

August 1996

# NASD TELEPHONE HOTLINE

## Enhancements Could Help Investors Be Better Informed About Brokers' Disciplinary Records







United States  
General Accounting Office  
Washington, D.C. 20548

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General Government Division

B-259990

August 19, 1996

The Honorable Edward J. Markey  
Ranking Minority Member  
Subcommittee on Telecommunications  
and Finance  
Committee on Commerce  
House of Representatives

Dear Mr. Markey:

This report responds to your request that we review the effectiveness of the National Association of Securities Dealer's (NASD) toll-free telephone information service, called the NASD hotline.<sup>1</sup> You were concerned about investors' access to the hotline and to the available disciplinary information on their broker-dealer firms or individual brokers.<sup>2</sup> You were particularly concerned that NASD does not disclose information through the hotline on two types of actions: (1) arbitration cases that are settled before a decision is reached and (2) civil lawsuits that allege sales practice violations by brokers. When investors do not have access to relevant information about a broker's background, they may risk placing funds in the hands of an unscrupulous broker. This report addresses (1) the accessibility of the NASD Regulation hotline to investors, including how investors are informed about the hotline; (2) users' perceptions about the usefulness and appropriateness of the types of information provided by the hotline; and (3) whether the information provided meets NASD Regulation's disclosure policies.

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## Results in Brief

The NASD Regulation hotline was established in October 1991. As of December 1995, over 300,000 callers have called the hotline to obtain disciplinary histories on their brokers. These investors represented less than 1 percent of those who directly owned shares in a publicly traded company or a mutual fund in 1992. Hotline callers whom we surveyed said that they became aware of the hotline service through newspaper and magazine articles, brokers, securities regulators, friends, relatives, or business associates. NASD Regulation has also publicized the hotline

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<sup>1</sup>After completion of our fieldwork, NASD reorganized creating two primary subsidiaries: Nasdaq and NASD Regulation. Nasdaq, the National Association of Securities Dealers Automated Quotation system, now called the Nasdaq Stock Market, Inc., is the trading market subsidiary of NASD. NASD Regulation, Inc., is the regulatory subsidiary with authority to regulate the broker-dealer profession. NASD Regulation is responsible for the activities discussed in this report.

<sup>2</sup>In this report the word broker, unless otherwise stated, is used to refer to both broker-dealer firms and individual brokers employed as their sales representatives.

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through investor protection brochures. However, these methods of publicizing the hotline may not reach all investors. The small percentage of investors who have used the hotline indicates that many investors may be making investment-related decisions without using this important source of information on their brokers' backgrounds.

Furthermore, our survey of 500 people who called the hotline during December 1994 and January 1995, indicated that most callers were very satisfied with the services provided and used the information NASD Regulation disclosed to them to make investment-related decisions, such as deciding whether to use a particular broker. The survey also showed that investors would find additional information useful in making these decisions. NASD Regulation currently does not disclose information that many callers thought should be included, such as whether their broker had been the subject of a settled civil case, a pending or settled arbitration, or a pending customer complaint. NASD Regulation officials said that NASD Regulation does not disclose this information because these cases involve unproven allegations. Nevertheless, most state securities regulators said they already disclose this information to investors who request it, and it comes from the same information system that NASD Regulation uses to answer hotline calls. Thus, the amount and type of information investors receive depends on whether they call NASD Regulation or their state securities regulator. After completion of our fieldwork, NASD Regulation and state securities regulators agreed to changes in brokers' reporting of customer complaint, arbitration, and civil litigation information to NASD Regulation. These changes could lead to disclosure of additional information by the NASD Regulation hotline.

Most of the information NASD Regulation provided to the callers we surveyed met NASD Regulation's disclosure policies. However, NASD Regulation does not routinely supervise or test to determine that all disclosable information was provided to hotline callers. In a random sample of 100 requests for information, we found that NASD Regulation did not meet its disclosure policies in 13 cases. These 13 cases had 42 instances in which NASD Regulation did not disclose all of the disclosable information, and 2 instances in which it disclosed more information than its policies allow. Our survey showed that hotline callers used the disciplinary history information to make investment-related decisions. Thus, in some cases, they may have made such decisions without having all available disclosable information.

## Background

In 1988, NASD established a Public Disclosure Program to respond to written inquiries about brokers' disciplinary histories. Two years later, in October 1990, Congress amended the Securities Exchange Act of 1934, Section 15A(i), to require that NASD establish and maintain a toll-free telephone number for the public to inquire about the disciplinary backgrounds of NASD-member brokers and their associated persons.<sup>3</sup> The act also requires that NASD promptly respond to such inquiries in writing. In October 1991, NASD established its hotline, which is operated by NASD Regulation's Public Disclosure Program.

## Information Available Through the Hotline

NASD initially provided hotline callers with information on final disciplinary actions of self-regulatory organizations (SRO) and federal and state securities regulators, as well as criminal convictions. In 1993, NASD expanded the types of information provided, partly in response to a recommendation in our 1993 report on penny stock regulation.<sup>4</sup> The NASD Regulation Public Disclosure Program now is to provide callers with information on

- pending and final disciplinary actions taken by SROs or federal and state securities regulators that relate to securities or commodities transactions, including censures and fines, bars, revocations, expulsions, suspensions, orders of permanent injunction, orders of preliminary injunction, orders of prohibition, some special stipulation orders, cease and desist orders, and denial of registration orders;
- pending NASD Regulation and other SRO complaints and dismissed NASD Regulation complaints;
- securities arbitration decisions involving public customers and their brokers and Commodity Futures Trading Commission reparation orders;
- securities-related civil judgments; and
- criminal convictions and indictments.

The information disclosed by the program is derived from the Central Registration Depository (CRD). CRD is a database, which NASD Regulation maintains, that contains employment and disciplinary histories of individual brokers as well as disciplinary actions taken against member broker-dealer firms. NASD and state securities regulators established CRD as

<sup>3</sup>An associated person is any person—partner, officer, director, salesperson, trader, manager, or employee—engaged in investment banking or securities business who is directly or indirectly controlling or controlled by an NASD member.

<sup>4</sup>Penny Stocks: Regulatory Actions to Reduce Potential for Fraud and Abuse (GAO/GGD-93-59, Feb. 3, 1993).

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a centralized licensing and registration system. Brokers are required to report to CRD formal disciplinary actions taken against them by the Securities and Exchange Commission (SEC), state securities regulators, SROs, or courts, including foreign entities, for violations related to the securities business and certain customer complaint and arbitration information. In addition to providing information on formal disciplinary actions, brokers are required to provide CRD with written notice of employment terminations. All required CRD information is to be reported within 30 days of the action's occurrence. Federal and state securities regulators and SROs also are to report disciplinary information to CRD and can use CRD information to determine whether a broker has violated securities laws or SRO rules. State securities regulators also have programs through which CRD information can be disclosed to the public upon request.

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## How the Hotline Operates

The public can obtain information either by submitting a written request on a NASD Information Request Form (NIRF) or by calling the toll-free hotline at 1-800-289-9999. The bulk of requests, over 90 percent as of November 1995, have been made through the hotline. NASD does not charge a fee when individuals request information to assist them in their personal investments. Business requests for information, such as those from attorneys or banks, must include a processing fee of \$30. The hotline currently operates from 8:00 a.m. to 6:00 p.m. (eastern time). NASD Regulation officials said that they are considering extending the hotline's hours to 8:00 p.m. (eastern time) to better accommodate west coast callers.

As of January 1996, one and one-half full-time equivalent staff are dedicated to answer hotline calls. However, if call volume necessitates, 12 operators who normally answer calls to NASD's general number are also available to answer hotline calls. In addition to the staff who answer calls, NASD Regulation's Public Disclosure Program also employs specialist staff to research disciplinary files and determine whether the information is either disclosable or nondisclosable. The specialists are to respond to written requests for information, which the public makes by using a NIRF. They also are to prepare written summaries of the disclosable information that is included in a computerized system called the NIRF database. As a result, the NIRF database contains disciplinary histories from CRD records that the specialists have reviewed and determined to be disclosable. As of January 1996, NASD Regulation officials said that they had two full-time specialists.

When a call is made to the hotline, NASD Regulation staff are to ask the caller for information to identify the subject of the inquiry such as name, address, or registration number. If the staff cannot identify the subject, they are to tell the caller and terminate the call. When the staff identify the subject, an automated search of the NIRF database determines if disclosable information exists. The staff are to send any disclosable information to the caller upon request. When the subject is identified in the NIRF database, but no disclosable information exists, the staff are to tell the caller and terminate the call. In addition, if the caller requests, staff are to send a letter stating that no disclosable information exists.

If the subject is not identified in the NIRF database, an automated search of CRD determines if a record exists on the subject. When a record exists, the staff are to tell the caller that the file has to be reviewed to determine if disclosable information exists. The specialist staff are to review the file on the subject broker to determine whether the information in the file is disclosable, create a NIRF database file on the subject, and send a copy of any disclosable information to the caller. When disciplinary history information is sent to a caller about individual brokers who are employed with NASD member firms, NASD Regulation also is to send the brokers a copy of this information, without the requesters' names.

## Scope and Methodology

To obtain information on the accessibility of the NASD Regulation hotline, we interviewed NASD Regulation officials; reviewed NASD Regulation Public Disclosure Program policies and procedures, and related documents; reviewed the results of calls to the hotline requesting disciplinary information; and conducted surveys of hotline callers and state securities regulators. To obtain information on users' perceptions of the hotline's accessibility and usefulness, we surveyed a random sample of nearly 500 of the more than 7,100 callers to the hotline during December 1994 and January 1995 to whom NASD Regulation sent disciplinary information. From this sample, we randomly selected a subsample of 100 callers for further review to determine whether the information NASD Regulation provided met its disclosure policies. We also surveyed securities regulators of all 50 states, the District of Columbia, and Puerto Rico to determine what information those regulators disclosed to the public and how they informed the public of the existence of their disclosure programs. For detailed technical information on our surveys, see appendix I. The questionnaires used and the results of our surveys of NASD Regulation hotline callers and state securities regulators are shown,

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respectively, in appendixes II and III. We also discussed with NASD Regulation officials the status of its CRD redesign effort.

We did our work in accordance with generally accepted government auditing standards between November 1994 and April 1996. We performed our work in New York, NY; the Washington, D.C., metropolitan area; and at NASD Regulation's Public Disclosure Program in Rockville, MD.

We obtained written comments on a draft of this report from NASD Regulation and oral comments from SEC, which are discussed and evaluated at the end of this report. NASD Regulation's written comments appear in appendix IV.

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## **The NASD Regulation Hotline Has Been Accessible to Many Investors but Many More May Not Know It Exists**

Since its inception in October 1991, many investors have called the NASD Regulation hotline. From year to year, the number of calls that NASD Regulation hotline staff handle has increased. Callers have been informed about the hotline by newspaper and magazine articles, brokers, securities regulators, friends, or business associates. However, these indirect methods of publicizing the hotline may not be successful in reaching large numbers of investors and, as a result, many investors may not know the hotline exists. More direct methods, such as including the hotline number on account documents, could help ensure that more investors are informed of the hotline.

