

Application for Securities Industry Registration or Transfer ("Form U-4") and the Uniform Termination Notice for Securities Industry Registration ("Form U-5"). The CRD system also contains information filed by regulators via the Uniform Disciplinary Action Reporting form ("Form U-6"). The CRD system contains administrative information (personal, organizational, employment history, registration and other information) and disclosure information (criminal matters, regulatory disciplinary actions, civil judicial actions, financial information, and information relating to customer disputes) filed on these forms. For purposes of this rule, "customer dispute information" includes customer complaints, arbitration claims, and court filings made by customers, and the arbitration awards or court judgments that may result from those claims or filings. This category of information contains allegations that a member or one or more of its associated persons has violated securities laws, regulations, or rules.

NASD operates the CRD system pursuant to policies developed jointly with the North American Securities Administrators Association ("NASAA"). NASD works with the SEC, NASAA, other members of the regulatory community, and member firms to establish policies and procedures reasonably designed to ensure that information submitted to and maintained on the CRD system is accurate and complete. These procedures, among other things, cover expungement of information from the CRD system in narrowly defined circumstances. NASAA and some states have taken the position that information in the CRD system is a record of any state that uses the information to make a licensing decision, and that state laws generally do not permit information to be expunged once it has been filed on the CRD system, absent a court order that explicitly directs expungement.

Since the inception of the CRD system in 1981, NASD generally has honored court-ordered expungements and, until January 1999, NASD also honored arbitrator-ordered expungements that were contained in final awards. In January 1999, after consultation with NASAA, NASD imposed a moratorium on arbitrator-ordered expungements from the CRD system.⁵ Under the moratorium, which is still in effect, NASD will not expunge information from the CRD system based on a directive contained in an arbitration

award rendered in a dispute between a public customer and a firm or its associated persons unless that award has been confirmed by a court of competent jurisdiction.⁶

Since imposing the moratorium, NASD has been considering how to craft an approach to expungement that would allow NASD, in its capacity as an SRO and as operator of the CRD system, effectively to challenge expungement directives that might diminish or impair the integrity of the system and to ensure the maintenance of essential information for regulators and investors.⁷ Such an approach necessarily requires NASD to balance three competing interests: (1) The interests of NASD, the states, and other regulators in retaining broad access to customer dispute information to fulfill their regulatory responsibilities and investor protection obligations; (2) the interests of the brokerage community and others in a fair process that recognizes their stake in protecting their reputations and permits expungement from the CRD system when appropriate; and (3) the interests of investors in having access to accurate and meaningful information about brokers with whom they conduct, or may conduct, business.

NASD is cognizant of the importance of ensuring that the expungement policy does not have an overly broad chilling effect on the settlement process or inappropriately interfere with the arbitration process or arbitrators' authority to award appropriate remedies. NASD and other regulators participating in the CRD system agree that expungement is extraordinary relief, and that courts granting expungement relief under the existing rules and procedures may not fully consider all of the competing interests referenced above. NASD believes that the additional safeguards and procedures proposed herein will allow fact finders and NASD to consider all competing interests before directing or granting expungement of customer dispute information from the CRD system.

⁶ Under existing CRD policy, and consistent with the 1999 moratorium, NASD may execute, without a court order, arbitration awards rendered in disputes between registered representatives and firms that contain expungement directives in which the arbitration panel states that expungement relief is being granted because of the defamatory nature of the information. These expungements are not covered by the moratorium and will not be covered by the proposed rules and policies.

⁷ In July 1999, NASD issued Notice to Members 99-54 seeking comment on possible approaches to addressing arbitrator-ordered expungements of information from the CRD system.

2. Statutory Basis

NASD believes that the proposed rule change, as amended, is consistent with the provisions of section 15A(b)(6) of the Act,⁸ in that the proposal 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. NASD believes that the proposed rule change, as amended, is designed to accomplish these ends by allowing fact finders and NASD to consider all competing interests before directing or granting expungement of customer dispute information.

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

NASD does not believe that the proposed rule change, as amended, would 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

In October 2001, NASD published Notice to Members 01-65 ("NtM 01-65" or "Notice") requesting comment on the establishment of certain criteria that must be met, and procedures that must be followed, before NASD would expunge certain information from the CRD system pursuant to an expungement order. NtM 01-65 encouraged members, investors, registered representatives, and other interested persons to comment. NASD proposed in NtM 01-65 that the CRD system expunge customer dispute information only if certain criteria are met and certain protocols followed. Specifically, NASD requested comment on whether expungement of customer dispute information from the CRD system should generally be limited to cases where the expungement order is based on a finding by an arbitrator or a court that (1) The subject matter of a claim or information in the system involves a case of factual impossibility or "clear error"; (2) the claim is without legal merit; or (3) the information contained in the CRD system is determined to be defamatory in nature.

NASD also sought comment on (1) Specific procedures that would be required to be followed depending on whether the finding that is made results from a contested proceeding or from a settled matter; (2) the adoption of a rule amending the Code of Arbitration

⁵ The moratorium was announced in Notice to Members 99-09.

⁸ 15 U.S.C. 78o-3(b)(6).