

NASD NOTICE TO MEMBERS 96-85

Customer Complaint Reporting Rule Update

Suggested Routing

- ☐ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ☒ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ☐ Operations
- ☐ Options
- ☒ Registration
- ☐ Research
- ☐ Syndicate
- ☒ Systems
- ☐ Trading
- ☒ Training

Executive Summary

On September 8, 1995, the Securities and Exchange Commission (SEC) approved NASD[®] Rule 3070 (formerly Article III, Section 50 of the NASD Rules of Fair Practice) (the Rule) for reporting customer complaint information and other specified events to NASD Regulation, Inc. (NASD Regulation). The Rule, which became effective on October 15, 1995, requires members to report to NASD Regulation the occurrence of 10 specified events, as well as quarterly summary statistical information regarding written customer complaints. Quarterly statistical electronic submissions were first due to NASD Regulation on January 15, 1996. (See *Special Notice to Members 95-81*.)

This Notice responds to the most common questions that members have raised relative to the Rule. Questions regarding this Notice may be directed to Daniel M. Sibears, District Oversight, NASD Regulation, at (202) 728-6911, or David A. Spotts, Office of General Counsel, NASD Regulation, at (202) 728-8014.

Background

NASD Regulation has established as a focus of its regulatory programs intense sales-practice examinations of member firms that employ registered persons who may pose heightened risks to public investors due to past misconduct related to abusive sales and trading practices (profiled registered representatives). To assist the NASD in the identification of profiled registered representatives, NASD Regulation has developed an automated system that draws on the Central Registration Depository (CRD) and NASD RegulationSM internal regulatory systems to analyze the current registered representative population. When this system is integrated with other sources of

information relating to examinations, disciplinary actions, customer complaints, and terminations for cause, NASD Regulation has the capacity to more precisely identify registered representatives who may pose risks to public investors, and thus, should be subject to closer than normal regulatory scrutiny.

In further support of these efforts, on October 1, 1995, the NASD adopted, with SEC approval, a customer complaint reporting rule. The Rule significantly strengthens NASD Regulation's regulatory and surveillance efforts by requiring member firms to report to NASD Regulation the occurrence of certain specified events, within 10 business days, and to file quarterly statistical information regarding written customer complaints.

The information reported by members provides NASD Regulation with important regulatory information that assists with the timely identification of problem members, branch offices, and registered representatives to detect and investigate potential sales practice violations. The Rule significantly parallels comparable provisions of New York Stock Exchange (NYSE) Rule 351 and it exempts members that are currently subject to NYSE 351 from the requirements of the Rule to ensure that there is no regulatory duplication for dual NASD/NYSE members.

To assist members in their compliance efforts, NASD Regulation is publishing this Notice to provide answers to frequently asked questions regarding the customer complaint reporting system and the Rule. The questions and answers have been organized into two sections; the first discusses system implementation issues and the second provides answers to interpretive questions regarding the application of the Rule.

Questions And Answers

I. Systems Implementation Questions And Answers

Question #1: What information is required to be provided when the firm's ID/CRD and SEC numbers are requested by the computer prompt?

Answer: The communications software, NASDnet, requires the member to provide six and five characters for the ID/CRD and SEC numbers, respectively. For example, if the firm's ID and SEC numbers are 12 and 8-99, respectively, provide 000012 for the firm's ID and 8-00099 for the SEC number.

Question #2: Under the customer complaint reporting section of the *Customer Complaint System User Manual* (Chapter Four, Page 29), what date should be provided when the software prompt asks for the date of the complaint letter? Should the member report the receipt date or the date of the written customer complaint letter?

Answer: To assist in a more efficient quarterly cutoff of customer complaint information, the complaint date should be the date the complaint letter is **first received** by the member. The member should maintain a systematic method (e.g., date stamping) for recording the dates that customer complaints are first received by the member. As a result of using the receipt date, the member may receive customer complaint letters during the current calendar quarter that are dated by the customer before the current calendar quarter.

Question #3: Once a customer complaint quarterly filing or specified event filing is submitted to NASD Regulation within the required time frames, is the member under any obligation to update or amend the earlier filing? For example, the member may subsequently learn

through an internal investigation that, in the member's opinion, the earlier submitted customer complaint is without merit.

Answer: No. A member should not update or modify an earlier submission to NASD Regulation unless the member learns that there was an error in the information previously submitted. Even if the member learns that the information in a customer complaint is later filed without action, a member is not permitted to delete or modify this earlier customer complaint submission.

Question #4: If a member receives a customer complaint letter regarding an associated person's conduct that includes more than one allegation, security, or damage amount, what information is the member required to submit to NASD Regulation?

Answer: The member is obligated to send one report for each customer complaint letter received. Even though the complaint may include more than one allegation, security, or damage amount, the member should report the most egregious problem code alleged (e.g., fraud, misrepresentation, unauthorized transaction), the security associated with the most egregious problem code, and the highest alleged damage amount.

Question #5: If more than one associated person is named in a customer complaint (i.e., an associated person and a branch manager or two associated persons), what information is the member required to submit to NASD Regulation?

Answer: A member is obligated to report a customer complaint filing for each person named in a customer complaint. Thus, if two associated persons are named by the complaint, the member should report two separate customer complaint filings to NASD Regulation.

II. Interpretive Questions And Answers

Question #1: Must all customer complaints received by a member, including non-sales practice complaints, be submitted to NASD Regulation through the electronic customer complaint reporting system?

Answer: Yes. All written customer complaints received on or after October 1, 1995, by a member are subject to the Rule and are required to be submitted to NASD Regulation. The term complaint would include all customer-initiated documents that involve a "written grievance."

Question #2: If a member receives a customer complaint on October 1, 1995, and receives a second written complaint from the same customer after October 1, 1995, regarding the same matter that includes new allegations regarding the member or an associated person, must the member consider the second letter a new customer complaint under the Rule?

Answer: Yes. Both letters would be subject to the Rule and should be submitted to NASD Regulation in the member's quarterly filing. The second letter involves a new grievance by the customer against an associated person or member, and the substance of the new allegations must be reported.

Question #3: Specified event number 10 [section (a)(10) of the Rule] requires a member to report to NASD Regulation the existence of any disciplinary action initiated by the member, including suspension, against an associated person. In this regard, is a member required to submit a filing under specified event item number 10 for each associated person who fails to meet his or her mandatory continuing education requirements under the Regulatory Element?

Answer: No. Associated persons who fail to satisfy their Regulatory Element continuing education requirements will have their registrations placed in an “inactive” status, and therefore, are not considered suspended under the specified event item. Of course, an associated person who is placed in an inactive status would be prohibited from functioning in any capacity that would require registration during this period of time.

Question #4: If a member and associated person(s) are defendants or respondents, or are subject to any claim for damages by a customer and, as a result of a judgement, award, or settlement, the parties have “joint and several” liability of over \$25,000, are two disclosure reports required to be submitted to NASD Regulation?

Answer: Yes. Both are involved in the claim for damages by the customer, and pursuant to the joint and several order, reports for each event must be made under the Rule. Under specified event items number 7 and 8 [Sections (a)(7) and (a)(8)] of the Rule, any judgment, award, or settlement in an amount over \$15,000 for an associated person and over \$25,000 for a firm, respectively, must be submitted to NASD Regulation. Since the liability is joint and several, the amount for each named party must be aggregated and reported as if the member and associated person(s) are separately liable for the specified amount. Since the amount in the above example is in excess of \$25,000, reports for the member firm and the associated person(s) must be filed.

Question #5: If a member receives a claim for damages by a customer in an amount that exceeds the \$15,000 or \$25,000 reporting thresholds referenced in Question #4, and the member decides to rescind the transaction

that was the subject of the claim, must the member submit a filing with NASD Regulation based on a specified event item?

Answer: Yes. Although a member may believe that the customer’s actual damages were negligible (i.e., less than the reportable amount) in light of the rescission, the written complaint nevertheless involved amounts that triggered the reporting thresholds. It is the total amount claimed by the customer or the amount of the rescinded transaction that is taken into consideration in determining whether to file under the Rule.

