

Notice to Members

NOVEMBER 2002

SUGGESTED ROUTING

Executive Representatives
Legal & Compliance
Operations
Senior Management

ACTION REQUESTED BY DECEMBER 2, 2002

Public Information Review

NASD Requests Comment on its Public Information Review Initiative

KEY TOPICS

Public Information Review

Executive Summary

NASD requests comment from members, associated persons, investors, investor groups, and other interested parties on a broad range of issues relating to information NASD makes public. NASD currently provides an unparalleled amount of information about firms, markets and regulation to the public. NASD's policy on public information, as established by various NASD rules, and guided by relevant federal law, has been the topic of frequent public attention. NASD has begun a corporate-wide initiative to review the information it collects or develops and the policies underlying its determination to make certain information public. The overall purpose of this initiative is to develop recommendations for a comprehensive Public Information Policy that will enhance investor protection without sacrificing the effectiveness of NASD regulatory programs or legitimate proprietary or privacy rights of member firms or their associated persons. The focus of this initiative is on information currently available to NASD, not increasing member firms' compliance or reporting obligations. Soliciting the views of NASD's constituents and the users of the information NASD makes public is a critical step in the conduct of this policy review.

NASD is considering changes that would expand the information it currently makes public, including changes to its Public Disclosure Program (PD Program).¹ Possible other changes include, for example, expanding the statistical information NASD makes available, increasing the broker-dealer information released and making arbitration award information more readily available to investors.

One of the key challenges in conducting this policy review is the need to balance investor protection and an investor's ability to make informed decisions with the legitimate proprietary interests of member firms and the privacy interests of associated persons and other individuals. For example, NASD does not currently release personal information such as Social Security Number, home address or physical description of associated persons² through its PD Program, and has no plans to do so.³ NASD is, however, considering expanding the information released via its PD Program to include historical form filing information and disclosure information reported by a former employer on Form U-5⁴ as soon as the information is filed. Currently, disclosure information reported via Form U-5 is not released via the PD Program until the broker re-associates with another broker-dealer and is required to report the information via Form U-4.⁵

Action Requested

NASD seeks comment from members, associated persons, investors, investor groups, and other interested parties on issues relating to its Public Information Policy review and supporting or opposing the options discussed in this *Notice*.

Comments must be received by **December 2, 2002**. Members and interested persons can submit their comments using the following methods:

- ♦ mailing written comments to NASD
- ♦ e-mailing written comments to pubcom@nasd.com
- ♦ submitting written comments online on NASD's Web Site (www.nasd.com)

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney

NASD

Office of the Corporate Secretary

1735 K Street, NW

Washington, DC 20006-1500

Important Note: The only comments that will be considered are those submitted in writing or by e-mail.

Before becoming effective, any rule changes developed relating to this *Notice to Members* must be submitted to and approved by the Securities and Exchange Commission (SEC).

Questions/Further Information

Questions concerning this *Notice* may be directed to Jay Cummings, Vice President, NASD Registration and Disclosure Department, at (240) 386-4773 or Ann Bushey, Director, Regulatory Review and Disclosure, NASD Registration and Disclosure Department, at (240) 386-4724.

Background

NASD has begun a corporate-wide initiative to review the information it makes public. The initiative involves a comprehensive review of the information collected or developed by NASD and the applicable rules and policies governing whether such information is made available to the general public. As part of the Public Information Policy review, a number of options have been identified and are being presented for comment in this *Notice*. NASD is interested in comments on its Public Information Policy generally and whether commenters support or oppose the options discussed in this *Notice*. NASD will consider these

comments when formulating rule or policy changes to its Public Information Policy.

