

Revised Forms U4 and U5

SEC Approval of Proposed Changes to Forms U4 and U5 and FINRA Rule 8312 (FINRA BrokerCheck Disclosure)

Effective Date: May 18, 2009

Effective Date (Regulatory Action Disclosure Questions): November 14, 2009

Executive Summary

The SEC recently approved amendments to Forms U4 and U5 as well as FINRA Rule 8312 (FINRA BrokerCheck® Disclosure).¹ The amendments, among other things, make significant changes to disclosure questions on the Forms, including the addition of questions about certain regulatory actions. The new regulatory action questions will enable FINRA and other regulators to identify more readily persons subject to a particular category of statutory disqualification under the federal securities laws and the FINRA By-Laws. Other amendments to the Forms include:

- ▶ new questions that require firms to report allegations of sales practice violations made against a registered person in an arbitration or litigation in which the registered person is not a named party; and
- ▶ an increase in the monetary threshold for reporting settlements of customer complaints, arbitrations or litigation from \$10,000 to \$15,000.

The revised Forms will be implemented in the Central Registration Depository (CRD® or CRD system) on May 18, 2009. The effective date for most of these changes (*i.e.*, the Forms changes and the amendment to FINRA Rule 8312)—with the exception of the new regulatory action disclosure questions—is May 18, 2009 (the “release date”). As discussed in more detail below, the effective date for the new regulatory action disclosure questions will be 180 days from the release date, or November 14, 2009.

May 2009

Notice Type

- ▶ Rule Amendment

Suggested Routing

- ▶ Legal and Compliance
- ▶ Operations
- ▶ Registered Representatives
- ▶ Senior Management
- ▶ Training

Key Topic(s)

- ▶ Central Registration Depository
- ▶ Form U4
- ▶ Form U5
- ▶ Statutory Disqualification
- ▶ Sales Practice Violations
- ▶ Willful Violations

Referenced Rules & Notices

- ▶ FINRA Rule 8312

Copies of the revised Forms are available at www.finra.org/crd/individualformchanges.

Questions concerning this *Notice* should be directed to:

- ▶ Richard E. Pullano, Associate Vice President and Chief Counsel, Registration and Disclosure, at (240) 386-4821; or
- ▶ Stan Macel, Assistant General Counsel, Office of General Counsel, at (202) 728-8056.

Background & Discussion

The SEC recently approved amendments to Form U4 (Uniform Application for Securities Industry Registration or Transfer) and Form U5 (Uniform Termination Notice for Securities Industry Registration) (together, the Forms) and to FINRA Rule 8312. As discussed in more detail below, the amendments:

- ▶ revise questions on the Forms to enable FINRA and other regulators to identify more readily individuals and firms subject to a particular category of statutory disqualification pursuant to Section 15(b)(4)(D) or (E) of the Exchange Act (referred to as willful violations);
- ▶ revise questions on the Forms regarding disclosure of arbitrations or civil litigation to elicit reporting of allegations of sales practice violations made against a registered person in arbitration or litigation in which that person is not a named party;
- ▶ raise the monetary threshold for reporting of settlements of customer complaints, arbitrations or civil litigation on the Forms from \$10,000 to \$15,000, and make a conforming change to reflect this revised monetary threshold in the description of “Historic Complaints” in FINRA Rule 8312;
- ▶ revise the definition of “Date of Termination” in Form U5, and enable firms to amend the “Date of Termination” and “Reason for Termination” sections of the Form U5, subject to certain conditions and notifications; and
- ▶ make additional clarifying, technical and conforming changes to the Forms.

These amendments become effective on **May 18, 2009**, except with regard to the new disclosure questions regarding willful violations, which become effective 180 days following this date, on **November 14, 2009**. Firms will be required to amend Forms U4 to respond to the new disclosure questions the first time they file Form U4 amendments for registered persons after May 18, 2009, at which time they may provide provisional “no” answers during the defined 180-day period), but must provide final answers to the questions no later than November 14, 2009, as discussed further below.

