

Notice to Members

MAY 2003

SUGGESTED ROUTING

Legal and Compliance
Operations
Senior Management

Rule 3070

SEC Approves Amendment to Rule 3070 to Require Filing with NASD of Criminal and Civil Complaints and Arbitration Claims

KEY TOPICS

Rule 3070
Reporting Requirements

Executive Summary

On March 3, 2003, the Securities and Exchange Commission (SEC) approved SR-NASD-2002-112, a proposal to amend NASD Rule 3070 to require members promptly to file with NASD copies of certain criminal and civil complaints and arbitration claims that name a member or an associated person as defendant or respondent.

The SEC approval order and text of amended Rule 3070 are attached.

Questions concerning this *Notice* should be directed to Philip Shaikun, Assistant General Counsel, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8451.

Background and Discussion

This rule change is part of NASD's continuing efforts to improve the quality and flow of information to NASD regarding allegations of broker misconduct. NASD believes that review of information contained in complaints and arbitration claims will enhance its regulatory efforts and better protect investors through early detection of broker misconduct and problem trends.

The amendment requires members promptly to file with NASD copies of the following documents: (1) any criminal complaints filed against the member or plea agreements entered into by the member that are covered by Rule 3070; (2) any securities or

commodities-related private civil complaints filed against the member; (3) any arbitration claim against the member; 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.

To minimize the burden on members and eliminate duplicative filing requirements, the amendment 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.

Upon receipt of documents subject to the amendment, members promptly should send copies by first class mail or courier to the following address:

NASD Member Regulation
Attn: 3070
1735 K Street, NW
Washington, DC 20006

The amendment does not change existing reporting requirements under Rule 3070 or Form U-4. Accordingly, although the amendment eliminates certain dollar thresholds for purposes of triggering the requirement to file with NASD a copy of a complaint or claim, members should continue to apply the applicable thresholds to determine whether notification is required under Rule 3070 or on Form U-4.

Effective Date

The Rule will become effective on May 21, 2003.

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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.

(g) Members shall not be required to comply separately with paragraph (f) in the event that any of the documents required by paragraph (f) have been the subject of a request by NASD's Registration and Disclosure staff, provided that the member produces those requested documents to the Registration and Disclosure staff not later than 30 days after receipt of such request. This paragraph does not supersede any NASD rule or policy that requires production of documents specified in paragraph (f) sooner than 30 days after receipt of a request by the Registration and Disclosure staff.

available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2002-03 and should be submitted by March 31, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 03-5570 Filed 3-7-03; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47434; File No. SR-NASD-2002-112]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the 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

March 3, 2003.

I. Introduction

On August 15, 2002, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder² 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. NASD amended the proposed rule change on December 9, 2002.³ Notice of the proposed rule change and Amendment No. 1 thereto was published for comment in the *Federal Register* on December 27, 2002.⁴

The Commission received five comment letters regarding the proposal.⁵ On February 12, 2003, NASD

filed a response to the comment letters.⁶ This order approves the proposed rule change as amended by Amendment No. 1.

II. Description of the Proposal

The proposed rule change amends 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 requires 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). To avoid duplicative filing, the rule proposal also provides that members need not separately produce the above-referenced documents if they have already been the subject of a request by NASD's Registration and Disclosure staff. These amendments are discussed in greater detail in the Commission's notice soliciting public comment on this proposal.⁷

III. Summary of Comments

The Commission received five comment letters on the proposed rule change.⁸ Although four of the commenters generally supported NASD's desire to obtain and collect information regarding broker misconduct, they each contended that the proposal was unduly burdensome for members and offered alternative suggestions for achieving NASD's stated objectives.⁹ The fifth comment letter was written in response to the SIA Letter and in support of the proposed rule change.¹⁰ World Group and A.G. Edwards stated that NASD would be unduly burdened by the volume of documents it would receive compared to the amount of new relevant information. MetLife and the SIA stated that the proposal was inconsistent with NASD's rule modernization initiative, which seeks to streamline NASD rules by maximizing regulatory efficiency while imposing the least regulatory burden.¹¹

In its response to commenters, NASD focused only on comments made in connection with this proposal. The World Group, 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 order does not address the policy change with respect to close-out letters.

NASD disagrees that the proposal would impose duplicative filing requirements on members or be unduly

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Patrice Gliniecki, Vice President and Deputy General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated December 6, 2002, and enclosures ("Amendment No. 1"). Amendment No. 1 replaced the original rule filing in its entirety.

⁴ See Securities Exchange Act Release No. 47060 (December 20, 2002), 67 FR 79203.