Some of the options relate to the expansion of NASD's PD Program. NASD established the PD Program in 1988 to provide investors with important information about the professional background, business practices, and conduct of NASD members and their associated persons. Recognizing the PD Program's value to investors, Congress passed legislation in 1990 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 (e.g., approved registrations and employment history) online via NASD's Web Site (www.nasd.com). In 1999, annual inquiries through the PD Program broke the 1,000,000 mark. In 2000, the SEC approved changes to NASD IM-8310-2 that allowed NASD to (1) release information about persons formerly associated with a member for a two-year period following the termination of their registration with NASD; (2) release information about terminated persons and firms that is provided on Form U-6 (the form regulators use to report regulatory actions)⁶, if such matters would be required to be reported on the Form U-4 or Form BD⁷; and (3) deliver automated disclosure reports, which include verbatim information submitted by filers on Uniform Registration Forms. The PD Program is structured to provide information on a per firm or per broker basis on firms or individuals identified by the requester of the information. NASD currently does not release certain information that other securities regulators may provide, particularly State securities regulators operating

under applicable state public records laws. Nor has it historically released comparative information regarding NASD firms and their associated persons.

NASD believes that the PD Program is a critical investor education and protection service, as demonstrated by the over 2 million inquiries now processed annually. The PD Program includes information on over 850,000 former and current registered individuals and over 6,000 current or former NASD registered firms. Information released through NASD's PD Program is derived from the Central Registration Depository (CRD®)⁸ system, a registration and licensing database used by regulators throughout the securities industry to register, license and regulate securities firms and their brokers.

Through the PD Program, summary information about securities-related arbitration awards involving NASD member firms is made available to the public. In addition, NASD's Dispute Resolution division has an arrangement with the *Securities Arbitration Commentator* (SAC) to provide copies of awards for inclusion in its Web-based publication service. As part of this arrangement, individual investors may search the SAC Web Site (accessible via the NASD Dispute Resolution Web Site), using the arbitration award number, to view or copy an award. The award number is contained in a broker or firm report obtained from NASD's PD Program.

NASD has a number of systems that collect data on matters that also must be reported through the CRD system. To ensure that the information is in fact reported on a timely basis, and therefore is available to the public through the PD Program, NASD plans to implement additional cross-checks to ensure that the matters reported to these systems are timely reported to the CRD system.

Discussion

The SEC, States and other self-regulatory organizations release a variety of information under their respective public information policies. These organizations often publish information NASD has available in its CRD system or other systems but does not release under its current information policy. NASD believes its Public Information Policy, including IM-8310-2 and any other relevant NASD Rules, should be amended as appropriate to enable investors to receive most of this information from NASD as well.

NASD seeks comment from members, associated persons, investors, investor groups, and other interested parties on issues relating to its Public Information Policy and whether commenters support or oppose the suggestions and options set forth in this *Notice* and discussed in more detail below.

1. Establish a Central Gateway for Access to Public Information

NASD makes a broad range of information available to the public, mostly through its Web Sites. There is, however, no single place from which to obtain a listing of the information that is publicly available. Public information is currently spread across multiple pages on at least three different Web Sites. Information frequently is presented without explanations that put the information in context or that define how statistical information has been derived.

To make information more useful and easily accessible, NASD is considering a single web location that would: (1) list and describe the public information NASD makes available; (2) provide a contact point for questions and/or

comments regarding NASD public information; (3) consolidate access to all public statistical information; and (4) enhance the statistical information NASD makes available to include certain demographic and industry segmentation data. The end result would be a central gateway for access to NASD's public information from which an Internet user could see, at-a-glance, the types of information NASD makes available and link to the specific or more detailed information he or she is interested in.

NASD seeks comment on other ways it can facilitate investor access to this information.

2. Enhance NASD's Public Disclosure Program

Over 2 million inquiries a year are processed through NASD's PD Program. It has become the primary source for investors and others seeking information about NASD member firms and their associated persons. To enhance investor protection, NASD believes that substantial changes should be made to its PD Program to:

- ♦ make it easier to use;
- ♦ provide disclosure information online;
- ♦ alert investors to key changes in available information about a broker or firm;
- ♦ put the information provided in context; and
- ♦ expand the types of information released through the PD Program.

Even with an expansion of the information available through the PD Program, there will be information available through other sources that is not available to NASD or that NASD is

unable to make public.⁹ For example, NASD does not have information regarding certain complaints made by investors to State regulators. The only source for this information is the State regulator. NASD believes the PD Program should provide investors and other users with additional information about other sources of information on NASD member firms and associated persons, including the SEC, States, other self-regulators, and, where possible, provide additional contact information for these sources.