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## **The Hotline Has Been Accessible to Many Callers**

Most of our survey respondents found the NASD Regulation hotline accessible—about 84 percent said they reached the hotline on the first call. Also, most of these callers, 71 percent, were not placed on “hold” after reaching the hotline. Of the callers that were placed on “hold,” 64 percent said they spoke to a representative within 3 minutes. Most of the callers that were placed on hold, 73 percent, did not consider the wait too lengthy or cause for hanging up. Few respondents, 2 percent, were disconnected after reaching the hotline.

According to NASD Regulation statistics, the number of calls to the hotline has increased since the hotline began operations in October 1991. Calls received by the hotline and those handled by NASD Regulation staff have more than doubled.<sup>5</sup> The statistics show that in 1992, the first full year of its operation, the hotline received almost 40,000 calls, of which NASD

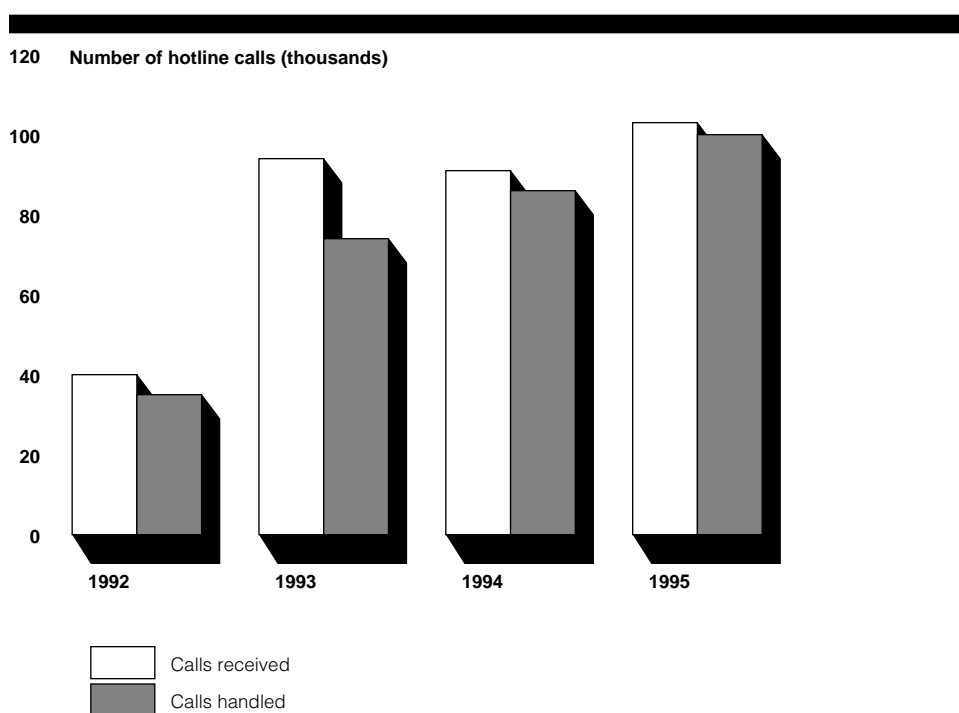
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<sup>5</sup>Handled refers to the number of telephone calls that NASD Regulation staff answered. The calls that were not handled were abandoned by the callers, which means the caller hung up or did not otherwise reach the NASD Regulation staff.



Regulation hotline staff handled about 35,000. In 1995, the most recent full year of operation, the hotline received about 103,000 calls, of which NASD Regulation handled almost 100,000. Figure 1 shows the number of NASD Regulation hotline calls received and handled from January 1992 through December 1995.

**Figure 1: NASD Regulation Hotline Calls Received and Handled, 1992 Through 1995**



Source: GAO analysis of NASD Regulation hotline statistics.

## Methods Used to Publicize the Hotline May Not Reach All Investors

Information informing investors about the NASD Regulation hotline is available to investors through several indirect sources. According to NASD Regulation officials, the hotline is publicized in two NASD brochures on investor protection, newspaper and trade press articles, and by public speaking engagements of NASD officials. According to these officials, calls to the hotline increase after it is publicized. For example, after a CNN program publicizing the July 1993 expansion of the public disclosure program, call volume increased to more than 4 times the daily average, reaching a peak volume of about 1,200 calls a day. The officials said that NASD Regulation plans to use the Internet to publicize its toll-free number

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on an NASD home page and allow investors to submit requests for information on brokers and firms on-line before the end of 1996.

Our survey of hotline callers showed that most callers to the hotline, about 80 percent, first became aware of the hotline either from newspaper and magazine articles; brokers; SEC, NASD, or state securities regulators; or friends, relatives, or business associates. Similarly, state securities regulators that we surveyed said that they publicize the availability of disciplinary information through public speaking engagements, agency brochures, press releases, and public service announcements on radio, television, and in the print media.

The number of calls to the hotline indicates that efforts to publicize it have been successful in reaching many investors. According to NASD Regulation statistics, about 307,000 callers, including repeat inquiries, called the hotline from October 1991 through December 1995. However, these callers constituted less than 1 percent of the estimated 41 million U.S. investors who directly owned shares in a publicly traded company or a mutual fund as of 1992.<sup>6</sup> All investors who know about the hotline may not necessarily call it, but the small number of callers in relation to the number of investors indicates that numerous investors still may not be aware of the hotline's existence.

The hotline provides information that could help investors avoid dealing with brokers that have disciplinary histories unacceptable to the investors. Therefore, all investors, particularly those opening new brokerage accounts, could use the information. SEC recognized this in its 1994 report on the hiring, retention, and supervisory practices of large securities firms. It recommended that SROs adopt rules requiring member firms to disclose to investors opening new accounts the availability of disciplinary information through the NASD Regulation hotline.<sup>7</sup>

One approach to ensure that larger numbers of investors are informed of the hotline might be similar to that taken under SEC penny stock rules.<sup>8</sup> These rules require that, before transactions are completed, brokers must provide investors with a risk disclosure document that includes the NASD

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<sup>6</sup>The number of U.S. investors is the latest available from the Federal Reserve Board's Surveys of Consumer Finances conducted in 1992 and analyzed by the New York Stock Exchange for its publication, *Shareownership* 1995.

<sup>7</sup>The Large Firm Project: A Review of Hiring, Retention, and Supervisory Practices (U.S. Securities and Exchange Commission, May 1994).

<sup>8</sup>SEC Rule 15c-2.

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Regulation hotline number. Although a separate disclosure document may not be necessary for routine securities transactions, more investors could learn about the hotline if the hotline number were included on account opening documents or account statements that are sent to investors. Another way to make disciplinary information more accessible would be to provide it directly to the public through some electronic communications media such as the Internet, as has been suggested by the head of NASD Regulation.

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## Disclosure of Additional Information Could Further Enhance Hotline Usefulness

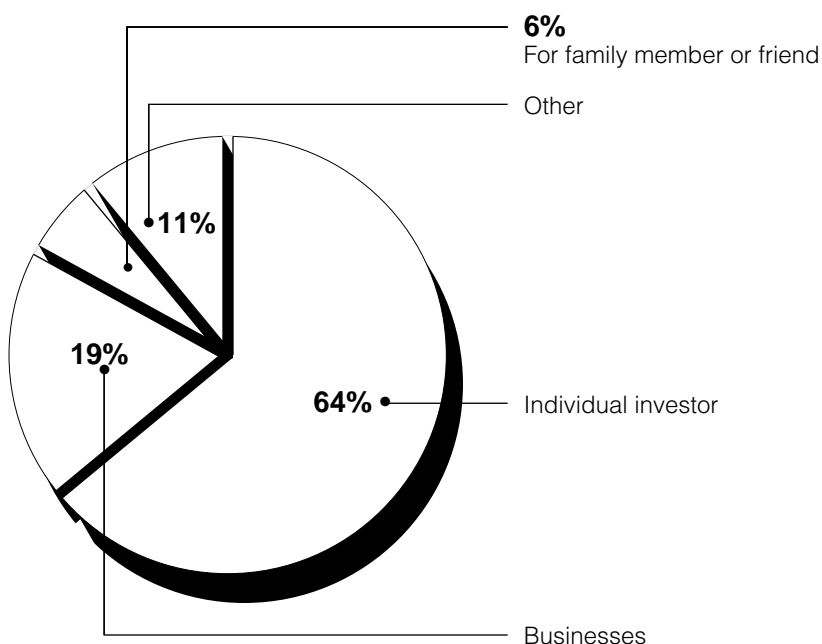
Our survey of NASD Regulation hotline callers showed that they were mostly very satisfied with the broker disciplinary information they received from NASD Regulation. However, they also responded that additional information, which NASD Regulation currently does not disclose, would be useful in assisting them to decide whether they wanted to do business with a particular broker. This additional information is already available to investors who contact most state securities regulators. NASD Regulation also does not inform hotline callers of the types of information that are not disclosed, unless the callers ask. As a result, callers may think they have all the relevant information on their brokers' history when they do not.

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## The NASD Regulation Hotline Provides Investors With Useful Information

Our survey also showed that the NASD Regulation hotline has provided individual investors with information that they used to make investment-related decisions such as selecting a broker. Our sample of hotline callers to which NASD Regulation sent information comprised mostly individual investors who called on their own behalf—about 64 percent of the total respondents. Other survey respondents included family members or friends calling on behalf of individual investors, about 6 percent of the total; businesses, about 19 percent; and other callers—primarily prospective employees calling about a broker-dealer's background—about 11 percent. Figure 2 shows the types of callers who used the hotline in our sample.

**Figure 2: Types of Hotline Callers as of August 1995**



Source: GAO analysis of GAO Customer Satisfaction Survey data.

Our survey showed that the primary reason respondents called the hotline was to determine whether a broker had a history of improper or illegal behavior. Hotline callers said that the information they received was a major factor affecting their decisions on authorizing their broker to make a securities transaction, opening a new brokerage account, deciding not to do business with a particular broker, or changing their broker.

Most hotline callers that we surveyed said they were very satisfied with the services received, including the time it took to reach hotline staff (about 67 percent), the ability of the staff to locate the subject broker (72 percent), the courtesy and professionalism of the staff (about 73 percent), the length of time it took to receive NASD Regulation's written response (about 55 percent), and the hours the hotline operated (about 62 percent). Only about 5 percent of the callers surveyed found our questions about the ability of the hotline staff to assist non-English speaking and hearing impaired callers applicable. Most of these were

satisfied with the staff's ability to assist both types of callers. A few callers, about 1 percent, hung up because they thought that the staff were not helpful or were discourteous.

Just over half of hotline callers, about 54 percent, called only once during a recent year, while almost half called 2 times or more during the year to obtain disciplinary information. Most hotline callers responded that they rely primarily on the NASD Regulation hotline for disciplinary information on their broker. About 81 percent of callers said they did not obtain disciplinary information from a state securities regulator.

### Hotline Callers Would Find Additional Information Useful

The respondents to our survey said that additional information available in CRD, but not disclosed by NASD Regulation, could also be useful to help them make decisions about whether to do business with a particular broker. The types of nondisclosable information that at least 70 percent of respondents said they thought would be either very or somewhat useful included whether a broker was

- granted a license or registration with limitations,
- the subject of a settled civil court case,
- the subject of an SRO review to determine whether to continue or stop membership rights,
- the subject of a court decision involving a bankruptcy or lien,
- the subject of a pending arbitration case with a securities regulator,
- the subject of a settled arbitration case with a securities regulator,
- the subject of a settled customer complaint filed with a securities regulator,
- the subject of a pending customer complaint filed with a brokerage firm,
- the subject of a settled customer complaint filed with a brokerage firm, and
- the subject of a disciplinary action or termination by his or her employer.

