



NASAA

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July 20, 2006

Ms. Nancy Morris, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

VIA EMAIL TO: rule-comments@sec.gov

Re: File No. SR-NASD-2003-168; Notice of Filing of Amendment Nos. 4 and 5 of the Proposed Rule Change Relating to the Release of Information Through NASD BrokerCheck

Dear Secretary Morris:

On behalf of the North American Securities Administrators Association (“NASAA”)¹, I hereby submit the following comments on the proposed changes to NASD’s public disclosure program known as “BrokerCheck.” BrokerCheck is NASD’s system that is designed to provide information about NASD registered stockbrokers to the public. The information used to populate BrokerCheck comes from the Central Registration Depository (“CRD”), a licensing and registration database used by regulators throughout the securities industry to register, license, and regulate securities firms and their brokers.²

In order to better understand NASAA’s comments regarding the above-referenced filing, a quick chronology of the various filings regarding BrokerCheck is helpful.

Chronology of BrokerCheck Filings

- November 2002: NASD issued *Notice to Members 02-74* summarizing changes it was contemplating for BrokerCheck. Among the changes listed in the *Notice to Members* is the disclosure of “historical form filings that may include disclosure events that are no longer reportable.”³

¹ NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum for these regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets.

² NASD operates the CRD system in accordance with an agreement with NASAA. CRD policy is jointly established by NASD and NASAA. The information on CRD includes disclosures relating to any disciplinary history of stockbrokers and is available to members of the public through public records requests to state securities regulators.

³ NASD *Notice to Members 02-74*, November 2002, at page 802.

- November 20, 2003: NASD filed a proposed rule change with the Securities Exchange Commission (“SEC” or “Commission”) describing proposed changes to BrokerCheck including the disclosure of “historic complaints” (“November 2003 Filing”).⁴
- September 27, 2004 - March 8, 2005: NASD filed three separate amendments to the original BrokerCheck filing.⁵
- June 30, 2005: The SEC published the “Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto Relating to the Release of Information Through the Public Disclosure Program” in the Federal Register.⁶
- June 2006: NASD filed Amendment Nos. 4 and 5 with the SEC.
- July 5, 2006: The SEC published a “Notice of Filing of Amendment Nos. 4 and 5 to the Proposed Rule Change Relating to the Release of Information Through NASD BrokerCheck.”⁷

Comments

From the outset, NASAA has had reservations regarding NASD’s proposed changes to the scope of the information available on BrokerCheck and expressed those concerns as early as January 6, 2003, in a comment letter to NASD.⁸ While NASAA was encouraged that NASD appeared to be moving in a direction of more public disclosure of important information on stockbrokers, NASD’s most recent BrokerCheck filings appear to be a reversal of course.

The primary purpose of the June 2006 amendments was to change the conditions under which NASD proposed to release historic complaints through BrokerCheck. Specifically, in Amendment No. 4, NASD proposed to amend the November 2003 Filing language to provide that historic complaints will be eligible for disclosure only if a matter becomes an historic complaint on or after the implementation date of the proposed rule change, which, in this case, would be ninety (90) days after the Commission approves the final rule. The effect of Amendment No. 4 is that historic complaint information that currently exists within CRD will

⁴ Proposed rule change to IM-8310-2 pursuant to 19b-4 of the Securities Exchange Act of 1934 filed with the Commission on November 20, 2003. In this filing, NASD defines “historic complaints” as customer complaints that are more than two years old and have not been settled and customer complaints, arbitrations, or litigation that have been settled for less than \$10,000.00.

⁵ Amendment No. 1 deleted certain provisions of the proposal related to criminal proceedings and addressed issues related to the delivery of information to the public. Amendments Nos. 2 and Three 3 were primarily filed to effectuate technical changes along with rewriting some provisions to make them easier to understand.

⁶ Exchange Act Rel. No. 51915 (June 23, 2005), 70 FR 37880 (June 30, 2005) (SR-NASD-2003-168). The Notice included the provisions relating to the disclosure of historical complaints.

⁷ Exchange Act Rel. No. 54053 (June 27, 2006), 71 FR 38196 (July 5, 2006) (SR-NASD-2003-168).

⁸ NASAA’s comment letter is available on the NASAA website at the following web address: <http://www.nasaa.org/content/Files/NASDPublicInformationReview.37627%2D43960.pdf>

never be released to the public through BrokerCheck.⁹ The only historic complaints that will be disclosed under Amendment No. 4 are those that become historical after the rule's effective date.

