

is settled for an amount exceeding \$25,000;

(9) is associated in any business or financial activity with any person who is subject to a "statutory disqualification" as that term is defined in the Securities Exchange Act of 1934, and the member knows or should have known of the association. The report shall include the name of the person subject to the statutory disqualification and details concerning the disqualification;

(10) is the subject of any disciplinary action taken by the member against any person associated with the member involving suspension, termination, the withholding of commissions or imposition of fines in excess of \$2,500, or otherwise disciplined in any manner which would have significant limitation on the individual's activities on a temporary or permanent basis.

(b) Each person associated with a member shall promptly report to the member the existence of any of the conditions set forth in paragraph (a) of this rule. Each member shall report to the Association not later than 10 business days after the member knows or should have known of the existence of any of the conditions set forth in paragraph (a) of this rule.

(c) Each member shall report to the Association statistical and summary information regarding customer complaints in such detail as the Association shall specify by the 15th day of the month following the calendar quarter in which customer complaints are received by the member. For the purposes of this paragraph, "customer" includes any person other than a broker or dealer with whom the member has engaged, or has sought to engage, in securities activities, and "complaint" includes any written grievance by a customer involving the member or person associated with a member.

(d) Nothing contained in paragraphs (a), (b) and (c) of this rule shall eliminate, reduce, or otherwise abrogate the responsibilities of a member or person associated with a member to promptly file with full disclosure, required amendments to Form BD, Forms U-4 and U-5, or other required filings, and to respond to the Association with respect to any customer complaint, examination, or inquiry.

(e) Any member subject to substantially similar reporting requirements of another self-regulatory organization of which it is a member is exempt from the provisions of this rule.

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## Schedule C

### Part V

#### [Disciplinary Actions]

[Every member shall promptly notify the Corporation in writing of any disciplinary action, including the basis therefor, taken by any national securities exchange or association, clearing corporation, commodity futures market or government regulatory body against itself or its associated persons, and shall similarly notify the Corporation of any disciplinary action taken by the member itself against any of its associated persons involving suspension, termination, the withholding of commissions or imposition of fines in excess of \$2,500, or any other significant limitation on activities.]

#### **II. Self-Regulatory Organization's Statement of the Purpose of and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

#### *(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

The purpose of the proposed rule change is to adopt an enabling rule which requires NASD members to report certain information on a timely basis to the NASD so that the NASD can more aggressively detect and investigate sales practice violations.

In furtherance of the NASD's varied initiatives to address sales practice abuses and supervisory concerns, the NASD is proposing an amendment to Article III of the Rules of Fair Practice (Rules) to require members to report to the NASD the occurrence of specified events and quarterly summary statistics concerning customer complaints. The proposed rule would provide important new regulatory information that will assist the NASD in the timely identification of problem members, branch offices, and registered representatives in order to more aggressively detect and investigate sales practice violations. If adopted, the proposed rule would significantly

parallel comparable provisions of existing Rule 351 of the New York Stock Exchange (NYSE).

The NASD is concerned that critical material information identified in the proposed rule, such as reports on statutory disqualifications, internal disciplinary actions, and quarterly statistical data regarding customer complaints received by a member is not now required by Form U-4 or other forms to be reported to the NASD. As such, this information is not available to the NASD staff on a routine, systematic, or timely basis. In this regard, the NASD believes that the affirmative obligation of members to provide the NASD with notice of certain events concerning member firms or their associated persons will significantly enhance the NASD's ability to quickly identify problem representatives and appropriately respond in a timely manner.

The SEC supported the NASD adoption of a customer complaint reporting rule similar to NYSE Rule 351 in its Large Firm Project Report issued in conjunction with a cooperative effort involving the NASD, SEC, and NYSE that examined the hiring and retention practices of nine of the largest broker-dealers in the United States. Similarly, the General Accounting Office (GAO) in its report titled Securities Markets: Actions Needed to Better Protect Investors Against Unscrupulous Brokers, recommended that member firms' customer complaint information be computer captured and utilized as an additional tool by regulators for identifying potentially problem firms.

As proposed, Subsection (a) of the rule requires member firms to file a report with the NASD when any of 10 different specified events occurs. These 10 events vary significantly, ranging from situations where a court, government agency, or self-regulatory organization (SRO) has determined there has been a violation of the securities laws, to circumstances where a firm has received a written customer complaint alleging theft or misappropriation of funds or securities, or forgery. Subsection (b) of the proposed rule requires each person associated with an NASD member to properly report to the member the existence of any of the 10 conditions set forth in Subsection (a) of the proposed rule. Subsection (b) also requires members to report to the NASD the existence of any of the conditions set forth in Subsection (a) not later than 10 business days after the member knows or should have known of the existence of such conditions.