Fewer respondents thought that information on dismissed customer complaints and withdrawn arbitration cases would be very or somewhat useful—64 and 66 percent, respectively.

As part of our review of the CRD and NIRF database files for 100 brokers that our survey respondents inquired about, we analyzed the extent and types of nondisclosable information recorded in CRD. We found nondisclosable information in 46 files. This information primarily involved pending arbitration cases, customer complaints, settled or withdrawn

arbitration cases, or NASD Regulation fines of \$1,000 or less. This is the same type of information that our survey respondents indicated would be useful. Unlike individual hotline callers, NASD member broker-dealers have access to all of this information for use in screening potential employees.

Further, our survey of state securities regulators showed that, when requested, almost all reported they already disclose the information that NASD Regulation does not disclose. These regulators are electronically linked to CRD, and thus get the information they disclose from the same database that NASD Regulation restricts. Table 2 shows the number of states that reported they disclosed information that NASD Regulation currently does not disclose.

**Table 2: Many States Reported They Disclosed Information Not Disclosed by NASD Regulation as of December 1995**

Information not disclosed by NASD Regulation	Number of states that disclose the information
License or registration granted with limitations.	47
Subject of a settled civil court case.	47
Subject of a court decision involving a bankruptcy or lien.	47
Subject of a pending arbitration case with a securities regulator.	41
Subject of a settled arbitration case with a securities regulator.	49
Subject of a withdrawn arbitration case with a securities regulator.	43
Subject of a settled customer complaint filed with a securities regulator.	45
Subject of a dismissed customer complaint filed with a securities regulator.	39
Subject of a pending customer complaint filed with a brokerage firm.	40
Subject of a settled customer complaint filed with a brokerage firm.	46
Subject of a dismissed customer complaint filed with a brokerage firm.	40
Registered representative subject to a disciplinary action or termination by his or her employer.	46

Source: GAO's Survey of State Securities Regulators.

Most of the state securities regulators said NASD Regulation should provide investors with the information that it currently does not disclose. For example, 49 thought that NASD Regulation should disclose whether a

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broker was the subject of a settled arbitration case, and 40 thought that NASD Regulation should disclose pending customer complaints. The state regulators said that they disclose the information because of their freedom of information laws and policies about investor protection and education.

NASD Regulation officials said that NASD Regulation does not disclose all information, particularly that involving customer complaints, because such complaints have not been fully investigated and may be unfounded. In 1994, we recommended that SEC and NASD develop procedures to balance regulatory surveillance and public disclosure interests pertaining to disclosure of customer complaint information to regulators and investors.<sup>9</sup> At that time, those organizations commented that release of unsubstantiated customer complaint information would raise due process and privacy concerns. NASD Regulation officials added later that release of the complaint information could damage a broker's reputation and result in lawsuits. NASD can be subject to lawsuits from hotline activities although it has limited protection from liability if a "good faith" error is made in a disclosure.<sup>10</sup> NASD Regulation officials pointed out that the potential for lawsuits has not affected NASD Regulation's policy decisions about whether to disclose information.

Officials of the North American Securities Administrators Association (NASAA), a lobbying group representing state securities regulators, told us that no state has ever been sued for disclosing disciplinary information.<sup>11</sup> They said that their greater concern is being the subject of legal actions based on complaints by the public for not disclosing the disciplinary information. In an October 1995 public address, the Chairman, SEC, suggested that consideration be given to making unadjudicated customer complaints public for a limited time, for example, 2 years; after which complaints that were either not pursued by regulators or deemed without merit would be removed from the reporting system.

After our fieldwork was completed, NASAA, the states, NASD Regulation, and securities industry representatives agreed to changes in the reporting of disciplinary information to CRD which could lead to disclosure of additional disciplinary information by the NASD Regulation hotline. To lessen brokers' concerns about disclosing information that may involve

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<sup>9</sup>Securities Markets: Actions Needed to Better Protect Investors Against Unscrupulous Investors (GAO/GGD-94-208, Sept. 14, 1994).

<sup>10</sup>15 U.S.C. § 78o-3(i).

<sup>11</sup>State governments have sovereign immunity from lawsuits and can only be sued in states where the law permits.

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unfounded allegations of wrongdoing, the changes would place limits on brokers' reporting of customer complaints and arbitration and civil case settlements. Brokers would be required to report to CRD information on (1) customer complaints less than 2 years old that allege damages of \$5,000 or more and (2) arbitrations and civil suits settled for \$10,000 or more. Before being implemented, the changes have to be approved by SEC. Actual public disclosure of this additional information by the NASD Regulation hotline, which was approved by the NASD Board of Governors in March 1996, would also require SEC approval.

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### Most Hotline Callers Were Not Told About Nondisclosable Information

NASD Regulation policy limits the information disclosed to hotline callers and includes no provision to routinely inform callers about any nondisclosable information. Hotline representatives' instructions for responding to callers discuss only disclosable information. NASD Regulation's written responses to callers are to include a list of the types of disclosable information but not the types of nondisclosable information.

Our survey showed that hotline representatives did not inform about 73 percent of callers about the types of nondisclosable information. About 23 percent said the hotline representatives provided this information, and about 4 percent said they did not remember. NASD Regulation officials said that the 23 percent who were told about the types of nondisclosable information probably had asked specifically about it. Thus, some callers were informed about the types of nondisclosable information while others were not. This inconsistency may cause some callers to make investment-related decisions based on the incorrect belief that they have been given all relevant information. More complete disclosure of relevant information could help ensure that consistent information is provided to all hotline callers.

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### Independent Review Could Help Ensure Disclosures Meet NASD Regulation Policies

The NASD Regulation hotline provides information to callers without quality assurance checks, such as independent review and testing of the information disclosed. In most cases that we reviewed, the information provided met NASD Regulation's disclosure policy. However, in 13 of the 100 cases, we found that either disclosable information was not disclosed or nondisclosable information was disclosed. Having all relevant information can help investors make more informed decisions about their broker. Quality assurance checks such as independent review and testing of the information could help ensure that disclosures meet NASD Regulation policies.



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## Hotline Did Not Always Provide Callers With All Disclosable Information

NASD Regulation disclosed information in accordance with its current disclosure policies in 87 of the 100 cases we reviewed.<sup>12</sup> However, 13 cases contained a total of 47 discrepancies when compared with information in CRD. In 42 of the 47 discrepancies, information considered disclosable was not sent to the caller. In two discrepancies, information considered nondisclosable under current NASD Regulation disclosure policy was sent to the caller. The other three discrepancies involved data entry errors—two that had no effect on information disclosed to the caller, and one that provided the caller with the same disclosable information twice under two different dates.

We found 31 of the 47 discrepancies in one case involving a request for information about a large national securities firm. Twenty-six of the 31 discrepancies were 1988 and 1989 arbitration cases that were listed in CRD but were not entered into the NIRF database. Four discrepancies were disclosable disciplinary actions that were not entered into the NIRF database, and one was the disclosable information that was entered into the NIRF database twice. The remaining 16 discrepancies occurred in 12 cases involving information requests about individuals or smaller securities firms. Twelve of these 16 discrepancies occurred in 8 cases when disclosable disciplinary actions were not disclosed to the callers. Two discrepancies, one in each of two cases, occurred when nondisclosable information was disclosed to callers. The final two cases involved data entry errors.

Apart from a 1994 internal review of the Public Disclosure Program, NASD Regulation officials told us that they do not perform routine independent review and testing of the information disclosed to callers. We found that 17 discrepancies resulted from either judgment errors of NASD Regulation staff in determining whether information was disclosable or errors in entering data into CRD and the NIRF database. NASD Regulation staff corrected these errors during our review. For the other 30 discrepancies, including the 26 arbitration cases, NASD Regulation officials could not explain why the information had not been included in the NIRF database. However, NASD Regulation staff corrected these discrepancies by adding the information to the NIRF database. The discrepancies we found that NASD Regulation corrected show that independent review and testing of the information derived from CRD could help reduce errors and help ensure that all disclosable information is provided to callers.

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<sup>12</sup>Our review consisted of 58 files of member broker-dealers and 42 files of registered sales representatives.

If NASD Regulation proceeds as planned to change its disclosure policy so that most of the disciplinary related information in CRD is considered disclosable, the chances for judgment errors by NASD Regulation staff in determining whether information is disclosable would diminish. Also, after the currently planned redesign of CRD is implemented, NASD Regulation officials expect that reports of disciplinary information will be prepared directly by querying CRD for disclosable information, rather than relying on staff judgments of whether CRD information is disclosable or nondisclosable.

## CRD Redesign Is Intended to Provide More Timely and Complete Information

NASD Regulation's ability to provide hotline callers with timely and complete information on brokers depends on how and when the information is reported to CRD. NASD Regulation officials said that in the absence of a systematic means in the current CRD to monitor timeliness of filings, they are concerned that it is possible that disclosures by brokers are not as timely as they should be. Also, according to the officials, current reporting of disciplinary information may not be as complete as it could be because all regulators are not obligated to report their disciplinary actions to CRD. They said that most regulators report directly into CRD electronically, or at least publish their disciplinary actions. For those regulators who publish their actions, NASD Regulation staff first are to review the publications and then enter the disciplinary information into CRD.

During 1996 and 1997, NASD Regulation plans to implement a redesigned CRD. According to NASD Regulation officials, the new CRD will contain many improvements that will make the system more useful to member firms, regulators, and investors. The redesigned CRD is to feature fully electronic reporting by both broker-dealers and regulators that is intended to provide more accurate and timely disciplinary information, and database modifications to allow better analytical capability. For example, the officials anticipate that NASD Regulation or SEC should be able to better select broker-dealers for examination based upon analyses of sales representatives' disciplinary records. The redesigned CRD is also to allow NASD Regulation to track the timeliness of disclosures by brokers. The NASD Regulation officials said that, as a result, the new CRD will upgrade the efficiency of the registration process, ensure more timely reporting of disciplinary information, and make the information easier for the public to understand because of its uniform reporting structure.

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NASD Regulation officials said CRD redesign is a large project that is being done in three phases over the next 2 to 3 years and is expected to cost about \$57 million. According to NASD Regulation officials, broker-dealers will be on-line during 1996, and federal and state securities regulators and SROS, beginning in 1997.

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## Conclusions

Although the number of hotline callers has grown since it was established in 1991, by 1995 the hotline was still used by only a small percentage of individual U.S. investors. Because NASD Regulation's methods for publicizing the hotline may not be successful in informing large numbers of investors about the hotline, many may be unaware of the hotline's existence or the valuable information available to its callers. Making more investors knowledgeable about the hotline could allow them to have better information on hand to assist them in making important investment-related decisions and also reduce the likelihood that they will become victims of unscrupulous brokers. This possibly could be done at relatively low cost by adding hotline information to already required, account-opening documents or to account statements. One step an NASD Regulation official has suggested is to make broker disciplinary information directly available to investors over the Internet.