NASD explains that it is changing the proposal regarding historic complaints as a result of comments submitted in response to the rule proposal. Apparently NASD was persuaded to reduce the disclosure threshold by commenters who argued that “firms and registered persons made certain decisions with respect to customer complaints, arbitrations, or litigations based on the rules under which the CRD system and BrokerCheck currently operate.”¹⁰ The commenters did in fact argue that NASD should not change the rules regarding the disclosure of complaints that had been settled. However, none of the comment letters making this argument actually provided any specific cases nor did they cite any surveys or studies in which stockbrokers actually settled customer disputes because the settlement would not be publicly disclosable after two years.¹¹ NASD appears to have agreed with the comments that “many of these persons might not have chosen to enter into settlement had they known the rules regarding their release to the public **might** be changed.”¹² By making this argument, NASD is asking the Commission to believe that stockbrokers would rather litigate customer disputes than settle them because the complaint would be publicly disclosed.

The argument that NASD members settled matters without the knowledge that the rules **might** change is specious. First of all, the complaint, were it litigated rather than settled, would also be disclosed on BrokerCheck and, in most situations, be more difficult to suppress than a customer complaint. Second, NASD’s *Notice to Members 02-74* issued in 2002 put their members on notice that the rules regarding the public disclosure of customer complaints might be changed and even more specifically, put members on notice that the rules regarding historic complaints were subject to revision and modification.¹³ NASD received over fifty-eight (58) comment letters in response to the *Notice to Members*. Clearly NASD membership was aware that the rules regarding the release of historic information **might** change.

NASD defends its proposal arguing that it strikes a “fair balance between public investors’ interest in the background of the individuals with whom they do business and the concerns of participants in the securities industry.”¹⁴ However, this proposal is such that it

⁹ At the time when CRD converted to a web-based application, much of the older customer complaint information was moved from the historic complaints section into legacy. The filings currently contained in the historic complaints are handled under current business rules for the system.

¹⁰ Letter responding to comments from Richard E. Pullano, Associate Vice President and Chief Counsel, Registration and Disclosure, NASD, June 6, 2006.

¹¹ For instance, in his comment letter John S. Simmers, CEO of ING, writes that “representatives might not have settled matters” without offering any objective evidence in support of this conclusion. Comment letters submitted by both the Association of Registration Management and the Securities Industry Association make similar statements without offering any substantiation. Furthermore, we note that the proposed language as contained in amendment number four comes directly from the comment letter submitted by the Securities Industry Association.

¹² Letter from Richard E. Pullano, Associate Vice President and Chief Counsel, Registration and Disclosure, NASD, June 6, 2006. Emphasis added.

¹³ NASD *Notice to Members 02-74*, page 802 states as follows, “For example, should NASD expand its [Public Disclosure] Program to include additional information reported on current Uniform Forms and provide investors access to historical form filings that may include disclosure events that are no longer reportable?”

¹⁴ Letter responding to comments from Richard E. Pullano, Associate Vice President and Chief Counsel, Registration and Disclosure, NASD, June 6, 2006.¹⁴

favors the industry's disclosure concerns much more than protecting the public. If NASD were truly concerned about striking a balance between the industry and investors they would have considered that their membership was aware of the planned changes to BrokerCheck dating back to November 2002 and proposed that date as the operative date for the effectiveness of the proposed rule. Such an approach would have reflected a considered balance between their members' interests in fairness and the investing public's interest in the information.

The proposed change to the disclosure of historic complaints also has implications in the planned public disclosure of customer complaints and other regulatory matters for individuals licensed as investment adviser representatives. NASAA is developing the Investment Adviser Public Disclosure - Individual ("IAPDI") system. NASD is working as the vendor in this undertaking. Originally NASAA was contemplating a system that would function in a manner almost identical to and thus be an integral part of the BrokerCheck system as proposed by NASD prior to the latest amendments. This system would have balanced the need for a user-friendly site with significant disclosure. However, the proposed change to the disclosure of historic complaints has made that plan unworkable as NASAA sees no benefit in developing a system that while technologically user-friendly excludes important information that should be publicly available. The impact of NASD's proposal, should it become effective, is that an investor seeking information regarding a financial services professional will receive from the IAPDI more comprehensive disclosure than would be available for the same financial services professional on BrokerCheck. Approximately ninety percent (90%) of the registered investment adviser representatives are also registered as stockbrokers and will have information available on both systems. Should NASD proposal as contained in Amendment Nos. 4 and 5 become effective, the same individuals will be subject to different levels of disclosure depending on whether a member of the public searches BrokerCheck or IAPDI.