Revisions Regarding Willful Violations

The amendments modify the Forms to enable FINRA and other regulators to query the CRD system to identify persons who are subject to disqualification as a result of a finding of a willful violation. Specifically, the amendments add additional questions to existing Questions 14C and 14E on Form U4. Question 14C, which inquires about SEC and Commodity Futures Trading Commission (CFTC) regulatory actions, adds three new questions regarding willful violations, Questions 14C(6), (7) and (8). Similarly, Question 14E, which concerns findings by a self-regulatory organization (SRO), adds three identical questions in the context of findings by any SRO, Questions 14E(5), (6) and (7). The Form U4 Regulatory Action Disclosure Reporting Page (DRP) will continue to elicit specific information regarding the status of the events reported in response to these questions.

Adding new disclosure questions to Form U4 requires firms to amend such forms for all their registered persons. To ensure that firms have appropriate time to populate the forms accurately, FINRA will delay the effective date solely for the new regulatory action disclosure questions until 180 days from the effective date of the remainder of the proposed rule change, or November 14, 2009. This schedule will provide firms with up to 180 days from the release date to answer the regulatory action disclosure questions.

In addition, FINRA will allow firms, at their discretion, to file provisional “no” answers to the six new regulatory action questions during the 180-day period between the release date and the effective date of the regulatory action disclosure questions.² During this time, the regulatory action disclosure questions will appear (in the CRD system) in a manner designed to help denote that such questions are not effective until 180 days from the release date and that any answers provided in response to such questions are provisional until such time as those questions become effective (namely, 180 days from the release date). Any “no” answers filed in response to the new regulatory action disclosure questions during such 180-day period that are not amended before November 14, 2009, will become final, and the firm and subject registered person will be deemed to have represented that the person has not been the subject of any finding addressed by the question(s).

If a firm determines that a registered person must answer “yes” to any part of Form U4 Questions 14C or 14E, the amendment filings must include completed DRP(s) covering the proceedings or action reported.³ With respect to Form U5, the amendments did not alter Question 7D (Regulatory Action Disclosure), but added new Question 12C to the Form U5 Regulatory Action DRP. As of May 18, 2009, firms that answer “yes” to Question 7D on Form U5 will be required to provide more detailed information about the regulatory action in Question 12C of the DRP. For regulatory actions in which the SEC, CFTC or an SRO is the regulator involved, Question 12C requires firms to answer questions eliciting whether the action involves a willful violation. These questions

correspond to the questions added to the Form U4. A firm will not be required to amend Forms U5 to answer Question 12C on the DRP and/or add information to a Form U5 Regulatory Action DRP that was filed previously unless it is updating a regulatory action that it reported as pending on the current DRP.

Furthermore, FINRA will provide firms with the ability to upload a “batch” file of Form U4 amendments into the CRD system for all of their registered persons for purposes of filing “no” answers to all of the new regulatory action disclosure questions. This feature will enable firms to submit a single batch (or bulk) file for the purposes of filing such “no” answers on behalf of multiple registered persons.⁴

Lastly, FINRA has filed a proposed rule change with the SEC to allow firms to file amendments to the Form U4 disclosure information without obtaining the registered person’s manual signature under certain circumstances.⁵

Revisions Regarding Allegations of Sales Practice Violations Against Registered Persons Made in Arbitrations or Litigation in Which the Registered Person Is Not a Named Party

The Forms have been revised to require the reporting of allegations of sales practice violations made against registered persons in a civil lawsuit or arbitration in which the registered person is not a named party.⁶ Specifically, Question 14I on Form U4 and Question 7E on Form U5 were amended to require the reporting of alleged sales practice violations made by a customer against persons identified in the body of a civil litigation complaint or an arbitration claim, even when those persons are not named as parties. The amendments add new Questions 14I(4) and (5) to Form U4 and Questions 7E(4) and (5) to Form U5, which in most respects reflect the language of the corresponding questions regarding alleged sales practice violations of persons identified in consumer complaints (*i.e.*, Questions 14I(2) and (3) in Form U4 and Questions 7E(2) and (3) in Form U5). The new questions apply only to arbitration claims or civil litigation filed on or after May 18, 2009; applicants and firms are not required to answer Questions 14I(4) or (5) on Form U4 or Questions 7E(4) or (5) on Form U5 with respect to arbitration claims or civil litigation filed before May 18, 2009.

