

initial evaluation or finding of reasonable cause, may lead to reports that are based on false information. This allegedly could result in damage to the reputation of members and associated persons who are innocent of wrongdoing. Therefore, commenters suggested that members be given an opportunity to screen customer complaints for veracity before filing, or to permit the filing of later reports to correct previously reported information after a member investigation.

#### Section (a)(3)

Four comments were made on this provision. Two commenters suggested that the reporting of prospective legal action may lend undeserved credibility to the accusations and may be prejudicial. In addition, one commenter stated that the proposal does not distinguish between minor and major violations and ventures into areas that are not within the jurisdiction of the NASD (i.e., insurance regulations, bank and trust company regulations).

Lastly, one commenter suggested that the definition of "proceedings" be defined and suggested adopting portions of the definition found on Form BD dealing with civil proceedings. The basis for the comment was to account for the differences among the various administrative procedures and regulatory processes of the 50 states, their agencies, and federal agencies and SROs.

#### Section (a)(4)

Three commenters on this provision suggested that the member should not have to report these matters to a second database when the information is already reported through the CRD system. Another commenter requested clarification of whether an action had to reach a final order or adjudication before reporting to the NASD.

#### Section (a)(5)

The majority of commenters to this section suggested that the proposed provision be revised to narrow the nature and range of offenses to securities related activities and determine a level of progression beyond arrest and arraignment before reporting to the NASD. In addition, several commenters suggested that current reporting under CRD system through Form U-4, question 22, is sufficient and was designed to obtain information that has a direct bearing on an individual's fitness to be employed in the securities industry.

#### Section (a)(6)

Five commenters submitted comments on this provision. Two commenters suggested modifications to the proposed rule to restrict the provision's application to persons with a "control relationship" with the entity (i.e., director, controlling shareholder, partner, officer or sole proprietor). According to the commenters, it is reasonable to attribute some responsibility to the person if he or she is in a control or principal relationship with the entity, not if the person is solely "associated" with the entity. Another commenter suggested that, unless the registered person notified the member of its activities, it would be difficult to comply with this provision.

#### Sections (a)(7) and (a)(8)

The commenters suggested that this provision required clarification for a number of specific fact situations. One commenter suggested that the reporting thresholds are too low for both the individual and the firm in today's litigious society and inflationary times, but did not provide any suggestions for alternate amounts.

#### Section (a)(9)

Several commenters suggested that this proposed provision is too broad and does not support its stated purpose. Comments included the difficulty for registered persons and firms to make the required determination of whether a person is "subject" to a statutory disqualification. According to the commenters, a registered person may enter into a business relationship with an individual without knowledge that the person committed a felony, not involving securities or investments, within the past ten years.

Other commenters suggested that the proposed provision should be modified to require reporting when a member or registered person "knows or learns" of the relationship with a statutorily disqualified person.

Two commenters suggested that it will be difficult for the member to comply without actual knowledge conveyed to them from the registered persons. One commenter suggested that the proposed provision is inconsistent with the intent to obtain information for the timely identification of problem broker-dealers and registered persons, in that, the information requested involved *de minimis* securities activities, non-securities business relationships, and similar situations.

One commenter mentioned the proposed provision be expanded to include the requirement to report detail

about the associated person's relationship with the statutorily disqualified person, such as, the nature of their business relationship.

#### Response to Comments

The most significant concerns of the commenters focused on (1) duplicative reporting; (2) public availability of the data to be reported; (3) the reporting of unresolved customer complaints; (4) the reporting protocol; (5) member obligations to ensure that their associated persons disclose reportable events to them; (6) the reporting of a broad array of violations; and (7) reporting arrests.

#### Duplicative Reporting

Many commenters did not recognize that existing reporting obligations, particularly through Form U-4, do not cover some of the most crucial information contained in the proposal. For example, Form U-4 does not and will not collect data on statutory disqualifications, internal disciplinary actions, or quarterly statistical data on customer complaints. Also, Form U-4 information is presently collected through the CRD system for registration and licensing purposes. That data is not available to the NASD staff on a routine, systematic, or timely basis for regulatory purposes and will not be available in the foreseeable future. On the other hand, the proposed rule is designed to separately collect data on a timely basis to substantially enhance regulatory initiatives relating to the detection of sales practice violations through the early identification of problem registered representatives. Significantly, the proposed rule squarely responds to SEC and GAO report recommendations. Those reports strongly urge the NASD to adopt a rule similar to NYSE Rule 351 for the purpose of enhancing sales practice initiatives and identifying problem registered representatives through the analysis of customer complaint patterns and other relevant information. Also responsive to concerns regarding duplicative reporting is the provision of the proposed rule which exempts members that have substantially similar reporting requirements to another SRO (i.e.: the NYSE under Rule 351). Further, upon implementation of the redesigned CRD which will provide more ready access to registration information, the NASD will undertake to review the proposed reporting rule to determine whether certain of the duplicative requirements may be eliminated. To the degree that such modifications are feasible, the NASD would intend to delete such provisions from the proposed rule.