

August 14, 2002

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-2002-112 – Proposed Amendments to Rule 3070 Requiring Members To File Copies Of Criminal and Civil Complaints and Arbitration Claims with NASD**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Philip Shaikun, Assistant General Counsel, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8451; e-mail: philip.shaikun@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President
and Corporate Secretary

Enclosures

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend NASD Rule 3070 to require members to file with NASD copies of certain criminal and civil complaints and arbitration claims. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

3070. Reporting Requirement

(a) through (c) No change.

(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] NASD 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] paragraphs (a), (b) and (c) of this Rule.

(f) Each member shall promptly file with NASD copies of:

(1) any indictment, information or other criminal complaint or plea agreement for conduct reportable under paragraph (a)(5) of this Rule;

(2) any complaint in which a member is named as a defendant or respondent in any securities or commodities-related private civil litigation;

(3) any securities or commodities-related arbitration claim filed against a member in any forum other than the NASD Dispute Resolution forum;

(4) any indictment, information or other criminal complaint, any plea agreement, or any private civil complaint or arbitration claim against a person associated with a member that is reportable under question 14 on Form U-4, irrespective of any dollar thresholds Form U-4 imposes for notification, unless, in the case of an arbitration claim, the claim has been filed in the NASD Dispute Resolution forum.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on July 24, 2002, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The NASD Board of Governors reviewed the proposed rule change at its meeting on July 25, 2002. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Philip Shaikun, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8451.

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

(a) Purpose

The proposed rule change would amend NASD Rule 3070 to require members to file promptly with NASD copies of certain criminal and civil complaints and arbitration claims against the member or a person associated with the member. The purpose of the rule proposal is to improve the quality and flow of information to NASD with respect to allegations of broker misconduct, so that NASD can enhance investor protection efforts by promptly taking appropriate regulatory action to address the specific alleged misconduct and to prevent similar or related misconduct in the future.

Specifically, the proposed rule change would require members to file with NASD copies of (1) any criminal complaints filed against the member or plea agreements entered into by the member that are covered by the rule; (2) any securities or commodities-related private civil complaints filed against the member; (3) any arbitration claim against the member (except those claims that have already been filed with NASD Dispute Resolution, in which case NASD obtains copies of such claims directly from NASD Dispute Resolution);

and (4) any criminal complaint or plea agreement, private civil complaint or arbitration claim against an associated person that is reportable under question 14 on Form U-4, irrespective of any dollar threshold requirements that question imposes for notification (except those arbitration claims that have already been filed with NASD Dispute Resolution).

Rule 3070 currently requires, among other things, that a member report to NASD when it is a defendant or respondent in felony criminal proceedings, certain misdemeanor criminal proceedings, or in certain civil or arbitration actions. As to the latter, Rule 3070(a)(7) requires that a member report to NASD when the member or a person associated with the member is a defendant or respondent in securities or commodities-related civil litigation or arbitration only when the proceeding has been disposed of by a judgment, award or settlement in an amount exceeding either \$15,000 (if the defendant or respondent is an associated person) or \$25,000 (if defendant or respondent is the member). No existing rules require a member routinely to file copies with NASD of complaints filed against it in any legal proceedings.

Similar to Rule 3070, question 14 on Form U-4 requires notice that an associated person has been charged or convicted of a felony or certain misdemeanors. It further requires notice that an associated person has been named as a respondent or defendant in a consumer-initiated arbitration or civil litigation involving a sales practice violation that is pending, resulted in a judgment, settled for \$10,000 or more, or contains a claim for compensatory damages of at least \$5,000. However, Form U-4 does not require that the member or associated person file with NASD a copy of the complaint that initiates such proceedings or any plea agreements to resolve reportable criminal charges. The rule proposal would require a member to file copies of any criminal complaint, plea agreement, private civil complaint or

arbitration claim that is reportable under question 14 on Form U-4, irrespective of any dollar threshold requirements that may be specified to trigger reporting on Form U-4 (except those arbitration claims that have already been filed with NASD Dispute Resolution).