Ease of Use - Redesign of Internet Application

NASD's Public Disclosure Internet application was initially deployed in 1998, with subsequent enhancements made in 1999 and 2000. Although NASD's PD Program Internet application was designed to be simple and efficient in its delivery of information, the Internet technology and standards available today offer significant opportunities to make NASD's PD Program easier to use and the information presented easier to understand.

To meet the needs of investors and other users, the PD Program must both provide a summary view of the wealth of detailed information that is available and the capability to view the detailed information. These two goals can best be achieved through an Internet-based approach using hyperlinks and other information architecture and presentation techniques.

Online Access to Disclosure Information

The information provided through the PD Program can be divided into two broad categories:

- ♦ **Administrative Information** – information about the firm or broker (registrations, employment history, types of business, etc.). Administrative information is available online and in Public Disclosure reports available by mail or e-mail.
- ♦ **Disclosure Information** – information provided in response to the disclosure questions on the Uniform Registration Forms (criminal, regulatory, disciplinary, customer sales practice complaints and related litigation or arbitration, etc.). Disclosure information is not available online and can only be obtained by requesting a Public Disclosure report by mail or e-mail.

The existing federal law mandating the PD Program, enacted in 1990, does not address providing disclosure information online. At the time the legislation was enacted, the PD Program was telephone-based. Investors and other users called the NASD Hotline (800-289-9999) to request reports and the legislation specifically reflected that medium for communication; Internet and online disclosure was not contemplated. Today, although the NASD Hotline is still available, investors and other users prefer to use the Internet and have expressed the strong desire to be able to obtain disclosure information online. Over 95 percent of the inquiries to the PD Program are now received through the Internet.

NASD believes it should continue to seek a change to the federal legislation governing the PD Program to provide for online presentation of disclosure information. Without the ability to display all data online, access to information and usability of the PD Program will continue to be hampered to the detriment of investor protection.

Public Disclosure Report Updates

NASD believes that current Internet technology provides a cost-effective means to provide investors and other users of the PD Program with e-mail notice if significant changes occur to the information available on a broker or member firm specified by an investor or other user of the PD Program.

NASD is considering adding functionality to the PD Program that would allow an investor or other user of the PD Program to request an e-mail notice when certain changes occur in the information previously provided to the investor or other user through the PD Program.

CRD Data and Form Filing Information

NASD has expanded the amount of information available through the PD Program since its inception in 1988. The most recent changes occurred in February 2000.¹⁰ Although a broad range of information available to regulators through the CRD system also is available to investors and others through the PD Program, NASD believes that more CRD information should be made publicly-available through the PD Program.

For example, NASD's PD Program does not release a broker's exam history or results¹¹ or other CRD system processing results; or the specific form filings and related information submitted during the course of a broker's career.¹² NASD also

does not release the date and reason for termination as reported on Form U-5. Further, as noted above, disclosure events reported via Form U-5 are disclosed only when (and if) a broker re-associates with another firm and is then required to report any new disclosure events via the Form U-4 filing submitted in connection with that application for registration. Similarly, the "firm information" currently disclosed through the PD Program does not include all information reported on Form BD, such as information regarding direct and indirect owners and control affiliates, answers and related details to all Form BD questions, disclosure information reported for control affiliates,¹³ or the actual initial Form BD and amendment filings submitted from time to time to keep a firm's CRD record current.

Given that state regulators and the SEC consider these form filings to be public documents,¹⁴ and with respect to Form BD, given that firms, as commercial entities, do not have the privacy interests of individual brokers, NASD seeks comment on whether or not it should expand the information released through its PD Program pursuant to IM-8310-2 to include some or all of the additional information described above – or any other information not specifically mentioned in this *Notice*. For example, should NASD expand its PD Program to include additional information reported on current Uniform Forms and provide investors access to historical form filings that may include disclosure events that are no longer reportable?

