



Securities Industry Association

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July 27, 2005

Jonathan G. Katz
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File No. SR-NASD-2003-168 -- NASD Proposed Amendments Relating
to the Release of Information Through the Public Disclosure Program

Dear Mr. Katz:

The Securities Industry Association (“SIA”)¹ appreciates the opportunity to offer comments in response to the referenced rule filing (“Rule Filing”), which seeks input on proposed expansions to the types of information NASD currently makes available through its public disclosure system (“BrokerCheck”). As detailed in SIA’s prior written submissions, as well as during several lengthy discussions with NASD staff, SIA supports NASD’s efforts to provide investors with additional tools that will better assist them in making informed decisions about firms and registered persons with whom they are, or may be, doing business.²

SIA continues to have serious concerns, however, about the proposed release of archived “Historic Complaints” which we believe would result in significant inequities to registered persons, as well as confuse investors who seek meaningful information from the BrokerCheck system. We therefore urge NASD to withdraw this provision from the Rule Filing as recommended below. Alternatively, we respectfully request that NASD adopt SIA’s proposed alternatives as suggested herein.

I. Introduction

As a threshold matter, SIA agrees that NASD’s existing public disclosure system would benefit from many of the technological enhancements under consideration. In particular, we fully support 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 550 securities firms to accomplish common goals. SIA’s primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (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. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated \$227.5 billion in domestic revenue and \$305 billion in global revenues. (More information about SIA is available at: www.sia.com.)

² See letter to Barbara J. Sweeney, NASD (January 6, 2003) and letter to Jonathan G. Katz, SEC (January 20, 2004), which we incorporate by reference herein.

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, supports and welcomes modifications that update, streamline and simplify the existing technology underlying the public disclosure system. Similarly, SIA also supports NASD's efforts to provide more comprehensive and constructive disclosures. SIA has long espoused the principles of fair and accurate disclosure to the investing public. Such disclosures, especially those that relate to individuals or firms with whom investors are contemplating doing business, are vital to the industry's ongoing commitment to strengthen public trust and confidence in our capital markets.

As NASD correctly notes, 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 and fairness interests at stake.³ In that regard, SIA greatly appreciates NASD staff's continued willingness to work with various constituencies to ensure that the disclosure information is sensible and helpful to the overriding purpose of providing investors with constructive information. Such cooperation and regular exchange of ideas have yielded a significantly improved rule proposal.

Regrettably, and notwithstanding strenuous industry objection, the current proposal still contains disclosure of the highly controversial "Historic Complaints."⁴ As before, SIA continues to have fundamental fairness concerns about the retroactive disclosure of unadjudicated customer complaints that have long since been archived by NASD. We believe that this expansion could have negative consequences to the broker community (the vast majority of whom are honest, hard working professionals), create a chilling effect on settlements and inundate investors with potentially misleading information. Indeed, in light of the ever-increasing regulatory focus on firm internal controls and supervisory structures, particularly in the area of registered representative activity, we believe that drudging up Historic Complaints adds little substantive value to the current disclosure system and may ultimately undermine the objectives of enhanced regulatory disclosure.

In short, more information does not necessarily equate to better disclosure. As with any disclosure regime, the benchmark here must be the quality of the disclosure, not merely the quantity of the disclosure. Thus, we respectfully request that the Historic Complaints provision be eliminated from the Rule Filing. Alternatively, we request that NASD adopt SIA's suggested alternatives, which would allow for the disclosure of Historic Complaints in a more reasonable and equitable manner.

II. SIA's Objections to the Release of Historic Complaints

Under the proposal, NASD would release all Historic Complaint information, *regardless of age*, if the registered person has a total of three or more disclosures in a ten-year period. This includes a total of three or more (i) currently disclosed regulatory actions; (ii) currently reported customer complaints, arbitration, or litigation disclosures; (iii) Historic Complaint disclosures; or (iv) any combination thereof. In addition, NASD would also

³ NASD Notice to Members 02-74 (October 24, 2002).

