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April 13, 2009

Ms. Elizabeth M. Murphy, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: Proposed FINRA Rule Change Relating to Proposed Changes  
to Forms U4 and U5  
File No.: SR-FINRA-2009-008 – Comment Letter**

Dear Ms. Murphy:

I write this letter on behalf of the National Society of Compliance Professionals (“NSCP”). NSCP is the largest nonprofit membership organization dedicated to serving and supporting compliance officials in the securities industry, with a membership of more than 1,700, including professionals from broker-dealers, investment advisers, banks, insurance companies, hedge funds and law firms. It serves compliance professionals exclusively through education, certification (CSCP), publications, consultation forums, and regulatory advocacy.

NSCP appreciates the opportunity to comment on FINRA’s proposed rule change relating to Forms U4 and U5 (the “Proposed Rule”) and these comments are intended to offer constructive observations. This letter focuses on two provisions of the Proposed Rule.

These provisions would introduce new disclosure obligations on the two registration forms, requiring firms to: (1) identify individuals and firms subject to statutory disqualification pursuant to § 15(b)(4)(D) or (E) of the Exchange Act (i.e., “willful violations”); and (2) report alleged sales practice violations in arbitration or litigation involving registered persons, including in matters in which the registered person is *not named* as a party.

NSCP strongly supports the public policy underpinnings for the registration forms and the proposed changes to provide prompt, proper and complete filings of all relevant reportable information. These goals should be advanced in the most practicable and cost-effective manner. It is also critical that reporting requirements be devised that are capable of being implemented in a clear and consistent manner, and not be open to vague or arbitrary application. With these objectives in mind, we offer the following specific comments on the two proposed changes.

### **Proposed Revisions Regard Willful Violations**

The proposed rule change would add new Questions 14C(6), (7) and (8) and Questions 14E(5), (6) and (7) to the Form U4 and would add Question 12C to the Form U5 Regulatory Action DRP. These new questions seek to elicit from registered persons whether the SEC or CFTC has ever found the person:

(1) “to have willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the Municipal Securities Rulemaking Board, or found [the person] to have been unable to comply with any provision of such Act, rule or regulation.”

(2) “to have willfully aided, abetted, counseled, commanded, induced, or procured the violation by any person of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the Municipal Securities Rulemaking Board,” or

(3) “failed reasonably to supervise another person subject to [the person’s] supervision, with a view to preventing the violation of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the Municipal Securities Rulemaking Board.”

According to the Rule Proposal:

[F]irms will need to determine promptly whether any of their registered persons have been subject to an action that requires reporting. Firms then will be required to amend Forms U4 to respond to these new questions the first time they file a Form U4 amendment after the effective date of the proposed rule change, but no later than 120 days following the effective date of the proposed rule change.

FINRA states in the rule filing that it “appreciates that adding new disclosure requirements to Form U4 will require firms to amend (or refile) such forms for the registered persons, and that this requirement may place an administrative burden on firms.” (Emphasis added.) NSCP regards this proposed new disclosure requirement as warranted and appropriate. It will assist regulators in determining whether an applicant or registrant is subject to a “statutory disqualification” as defined in Section 3(a)(39) of the Securities Exchange Act of 1934, as amended. Importantly,

and in contrast to the second change discussed later in this letter FINRA has indicated that new disclosure requirement will not just apply prospectively to newly registered personnel. Rather, this amendment will also require firms to ascertain the accuracy of the Form U4 filings of all of their currently registered personnel. In recognition of this administrative burden, FINRA has provided for a 120-day compliance implementation period.

While we appreciate FINRA's recognition of the administrative burden imposed by retroactive application of this change, and this intended implementation period, we believe compliance burdens during this transition process for currently registered personnel could be made more manageable with a limited additional, implementation alternative. Many broker-dealers employ some form of annual information collection process by which they require their currently registered personnel to provide compliance-related information. Typically, these procedures ask registered personnel to verify the continuing accuracy of previously disclosed information, including the information contained on their Forms U4, and to report to the firms any new disclosures. Often, personnel are asked to certify to the disclosures. These annual updates can be collected manually, but are most often obtained electronically. It would appreciably reduce the burdens on firms that have such annual compliance certification programs if determinations regarding the new questions could be incorporated into the annual process. Accordingly, we would request FINRA to consider, in addition to the proposed 120 day implementation schedule, permitting firms alternatively to obtain the requested information during the course of a regularly scheduled annual compliance certification process, so long as the information is obtained no later than December 31, 2009.

