

Request for Rulemaking Concerning the Central Registration Depository Disclosure Regime of the National Association of Securities Dealers, Inc.

Dec. 16, 2002

Dan Jamieson
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Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: Petition for rulemaking, via regular mail

Dear Mr. Katz:

I hereby petition the SEC to take action to ensure a lawful disclosure regime in the securities industry. This petition is timely because the NASD is now engaged in reviewing its CRD disclosure regime (see NASD NTM 02-74). Yet the NASD and other regulators are ignoring key areas where reform is needed to comply with the '34 Act and possibly other laws.

The NASD's disclosure program is governed by federal law, SEC regulations, and NASD rules approved by the SEC. Other sources of disclosure data may be governed by different rules. Changes required via this petition may be needed in disclosure Forms BD and U-4, the NASD's Information Policy, including IM-8310-2 and any other relevant SRO or SEC rules, interpretations and disclosure forms.

1) I petition the SEC to put a stop to the reporting of unproven allegations against individual brokers; to study other disclosure regimes as to how to appropriately handle allegations; and to ensure an equitable balance between letting information get on the CRD vs. getting it off.

The level of disclosure required by the CRD system has crossed the line and become a serious and harmful invasion of privacy for individuals, including hundreds of thousands of registered employees and independent contractors. The unchecked, raw data provided about associated persons' personal and employment histories could well be unconstitutional. Unproven allegations against individuals and possibly against firms, should not be disclosed, including unproven customer complaints and termination information. This is only fair. No other profession faces such untoward scrutiny. For example, under the Sarbanes-Oxley Act, accountants who are under investigation will make no public disclosures until they have been given a chance to shape up, fail at that effort, and then lose their case in a formal disciplinary proceeding. Only then would their public records be affected. Neither do doctors, attorneys or airline pilots have their reputations tarred by such extensive disclosure, and certainly not by disclosure of unproven allegations. A full review of various disclosure regimes is needed because the NASD cannot look out for the interests of its members' employees. The association has clearly shown a history of siding with its member

firms, especially in regards to rules affecting associated persons. This bias is an understandable result of self-regulation; it can be mitigated, however, by the SEC carefully reviewing how Congress, professions and states have balanced the need for disclosure with the privacy interests of individuals involved in the regulated trade, and ensuring that NASD follow disclosure regimes similar to those used in other industries, at least when it comes to reporting raw allegations.

Surely, withholding unproven allegations is appropriate, especially given how difficult it is to get information off the CRD system. While thresholds for disclosing raw allegations have been dropped, at the same time it has become more difficult to remove spurious data. (The NASD has even proposed inserting itself into the expungement process as a party to a court-ordered expungement order!) The result is an "easy on, never off" policy that is fundamentally unfair and in violation of the '34 Act.

2) I petition the SEC to equalize the disclosure regime for firms, making it the same as the regime for brokers.

Under NASD Conduct Rule 3070, firms report to the NASD certain customer complaints, and all settlements against the firm of \$25,000 and against all brokers associated with the firm for \$15,000, as well as statistical summary information regarding customer complaints. The NYSE requires similar reporting.

Why then, is this information at the firm level not disclosed by the NASD through CRD, just as it is for individual brokers (via the U-4)?

One reason may be that regulators have not thought it important for investors to be informed about the disciplinary history of a firm. Yet history shows this assumption to be false. For example, how many penny stock firms could have existed had a vibrant system of firm-level customer complaint disclosure been in place and enforced? How many investors would have been helped had they seen complaints from investors or from former or current brokers of a firm regarding the firm's suspect research?

Following are specific inequities between what individual brokers must report, versus what member firms must report. These inequities benefit member firms. The Exchange Act expressly forbids such discrimination and unfairness.

--*Settlements*: Brokers must publicly report settlements of \$10,000 or more. Not only do firms not publicly disclose settlements, they need not bother reporting settlements to regulators until such settlements reach the \$25,000 level; or, in the case of their associated persons, the \$15,000 level. Why the lack of public disclosure for firms? Why the difference in reporting thresholds? More cases are settled than arbitrated--especially those cases involving egregious conduct by the broker or firm, which are more likely to be settled away from the public eye. The result is that probably the vast majority of cases brought against a firm where the customer is given some compensation are never disclosed on the firm's CRD record. This is a major loophole in the CRD system. Non-disclosure of settlements at the firm level also causes conflicts with brokers who may want to fight a case and preserve a clean record, while the firm could care less because there is no reputational risk for a firm in settling a case. Lack of settlement disclosure also helps drive expungement activity, by making it easy for a firm to settle a case when the broker involved is removed from the complaint; when this happens, the public sees no record of the case whatsoever, and the broker, even if a rogue, keeps a clean record and may continue bringing revenue into the firm.

--*Customer complaints*: While individual brokers must publicly disclose most customer complaints, and certainly those that allege \$5,000 or more in damages, firms do not. Why? And is a full database of customer complaints available, that is, an aggregate total from SEC and state complaint files together with SRO data? If not, why not? The NASD proposes showing aggregate data somehow, so why not require it to show a complete complaint data set?

If unproven allegations are to be disclosed, then the SEC must ensure that firms disclose all customer complaints. Ideally, a full set of data would be disclosed.

