

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-55127; File No. SR-NASD-2003-168)

January 18, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Amendment No. 6 and Order Granting Accelerated Approval to Proposed Rule Change Relating to the Release of Information Through NASD's BrokerCheck

I. Introduction

On November 21, 2003, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend NASD Interpretive Material ("IM") 8310-2 (as proposed, "NASD BrokerCheck Disclosure") and add IM-8310-3 ("Release of Disciplinary Complaints, Decisions and Other Information"). NASD filed Amendment Nos. 1, 2, and 3 to the proposed rule change on September 28, 2004, March 8, 2005, and April 12, 2005, respectively. The proposed rule change, as amended by Amendment Nos. 1, 2 and 3, was published for comment in the Federal Register on June 30, 2005.<sup>3</sup> In response to the First Notice, the Commission received eight comment letters.<sup>4</sup> On June 6, 2006, NASD submitted a response to the comment

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 51915 (June 23, 2005), 70 FR 37880 ("First Notice").

<sup>4</sup> See Letters from Barry Augenbraun, Senior Vice President and Corporate Secretary, Raymond James Financial, Inc., dated July 8, 2005 ("Raymond James Letter"); Joseph D. Fleming, Managing Director and Chief Compliance Officer, Piper Jaffray & Co., dated July 13, 2005 ("Piper Jaffray Letter"); Ronald C. Long, Senior Vice President, Regulatory Policy and Administration, Wachovia Securities, LLC, dated July 18, 2005 ("Wachovia Letter"); Mario Di Trapani, President, Association of Registration Management, dated July 19, 2005 ("ARM Letter I"); John S. Simmers, CEO, ING Advisors Network, dated July 19, 2005 ("ING Letter"); Coleman Wortham III, President and CEO, Davenport & Company LLC, dated July 20, 2005 ("Davenport Letter"); Jill

letters<sup>5</sup> and filed Amendment No. 4 to the proposed rule change. On June 22, 2006, NASD filed Amendment No. 5 to the proposed rule change. The Commission published the proposed rule change, as further amended by Amendment Nos. 4 and 5, for comment in the Federal Register on July 5, 2006.<sup>6</sup> In response to the Second Notice, the Commission received four comment letters.<sup>7</sup> On August 30, 2006, NASD submitted a response to the additional comment letters<sup>8</sup> and filed Amendment No. 6 to the proposed rule change.<sup>9</sup> The Commission received one comment letter on NASD Response Letter II.<sup>10</sup>

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Gross, Director of Advocacy, and Rosario M. Patane, Student Intern, Pace Investor Rights Project, dated July 21, 2005 (“Pace Letter”); and Ira Hammerman, Senior Vice President and General Counsel, Securities Industry Association, dated July 27, 2005 (“SIA Letter I”) to Jonathan G. Katz, Secretary, Commission.

<sup>5</sup> See Letter from Richard E. Pullano, Associate Vice President and Chief Counsel, Registration and Disclosure, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation (“Division”), Commission, dated June 6, 2006 (“NASD Response Letter I”).

<sup>6</sup> See Securities Exchange Act Release No. 54053 (June 27, 2006), 71 FR 38196 (“Second Notice”).

<sup>7</sup> See Letters from Pamela S. Fritz, Chief Compliance Officer, MWA Financial Services, Inc., dated July 18, 2006 (“MWA Financial Letter”); Eileen O’Connell Arcuri, Executive Committee Member, ARM, dated July 20, 2006 (“ARM Letter II”); Stuart J. Kaswell, Senior Vice President and General Counsel, SIA, dated July 20, 2006 (“SIA Letter II”); and Patricia D. Struck, NASAA President, Wisconsin Securities Administrator, North American Securities Administrators Association, Inc. (“NASAA”), dated July 20, 2006 (“NASAA Letter I”) to Nancy M. Morris, Secretary, Commission.

<sup>8</sup> See Letter from Richard E. Pullano, Associate Vice President and Chief Counsel, Registration and Disclosure, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated August 30, 2006 (“NASD Response Letter II”).

<sup>9</sup> See Partial Amendment dated August 30, 2006. In Amendment No. 6, NASD indicated that it is amending its initial proposal which would have changed the manner in which it will measure the two-year time frame for customer complaint disclosures to begin on the date on which the member received the complaint. Accordingly, for purposes of disclosure pursuant to IM-8310-2, NASD will continue to disclose complaints through BrokerCheck for 24 months, beginning on the date that the complaint is reported to the Central Registration Depository (“CRD®” or “CRD System”), regardless of the date on which the member received the complaint. In addition, NASD clarified that it currently releases summary information concerning arbitration awards issued by NASD arbitrators

This order grants accelerated approval to the proposed rule change, as amended by Amendment Nos. 1 through 6 and solicits comments from interested persons on the filing as amended by Amendment No. 6.