Under that scenario, the investing public will be forced to search for information on financial service professionals using two different systems. Members of the public could use NASD's system as proposed to the Commission and run the risk of missing critical disclosure. Or, the public could access more comprehensive disclosure information using IAPDI as implemented by the States. Either way, users would be forced to check both systems in order to get the complete disclosure picture for their financial services provider. The States have for years provided historical complaint information along with other information not disclosed on BrokerCheck. Despite the fact that NASD claimed in the *Notice to Members 02-74* that the public should be able to get information provided by the States from BrokerCheck as well, Amendment No. 4 undoes the progress made in the original proposal to accomplish this goal.¹⁵

NASAA is concerned about this uneven level of disclosure and believes that it is unfair to registered persons as well as the public. There is a considerable likelihood that the same person will be treated differently for disclosure purposes depending on which system, BrokerCheck or

¹⁵ NASD *Notice to Members 02-74* states as follows: "The SEC, States, and other self-regulatory organizations release a variety of information under their respective public information policies. These organizations often publish information NASD has available in its CRD system or other systems but does not release under its current information policy. NASD believes its Public Information Policy, including IM-8310-2 and any other relevant NASD Rules, should be amended as appropriate to enable investors to receive most of this information from NASD as well." NASD *Notice to Members 02-74*, November 2002, page 800.

IAPDI, an investor searches. Members of the public will have to check multiple sources for disclosure on the same person. This will only add to investor confusion when it comes to the roles of various financial services professionals. Ultimately, different investors likely will receive different information on the same person because NASD has chosen to restrict what information it will disclose on BrokerCheck.

NASAA also is greatly concerned about NASD's proposal to change the way it measures the two-year time frame for complaint disclosure. In the original rule proposal NASD noted, **only** in a footnote, that it was changing the manner in which it currently calculates the two-year period for disclosure of customer complaints. NASD now proposes that the two-year time period begins to run when the complaint is filed with the firm. This is a departure from prior NASD practice under which the time frame was calculated based on when the complaint was reported by the firm on CRD.

The reasoning behind counting the two-year period from the date the firm reports the complaint is to prohibit any attempts by the firm to manipulate, by delaying reporting, the amount of time the complaint will be publicly disclosable. NASD obviously understands this point and summarized this very issue in the text of the Form U4 and Form U5 Interpretative Questions on NASD's website.¹⁶

Under Question 14I(3), Q2 asks the following question:

How is the 24-month period calculated for purposes of reporting a complaint on the Form U4 and disclosing information through NASD BrokerCheck?

NASD provides the following answer:

For purposes of a registered person's obligation to report a customer complaint, the 24 months is calculated from the date the complaint is filed with the firm. However, the complaint will be disclosed through NASD BrokerCheck for 24 months beginning on the date that the U4 filing on the complaint is entered on CRD.

NASD explains the approach of calculating the two-year period from the date the complaint is disclosed on CRD by noting that the policy was developed in consultation with NASAA to encourage prompt reporting of customer complaints. Furthermore, NASD explains that it considered but rejected a policy that would use the firm filing date for both determining the registered person's reporting obligation and the public disclosure period. That policy was rejected because it could encourage registered persons or firms to withhold reports of customer complaints and thereby shorten the disclosure period.

NASD did not consult with NASAA regarding this change despite the fact that the original policy was established in consultation with NASAA and the existence of agreements whereby NASD and NASAA discuss changes that impact CRD. This is a significant change in

¹⁶ Form U4 and U5 Interpretive Questions found on NASD website at www.nasd.com/RegulatorySystems/CRD/FilingGuidance/NASDW_005243

policy and should not have been the subject of a footnote and is particularly outside the scope of the normal way in which policy changes are made. Such changes are required to be discussed in the context of the NASAA/NASD CRD/IARD Steering Committee where for many years policy issues regarding the operations of both CRD and IARD have been set in a collaborative effort between NASAA and NASD. Furthermore, NASD does not adequately explain why it has decided to adopt a policy it previously rejected. NASAA believes that this shift in policy will promote the behavior that NASD cautions against on its website, i.e., encouraging registered persons and firms to delay and perhaps withhold completely reporting of customer complaints.