--*Investment-related lawsuits*. While individual brokers must report and publicly disclose all investment-related lawsuits, firms report only select suits to regulators but do not publicly report this data. Why don't firms report all suits on Form BD? At a minimum firms should publicly disclose suits alleging theft, misappropriation or forgery—data the NASD possesses now. If unproven allegations are to be disclosed, the SEC must ensure disclosure of all investment related lawsuits pending against firms. This would include disclosure of data now reported on lawsuits alleging theft, misappropriation or forgery.

--*Regulatory investigations vs. proceedings*. While individual brokers must report regulatory "investigations," firms must report only regulatory "proceedings." A proceeding is defined in the Forms BD and U-4 as a more formal stage of an investigation. This higher threshold for firms is unfair. Why are not regulatory investigations against firms publicly reported on the CRD as they are with brokers?

The level at which a regulatory inquiry should be disclosed could be worthy of debate. However, regulators have wisely created some threshold for public disclosure of a regulatory inquiry by an associated person: the receipt of a Well's notice. This threshold gives credence to this petition's argument that some kind of similar threshold be given to raw allegations.

As the SEC's Division of Market Regulation's 1994 Large Firm Project report noted, on Page 14:

"The Staff recommends that all SROs should make public disciplinary actions against member firms and individuals when the SRO initiates the disciplinary action by filing formal charges. The NASD began disclosing its initiated disciplinary actions in July 1993. The NYSE's Board of Directors approved a proposal to make its statements of charges public by having them available through the CRD. The disciplinary filings to the CRD from the NYSE commenced on April 25, 1994. Other exchanges, however, do not publicly disclose their disciplinary actions until the matter has been resolved or action completed by the SRO. The Division believes that, once an SRO has made a determination that there is probable cause for believing the securities laws or the rules of the SRO have been violated and has actually initiated a disciplinary action, this information should be publicly available through inclusion in the CRD maintained by the NASD on behalf of the states and the SROs. In addition to the benefits to investors of inclusion of this information in the CRD, such disclosure will remove existing benefits firms receive from dilatory tactics that delay resolution of the disciplinary proceeding." [Emphasis added.]

Division Staff made no distinction between firm and broker disclosure in opining that "SROs should make public disciplinary actions against member firms and individuals when the SRO initiates the disciplinary action by filing formal charges." (Emphasis added.) How did the "formal charges" standard come to be a lower threshold for brokers, and a higher threshold for member firms?

The SEC must change Form BD to comport with U-4 requirements and ensure equal reporting by firms and brokers of formal charges by regulators.

--*Criminal charges.* Form BD requires only that firms disclose criminal charges and convictions for the last 10 years. But individual brokers must disclose all criminal charges and convictions and this data is disclosed on the CRD. Why the difference?

The SEC must require firms to disclose all past criminal charges and convictions.

Because most or all of the above items are already reported in one form or another, disclosing this data will not increase member firms' compliance or reporting obligations.

One would hope that these discrepancies in the disclosure regime are not due to industry influence over the NASD. But clearly, the less-stringent disclosure requirements for firms exist, and work to the industry's advantage in keeping a cleaner image and minimizing evidence for private litigation.

Due to all the issues of fairness and lack of public disclosure described above, the current disclosure system violates the 34 Act's requirement for fair dealing, nondiscriminatory treatment and rules that act in the public interest. Therefore, the SEC must undertake to fix the inequities

3) I petition the SEC to ensure disclosure of all arbitration awards from all forums, and require or encourage basic explanations from arbitrators in the award.

In the SEC's 1994 Large Firm project report on rogue brokers, in Appendix A, page 9, the report says the "Division of Market Regulation has requested that all SROs operating arbitration programs forward information concerning arbitration decisions rendered in their forum directly to the CRD system so that this information is consistently disclosed to the public regardless of the arbitration forum and regardless of whether the registered representative timely files or amends a Form U-4 or RE-3." Meanwhile, in conjunction with the SROs, the *Securities Arbitration Commentator* newsletter collects and disseminates arbitration awards from *all* forums.

Despite the request from the Division nearly a decade ago, only awards from NASD arbitration forums are reported on CRD.

Further, SROs actively discourage arbitrators from explaining their decisions, further reducing important disclosure information that could help investors spot problem actors and firms, or help repair the reputation of a party unfairly charged. This non-explanation policy should be changed. After all, the real reason more detail is not given, at least in part, is to give firms more "wobble room" in how the case gets reported, according to one SRO arbitration official. Providing "wobble room" to firms (which by industry convention author or approve most U-4 language) while investors in a case have no ability to describe the outcome, is a violation of the '34 Act.

The SEC must ensure that all arbitrations are reported. It must also ensure that arbitration panels provide some minimal level of explanation, or at a minimum require that SROs do not in any way discourage panelists from doing so.

4) I petition the SEC to ensure that associated persons are alerted to, and can respond to, any data about them in all levels and databases of the CRD, including the Registration Comments section, and that all such entries are archived.

A section in the CRD system, the Registration Comments section, allows firms to *unofficially* change the reason for termination and comment about why a broker was terminated. Although state and federal regulators have online access to the information, the comments section is not a part of the official CRD record and not disclosable through the NASD's public disclosure system, although individual states may disclose the information. What's more, firms can apparently delete or amend their own comments at any time, and the records are not archived unless they're printed and saved while still in the system. It's unclear whether brokers are notified of any registration comments in their records and whether they get a chance to respond, as they can with U-5 information.

The SEC must ensure that brokers have access to all job-related CRD data regardless of where the data resides.

Sincerely,

Dan Jamieson