## II. Description of Proposed Rule Change

### A. Background

NASD established NASD BrokerCheck (“BrokerCheck”) in 1988 to provide investors with information on the professional background, business practices, and conduct of NASD members and their associated persons. In 1990, Congress passed legislation requiring NASD to establish and maintain a toll-free telephone number to receive inquiries regarding its members and their associated persons. In 1998, NASD began providing certain administrative information, such as approved registrations and employment history, online via NASD’s Web site. In 2000, NASD amended IM-8310-2(a) which amendment: (1) established a two-year period for disclosure of information about persons formerly registered with NASD; (2) authorized release of information about terminated persons and firms that is provided on the Form U6 (the form regulators use to report disciplinary actions), if such matters would be required to be reported on Form U4 (“Uniform Application for Securities Industry Registration or Transfer”) or Form BD (“Uniform Application for Broker-Dealer Registration”); and (3) provided for delivery of automated disclosure reports, which include information as reported by filers on the uniform forms. In 2002, NASD initiated a comprehensive review of the information

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and will continue to work with other regulators regarding disclosure of arbitration awards issued in other forums. In conjunction with this clarification, NASD proposed to amend the text of proposed IM-8310-2(b)(3) to correct the placement of the word “certain” so that it modifies “arbitration awards” rather than “summary information.”

<sup>10</sup> See Letter from Patricia D. Struck, NASAA President, Wisconsin Securities Administrator, NASAA, to Nancy Morris, Secretary, Commission, dated September 7, 2006.

that NASD makes publicly available under IM-8310-2, which included an evaluation of BrokerCheck from the perspective of public investors regarding their experience in obtaining information, as well as their assessment of the value of the information they received. NASD subsequently issued Notice to Members 02-74 in November 2002, seeking comment on, among other things, the possible expansion of information that NASD makes available to the public and Notice to Members 03-76 in December 2003, seeking comment on proposed enhancements to the existing approach for the electronic delivery of written reports used by BrokerCheck.<sup>11</sup>

B. Proposed Rule Change

Information NASD Proposes to Release

While all disclosures would be subject to certain exceptions as described more fully below, NASD proposes to release through BrokerCheck certain information as applicable regarding current or former members, associated persons, or persons who were associated with a member within the preceding two years. Under proposed IM-8310-2, NASD would release any information reported on the most recently filed Form U4, Form U5 (“Uniform Termination Notice for Securities Industry Registration”), Form U6, Form BD, and Form BDW (“Uniform Request for Broker-Dealer Withdrawal”) (collectively, “Registration Forms”).

NASD also proposes to release currently approved registrations, summary information about certain arbitration awards against a member involving a securities or commodities dispute with a public customer,<sup>12</sup> information with respect to qualification examinations passed by the

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<sup>11</sup> See First Notice for a discussion on the comments received on Notice to Members 02-74 (November 2002) and Notice to Members 03-76 (December 2003).

<sup>12</sup> NASD currently releases summary information concerning arbitration awards issued by NASD arbitrators and will continue to work with other regulators regarding disclosure of arbitration awards issued in other forums. See Amendment No. 6, supra note 9.

person and the date passed,<sup>13</sup> and, in response to telephonic inquiries via the BrokerCheck toll-free telephone listing, whether a member is subject to the provisions of NASD Rule 3010(b)(2), the Taping Rule. In addition, NASD proposes to release the name and succession history for current or former members.

The proposed rule change also would address the reporting of Historic Complaints, defined by NASD as the information last reported on Registration Forms relating to customer complaints that are more than two years old and that have not been settled or adjudicated, and customer complaints, arbitrations, or litigations that have been settled for an amount less than \$10,000 and which are no longer reported on a Registration Form.<sup>14</sup> NASD proposes to release Historic Complaints only if all three of the following conditions have been met: (1) any such matter became a Historic Complaint on or after the implementation date of this proposed rule change;<sup>15</sup> (2) the most recent Historic Complaint or currently reported customer complaint, arbitration, or litigation is less than ten years old; and (3) the person has a total of three or more currently disclosable regulatory actions, currently reported customer complaints, arbitrations, or litigations, or Historic Complaints (subject to the limitation that they became a Historic Complaint on or after the implementation date of this proposed rule change), or any combination thereof. Once all these conditions have been met, NASD would release all information regarding the person's Historic Complaints, again provided they became Historic Complaints on or after the implementation date of this proposed rule change.

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<sup>13</sup> NASD would not, however, release information regarding examination scores or examinations that the person failed.

<sup>14</sup> NASD does not currently make Historic Complaints available to the public.

<sup>15</sup> NASD has indicated that the implementation date of this proposed rule change would be no later than 90 days following Commission approval.

NASD also proposes to provide persons with the opportunity to submit a brief comment, in the form and in accordance with procedures established by NASD, which would be included in the information NASD releases through BrokerCheck. Only comments relating to the information provided through BrokerCheck would be included.<sup>16</sup> Persons who were associated with a member within the preceding two years but who are no longer registered with a member that wish to submit a comment would be required to submit a signed, notarized affidavit in the form specified by NASD.<sup>17</sup> Persons who are currently registered with a member firm would continue to be required to amend Form U4, where possible, instead of submitting a separate comment.<sup>18</sup> These comments also would be made available through the CRD system to participating regulators, and to any member firms that the person who submitted the comment is associated with or is seeking to be associated with.<sup>19</sup>

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<sup>16</sup> Consistent with current practice, NASD would reserve the right to reject comments or redact information from a comment or a report, on a case-by-case basis, that contains confidential customer information, offensive or potentially defamatory language or information that raises significant identity theft, personal safety or privacy concerns, which concerns are not outweighed by investor protection concerns. NASD, in rare circumstances, has excluded or redacted information in cases involving stalking or terrorist threats.