In considering any expansion of the information released through the PD Program, NASD will continue to balance the benefits of making this information available against the legitimate proprietary interests of member firms

and the privacy interests of associated persons and other individuals whose information might be subject to disclosure. For example, NASD does not currently release personal information such as Social Security Number, home address or physical description of associated persons, and has no plans to do so. Further, NASD does not intend to disclose the date of termination and/or reason for termination as reported on Form U-5 until such time as the Form U-5 is amended to allow firms to correct any filing errors made in reporting the date or reason for termination.¹⁵

NASD also seeks comment on whether it should provide a means for former brokers to file a response to information filed on Form U-5 by a firm with which they were associated or filed by a regulator on Form U-6. Further, NASD seeks comment on whether such a response should be through a Uniform Registration Form filing (either an existing form or a new form created for this purpose) and whether such response should be included in the CRD system and the PD Program or whether such response should be filed exclusively with NASD and made available only through the PD Program.

Putting the Information in Context

Although NASD cannot rate brokers or firms or specifically advise an investor whether or not to conduct business with a particular broker or firm, NASD believes that expanding the information available through the PD Program to include certain comparative information would help an investor better understand and evaluate the information on the specific broker or firm he or she may be interested in or how his or her broker or firm compares to the rest of the industry.

NASD seeks comment on whether or not to expand the information released through the PD Program to include comparative information to help put the specific broker or firm information into context. For example, NASD proposes adding comparative information such as the total number of active brokers or firms, certain industry averages, the universe of active brokers or firms that have disclosure, the average number of disclosure events by category for brokers or firms that do have disclosure, and possibly breaking down the total number of disclosure events for a broker or firm by the number of disclosure events initiated in the past 1, 3, or 5 years or that occurred more than 10 years ago.

Comment on the Public Disclosure Program

In addition to the specific issues for comment identified in this section, NASD seeks comment on the PD Program in general, including comment on: making disclosure information available online; expanding the information made available through the PD Program; the overall design and delivery of information available via the Public Disclosure Internet application (accessing the application, navigation, online delivery of the information, display and usability of the data); and a Public Disclosure report update service (including the types of events that would trigger an update).

3. Implement Additional Safeguards to Ensure Timely Reporting of Disclosure Information.

The largest and most visible component of NASD's Public Information is the PD Program. The PD Program depends largely on the system of firm and broker

self-reporting to the CRD system through the uniform registration forms. Although there are a broad range of safeguards¹⁶ in place today that serve as a “check and balance” to the overall self-reporting process, NASD believes more can be done across NASD regulatory systems to ensure data integrity, reduce or eliminate reporting gaps, and ensure that the information is reported quickly, thereby providing investors and the general public with the most current and complete information. NASD also believes that these additional safeguards will not increase an individual or firm’s current reporting obligations or add significant burdens to firm compliance activities and requirements.

In this regard, NASD is considering the following additional safeguards to help achieve its objectives:

- ♦ Expand existing NASD staff review of sources of information other than the CRD system to ensure that information required to be reported by firms and brokers through the CRD system is filed in a timely manner.
- ♦ Implement a new NASD agent registration status called “Inactive Disclosure Review” that would be applied whenever NASD staff discovers that an individual in an approved NASD registration status fails to meet a reporting requirement or fails to respond to a staff request for disclosure or related information within a prescribed period of time. This “Inactive Disclosure Review” status would parallel the existing “Inactive CE” and “Inactive Prints” agent registration statuses. A representative with this status would not be permitted to conduct sales or other regulated activity until the reporting obligation or response to the staff’s request is satisfied.
- ♦ Impose a late disclosure filing fee whenever a new disclosure event, or a required update to an existing disclosure event, is reported to NASD more than 30 days¹⁷ from the date triggering the reporting obligation (e.g., the date the action was initiated or the date the firm or individual learned of the facts or circumstances giving rise to the reporting requirement).¹⁸
- ♦ Require all registered individuals (approximately 7.5 percent of registered representatives) who have not yet filed a Form U-4 amendment electronically through the CRD system to do so. This will ensure that regulators and the investing public have access to information reported on the current registration forms and verified by the filing broker and firm.¹⁹
- ♦ Establish a web page on NASD’s Web Site where investors, attorneys or others can report instances where they believe a particular disclosure event that is required to be reported via Form U-4, Form U-5, or Form BD has not been reported. The underlying premise of this proposal is that an investor or other interested individual would alert NASD of the potential reporting requirement after viewing an individual or firm’s Public Disclosure information and seeing that the specific event in question (e.g., complaint or arbitration they had filed) is not included as part of the broker or firm’s public disclosure record.