⁴ Historic Complaints are defined as (i) customer complaints that are more than two years old and have not been settled or adjudicated; or (ii) customer complaints, arbitrations, or litigation that have been settled for an amount less than \$10,000.

require that the most recent customer complaint have been filed within the past 10 years. NASD justifies the Historic Complaint disclosures by explaining that by releasing Historical Complaints for registered representatives who meet the 3 disclosures in 10 years threshold, NASD would enable public investors “to determine for themselves whether a particular broker has demonstrated a pattern of conduct over the years and the significance if any, they should attach to the Historic Complaint information.”⁵

A. Disclosure of Historic Complaints Ignores the Inherent Differences Between the CRD and BrokerCheck Systems

Among the most troubling aspects of the proposed Historic Complaints disclosure is that it ignores the inherent differences between the Central Registration Depository (“CRD”) and BrokerCheck. As the central licensing database for the securities industry, the CRD system was created for use by *regulators* in connection with registration and licensing matters. Consequently, the CRD database captures an unparalleled amount of information, unmatched by any other professional or commercial licensing system. This includes registration information, personal and professional information, as well as virtually *all* customer-initiated complaint information regardless of veracity or outcome.⁶ Moreover, because of the sensitivity of the data, the CRD system itself permits varying degrees of access, depending the identity of the requester and intended purpose of the request. Securities regulators, therefore, have the broadest range of access, while others, including member firms, have limited access to specific subsets of that information.

By contrast, BrokerCheck is the platform through which the general public may view *some* of the information contained within CRD. Established in 1988 and originally called the Public Disclosure Program, BrokerCheck is intended to provide investors with fair and *informative* disclosure that adequately balances the public’s need for relevant information against the equally compelling privacy and due process rights of registered persons. To that end, BrokerCheck currently provides investors with a wide array of information about the registered persons’ professional background, regulatory and litigation history, as well as certain customer dispute information. By the same token, and due to public policy and fairness considerations, BrokerCheck also archives (i.e., removes from the public disclosure system) certain potentially inflammatory or outdated information after a certain period of time. This includes, for example, satisfied personal judgments or liens, bankruptcies initiated over ten years ago, and Historic Complaint information.

Notably, while archived disclosures no longer appear on BrokerCheck, there is no limitation period after which they are automatically removed from the CRD. Therefore, a false accusation of wrongdoing will remain affixed to a registered person’s permanent CRD record unless and until expunged by court order. The difficulty, of course, is that NASD recently imposed additional procedural requirements for registered persons seeking to remove meritless claims from their record. While we do not seek to recommence the debate over the wisdom or fairness of the expungement rules here, it is both appropriate and

⁵ Securities Exchange Act Release No. 51915 (June 23, 2005), 70 Fed. Reg. 37880, 37884 (June 30, 2005) (Rule Filing).

⁶ For individuals, the CRD system houses information about residential history; education and employment experience; regulatory and disciplinary history; criminal arrests and convictions; personal bankruptcies, judgments and liens; and customer complaints, litigations and arbitrations.

necessary to consider carefully how the recent contraction of the expungement remedy and the proposed changes to the BrokerCheck will interact. We believe that these tandem changes will create a disclosure system that unfairly forces securities professionals to have to explain away baseless allegations that have long since been archived for the duration of their professional careers. Such a result, we believe, is unjust, unwarranted and should not be countenanced.

B. NASD's Rationale for the Release of Archived Historic Complaint Information is Fundamentally Flawed

As noted above, NASD supports the disclosure of archived Historic Complaint information by explaining that it will only release this information if a registered person meets the proposed 3 disclosures in 10 years threshold, which NASD deems as potentially indicative of a "pattern of conduct" by the registered person.

Three Disclosures in 10-Years is Not Necessarily Indicative of a Pattern

NASD's reasoning is flawed because it incorrectly presumes that all disclosures housed in the CRD system have merit. This simply is not the case. Because the Uniform Forms require firms and associated persons to report *all* customer disputes *alleging* sales practice violations no matter how frivolous, registered persons (particularly those that service a large number of retail accounts) may have multiple customer complaint disclosures on their CRD record that are without factual or legal basis.⁷ This is particularly true within the context of Historic Complaints, which is why many of these sit idle for years without any further activity by either the firm or the customer.

