

NASD Notice to Members 98-101

NASD Requests Comment On
Proposed Amendments To
Disclosure Questions On
Forms U-4 And U-5;
**Comment Period Expires
January 15, 1999**

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

NASD Regulation, Inc. (NASD RegulationSM) is proposing to amend disclosure questions on the Form U-4 and Form U-5 that were approved by the Securities and Exchange Commission (SEC) in July 1996, but have not been made effective pending the full implementation of the modernized Central Registration Depository (CRDSM), and is soliciting comment on the proposed amendments. First, NASD Regulation proposes to amend Question 22I(2) on the 1996 Form U-4 and Question 17B on the 1996 Form U-5 to require the reporting of any settlement for \$10,000 or more of an oral or written customer complaint alleging sales practice violations. The 1996 Forms U-4 and U-5 questions require such settlements to be reported only if the customer submits such a complaint in writing. Second, NASD Regulation proposes to amend Questions 14 and 15 on the 1996 Form U-5 to require a terminating firm to report certain criminal and regulatory actions on a former registered person that are initiated after that person is terminated if the action is in connection with events that occurred while the person was employed by or associated with the firm. The 1996 Form U-5 questions require a firm to report such actions only if the actions occurred while a person was employed by or associated with the firm. Finally, NASD Regulation proposes to amend Question 17 on the 1996 Form U-5, which requires a firm to report customer complaints filed against former registered persons, to harmonize it with the parallel question on the 1996 Form U-4 (*i.e.*, Question 22I). This proposed change is designed to permit the archiving of customer complaints that are more than 24 months old and no longer reportable, regardless of whether the customer complaint is reported on Form U-4 or Form U-5. The text of these disclo-

sure questions with the amendments follows this *Request For Comment*.

The North American Securities Administrators Association (NASAA) approved all of the amendments to the Forms U-4 and U-5 at its October 1998 membership meeting.

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, Associate Director and 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 **January 15, 1999**. 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 NASD Board of Governors, and must be approved by the SEC.

NASD Regulation Request For Comment 98-101

Executive Summary

NASD Regulation, Inc. (NASD RegulationSM) is proposing to amend disclosure questions on the Form U-4 and Form U-5 that were approved by the Securities and Exchange Commission (SEC) in July 1996, but have not been made effective pending the full implementation of the modernized Central Registration Depository (CRDSM), and is soliciting comment on the proposed amendments. First, NASD Regulation proposes to amend Question 22I(2) on the 1996 Form U-4 and Question 17B on the 1996 Form U-5 to require the reporting of any settlement for \$10,000 or more of an oral or written customer complaint alleging sales practice violations. The 1996 Forms U-4 and U-5 questions require such settlements to be reported only if the customer submits such a complaint in writing. Second, NASD Regulation proposes to amend Questions 14 and 15 on the 1996 Form U-5 to require a terminating firm to report certain criminal and regulatory actions on a former registered person that are initiated after that person is terminated if the action is in connection with events that occurred while the person was employed by or associated with the firm. The 1996 Form U-5 questions require a firm to report such actions only if the actions occurred while a person was employed by or associated with the firm. Finally, NASD Regulation proposes to amend Question 17 on the 1996 Form U-5, which requires a firm to report customer complaints filed against former registered persons, to harmonize it with the parallel question on the 1996 Form U-4 (*i.e.*, Question 22I). This proposed change is designed to permit the archiving of customer complaints that are more than 24 months old and no longer reportable, regardless of whether the customer complaint is reported on Form U-4 or Form U-5. The text of these disclosure questions with the amendments follows this *Request For Comment*.

The North American Securities Administrators Association (NASAA) approved all of the amendments to the Forms U-4 and U-5 at its October 1998 membership meeting.

Background And Discussion

NASD Regulation is proposing amendments to four disclosure questions on the Forms U-4 and U-5 that were approved by SEC in July 1996, but have not been made effective pending the full implementation of the modernized CRD.¹ As discussed below, these amendments involve changes to Question 22I(2) on the 1996 Form U-4, and Questions 14, 15, and 17 on the 1996 Form U-5. The text of these questions with the amendments marked follows this *Request For Comment*.

First, NASD Regulation proposes to amend Question 22I(2) on the 1996 Form U-4 and Question 17B on the 1996 Form U-5 regarding the reporting of settled customer complaints. The 1996 questions require the reporting of any settlement for \$10,000 or more of a *written* customer complaint alleging sales practice violations. NASD Regulation believes that a settlement of \$10,000 or more should be reported, regardless of whether the complaint that led to the settlement was written or oral. Thus, NASD Regulation proposes that the 1996 Form U-4 Question 22I(2) be amended to read as follows: "Have you even been the subject of an investment-related, consumer-initiated complaint, not otherwise reported under question 22I(1) above, which alleged that you were involved in one or more sales practice violations, and which complaint was settled for an amount of \$10,000 or more?" The question, as amended, would not require the reporting of all oral customer complaints alleging sales practice violations, just those that are settled for \$10,000 or more. A corresponding change to Question 17B on the 1996 Form U-5 also is proposed.