A “yes” answer to new Questions 14I(4) or 14I(5) in Form U4 or Questions 7E(4) or 7E(5) in Form U5 indicates that the applicant or registered person, though not named as a respondent/defendant in a customer-initiated arbitration or civil lawsuit, was either named in or could be reasonably identified from the body of the arbitration claim or civil litigation as a registered person who was involved in one or more of the alleged sales practice violations. A firm is required to report a “yes” answer only after it has made a good-faith determination after a reasonable investigation that the alleged sales practice violation(s) involved the registered person.⁷

As a result of these amendments, as of May 18, 2009, alleged sales practice violations made by a customer against persons identified in the body of a civil litigation complaint or arbitration claim (as described above) will be treated the same way that customer complaints are treated in the Forms.⁸ For example, such matters will be required to be reported no later than 30 days after receipt by the firm. In addition, as has been the practice with respect to customer complaints reported to the CRD system, registered persons will have an opportunity to provide context on the reported matter on Form U4; persons not currently registered with a FINRA member firm, but who were registered within the previous two years, will be afforded an opportunity to provide context on the reported matter through a Broker Comment.⁹ Such matters will be disclosed through BrokerCheck consistent with FINRA Rule 8312.¹⁰ To the extent such a matter becomes non-reportable (if, for example, the arbitration or litigation is dismissed and the dismissal is not part of a settlement, or it is settled for less than the monetary threshold designated on Form U4), it will, like other customer complaints that become non-reportable, be eligible for disclosure through BrokerCheck as an “Historic Complaint,” provided it meets certain criteria.¹¹

Revisions to the Monetary Threshold for Reporting Customer Complaints, Arbitrations or Litigation

Recognizing that the current monetary threshold for settlements of customer complaints, arbitrations or litigation was set in 1998 and has not been adjusted for inflation, the amendments raise the existing settlement amount from \$10,000 to \$15,000 to reflect more accurately the business criteria (including the cost of litigation) firms consider when deciding to settle claims. This change is reflected in Question 14I on Form U4 and Question 7E on Form U5.

In addition, the description of “Historic Complaints” in FINRA Rule 8312 has been amended to conform to this revised monetary threshold. Under FINRA Rule 8312, FINRA will release Historic Complaints under BrokerCheck where:

- any such matter became a Historic Complaint on or after March 19, 2007;
- the most recent Historic Complaint or currently reported customer complaint, arbitration or litigation is less than ten years old; and
- the person has a total of three or more currently disclosable regulatory actions, currently reported customer complaints, arbitrations or litigation, or Historic Complaints (subject to the limitation that they became a Historic Complaint on or after March 19, 2007), or any combination thereof.

Historic Complaints will include customer complaints, arbitrations or litigation that have been settled for less than \$10,000 prior to May 18, 2009 (subject to the limitation that they became a Historic Complaint on or after March 19, 2007), or settled for less than \$15,000 on or after May 18, 2009. As a result, FINRA will continue to release through BrokerCheck those customer complaints, arbitrations or litigation settled for more than \$10,000 but less than \$15,000 prior to May 18, 2009. Customer complaints, arbitrations or litigation settled for less than \$15,000 on or after May 18, 2009 will be considered Historic Complaints for purposes of BrokerCheck.

Revisions Regarding “Date of Termination” and “Reason for Termination”

Revisions to Form U5 provide that the date to be provided by a firm in the “Date of Termination” field is the “date that the firm terminated the individual’s association with the firm in a capacity for which registration is required.” The amendments further clarify that, in the case of full terminations, the “Date of Termination” provided by the firm will continue to be used by FINRA and other SROs and jurisdictions to determine whether an individual is required to requalify by examination or obtain an appropriate waiver upon reassociating with a firm.¹² Revisions to Form U5 also clarify that the relevant SRO or jurisdiction determines the effective date of termination of registration. In general, for purposes of retention of jurisdiction by FINRA,¹³ FINRA considers the effective date of termination to be the date that the Form U5 is received by CRD (generally the date of filing of the Form U5 with CRD).¹⁴

