether NASD will conduct any review to ferret out potential erroneous or duplicative filings.

VI. Conclusion

SIA appreciates the opportunity to provide comments on NASD's public information review initiative. We commend NASD for its efforts to undertake this comprehensive review and echo the principle that any effort to broaden the scope of public disclosure must be tempered by fundamental privacy considerations. We cannot, however, support many of the proposed modifications, as we believe them to be unjustified, irrelevant and contrary to the stated objectives of enhanced, quality disclosure of meaningful information. Moreover, when viewed in light of NASD's recent curtailment of the expungement remedy, many of the proposed changes to the PD Program will create an unfair disclosure regime that will force associated persons and their employers to operate in an atmosphere tainted by baseless claims of wrongdoing that remain affixed to their permanent records absent court ordered expungement.

We hope this letter has been helpful and look forward to working with NASD to craft practical solutions that meet the important goals of the proposed expansions. If we can provide any further information or clarification of points made in this letter, please contact me or Amal Aly, Associate General Counsel, at (212) 618-0568.

Sincerely,

Stuart J. Kaswell
Senior Vice President and
General Counsel

cc: Robert R. Glauber, Chief Executive Officer and Chairman, NASD
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