The effectiveness of the NASD Regulation hotline greatly depends on NASD Regulation's willingness to fully inform investors of their brokers' disciplinary records. By not disclosing information from CRD that most state securities regulators said they already disclose, NASD Regulation may be putting some of its hotline callers at a disadvantage if they do not know that they can call state regulators for the nondisclosable information. Providing all disciplinary-related information, including unproven pending allegations, raises a risk of unfairly tarnishing brokers' reputations. While we recognize this risk and agree that proper risk management controls are needed, we also believe that protecting potential investors and the integrity of securities markets are equally important goals. Further, the CRD reporting changes that NASD Regulation and state regulators have agreed to make are intended to help protect brokers' reputations.

Under NASD Regulation's current disclosure program, NASD Regulation staff have to review disciplinary information and make judgments about whether information is disclosable. This and other problems have resulted in instances when callers were not provided with all of the disclosable information about their brokers or were provided with information that should not have been disclosed. Quality assurance checks such as

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independent review and testing of the information derived from CRD would help ensure that errors are corrected and all disclosable information is provided to callers.

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## Recommendations

To help ensure that all relevant information is made available to as many investors as possible, we recommend that the Chairman, SEC, encourage and support NASD Regulation efforts to

- explore other ways of publicizing the hotline to a wider audience of investors, such as including the hotline number on account-opening documents or account statements, and making disciplinary related information directly available to investors through the Internet.
- provide hotline callers with all the relevant disciplinary-related information available in CRD, such as whether a broker is the subject of a customer complaint, a settled arbitration, or a settled civil case; if NASD Regulation does not disclose this additional information, it should at least inform callers that the information is available from most state regulators.
- develop and implement cost-effective quality assurance checks, such as independent review and testing of information derived from CRD, to ensure that information provided to hotline callers is disclosable and complete.

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## Agency Comments and Our Evaluation

We provided a draft of this report to NASD and SEC for review and comment. We obtained written comments from NASD Regulation (see app. IV). We obtained oral comments from SEC's Division of Market Regulation and Office of Compliance Inspections and Examinations in a meeting on July 23, 1996.

NASD Regulation was pleased that our review showed a high degree of user satisfaction with the telephone hotline. It generally agreed with our findings and conclusions and said it had already begun, or plans to begin, actions that would result in implementation of our recommendations.

In response to our recommendation to explore other ways of publicizing the hotline to a wider audience of investors, NASD Regulation noted actions that it is taking to further publicize the hotline. It stated that it plans to provide a means through the Internet for investors to access electronically the data in the CRD after full implementation of the redesigned CRD in 1998. In addition, NASD Regulation said it has established an Office of Individual Investor Services that will actively promote and publicize the availability of disciplinary information through its Public Disclosure Program. NASD

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Regulation also stated that its membership committee plans to give full consideration to including the hotline number on account-opening documents or account statements.

In response to our recommendation to provide hotline callers with all the relevant disciplinary related information available in CRD, NASD Regulation said that the NASD Board of Governors has approved the expansion of the Public Disclosure Program and will file the appropriate amendments with SEC in August 1996.

In response to our recommendation to develop and implement cost-effective quality assurance checks, NASD Regulation said that it has introduced a revised process to ensure the accuracy of disclosure reports. It said that all new disclosures are reviewed by a second staff person and that a statistical quality control process will be instituted to measure systematically the accuracy of the program. In addition, NASD Regulation said that the program will be subject to periodic independent audits by its Internal Review group.

SEC generally agreed with our findings and conclusions and expressed support for the types of changes that we recommend. SEC suggested several technical changes that have been made where appropriate.

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As agreed with you, unless you publicly release its contents earlier, we plan no further distribution of this report until 5 days from its issue date. At that time we will provide copies to the Chairman, House Committee on Commerce; the Chairman, Subcommittee on Telecommunications and Finance; the Ranking Minority Member, Committee on Commerce; other interested committees and subcommittees; SEC; NASD; and other interested parties. We will also make copies available to others upon request.

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Major contributors to this report are listed in appendix V. Please contact me on (202) 512-8678 if you have any questions about this report.

Sincerely yours,

A handwritten signature in black ink, reading "James L. Bothwell". The signature is written in a cursive style with a large initial "J" and a stylized "B".

James L. Bothwell  
Director, Financial Institutions  
and Markets Issues

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# Contents

Letter		1
Appendix I		24
Technical Appendix	Hotline Customer Satisfaction Survey	24
	Survey of State Securities Regulators	28
Appendix II		29
NASD Hotline		
Customer Satisfaction		
Survey		
Appendix III		40
Survey of State		
Securities Regulators		
Appendix IV		51
Comments From		
NASD		
Appendix V		57
Major Contributors to		
This Report		
Tables	Table 2: Many States Reported They Disclosed Information Not Disclosed by NASD Regulation as of December 1995	12
	Table I.1: Disposition of Hotline Caller Survey Sample	26
Figures	Figure 1: NASD Regulation Hotline Calls Received and Handled, 1992 through 1995	7
	Figure 2: Types of Hotline Callers as of August 1995	10



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## Contents

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## Abbreviations

CRD	Central Registration Depository
NASAA	North American Securities Administrators Association
NASD	National Association of Securities Dealers
NIRF	NASD Information Request Form
SEC	Securities and Exchange Commission
SRO	Self-Regulatory Organization

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# Technical Appendix

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To answer questions about the accessibility and usefulness of the NASD hotline, we surveyed a sample of hotline callers who inquired about brokers and were mailed disciplinary history information from the disclosable portion of CRD records. To review the completeness of the information disclosed, we compared the CRD records of a subsample of 100 of the subjects of these inquiries to the information NASD disclosed to the hotline callers. In addition, we surveyed all state securities administrators to help document the differences in disclosure policies and to determine the states' publicity efforts. The NASD hotline customer satisfaction survey and the survey of state securities regulators and their results are shown in appendixes II and III, respectively.

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## Hotline Customer Satisfaction Survey

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### Survey Sample

To obtain representative and precise estimates of the levels of customer satisfaction, completeness of disclosure, and accuracy of hotline information, we first needed to draw random samples of callers and the subjects they asked about from a complete listing of all callers and subjects, without duplications, omissions, or ineligible entries.

We first drew an initial unstratified random sample of 552 of all 7,176 response letters produced by NASD in answer to investor inquiries, as recorded in the NIRF database from December 1, 1994, through January 31, 1995. We chose this period, the most recent possible, because we wanted to measure caller opinions with the minimum possible memory loss. After examining the characteristics of the information requests made in this period, and consulting with NASD, we determined that these inquiries were typical of recent NASD hotline activity.

The sample frame, and our initial sample, contained some responses to requests that we deemed ineligible for our study. We removed from our initial sample any requests for information identified by the NIRF database record to have been made by firms—banks, law firms, broker-dealers—and other requesters acting as agents for private firms. For the caller survey, it was our aim to learn about the experiences of the individual public investor. Unfortunately, we could only remove those callers who clearly identified themselves to hotline personnel as private sector callers and were recorded in the NIRF database as firms.

Approximately 11 percent of the elements in our initial sample were identified as private-sector requests. An undetermined number of callers self-identified themselves as public requesters, yet may have represented firms in some capacity.

In addition, we attempted to remove all inquiries made by the subjects themselves—registered representatives calling to request a copy of their own disciplinary history—because they would not be typical of the individual public investor. For the caller survey, we also removed multiple inquiries made by the same caller about different subjects. Finally, we removed from the caller survey sample any requests that were made in writing, rather than in a phone call to the toll-free hotline.

After removing these ineligible cases from our first sample of 552, we were left with an adjusted sample size of 448 NASD responses to caller inquiries. Then, we drew a supplemental sample of 58 from the initial 7,176 response letters, of which 40 remained after removing ineligible elements. This left us with an adjusted sample size of 488. Furthermore, while collecting data from this sample, we discovered that an additional 5 were also ineligible for some of the reasons mentioned above, leaving us with a final sample size of 483 eligible sampled elements. See table I.1 for a more complete description of the dispositions of the mail survey sample.

**Table I.1: Disposition of Hotline Caller Survey Sample**

Disposition	Number of elements
<b>Initial sample selected before adjustments</b>	
Number of elements in first sample	552
Number of elements in supplemental sample	58
<b>Total initial sample before adjustments</b>	<b>610</b>
<b>Initial sample elements found to be outside study population</b>	
Requests made by firm and nonpublic requesters	66
Requests submitted in writing	20
Multiple requests made by requester already in sample	20
Requests made by registered representatives	12
Requests initiated by NASD personnel, foreign addresses	4
Other ineligible elements found during survey period	5
<b>Total ineligible elements</b>	<b>127</b>
<b>Final disposition of eligible sample elements</b>	
Eligible elements (total initial sample minus total ineligible)	483
Usable mail questionnaires completed	294
Undeliverable (No valid address)	11
Returned incomplete or unusable	2
Attempted telephone contact for follow-up interview	171
Telephone interviews completed	96
Unable to contact by telephone after five attempts	48
Refused telephone interview	27
<b>Overall survey responses</b>	
Completed mail questionnaires and telephone interviews	390
<b>Overall response rate</b>	<b>81 (percent)</b>

Source: GAO analysis.

## Hotline Caller Survey Design and Administration

For the survey of hotline callers, we developed a mail questionnaire (shown in app. II) to measure callers' satisfaction with their contact with hotline personnel and the information they received by mail from NASD. We also included questions to collect background information on the callers, their reasons for calling the hotline, and how they learned of the hotline. To ensure that the survey would collect the intended data, the questionnaire was pretested with actual investors from New York and Virginia, whom we identified from our listing of the hotline-caller population.

In late April 1995, we mailed questionnaires to all 483 investors in our final sample of callers. In the third week of May 1995, we mailed replacement questionnaires to the sampled callers who had not yet responded. After an additional 6 weeks, we began to make follow-up telephone calls to almost all (171) of the hotline callers in our sample who had not yet responded. In these contacts with nonrespondents, we used a telephone questionnaire to collect answers to some of the more important survey questions from the mail questionnaire. We made up to five attempts to reach the nonrespondents by telephone. See table I.1 for the final dispositions of the 171 nonresponse follow-up cases. In August 1995, we closed out the telephone follow-up effort, having received an additional 96 usable responses, for a total of 390 usable responses. This represents an overall response rate of 81 percent.

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## Survey Error and Data Quality

Because we surveyed only one of a large number of possible samples of caller inquiries to develop the statistics in this report, each of the population estimates made from this sample has a sampling error, which is a measure of the precision with which the estimate approximates the population value. The sampling error is the maximum amount by which estimates derived from our sample could differ from estimates from any other sample of the same size and design, and is stated at a confidence level, in this case of 95 percent. This means that if all possible samples were selected, the interval defined by their sampling errors would include the true population value 95 percent of the time.

In addition to the reported sampling errors, the practical difficulties of conducting any survey may introduce other types of errors, commonly referred to as nonsampling errors. For example, differences in how a particular question is interpreted, in the sources of information that are available to respondents, or in the types of people who do not respond can introduce unwanted variability into the survey results. We included steps in both the data collection and data analysis stages for the purpose of minimizing such nonsampling errors.