That NASD would change a policy and eliminate an incentive for firms to timely file complaints is particularly unusual in light of recent enforcement actions taken by NASD. In July 2004, NASD fined Morgan Stanley \$2.2 million for late reporting and temporarily suspended the firm from hiring new brokers.¹⁷ This action followed disciplinary actions initiated by Maryland, Florida and Vermont against the firm for failing to update reportable information. In November of the same year NASD reported additional fines of \$9.2 million against twenty-nine firms for late reporting and also prohibited Merrill Lynch and Wachovia from hiring new brokers for five (5) days.¹⁸

Even more troubling is the fact that NASD maintained its position on changing how it would count the two-year period even as the organization was announcing actions for late filings by firms. Despite the fact that many NASD members ignored their obligation to timely amend filings, NASD's BrokerCheck filings with the Commission in 2004, 2005, and 2006 continued to propose the change to count the twenty-four months to run from the date of filing with the firm. Rather than tightening regulation in the face of blatant and widespread violations, NASD continued to endorse its proposal easing the incentives to timely file customer complaint information.

While NASD writes in its various filings that it is moving to make additional information available to the public through BrokerCheck, a comparison of the current system, the enhancements as proposed in November 2003, and the final version as reflected in the amendments filed in June 2006 actually paints a different picture. Currently, information that has not been reported to CRD or that is not required to be reported or is no longer reportable on Form U4 or Form BD is not disclosed. Examples of information not required to be reported or are no longer reportable include judgments and liens originally reported as pending that subsequently have been satisfied; bankruptcy proceedings filed more than 10 years ago; and consumer-initiated, written complaints that are settled for less than \$10,000 or that have not resulted in arbitration claims or civil litigation. Such consumer-initiated, written complaints are, however, required to be reported on the Form U4 and disclosed through NASD BrokerCheck for two years. The November 2003 filing with the Commission proposed to expand BrokerCheck by disclosing historic complaints under certain circumstances. The amendments filed in June 2006 propose that only those complaints that satisfy the definition of historic complaints filed ninety (90) days after the rule is declared effective will be reported to the public. The end result is that the BrokerCheck system as amended through Amendment Numbers 4 and 5 will never equal the disclosure contemplated in the November 2003 BrokerCheck filing.

¹⁷ NASD news release at http://www.nasd.com/PressRoom/NewsReleases/2004NewsReleases/NASDW_01089.

¹⁸ NASD news release at http://www.nasd.com/PressRoom/NewsReleases/2004NewsReleases/NASDW_012595.

NASD states that the disclosure of historic complaints would be beneficial to the investing public explaining that, “Public investors will be able to determine for themselves whether a particular broker has demonstrated a pattern of conduct over the years and the significance, if any, they should attach to Historical Complaint information.”¹⁹ The most recent amendments demonstrate that NASD has reconsidered the utility of placing this information in the public’s hands. This action seems contrary to NASD’s desire to protect the public, especially at a time when both state and federal regulators, including NASD are raising to new levels the alarm over abusive tactics by those in the financial services industry aimed at the senior community.

NASD claims that the proposed changes to BrokerCheck are intended to strike a balance between concerns over privacy and fairness raised by its membership and the protection of investors. Because we believe that this latest series of amendments shifts that balance against the interest of investors, we urge the Commission not to approve the BrokerCheck proposal.

Sincerely,

A handwritten signature in black ink, appearing to read 'Patricia D. Struck', with a long horizontal stroke extending to the right.

Patricia D. Struck
NASAA President
Wisconsin Securities Administrator

cc: Christopher Cox, Chairman
Paul S. Atkins, Commissioner
Roel C. Campos, Commissioner
Annette L. Nazareth, Commissioner
Kathleen L. Casey, Commissioner
Buddy Donahue, Director, Division of Investment Management
Robert L. Colby, Deputy Director, Division of Market Regulation
Douglas Shulman, Vice Chairman & Pres., Markets, Services and Information, NASD
James J. Cummings, Sr. Vice Pres., Registration and Disclosure, NASD
Richard E. Pullano, Assoc. V.P. & General Counsel, Registration and Disclosure, NASD

¹⁹ Proposed rule change to IM-8310-2 pursuant to 19b-4 of the Securities Exchange Act of 1934 filed with the Commission on November 20, 2003, at page 19.