
For the Commission, by the Division of Market Regulation, pursuant to delegated authority.  

Margaret H. McFarland,  
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc., To Amend NASD Rule 3070 To Require Members To File Copies of Criminal and Civil Complaints and Arbitration Claims With NASD


I. Introduction

On August 15, 2002, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) and Rule 19b–4 thereunder to amend Rule 3070 of its rules to require members promptly to file copies with NASD of certain criminal and civil complaints and arbitration claims against a member or a person associated with a member. NASD amended the proposed rule change on December 9, 2002. Notice of the proposed rule change and Amendment No. 1 thereto was published for comment in the Federal Register on December 27, 2002.

The Commission received five comment letters regarding the proposal. On February 12, 2003, NASD filed a response to the comment letters. This order approves the proposed rule change as amended by Amendment No. 1.

II. Description of the Proposal

The proposed rule change amends NASD Rule 3070 to require members to file promptly with NASD copies of certain criminal and civil complaints and arbitration claims against the member or a person associated with the member. The purpose of the rule proposal is to improve the quality and flow of information to NASD with respect to allegations of broker misconduct, so that NASD can enhance investor protection efforts by promptly taking appropriate regulatory action to address the specific alleged misconduct and to prevent similar or related misconduct in the future.

Specifically, the proposed rule change requires members to file with NASD copies of (1) any criminal complaints filed against a member or plea agreements entered into by the member that are covered by the rule; (2) any securities or commodities-related private civil complaints filed against the member; (3) any arbitration claim against the member (except those claims that have already been filed with NASD Dispute Resolution, in which case NASD obtains copies of such claims directly from NASD Dispute Resolution); and (4) any criminal complaint or plea agreement, private civil complaint or arbitration claim against an associated person that is reportable under question 14 on Form U–4, irrespective of any dollar threshold requirements that question imposes for notification (except those arbitration claims that have already been filed with NASD Dispute Resolution). To avoid duplicative filing, the rule proposal also provides that members need not separately produce the above-referenced documents if they have already been the subject of a request by NASD’s Registration and Disclosure staff. These amendments are discussed in greater detail in the Commission’s notice soliciting public comment on this proposal.

III. Summary of Comments

The Commission received five comment letters on the proposed rule change. Although four of the commenters generally supported NASD’s desire to obtain and collect information regarding broker misconduct, they each contended that the proposal was unduly burdensome for members or be unduly burdensome

For members and offered alternative suggestions for achieving NASD’s stated objectives. The fifth comment letter was written in response to the SIA Letter and in support of the proposed rule change. World Group and A.G. Edwards stated that NASD would be unduly burdened by the volume of documents it would receive compared to the amount of new relevant information.

In its response to comments, NASD focused only on comments made in connection with this proposal. The World Group, MetLife and A.G. Edwards Letters also addressed a change in NASD’s policy regarding letters to NASD issues when a determination is made to close an investigation without disciplinary action (referred to as “close-out letters”). While notice of the policy change with respect to close-out letters was contained in the same Notice to Members 02–53 that announced that NASD had filed with the SEC its proposal to amend Rule 3070, that policy change is not part of this rule filing. Accordingly, this order does not address the policy change with respect to close-out letters.

NASD disagrees that the proposal would impose duplicative filing requirements on members or be unduly burdensome.

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19 See Special NASD Notice to Members 01–35.
streamline the current reporting system by requiring member firms to report events to NASD only once through a new electronic medium. NASD responded that while MetLife’s general proposal to develop a new system is worth long-term consideration, its feasibility is uncertain and, in any event, it does not now provide a viable alternative to the current proposal.

A.G. Edwards stated that most of the information required to be reported in the proposal is already required to be reported by members on the CRD. A.G. Edwards suggested that NASD assume the responsibility to report to the CRD any required information based on its review of the complaints and arbitration claims. They thought this would relieve members from the regulatory burden of reporting these actions to the CRD and would relieve some of the questions that they believe have arisen in regard to the reliability of that reporting. NASD responded that its does not believe such steps are necessary or appropriate. NASD explained that the rule proposal requires different information for different regulatory purposes from that reported to the CRD, and NASD believes it has reasonably minimized the burden on members under the proposal.

The SIA stated that the rule should be limited to copies of retail customer lawsuits and arbitrations that allege sales practice violations in accordance with current Form U-4 and U-5 reporting requirements and dollar thresholds. The SIA stated that such an approach would be more resource-efficient and would produce more targeted reviews of complaints by NASD, NASD noted in its response that the SIA seeks to exclude from the proposal complaints in “nearly all class actions; non-retail civil litigation, including product failure, and operational complaints, and small claims involving relatively small dollar amounts.”

The proposal requires a member to file with NASD any criminal complaint or plea agreement, private civil complaint or arbitration claim against an associated person that is reportable under question 14 on Form U-4, irrespective of any dollar threshold requirements that question imposes for notification (except those arbitration claims that have already been filed with NASD Dispute Resolution).