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## Verification of Disciplinary History Disclosed by the NASD Hotline

To make the comparison of information available in the NIRF database to the full CRD, we drew a random subsample of 100 of the registered representatives and broker-dealers who were the inquiry subjects from our first sample of 552 hotline callers (see table I.1). After removing seven duplicate inquiry subjects (in which the same broker dealer was the subject of more than one sampled inquiry), and drawing another seven

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replacement subjects, we proceeded to collect CRD data on a total of 100 eligible subjects.

For each of the subjects, we completed a data collection instrument summarizing the subject's recent disclosable and nondisclosable disciplinary history. Our goal was to determine whether hotline callers received the correct and complete information in accordance with NASD's disclosure policies. For the comparison sample, our data collection instrument covered disciplinary actions found on CRD from January 1, 1990, through January 31, 1995. For information we found on CRD that was not disclosable, we documented the type of action, the allegation, and if applicable, the dollar amounts being contested.

We did not validate the accuracy of any of the information found in the CRD. Because we reviewed only one possible sample of CRD subject records, our estimates for the body of NIRF database records as a whole is subject to the same sampling and nonsampling errors as described above for the Hotline Customer Satisfaction Survey.

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## Survey of State Securities Regulators

For the survey of state securities regulators, we obtained a list of state securities administrators in all 50 states, Puerto Rico, and the District of Columbia. This list was produced by the North American Securities Administrators Association and was dated February 6, 1995.

We mailed out 52 questionnaires in early May 1995. When the survey was closed out in September of 1995, we had received a total of 51 completed surveys. Because the survey of state securities regulators covered all elements of this population, this component of our research is not subject to sampling errors as described above. Nonsampling errors, however, can affect any survey.

# NASD Hotline Customer Satisfaction Survey



U.S. General Accounting Office

## National Association of Securities Dealers (NASD) Hotline- Customer Satisfaction Survey

### INTRODUCTION

The U.S. General Accounting Office, an agency of Congress, is currently evaluating the effectiveness of the National Association of Securities Dealers (NASD)'s Toll-Free Hotline. The purpose of this questionnaire is to assist Congress in evaluating the NASD Hotline's efforts in: (1) providing accurate, complete, and useful broker and brokerage firm disciplinary history information to investors; (2) making the Hotline accessible to investors; and (3) publicizing the existence of the Hotline number.

This questionnaire asks questions about your recent experience using the NASD Hotline. The label on the bottom of this page provides information on the specific inquiry. Your responses to our questions will greatly assist us in evaluating the effectiveness of the NASD Hotline and reporting our findings to Congress. The questionnaire can be easily answered by checking boxes and filling in blanks. It should take about 20 minutes to complete. Space has been provided at the end of the questionnaire for any additional comments you may want to make. If needed, additional pages may be attached.

The number on this questionnaire is included only to aid us in our follow-up efforts. GAO will take the following steps to safeguard the privacy of your responses. Before releasing our report to Congress, we will delete the number so your questionnaire can no longer be matched with your name. Survey results will be reported in summary form for all respondents. Any discussion of individual answers will omit information identifying the respondent.

Please take a few minutes to complete the questionnaire and mail it to us in the enclosed pre-paid envelope within 10 days of receipt. In the event the envelope is misplaced, please mail the completed survey to:

U.S. General Accounting Office  
441 G Street, NW  
Room 3B28  
Washington, DC 20548  
Attention: John Carrera

If you have any question you may call Mr. Carrera at 212-264-6461. Thank you for assisting us in this effort.

Our review of NASD Hotline records indicate you made an inquiry about the following individual or brokerage firm on the date indicated:

Label Here

**Appendix II**  
**NASD Hotline Customer Satisfaction Survey**

**I. Information About Your Recent Inquiry to The NASD Hotline**

**Instructions:** All of the information requested in this section pertains **only** to your recent inquiry to the NASD Hotline. Please refer to the label on the bottom of page 1 which contains the date of the inquiry and the individual or firm you inquired about.

1. In what capacity did you call the NASD Hotline regarding this inquiry? (Check one.) N=388

- 72.7% For myself, as a private investor
- 2.8% As a legal representative to a corporate or institutional investor
- 4.9% As a legal representative to an individual investor
- 7.0% On behalf of a friend or family member
- 12.6% Other - Please specify:

**I.A. Reaching The NASD Hotline Regarding this Inquiry**

2. In all, how many attempts did you have to make to reach the Hotline before you were connected? (Enter number. If you were connected the first time you called the Hotline, enter 1.) N=281

- 1 . . . . . 83.8%                      mean = 1.2
- 2 . . . . . 7.2%
- 3-14 . . . 5.5%

3. When you were trying to reach the Hotline representative regarding this inquiry, was the telephone line ever busy? (Check one.) N=55

- 14.5% (Do not remember)
- 32.7% No
- 52.7% Yes --> How many times did you receive a busy signal? (Enter number.) N=27

- 1 . . . . 33.3%
- 2 . . . . 22.2%
- 3 . . . . 11.1%
- 4 . . . . 5.6%
- 10 . . . 2.8%

Range 1-10  
mean = 2.1

4. Once you reached the Hotline, were you placed on hold waiting for a Hotline representative? (Check one.) N = 290

- 4.8% Do not remember
- 70.7% No --> **Skip to Question 6.**
- 24.5% Yes --> How long were you on hold before being connected to a Hotline representative? (Enter approximate number of minutes. If you were on hold more than once, provide an estimated average.) N=69

- 1 min. . . 30.6%    Range 1-10
- 2 . . . . . 23.5%    mean = 2.6
- 3 . . . . . 9.4%
- 4-10 . . . 17.6%
- Do not remember . . 18.8%

5. If placed on hold, did you ever hang up the phone without being able to speak to a Hotline representative because the wait was too long? (Check one.) N=88

- 13.6% Do not remember
  - 72.7% No
  - 13.6% Yes --> How many times did you have to hang up without contacting a Hotline representative? N=12
- 1 . . . 30.4%    Range 1-3
  - 2 . . . 17.4%    mean = 1.5
  - 3 . . . 4.3%
  - Do not remember . . 47.8%



Appendix II  
NASD Hotline Customer Satisfaction Survey

6. After reaching the Hotline representative, did you ever hang up because you felt the representative was not being helpful or was being discourteous? (Check one.) N=293

1.7%	Do not remember
97.3%	No
1.0%	Yes --> How many times did you hang up? (Enter number.)
	N=8
	1 . . . . 25.0%
	2 . . . . 12.5%
	Do not remember . . . 62.5%
	Range 1-2
	mean =1.3

7. After reaching a Hotline representative, were you ever disconnected? (Check one.)

1.4%	Do not remember
96.9%	No
1.7%	Yes --> How many times were you disconnected? (Enter number.)
	N=5
	1 . . . . 44.4%
	2 . . . . 11.1%
	Do not remember . . . 44.4%
	Range 1-2
	mean 1.2

**Appendix II**  
**NASD Hotline Customer Satisfaction Survey**

**I.B. Reasons Why You Made This Inquiry to The NASD Hotline**

8. How much of a factor were each of these reasons for why you called the NASD Hotline?  
*(Check one box in each row.)*

	Major factor for my call to the Hotline (1)	Minor factor for my call to the Hotline (2)	Not a factor for my call to the Hotline (3)
a. It was my first time looking for a broker or brokerage firm. N=263	17.1%	4.2%	78.7%
b. I wanted to know whether a broker or brokerage firm I <u>was considering</u> had a history of improper or illegal behavior. N=278	66.9%	2.9%	30.2%
c. I wanted to know whether my <u>current</u> broker or brokerage firm had a history of improper or illegal behavior. N=278	41.4%	5.0%	53.6%
d. I needed additional information to support a complaint I filed with the SEC, a stock exchange, or the NASD. N=268	13.8%	1.9%	84.3%
e. I needed additional information to support a complaint I filed with a state securities regulator. N=263	5.3%	0.8%	93.9%
f. I needed additional information to support a complaint I filed with a brokerage firm. N=263	11.0%	0.8%	88.2%
g. I needed additional information to support a current arbitration proceeding against a broker or brokerage firm. N=260	13.5%	1.2%	85.4%
h. I needed additional information to support a current civil or criminal court proceeding against a broker or brokerage firm. N=261	6.9%	0.8%	92.3%
i. Other reason- <i>Please specify:</i> N=55	89.1%	1.8%	9.1%

9. Of all the reasons listed above for calling the NASD Hotline, which was the primary reason that you called the Hotline? *(Please circle the letter from the previous question designating the primary reason you called the Hotline.)*

The primary reason I called the NASD Hotline was *(From above categories)* N=292

a . . . . . 4.5%  
b . . . . . 49.0%  
c . . . . . 23.3%  
d . . . . . 2.7%  
e . . . . . 0.0%  
f . . . . . 1.7%  
g . . . . . 4.8%  
h . . . . . 2.1%  
i . . . . . 12.0%

**Appendix II**  
**NASD Hotline Customer Satisfaction Survey**

**I.C. How Did You Use the Information You Received From This Inquiry**

10. Did you take any of the following actions? If yes, how much of a factor was the information you received from the NASD Hotline in your decision to take the action?  
*(Check yes or no for each row. If yes, continue to the right.)*

			In deciding to take the action, the information I received from the NASD Hotline was ...		
			a major factor (1)	a minor factor (2)	not a factor (3)
a. I authorized my broker or brokerage firm to make a securities transaction.	<input type="checkbox"/> Yes ---> <input type="checkbox"/> No	<b>If yes --&gt;</b> N=89	50.6%	25.8%	23.6%
b. I opened a new account with the broker or brokerage firm I inquired about.	<input type="checkbox"/> Yes ---> <input type="checkbox"/> No	<b>If yes --&gt;</b> N=98	62.2%	21.4%	16.3%
c. I decided not to do business with this broker or brokerage firm.	<input type="checkbox"/> Yes ---> <input type="checkbox"/> No	<b>If yes --&gt;</b> N=120	59.2%	22.5%	18.3%
d. I changed my broker or brokerage firm.	<input type="checkbox"/> Yes ---> <input type="checkbox"/> No	<b>If yes --&gt;</b> N=68	51.5%	20.6%	27.9%
e. I filed a complaint with the brokerage firm.	<input type="checkbox"/> Yes ---> <input type="checkbox"/> No	<b>If yes --&gt;</b> N=42	45.2%	16.7%	38.1%
f. I filed a complaint with a securities regulator ( <i>e.g., SEC, NASD, the state, etc.</i> )	<input type="checkbox"/> Yes ---> <input type="checkbox"/> No	<b>If yes --&gt;</b> N=48	50.0%	20.8%	29.2%
g. I filed a private civil lawsuit against the broker or brokerage firm.	<input type="checkbox"/> Yes ---> <input type="checkbox"/> No	<b>If yes --&gt;</b> N=21	28.6%	4.8%	66.7%
h. I took some other action - <i>Please specify:</i>	<input type="checkbox"/> Yes ---> <input type="checkbox"/> No	<b>If yes --&gt;</b> N=68	70.6%	22.1%	7.4%

