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U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
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Re: **SR-NASD-2002-112 – Response to Comments**

This letter responds to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) to SR-NASD-2002-112, a proposal to amend NASD Rule 3070 to require members to file with NASD copies of certain criminal and civil complaints and arbitration claims. The proposed rule change and Amendment No. 1 thereto were published for comment in the Federal Register on December 27, 2003.¹ The SEC received four letters in response to the rule change.² This response addresses only those comments directed at the proposal to amend Rule 3070.³

Generally, commenters supported the proposal’s stated goal to improve the quality and flow of information to NASD with respect to allegations of broker misconduct. However, each of the commenters contended that the rule proposal created a significant or undue burden on members. In addition, MetLife suggested that the rule proposal would impose duplicative reporting requirements on members that already notify NASD of events on Forms U-4, U-5, BD and under existing Rule 3070 obligations. WGS and A.G. Edwards further expressed concern that NASD also would be burdened by the volume of documents it would receive under the proposal and questioned the value of the information by comparison.

¹ Exchange Act Release No. 47060 (December 20, 2002), 67 FR 79203 (December 27, 2002).

² Letter from World Group Securities, Inc. to Jonathan G. Katz, dated September 19, 2002 (“WGS”); Letter from Metropolitan Life Insurance Co. to Secretary, SEC, dated December 27, 2002 (“MetLife”); Letter from A.G. Edwards & Sons, Inc. to Jonathan G. Katz, dated January 17, 2003 (“A.G. Edwards”); Letter from Securities Industry Association to Jonathan G. Katz, dated January 24, 2003 (“SIA”). The WGS letter responds to NASD *Notice to Members* 02-53 (August 2002), which announced that NASD had filed its proposed rule change proposal with the SEC. Since NASD subsequently amended the proposal before the SEC published it for comment, the WGS letter addresses only the original proposal as described in the *Notice to Members*.

³ The WGS, MetLife and A.G. Edwards letters also addressed a change in NASD’s policy regarding letters NASD issues when a determination is made to close an investigation without disciplinary action (referred to as “close-out letters”). While notice of the policy change with respect to close-out letters was contained in the same *Notice to Members* 02-53 that announced that NASD had filed with the SEC its proposal to amend Rule 3070, that policy change is not part of this rule filing. Accordingly, this letter does not address comments on the policy change with respect to close-out letters.

NASD disagrees that the proposal would impose duplicative filing requirements on members or be unduly burdensome. As explained in the rule filing and Amendment No. 1, members are not required under existing rules to routinely file with NASD the documents sought under the proposal. NASD believes that information contained in those complaints and arbitration claims will enhance its regulatory efforts and better protect investors through early detection of broker misconduct and identification of problem trends. As to the burden on NASD, deference must be given to NASD's determination that, on balance, the value of information it will receive outweighs any additional work for the organization.

At the same time, the rule proposal minimizes the burden on members, including duplicative filing requirements: it specifically carves out any arbitration claims that are originally filed in the NASD Dispute Resolution forum and those documents that have already been requested by NASD's Registration and Disclosure staff (provided such documents are produced to Registration and Disclosure within 30 days of the request). Moreover, the rule requires only the filing of those complaints and claims most likely to contain information relevant to NASD's regulatory mission, excluding, for example, private civil litigation complaints or arbitration claims that do not involve securities or commodities-related conduct.

WGS suggested that the current reporting systems are adequate to alert NASD to issues of regulatory concern. For the reasons explained above, NASD believes that the current reporting system fails to capture important information that could improve its regulatory efficacy. MetLife asserted that NASD should develop an entirely new technological system that would allow events to be reported only once through an electronic medium. While MetLife's general proposal to develop a new system is worth long-term consideration, its feasibility is uncertain and, in any event, it does not now provide a viable alternative to the current proposal.

SIA suggested that NASD limit the rule proposal to cover only copies of lawsuits and arbitrations filed by retail customers that allege sales practice violations and are reportable on Forms U-4 and U-5.⁴ In so doing, SIA seeks to exclude from the proposal complaints in "nearly all class actions; non-retail civil litigation, including product failure, and operational complaints, and small claims involving relatively small dollar amounts."⁵ SIA further suggested that NASD eliminate the provision in the proposal that would require members to report when they are indicted, convicted of, or plead guilty to a criminal offense.

NASD believes the SIA proposal is too narrow in scope and could lead to confusion. First, under the SIA formulation to limit the proposal to retail customer complaints and claims, NASD would not receive complaints alleging egregious conduct between members (such as collusive market making) or involving institutional customers (such as a kickback scheme in the

⁴ The current rule proposal requires a member to file with NASD 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).

⁵ SIA letter at p. 2.

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distribution of initial public offerings). Such allegations of misconduct certainly constitute relevant regulatory information, so NASD sees no sound policy reason to limit the subject matter of complaints to those involving retail customers. Since these and other allegations sometimes first appear in criminal proceedings, NASD believes it appropriate to maintain the requirement in the proposal to file copies of such documents.

Second, the suggestion to limit the proposal to complaints and claims alleging sales practice violations would undermine a significant animating purpose of the rule proposal, namely to detect securities or commodities related patterns of conduct or emerging trends that might warrant regulatory actions. The regulatory intent would be frustrated if members were permitted to parse the language of potential filings to determine whether its substance technically comprised a sales practice violation. Furthermore, litigation and arbitrations that related to securities or commodities conduct, but do not amount to a sales practice violation, nevertheless may prove to correlate to other conduct injurious to the investors and markets. These determinations can only be reached if NASD has access to data that has not been filtered by application of nuance to a legal term of art.

Third, with respect to associated persons, NASD believes 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, because, as we have stated above, those actions can highlight patterns of conduct or emerging trends that might warrant regulatory actions.

Finally, A.G. Edwards stated that it would not object to the rule proposal if the burden imposed were offset by NASD assuming the responsibility to report to CRD any required information based on its review of the complaints and arbitration claims. NASD does not believe such steps are necessary or appropriate. The rule proposal requires different information for different regulatory purposes from that reported to CRD, and NASD believes it has reasonably minimized the burden on members under the proposal.

We hope this response to comments is helpful, and we encourage the Commission to approve the rule proposal as filed as soon as possible. Please feel free to contact me at (202) 728-8451 if you wish to discuss this matter further.

Sincerely,

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