American Council of Life Insurance

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Senior Counsel

January 29, 1998

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
Room 6184, Stop 6-9
450 Fifth Street, N.W.
Washington, D.C. 20549

RE: Release No. 34-39510; File No. SR-NASD-97-24.

Dear Mr. Katz:

The American Council of Life Insurance (the "ACLI") hereby files comment on Release No. 34-39510, which publicly notices changes to the NASD Conduct Rules governing broker/dealer supervision and record retention. These recent modifications warrant careful scrutiny and analysis.

The ACLI has 532 member life insurance companies which represent 89.6% of the total assets of all U.S. life insurance companies. Many of our member companies offer and distribute variable annuities, variable life insurance and mutual funds through broker/dealers subject to the NASD Conduct Rules. The life insurance industry greatly supports meaningful enhancements to broker/dealer compliance and supervision. It is critically important that regulations governing broker/dealers be developed with all categories of broker/dealers in mind, and not just one segment of the industry. Careful adherence to the Administrative Procedure Act will ensure even handed promulgation of regulations with the opportunity for balanced, informed input.

NASD RULE CHANGE IN BRIEF

The newly approved NASD rule changes are significant, and have been evolving since 1996 in several different proposals. At its inception, the initiative sought to fulfill the SEC's recommendation to adapt SRO supervisory rules to accommodate the use of electronic communication. In response, the NASD proposed conduct rule amendments that provided firms with *flexibility* in developing appropriate supervisory procedures to review incoming and outgoing customer correspondence.

In the final phase of this action, however, the SEC approved, by accelerated order, NASD rule amendments and a NASD Notice to Members that deviate substantially from the

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amendments as proposed.[1] In short, while purporting to make supervisory review of correspondence more flexible, the latest amendments to the rule are more rigid and will "require the review of all incoming non-electronic correspondence directed to registered representatives."[2]

STATEMENT OF POSITION

Several aspects of the SEC's accelerated approval of the NASD's Rule change contradict the Administrative Procedure Act. The final NASD rule and its accompanying Notice to Members include provisions exactly opposite the SEC and NASD proposals concerning the review of incoming written communications with customers. There was no opportunity for comment on these significant deviations.[3] We strongly oppose the SEC's approval of new items that appeared for the first time in Release No. 34-39510 (the "release").

The NASD initiative has a significant anticompetitive impact on limited purpose broker/dealers. The NASD rule change, as amended and interpreted by the NASD, fits only one category of broker/dealers subject to the NASD's jurisdiction. The amended initiative failed to properly consider the interests of all broker/dealers and their salespersons. Compliance as explained in the NASD's approved Notice to Members is not functionally executable under the structure and operation of many limited purpose broker/dealers. This disparity will burden competition severely and unnecessarily.

BACKGROUND: THE STRUCTURE AND OPERATION OF LIMITED PURPOSE BROKER/DEALERS AFFILIATED WITH LIFE INSURANCE COMPANIES

Broker/dealers affiliated with life insurance companies are significantly different from full service or "wire-house" broker/dealers in their structure, operation, products and services. The amendments to NASD Rule 3010 have a significantly greater impact on broker/dealers affiliated with life insurers due to these differences. An overview of these broker/dealers and their functions will facilitate an understanding of the industry's objections.

The securities activities of broker/dealers affiliated with life insurers are a component of a larger insurance business. Many registered representatives operate principally as life insurance and annuity salespersons. Securities sales frequently constitute an incidental amount of business relative to insurance product sales by an office or registered representative. As a by-product of this relationship, supervision and compliance is often conducted through the vehicle of an

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[1] Release No. 34-39510 (referred to hereafter as "the release") appeared in Federal Register Vol. 63, No. 5, dated January 8, 1998, and contained a 21-day comment period expiring January 29, 1998.

[2] *Id.* at 1134.

[3] Moreover, some of the changes introduced for the first time in the release relate to a NASD Notice to Members that was not published as part of this package in the Federal Register. Curiously, the release invites comment on NASD Amendment No. 1 and the NASD Notice to Members after they were approved by the SEC on December 31, 1998, even though neither was published in the Federal Register.

insurance distribution system. Consequently, registered representatives of broker/dealers affiliated with life insurers are often present in numerous small, geographically dispersed offices. NASD rules, and broker/dealers' compliance with them, are tailored to reflect these differences.

