

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41575; File No. SR-NASD-99-28]

Self-Regulatory Organizations; Filing and Order Granting Accelerated Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Amendments to Rule 1140

June 29, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 2, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary NASD Regulation, Inc. ("NASD Regulation" or "NASDR"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by NASDR. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

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

NASDR proposes to amend and implement Rule 1140 to require electronic filing of Form U-4, the Uniform Application for Securities Industry Registration or Transfer, and the Form U-5, the Uniform Termination Notice for Securities Industry Termination (collectively "Forms") and to make other conforming changes. Additions are italicized; deletions are bracketed.

1140. Electronic Filing Rules

(a) Filing Requirement.

All forms required to be filed by *Article IV, Sections 1, 7, and 8, and Article V, Section 2 and 3, of the NASD By-Laws* shall be filed through an electronic process or such other process the Association may prescribe to the Central Registration Depository.

(b) Supervisory Requirements

(1) In order to comply with the supervisory procedures requirement in Rule 3010 [of the Conduct Rules], each member [must] *shall* identify a Registered Principal(s) or corporate officer(s) who has a position of authority over registration functions, to be

responsible for supervising the electronic filing of appropriate forms pursuant to this Rule.

(2) The Registered Principal(s) or corporate officer(s) who has or have the responsibility to review and approve the forms filed pursuant to this Rule [will] *shall* be required to acknowledge, electronically, that he is filing this information on behalf of the [firm] *member* and the [member firm's] *member's* associated persons.

(c) Form U-4 Filing Requirements

(1) Initial and transfer electronic application filings [will] *shall* be based on a signed Form U-4 provided to the [firm] *member* by the applicant. As part of the [member firm's] *member's* recordkeeping requirements, it [must] *shall* retain the applicant's signed Form U-4 and make it available upon regulatory request.

(2) [Amendments to the disclosure information in Item 22 can be filed electronically without obtaining the associated person's signature on Form U-4. The member will be required to provide the associated persons with a copy of the amended disclosure information that was filed. In providing this material to the associated person, the firm must obtain the written acknowledgement [sic] that the information has been received and reviewed. The member must maintain this acknowledgement in its books and records and must make it available upon regulatory request.]

Fingerprint Cards

Upon filing an electronic Form U-4 on behalf of an applicant for registration, a member shall promptly submit a fingerprint card for the applicant. NASD Regulation may make a registration effective pending receipt of the fingerprint card. If a member fails to submit a fingerprint card within 30 days after NASD Regulation receives the electronic Form U-4, the person's registration shall be deemed inactive. In such case, NASD Regulation shall notify the member that the person must immediately cease all activities requiring registration and is prohibited from performing any duties and functioning in any capacity requiring registration. NASD Regulation shall administratively terminate a registration that is inactive for a period of two years. A person whose registration is administratively terminated may reactivate the registration only by reapplying for registration and meeting the qualification requirements of the applicable provisions of the Rule 1020 Services and the Rule 1030 Series. Upon application and a showing of good cause, the Association may extend the 30-day period.

(d) Form U-5 Filing Requirements
Initial filings and amendments of Form U-5 [will] *shall* be [done] *submitted* electronically. As part of the [member firm's] *member's* recordkeeping requirements, it [must] *shall* make [them] *such records* available upon regulatory request.

(e) Third Party Filing

A member may employ a third party to file the required forms electronically on its behalf[, if the member and the third party have executed the Association's Broker-Dealer Agent-Filing Addendum to CRD Subscriber Agreement].

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Rule 3010. Supervision
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(e) Qualifications Investigated

Each member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications, and experience of any person prior to making such a certification in the application of such person for registration with this Association. Where an applicant for registration has previously been registered with the Association, the member shall obtain from the [Firm Access Query System (FAQS)] *Central Registration Depository* or from the applicant a copy of the Uniform Termination Notice of Securities Industry Registration (Form U-5) filed with the Association by such person's most recent previous NASD member employer, together with any amendments thereto that may have been filed pursuant to Article IV, Section 3 of the Association's By-Laws. The member shall obtain the Form U-5 as required by this Rule no later than sixty (60) days following the filing of the application for registration or demonstrate to the Association that it has made reasonable efforts to comply with the requirement. A member receiving a Form U-5 pursuant to this Rule shall review the Form U-5 and any amendments thereto and shall take such action as may be deemed appropriate.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NASDR included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. NASDR has prepared summaries, set forth in Sections A, B,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

On July 15, 1996, the Commission approved NASD Rule 1140.³ The purpose of this rule was to require members to file Form U-4 and U-5 electronically on a redesigned Central Registration Depository ("CRD") system then under development. That system used network-based architecture and proprietary software developed by the NASD. In 1997, NASDR determined to proceed with a new approach to the CRD system that will permit members to submit CRD filings electronically via NASDR's World Wide Web site ("Web CRD"),⁴ rather than using network-based architecture and proprietary software to submit such filings.⁵ As a result, Rule 1140 has never been implemented.