⁵ See letter from Kevin L. Palmer, Legal Department, World Group Securities, Inc. ("World Group"), to Jonathan G. Katz, Secretary, Commission, dated September 19, 2002 ("World Group Letter") (World Group commented on NASD

Notice to Members 02-53 concerning the proposed amendment to NASD Rule 3070 prior to the Commission's publication of the proposed rule filing); letter from Marc A. Cohn, Assistant Vice President, Metropolitan Life Insurance Company ("MetLife"), to Jonathan G. Katz, Secretary, Commission, dated December 27, 2002 ("MetLife Letter"); letter from Stephen G. Sneeringer, Senior Vice President & Counsel, A.G. Edwards & Sons, Inc. ("A.G. Edwards"), to Jonathan G. Katz, Secretary, Commission, dated January 17, 2003 ("A.G. Edwards Letter"); letter from Edward Turan, Chairman, Arbitration Committee, Securities Industry Association ("SIA") and John Polanin, Jr., Chairman, Self-Regulation and Supervisory Practices Committee, SIA, to Jonathan G. Katz, Secretary, Commission, dated January 24, 2003 ("SIA Letter"), and letter from David A. Weintraub, Attorney at Law, David A. Weintraub, P.A. ("Weintraub"), to Jonathan G. Katz, Secretary, Commission, dated February 6, 2003 ("Weintraub Letter"). The comment letters are described in Section III, *infra*.

⁶ See letter from Philip A. Shaikun, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated February 11, 2003 ("NASD Response Letter"). The NASD Response Letter does not respond to the Weintraub Letter because the Weintraub Letter was received by the Commission after NASD filed the NASD Response Letter.

⁷ See *supra*, note 4.

⁸ See *supra*, note 5.

⁹ See World Group Letter, MetLife Letter, A.G. Edwards Letter and SIA Letter.

¹⁰ See Weintraub Letter.

¹¹ See *Special NASD Notice to Members* 01-35.

burdensome. NASD notes that 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, NASD states that 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.

NASD states that 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.

World Group stated that the current reporting system appears to be an effective means for monitoring the misconduct or alleged misconduct of brokers and representatives. They noted that NASD has spent significant resources on the development of Integrated National Surveillance and Information Technology Enhancements (INSITE) to aid in more effective firm examinations. World Group stated that it might be more efficient to amend Rule 3070 to require the reporting of the additional information required by the proposal in the current reporting system. NASD responded that it believes that the current reporting system fails to capture important information that could improve its regulatory efficacy.

MetLife stated that the proposal required the reporting of information that is reportable through electronic filings on Forms U-4, U-5, BD and Rule 3070 reports with certain exclusions for certain events based on dollar amounts. They stated that the current system is already fractured, redundant and burdensome in that the same incident may have to be reported twice on different mediums such as a Form U-4, U-5 or BD amendment and a Rule 3070 filing. They suggested that NASD

streamline the current reporting system by requiring member firms to report events to NASD only once through a new electronic medium. NASD responded that 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.

A.G. Edwards stated that most of the information required to be reported in the proposal is already required to be reported by members on the CRD. A.G. Edwards suggested that NASD assume the responsibility to report to the CRD any required information based on its review of the complaints and arbitration claims. They thought this would relieve members from the regulatory burden of reporting these actions to the CRD and would relieve some of the questions that they believe have arisen in regard to the reliability of that reporting. NASD responded that it does not believe such steps are necessary or appropriate. NASD explained that the rule proposal requires different information for different regulatory purposes from that reported to the CRD, and NASD believes it has reasonably minimized the burden on members under the proposal.

The SIA stated that the rule should be limited to copies of retail customer lawsuits and arbitrations that allege sales practice violations in accordance with current Form U-4 and U-5 reporting requirements and dollar thresholds. The SIA stated that such an approach would be more resource-efficient and would produce more targeted reviews of complaints by NASD. NASD noted in its response that the 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."¹² The 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).

The NASD Response Letter states the following in support of NASD's belief that the SIA proposal is too narrow in scope and could lead to confusion.¹³ 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 distribution of initial public offerings). Such allegations of misconduct 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, limiting the proposal to complaints and claims alleging sales practice violations would undermine a significant purpose of the rule proposal, namely to detect securities or commodities-related patterns of conduct or emerging trends that might warrant regulatory action. The regulatory intent would be frustrated if members were permitted to parse the language of a potential filing 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 those actions can highlight patterns of conduct or emerging trends that might warrant regulatory actions.

The Weintraub Letter was written in response to the SIA Letter with regard to the reporting of customer complaints. The SIA stated that the rule should be limited to copies of retail customer lawsuits and arbitrations that allege sales practice violations in accordance with current Form U-4 and U-5 reporting requirements. The Weintraub Letter stated that whether a customer-initiated arbitration is reportable on the Form U-4 or not has absolutely no connection to the seriousness of the underlying allegations, or the need for regulatory scrutiny.