The range of products offered by these limited purpose broker/dealers is typically narrow and focuses upon the distribution of variable insurance contracts and mutual funds. It may be helpful to consider those securities activities and services *not* offered by most broker/dealers affiliated with life insurers. Typically, these firms do not maintain discretionary accounts permitting registered representatives to purchase and sell securities on behalf of a client without specific approval of each transaction. On an industry-wide basis, these broker/dealers generally do not take custody of client funds, securities or assets. This type of firm does not typically "carry" customer accounts.

Insurance broker/dealers usually require that payment for variable insurance or securities products be made by check payable to the processing office, and not by check payable to the agent/registered representative. Variable contracts and shares in investment companies are issued directly to purchasers and do not constitute bearer instruments. Consequently, the opportunity for misappropriation of these instruments by registered representatives is virtually nonexistent.

Broker/dealers affiliated with life insurers generally do not maintain "open accounts" or facilitate the implementation of stop orders and limit orders, which obviates many potential brokerage problems. Similarly, because these broker/dealers do not typically make available cash management accounts or manage free cash balances, many associated operational and logistical difficulties are absent. Broker/dealers affiliated with life insurers do not make markets in securities or underwrite new issues of securities. This obviates common pressures for unsuitable sales practices.

In several instances, the federal securities laws and the NASD regulations provide appropriate regulatory exceptions because these limited purpose broker/dealers are different from full service broker/dealers. For example, SIPC membership is not required (or allowed) because these entities do not make margin loans or take custody of customer assets or securities. Similarly, net capital requirements do not apply since these limited purpose broker/dealers do not take custody of customer assets or maintain "accounts".

Because of these many functional differences, the Rule 3010 amendments impose a disproportionately greater burden on these broker/dealers compared to full service firms. Changes to the NASD's Rules of Fair Practice must comport with the provisions of Section 15A(b)(2) and 15A(b)(6) of the 1934 Act. Securities activities provide the fundamental threshold for these statutory provisions concerning self-regulatory rules. SRO rules, therefore, must have a tangible nexus to securities activities. Congress specifically addressed this issue when it amended the Exchange Act in 1975 concerning the rulemaking authority of self-regulatory organizations. The 1975 Senate Committee Report on this statutory amendment states that:

> The growing diversification of securities firms into non-securities activities has raised, and will continue to raise, significant questions about the adequacy of the present regulatory structure. However, the diversification of securities firms should not

automatically extend the jurisdiction of the self-regulatory agencies. Until it is specifically demonstrated to the Congress that non-securities activities of firms which are members of self-regulatory agencies should be limited or regulated in the public interest, such firms should be free to undertake and pursue these activities in the same matter as other business organizations, subject only to cost regulatory limitations necessary to assure protection of public investors and the public interest.[4]

The amended rule's requirement to review all registered representatives' incoming written correspondence will intrude on a substantial part of many salespersons' pure insurance business that is unrelated to securities sales or execution. This conflicts with the carefully constrained grant of SRO authority from Congress.

I. THE SEC'S APPROVAL OF AMENDMENTS TO NASD CONDUCT RULE 3010 VIOLATED THE ADMINISTRATIVE PROCEDURE ACT

Section 553(b)(3)[5] of the Administrative Procedure Act (the "APA") requires that federal agencies file a Federal Register notice of rulemaking that includes a meaningful explanation of the proposed rule or rule amendments. This threshold standard is fundamental to federal agency rulemaking and the core of the APA. Through this mechanism, interested parties can provide informed commentary and input to help shape initiatives in the most appropriate fashion. Absent this statutory requirement, rulemaking would occur in a nebulous vacuum.

Over the years since the APA has existed, the courts have frequently evaluated whether a final rule adopted by a federal agency is so different from the proposed rule published in the notice to necessitate a new period of notice and comment. In addressing this question, the courts have carefully examined whether the notice of proposed rulemaking fairly apprized interested parties with an opportunity to comment. [6] Courts have consistently overturned rules where the final rule departs radically form the proposed rule, or where there was an inadequate analysis of the economic impact of the rule or amendment.[7] Measured against these unambiguous judicial

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[4] S. Rep. No. 75, 94th Cong. 1st Sess. 27-28 (1975).