<sup>17</sup> NASD would publish instructions for submitting comments on its Web site for such persons. NASD would review the affidavit to confirm relevance and compliance with the established instructions and, if it met the criteria, would add the comment to the written report provided through BrokerCheck. The person submitting the comment would be able to replace or delete the comment in the same way.

<sup>18</sup> NASD indicated that it would include instructions on how firms could amend archived disclosures in a Notice to Members announcing approval of this proposed rule change and also would post frequently asked questions and answers about this process on NASD's Web site. See NASD Response Letter I.

<sup>19</sup> The availability of comments submitted by persons who were associated with a member within the preceding two years but who are no longer registered with a member through the CRD system would parallel the availability of a report on a broker through BrokerCheck. For example, such comments would no longer be available through the CRD system if the broker has been out of the industry for more than two years.

NASD also proposes that, upon written request, NASD could provide a compilation of information about NASD members, subject to terms and conditions established by NASD, and after execution of a licensing agreement prepared by NASD. NASD expects to charge commercial users of such compilations reasonable fees as determined by NASD.<sup>20</sup> Such compilations of information would consist solely of information selected by NASD from Forms BD and BDW and would be limited to information that is otherwise publicly available from the Commission.

#### Information NASD Proposes Not to Release

Notwithstanding information that NASD proposes to release above, NASD would not release Social Security numbers, residential history information, physical description information, information that NASD is otherwise prohibited from releasing under Federal law or information provided solely for use by regulators. Additionally, NASD proposes to reserve the right to exclude, on a case-by-case basis, information that contains confidential customer information, offensive or potentially defamatory language, or information that raises significant identity theft, personal safety, or privacy concerns that are not outweighed by investor protection concerns.

NASD also proposes not to release information about current or former members, associated persons or persons who were associated with a member within the preceding two years that has been reported on the Registration Forms relating to regulatory investigations or proceedings if the reported regulatory investigation or proceeding was vacated or withdrawn by the instituting authority. Additionally, NASD proposes not to release the most recent information reported on the Registration Forms if: (1) NASD has determined that the

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<sup>20</sup> The Commission notes that such proposed fees would need to be filed with the Commission pursuant to Section 19(b)(2) of the Act.

information was reported in error by a member, regulator, or other appropriate authority; or (2) the information has been determined by regulators, through amendments to the uniform Registration Forms, to be no longer relevant to securities registration or licensure, regardless of the disposition of the event or the date the event occurred.

With respect to information reported on the Form U5, NASD proposes not to release Form U5 information for 15 days following the filing of such information with NASD, in order to give persons on whose behalf the Form U5 was submitted an opportunity to file a Form U4 or submit a separate comment to NASD for inclusion with the information released pursuant to BrokerCheck, regarding disclosure information reported on Form U5 and any amendments thereto. NASD would then release both the Form U5 disclosure and the person's comment, if any, to a requestor. However, NASD proposes to continue its current practice of not releasing "Internal Review Disclosure" information reported by members, associated persons, or regulators on Section 7 of Form U5<sup>21</sup> or the "Reason for Termination" information reported on Section 3 of Form U5. Nonetheless, under IM-8310-2, as proposed, information regarding certain terminations for cause (*i.e.*, those that meet the criteria in current Question 7F on Form U5) would be disclosed through BrokerCheck. Finally, NASD currently does not release information reported on Schedule E of the Form BD.<sup>22</sup> Under the proposed rule change, NASD would continue not to release this information.

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<sup>21</sup> Although the response to the internal review question and related information reported on the associated disclosure reporting page would not be released, if the matter subject to the internal review is or becomes reportable under the investigation, termination, or other disclosure questions, the disclosure made pursuant to these other disclosure questions would be released.

<sup>22</sup> The Commission notes the Division has granted no-action relief indicating that it will not recommend enforcement action to the Commission under Rules 15b1-1, 15b3-1, 15Ba2-2, and 15Ca2-1 under the Act for broker-dealers that file the Uniform Branch Office Registration Form ("Form BR"), and do not complete Schedule E, or file amendments to

### Electronic Delivery of Written Reports

Currently, NASD makes written reports available to the public by U.S. mail in printed form and by email in an electronic format upon receipt of a request via email or the established toll-free number. Due to a number of practical issues that have arisen regarding email delivery, NASD plans to replace the current delivery approach with a link to a controlled-access server that would allow access to the requested report through a secure Internet session in response to inquiries via email or through the established toll-free number. Access to the information would be limited to the written report requested, and only the individual making the request would be granted access to the database. A requestor also would be able to view investor education materials that would aid him or her in understanding the written report. NASD also would continue to provide hard copy reports to those requesting hard copies.

### Other Changes

NASD also proposes to make conforming changes to IM-8310-2, including making various numbering and lettering changes, moving former subsections (b) through (m) into new IM-8310-3, and updating references to “the Association” and “NASD Regulation, Inc.”

### III. Comment Summary and NASD’s Response

As noted above, the Commission received eight comment letters with respect to the First Notice and four comment letters with respect to the Second Notice.<sup>23</sup> After the First and Second Notices, NASD filed two response letters, respectively, to address the concerns raised by the

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Schedule E, of the Form BD, as of the date on which the transition to the Form BR began and the CRD® no longer accepted Schedule E filings, which occurred in October 2005. See Letter from Catherine McGuire, Chief Counsel, Division, Commission, to Patrice M. Gliniecki, Senior Vice President and Deputy General Counsel, NASD, dated September 30, 2005.