The same reasoning applies to many settlements of customer disputes. As with customer complaints that are neither settled nor pursued in arbitration or litigation, settlements are not *per se* significant, nor do they necessarily represent an acknowledgement of wrongdoing. Rather, parties often settle disputes -- including those without merit -- for many reasons, not the least of which is a desire to avoid the considerable time, effort and expense that a full blown arbitration or litigation invariably will entail. As a result, parties frequently will enter into settlements based on a cost-benefit analysis or a firm business decision to maintain client goodwill. Thus, contrary to NASD's assertions, we do not support the notion that NASD's proposed threshold of three disclosures within in a ten-year period is germane to a registered person's competency and business conduct.

Release of Archived Complaint Information Is Highly Prejudicial and Potentially Misleading to Investors

We are also unconvinced by NASD's assertion that once it places Historic Complaint information in the public domain, the general public will be able to make informed, objective independent decisions about what weight, if any, to give this information. The fact is, regardless of how much qualifying language NASD attaches to the Historic Complaint

⁷ For example, a customer dispute can stem from frustration with poor market conditions or unrealistic expectations.

disclosures,⁸ the average users of the BrokerCheck system will not be able to objectively assess the value of the Historic Complaint disclosures as compared to other types of disclosures. On the contrary, by including Historic Complaint information on NASD's BrokerCheck website – the purpose of which is to assist investors in making “informed” decisions about the brokers with whom they will do business – NASD will appear to affix a level of legitimacy to those disclosures. Otherwise, why would a regulator alert the public about previously archived allegations contained in complaints spanning a ten-year period?

Notably, while NASD specifically excludes information that is no longer reportable under the current Uniform Forms from the BrokerCheck system, NASD expressly carves out Historic Complaints from this standard.⁹ Such an approach is ill conceived, however, because it 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 information. As NASD freely admits, “NASD currently provides an unparalleled amount of information about firms, markets and regulation to the public.”¹⁰ Expansion of the current public disclosure framework to include outdated, unproven, archived Historic Complaint information adds very little to the interests of investors seeking meaningful information about their brokers.

C. The Proposal Could Have an Adverse Impact on Settlements and Overwhelm NASD's Dispute Resolution Process

Equally troubling is the chilling effect this proposal could have on settlements. As noted above, settlements of customer complaints can be motivated by several factors, including economic and client relation considerations. Once NASD creates a disclosure regime that includes settlements as the basis for disclosure of *all* Historic Complaint information, there will be little incentive to settle claims, particularly those under \$10,000. Firms and registered persons will insist on challenging every customer dispute, no matter how unfounded, thereby forcing investors to proceed in arbitration or abandon the claim for lack of resources. NASD Dispute Resolution, in turn, will become flooded with new cases that otherwise would have been amicably settled. Clearly, such an outcome does not advance the interests of investor protection or other public interest.

III. SIA Alternatives

While SIA opposes the inclusion of Historic Complaints and hopes that the SEC will reject that aspect of the Rule Filing, should the SEC determine that there might be certain circumstances in which Historic Complaint information is important to the objectives of

⁸ Based on a preliminary prototype provided to SIA by NASD staff, the BrokerCheck system will contain the following cautionary language “reporting disclosures does not necessarily indicate that the broker has been engaged in any wrongdoing.”

⁹ See Rule Filing at 37884.

¹⁰ NASD Notice to Members 02-74.

investor protection, we respectfully request that the Rule Filing be modified to incorporate SIA's suggested alternatives.

A. Disclosure of Historic Information Should Not Be Retroactive

Among the most problematic aspects of the Rule Filing is the retroactive disclosure of archived Historic Complaint information well after decisions were made as to how to handle particular customer disputes. Often times, registered persons will agree to their firms' settlement request with the understanding that NASD will archive the settlement information after two years, thus having no long-term negative effect on their reputations or business relationships. SIA seriously questions the fairness of a regulatory framework that would change the standard for public disclosure, years after the fact when there is little doubt that many registered persons simply would not have entered settlements (especially for non-meritorious cases) had the current rule proposal been in effect. Thus, to the extent NASD proceeds with disclosure of Historic Complaint information, we strongly urge NASD to apply a prospective standard and disclose only those complaints reported after the effective date of the new rule.

