



Via email and overnight mail

October 15, 2003

Ms. Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street NW
Washington, DC 20006-1500

Re: Proposed Amendments to Rule 3010

Dear Ms. Sweeney:

The Association of Registration Management (“ARM”) welcomes the opportunity to comment on NASD’s proposed amendments to Rule 3010 (see NASD Notice to Members 03-49). The proposed amendment would require heightened supervision for those associated persons having a specific threshold of industry/regulatory-related disclosure events.

ARM appreciates NASD’s objectives in attempting to sensitize firms in their efforts to maintain closer supervision of those individuals whose Central Registration Depository (“CRD”) record might suggest that additional scrutiny is in order. Improving investor protection and maintaining market integrity are obviously laudable considerations and ARM is, of course, wholly supportive of the regulatory community in this regard.

ARM, though, has recently come to learn that NASD intends for *both* reportable and non-reportable (or archived) events to count toward meeting the threshold for industry/regulatory-related events that would trigger special supervision. ARM believes this approach is inappropriate.

We are mindful that over the years CRD has evolved from a registration and licensing system used by industry and regulators for registration and licensing into a public disclosure database for customers wishing to check backgrounds of those persons and entities that they contemplate conducting (or continue conducting) business with. In reacting to the expanded use of CRD for this purpose, NASD, the New York Stock

Exchange and the North America Securities Administrators Association took great care in amending Forms U4 and U5 (sources for individual disclosures) in order to allow for an archival process for those incidents which were deemed to be of little or no regulatory significance. ARM believes that this was done (and rightfully so) because of the inherent unfairness in stigmatizing a broker who may have been named in an unsubstantiated or frivolous complaint, who may have been named in an arbitration claim in error or perhaps was found by a court or arbitration panel *not* to have committed any wrongdoing. Keep in mind that reporting obligations are driven by allegations (and dollar thresholds that are very small) without regard to validity or even possibility. As a result of a reporting scheme that is based upon allegations (that may later be proven to be untrue) and realizing that the ability to seek expungement is limited and often constrained by cost, an archival process was established in order to “back burner”, if you will, those matters that were deemed to be of no regulatory importance.

If archived complaints were to be considered in meeting these thresholds, the proposed rule could require a firm to evaluate the need to initiate a special supervisory plan even if the associated person was proven to have committed no wrongdoing. Such a proposed rule could also have the unintended consequence of unfairly hindering an associated person’s ability to change employers. For example, if a broker was named as a respondent in three separate arbitration claims involving a product failure and an arbitration panel found in each instance that the broker had committed no wrongdoing, the broker would nonetheless have reached the contemplated threshold for special supervision. Broker-dealers would then be less likely to extend an offer of employment to such an individual because (whether in perception or reality) such a hire could increase a firm’s liability and become the cause of undue regulatory scrutiny. Clearly, one can see some of the unintended consequences were such an individual to be “flagged”.

ARM again asserts that NASD should disregard non-reportable or archived complaints for the purpose of tallying incidents and only allow *reportable* events to be considered in determining if a targeted threshold has been met. ARM would respectfully remind NASD that (with or without these proposed amendments) firms remain under a continuing regulatory obligation to supervise their employees. As well, there has long been a requirement that firms thoroughly investigate the background and repute of those individuals it wishes to employ and to supervise them accordingly (precisely for these reasons, NASD makes the "Prehire" functionality available via CRD and requires firms to obtain Form U5 copies for those representatives it hires from other broker-dealers).

ARM realizes the proposed rule provides firms with the flexibility to take various information into account and allows firms to take whatever steps are deemed necessary to satisfy the requirement. We believe, though, the imposition of this requirement regarding non-reportable or archived complaints would then become a situation whereby form takes precedence over substance. For example, if a firm has a registered representative with three customer complaints in the last five years, all of which were found to be meritless

(and therefore no longer reportable), the firm would reasonably conclude that the representative did nothing wrong and that heightened supervision would not be warranted. What other conclusion could the firm possibly draw? Certainly, firms would have to document their review but we question what purpose such a review would serve.

ARM also disagrees with the conclusion drawn by NASD's CRD data review, which was conducted in an attempt to determine what specific numerical threshold would be appropriate to trigger heightened supervision. While ARM will not dispute that the aggregate numbers show that less than one half of one percent of *all registered persons* have three or more customer complaints, we disagree with the conclusion NASD draws by this review; namely, that three or more complaints is, relatively speaking, an unusually high number. Customer complaints and (to a large extent) regulatory actions are typically associated with retail brokers. What the statistical analysis fails to consider is that not all 663,000 registered individuals in the CRD database are retail brokers. Indeed, a significant number of these individuals are bankers, analysts, traders, capital markets salespersons, compliance and audit professionals, product professionals and operations/back-office support personnel—personnel who are virtually never involved in sales practice complaints and who are very infrequently the subject of regulatory proceedings or terminations for compliance reasons. Had this consideration been factored into the study, NASD would have likely concluded that three complaints in five years would not necessarily be as uncommon occurrence as thought (especially in a bear market) and that four or perhaps five complaints might have been a more appropriate threshold.

ARM asks that, if indeed the adoption of the proposed amendments were to occur, NASD build a programmatic notification process to firms (utilizing CRD data) so that they know with certainty the names of those individuals that NASD has identified as having reached the thresholds. Firms can then accordingly take some form of action.

Lastly, ARM does not believe that thirty days constitutes sufficient time to allow a firm to review an entire history and develop a meaningful supervisory plan. Please keep in mind that complaints are often filed with an associated person's previous employer and involve alleged misconduct occurring at that firm. Because the alleged misconduct occurred at a previous employer, employing firms would need ample time to obtain a copy of the complaint, interview the associated person (to ask that he/she address the allegations asserted in the complaint) and, after considering factors such as client-base, product mix, etc., prepare a supervisory plan specific to that particular situation that satisfies both the firm and the associated person's manager, the manager having the ultimate responsibility of executing the plan. We suggest that ninety days is more realistic in the review and development of an effective supervisory plan.

In summary, ARM appreciates NASD's objectives for proposing this rule but we again state our belief that only relevant and currently reportable industry/regulatory-related

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events should be used for threshold considerations. We also believe NASD should be the official source for identifying those who have met the threshold and that ninety days instead of the proposed thirty be given to firms for the development of a supervisory plan. These are some of the issues that concern ARM and our membership with respect to the proposed amendments to Rule 3010. We again don't see customer protection being any better served nor do we see market integrity being any better maintained by possible regulation that may be commendable in theory but that is also, in our view, burdensome and, in some instances, unfair and uncalled for.

Thank you for your time and attention to this matter.

Very truly yours,

Mario Di Trapani
President