<sup>23</sup> See supra notes 4 and 7.

commenters.<sup>24</sup> The Commission then received a second comment letter addressing NASD Response Letter II.<sup>25</sup>

Generally, the initial set of commenters took issue with the portion of the proposed rule change regarding disclosure of an individual's Historic Complaints, which includes information last reported on the Registration Forms relating to customer complaints that are more than two years old and that have not been settled or adjudicated and customer complaints, arbitrations, or litigations that have been settled for an amount less than \$10,000 and are no longer reported on a Registration Form. Although one commenter suggested that all Historic Complaints should be disclosed to customers,<sup>26</sup> most of the commenters argued that the proposed changes to NASD's rules relating to Historic Complaints would have harmful effects on member firms and investors, with several of the commenters requesting that the Commission not approve the proposed rule change because of this provision.<sup>27</sup> For instance, several of the commenters believed that the release of a broker's Historic Complaints would give too much weight to unproven allegations and complaints and thereby could unfairly harm the broker's reputation.<sup>28</sup> These commenters

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<sup>24</sup> See NASD Response Letters I and II.

<sup>25</sup> See NASAA Letter II.

<sup>26</sup> See Pace Letter.

<sup>27</sup> See, e.g., Davenport Letter, Piper Jaffray Letter, Raymond James Letter, and Wachovia Letter. See also SIA Letter I (objecting to the proposed release of archived Historic Complaints).

<sup>28</sup> See, e.g., ARM Letter I, Davenport Letter, ING Letter, Piper Jaffray Letter, Raymond James Letter, SIA Letter I, and Wachovia Letter. One commenter believed this emphasis on unsubstantiated and unadjudicated customer complaints to be "fundamentally unfair" and that NASD's proposal "significantly erodes" due process and undermines the customer arbitration process. This commenter also asserted that registered representatives should have the opportunity to defend against regulatory allegations before such allegations are used as the basis of expanded adverse disclosure. See Davenport Letter. Another commenter argued that, unlike the current system, NASD's proposal would make it possible for frivolous claims to remain reportable as a Historic Complaint potentially for years to come and could allow a "vexatious complainant" to

argued that disclosure of all the complaints could be misleading to investors and invite them to form conclusions based on allegations that may not have merit and are not necessarily representative of a pattern of misconduct.<sup>29</sup> Two commenters also argued that disclosing archived complaints to the public would ignore the fact that this type of information was originally reported for regulatory purposes in connection with registration and licensing matters.<sup>30</sup> Similarly, another commenter indicated<sup>31</sup> that since the reporting process was “first and foremost a regulatory tool and not a public disclosure tool,” firms had often reported events that were not clearly reportable. This commenter believed that the proposed rule change would now have the effect of discouraging firms from reporting questionable matters.<sup>31</sup>

Furthermore, several commenters expressed concern that NASD’s proposal would inhibit firms from settling minor claims, since these could be publicly disclosed, and thereby create an incentive for firms to litigate customer complaints more often.<sup>32</sup> Some of these commenters asserted that the settlement of customer complaints does not necessarily indicate an acknowledgement of improper behavior by the broker, but rather is frequently the result of a

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place a broker in the continuous status of having all of its Historic Complaints disclosed by repeatedly making frivolous claims to meet the “three or more” standard. See Wachovia Letter.

<sup>29</sup> See, e.g., ARM Letter I, Davenport Letter, ING Letter, Piper Jaffray Letter, Raymond James Letter, SIA Letter I and Wachovia Letter. See also SIA Letter II.

<sup>30</sup> See ARM Letter I and SIA Letter I (arguing that the disclosure of Historic Complaints ignores the inherent differences between the CRD system, which is used by regulators, and the BrokerCheck system, which discloses to the public a subset of the information contained within the CRD system). See also ING Letter.

<sup>31</sup> See ING Letter.

<sup>32</sup> See, e.g., ARM Letter I, Davenport Letter, ING Letter, Piper Jaffray Letter, Raymond James Letter, SIA Letters I and II, and Wachovia Letter. See also ARM Letter II.

cost/benefit analysis or an effort to maintain client goodwill.<sup>33</sup> Accordingly, several of the commenters believed that the adverse impact on settlements would not serve the interest of investors or advance the public interest.<sup>34</sup> Additionally, believing that the proposal would encourage a broker to litigate customer complaints in order to protect its record, some commenters maintained that the increase in cost and time spent on customer complaints would adversely affect member firms and investors alike.<sup>35</sup>

A few commenters also opposed NASD's proposed threshold which would trigger the release of all Historic Complaints, *i.e.*, if the person has three or more currently disclosable regulatory actions, currently reported customer complaint, arbitration, or litigation disclosures, or Historic Complaint disclosures, and the most recent Historic Complaint or currently reported customer complaint, arbitration, or litigation is less than 10 years old.<sup>36</sup> While most of these commenters appeared to incorrectly understand NASD's proposed application of the ten-year condition,<sup>37</sup> these commenters generally believed that three disclosures over ten years would not

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<sup>33</sup> See, *e.g.*, ARM Letter I, Davenport Letter, ING Letter, Piper Jaffray Letter, Raymond James Letter, SIA Letter I and Wachovia Letter.