The purpose of the proposed rule change is to amend Rule 1140 to make it consistent with the newly developed Web CRD and to implement the Rule on the planned date of deployment of Web CRD, which is August 16, 1999.⁶ First, current paragraph (c)(2) is deleted. As approved in 1996, this provision would have permitted a firm to amend disclosure information in Item 22 of the Form U-4 without obtaining the registered person's signature if the firm provided a copy of the filing to the

registered person and obtained and maintained a record of an acknowledgment by the registered person. NASDR has not provided for such a practice in the initial release of the Web CRD system in August 1999. NASD may consider providing for such a practice in the future.⁷

Second, a new paragraph (c)(2) would be added to the Rule to address the continued submission of paper fingerprint cards in the Web CRD electronic filing environment. This amendment is necessary because it is not feasible at this time to implement electronic filing of fingerprint cards. In Web CRD, firms will: (1) include a barcode number from the fingerprint card in an electronic Form U-4 filing; and (2) undertake to submit the fingerprint card by mail or delivery service.⁸ The amended rule would authorize NASDR to make a registration effective pending receipt of the fingerprint card. The rule also would be amended to authorize NASDR to place a person in an inactive status if NASDR does not receive the fingerprint card within 30 days of the filing of a Form U-4. This will enable NASDR to address those instances in which fingerprint cards (which are required by NASD and SEC rules⁹) are not submitted in a timely fashion.¹⁰

Paragraph (e) of Rule 1140 also is amended. This paragraph permits members to use a service bureau for filing the Forms if the member and the service bureau have executed a Filing Addendum to the CRD Subscriber Agreement. The reference to the Agreement is deleted because such agreements, which were necessary to protect the NASD's proprietary software, are not necessary in the Web CRD environment because proprietary software is not used. As with other electronic filings required under the NASD Rules, members may use a service bureau to submit electronic

filings, but the member will remain ultimately responsible for the timeliness and content of the filings. NASDR is working with service bureaus to make sure they are prepared to provide this service to members. Other grammatical changes have been made to the Rule.

In 1996, the NASD Board had intended to provide a one-year transition during which the NASD would continue to process paper filings for firms with 50 or fewer registered representatives. The NASDR Board has reconsidered this issue and determined that a transition period is not necessary. Web CRD, unlike the earlier system, does not require a firm to purchase any special hardware or software; members will have low-cost access to the system through NASDR's Web site.¹¹ NASDR also has been working closely with end-users (*i.e.*, broker-dealers, states, self-regulatory organizations, and the Commission) to prepare them for Web CRD. To familiarize end-users with the system and how it will operate, NASDR has conducted several successful pilot programs during 1998 and early 1999 in preparation for the deployment of Web CRD in August 1999. In addition, NASDR has conducted conferences nationwide to provide end-users with an opportunity to familiarize themselves with Web CRD.¹² NASDR also is providing current CRD users with periodic updates discussing the features and functionality of Web CRD through the *CRD/PD Bulletin* and *Web CRD Update*, publications that are available in hard copy and on NASDR's Web site. Also, beginning in February 1999, NASDR began providing current CRD users with Web CRD user accounts and passwords. End-users will have an opportunity to practice accessing and working in the Web CRD system in July 1999 prior to deployment the following month. Furthermore, NASDR has prepared Web-base tutorials (accessible through NASDR's Web site) for all end-

³ Securities Exchange Act Release No. 37439 (July 15, 1996), 61 FR 37950 (July 22, 1996).

⁴ The address for NASDR's website is <http://www.nasdr.com>.

⁵ Web CRD is designed to support electronic filing of Forms U-4, U-5, U-6, BD, and BDW via NASD Regulation's World Wide Web site. Ultimately, NASD Regulation expects that all filings for both broker-dealers and their associated persons will be submitted exclusively through electronic means. All Forms U-4 and U-5 (*i.e.*, the uniform securities industry applications for registration and termination, respectively) will be submitted electronically upon deployment of Web CRD on August 16, 1999. See Securities Exchange Act Release No. 41326 (April 22, 1999), 64 FR 23366 (April 30, 1999) (notice of filing of File No. SR-NASD-98-96); Securities Exchange Act Release No. 41560 (June 25, 1999) (order approving File No. SR-NASD-98-96, which implemented Web CRD and amended certain disclosure questions).

⁶ NASDR also revised Forms U-4 and U-5 that are designed to be used with the new Web CRD system. These Forms become effective on August 1, 1999. For a description of the transition period from July 31 to August 16, 1999, see Securities Exchange Act Release No. 41326 (April 22, 1999), 64 FR 23366 (April 30, 1999) (notice of filing of File No. SR-NASD-98-96) and Securities Exchange Act Release No. 41560 (June 25, 1999) (order approving File No. SR-NASD-98-96, which implemented Web CRD and amended certain disclosure questions).

⁷ The current practice of permitting administrative information on pages 1 and 2 of Form U-4 to be amended without obtaining the registered person's signature will be continued in Web CRD. This practice was approved in the Commission's 1996 order. See Securities Exchange Act Release No. 37439 (July 15, 1996); 61 FR 37950 (July 22, 1996).