**Appendix II**  
**NASD Hotline Customer Satisfaction Survey**

**I.D. Quality of the Disciplinary History Information You Received From This Inquiry**

11. Regarding this inquiry, in addition to obtaining information from the NASD Hotline, did you obtain disciplinary history information about this broker or brokerage firm from a state securities regulator? (*Check one.*)

N=375

18.9% Yes ---> *Continue with question 12.*

80.9% No ---> *Skip to question 13.*

0.3% Do not remember

12. Comparing the disciplinary history information you received from the NASD Hotline with that you received from the state securities regulator, which would you say was better on the following factors?  
(*Check one box in each row.*)

	NASD information was much better (1)	NASD information was somewhat better (2)	They were about the same (3)	State information was somewhat better (4)	State information was much better (5)	No opinion (6)
a. The accuracy of the information you received N=56	14.3%	10.7%	26.8%	8.9%	17.9%	21.4%
b. The scope of the information you received N=53	22.6%	11.3%	18.9%	15.1%	18.9%	13.2%
c. The usefulness of the information you received N=52	11.5%	15.4%	32.7%	9.6%	17.3%	13.5%
d. Other quality factor - <i>Please specify:</i> N=2	50.0%	-	50.0	-	-	-

**Appendix II**  
**NASD Hotline Customer Satisfaction Survey**

**I.E. Quality of Service For This Inquiry to The NASD Hotline**

13. Considering the following factors, how satisfied or dissatisfied were you with the overall quality of the service you received from the NASD Hotline regarding this inquiry? *(Check one box in each row.)*

	Very satisfied (1)	Somewhat satisfied (2)	As satisfied as dissatisfied (3)	Somewhat dissatisfied (4)	Very dissatisfied (5)	Not applicable/ No basis to judge (6)
a. Hours of operation of the NASD Hotline N=374	61.8%	22.7%	5.1%	1.3%	0.5%	8.6%
b. Time it took to connect with a Hotline representative N=373	67.3%	20.6%	4.8%	2.4%	0.8%	4.0%
c. Courteous and professional behavior of the Hotline representative N=375	73.3%	17.3%	5.1%	0.8%	1.1%	2.4%
d. Hotline representative's ability to find the broker or firm you were inquiring about N=282	72.0%	17.0%	3.9%	2.1%	2.1%	2.8%
e. Length of time it took to receive the written response from NASD. N=374	55.3%	25.9%	4.5%	6.1%	5.1%	2.9%
f. Ability of the Hotline representative to assist non-english speaking callers <i>(If not applicable to you, check column 6.)</i> N=277	4.0%	0.4%	0.4%	-	0.4%	94.9%
g. Ability of the Hotline representative to assist hearing- impaired callers <i>(If not applicable to you, check column 6.)</i> N=277	2.9%	0.4%	1.1%	-	0.4%	95.3%
h. Other - Please specify:  N=19	21.1%	10.5%	-	5.3%	36.8%	26.3%

Appendix II  
NASD Hotline Customer Satisfaction Survey

14. Did the Hotline representative inform you of the types of disciplinary information that are disclosed by the NASD Hotline? (Check one.) N=286

2.4% Do not remember

53.5% No --> Go to Question 15.

44.1% Yes ---> If yes ---> In your opinion, how adequate or inadequate was the Hotline representative's explanation of the types of disciplinary information that are disclosed by the NASD Hotline? (Check one.) N=128

24.2% More than adequate

53.9% Generally adequate

12.5% As adequate as inadequate

7.0% Generally inadequate

2.3% Very inadequate

15. Did the Hotline representative inform you of the types of disciplinary information that are NOT disclosed by the NASD Hotline? (Check one.) N=283

4.2% Do not remember

72.8% No --> Go to Question 16.

23.0% Yes ---> If yes ---> In your opinion, how adequate or inadequate was the Hotline representative's explanation of the types of disciplinary information that are NOT disclosed by the NASD Hotline? (Check one.) N=66

30.3% More than adequate

48.5% Generally adequate

10.6% As adequate as inadequate

7.6% Generally inadequate

3.0% Very inadequate

**Appendix II**  
**NASD Hotline Customer Satisfaction Survey**

**II. Type of Disciplinary Information on Brokers and Brokerage Firms that Investors Need**

16. At the current time, the following disciplinary history information is **NOT** disclosed by the NASD Hotline.

In your opinion, how useful or not useful would the following disciplinary history be in helping you make decisions about a broker or brokerage firm? *(Check one box in each row.)*

Disciplinary information about whether the broker or brokerage firm was . . .	Very useful (1)	Somewhat useful (2)	Moderately useful (3)	Of little use (4)	Of no use (5)	No opinion (6)
a. denied a license or registration N=362	83.7%	8.3%	2.2%	1.4%	1.1%	3.3%
b. granted a license or registration with limitations N=264	71.6%	17.4%	5.3%	1.9%	0.8%	3.0%
c. subject of a <u>settled</u> criminal or civil court case N=362	75.1%	16.0%	6.1%	0.3%	1.1%	1.4%
d. subject of a court decision involving a bankruptcy or lien N=264	68.6%	14.4%	8.7%	3.4%	1.1%	3.8%
e. subject of a stock exchange or NASD review on whether to continue or stop membership rights N=267	76.8%	12.7%	4.9%	1.1%	1.5%	3.0%
f. subject of a <u>pending</u> arbitration case with a securities regulator (e.g., NASD) N=359	63.2%	20.9%	9.2%	2.2%	1.7%	2.8%
g. subject of a <u>settled</u> arbitration case with a securities regulator (e.g., NASD) N=362	66.0%	21.5%	6.1%	2.2%	1.4%	2.8%
h. subject of a <u>withdrawn</u> arbitration case with a securities regulator (e.g., NASD) N=263	39.2%	27.0%	12.5%	11.8%	3.4%	6.1%
i. subject of a <u>settled</u> customer complaint filed with a securities regulator (e.g., SEC, NASD, the state, etc.) N=363	65.3%	20.4%	9.1%	0.8%	1.9%	2.5%
j. subject of a <u>dismissed</u> customer complaint filed with a securities regulator (e.g., SEC, NASD, the state, etc.) N=268	42.9%	20.9%	14.2%	7.1%	9.3%	5.6%
k. subject of a <u>pending</u> customer complaint filed with a brokerage firm N=364	57.7%	20.1%	11.8%	6.0%	1.9%	2.5%
l. subject of a <u>settled</u> customer complaint filed with a brokerage firm N=365	62.7%	20.8%	8.8%	3.0%	1.9%	2.7%
m. subject of a <u>dismissed</u> customer complaint filed with a brokerage firm N=267	42.7%	21.3%	15.0%	8.2%	7.1%	5.6%
n. broker subject to a disciplinary action or termination by his/her employer N=363	84.8%	7.2%	2.2%	0.8%	2.2%	2.8%
o. Other information - Please specify: _____ N=16	81.3%	12.5%	-	-	-	6.3%

**Appendix II**  
**NASD Hotline Customer Satisfaction Survey**

**III. Background Information**

17. How did you **first become aware** of the NASD's Toll-Free Hotline service? (*Check one box only.*) N=371

- 10.1% I called the SEC Hotline
- 12.1% A friend, relative, or business associate told me about it
- 15.1% A broker told me about it
- 14.3% A securities regulator (*i.e., from SEC, NASD, the state, etc.*) told me about it
- 3.5% Another person told me about it - *Please specify this person's position:* \_\_\_\_\_
  - I read about it in a brochure from a securities regulator (*i.e., from SEC, NASD, the state, etc.*)
- 2.4% I read about it in a brochure from a brokerage firm
- 29.6% I read about it in a newspaper or magazine article
- 1.6% I read about it in a book
- 1.3% I read about it in some other publication - *Please specify this publication:* \_\_\_\_\_
- 1.1% I saw an advertisement about it in a newspaper, magazine, billboard, radio, or TV
- 3.0% I heard it mentioned on a radio or TV program
- 5.9% I learned about it from another source - *Please specify this source:* \_\_\_\_\_

18. **Between April 31, 1994 and March 31, 1995**, how many times did you call the NASD Hotline to request information? (*Check one.*)

N=289

- 54.3% 1 time
- 21.1% 2 times
- 7.6% 3 times
- 3.8% 4 times
- 4.5% 5 times
- 6.2% 6 to 10 times
- 0.3% 11 to 25 times
- 26 to 50 times
- 0.3% 51 to 100 times
- Over 100 times
- 
- 1.7% Do not remember



**IV. Comments or Additional Information**

19. Please provide any additional information that you believe will explain your answers, or any comments or suggested improvements about the NASD Hotline, the information needs of individual investors, or this questionnaire. Attach additional sheets if necessary.

N=295

Comments recieved from 38.6% of mailed questionnaires.

Thank you for your assistance.  
Please return your completed questionnaire in the enclosed prepaid envelope.

# Survey of State Securities Regulators



U.S. General Accounting Office

## Survey of State Securities Regulators

### INTRODUCTION

The U.S. General Accounting Office, an agency of Congress, is currently evaluating the effectiveness of the National Association of Securities Dealers (NASD)'s Toll-Free Hotline.

The purpose of this questionnaire is to assist us in identifying: (1) differences in disclosure policies among the states and the NASD concerning disciplinary history information about registered representatives and brokerage firms; (2) the methods that states use to publicize the availability of such information; and (3) the opinions of state securities regulators concerning the disclosure policy of the NASD Hotline.

This survey should be completed by the state's securities regulator or his/her designee. Most of the questions can easily be answered by checking boxes or filling in blanks. It should take about 15 minutes to complete. Space has been provided for additional comments at the end of the questionnaire.

Thank you for your continued cooperation.

### Instructions

Please return the completed questionnaire in the enclosed preaddressed envelope within 10 days of receipt. In the event the envelope is misplaced, please mail the completed questionnaire to:

U.S. General Accounting Office  
7 World Trade Center, 25th Floor  
New York, NY 10048  
Attention: Mr. John Carrera

If you wish, you may fax your completed questionnaire to Mr. Carrera at (212) 264-5154.

If you anticipate any difficulty in returning this questionnaire in the requested time or have any questions, please call Mr. Carrera at (212) 264-6461.

Please provide the following information so that we can contact you if we need to clarify an answer.

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Phone: (\_\_\_\_) \_\_\_\_\_

**Appendix III  
Survey of State Securities Regulators**

**I. Your Agency's Disclosure of Disciplinary History Information Contained in the Central Registration Depository (CRD) Database**

1. Which of the following types of CRD disciplinary history information about registered representatives and brokerage firms does your agency disclose to inquiring individual investors?  
(Check one box in each row.)