Second, NASD Regulation proposes to amend Questions 14 and 15 on the 1996 Form U-5, which require a terminating firm to report certain criminal actions and regulatory actions, respectively. The 1996 versions of these questions require a terminating firm to report criminal or regulatory actions involving an individual that occur while the individual was employed by or associated with the firm. NASD Regulation proposes to amend these questions by extending a firm's reporting obligation to include criminal and regulatory actions that are initiated after termination if the action is in connection with events that occurred while the individual was employed by or associated with the firm. This proposed amendment is intended to address those instances where a firm may have actual notice of the initiation of a criminal or regulatory action involving an individual after he or she has been terminated. Notwithstanding the proposed change, firms would not be required to report criminal or regulatory events that occur after an individual's termination if the firm has no notice of the event. In this regard, NASD Regulation is working with NASAA and other regulators to issue an interpretation that provides guidance on what constitutes actual notice. Generally speaking, firms would receive actual notice of the initiation of a criminal or regulatory action against a terminated person only if that action is based on events that occurred in connection with the former associated person's employment.

Finally, NASD Regulation proposes amending Question 17 on the 1996 Form U-5, which requires the reporting of certain customer complaints, to harmonize it with the parallel question on the 1996 Form U-4 (*i.e.*, Question 22I). The proposed change is designed to permit the archiving of customer complaints that are more than 24 months old and no longer

reportable, regardless of whether the customer complaint is reported on Form U-4 or Form U-5.

Proposed Revisions

(Note: New text is underlined; deletions are bracketed.)

1996 Form U-4 Question 22I(2):²

Have you ever been the subject of an investment-related, consumer-initiated [written] complaint, not otherwise reported under question 22I(1) above, which alleged that you were involved in one or more sales practice violations, and which complaint was settled for an amount of \$10,000 or more?

1996 Form U-5 Question 14:³

While employed by or associated with your firm, or in connection with events that occurred while the individual was employed by or associated with your firm, was the individual:

A. convicted of or did the individual plead guilty or nolo contendere ("no contest") in a domestic, or foreign or military court to any felony?

B. charged with any felony?

C. convicted of or did the individual plead guilty or nolo contendere ("no contest") in a domestic, foreign or military court to a misdemeanor involving: investments or an investment-related business, or any fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?

D. charged with a misdemeanor specified in 14(C)?

1996 Form U-5 Question 15:⁴

While employed by or associated with your firm, or in connection with events that occurred while the individual was employed by or associated with your firm, was the individual involved in any disciplinary action by a domestic or foreign governmental body or self regulatory organization (other than those designated as a "minor rule violation" under a plan approved by the U.S. Securities and Exchange Commission) with jurisdiction over the investment-related businesses?

1996 Form U-5 Question 17:⁵

A: In connection with events that occurred while the individual was employed by or associated with your firm, was the individual:

(1) named as a respondent/defendant in an investment-related, consumer-initiated arbitration or civil litigation which alleged that the individual was involved in one or more sales practice violations and which:

(a) is still pending, or;

(b) resulted in an arbitration award or civil judgment against the individual, regardless of amount, or;

(c) was settled for an amount of \$10,000 or more² [or, or;]

(2) the subject of an investment-related, consumer-initiated [written] complaint, not otherwise reported under question 17(A)(1) above, which alleged that the individual was involved in one or more sales practice violations, and which complaint was settled for an amount of \$10,000 or more?

B. In connection with events that occurred while the individual was employed by or associated with your firm, [but for a period not to exceed the most recent twenty-four (24) months of employment,] was the individual the subject of an investment-related, consumer-initiated written complaint, not otherwise reported under question 17(A) above, which:

[(1) alleged that the individual was involved in one or more sales practice violations and contained a claim for compensatory damages of \$5,000 or more (if no damage amount is alleged, the complaint must be reported unless the firm has made a good faith determination that the damages from the alleged conduct would be less than \$5,000), or];

(1) would be reportable under question 22I(3)(a) on Form U-4, if the individual were still employed by your firm, but which has not previously been reported on the individual's Form U-4 by your firm; or

[(2) alleged that the individual was involved in forgery, theft, misappropriation or conversion of funds or securities?]

(2) would be reportable under question 22I(3)(b) on Form U-4, if the individual were still employed by your firm, but which has not previously been reported on the individual's Form U-4 by your firm.

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.

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Endnotes

¹The NASD is currently using the Interim Forms U-4 and U-5 that were approved by the SEC in January 1998 for use until the modernized CRD is completed. The Interim Forms include all of the substantive changes and some of the changes to the instructions that were approved in 1996 and reformatted them in a manner that is compatible with the current CRD system.

²This Question appears as Question 22H(2) on the Interim Form U-4 (Rev. 11/97).

³This Question appears as Question 13C on the Interim Form U-5 (Rev. 11/97).

⁴This Question appears as Question 13A on the Interim Form U-5 (Rev. 11/97).

⁵This Question appears as Question 13B on the Interim Form U-5 (Rev. 11/97).

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