NASD seeks comment on the safeguards noted above and any additional safeguards that NASD should consider.

4. Improve Ease of Access to Arbitration Awards.

NASD developed the *Securities Arbitration Commentator (SAC)* portal to provide access to arbitration awards for parties in subsequent arbitration cases. As part of the arbitrator selection process, parties are entitled to review the background of all potential arbitrators for their case, including prior decisions of those arbitrators. For each potential arbitrator, NASD provides parties with a report containing extensive background information and a list of that arbitrator's prior awards. With that list, parties can easily view or print awards at any time with no charge. This mechanism was designed to replace a system in which the parties requested copies of awards from NASD. Many requests were extensive and the more voluminous requests resulted in fees charged to parties.

SAC collects arbitration awards from NASD, from other self-regulatory organizations, and from the American Arbitration Association. SAC is in business to provide award summaries and searches of its award database for a fee. SAC's customers are typically attorneys for parties in arbitration matters. However, it may be possible for NASD to work with SAC to enhance the services available to individual investors in a public disclosure context. In addition, the PD Program could be enhanced to identify awards in a way that would allow more meaningful searches using the current SAC database.

NASD seeks comment on these approaches and other issues regarding the availability of dispute resolution information.

5. Other NASD Information

NASD collects a broad range of information to fulfill its regulatory mission. Because of the proprietary and confidential nature of much of this information, and its potential use in investigations, examinations or disciplinary actions, NASD believes that this information should remain non-public. In assessing whether this information should be made public, NASD initially has concluded to implement the safeguards described above to ensure that the regulatory information most pertinent to investors (*i.e.*, the information generally elicited by the uniform registration forms) is timely and fully reported to the CRD system (so it is available to regulators) and the PD Program so that it is available to investors and other users.

NASD seeks comment on this proposed approach and on any other information that NASD should consider making publicly available.

Summary

As previously stated, NASD currently provides an unparalleled amount of information about firms, markets and regulation to the public. NASD's policy on public information, as established by various NASD rules, and guided by relevant federal law, has been the topic of frequent public attention. NASD has undertaken a corporate-wide initiative to review (1) the information it collects or develops and (2) the policies underlying its determination to make certain information public. The overall objective of this initiative is to develop recommendations for a comprehensive Public Information Policy that will enhance investor protection without sacrificing the effectiveness of NASD

regulatory programs or legitimate proprietary or privacy rights of member firms or their associated persons, or increasing member firms' compliance obligations or burdens. Soliciting the views of NASD's constituents and the users of the information NASD makes public is a critical step in the conduct of this policy review.

As discussed in this *Notice*, NASD is considering changes that would expand the information it currently makes public, including changes to its PD Program.

One of the key challenges in conducting this policy review is the need to balance investor protection and an investor's ability to make informed decisions with the legitimate proprietary interests of member firms and the privacy interests of associated persons and other individuals.

NASD believes that a more comprehensive Public Information Policy will enhance investor protection without sacrificing the effectiveness of NASD regulatory programs. NASD looks forward to receiving comments from members, associated persons, investors, investor groups, and other interested parties on the broad range of issues related to information NASD makes public and on whether commenters support or oppose the options discussed in this *Notice*.

Endnotes

- 1 NASD Interpretive Material (IM) 8310-2(a) governs the information released via NASD's PD Program.
- 2 This information is required to be reported by associated persons registered with NASD on their Uniform Registration Form U-4.
- 3 Other regulators may make this information public, depending on applicable law. See Note 9, below.
- 4 Form U-5: The Uniform Termination Notice for Securities Industry Registration.
- 5 Form U-4: The Uniform Application for Securities Industry Registration or Transfer.
- 6 Form U-6: Uniform Disciplinary Action Reporting Form.
- 7 Form BD: Uniform Application for Broker-Dealer Registration. Form BD is an SEC form. As such, the SEC must adopt any proposed changes to Form BD.
- 8 NASD operates the CRD system in accordance with an agreement with the North American Securities Administrators Association (NASAA). CRD policy is jointly established by NASD and NASAA.
- 9 NASD's PD Program is governed by federal law, SEC regulations, and NASD rules approved by the SEC. Other sources may be governed by different substantive legal requirements. State disclosure programs are governed by state law, which may enable the State to provide additional information on firms or brokers licensed by the state.
- 10 Broker information currently released via the PD Program includes the broker's name and CRD number, approved registrations (provided the individual is NASD registered), 10 years of employment history (includes current and previous employment), "other business" (if any) as reported on Form U-4, and all disclosure events currently required to be reported on Form U-4 (including disclosure events reported by regulators via Form U-6, and disclosure events reported by previously employing NASD firms via Form U-5 once a subsequent Form U-4 is submitted and the individual is then required to report any new disclosure events via Form U-4). Information released through the PD Program on current and former NASD registered firms includes: applicant's name, CRD number, SEC number, main office address, mailing address, business telephone number, NASD district office assignment, approved registrations (provided the firm is NASD registered), all disclosure events involving the firm required to be reported on Form BD (including disclosure events reported by regulators via Form U-6), and summary information about securities (or commodities) related NASD arbitration awards.
- 11 Exam information includes: exams requested, taken or not taken, and exam results (i.e., pass/fail or specific grades). NASD proposes providing pass/fail instead of actual scores in part because the number of questions and the required passing score varies from exam to exam and can change over time. Exam scores are not designed to predict performance or future regulatory compliance.
- 12 Historical form filing information includes the specific form filings submitted to the CRD system and the information contained in the specific filing, including any disclosure events that were reported in error or that were required to be reported on a specific filing but are no longer reportable on the individual's current Form U-4 filing (based on a change to the question or a "sunset" provision within the question that requires reporting only for a specified period of time).
- 13 Control affiliate disclosure can be obtained (if reported to the CRD system) by a separate request for information on the control affiliates.
- 14 Forms U-4, U-5, U-6, BD, BDW and related amendment filings.
- 15 The Form U-5 and related instructions do not currently allow firms to amend any information reported on the form other than the associated person's residential address and disclosure information. As a result, firms that may make filing errors by entering an incorrect date or selecting an incorrect reason for termination from a drop down list have no mechanism to correct these errors via a Form U-5 amendment filing.

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- 16 Today's safeguards include, but are not limited to: Criminal History Record Information (CHRI) received from the Federal Bureau of Investigation as part of the fingerprint card processing results, which provides an independent source of criminal history information (fingerprint cards are submitted to NASD pursuant to Exchange Act Rule 17f-2); regulator reporting of disciplinary actions initiated against a broker or firm via Form U-6; and existing information sharing within NASD departments and among other regulators.
- 17 Note that 30 calendar days is used here as an example. The requisite number of days is to be determined; however, it likely would be based on calendar days, and would be at least 30 days, except in cases involving a statutory disqualification. NASD's By-Laws, Article IV, Section 1(c) and Article V, Section 2(c), state that all applications with NASD must be kept current at all times by supplementary amendments and that such amendments should be filed with NASD not later than 30 days after learning of the facts or circumstances triggering the amendment filing requirement. Further, if the amendment involves a statutory disqualification as defined in Section 3(a)(39) and Section 15(b)(4) of the Exchange Act, the By-Laws state that the amendment should be filed not later than 10 days after the disqualification occurs.
- 18 The intent of the late filing fee is not to generate revenue, but rather to deter late filing and ensure that the required amendment filings are submitted timely, thereby making the information available to the public as soon as possible. The fee would be imposed any time a reportable event was initially disclosed more the 30 days from the event date.
- 19 In substantially all cases, the information provided through the PD Program represents the verbatim record as it was reported to NASD on the uniform registration form then in effect. The disclosure and other questions on these forms have changed substantially over time. In addition, in certain limited circumstances relating to the conversion to electronic form filing, NASD combined information about a single event that was reported by different sources. Filing electronically on the current form would address both issues. No fee would be charged member firms for this filing, unless the filing reported new or updated disclosure, in which case the standard disclosure review fee would apply.
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