NASD believes the rule proposal would enhance its regulatory efforts and investor protection mission. Absent the proposed filing requirements, in many instances, NASD might never learn of the specific allegations unless they are also voluntarily reported to NASD or, pursuant to Rule 3070(a)(2), are the subject of a written customer complaint to the member involving allegations of theft or misappropriation of funds or securities, or of forgery. Regulation will be more effective if NASD obtains the detailed allegations at the time a criminal, civil or arbitration complaint or claim is filed, so that an inquiry, if warranted, can begin promptly. Moreover, the information can be combined with other sources of regulatory intelligence to identify patterns and trends at the earliest possible stage, thereby deploying resources to high risk areas that better protect investors. With respect to associated persons, it is important to receive copies of complaints and claims reportable under question 14 on Form U-4, even when they fall below specified dollar thresholds, as such matters may also point to trends or otherwise flag conduct where regulatory action might be warranted.

NASD believes the regulatory benefits of the proposed rule change outweigh the additional burden on members to file with NASD copies of the specified documents, and NASD further believes that the rule proposal minimizes that burden in that the rule requires only the filing of those complaints and claims most likely to reveal information to assist its regulatory mission. For example, members would not be required to file private civil litigation complaints or arbitration claims that do not relate to securities or commodities-

related conduct. Moreover, the proposal would not require members to file with NASD any arbitration claims that are originally filed in the NASD Dispute Resolution forum. NASD is already incurring the cost to make copies of those claims and will continue to do so under the proposal. As with other complaints and claims that would be required to be filed under the proposal, the Dispute Resolution arbitration claims would be forwarded after copying to a unit within NASD that will evaluate the allegations in the documents for possible regulatory action.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposal will improve its ability to detect and prevent fraudulent and manipulative conduct and to develop regulatory responses to problem areas at the earliest possible time.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD, INC.

BY: _____
Barbara Z. Sweeney , Senior Vice President and
Corporate Secretary

Date: August 14, 2002

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD- 2002-112)
[date]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. to Amend NASD Rule 3070 to Require Members to File Copies of Criminal and Civil Complaints and Arbitration Claims with NASD

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on [date], the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD is proposing to amend Rule 3070 of its rules to require members promptly to file copies with NASD of certain criminal and civil complaints and arbitration claims against a member or a person associated with a member. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

3070. Reporting Requirement

(a) through (c) No change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(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] NASD 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] paragraphs (a), (b) and (c) of this Rule.

(f) Each member shall promptly file with NASD copies of:

(1) any indictment, information or other criminal complaint or plea agreement for conduct reportable under paragraph (a)(5) of this Rule;

(2) any complaint in which a member is named as a defendant or respondent in any securities or commodities-related private civil litigation;

(3) any securities or commodities-related arbitration claim filed against a member in any forum other than the NASD Dispute Resolution forum;

(4) any indictment, information or other criminal complaint, any plea agreement, or any private civil complaint or arbitration claim against a person associated with a member that is reportable under question 14 on Form U-4, irrespective of any dollar thresholds Form U-4 imposes for notification, unless, in the case of an arbitration claim, the claim has been filed in the NASD Dispute Resolution forum.

* * * * *

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, 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. 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

(a) Purpose

The proposed rule change would amend NASD Rule 3070 to require members to file promptly with NASD copies of certain criminal and civil complaints and arbitration claims against the member or a person associated with the member. The purpose of the rule proposal is to improve the quality and flow of information to NASD with respect to allegations of broker misconduct, so that NASD can enhance investor protection efforts by promptly taking appropriate regulatory action to address the specific alleged misconduct and to prevent similar or related misconduct in the future.