The NASD Response Letter states the following in support of NASD’s belief that the SIA proposal is too narrow in scope and could lead to confusion. First, under the SIA formulation to limit the proposal to retail customer complaints and claims, NASD would not receive complaints alleging egregious conduct between members (such as collusive market making) or involving institutional customers (such as a kickback scheme in the distribution of initial public offerings). Such allegations of misconduct constitute relevant regulatory information, so NASD sees no sound policy reason to limit the subject matter of complaints to those involving retail customers. Since these and other allegations sometimes first appear in criminal proceedings, NASD believes it appropriate to maintain the requirement in the proposal to file copies of such documents.

Second, limiting the proposal to complaints and claims alleging sales practice violations would undermine a significant purpose of the rule proposal, namely to detect securities or commodities-related patterns of conduct or emerging trends that might warrant regulatory action. The regulatory intent would be frustrated if members were permitted to parse the language of a potential filing to determine whether its substance technically comprised a sales practice violation. Furthermore, litigation and arbitrations that related to securities or commodities conduct, but do not amount to a sales practice violation, nevertheless may prove to correlate to other conduct injurious to the investors and markets. These determinations can only be reached if NASD has access to data that has not been filtered by application of nuance to a legal term of art.

Third, with respect to associated persons, NASD believes it is important to receive copies of complaints and claims reportable under question 14 on Form U-4, even when they fall below specified dollar thresholds, because those actions can highlight patterns of conduct or emerging trends that might warrant regulatory actions.

The Weintraub Letter was written in response to the SIA Letter with regard to the reporting of customer complaints. The SIA stated that the rule should be limited to copies of retail customer lawsuits and arbitrations that allege sales practice violations in accordance with current Form U-4 and U-5 reporting requirements. The Weintraub Letter stated that whether a customer-initiated arbitration is reportable on the Form U-4 or not has absolutely no connection to the seriousness of the underlying allegations, or the need for regulatory scrutiny.
IV. Discussion and Commission Findings

After careful consideration, the Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a registered securities association and, in particular, with the requirements of Section 15A(b)(6). Specifically, the Commission finds that approval of the proposed rule change is consistent with Section 15A(b)(6) of the Act in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and in general, to protect investors and the public interest.

The Commission believes that the proposed rule change will enhance NASD’s regulatory efforts and investor protection mission. The proposal should improve NASD’s ability to detect and prevent fraudulent and manipulative conduct and enable it to develop regulatory responses to problem areas at the earliest possible time. The Commission further believes that the regulatory benefits of the proposed rule change outweigh the additional burden on members to file with NASD copies of the specified documents, and that the proposal minimizes that burden in that the rule requires only the filing of those complaints and claims most likely to reveal information that should assist NASD’s regulatory mission.

V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (SR-NASD–2002–112), as amended, be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; Notice of Filing of Amendment Nos. 1, 2, and 3 to a Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Business Continuity Plans and Emergency Contact Information


Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") and Rule 19b–4 thereunder, the National Association of Securities Dealers, Inc. ("NASD"), on August 7, 2002, filed with the Securities and Exchange Commission ("Commission"), a proposed rule change to require its members to establish and maintain business continuity plans. The Commission published the proposed rule change in the Federal Register on September 9, 2002. The Commission received three comments in response to the Original Notice. The NASD submitted amendments to the proposed rule change on December 12, 2002; January 8, 2003; and February 19, 2003. The Commission is publishing this notice of Amendment Nos. 1, 2, and 3 to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The NASD is proposing to clarify that the proposed rule change, which would require member firms to create and maintain business continuity plans and to provide the NASD with certain information to be used in the event of future significant business disruptions, also would require members’ business continuity plans to be reasonably designed to enable members to continue their business in the event of a significant business disruption. Below is the text of the proposed rule change, as amended. The base rule text is that proposed in the Original Notice. Language added by Amendments Nos. 1, 2 and 3 is italicized; language deleted by the amendments is in brackets.

* * * * * 3500. Business Continuity Plans

3510. Business Continuity Plans

(a) Each member must create and maintain a written business continuity plan identifying procedures [to be followed in the event of] relating to an emergency or significant business disruption. Such procedures must be reasonably designed to enable the member to continue its business in the event of future significant business disruptions. The business continuity plan must be made available promptly upon request to NASD staff.

(b) Each member must update its plan in the event of any material change to the member’s operations, structure, business, or location. Each member must also conduct an annual review of its business continuity plan to determine whether any modifications are necessary in light of changes to the member’s operations, structure, business, or location.

(c) The [requirements of] elements that comprise a business continuity plan are flexible and may be tailored to the size and needs of a member. Each plan, however, must at a minimum, address:

1. Data back-up and recovery (hard copy and electronic);
2. All mission critical systems;
3. Financial and operational assessments;
4. Alternate communications between customers and the member;
5. Alternate communications between the member and its employees;
6. Business constituent, bank, and counter-party impact;
7. Regulatory reporting; and
8. Communications with regulators.

Each member must address the above-listed categories to the extent applicable and necessary to enable the member to continue its business in the event of a significant business disruption. If any of the above-listed categories is not applicable, the member’s business continuity plan need not address the category. The member’s business continuity plan, however, must document the rationale for not including such category in its plan. If a member relies on another entity for any one of the above-listed categories or any mission critical system, the member’s business continuity plan must address this relationship.

(d) Members must designate a member of senior management to...