N's reported for this question

<b>Disciplinary information about whether the registered representative or brokerage firm was . . .</b>	<b>Yes, we do disclose this (1)</b>	<b>No, we do not disclose this (2)</b>	
a. barred from the industry	50	-	N/A=1
b. subject of a suspension of his/her license/registration	50	-	N/A=1
c. subject of a revocation of his/her license/registration	50	-	N/A=1
d. expelled from the industry	50	-	N/A=1
e. censured by a securities regulator	50	-	N/A=1
f. fined by a securities regulator	50	-	N/A=1
g. subject of a securities-related order of permanent injunction	50	-	N/A=1
h. subject of a securities-related order of preliminary injunction	49	1	N/A=1
i. subject of a securities-related order of prohibition	50	-	N/A=1
j. subject of a securities-related special stipulation order	48	1	N/A=1
k. subject of a securities-related cease and desist order	50	-	N/A=1
l. subject of a Commodities Futures Trading Commission (CFTC) reparation order	46	4	N/A=1
m. subject of a criminal conviction	46	4	N/A=1
n. subject of a criminal indictment	42	7	N/A=1
o. subject of a dismissed indictment	40	9	N/A=1
p. subject of a securities-related civil judgment	49	1	N/A=1
q. subject of a securities-related arbitration decision	47	3	N/A=1
r. subject of a pending SRO complaint	41	9	N/A=1
s. subject of a dismissed NASD complaint	42	8	N/A=1
t. subject of an SRO hearing to determine whether to continue or stop membership rights	42	8	N/A=1

**Appendix III  
Survey of State Securities Regulators**

Question 1 (*Continued*)      Which of the following types of CRD disciplinary history information about registered representatives and brokerage firms does your agency disclose to inquiring individual investors? (*Check one box in each row.*)

<b>Disciplinary information about whether the registered representative or brokerage firm was . . .</b>	<b>Yes, we do disclose this (1)</b>	<b>No, we do not disclose this (2)</b>	
u. denied a license or registration	49	1	N/A=1
v. granted a license or registration with limitations	47	3	N/A=1
w. subject of a <u>settled</u> criminal or civil court case	47	-	N/A=1 Both 1&2=2
x. subject of a court decision involving a bankruptcy or lien	47	3	N/A=1
y. subject of a <u>pending</u> arbitration case with a securities regulator ( <i>e.g., NASD</i> )	41	9	N/A=1
z. subject of a <u>settled</u> arbitration case with a securities regulator ( <i>e.g., NASD</i> )	49	1	N/A=1
aa. subject of a <u>withdrawn</u> arbitration case with a securities regulator ( <i>e.g., NASD</i> )	43	7	N/A=1
bb. subject of a <u>settled</u> customer complaint filed with a securities regulator	45	4	N/A=1 Both 1&2=1
cc. subject of a <u>dismissed</u> customer complaint filed with a securities regulator	39	10	N/A=1 Both 1&2=1
dd. subject of a <u>pending</u> customer complaint filed with a brokerage firm	40	10	N/A=1
ee. subject of a <u>settled</u> customer complaint filed with a brokerage firm	46	3	N/A=1 Both 1&2=1
ff. subject of a <u>dismissed</u> customer complaint filed with a brokerage firm	40	8	N/A=1 Both 1&2=1
gg. registered representative subject to a disciplinary action or termination by his/her employer	46	4	N/A=1
hh. Other information - <i>Please specify:</i>	10	2	-

**Appendix III  
Survey of State Securities Regulators**

2. To what extent, if at all, do the following factors influence the scope of your agency's disclosure policy on CRD disciplinary history information? *(Check one box in each row.)*

	To a very great extent (1)	To a great extent (2)	To a moderate extent (3)	To some extent (4)	To little or no extent (5)	Not applicable (6)
a. My state's freedom of information law N=44	81.8%	11.4	2.3%	2.3%	2.3%	N=7
b. My agency's policies about investor protection and education N=46	56.5%	32.6%	6.5%	2.2%	2.2%	N=4
c. Other - Please specify: N=12	75.0%	8.3%	8.3%	8.3%	-	-

3. Has your agency formally or informally assessed what type of CRD disciplinary history information is useful to investors for making decisions about registered representatives and brokerage firms? *(Check one.)*

N=51

21.6% Yes ---> *If possible, please attach a copy of your results. Thank you.*

78.4% No

**Appendix III  
Survey of State Securities Regulators**

4. Which of the following methods, if any, does your agency use to publicize the availability of CRD disciplinary history information on registered representatives and brokerage firms?  
(Check yes or no each row. If yes, continue to the right.)

N's reported

		If you use this method, does it include publicizing the existence of your toll-free telephone number?  (If your agency does not, have a toll-free number, leave this column blank.)
a. Press releases	33 <input type="checkbox"/> Yes ---> If yes ---> 17 <input type="checkbox"/> No	13 Yes
b. Public speaking engagements by agency officials at investor seminars, conferences, etc.	41 <input type="checkbox"/> Yes ---> If yes ---> 10 <input type="checkbox"/> No	19 Yes
c. Public service announcements on radio, television, billboards, and printed media	30 <input type="checkbox"/> Yes ---> If yes ---> 20 <input type="checkbox"/> No	15 Yes
d. Agency brochures	39 <input type="checkbox"/> Yes ---> If yes ---> 12 <input type="checkbox"/> No	17 Yes
e. Paid commercials on radio, television, billboards, and printed media	6 <input type="checkbox"/> Yes ---> If yes ---> 41 <input type="checkbox"/> No	4 Yes
f. Other methods - Please specify:	9 <input type="checkbox"/> Yes ---> If yes ---> <input type="checkbox"/> No	4 Yes

**Appendix III  
Survey of State Securities Regulators**

5. For those publicity methods that your agency uses, in your opinion, how much of a contribution has each method made to the volume of requests for CRD disciplinary history information that your agency receives?  
(Check one box in each row. If your agency does not use the method, check column 7.)

	Very great contri- bution	Great contri- bution	Moderate contri- bution	Some contri- bution	Little or no contri- bution	No basis to judge	Not applicable, we do not use this method (7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
a. Press releases N=33	21.2%	24.2%	33.3%	18.2%	-	3.0%	N=17
b. Public speaking engagements by agency officials at investor seminars, conferences, etc. N=42	2.4%	16.7%	38.1%	26.2%	7.1%	9.5%	N=9
c. Public service announcements on radio, television, billboards, and printed media N=31	6.5%	35.5%	22.6%	22.6%	3.2%	9.7%	N=20
d. Agency brochures N=39	10.3%	15.4%	30.8%	28.2%	2.6%	12.8%	N=12
e. Paid commercials on radio, television, billboards, and printed media N=8	12.5%	37.5%	12.5%	-	-	37.5%	N=41
f. Other methods - Please specify: _____ N=11	27.3%	36.4%	18.2%	-	-	18.2%	N=5

6. Has your agency formally or informally assessed the effectiveness of your publicity program(s)? (Check one.)

N=48

10.4% Yes ---> *If possible, please attach a copy of the results. Thank you.*

89.6% No

Appendix III  
Survey of State Securities Regulators

7. Which methods can investors use to request CRD disciplinary history information from your agency about registered representatives or brokerage firms? (Check all that apply.)

N's reported

- 21 By calling a toll-free telephone number
- 49 By calling a non-toll-free telephone number
- 50 By mail
- 47 By fax
- 49 By visiting the office (Walk-in)
- 2 By other method(s) - Please specify: \_\_\_\_\_

8. In what form(s) does your agency provide CRD disciplinary history information to investors? (Check all that apply.)

N's reported

- 43 By telephone
- 49 By mail
- 38 By fax
- 14 By other method(s) - Please specify: \_\_\_\_\_

9. Does your agency have a toll-free telephone number? (Check one.)

N=51

47.1% Yes ---> *Continue with Question 10.*

52.9% No ---> *Skip to Question 11.*

10. What was the primary reason for setting up a toll-free telephone number? (Check one.)

N=24

79.2% As a method to implement our agency's investor protection/education policies

- Specifically required by state legislation

20.8% Other reason - Please specify: \_\_\_\_\_



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**Appendix III**  
**Survey of State Securities Regulators**

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11. Does your agency refer investors to call the NASD Toll-Free Hotline for CRD disciplinary history information about registered representatives or brokerage firms? *(Check one.)*

N=51.

27.5% Yes, on a routine basis

49.0% Yes, but only if asked for other sources of information

23.5% No

12. Please explain why your agency does or does not refer investors to the NASD Hotline.

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**Appendix III**  
**Survey of State Securities Regulators**

**II. Statistics**

13. For the calendar years indicated, how many investor inquiries has your agency received concerning the CRD disciplinary history of registered representatives and brokerage firms? *(Enter numbers and percents. If actual numbers or percents are not readily available, please provide your best estimates.)*

Calendar year	Total number of requests for CRD disciplinary history information <i>(Walk-ins, telephone calls, written requests, etc.)</i>				Of these total requests, what percent were received through your toll-free telephone number? <i>(If your agency does not have a toll-free number, leave this column blank.)</i>		
1994	N=36	Mean=1,508	Median=326	Range 24-24,000	N=9	Mean=52%	Range 5%-100%
1993	N=33	Mean=1,427	Median=315	Range 5-21,378	N=4	Mean=56%	Range 40%-75%
1992	N=32	Mean=1,322	Median=250	Range 14-19,685	N=4	Mean=34%	Range 0%-75%
1991	N=30	Mean=1,207	Median=225	Range 10-17250	N=4	Mean=34%	Range 0%-75%

14. Please provide the following information:

*(Enter dollar values and percents. If actual dollar values and percents are not readily available, please provide your best estimates.)*

Calendar year	Your agency's total budget for each year	Percent of agency budget devoted to service investors' inquiries about CRD disciplinary history information  <i>(Exclude cost of operating your toll-free telephone number, if any.)</i>	Percent of agency budget devoted to support the operation of your toll-free telephone number  <i>(If your agency does not have a toll-free number, leave this column blank.)</i>
1995	N=36 Mean=\$1,954,963	N=22 Mean=1.6%	N=11 Mean=0.6%
1994	N=35 Mean=\$1,813,909	N=20 Mean=1.8%	N=9 Mean=0.6%
1993	N=34 Mean=\$1,705,360	N=20 Mean=1.8%	N=7 Mean=0.8%
1992	N=33 Mean=\$1,662,558	N=20 Mean=1.7%	N=7 Mean=0.8%
1991	N=30 Mean=\$1,660,642	N=20 Mean=1.6%	N=7 Mean=0.9%

**Appendix III  
Survey of State Securities Regulators**

**III. Your Views About the NASD Toll-Free Investor Hotline**

15. The NASD Hotline **DOES NOT** disclose the following types of CRD disciplinary history information about registered representatives and brokerage firms. Which of these types of information do you believe the NASD hotline **SHOULD** or **SHOULD NOT** disclose to individual investors? (Check one box in each row.)