<sup>34</sup> See, *e.g.*, ING Letter, Piper Jaffray Letter, Raymond James Letter, SIA Letter I and Wachovia Letter.

<sup>35</sup> See, *e.g.*, ARM Letter I, ING Letter and Wachovia Letter. One commenter predicted that NASD Dispute Resolution would be overwhelmed by having to handle cases which otherwise would have been settled. See SIA Letter I.

<sup>36</sup> See, *e.g.*, ING Letter, MWA Financial Letter, SIA Letter I and Wachovia Letter. But see Pace Letter (arguing that the "three or more" disclosed incident threshold for reporting all Historic Complaints was too high and that BrokerCheck should disclose all Historic Complaints to customers).

<sup>37</sup> The Commission notes that most of these commenters misunderstood NASD's proposal, believing that NASD would release all Historic Complaint information, regardless of age, if the registered person has a total of three or more disclosures within a ten-year period. The Commission clarifies that the ten-year condition of NASD's proposal would require that only the most recent of the Historic Complaint or currently reported customer complaint, arbitration, or litigation must be less than ten years old, which would trigger disclosure of all Historic Complaints, if the other conditions are met.

necessarily be indicative of a pattern of conduct by the registered representative because it could include frivolous and baseless complaints filed against the representative.<sup>38</sup> Three of these commenters suggested that the threshold for reporting Historic Complaints should be amended to be five reportable events within a three-year period,<sup>39</sup> with one commenter also recommending that the look back for Historic Complaints should be limited to ten years.<sup>40</sup> One commenter also believed that certain types of complaints should be excluded from the list of disclosable events that would trigger reporting of Historic Complaints, such as certain complaints filed by joint or related account holders, operational complaints or those alleging primarily a product failure or poor performance.<sup>41</sup> Other commenters suggested that denied or unsubstantiated claims<sup>42</sup> and unadjudicated regulatory allegations<sup>43</sup> should not be counted towards the threshold requirement for disclosing Historic Complaints.

As part of their argument regarding the proposed rule's unfairness in disclosing trivial or frivolous claims, three commenters asserted that NASD's proposal to allow brokers to provide a brief commentary in response to the disclosed information would not provide an adequate safeguard for brokers.<sup>44</sup> As evidence of the proposed rule's imbalance against brokers, these

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<sup>38</sup> See, e.g., ING Letter, MWA Financial Letter, and SIA Letter I. See also Wachovia Letter.

<sup>39</sup> See ING Letter, MWA Financial Letter, and SIA Letter I.

<sup>40</sup> See ING Letter.

<sup>41</sup> See SIA Letter I.

<sup>42</sup> See ARM Letter I.

<sup>43</sup> See Davenport Letter.

<sup>44</sup> See Piper Jaffray Letter, Raymond James Letter, and Wachovia Letter. See also ARM Letter I and SIA Letter I (criticizing the expungement process as a viable remedy for a registered person to remove meritless claims from its record).

commenters pointed to the procedural obstacles that brokers would have to overcome in order to submit a comment.<sup>45</sup>

In addition, to address the harm of disclosing potentially misleading information to investors and to protect against potential abuses by disgruntled customers, a few commenters suggested adding certain protections to the proposal,<sup>46</sup> including changing the proposal so that Historic Complaints, by default, would not be disclosed unless NASD reviewed the matter to determine whether to disclose the Historic Complaints.<sup>47</sup> To assist investors in evaluating information regarding unadjudicated claims and de minimis settlements, the same commenter suggested that NASD insert a clarifying statement indicating that a matter may have been unadjudicated because the customer declined to pursue the matter or that it was settled for a modest amount to avoid litigation and should not be considered an admission of liability or responsibility.<sup>48</sup> Another commenter suggested that NASD require customers and their counsel to attest that they have a reasonable, good-faith basis for naming a registered person and that NASD provide to customers who are preparing to file claims additional investor education

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<sup>45</sup> For instance, two of these commenters believed that the comment process would be administered by a “skeptical NASD staff” that would have the right to reject any brief comment. See Piper Jaffray Letter and Raymond James Letter. The other commenter criticized the signed, notarized affidavit that certain brokers would have to provide in order to submit a comment. See Wachovia Letter. But see Pace Letter. This commenter supported NASD’s proposed comment process for associated persons to respond to disclosed material and believed it provided an opportunity for them to explain any information they perceive to be incomplete.

<sup>46</sup> See, e.g., SIA Letter I and Wachovia Letter.

<sup>47</sup> See Wachovia Letter. The commenter believed that, if brokers were aware that NASD would exercise discretion and judgment in determining when Historic Complaints should be disclosed, then brokers would have less of an incentive to litigate. Id.