Question #6: Are insurance affiliated broker/dealers (IABD), or broker/dealers who also maintain insurance operations in the same corporate entity, required to include in their quarterly customer complaint statistical reports customer complaints involving persons who are both registered representatives and insurance agents who receive customer complaints regarding the sale of insurance-related non-securities products (e.g., fixed insurance products)?

Answer: No. Subsection (c) of the Rule defines “customer” as any person other than a broker/dealer with whom the member has engaged, or has sought to engage, in **securities activities**, therefore, it was intended to exclude non-securities products.

All affected members must report all customer complaints involving securities products that involve persons who are both registered representatives and insurance agents, but should **not** report complaints that relate to non-securities activities (such as fixed insurance products) from the member’s quarterly customer complaint submission.

Question #7: As a follow-up to Question #6, are there any circumstances under which a member must

report a customer complaint involving the sale of an insurance-related non-securities product?

Answer: Yes. Sub-section (a)(2) of the Rule requires a member to report to NASD Regulation a specified event filing within 10 business days when a member or associated person “is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery.” Therefore, affected members must report certain customer complaint information, including information relating to the sale of insurance related non-securities products.

Question #8: If a member settles an arbitration or civil litigation on or after October 1, 1995, in excess of the threshold amounts for a matter commenced prior to October 1, 1995, is the member required to submit a filing based on a specified event item?

Answer: Yes. In determining whether to submit a filing based on specified event item number 7 [section (a)(7)], a member should submit a filing based on the date of the judgment, award, or settlement and not the date of the original matter.

Question #9: If a mutual fund distributor broker/dealer receives a customer complaint regarding an alleged sales practice problem of another selling broker/dealer (or associated person of such other broker/dealer), is the mutual fund distributor broker/dealer required to file the complaint with NASD Regulation?

Answer: No. Since the customer complaint involves the sales practices of another member broker/dealer, the mutual fund broker dealer is not obligated to file the report for the other member firm. The mutual fund broker/dealer should promptly provide the customer complaint to the

selling broker/dealer and retain a copy of the original customer complaint in its records. While not required by the Rule, the distributor broker/dealer is encouraged to provide a copy of the complaint to the local NASD Regulation District Office.

Question #10: If a member terminates a registered person as a result of an internal investigation or inquiry by the member and then properly files a Form U-5 with CRD, must the member also submit a specified event item with NASD Regulation under the Rule?

Answer: Yes. Although the member has submitted a timely Form U-5 through the CRD system, the member must also submit a specified event item number 10 [section (a)(10)] filing through the customer complaint reporting system.

Question #11: When NASD Regulation receives a customer complaint directly from a customer and the

member firm has not received the complaint or a copy, upon notification and receipt of the complaint by the member from NASD Regulation, is the member obligated to report the complaint through the customer complaint reporting system?

Answer: Yes. Although NASD Regulation is already investigating the customer complaint, the member is still required to report the complaint in its quarterly filing or specified event filing.

Question #12: If a member receives a customer complaint alleging theft, misappropriation of funds or securities, or forgery and files the appropriate specified event filing under section (a)(2) with NASD Regulation within 10 business days, is the member also required to submit a quarterly customer complaint filing with NASD Regulation regarding the same event?

Answer: Yes. Although a member timely files its specified event filing

number 2, the member is also obligated to submit a separate report of the customer complaint in its next quarterly statistical filing.

Question #13: If a member receives notification that it or an associated person was named in an arbitration or civil litigation regarding a customer dispute, is the member obligated to file either a specified event filing or a customer complaint filing with NASD Regulation?

Answer: No. Under the Rule, a member is obligated to report only settled or completed arbitrations or civil litigation matters and only where the award, judgment, or settlement exceeds a certain specified dollar amount. The member may, however, have a separate obligation to report these matters to the NASD through the CRD system on Forms U-4, U-5, and BD.