⁸ A person submitting the electronic Form U-4 filing will be asked to enter the barcode on the fingerprint cards into a designated field on the screen; the screen will also contain language indicating that, by entering the barcode, the filer is representing that he is or will be submitting the hard copy fingerprint cards by mail or delivery service.

⁹ See NASD Rule 1013(a)(1)(C) and 17 CFR 240.17f-2.

¹⁰ Web CRD will have a mechanism that will enable firms to identify individuals whose paper fingerprint cards have not been delivered to NASDR within the 30-day period.

¹¹ Electronic filing in Web CRD will be simpler for broker-dealers because it requires only that a broker-dealer have access to an Internet browser (*e.g.*, Internet Explorer, Netscape) and to the Internet through an account with an Internet Service Provider (*e.g.*, Microsoft Network, MCI WorldCom, America OnLine). Accordingly, electronic filing can be accomplished with significantly less difficulty and at a lower cost than possible under the earlier CRD redesign approach, which required that firms subscribe to proprietary software and, in most cases, upgrade their computer hardware. In addition, members are already required to have an electronic mail account and to be able to access NASDR's Web site for the purpose of updating their Firm Contact Questionnaire. See NASD By-Laws Article IV, Section 3.

¹² 1999 Conferences have been held in Los Angeles, CA (April 7-8); Atlanta, GA (April 14-15); Washington, DC (April 20-21); New York, NY (April 29-30 and May 21); and Chicago, IL (May 4-5).

users that explain how to navigate and use the system.

Rule 3010 also is amended to remove a reference to the Firm Access Query System (FAQS), a system that currently permits members to view certain information in the CRD for the purpose of investigating applicants for employment. Upon deployment of Web CRD, FAQS will be obsolete; members will use Web CRD to conduct qualifications investigations and will have access to all of the same information that was available to them under FAQS.

NASDR proposes to make Rule 1140, as amended, effective for all members on August 16, 1999. The effective date will be announced at least 30 days in advance in a Notice To Members.

2. Statutory Basis

NASDR believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)¹³ of the Act, which requires, among other things, that the Association's rules must be 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. NASDR believes that the proposed rule change will make processing of Forms U-4 and U-5 more efficient, will allow members and regulators to have quicker access to information contained in those filings, and facilitate oversight of securities industry firms and their personnel.

B. Self-Regulatory Organization's Statement on Burden on Competition

NASDR does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. Copies of the submission,

all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-99-28 and should be submitted by July 28, 1999.

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

The Commission finds that the proposed rule change is consistent with the requirements of the Act¹⁴ and the rules and regulations thereunder applicable to the NASD.¹⁵ Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6)¹⁶ which requires, among other things, that the rules of an association be designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination among customers, issuers, brokers, or dealers.

The Commission has determined to approve the changes to the NASD rules that would require electronic filing. The Commission believes that electronic filing will streamline the registration and termination process for individuals and firms. Under the NASDR's proposal, an individual seeking registration will be required to fill out an electronic Form U-4, which will be available on NASDR's website, and submit it electronically. Further, when an associated person ends his association with a broker-dealer, the broker-dealer will be required to fill out an electronic Form U-5, which will also be available on the NASDR's website, and submit it electronically.

¹⁴ In reviewing this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. The Commission notes that electronic filing provides SROs and states with an efficient means of receiving and maintaining information on associated persons. Moreover, the impact on competition is negligible because all NASD member firms will be subject to the electronic filing requirement. 15 U.S.C. 78c(f).

¹⁵ 15 U.S.C. 78o-3.

¹⁶ 15 U.S.C. 78o3(b)(6).

In addition, under the proposal, firms and individuals will no longer rely on the mail system to transmit the forms to NASDR. Now, individuals and firms will electronically submit Forms U-4 and U-5 through the World Wide Web, which means NASDR should receive the forms more quickly. The Commission also believes that investors will benefit from the expedited registration and termination process because the faster NASDR receives the forms, the faster information on the forms can be disclosed to investors through the NASD's Public Disclosure program.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that NASD Rule 1140, in substantive form, was approved by the Commission in 1996.¹⁷ The Commission also notes that the rule is currently in the NASD Manual, but is not in effect. Further, this proposal's companion filing,¹⁸ which implemented Web CRD and amended disclosure questions on Forms U-4 and U-5, received no comments when it was submitted for the requisite notice and comment period. The NASD will implement this proposal simultaneously with the companion filing. Accelerated approval will provide the NASD lead time to issue a Notice to Members explaining how the process will work. Thus, the Commissions finds no reason to delay the effectiveness of a rule that has been previously approved and will serve to facilitate an important investor benefit—Web CRD. The Commission finds, therefore, that granting accelerated approval to the proposed rule change is appropriate and consistent with Section 15A¹⁹ of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NASD-99-28)—is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 99-17152 Filed 7-6-99; 8:45 am]

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¹⁷ See *supra* note 3.

¹⁸ See *supra* note 5.

¹⁹ 15 U.S.C. 78o-3.

²⁰ 17 CFR 200.30-3(a)(12).

¹³ 15 U.S.C. 78o-3(b)(C).