

**Securities Industry Association**

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December 19, 1997

Joan Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, DC 20006-1500

Dear Ms. Conley:

We are writing on behalf of the Legal and Compliance Division and the Federal Regulation and the Self Regulation Committees of the Securities Industry Association ("SIA") ¹ in response to NASD Regulation's request for comment on Notice to Members 97-77 ("the Notice"). The Notice proposes to 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. We appreciate the opportunity to comment on this important proposal.

The SIA believes that the Notice goes a long way toward striking an appropriate balance between encouraging candid and accurate disclosure by member firms on Forms U-4 and U-5 and allowing member firms to defend themselves against frivolous actions alleging that statements made on such Forms are defamatory. The SIA is supportive of the proposal's suggestion to establish a uniform, national standard of qualified immunity for arbitration proceedings. Although such a standard does not represent any enhanced legal protection for member firms in the sense that this is the standard applied in most parts of the country, it should eliminate future litigation over the existence and appropriate level of immunity afforded a member firm in any particular arbitration proceeding around the country. ²

We also believe that the Notice correctly proposes that the standard of proof for proceedings involving claims that Form U-4 or U-5 disclosures are defamatory should be one of clear and convincing evidence rather than a preponderance of evidence. We believe that the NASD is correct to be concerned that the preponderance of evidence standard of proof is so low that it will not have the effect of discouraging frivolous litigation, or the threat of frivolous litigation, relating to statements made on Forms U-4 or U-5.

We believe, however, that certain aspects of the NASD's proposal require further consideration before the final rule is adopted. First, paragraph (a)(1) of the rule would require a member firm to "make truthful, accurate, and complete statements" on

Forms U-4 and U-5. (emphasis added). The Notice, however, makes clear that this paragraph is only intended to "reaffirm the current disclosure obligations of NASD members," which it describes in the immediately preceding sentence to be that "members are currently required to make truthful and accurate disclosures."

It appears that, in attempting to restate a member firm's current obligation, the proposed rule inadvertently expanded the obligation by adding the concept that a filing must meet some undetermined test of "completeness." This should be corrected. The notion that a filing must be complete in addition to being truthful is fraught with uncertainty and adds nothing to what the proposed rule is seeking to accomplish. If the rule is adopted with its present language, member firms unquestionably will be subject to allegations from affected registered persons that, although the statements made on a Form U-4 or U-5 are truthful and accurate, they left out some immaterial detail, rendering them "incomplete." The NASD should eliminate the possibility of such a frivolous claim by modifying the proposed rule to state that members must make truthful and accurate statements on covered forms.

We believe that the NASD also should reconsider the proposed rule's requirement that a Form U-5 filing be delivered to the associated person with respect to which it is made at least ten days before it is filed with the NASD. Although many firms seek in many instances to provide a copy of Form U-5 to the affected associated person or their counsel prior to filing with the NASD, we do not think this should be mandated by rule.

This aspect of the proposal presents several difficulties. First, the requirement that a Form U-5 filing be shown to the associated person increases the possibility that such Forms will not be filed within the required thirty days. The proposed ten day period could encourage extended negotiations with an associated person over the language of the Form. Such a long period also effectively reduces to twenty days the time that member firms have to make Form U-5 filings. In light of the current emphasis by regulators on the importance of timely filing, and the need to act with care in making

such filings, it seems unfair and counterproductive to reduce substantially the time within which member firms must act.

Second, the proposal also does not make clear what constitutes delivery of a Form. It states only that the Form "shall be delivered to such associated person at least ten days before" it is filed. The rule leaves uncertain whether an effort to notify the affected person meets the delivery requirement or whether delivery to an attorney or other agent on behalf of the affected person is sufficient. Further, the rule does not recognize that in certain egregious situations contacting the affected person makes little sense and simply fosters delay. (For instances, an associated person who has been found to have misappropriated customer funds and is dismissed should not be able to delay for ten days public disclosure of their misconduct). In light of these difficulties, we urge the NASD to modify the proposed rule to eliminate the requirement that a Form U-5 be delivered to the affected person ten days prior to filing. Changing this provision to require that a member make a good-faith effort to

deliver a copy of the Form to the affected person concurrently with its filing would greatly alleviate our concerns.

In addition, we believe that the proposal should provide qualified immunity from any legal action based upon the language contained in the Form U-4 or U-5, not simply defamation actions. In an effort to circumvent the proposed qualified immunity standard, associated persons could seek to challenge statements made on Forms U-4 or U-5 on other legal grounds. We believe that the proposal should be expanded to preclude such claims.

In addition to the foregoing, the Notice sought comment on several other aspects of the proposed rule and we seek to briefly respond to those matters below.

The Notice seeks comment on whether to make the proposed qualified immunity available only if the member firm has a registered person or an attorney sign the Form. We strongly believe that the availability of qualified immunity should not be restricted in this respect. As a matter of public policy, the protection of qualified immunity should be available whenever a firm has behaved in the manner consistent with by the terms of the qualified immunity rule. It makes no sense to condition the availability of this protection on who signs the Form; there is no reason to think that Forms will become more truthful or accurate because the rule mandates who must sign them. Moreover, such a proposal needlessly interferes with the operations of member firms. The entire process of reviewing and filing Forms U-4 and U-5 is performed differently in different firms, but is uniformly taken seriously by all responsible member firms. Firms should be free to meet their filing obligation in the manner that makes the most sense for them. Firms that do not address this obligation in a responsible way, of course, will remain subject to the risk of a defamation action.

The Notice also seeks comment on whether an expedited arbitration or mediation process should be established to address potential disputes regarding disclosures on Forms U-4 and U-5 before filing. We believe that it would not be advisable to adopt such a procedure. Such a procedure unquestionably would result in delaying, potentially for extended periods of time, the filing of required forms. Moreover, the existence of such a procedure could cause firms not to provide as fulsome disclosure as they otherwise would in an effort to avoid an expedited hearing process. It is apparent to us that both of these results frustrate, rather than achieve the goal of truthful, accurate and timely disclosure on Forms U-4 and U-5.

We appreciate the attention that the NASD has devoted to this issue and the opportunity you have afforded us to comment on the proposal. The undersigned are, of course, available to discuss this matter further with the NASD staff at its earliest convenience.

Sincerely,

Robert C. Errico, President,
Legal and Compliance Division

cc: Evan Stewart, Chair

Federal Regulation Committee

R. Gerald Baker, Chairman
Self Regulation Committee

Footnotes:

¹ The Securities Industry Association brings together the shared interests of more than 770 securities firms throughout North America to accomplish common goals. SIA members -- including investment banks, broker-dealers, and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the U.S. SIA members collectively account for approximately 90 percent, or \$100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans. More information about SIA is available at our Internet web site, <http://www.sia.com>.

² In fact, in New York the Notice's proposal of qualified immunity provides less protection than the absolute immunity provided under state law. See Culver v. Merrill Lynch & Co., Inc., 94 Civ. 8124 (LBS), 1995 U.S. Dist. Lexis 10017 (S.D.N.Y. July 17, 1995). Although the SIA believes that, with the modifications mentioned herein, the Notice's proposal of qualified immunity represents an acceptable compromise on this issue, some of its member firms believe that statements made in Forms U-4 and U-5 should be protected by absolute immunity.