

March 30, 1999

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D. C. 20549
Mail Stop 10-1

Re: **File No. SR-NASD-98-96, Amendment No. 1;
Amendments to Forms U-4 and U-5**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed herewith is Amendment No. 1 to File No. SR-NASD-98-96 and a 3 1/2" disk containing the amendment in Microsoft Word 7.0 to facilitate production of the Federal Register release. Replacement pages for Exhibit 4 and new Exhibits 5 and 6 are enclosed.

On page 2, second paragraph, amend "meeting on October 7, 1998" to "meetings on October 7, 1998, and March 24, 1999". Amend "meeting on October 8, 1998" to "meetings on October 8, 1998 and March 25, 1999".

On page 2, delete the third paragraph.

On page 3 et seq., all references to "Modernized CRD" should be changed to "Web CRD".

On pages 4 and 12, delete footnotes 5 and 6, respectively.

On pages 7 and 15, insert the following new sentences after the second sentence in the first full paragraph: "For example, on the Customer Complaint DRP, when the firm clicks on the field for the customer's state of residence, a pick list of states will appear and the firm will click on one to fill in the field, rather than having to manually type in a selection. Pick lists will also appear for other fields on the electronic Proposed Forms. In all pick lists (except states of residence and types of judgments/liens), a firm may select "Other" if none of the choices presented in the pick

list is appropriate."

On pages 7 and 15, delete the fourth sentence in the first full paragraph.

On pages 7 and 15, in the last sentence of the first full paragraph, delete "any such changes" and insert "every change".

On pages 7 and 15, insert the following new paragraph after the first full paragraph:

"Four disclosure questions on the Proposed Forms also are amended. These substantive amendments involve: (1) an expansion of the Form U-4 question eliciting information on settled customer complaints to include those oral complaints involving sales practice allegations that are settled for \$10,000 or more; (2) a modification of the Form U-5 question eliciting information on customer complaints to make that reporting requirement consistent with the parallel question on the Form U-4 (effectively eliminating the reporting requirement for and permitting the archiving of customer complaints that are over 24 months old and are not otherwise reportable); and (3) an expansion of the reporting requirement on the Form U-5 to include criminal or regulatory actions initiated on the basis of events that occurred while an individual was employed by the firm, even if the actions were initiated after the individual had been terminated."

Amend the second full paragraph on pages 7 and 15 to read as follows:

"NASD Regulation proposes to make the Proposed Forms effective on August 16, 1999. NASD Regulation will announce this date in a Notice To Members that will be published not later than July 16, 1999."

On pages 8 and 16, delete the sentence "Written comments were neither solicited nor received." and replace it with the following:

"NASD Regulation solicited member comment on the substantive changes to Form U-4 and U-5 disclosure questions in Notice To Members 98-101. A copy of the Notice is attached as Exhibit 5. NASD Regulation received 15¹ comments in response to the Notice; a copy of the letters is attached as Exhibit 6.

Five commenters were in favor of or had no objection to the proposed rule change requiring the reporting of settlements of oral sales practice complaints and six were opposed. The Securities Industry Association's ("SIA") Self-Regulation and Supervisory Practices Committee was among the five commenters opposing the proposed change. The SIA expressed concern about the proposed change on the basis that: (1) it is inconsistent with the Commission's revised proposed books and records

¹ The comments from persons associated with the John G. Kinnard & Co. are treated as one comment because they are identical.

rules, which only require the reporting of customer-initiated complaints that are written; (2) a firm may be more vulnerable to a defamation claim brought by a former employee if there is no writing to substantiate the oral customer complaint that resulted in the settlement of \$10,000 or more; and (3) it is currently unclear which types of disputes would give rise to a reportable offense and therefore, some execution adjustments might unintentionally be characterized as a sales practice matter.

While NASD Regulations appreciates the SIA's concern, it disagrees with the SIA's argument that the proposed change requires reporting of oral *complaints*; on the contrary, the proposed change would require the reporting of *settlements* of \$10,000 or more of a customer complaint (written or oral) alleging a sales practice violation. NASD Regulation believes that this proposed change is not inconsistent with the Commission's proposed books and records rules because the question addresses the reporting of the settlement and not the oral complaint. Moreover, the staff believes that settlements of such amounts may be indicative of potential sales practice abuses (irrespective of whether the complaint is made orally or in writing) and is therefore consistent with one of the purposes underlying the Commission's proposed rules, which is to assist regulators in determining whether an associated person has engaged or is continuing to engage in securities violations such as abusive sales practices. In addition, as the SIA acknowledges, firms are unlikely to settle a customer sales practice complaint for \$10,000 or more without something in writing. Finally, NASD Regulation staff and representatives of NASAA are prepared to issue interpretive guidance that would provide greater clarity in the area of what constitutes a sales practice violation (as opposed, for example, to a disagreement over an execution that does not involve an alleged rule violation) and to provide guidance to firms on procedures they should follow to support the reporting of these items.

Seven commenters addressed the proposed changes to the Form U-5 questions regarding the expanded reporting of regulatory and criminal actions. Under the proposed new question, firms would be required to report regulatory and criminal actions that were initiated after a registered person has left the firm, if the firm receives actual notice of such actions. The current question requires the reporting of these matters only while the registered person is employed by the firm. Commenters generally expressed concern about having to continually monitor former employees in order to meet this reporting requirement. Commenters therefore requested that "actual notice" of the initiation of a criminal or regulatory event be defined through interpretive guidance before or in conjunction with the question change. Three commenters also requested that the proposed change be limited to criminal or regulatory events that are directly related to the former employee's employment with the member and that actual notice be defined as written notice to a principal responsible for making regulatory filings or other appropriate person in the legal or compliance department. Two commenters stated that reporting under these questions should be time-limited, e.g., to two years after termination.

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NASD Regulation agrees that the issuance of interpretive guidance is appropriate. NASD Regulation staff has discussed such interpretive guidance with NASAA and has reached an agreement in principle regarding an interpretation. This interpretation will clearly articulate that firms are not obligated to report events unless they receive actual notice; in this context, actual notice would mean express notice -- that is, a communication by the responsible agency/authority regarding the initiation of a criminal or regulatory action directly to a representative of the firm who is cognizant of the Form U-5 reporting requirement. This interpretation would address a majority of commenters' concerns; however, it does not address the time limit on Form U-5 reporting that was suggested by some commenters. Nevertheless, NASD Regulation staff agrees that the establishment of an outside time limit for reporting on Form U-5 should be explored and has begun discussions with NASAA on this issue."

If you have any questions regarding this Amendment, please contact Mary Dunbar, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8252; e-mail dunbarm@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

John M. Ramsay
Vice President and Deputy General Counsel

Enclosures