<sup>48</sup> Id.

material explaining the implications of naming a particular registered person and the potential damaging implications.<sup>49</sup>

To address these concerns, NASD indicated that it has developed an educational component to the proposed BrokerCheck report and Web site that NASD believes would put Historic Complaints in the appropriate context and enable investors to give them appropriate weight when evaluating a particular firm or registered person.<sup>50</sup> Specifically, NASD noted that there would be an introductory section preceding the BrokerCheck report explaining that certain reported items may involve pending actions or allegations that may be contested and not resolved or proven, and that these items may be withdrawn or dismissed, resolved in favor of the registered person, or concluded through a negotiated settlement with no admission or conclusion of wrongdoing. In addition, NASD noted that the BrokerCheck report would include certain status information for each Historic Complaint that would indicate whether or not the complaint was settled. NASD also indicated that it would advise readers through the BrokerCheck report and its Web site that they should not rely solely on the information available through BrokerCheck and should consult other sources to the extent possible for information about the registered person.

In response to commenter's criticisms against the brief commentary mechanism that individuals can use to respond to disclosed information, NASD emphasized that registered persons would be able to submit information providing context and perspective about any event, including Historic Complaints. NASD noted that individuals typically provide such information in a comment section on the Form U4 at the time the event is reported, and that the registered individual can add to its previously submitted comment or comment for the first time through its

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<sup>49</sup> See SIA Letter I.

<sup>50</sup> See NASD Response Letter I.

firm using the CRD system.<sup>51</sup> In addition, NASD noted that individuals who are no longer registered would be able to provide comment through a signed affidavit to CRD. NASD also represented that it would not edit the comments, except that it reserved the right to reject or redact comments that contain confidential customer information, offensive or potentially defamatory language, or information that raises significant identity theft, personal safety or privacy concerns that are not outweighed by investor protection concerns.<sup>52</sup>

Furthermore, a few commenters expressed concern over the fairness of retroactively altering the rules regarding the disclosure of Historic Complaints, including the disclosure of settlements after such settlements have been made, since registered persons often agree to settlements based on the assumption that the settlement information would not become part of the public record or have long-term negative effects on their reputations or business relationships.<sup>53</sup> Two commenters suggested that NASD should prospectively implement its proposed rules regarding the disclosure of Historic Complaints and only disclose complaints reported after the effective date of the proposed rule change.<sup>54</sup>

In response to commenter's concerns that firms and registered persons may have made certain decisions relating to customer complaints, arbitrations, or litigations based on the current

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<sup>51</sup> If the proposed rule change is approved by the Commission, NASD represented that it will provide instructions in a Notice to Members on how firms may amend archived disclosures and will also post frequently asked questions and answers about this process on NASD's Web site. See NASD Response Letter I.

<sup>52</sup> According to NASD, each person, whether registered or formerly registered, will be responsible for ensuring that a Historic Complaint that is not currently disclosed through BrokerCheck adequately reflects its comment about the matter in the event such matter becomes disclosed to the public. Id.

<sup>53</sup> See, e.g., ARM Letters I and II, ING Letter and SIA Letters I and II.

<sup>54</sup> See ING Letter and SIA Letter I. See also ARM Letter II, discussed further below (requesting that NASD not apply the new guidelines to any matters that are currently pending as well).

rules under which the CRD system and BrokerCheck operate, NASD proposed in Amendment Nos. 4 and 5 to provide that only Historic Complaints that become Historic Complaints on or after the implementation date of the proposed rule change (i.e., those that are archived on or after the implementation date) would be eligible for disclosure through BrokerCheck.<sup>55</sup> NASD stated that such a change would be in the public interest. Under this proposed modification, NASD would disclose through BrokerCheck all of an individual's Historic Complaints that became Historic Complaints on or after the implementation date of the proposed rule change if: (1) the most recent Historic Complaint or currently reported customer complaint, arbitration, or litigation is less than ten years old, and (2) the person has a total of three or more currently disclosable regulatory actions, currently reported customer complaints, arbitrations, or litigations, or Historic Complaints (subject to the limitation that they became a Historic Complaint on or after the implementation date of the proposed rule) or any combination thereof. According to NASD, the revised approach would strike a fair balance between public investors' interests in the background of the individuals with whom they do business and the concerns of participants in the securities industry.

In reaction to NASD's proposed changes in Amendment Nos. 4 and 5, the Commission received four additional comment letters. After the Second Notice, two commenters expressed support for this recent change by NASD to provide that Historic Complaints will not be eligible for disclosure if the matter became a Historic Complaint before the implementation date of the proposed rule change.<sup>56</sup> Another commenter wanted NASD to go even further by recommending that the new BrokerCheck program disclose only those matters that commence

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<sup>55</sup> See NASD Response Letter I. See also Amendment No. 4.

<sup>56</sup> See MWA Financial Letter and SIA Letter II.

following the rule change and not include any matters that are currently pending.<sup>57</sup> According to this commenter, current matters entered into before the rule change should be archived after two years as the current guidelines allow.<sup>58</sup>

However, one commenter expressed serious reservations regarding the proposed limitation on the disclosure of Historic Complaints.<sup>59</sup> Specifically, this commenter argued that the effect of the recent amendment is that Historic Complaint information that currently exists within CRD would never be released to the public through BrokerCheck, while the only Historic Complaints that would be disclosed are those that become Historic Complaints after the proposal's effective date. This commenter was not persuaded by other commenters' arguments that the proposed rule should be implemented prospectively because firms and registered persons might have relied on the current rules under which CRD and BrokerCheck operate when they decided to settle certain customer complaints, arbitrations, or litigations. First, the commenter maintained that these other commenters did not substantiate their argument with any specific cases, surveys, or studies in which registered representatives actually settled customer disputes because they would not be publicly disclosed after two years.<sup>60</sup> Second, the commenter disagreed with other commenters' assertions that NASD members had settled matters without the knowledge that the rules might change in the future. In support of its argument, the commenter indicated that NASD's Notice to Members 02-74 that was issued in 2002 put NASD members on notice that the rules regarding the public disclosure of customer complaints and, more

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<sup>57</sup> See ARM Letter II.

