

FINRA Proposes Significant Changes to Forms U4 and U5

March 5, 2009

The Financial Industry Regulatory Authority (FINRA) recently filed with the Securities and Exchange Commission (SEC) a proposed rule change that, if adopted, would make significant changes in the reporting of certain disclosure items on the Uniform Application for Securities Industry Registration or Transfer (Form U4) and the Uniform Termination Notice for Securities Industry Registration (Form U5).

The proposed changes to Forms U4 and U5 will need to be published for comment and approved by the SEC before they can take effect, although FINRA has indicated that the changes, if approved, could be rolled out by May 2009.

The changes could impose a substantial administrative burden on member firms as they will be required to go back and review filed Forms U4 and U5 to amend those forms to reflect answers to newly added questions designed to identify “statutorily disqualified” persons. The amendments will also make a major change in the reporting of arbitrations and civil litigation where individuals are not named in the complaint but are named or identified in the body of the complaint.

Background

Representatives of broker-dealers and investment advisers use Form U4 to register with the states and with self-regulatory organizations (e.g., FINRA). Forms are filed electronically by their employing firms using the Central Registration Depository. Broker-dealer agents and investment adviser representatives have an obligation to update previously filed Forms U4 with any new information required to be disclosed. FINRA makes information filed on Form U4 publicly available through its BrokerCheck program.

Broker-dealers and investment advisers use Form U5 to terminate a representative’s registration in a particular jurisdiction or with a particular self-regulatory organization. Firms terminating the registration of an associated person must respond to a series of disclosure questions. Firms also have the obligation to update previously filed Forms U5 if they become aware of new disclosure information.

Proposed Changes

Willful Violations. FINRA is proposing to amend Forms U4 and U5 to make it easier to identify persons who are subject to a “statutory disqualification” and who are therefore required to have additional self-regulatory organization reviews. Among the items that would cause a person to become subject to a statutory disqualification are “willful” violations of the federal securities laws, the Commodity Exchange Act, or the rules of the Municipal Securities Rulemaking Board. Under the proposed rule changes, both Forms U4 and U5 would be amended to add questions requiring disclosure of findings of “willful” violations. Firms would be given 120 days from the effective date of the rule changes to amend their registered persons’ forms to respond to these new questions.

Arbitrations and Civil Litigation. Under the current forms, firms are required to report arbitrations and civil litigation that allege registered person involvement in one or more sales practice violations, but only if the registered person is named in the arbitration or civil litigation. The proposed rule changes would revise the forms to require

the reporting of allegations of sales practice complaints made against registered persons in a civil lawsuit or arbitration even if the registered person is not named in the arbitration claim or civil litigation. Reporting would be required if the registered person was either named in or could reasonably be identified from the body of the arbitration claim or civil litigation as a registered person who was involved in one or more of the alleged sales practice violations. FINRA staff has indicated that this change will be implemented only prospectively.

Monetary Threshold for Reporting Complaints. Currently under Forms U4 and U5, settlements of consumer-initiated litigation and arbitration must be reported only if they are in excess of \$10,000. Because this monetary threshold has not been adjusted since 1998, FINRA is proposing to increase the minimum reporting requirement to \$15,000.

Date of and Reason for Termination. FINRA also proposes two changes with respect to the date of and reason for termination of a registered person for purposes of Form U5. First, FINRA proposes to clarify that the date to be provided by a firm in the “date of termination” field is the “date the firm terminated the individual’s association with the firm in a capacity for which registration is required.” Second, the proposed rule changes would permit a firm to change the date of and reason for termination, but would require the firm to state a reason for the change. Under current procedure, no changes in the date of or reason for termination is permitted even if the data submitted is incorrect due to a clerical error.

Technical Amendments. The proposed rules also include a series of technical amendments that are designed to make the electronic filing and reporting process for Forms U4 and U5 easier. For example, several questions would contain “check all that apply” responses instead of a drop-down menu limited to a “principal” response. The proposed rules would also facilitate disclosure between firms; for example, firms could be notified when an employee’s reason for termination at a prior firm is amended by a prior employer.

Further Questions

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