[5] 5 USC §553(b)(3) (1996).

[6] *See, Chocolate Mfrs. Assn. v. Block*, 755 F. 2d 1098 (1985) [rule invalid when proposal described in NPRM is replaced by a final rule that reaches a conclusion *exactly opposite* that proposed].

[7] *See, McCulloch Gas Processing Corp. v. Dept. of Energy*, 650 F.2d 1216 (1981)[rule invalid where no notice of major substantive modifications between the proposed rule and the rule as adopted]; *Accord, Natural Resources Defense Council, Inc. v. EPA*, 824 F.2d *(1987)*[rehearing ordered because provisions of final rule opposite proposal]; *American Medical Assn. v. United States*, 668 F. Supp. 1085 (1987); *American Frozen Food Institute v. Train*, 539 F. 2d 107 (1976); *Nat'l Black Media Coalition v. FCC*, 791 F.2d 1016 (1986)[when final rule not a "logical

standards, the SEC's accelerated approval of the NASD's amendments to Rule 3010 is defective under the APA. The rule's requirement to review all incoming written correspondence is *exactly opposite* what both the NASD and the SEC proposed for comment, as demonstrated in the chronological sequence below. Under the APA, the scope of proposed regulations simply cannot be revised in a more restrictive manner than in the proposed rulemaking without renoticing the proposal for comment. [8]

Due to the nature of their decentralized sales operations, many limited purpose broker/dealers cannot functionally comply with the amended rule. Amendment No.1 and the proposed NASD Notice to Members were only submitted to the SEC on December 4, 1997, and were never an issue on which comment could have been offered. For limited purpose broker/dealers that are not NYSE members, these changes are substantial, and will significantly burden operations unique to this segment of the broker/dealer industry.

The amended rule also introduces competitive constraints that were not considered by the SEC in its accelerated approval of Amendment No. 1 on December 31, 1997. While these regulatory changes are characterized as simply conforming NASD standards with New York Stock Exchange rules and interpretations, it should be carefully noted that many NASD broker/dealers are not NYSE members. The new changes exposed for the first time in the adoption release do more than simply reflect the continuation of preexisting NYSE practices. The new changes take a one-size-fits-all approach patterned after full service NYSE broker/dealers that could cause severe disruption for broker/dealers that are not NYSE members.[9]

As explained in the background above, limited purpose broker/dealers, such as those affiliated with life insurance companies, have structures and operations significantly different

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outgrowth" of NPRM, if the final rule deviates too sharply from the proposal, affected parties will be deprived of notice and an opportunity to respond to the proposal].

[8]*See, A Guide to Federal Agency Rulemaking* (U.S. Administrative Conference) at 121 ("variance between initial proposal in the NPRM and the final rule"). The Administrative Conference recommends a new notice of proposed rulemaking "whenever the provisions of the rule the agency plans to adopt are so different from the original proposal that the initial NPRM no longer fairly apprises (sic) the public of the issues to be resolved in the rulemaking." *Id.* at 122. *See also*, Comment, *the Need for an Additional Notice and Comment Period When Final Rules Differ Substantially from Interim Rules*, 1981 Duke L.J. 377 (1981); *Accord*, Verkuil, *Congressional Limitations on Judicial Review*, 57 Tulane L. Rev.733 (1983)at 758, Grunewald, *The NLRB's First Rulemaking: An Exercise in Pragmatism,* 1991 Duke L.J. 274 (1991) at 302 n.131.

[9]In several recent NASD actions, there has been a troubling pattern of initiatives being designed around the template of full service broker/dealers only. In part, this occurs because the NASD's substantive committees are largely served by wire house or full service firms that may not understand the unique, but appropriate, operations of limited purpose firms. The SEC's approval mechanisms should be exercised carefully in initiatives which may impair competition in favor of full service firms. Limited purpose broker/dealers employ over 50% of the NASD's population of registered representatives. In spite of these compelling statistics, NASDR failed to include the input of its committees knowledgeable about broker/dealers affiliated with life insurers.

from full service, wire-house broker/dealers. Amended Rule 3010, as interpreted in NTM 98-11, will have a disproportionate impact. The complete lack of opportunity to address these significant modifications that will burden competition is wrong. The hidden reversal of position is apparent in reviewing the evolution of the initiative in chronological sequence.