The rule change also permits a firm, as of May 18, 2009, to amend the “Date of Termination” and “Reason for Termination” fields in a Form U5 it previously submitted, but in such cases it requires the firm to provide a reason for each amendment. To monitor such amendments, including those reporting terminations for cause, FINRA will notify other regulators and the broker-dealer with which the registered person is currently associated (if the person is associated with another firm) when a date of termination or reason for termination has been amended. The original date of termination or reason for termination will remain in the CRD system in form filing history.¹⁵

Additional Revisions

The Forms were amended to make various clarifying, technical and conforming changes generally intended to clarify the information elicited by regulators and to facilitate reporting by firms and regulators. For example, the amendments eliminated as unnecessary certain cross-references in Questions 14I on Form U4 and 7E on Form U5 regarding the manner in which individuals and firms must report allegations of sales practice violations against registered persons made through arbitration or civil litigation or through consumer-initiated complaints. Additionally, certain “free text” fields were converted to discrete fields on the DRPs of Forms U4 and U5. These revisions to the DRPs generally do not change the information currently elicited, but rather change the presentation of the DRPs.¹⁶ For example, the revised DRPs will enable filers to provide more specific information utilizing pre-established picklists for the following types of information:

- product type;
- sanction/disposition; and
- status of the sanction
(*i.e.*, whether the sanction remains in effect at the time of filing).

This format is designed to elicit additional details at the initial filing stage, and will allow for completeness checks to prevent firms from submitting filings without having provided information in response to the allegations and disposition detail questions. Such checks generally should make the filing process more efficient.

The amendments also add to Section 7 of Form U5 (Disclosure Questions) an optional “Disclosure Certification Checkbox” that will enable firms to affirmatively represent that all required disclosure for a terminated person has been reported and the record is current at the time of termination. Checking this box will allow the firm to bypass the process of re-reviewing a person’s entire disclosure history for purposes of filing Form U5 in situations in which disclosure is up to date at the time of the person’s termination.

The amendments make additional technical changes to the Forms. For example, they incorporate the definition of “found” from the Form U4 Instructions into the Form U5 instructions; provide more detailed instructions regarding the reporting of an internal review (conducted by the firm); and clarify how an individual may file comments to an Internal Review DRP.

Endnotes

- 1 See Exchange Act Release No. 59916 (May 13, 2009) (SEC Order Approving SR-FINRA-2009-008).
- 2 The CRD system will process Form U4 filings as follows: answers to current Questions 14C and 14E will be transferred without change to Questions 14C(1) through (5) and 14E(1) through (4), respectively. In addition, all registered persons will have “null” values in new Questions 14C(6), (7) and (8), and 14E(5), (6) and (7). In other words, answers to these new questions will be blank (*i.e.*, not populated with either a “yes” or “no” answer). Firms must affirmatively answer these new questions by clicking the appropriate “yes” or “no” radio buttons. If a firm does not affirmatively answer the new questions for registered persons, the filing of any amendments to the Form will fail the CRD-system completeness check and will not be successfully submitted to the CRD system.
- 3 FINRA notes that there will be no charge for the submission of “no” answers to the new questions. A disclosure review fee will be assessed only in those situations in which a “yes” answer is submitted, in order to defray the costs associated with staff review of the disclosure event, consistent with current practice.
- 4 FINRA will provide additional specific details regarding this feature to firms that elect to use it. However, in short, the feature will enable firms to sign onto CRD and file “no” answers for as many as 65,000 registered persons at one time. The feature will be available to all firms upon the implementation of the new Forms, and throughout the 180-day implementation period during which firms are required to submit answers to the questions. After the 180-day implementation period, the feature will be disabled.
- 5 See Exchange Act Release No. 59784 (April 17, 2009), 74 FR 18779 (April 24, 2009) (Notice of Filing of Proposed Rule Change: File No. SR-FINRA-2009-019).
- 6 Formerly, firms were not required to report on a registered person’s Form U4 that a customer had alleged a sales practice violation against such person in the body of a lawsuit or arbitration claim, unless the registered person also had been named as a defendant/respondent. A firm also was not required to report on Form BD (Uniform Application for Broker-Dealer Registration) that it had been named as a respondent in a consumer-initiated arbitration or to report that a sales practices violation was alleged against one of its registered persons under these circumstances. As a result, this form of “customer complaint” against a registered person or firm has been unreported via the Forms and, therefore, unavailable to regulators or prospective broker-dealer employers of the registered person via CRD or to the public through BrokerCheck.