B. NASD Should Utilize A Five Events in Three Years Threshold for the Release of Historic Complaints

In addition to the forgoing, SIA also believes that the appropriate threshold for identifying those registered persons most likely to engage in a *pattern* of sales practice violations is one that focuses on persons with five disclosure events within three years, instead of the proposed three events within ten years. Currently, SRO Examination Guidance¹¹ uses a three-year look back period to achieve the objective of assessing a registered person's "recent history of final disciplinary actions." In that regard, the NYSE historically has defined "high profile" registered representatives as persons with five or more sales practice complaints in a rolling three-year period. Thus, to the extent NASD wishes to craft a threshold for disclosure of Historic Complaints, we strongly recommend that it adopt the NYSE approach of five disclosures in three years.

C. NASD Should Exclude Additional Types of Complaints From the Disclosure Threshold

In all events, we also urge NASD to specifically exclude certain types of complaints when calculating the number of threshold regulatory events for purposes of disclosing Historic Complaints. These include: (i) complaints filed by joint or related account holders based on the same set of facts and circumstances; and (ii) operational complaints or complaints alleging primarily a product failure or poor performance, even if the registered person is named in the related litigation or arbitration.

¹¹ In a report issued by staff of the SEC, NASD, NYSE and NASAA, "A Review of the Sales Practice Activities of Selected Registered Representatives and the Hiring, Retention, and Supervisory Practices of the Brokerage Firms Employing Them," a recommendation was made to have member firms enhance their supervision of registered representatives with a recent history of final disciplinary actions involving sales practice abuse or other customer harm.

IV. NASD Should Adopt Additional Measures to Promote Responsible Pleading Practice

As described above, the CRD system captures virtually all customer complaints irrespective of merit or factual basis. As a result, the system is subject to potential abuses by disgruntled customers or unscrupulous claimant's counsel. Experience shows that many claims and complaints contain a garden variety of alleged wrongful acts, including fraud, churning, unauthorized trading and conversion of funds, without prior sufficient knowledge of all facts to substantiate the claim. Therefore, we think it both prudent and fair that NASD implement meaningful safeguards to ensure that claimants and/or lawyers who engage in this practice (i) understand the significant consequences of what they are doing and (ii) have a reasonable, good faith basis for naming the particular registered person. One option worthy of consideration is to require claimants and their counsel to attest at the time the statement of claim is filed that there is a good-faith basis for naming the registered person(s).¹²

At a minimum, we strongly suggest that NASD provide additional investor education material to the initial claim packet sent to customers preparing to file a claim that clearly explains the implications of naming a particular registered person and include the potential damaging implications. Not only will these measures help promote more responsible pleading practice, they will ultimately enhance the integrity of the CRD system, and in turn the quality of information upon which regulators, investors and firms all rely upon.

V. Conclusion

Once again, we fully support NASD's efforts to enhance the BrokerCheck system and echo the principle that any effort to broaden the scope of public disclosure must be tempered by fundamental privacy and due process considerations. We continue to object, however, to the release of archived Historic Complaints as unjustified, irrelevant and contrary to the stated objectives of enhanced, quality disclosure of meaningful information. As gatekeeper of the securities industry-licensing database, NASD owes a duty of trust to the securities professionals who must submit 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 be mindful of the original intent of the CRD system and take the necessary measures to ensure that the information it releases to the public is relevant, accurate and respectful of the compelling interests at stake. Unfortunately, we do not believe that the retroactive disclosure of archived information meets this standard.

¹² This could be accomplished through either: (i) modification of the Uniform Submission Agreement to include a separate signature line, whereby a Claimant would certify to a good-faith basis for naming the individual registered representative as a Respondent; or (ii) a requirement that claimants attest in writing that they have read the materials provided by NASD and have a good-faith basis for naming an individual Respondent.

We thank you for the opportunity to comment and hope this letter has been helpful. 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,

Ira Hammerman
Senior Vice President and
General Counsel

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