N's reported

Disciplinary information about whether the registered representative or brokerage firm was . . .	The NASD Hotline <b>SHOULD</b> disclose this information (1)	The NASD Hotline <b>SHOULD NOT</b> disclose this information (2)	
a. denied a license or registration	49	2	
b. granted a license or registration with limitations	47	4	
c. subject of a <u>settled</u> criminal or civil court case	46	1	Both 1&2=1 No opinion=1
d. subject of a court decision involving a bankruptcy or lien	43	6	Both 1 &2=1
e. subject of a <u>pending</u> arbitration case with a securities regulator (e.g., NASD)	39	10	No opinion=1
f. subject of a <u>settled</u> arbitration case with a securities regulator (e.g., NASD)	49	1	No opinion=1
g. subject of a <u>withdrawn</u> arbitration case with a securities regulator (e.g., NASD)	39	10	
h. subject of a <u>settled</u> customer complaint filed with a securities regulator	44	4	No opinion=1
i. subject of a <u>dismissed</u> customer complaint filed with a securities regulator	35	13	No opinion=1
j. subject of a <u>pending</u> customer complaint filed with a brokerage firm	39	10	
k. subject of a <u>settled</u> customer complaint filed with a brokerage firm	45	3	No opinion=1
l. subject of a <u>dismissed</u> customer complaint filed with a brokerage firm	36	13	
m. registered representative subject to a disciplinary action or termination by his/her employer	44	5	
n. Other information - Please specify:	5	-	

**Appendix III**  
**Survey of State Securities Regulators**

16. In your opinion, how adequate or inadequate are NASD's efforts to publicize the NASD Hotline to investors? (*Check one.*)

N=51

- More than adequate
- 19.6% Generally adequate
- 25.5% As adequate as inadequate
- 13.7% Generally inadequate
- 13.7% Very inadequate
- 
- 27.5% No basis to judge

**IV. Comments**

17. If you have any additional comments on any issue that we covered in this questionnaire, please provide them in the space below. If necessary, you may attach additional sheets.

9 states provided comments

Thank you for your assistance.  
Please return your completed questionnaire in the enclosed prepaid envelope  
or fax the questionnaire to John Carrera at (212) 264-5154.

# Comments From NASD

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



*Elisse B. Walter, Esq., NASD Regulation, Inc.*

National Association of Securities Dealers, Inc. ■ 1735 K Street, NW ■ Washington, DC 20006-1500 ■ 202-728-8000

July 16, 1996

Mr. James L. Bothwell  
Director, Financial Institutions  
and Markets Issues  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Bothwell:

Thank you for providing NASD Regulation, Inc. an opportunity to comment on your report entitled "NASD TELEPHONE HOTLINE: Enhancements Could Help Investors Be Better Informed About Brokers' Disciplinary Records." We are pleased that your review generally showed a high level of user satisfaction with the NASD Regulation telephone hotline. Our comments focus on the recommendations to the Chairman of the Securities and Exchange Commission (SEC) on pages 33 - 34; the manner in which you present the results of the survey of hotline users; and the absence of any reference to the NASD's action to initiate the "Public Disclosure Program" in 1988. We also suggest that certain statements in the draft be reworded to make them more technically accurate.

#### First Recommendation

**"[E]xplore other ways of publicizing the hotline to a wider audience of investors, such as including the hotline number on account opening documents or account statements, and making disciplinary-related information directly available to investors through the Internet."**

NASD Regulation is committed to making the hotline available to the widest audience of investors. As noted in the draft report, we publicize the availability of the hotline in a number of NASD Regulation publications. In addition, we actively promote the availability of the hotline service on the numerous occasions in which we respond to press inquiries regarding the disciplinary history of brokers and member firms. By July 31, NASD Regulation will establish a site on the World-Wide Web that will publicize, among other matters of interest to investors, the hotline number. Later this year, the Web site will be upgraded to allow investors to submit requests for information on brokers and firms on-line through the Internet. As the report notes, earlier this year we announced longer-range plans to provide a means through the Internet for investors to access electronically the data in the Central Registration Depository (CRD). The timing of this electronic access capability will depend on the full implementation of the redesigned CRD in 1998; electronic access will be available as soon as practicable thereafter.

Now on p. 18.

James L. Bothwell  
July 16, 1996

Page 2

NASD also has established an Office of Individual Investor Services to service the needs and promote the interests of individual investors and to develop programs that foster increased investor protection. This Office will actively promote and publicize the availability of disciplinary information through the NASD Regulation Public Disclosure Program.

The recommendation to include the hotline number on account opening documents or account statements will be given full consideration by the Membership Committee of NASD Regulation at its meeting on August 5th. The Committee will then submit its findings and any recommendations to the Board in September. To implement a recommendation to include the hotline number on account documents, it will be necessary for the NASD to file a rule change for approval with the SEC.

Second Recommendation

**“[P]rovide hotline callers with all the relevant disciplinary-related information available in CRD, such as whether a broker is the subject of a customer complaint, a settled arbitration, or a settled civil case; if NASD cannot disclose this additional information it should at least inform callers that the information is available from most state regulators.”**

At its March 1996 meeting, the Board of Governors of the NASD approved the expansion of the Public Disclosure Program, and that program responds in full and in fact goes beyond this recommendation. We will file the appropriate amendments with the SEC in early August. We plan to implement the program changes with the introduction of the revised Forms BD, U-4 and U-5 in the initial phase of the redesigned CRD implementation. All disclosures submitted on any item on page 3 of Form U-4 will be made available to investors calling the hotline. This will include criminal and regulatory matters, civil judgments and arbitration decisions currently disclosed, as well as:

- All pending arbitrations and civil proceedings;
- Pending written customer complaints alleging compensatory damages of \$5,000 or more;
- Settlements of \$10,000 or more of arbitrations, civil suits and customer complaints;
- Current investigations involving criminal or regulatory matters;
- Terminations of employment after allegations involving violations of investment-related statutes or rules, fraud, theft or failure to supervise investment-related activities; and
- Bankruptcies and outstanding liens or judgments.

James L. Bothwell  
July 16, 1996

Page 3

Given the scope of these changes and the fact the NASDR Board already has approved the filing of a rule change with the SEC, we believe it would be appropriate for the GAO to rephrase its recommendation to the Chairman of the SEC to urge the SEC to approve the NASD Regulation rule filing as soon as possible after it is filed with the SEC.

Third Recommendation

**“[D]evelop and implement cost-effective quality assurance checks, such as independent review and testing of information derived from CRD, to ensure that information provided to hotline callers is disclosable and complete.”**

NASD Regulation concurs in this recommendation and has introduced a revised process to ensure the highest degree of accuracy for the disclosure reports. All new disclosures are reviewed by a second disclosure review staff person. In addition, Membership Operations management will institute a statistical quality control process to measure systematically the accuracy of the program. Because we view the Public Disclosure Program as an invaluable information resource for investors, we also will have NASD’s Internal Review group, which is independent of NASD Regulation, conduct periodic audits of the Public Disclosure Program.

We also concur in your assessment that a broad disclosure policy, like that embodied in our response to your second recommendation, will eliminate the bases for certain errors in the disclosure program. The new, more highly structured data base of the redesigned CRD will further ensure the highest degree of accuracy for the disclosure program.

Presentation of Survey Results

We believe that the current draft understates the extent to which hotline users report high levels of satisfaction with the service they receive when they use the hotline. The survey shows high percentages of users report they are “very satisfied” with the core service aspects of the hotline, including hours of operation, time to connect, courteousness of the hotline representative, and the ability of the representative to find the broker about whom the caller is inquiring. We believe these results are noteworthy, especially in view of the high volume of calls in 1995. We suggest that the RESULTS IN BRIEF section would be more accurate if it contained this information, and that the summary of the survey on page 18, which states that callers were “generally satisfied,” should be restated to make it clearer that callers in fact were generally very satisfied.

NASD Initiation of Public Disclosure Program

The current draft report fails to note that the NASD established the Public Disclosure Program on its own initiative in April 1988, two years before Congress required the NASD to establish and maintain a toll-free telephone number for the public. This was an important

See comment 1.

See comment 2.

Now on pp. 9-10.

See comment 3.

James L. Bothwell  
July 16, 1996

Page 4

initiative by the NASD and, indeed, set a precedent for the eventual amendments to the Securities Exchange Act of 1934 mandating the hotline. As such, it should be recognized in the final GAO report.

Miscellaneous Drafting Matters

The heading in the middle of page 13 of the draft report states that methods used to publicize the hotline are not designed to reach all investors. We believe that this is inaccurate. While our methods may not reach all investors, they were not designed to have that effect. We recommend that the final report restate the heading to read: "Methods Used to Publicize the Hotline Do Not Reach All Investors." A similar change should be made in the second sentence of the first paragraph of the conclusion on page 32.

The report notes on page 24 that 39 state securities regulators thought that NASD Regulation should disclose dismissed customer complaints. NASD Regulation may file a formal complaint against a firm or a broker based on a customer complaint. If that action were dismissed by a hearing panel, we would still disclose it in the Public Disclosure Program. A customer complaint filed with NASD Regulation can result in a formal complaint proceeding, an informal disciplinary action, or it is closed without action. Regardless of our action on the customer complaint, the matter may be pursued by the customer directly with the firm, in arbitration or in civil court, and may be reportable to the CRD and disclosable to the public through the hotline if applicable standards are met. You should consider, therefore, clarifying what is meant by the term "dismissed customer complaints."

On page 30 of the draft report under the CRD Redesign heading, there is a statement to the effect that NASD Regulation officials said that disclosure of disciplinary information by brokers is not as timely as they would like it to be. This does not reflect our position. We recommend, therefore, that this be restated to reflect that, in the absence of a systematic means in the current CRD to monitor timeliness of filings, NASD Regulation officials are concerned that it is possible that disclosures by brokers are not as timely as they should be.

We would note two further drafting issues. We recommend distinguishing firms from individuals throughout the report rather than using the term "broker" to denote both as explained in your footnote on page 1. The two are not necessarily interchangeable and the report would, in our opinion, be more understandable if the distinction is maintained. Lastly, we ask that the term "NASD Regulation" be substituted throughout the report where appropriate. Our staff would be happy to assist in making this set of changes.



James L. Bothwell  
July 16, 1996

Page 5

We are pleased to have the opportunity to provide our comments and appreciate the professional manner in which the GAO staff has carried out its inspection. We remain available to provide any additional information that you may need.

Sincerely,

A handwritten signature in black ink that reads "Elisse B. Walter". The signature is written in a cursive, flowing style.

Elisse B. Walter  
Chief Operating Officer

cc: Mary L. Schapiro

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The following are GAO's comments on NASD's July 16, 1996, letter.

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## GAO Comments

1. NASD said that we should rephrase our recommendation to urge SEC to approve its proposed rule as soon as it is filed with SEC. Our recommendation meets our intent to ensure that investors get the information they need to make informed investment decisions. It would be premature to make the recommendation as specific as NASD suggests until its rule amendments are filed with SEC.
2. NASD said that we should emphasize the extent to which users reported high levels of satisfaction with the service they receive when they use the hotline. Text was modified to include the percentage range of those who responded very satisfied.
3. Text was added to note the 1988 establishment of the NASD Public Disclosure Program.
4. Caption and text were modified to state that the methods used to publicize the hotline may not reach all investors.
5. NASD noted variations on the handling of formal complaints and customer complaints and suggested that we clarify what is meant by dismissed customer complaints. To eliminate the confusion about the definition of dismissed customer complaints, we have changed the example to pending customer complaints.
6. Text was revised to include NASD's recommended language regarding the absence of a systematic means in the current CRD to monitor the timeliness of filings.
7. NASD recommended that we distinguish firms from individuals throughout the report rather than use the term "broker" as explained in a footnote on page 1. We have carefully reviewed every instance in which we use the term "broker" to refer to both broker-dealers and their individual associated persons. In every case, the term broker refers to both. We distinguish between the two only when we refer to either one or the other.
8. NASD asked that we use NASD Regulation throughout the report to refer to the entity responsible for the hotline. We added a footnote explaining the restructuring of NASD and refer to NASD Regulation where appropriate.

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