

SPECIAL NASD NOTICE TO MEMBERS 95-81

SEC Approves Rules For Reporting Customer Complaint Information

Suggested Routing

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Executive Summary

On September 8, 1995, the Securities and Exchange Commission (SEC) approved a new rule under Article III, Section 50 of the Rules of Fair Practice (Rules) for reporting customer complaint information and other specified events to the NASD®. The new rule requires members to report to the NASD the occurrence of 10 specified events and quarterly summary statistics concerning customer complaints. The new rule will provide important new regulatory information that will assist the NASD in the timely identification of problem members, branch offices, and registered representatives in order to more aggressively detect and investigate sales practice violations. The rule, as adopted, significantly parallels comparable provisions of New York Stock Exchange (NYSE) Rule 351, and also eliminates any regulatory duplication by exempting members that are currently subject to similar reporting requirements of another self-regulatory organization (SRO). The rule change is effective October 1, 1995. Electronic filings of specified events that occur from October 1, and thereafter, are required to be reported within 10 business days after the member knows of, or should have known of, the existence of the event. The first electronic submission of quarterly statistical data will be due January 15, 1996.

Background

The NASD's regulation program requires District Offices to identify and conduct intense sales practice examinations of main offices, branch offices, and individuals associated with such offices who may pose certain regulatory concerns due to, among other things, past misconduct related to abusive sales and trading practices.

The NASD has developed an automated system that draws on the Central

Registration Depository (CRDSM) and NASD internal regulatory systems to analyze and profile the current registered representative population. When incorporated with NASD regulatory intelligence about examinations, disciplinary actions, customer complaints, and terminations for cause, the NASD has the capacity to more precisely and expeditiously profile registered representatives that may pose regulatory risks to public investors.

Over the past several years, the NASD has taken a number of actions to:

- emphasize improvement in the hiring and termination practices of member firms;
- commit additional resources to sales practice cases;
- increase scrutiny of member supervisory systems, practices, and procedures; and
- increase sanctions for sales practice violations.

Members employing individuals with a history of compliance or disciplinary problems have also been made aware of their heightened standard of supervisory responsibility which demands that special supervisory practices address the particular problems of those individuals.

To enhance these efforts further, the NASD has adopted, with SEC approval, a new customer complaint rule that significantly strengthens the NASD's regulatory and surveillance efforts by requiring member firms to report to the NASD the occurrence of certain specified events and summary statistics concerning customer complaints.

Summary Of The Approved Rule

Subsection (a) of the rule requires member firms to file a report with the

NASD when any of 10 specified events occurs. These 10 events vary significantly, ranging from situations where a court, government agency, or SRO has determined there has been a violation of the securities laws, to circumstances where a firm has received a written customer complaint alleging theft, misappropriation of funds or securities, or forgery. Subsection (b) of the rule requires each person associated with an NASD member to report promptly to the member the existence of any of the 10 conditions in Subsection (a) of the rule, and the member must report these events to the NASD within 10 business days of when the member knows, or should have known, of the event. Specified events that occur on and after October 1, 1995, are subject to this reporting requirement.

Subsection (c) of the rule further requires members to report to the NASD statistical and summary information regarding written customer complaints received by the member firm or relating to the firm or any of its associated persons. No report is required if the member does not receive a customer complaint. The statistical and summary information regarding customer complaints is due by the 15th of the month following the calendar quarter in which the customer complaints are received by the member. (If the 15th of the month falls on a weekend or holiday, the report is due the next business day.) Initial quarterly reports are due by January 15, 1996, for the calendar quarter ending December 31, 1995. For example, if the member received a customer complaint during that calendar quarter, the member must file the required report by January 15, 1996. The NASD Regulation staff will routinely conduct on-site inspections as part of the examination process and use automated surveillance techniques to ensure full and timely compliance with this important new rule.

Subsection (e) of the rule eliminates the possibility of any regulatory duplication by providing an exemption from filing with the NASD for members already subject to similar reporting requirements of another SRO. NYSE Rule 351 is the only such rule in place at this time.

Systems Implementation

By October 1, 1995, the NASD will be distributing to its members the NASD Customer Complaint System Software (CCSS), with applicable communications software (NASDnetSM) to help members comply with the reporting requirements of the new rule. CCSS will permit members to file the required information electronically with the NASD through an electronic filing mechanism similar to PC FOCUSSM. Along with the software, the NASD will distribute a users guide, which will help explain the software and attempt to answer most installation questions that may arise.

For the software to operate efficiently, each member must maintain the following hardware configuration:

- at least a 286 Personal Computer with DOS operating system;
- 640K of RAM;
- 2.4MB hard drive;
- 3.5" disk drive;
- CGA, EGA, VGA, or monochrome monitor; and
- Hayes-compatible modem with a 1200, 2400, or 9600 baud rate.