Specifically, the proposed rule change would require members to file with NASD copies of (1) any criminal complaints filed against the member or plea agreements entered into by the member that are covered by the rule; (2) any securities or commodities-related private civil complaints filed against the member; (3) any arbitration claim against the member (except those claims that have already been filed with NASD Dispute Resolution, in which case NASD obtains copies of such claims directly from NASD Dispute Resolution); and (4) any criminal complaint or plea agreement, private civil complaint or arbitration claim

against an associated person that is reportable under question 14 on Form U-4, irrespective of any dollar threshold requirements that question imposes for notification (except those arbitration claims that have already been filed with NASD Dispute Resolution).

Rule 3070 currently requires, among other things, that a member report to NASD when it is a defendant or respondent in felony criminal proceedings, certain misdemeanor criminal proceedings, or in certain civil or arbitration actions. As to the latter, Rule 3070(a)(7) requires that a member report to NASD when the member or a person associated with the member is a defendant or respondent in securities or commodities-related civil litigation or arbitration only when the proceeding has been disposed of by a judgment, award or settlement in an amount exceeding either \$15,000 (if the defendant or respondent is an associated person) or \$25,000 (if defendant or respondent is the member). No existing rules require a member routinely to file copies with NASD of complaints filed against it in any legal proceedings.

Similar to Rule 3070, question 14 on Form U-4 requires notice that an associated person has been charged or convicted of a felony or certain misdemeanors. It further requires notice that an associated person has been named as a respondent or defendant in a consumer-initiated arbitration or civil litigation involving a sales practice violation that is pending, resulted in a judgment, settled for \$10,000 or more, or contains a claim for compensatory damages of at least \$5,000. However, Form U-4 does not require that the member or associated person file with NASD a copy of the complaint that initiates such proceedings or any plea agreements to resolve reportable criminal charges. The rule proposal would require a member to file copies of any criminal complaint, plea agreement, private civil complaint or arbitration claim that is reportable under question 14 on Form U-4, irrespective of any dollar

threshold requirements that may be specified to trigger reporting on Form U-4 (except those arbitration claims that have already been filed with NASD Dispute Resolution).

NASD believes the rule proposal would enhance its regulatory efforts and investor protection mission. Absent the proposed filing requirements, in many instances, NASD might never learn of the specific allegations unless they are also voluntarily reported to NASD or, pursuant to Rule 3070(a)(2), are the subject of a written customer complaint to the member involving allegations of theft or misappropriation of funds or securities, or of forgery. Regulation will be more effective if NASD obtains the detailed allegations at the time a criminal, civil or arbitration complaint or claim is filed, so that an inquiry, if warranted, can begin promptly. Moreover, the information can be combined with other sources of regulatory intelligence to identify patterns and trends at the earliest possible stage, thereby deploying resources to high risk areas that better protect investors. With respect to associated persons, it is important to receive copies of complaints and claims reportable under question 14 on Form U-4, even when they fall below specified dollar thresholds, as such matters may also point to trends or otherwise flag conduct where regulatory action might be warranted.

NASD believes the regulatory benefits of the proposed rule change outweigh the additional burden on members to file with NASD copies of the specified documents, and NASD further believes that the rule proposal minimizes that burden in that the rule requires only the filing of those complaints and claims most likely to reveal information to assist its regulatory mission. For example, members would not be required to file private civil litigation complaints or arbitration claims that do not relate to securities or commodities-related conduct. Moreover, the proposal would not require members to file with NASD any

arbitration claims that are originally filed in the NASD Dispute Resolution forum. NASD is already incurring the cost to make copies of those claims and will continue to do so under the proposal. As with other complaints and claims that would be required to be filed under the proposal, the Dispute Resolution arbitration claims would be forwarded after copying to a unit within NASD that will evaluate the allegations in the documents for possible regulatory action.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposal will improve its ability to detect and prevent fraudulent and manipulative conduct and to develop regulatory responses to problem areas at the earliest possible time.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 such filing will also be available for inspection and copying at the principal office of NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary