

Special NASD Notice to Members 98-71

NASD Regulation Requests
Comment On Whether To
Modify The Public Disclosure
Program To Limit The Period
For Disclosure Of Certain
Criminal Information;
**Comment Period Expires
September 30, 1998**

Suggested Routing

- ☒ Senior Management
- ☐ Advertising
- ☐ Continuing Education
- ☐ Corporate Finance
- ☐ Executive Representatives
- ☐ Government Securities
- ☐ Institutional
- ☐ Insurance
- ☐ Internal Audit
- ☒ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ☐ Operations
- ☐ Options
- ☒ Registered Representatives
- ☒ Registration
- ☐ Research
- ☐ Syndicate
- ☐ Systems
- ☐ Trading
- ☐ Training
- ☐ Variable Contracts

Executive Summary

Under the current interpretation governing the Public Disclosure Program, information on all felony offenses is disclosed indefinitely. NASD Regulation, Inc. (NASD Regulation) requests comment from members and other interested persons on whether to: (1) maintain the current interpretation; or (2) amend the interpretation to disclose indefinitely information concerning "investment-related" offenses, as described below, but limit to 10 years disclosure of information concerning all other felonies. Any such change would not affect the information required to be reported on Form U-4 and permanently made available to federal and state regulators, self-regulatory organizations (SROs), and prospective employers in the securities industry. In other words, such information would remain on an individual's record, but as proposed would not be disclosed publicly after 10 years.

NASD Regulation is seeking comment on this issue at this time for two principal reasons. First, associated persons have expressed the view that some aged felony charges or convictions do not bear any relationship to the securities industry or reflect on their capacity for fair dealing. Second, information disclosed under the Public Disclosure Program will soon be more easily and widely accessible via the NASD Regulation Web Site (www.nasdr.com). NASD Regulation will weigh the comments it receives in determining whether or not continued public disclosure of certain aged felony offenses through this widely accessible medium strikes the most appropriate balance between a public investor's interest in knowing relevant information about an associated person and such person's privacy and reputational interests.

Questions concerning this *Request For Comment* may be directed to Ann E. Bushey, Assistant Director,

CRD/Public Disclosure, NASD Regulation, at (301) 590-6389; Mary M. Dunbar, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8252; or Richard E. Pullano, Counsel, CRD/Public Disclosure, NASD Regulation, at (301) 212-3789.

Request For Comment

NASD Regulation encourages all interested parties to comment on the proposal. Comments should be mailed to:

Joan Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500

or e-mailed to:
pubcom@nasd.com

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

Comments must be received by **September 30, 1998**. Before becoming effective, any rule change developed as a result of comments received must be adopted by the NASD Regulation Board of Directors, may be reviewed by the National Association of Securities Dealers, Inc. (NASD®) Board of Governors, and must be approved by the Securities and Exchange Commission (SEC).

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Background And Discussion Current Interpretation On Disclosure

The securities industry and its regulators have established exceptionally stringent licensing and qualification requirements. Among other things, persons seeking registration to sell securities are required to file a Form U-4 with Central Registration Depository (CRD) that describes their employment and disciplinary history, including whether they have been charged with or convicted of any felony or certain misdemeanors. Form U-4 requires reporting of any charge or conviction of, or guilty and no contest plea to: (1) any felony or misdemeanor involving investments or investment-related business, fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses (hereinafter collectively referred to as "investment-related" offenses); and (2) any other felony (hereinafter referred to as "other felony" offenses).¹

Under NASD Regulation's current Public Disclosure Program (Program), all of this criminal history, as well as other employment and disciplinary information reported to the CRDSM system, is disclosed to the public in response to a written, telephonic, or electronic inquiry. The Program is governed by Interpretive Material 8310-2 of the NASD rules (Interpretation). The principal purpose of the Program is to help investors make informed choices

about the persons and firms with whom they may wish to do business. The securities industry is unique in providing this level of information about its licensed persons to the public.²

The NASD established the Program in 1988. At that time, investors were required to make their inquiries in writing. In 1990, Congress amended the Securities Exchange Act of 1934 (Exchange Act) to expand access to the Program by requiring the NASD to establish and maintain a toll-free telephone number to receive investor inquiries.³ Until 1998, the NASD responded to all inquiries by mailing a summary of the public disclosure information to the requester. In 1998, the Program was expanded to provide administrative data (*e.g.*, employment history, registration statuses, etc.) via the Internet and to accept electronic mail requests for any remaining public disclosure information; NASD Regulation responds to such requests by electronic mail. In 1999, NASD Regulation will expand disclosure via the Internet further to provide any requester with on-line access to all information disclosed under the Program, including criminal history.

Proposed Change To Interpretation

In response to a variety of concerns raised by a number of associated persons, NASD Regulation is seeking comment on a policy change that would establish a 10-year time limit on disclosure of information on "other felonies."⁴ NASD Regulation believes it is appropriate to seek comment at this time because of the unique nature of the Program and the significant issues implicated by the current Interpretation. NASD Regulation presented this proposed policy change to a number of NASD Regulation district and standing committees and received mixed responses.

Some associated persons and others have argued that aged information on "other felony" offenses is unrelated to the securities business or to the person's capacity for fair dealing, and therefore such information is not relevant to an investor's decision to do business with a particular person. According to this view, public disclosure of such information through the Web Site for an indefinite period of time subjects associated persons to a continuing penalty that serves no remedial purpose, particularly if the criminal charge or conviction occurred many years ago and the person's disciplinary record is otherwise unsullied. In addition, there is some concern that the ease of Web access and the instantaneous provision of information will encourage persons other than investors (*e.g.*, neighbors or competitors) to investigate the associated person's background and misuse the information. This concern extends not only to business and personal reputations, but also to the reputations of children, spouses, and other family members, particularly where the associated person and his or her family live in a small community.

The proposed policy change would address these concerns by limiting to 10 years the public disclosure of "other felony" offenses, which would include, among others, driving while intoxicated, possession or sale of controlled substances, and certain violent crimes. For example, if a 50-year-old registered person had been charged with, or convicted of, driving while intoxicated at age 25, and the offense in that particular state was a felony, then NASD Regulation could discontinue disclosure under the proposed policy change.

The 10-year time limit is consistent with other provisions of the law that concern the disclosure or probative value of criminal history information. For example, the 10-year limit would

ensure public disclosure of the "other felony" convictions that cause someone to be subject to a statutory disqualification under the provisions of the Exchange Act during the period that they are subject to disqualification. Such individuals may not apply to work or, if registered, continue to work in the securities industry without first seeking and obtaining appropriate regulatory approvals.⁵ A 10-year disclosure period for "other felony" offenses also is consistent with the 10-year time limitation for the reporting of all criminal events for member firms and their control affiliates on Form BD.⁶ Further, Rule 206(4) under the Investment Advisers Act of 1940, which specifies which financial and disciplinary information an investment adviser must disclose to a client, requires disclosure of convictions for specified offenses for a period of 10 years from the time of the event. Finally, the Federal Rules of Evidence place a low probative value on convictions that are more than 10 years old in determinations of admissibility for purposes of impeaching the credibility of a witness.⁷ These provisions of law suggest that the proposed 10-year limit on disclosure of certain felonies may be appropriate.

While some NASD Regulation district and standing committees expressed support for this proposal for the reasons set forth above, other committees expressed opposition to the proposal. Some committees expressed concern that non-disclosure of even aged criminal information could undercut the investor education and protection purposes of the Program. Some investors may believe any information concerning an associated person's ability to obey the law is relevant, even after 10 years; for such investors, criminal behavior may reflect on the associated person's moral character, which may affect the investor's ability to develop a trusting business relation-

ship.⁸ Some committees expressed concern that the proposal could have incongruous results, *i.e.*, indefinite disclosure of insignificant misdemeanor offenses but time-limited disclosure of serious felonies. To avoid such results, some committees suggested that violent crimes against a person, certain crimes against the government (including tax evasion), and offenses involving drug trafficking should always be disclosed, but that disclosure of certain misdemeanor convictions and criminal charges could be time-limited. Such misdemeanors could include, for example, a shoplifting offense involving an item of little value or an offense that could be characterized as a "youthful indiscretion."