Any questions regarding the installation of the CCSS or NASDnet communications software can be directed to the NASD Regulatory Systems Customer Support Hotline at (800) 321-6273.

Recision Of Schedule C, Part V

Before adopting this new rule amendment, Part V of Schedule C to the NASD By-Laws required members to promptly notify the NASD in writing of any disciplinary action that the member had taken against any of its associated persons involving suspension, termination, the withholding of commissions or imposition of fines in excess of \$2,500, or any other significant limitation on activities. As this existing disclosure requirement is incorporated into Subsection (a)(10) of the approved rule, the SEC approved the recision of Part V of Schedule C to the NASD By-Laws.

Questions regarding this Special Notice may be directed to David Spotts or Daniel Sibears, NASD Regulatory Policy Department, at (202) 728-8221; Craig Landauer, Office of General Counsel, at (202) 728-8294; or to the members' local NASD District Office. All questions regarding system implementation may be directed to NASD Regulatory Systems Customer Support at (800) 321-6273 or (301) 208-2818.

Text Of New Rule

(Note: New text is underlined.)

NASD Rules of Fair Practice

Article III, Section 50

(a) Each member shall promptly report to the Association whenever such member or person associated with the member:

(1) has been found to have violated any provision of any securities law or regulation, any rule or standards of conduct of any governmental agency, self-regulatory organization, or financial business or professional organization, or engaged in conduct which is inconsistent with just and

equitable principles of trade; and the member knows or should have known that any of the aforementioned events have occurred;

(2) is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery;

(3) is named as a defendant or respondent in any proceeding brought by a regulatory or self-regulatory body alleging the violation of any provision of the Securities Exchange Act of 1934, or of any other federal or state securities, insurance, or commodities statute, or of any rule or regulation thereunder, or of any provision of the By-laws, rules or similar governing instruments of any securities, insurance or commodities regulatory or self-regulatory organization;

(4) is denied registration or is expelled, enjoined, directed to cease and desist, suspended or otherwise disciplined by any securities, insurance or commodities industry regulatory or self-regulatory organization or is denied membership or continued membership in any such self-regulatory organization; or is barred from becoming associated with any member of any such self-regulatory organization;

(5) is indicted, or convicted of, or pleads guilty to, or pleads no contest to, any criminal offense (other than traffic violations);

(6) is a director, controlling stockholder, partner, officer or sole proprietor of, or an associated person with, a broker, dealer, investment company, investment advisor, underwriter or insurance company which was suspended, expelled or had its registration denied or revoked by any agency, jurisdiction or organization or is associated in such a capacity

with a bank, trust company or other financial institution which was convicted of or pleaded no contest to, any felony or misdemeanor;

(7) is a defendant or respondent in any securities or commodities-related civil litigation or arbitration which has been disposed of by judgement, award or settlement for an amount exceeding \$15,000. However, when the member is the defendant or respondent, then the reporting to the Association shall be required only when such judgement, award of settlement is for an amount exceeding \$25,000;

(8) is the subject of any claim for damages by a customer, broker, or dealer which is settled for an amount exceeding \$15,000. However, when the claim for damages is against a member, then the reporting to the Association shall be required only when such claim is settled for an amount exceeding \$25,000;

(9) is associated in any business or financial activity with any person who is subject to a "statutory disqualification" as that term is defined in the Securities Exchange Act of 1934, and the member knows or should have known of the association. The report shall include the name of the person subject to the statutory disqualification and details concerning the disqualification;

(10) is the subject of any disciplinary action taken by the member against any person associated with the member involving suspension, termination, the withholding of commissions or imposition of fines in excess of \$2,500, or otherwise disciplined in any manner which would have significant limitation on the individual's activities on a temporary or permanent basis.

(b) Each person associated with a member shall promptly report to the member the existence of any of the conditions set forth in paragraph (a) of this rule. Each member shall report to the Association not later than 10 business days after the member knows or should have known of the existence of any of the conditions set forth in paragraph (a) of the rule.

(c) Each member shall report to the Association statistical and summary information regarding customer complaints in such detail as the Association shall specify by the 15th day of the month following the calendar quarter in which customer complaints are received by the member. For the purposes of this paragraph, "customer" includes any person other than a broker or dealer with whom the member has engaged, or has sought to engage, in securities activities, and "complaint" includes any written grievance by a customer involving the member or person associated with a member.

(d) Nothing contained in paragraph (a), (b) and (c) of this Section shall eliminate, reduce, or otherwise abrogate the responsibilities of a member or person associated with a member to promptly file with full disclosure, required amendments to Form BD, Forms U-4 and U-5, or other required filings, and to respond to the Association with respect to any customer complaint, examination, or inquiry.

(e) Any member subject to substantially similar reporting requirements of another self-regulatory organization of which it is a member is exempt from the provisions of this Section.

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