

# New Disclosure Questions Required by Enactment of the Sarbanes-Oxley Act

Section 604 of the Sarbanes-Oxley Act amended the Act by adding new categories of "statutory disqualification." Under the expanded definition, members and their associated persons may be subject to a statutory disqualification (*i.e.*, may be required to obtain regulatory approval before becoming a member of NASD or becoming associated with an NASD member) if they are subject to certain orders issued by a state securities commission or state insurance commissioner (or any agency or officer performing like functions); state authorities that supervise or examine banks, savings associations, or credit unions; an appropriate federal banking authority, or the National Credit Union Administration. Specifically, persons (including members) may be subject to a statutory disqualification based on orders issued by the above agencies that (1) bar a person from association or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities or (2) are based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.<sup>7</sup>

The Form U-4 has historically been the vehicle for the reporting of events that may cause a person to become subject to statutory disqualification. NASD generally takes the lead in amending the Forms. Accordingly, with the concurrence of a working group of regulators, including state regulators, representatives of other SROs, and SEC observers, NASD is proposing to amend section 14 (Disclosure Questions) of the Form U-4 to elicit reporting of regulatory actions that may now make individuals subject to a statutory disqualification under the expanded definition of "statutory disqualification" in the Act created by passage of the Sarbanes-Oxley Act.

The proposed rule change renumbers current Regulatory Action Disclosure Question 14D on the Form U-4 as Question 14D(1), adds Question 14D(2) to mirror the language in section 15(b)(4)(H) of the Act,<sup>8</sup> and modifies the "Regulatory Action DRP" on the Forms. To aid in reporting events under Question 14D(2), NASD proposes amending the "Specific Instructions" section of the Form U-4 with respect to section 14 (Disclosure Questions). NASD proposes adding two new

defined terms, "final order"<sup>9</sup> and "federal banking agency,"<sup>10</sup> to the "Explanation of Terms" section of the Form U-4. NASD also proposes amending the "Regulatory Action" DRP on the Form U-4 to aid in reporting events required to be reported pursuant to the Sarbanes-Oxley Act.

## Form U-5 DRP and Question Addition Relating to Terminations for Cause

NASD proposes adding to the Form U-5 a new disclosure question (Question 7F) and corresponding DRP to mirror Question 14J on the Form U-4. This question would allow firms to report that an individual was terminated after allegations of certain violations, fraud, wrongful taking of property, or failure to supervise, and would further clarify the individual's obligation to report the termination on the Form U-4. Currently, NASD staff must rely on the reason for termination or a firm-initiated internal review as reported (by the former employing firm) on an individual's Form U-5 to determine whether that individual is required to answer Question 14J (on the Form U-4) affirmatively. The new Question 7F on the Form U-5 should clarify for NASD staff and terminated individuals the basis for and circumstances surrounding the termination (and whether it requires an affirmative answer on the corresponding Form U-4 question) and will enable firms appropriately to identify and provide supporting details regarding terminations for cause. Similarly, NASD proposes adding "resign or resigned" as an explained term on the Form U-5 to parallel the same term on the Form U-4 for purposes of the new Question 7F.

## Modifications to the Form U-4 Relating to Fingerprinting Requirements

NASD proposes to streamline the language associated with questions under section 2 (Fingerprint Information) and section 6 (Registration Requests with Affiliated Firm) on the Form U-4 to clarify fingerprinting requirements, including electronic filing representations, exceptions to the fingerprint requirement, and fingerprint requirements for investment adviser

representative only applicants. In conjunction with the proposed changes relating to the fingerprint questions, NASD is proposing to amend the "Specific Instructions" section of the Form U-4 with respect to section 2 (Fingerprint Information) and Section 6 (Registration Requests with Affiliated Firms).

Under section 2 (Fingerprint Information), NASD proposes to modify the "Electronic Filing Representation" subsection to address two situations that are not adequately covered by the current language. The first involves a firm's submitting fingerprint results on behalf of an individual whose fingerprints were processed through another SRO, in lieu of submitting fingerprint cards. The second occurs when a firm is seeking registration for an individual who (1) is currently employed by the firm (usually in an unregistered capacity) and (2) previously has been fingerprinted (either through NASD or another SRO).

The current electronic filing representation states that the firm is submitting or will promptly submit fingerprint cards as required by applicable SRO rules. In the two situations described above, firms will not be submitting fingerprint cards contemporaneously with, or within 30 days of, filing a Form U-4. The proposed language will allow firms and individuals to represent that the filing firm has continuously employed the individual since the last submission of a fingerprint card to NASD (and therefore is not required to resubmit a card at this time) or has continuously employed the individual since the individual had his or her fingerprints processed through another SRO, and the individual will submit (or has submitted) the processed results to the Central Registration Depository ("CRD") system.

Also, under section 2 (Fingerprint Information), NASD proposes to modify the "Exceptions to the Fingerprint Requirement" subsection. Currently, firms can claim an exception to the fingerprint requirement by affirming that the individual has been continuously employed by the filing firm in an unregistered capacity (and had previously submitted a fingerprint card in connection with that employment) or meets one or more exemptions under SEC Rule 17f-2.<sup>11</sup> The proposed modification to the "Exceptions to the Fingerprint Requirement" questions would allow a firm to select the specific permissive exemption under SEC Rule 17f-2(a)(1)(i)

<sup>7</sup> Section 15(b)(4)(H) of the Act, 15 U.S.C. 78o(b)(4)(H).

<sup>8</sup> *Id.*

<sup>9</sup> The new term "final order" is to be defined in the Form U-4 as follows: FINAL ORDER, for purposes of Question 14D(2), means a written directive or declaratory statement issued by an appropriate federal or state agency (as identified in Question 14D(2)) pursuant to applicable statutory authority and procedures, that constitutes a final disposition or action by that federal or state agency.

<sup>10</sup> The new term "federal banking agency" is to be defined in the Form U-4 as follows: FEDERAL BANKING AGENCY shall include any Federal banking agency as defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

<sup>11</sup> 17 CFR 240.17f-2.