In light of these concerns, NASD Regulation seeks comment as to whether an alternative proposal to that described in the Executive Summary would be appropriate. For example, the classes of aged felony offenses that would not be disclosed could be narrowed to specified categories, or the period of disclosure could be lengthened to 15 or 20 years, rather than 10 years. In providing comments about any alternative proposal, NASD Regulation asks that commenters keep in mind the technical and administrative limitations of the Public Disclosure Program. While the computer systems that support the Program could be programmed to limit disclosure by date of occurrence or general category of offense (*i.e.*, "investment-related" felony, "investment-related" misdemeanor, or "other felony"), any further refinements would require the review of individual criminal histories and manual settings to the computer system, which would be costly, time-consuming, and necessarily more subjective.

Conclusion

The Public Disclosure Program serves an important investor protection purpose and has been endorsed by Congress and the Securities and Exchange Commission (SEC). NASD Regulation believes that careful consideration should be given to balancing the interests of both the investing public and associated persons, particularly given the personal privacy interests implicated by permitting the public to obtain criminal information anonymously over the Internet, when such information otherwise would not be available to the public without considerable effort.⁹ Accordingly, NASD Regulation seeks comment from interested parties on what standard of disclosure strikes an appropriate balance between an investor's interest in relevant information and an associated person's privacy interest.

Request For Comment

NASD Regulation encourages all interested parties to comment on the proposal. Comments should be mailed to:

Joan Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500

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

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Endnotes

¹ Form U-4 has elicited information about all felony offenses since 1981. In 1990, with the passage of the International Securities Enforcement Cooperation Act of 1990, convictions less than 10 years old for any felony offense (not just those relating to investments, fraud, or theft) became the basis for a statutory disqualification under Section 3(a)(39) of the Exchange Act.

² NASD Regulation is not aware of any other profession that discloses on-line such comprehensive disciplinary and criminal history, even if such information is required to be reported for licensing purposes. Currently, 14 states provide information on-line about medical professionals, including physicians, physician's assistants, and nurses. See www.docboard.org. Like the current Public Disclosure Program on the Internet for brokers, most states provide the medical professional's name, status, work address, birth date, date of license and license expiration, education, and specialty. Twelve of the 14 states also include whether "disciplinary" information exists; if so, the Web sites do not provide details on-line but rather direct the person to contact the state medical board. Two states, California and Massachusetts, provide disciplinary information on-line. California releases certain hospital disciplinary actions, malpractice judgments, and arbitration awards. Massachusetts releases any of the following that occurred in the last 10 years: felony or serious misdemeanor convictions, malpractice actions, and disciplinary actions by a hospital or the state medical board.

³ Section 15A(i) of the Exchange Act provides, in pertinent part, "[a] registered securities association shall . . . establish and maintain a toll-free telephone listing to receive inquiries regarding disciplinary actions involving its members and their associated persons, and . . . promptly respond to such inquiries in writing." The legislative history indicates that the appropriate scope of disciplinary actions should be developed by the NASD, working with the SEC and state securities regulators. The toll-free number is (800) 289-9999. The NASD received over 137,000 requests for public disclosure summaries in 1997 via the toll-free number.

⁴ As under the current Interpretation, the "investment-related" offenses listed above would continue to be disclosed to the public indefinitely.

⁵ Under Section 3(a)(39)(F) of the Exchange Act, criminal convictions of felonies and certain enumerated misdemeanors that are more than 10 years

old do not cause a person to be subject to a statutory disqualification. The disqualification provisions in the Investment Company Act of 1940 (Section 9(a)(1)) and the Investment Advisers Act of 1940 (Section 203(e)) also contain 10-year limits for criminal convictions.

⁶ Form BD is the uniform form used by broker-dealers to apply for registration with the SEC, states, and SROs. The term "control affiliates" generally refers to owners, officers, and directors of the broker/dealer. A control affiliate is sometimes

required to file a Form U-4 as well, which, as described above, requires reporting of criminal history without time limitation.

⁷ Fed. R. Evid. 609.

⁸ Compare Jeffrey P. Donohue, Developing Issues Under the Massachusetts Physician Profile Act, 23 Am. J. Law & Medicine, 115, 120 (1997).

⁹ Although the criminal information at issue here generally is a matter of public record, the availabili-

ty of such information to the general public is usually limited or is difficult to access. NASD Regulation is not aware of any other organization or medium that would provide the general public with immediate access to this broad a range of criminal information in one centralized place.

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