<sup>58</sup> Id.

<sup>59</sup> See NASAA Letter I.

<sup>60</sup> The commenter criticized NASD for agreeing with other commenters that "stockbrokers would rather litigate customer disputes than settle them because the complaint would be publicly disclosed." Id.

specifically, the rules regarding Historic Complaints might be revised and modified.<sup>61</sup> This commenter asserted that if NASD wanted to strike a balance between the industry and investors, NASD should have considered that its membership was aware of the proposed changes to BrokerCheck since its Notice to Members in 2002 and should have proposed the earlier date as the date for measuring which complaints would fall within the definition of Historic Complaints under the proposed rule change. Furthermore, this commenter argued that, if the proposal were implemented as proposed in Amendment No. 4, more comprehensive information could be available for the same financial services professional in the Investment Adviser Public Disclosure – Individual (“IAPDI”) system, which is currently being developed, than in BrokerCheck. The commenter maintained that this would go against NASD’s original intent of providing the same level of information through BrokerCheck that the states provide and could lead to investor confusion.<sup>62</sup> Finally, this commenter took issue with NASD’s proposal to alter the way it would measure the two-year reporting and disclosure period for customer complaints. While NASD currently calculates the two-year period for disclosure of customer complaints as of the date the complaint was reported on Forms U4 and U5, NASD had proposed to consider this two-year period to begin on the date on which the member received the complaint, both for purposes of reportability on Forms U4 and U5 and for disclosure purposes. This commenter believed this change could encourage registered persons and their firms to manipulate the

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<sup>61</sup> The commenter cited to the 58 plus comment letters that NASD received in response to this Notice to Members as evidence that NASD’s membership was aware that the rules regarding the release of historic information might change. Id.

<sup>62</sup> The commenter was concerned that the same person would be treated differently for disclosure purposes depending on which system, BrokerCheck or IAPDI, an investor searches, and that the public would have to check multiple sources for disclosure on the same person. Id.

amount of time the complaint would be publicly disclosed by delaying the reporting or perhaps withholding the reporting of customer complaints while the two-year period is running.

In response to this commenter's objection to NASD's proposal to disclose a Historic Complaint only if the item became a Historic Complaint on or after the implementation date of the proposal, NASD maintained that its proposal is an evenhanded approach that would provide investors with additional information about brokers who have demonstrated a pattern of conduct of accumulating complaints, regulatory actions, arbitrations, or litigations, and that would also address the fairness concerns of participants in the securities industry by not retroactively changing the rules governing the disclosure of such events.<sup>63</sup> To address the commenter's concern over measuring the two-year time period for disclosing customer complaints through BrokerCheck from the date the complaint is filed with the firm, rather than the date the complaint is reported to the CRD system, NASD stated that, to the extent a firm may not timely amend a registered person's Form U4 to report a customer complaint, the event should still be disclosed through BrokerCheck for two years. Accordingly, NASD decided not to amend the manner in which it currently measures the two-year time frame for complaint disclosures and provided that complaints will continue to be disclosed through BrokerCheck for 24 months beginning on the date that the complaint is reported to the CRD system.<sup>64</sup>

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<sup>63</sup> See NASD Response Letter II and Amendment No. 6. But see NASAA Letter II. Continuing to object to NASD's proposal to disclose only those items that become a Historic Complaint after the implementation date, the commenter criticized NASD Response Letter II in failing to specifically respond to issues the commenter raised in its initial comment letter and urged the Commission to not approve the proposed rule change.

<sup>64</sup> See NASD Response Letter II.

#### IV. Discussion and Commission's Findings

After careful consideration of the proposal, the comment letters, and NASD's responses to the comment letters, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.<sup>65</sup> The Commission believes that the proposed rule change, as amended, is consistent with Section 15A(b) of the Act,<sup>66</sup> in general, and furthers the objectives of Section 15A(b)(6),<sup>67</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and in general, to protect investors and the public interest. In addition, the Commission believes that the proposed rule change, as amended, is consistent with Section 15A(i) of the Act,<sup>68</sup> which requires that NASD establish and maintain a toll-free telephone listing, and a readily accessible electronic or other process, to receive and promptly respond to inquiries regarding registration information on its members and their associated persons.

The Commission believes that investors must be given the information necessary to make an informed decision about whether or not to conduct business with a particular broker-dealer or associated person. At the same time, the Commission recognizes that broker-dealers and their associated persons have legitimate concerns related to the harm their reputations could suffer from inaccurate or misleading information being made available to the public, as well as from the release of confidential personal information. The Commission believes that the proposed

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<sup>65</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>66</sup> 15 U.S.C. 78o-3(b).

<sup>67</sup> 15 U.S.C. 78o-3(b)(6).