In addition to the above, we would appreciate clarification from FINRA regarding the steps it would deem sufficient for a member firm to "determine" whether any of their registered personnel have reportable matters. The following are some specific questions raised by our members. Will requesting the information from registered persons be sufficient due diligence? Is a firm required to seek formal certifications from its registered persons or would a simple survey (e.g., an outside business activity survey) suffice? Must firms independently search Commission, CFTC or SRO data bases to confirm the accuracy of registered personnel representations? Will firms have to consult with outside counsel about whether or not the action

trips the reporting requirement? Clarification regarding FINRA's expectations regarding the manner in which determinations are to be made will foster improved compliance and avoid the need for firms to conduct follow-up surveys if their initial approach is deemed inadequate.

### **Reporting Where The Registered Person Is Not A Named Party**

The Proposed Rule would revise Forms U4 and U5 to require the reporting of allegations of sales practice violations against registered persons in a civil lawsuit or arbitration *in which the*

***registered person is not a named party.*** NSCP urges FINRA to reconsider the appropriateness of this proposal. The approach embodied in the current Form U4 and U5 reporting requirements respects the stated intent of the complainant. If an arbitration or lawsuit is filed against a firm, and no registered personnel are named, the registered person is not required to report the action as a customer complaint. The customer's intent or decision not to name the registered person is not second-guessed. In almost all cases, the complainant will be represented by counsel. Hence, the decision to name or not to name any registered individuals in addition to the firm will generally be a deliberate one. It is reasonable for regulatory reporting system to honor that determination. This current approach also has the significant advantage of being objective, mechanical and largely free from second-guessing.

We appreciate that there will be instances in which the pleadings in an arbitration or lawsuit will leave little, if any, doubt that the complainant is voicing sales practice complaints against a specific identified registered person at the firm against which the suit has been filed. In many cases, however, we are concerned that the determination of whether one or more registered persons are the subject of alleged sales practice violations will be more difficult to discern.

For example, if a lawsuit alleges that misstatements have been made, or disclosures omitted, about the risks associated with an investment in a structured product, should the firm identify all registered persons associated with the development of the product? Should the firm name only the head of product development? Should the firm only name the point of sale contact?

If a lawsuit relates to an account serviced by multiple registered representatives, none of whom had "primary" responsibility to service the client, is a sales complaint about a product a trigger for reporting everyone "on the account?" How should a lawsuit be handled that clearly sets forth point of sale misrepresentations but declines (perhaps deliberately) to identify by name the complaining customer's registered representative.

We believe similar uncertainty may arise about reporting requirements related to sales practice supervision. The rule proposal does not explicitly state whether alleged sales practice supervision deficiencies would be required to be reported. Notably, supervisory negligence is alleged in virtually every retail sales practice securities arbitration. NSCP believes that the Proposed Rule would have been more workable in a time, now long gone, when only "traditional" broker-client relationships prevailed. As it is, there are many business models where, although the sales practice issue is readily identifiable, the responsible registered person or persons is not.

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We are concerned about the potential litigation exposure created for member firms by this proposal. As FINRA is aware, member firms historically have borne the risk that scrupulous reporting on Forms U4 and U5 will be characterized as overzealous or malicious by the subject registered person and could subject the firm to a defamation action by the aggrieved registrations. We believe this risk will be significantly increased by a requirement to disclose on Form U4 or U5 arbitrations or lawsuits in which the registered person is not a captioned party, and possibly not even identified by name anywhere within the suit.

NSCP would be pleased to discuss the issues we have addressed in this letter with FINRA staff, and we would be happy to arrange a dialogue between FINRA staff and NSCP members from a cross-section of firms if that would be helpful. Please contact me at 860.672.0843 with any questions. Thank you.

Sincerely,

A handwritten signature in black ink, appearing to be 'Joan Hinchman', with a long horizontal flourish extending to the right.

The National Society of Compliance Professionals, Inc.

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