¹² See NASD Response Letter at 2, SIA Letter at 2.

¹³ See NASD Response Letter at 2-3.

IV. Discussion and Commission Findings

After careful consideration, the Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a registered securities association and, in particular, with the requirements of Section 15A(b)(6).¹⁴ Specifically, the Commission finds that approval of the proposed rule change is consistent with Section 15A(b)(6) of the Act in that it is 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.¹⁵

The Commission believes that the proposed rule change will enhance NASD's regulatory efforts and investor protection mission. The proposal should improve NASD's ability to detect and prevent fraudulent and manipulative conduct and enable it to develop regulatory responses to problem areas at the earliest possible time. The Commission further 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 that the proposal minimizes that burden in that the rule requires only the filing of those complaints and claims most likely to reveal information that should assist NASD's regulatory mission.

V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (SR-NASD-2002-112), as amended, be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 03-5572 Filed 3-7-03; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47441; File No. SR-NASD-2002-108]

Self-Regulatory Organizations; Notice of Filing of Amendment Nos. 1, 2, and 3 to a Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Business Continuity Plans and Emergency Contact Information

March 4, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² the National Association of Securities Dealers, Inc. ("NASD"), on August 7, 2002, filed with the Securities and Exchange Commission ("Commission"), a proposed rule change to require its members to establish and maintain business continuity plans. The Commission published the proposed rule change in the **Federal Register** on September 9, 2002.³ The Commission received three comments in response to the Original Notice. The NASD submitted amendments to the proposed rule change on December 12, 2002;⁴ January 8, 2003;⁵ and February 19, 2003.⁶ The Commission is publishing this notice of Amendment Nos. 1, 2, and 3 to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The NASD is proposing to clarify that the proposed rule change, which would require member firms to create and maintain business continuity plans and to provide the NASD with certain information to be used in the event of future significant business disruptions, also would require members' business continuity plans to be reasonably designed to enable members to continue their business in the event of a significant business disruption. Below is the text of the proposed rule change, as

amended. The base rule text is that proposed in the Original Notice. Language added by Amendments Nos. 1, 2 and 3 is italicized; language deleted by the amendments is in brackets.

* * * * *

3500. Emergency Preparedness

3510. Business Continuity Plans

(a) Each member must create and maintain a written business continuity plan identifying procedures [to be followed in the event of] *relating to an emergency or significant business disruption. Such procedures must be reasonably designed to enable the member to continue its business in the event of future significant business disruptions.* The business continuity plan must be made available promptly upon request to NASD staff.

(b) *Each member must update its plan in the event of any material change to the member's operations, structure, business, or location.* Each member must also conduct an annual review of its business continuity plan to determine whether any modifications are necessary in light of changes to the member's operations, structure, business, or location.

(c) The [requirements of] *elements that comprise a business continuity plan are flexible and may be tailored to the size and needs of a member.* Each plan, however, must at a minimum, address:

- (1) Data back-up and recovery (hard copy and electronic);
 - (2) All mission critical systems;
 - (3) Financial and operational assessments;
 - (4) Alternate communications between customers and the member;
 - (5) Alternate communications between the member and its employees;
 - (6) Business constituent, bank, and counter-party impact;
 - (7) Regulatory reporting; and
 - (8) Communications with regulators.
- Each member must address the above-listed categories to the extent applicable and necessary to enable the member to continue its business in the event of a future significant business disruption. If any of the above-listed categories is not applicable, the member's business continuity plan need not address the category. The member's business continuity plan, however, must document the rationale for not including such category in its plan. If a member relies on another entity for any one of the above-listed categories or any mission critical system, the member's business continuity plan must address this relationship.*
- (d) *Members must designate a member of senior management to*

¹⁴ 15 U.S.C. 78o-3(b)(6).

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

¹⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 46444 (August 30, 2002), 67 FR 57257 ("Original Notice").

⁴ See letter from Brian J. Woldow, Office of General Counsel, NASD, to Katherine A. England, Division of Market Regulation, Commission, dated December 11, 2002 ("Amendment No. 1").

⁵ See letter from Brian J. Woldow, Office of General Counsel, NASD, to Katherine A. England, Division of Market Regulation, Commission, dated January 8, 2003 ("Amendment No. 2").

⁶ See letter from Brian J. Woldow, Office of General Counsel, NASD, to Katherine A. England, Division of Market Regulation, Commission, dated February 19, 2002 ("Amendment No. 3").