<sup>68</sup> 15 U.S.C. 78o-3(i).

rule change would adequately balance the needs of investors with the interests of broker-dealers and their associated persons by increasing the amount of information available through BrokerCheck, while adopting certain protections for broker-dealers and their associated persons. For instance, under the proposed rule change, NASD would not release certain confidential personal information or other information about an associated person or a member which is irrelevant or misleading.

Many of the commenters expressed concern regarding the release of Historic Complaints. Commenters argued, among other things, that the proposal would give too much weight to unproven allegations and complaints and could be misleading to investors, that the proposed threshold for disclosure of Historic Complaints is too low and over-inclusive, and that firms would be inhibited from settling minor claims, which are often settled as the result of a cost/benefit analysis or in an effort to maintain client goodwill, since they could be publicly disclosed.

The Commission notes that NASD has protections in place that should address the issues raised by the commenters. First, NASD would allow associated persons to submit relevant comments for inclusion with the information provided by BrokerCheck. While some of the commenters disputed the protections that the “brief comment” process would provide, the Commission notes that, as NASD reiterated in its response to comments, NASD would only reject or redact comments in very limited circumstances and, furthermore, would only do so if the concerns raised by the comments are not outweighed by investor protection concerns. In addition, NASD will include an introductory section preceding the BrokerCheck report that would provide a context within which to consider complaints, status information in the report that would make clear whether or not a Historic Complaint was settled, and advisories in the

BrokerCheck report and on the Web site that would indicate that the reader should not rely solely on the information available through BrokerCheck.

Some commenters were concerned that altering the rules regarding disclosure of settlements after such settlements had been made would be unfair. The Commission believes NASD's decision to only release information on Historic Complaints that become Historic Complaints on or after the implementation date of the proposed rule change is a reasonable response to that concern. For instance, under the proposal, as amended, persons entering into new settlements would be fully aware that, if such settlements were for less than \$10,000 and are no longer reported on a Registration Form, they would be disclosed as Historic Complaints if the threshold requirements for disclosure were met.

One commenter argued strongly against NASD's proposal to only release Historic Complaints that become Historic Complaints on or after the implementation date of the proposed rule change. This commenter asserted, among other things, that there had been sufficient notice of this proposal since November 2002 and that a better approach would be to release Historic Complaints that became Historic Complaints on or after that date. The Commission recognizes that differing judgments could be made as to the relevance of various Historic Complaints and the appropriate balance between the informational needs of investors and the interests of broker-dealers and their associated persons in assuring misleading information about them is not disseminated. The Commission believes NASD has struck a reasonable balance, and notes that, even using the implementation date as the "cutoff" for disclosure of Historic Complaints, the amount of information that would be disclosed through BrokerCheck would increase under this proposed rule change.

The same commenter argued that NASD should not change the way in which it measures the two-year disclosure period for customer complaints, which currently begins on the date the member reports the complaint. This commenter was concerned that, if complaints were only disclosed for two years from the date they were received by the member, there would be an incentive to delay or even withhold the reporting of customer complaints in order to shorten the disclosure period. The Commission notes that in Amendment No. 6 NASD has withdrawn this portion of its proposal. Accordingly, customer complaints will continue to be disclosed for two years from the date on which they are reported.

With regard to all other issues raised by the commenters, the Commission is satisfied that NASD has adequately addressed the commenters' concerns. The Commission further notes NASD's planned electronic distribution system should provide NASD with the flexibility to provide a report delivery solution that is more user-friendly, and that more efficiently meets investors' needs in light of changing technology, while still providing safeguards against data piracy.

While BrokerCheck is a valuable tool for an investor to use to get information about a firm or a registered person with whom the investor is considering doing business, the Commission would urge investors to check with each state where the firm has done business or where the sales person has been registered to obtain a complete picture of his or her disciplinary history.

#### Accelerated Approval

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication in the Federal Register pursuant to Section 19(b)(2) of

the Act.<sup>69</sup> In Amendment No. 6, NASD: (i) indicated that it was withdrawing its original proposal to change the start date of the two-year period for disclosure of a customer complaint to the date on which the member receives the complaint; and (ii) clarified that it currently releases summary information concerning certain arbitration awards issued by NASD arbitrators and will continue to work with other regulators regarding disclosure of arbitration awards issued in other forums, and made a corresponding change to the proposed rule text. The Commission notes that NASD's amendments were largely in response to comments that the Commission received. The Commission believes that Amendment No. 6 adequately responds to commenters' concerns and notes that the proposed changes raise no new issues of regulatory concern. Accordingly, the Commission believes that granting accelerated approval to the filing is appropriate.

#### V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the filing, including whether the filing is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2003-168 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

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<sup>69</sup> 15 U.S.C. 78s(b)(2).

All submissions should refer to File Number SR-NASD-2003-168. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2003-168 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder applicable to a national securities association, and, in particular, Section 15A(b)(6) of the Act<sup>70</sup> and 15A(i) of the Act.<sup>71</sup>

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>72</sup> that the proposed rule change (SR-NASD-2003-168) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>73</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>70</sup> 15 U.S.C. 78o-3(b)(6).

<sup>71</sup> 15 U.S.C. 78o-3(i).

<sup>72</sup> 15 U.S.C. 78s(b)(2).

<sup>73</sup> 17 CFR 200.30-3(a)(12).