Endnotes (continued)

- 7 The Instructions to the Forms have been amended to note that the revised questions should be answered “yes” if the individual was not named as a respondent/defendant but (1) the Statement of Claim or Complaint specifically mentions the individual by name and alleges the individual was involved in one or more sales practice violations or (2) the Statement of Claim or Complaint does not mention the individual by name but the firm has made a good faith determination that the sales practice violation(s) alleged involves one or more particular individuals.
- 8 The Customer Complaint/Arbitration/Civil Litigation DRPs have corresponding changes, including, *e.g.*, eliciting specifically whether, in the case of an arbitration or litigation, the individual was named as a respondent or defendant. Furthermore, the DRPs require the alleged damages and disposition for matters in which sales practice violations are alleged against an individual who was not named in an arbitration or litigation.
- 9 Individuals who currently are registered with FINRA, are associated with a member firm and who wish to provide an update or context to information that is disclosed through BrokerCheck are required to file an amended Form U4. Individuals who are no longer registered with FINRA, but who have been FINRA-registered within the last two years (and thus about whom information is available through BrokerCheck pursuant to Rule 8312) may not provide an update or context to an event via the Form U4. Instead, such individuals may submit a Broker Comment to provide an update or context to information that is disclosed through BrokerCheck.
- 10 FINRA recently filed a proposed rule change with the SEC seeking to expand BrokerCheck with respect to former associated persons to provide public access to certain information about such persons, regardless of when they were associated with a member, if they were the subject of any final regulatory action that is required to be reported on the Forms. *See* SR-FINRA-2009-029.
- 11 *See* FINRA Rule 8312(b)(7).
- 12 For partial terminations, a firm is only required to provide a “Date of Termination” when submitting post-dated termination requests during the renewal period (*i.e.*, to effect a termination of registration at year-end). For all other partial terminations, the “Date of Termination” is an optional field for firms to complete.
- 13 Article 5, Section 4 of the FINRA By-Laws provides that FINRA generally retains initial jurisdiction over a person whose association with a member firm has been terminated for purposes of a complaint under FINRA’s rules based upon conduct that commenced prior to termination for a period of two years after the effective date of termination of registration.
- 14 FINRA notes that Article 5, Section 3(a) of the FINRA By-Laws states that termination of registration shall not take effect so long as any complaint or action under FINRA’s rules is pending against a member and to which complaint or action such associated person is also a respondent or so long as any complaint or action is pending against such person individually under FINRA’s rules. *See also In re Donald M. Bickerstaff*, 52 S.E.C. 232, 233 (April 17, 1995) (noting that, absent a pending

Endnotes (continued)

- complaint or an examination in process, termination of registration became effective upon receipt of the Form U5 termination notice). FINRA further notes that in the case of post-dated requests for full termination during the renewal period, for purposes of retention of jurisdiction by FINRA, the effective date of termination generally will be the (post-dated) date of termination provided by the firm and not the date that CRD received the form.
- 15 With respect to the requalification period, FINRA is not proposing to allow an amended date of termination to systematically reset the two-year window in CRD. Instead, should an individual be notified that he or she is required to requalify by examination as a result of an erroneous date of termination that was subsequently amended by a firm, the individual would be required to submit a request for a waiver, and FINRA would consider the amended date of termination in connection with its review of the request. FINRA does not expect this situation to occur often; moreover, FINRA would review such requests in an expeditious manner.
- 16 As discussed *supra*, the Form U5 Regulatory Action DRP added Question 12C that corresponds to Form U4 Questions 14C (6 through 8) and 14E (5 through 7). The Forms U4 and U5 Regulatory Action DRPs have been expanded to ask details with respect to fines and penalties, including whether the money has been paid, is subject to a payment plan or has been waived.