



National Association of Insurance and Financial Advisors

2901 Telestar Court • Falls Church, VA 22042-1205 • (703) 770-8188 • www.naifa.org

April 17, 2009

Florence Harmon
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Via Electronic Mail: rule-comments@sec.gov

Re: SEC Request for Comments on FINRA's Proposed Rule Change to Amend Uniform Application for Securities Industry Registration or Transfer (Form U4) and Uniform Termination Notice for Securities Industry Registration (Form U5) ([File Number SR-FINRA-2009-008](#)).

Dear Ms. Harmon:

This letter will present the views of the National Association of Insurance and Financial Advisors ("NAIFA") in response to the Securities and Exchange Commission's request for comments on the issues raised by FINRA's Proposed Rule Change to Amend Uniform Application for Securities Industry Registration or Transfer (Form U4) and Uniform Termination Notice for Securities Industry Registration (Form U5) (collectively, the "Forms").

NAIFA is a national federation of over 700 state and local associations, whose members live and work in every congressional and state legislative district. The 60,000 members of these associations are bound by NAIFA's Code of Ethics and are full time professionals in insurance and related financial services. Founded in 1890, NAIFA is the nation's oldest and largest trade association of insurance and financial services professionals. NAIFA's mission is to improve the business environment, enhance the professional skills and promote the ethical conduct of agents and others engaged in insurance and related financial services that assist the public in achieving financial security and independence. Over half of all NAIFA members are licensed as registered representatives of broker-dealers and market and service mutual funds.

FINRA recently filed with the SEC a proposed rule change that would revise certain questions on the Forms and require significant changes in the reporting of certain disclosure items on the Forms. While NAIFA believes that certain elements of the FINRA proposal are warranted and appropriate, NAIFA is specifically concerned about a revision to the Forms that would require the reporting of allegations of sales practice complaints made against registered persons in a civil lawsuit or arbitration proceeding, even if the registered person is not named as a party in the arbitration claim or civil litigation. Reporting would be required if the registered person was either named in or could reasonably be identified from the body of the arbitration claim or civil litigation as a registered person who was involved in one or more of the alleged sales practice violations.

NAIFA recognizes the importance of investor protection and applauds FINRA's efforts to safeguard investor interests. Indeed, we believe that some of the provisions in the proposed rule change will serve that end. We are deeply concerned, however, about the aforementioned provision regarding the broad disclosure of arbitration proceedings or civil litigation to elicit reporting of allegations of sales practice violations made against a registered person in arbitration or litigation in which that person is not named as a party. Under the current reporting requirements, a registered person is not required to report that a customer has alleged a sales practice violation against such person in the body of a lawsuit or arbitration claim, unless the registered person also has been named as a defendant or a respondent. We believe that requiring registered persons to disclose such allegations in proceedings in which the registered person is not a named party would have a number of deleterious consequences.

Our comments will focus on the following points:

- First, requiring registered persons to report allegations of sales practice violations made against a registered person in arbitration or litigation in which that person is not named as a party would result in uncertainty, inconsistent application, and ultimately the information elicited would be regarded by consumers as unreliable.
- Second, as a matter of fairness, it is troubling that a registered person would have to officially report unsubstantiated claims, which the person would have no opportunity to defend or refute.
- Third, the standards proposed by the rule change are ambiguous; a registered person must report an alleged sales practice violation if the person can be "reasonably identified from the body of the arbitration claim or civil litigation." This standard provides no bright-line rule, and it is unclear to what lengths a registered person must go to make this determination.

1. The proposed rule change would result in uncertainty, inconsistent application, and ultimately the information elicited would be regarded by consumers as unreliable.

The proposed rule change would require a registered entity, though not named as a respondent or defendant in a customer-initiated arbitration or civil lawsuit, to report if it was either named in, or could be reasonably identified from, the body of the arbitration claim or civil litigation as a registered person who was involved in one or more of the alleged sales practice violations. A registered person would be required to report after it has made a “good faith determination” after a “reasonable investigation” that the alleged sales practice violation involved the registered person.

The proposed standard poses a difficult administrative problem, namely that a registered person is required to report a claim even though it is not a party to the claim and has not necessarily been notified of the claim’s existence. A registered person is thus potentially required to conduct a “reasonable investigation” into claims that it has no reason to believe will apply to that registered person, on the chance that it will discover somewhere in a claim a reference to itself. Considering the number of claims and civil litigation cases filed, the administrative burden imposed by this rule is substantial.

This proposed standard is ambiguous, untenable and imposes an unreasonable burden on registered persons, and will necessarily lead to inconsistent compliance. Only registered persons with the resources and wherewithal to undertake these investigations will be able to comply. Additionally, because of the amount of discretion allowed to registered persons as to what can be considered “reasonable” and “good faith,” the standard for reporting will vary widely. Inconsistency in the application of these standards will result in inconsistent and varying levels of reporting, and ultimately generate a sense that the reports are unreliable, the result being that the Forms will cease to be a valuable public resource.

In sum, the standard is too ill-defined, and leaves too much to the discretion of the individual registered persons. In the interests of maintaining consumer confidence in the information elicited by the Forms, it is important to have a fair and bright-line standard that can be easily applied.

2. The proposed rule change is troubling because a registered person would be required to officially report vague and unsubstantiated claims which it would have no opportunity to defend or refute.

Although the spirit of this proposed rule change is to give investors more information, the public as a whole is not served by being exposed to every rumor, no matter how tenuously related to fact. The unintended consequence of this proposed rule change is will be potentially significant damage to the hard-earned reputation of the registered person. This should not be tolerated until clear and convincing proof exists. Furthermore, a named party in a lawsuit or arbitration has an opportunity to refute the allegations against him and “clear his name.” Someone who has not been named as a party in a lawsuit or arbitration does not have this same opportunity or ability, and any allegations

made against him will likely go unanswered and unchallenged. The damage has been done even if the claim is completely frivolous.

We strenuously oppose the imposition of this “guilty before charged” standard which could result in reputations built on trusted relationships and livelihoods being irreparably damaged by unsubstantiated claims made in a proceeding in which a person has not been named as a defendant or respondent. While we strongly believe that people who engage in unscrupulous or misleading sales practices should be aggressively prosecuted and subject to appropriate and meaningful sanctions, the SEC should not allow a person’s reputation to be irreparably damaged by unproven claims or allegations made in a lawsuit or arbitration proceeding in which the individual has not been named as a party.

Registered persons should be allowed a meaningful opportunity to respond to unadjudicated allegations before having their reputation sullied through the reporting of these matters.

3. The lengths to which registered persons must go to remain in compliance are undefined; the proposed rule change provides no bright-line rule, and it is unclear to what lengths a registered person must go to make this determination.

As a final point, we wish to emphasize that the vague standards proposed by FINRA give no substantive guidance to well-meaning registered persons attempting to determine whether they are involved in a claim. The wording of the proposed standard reveals an important ambiguity. Realizing that whether a claim involves a particular registered person may not always be a straightforward matter, FINRA chose to include language that requires registered persons to make a “good faith determination.” In other words, FINRA is contemplating that some registered person may not even be mentioned by name in the body of a claim or civil suit, but it is nonetheless the responsibility of a registered person to discover such occurrences.

As noted above, it is unclear whether “good-faith” determinations should be made using only the “four corners” of a document alleging a sales practice violation against another party, or alternatively, whether registered persons are required to take into account information found in newspapers, public filings or other sources to arrive at a determination that it is involved in a claim. Moreover, it is not clear if registered persons are required to consider non-public information in their “good faith” determinations.

The consequences of this proposed change are far-reaching and will have substantial negative effects on otherwise compliant registered persons.

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In sum, NAIFA strongly recommends that FINRA’s proposed changes to Forms U4 and U5, requiring registered persons to report allegations of sales practice violations made

against a registered person in arbitration proceeding or litigation in which that person is not named as a party, not be adopted. The current standard provides both valuable benefits to investors and a clear-cut standard which enables registered persons to remain in compliance.

Thank you for your consideration of our views. Please contact the undersigned if you have any questions regarding our comments.

Yours Truly,

/s/ Gary A. Sanders

Gary A. Sanders
Vice President
Securities and State Government Relations