A. THE INITIATIVE FROM PROPOSAL TO ADOPTION: AN UNANNOUNCED REVERSAL OF POSITION

The SEC's accelerated approval of amendments to NASD Conduct Rule 3010 and NASD Notice to Members 98-11 reflect the *exact opposite* of both the SEC and the NASD proposals in several critical respects. This peculiar and unexplained reversal of positions is readily apparent upon examining the substance and explanation of the initiative at each sequence of its administrative evolution, summarized below.

1. NASD Notice to Members 96-82 (December, 1996) Soliciting Comment on Proposed Rules Governing Supervision, Review and Record Retention of Correspondence

In this action, the NASD carefully patterned amendments to conduct Rule 3010 after a New York Stock Exchange rule amendment that was "designed to recognize the growing use of electronic communications such as 'e-mail' while still providing for appropriate supervision."[10] According to the notice:

> "the NYSE's [then] current rules require firms to review all communications with the public relating to their business. For example, a registered representative's correspondence to a customer must be reviewed prior to being sent, and all incoming correspondence must be reviewed by the firm before it is given to the representative. Under the NYSE proposal, *prior review of all outgoing correspondence and review of all incoming correspondence would no longer be required.* Instead, firms would be allowed flexibility in developing procedures for review of such correspondence tailored to the nature and size of a firm's business and customers.[11]

In its notice, the NASD further stated:

- "The proposed amendments to NASD rules governing review of correspondence would similarly . . . *provide firms with flexibility in developing reasonable*

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[10]NASD Notice to Members 96-82 (December 1996) at 683.

[11]*Id.* at 683 [emphasis added].

procedures for the review of correspondence. The proposed approach is designed to be consistent with the one adopted by the NYSE."[12]

- "Consistent with the NYSE proposal, . . . [NASD] *firms would no longer be required to review each item of correspondence.* Instead, firms could use reasonable sampling techniques, such as random spot-checking."[13]

- "Amended Rule 3010(d)(2) would require each member to develop written procedures for review of incoming and outgoing correspondence *tailored to its structure and the nature and size of its business and customer base.*"[14]

Clearly, the emphasis in the NASD's Notice to Members 96-82 was to provide broker/dealers with flexibility in developing reasonable procedures for the review of correspondence. The Notice to Members is unequivocal that, like the NYSE proposal, review of all incoming correspondence would no longer be required. Instead, firms would be permitted to develop reasonable procedures under the circumstances taking into consideration the number, size and location of offices, the volume of overall communications, the range of activities conducted by salespeople, the nature and extent of training, and disciplinary histories of salespeople.

2. Exchange Act Release No. 38548 (April 25, 1997); Notice of Proposed NASD Rule Change Relating to Supervision and Record Retention Rules

In this Release, the SEC invited comment on the NASD's proposed change to Conduct Rule 3010. Like NASD Notice to Members 96-82, the SEC release emphasized the updating supervisory review requirements in the advent of electronic communications with customers. The SEC's release also notes that the NASD rule change was designed to parallel a New York Stock Exchange proposal in which *"prior review of all outgoing correspondence and review of all incoming correspondence would no longer be required."*[15] The SEC's release also noted that:

- "Instead, firms would be allowed flexibility in developing procedures for review of such correspondence tailored to the nature and size of a firm's business and customers."[16]

- "The NYSE's proposal would require firms to develop written procedures for review of communications with the public that are designed to provide reasonable

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[12] *Id.* at 684 [emphasis added].

[13] *Id.* at 684 [emphasis added].

[14] *Id.* at 685 [emphasis added].

[15] Release No. 34-38548 (April 25, 1997) 1997 SEC Lexis 917 at 3.

[16] *Id.* at 4.

supervision of each registered representative."[17]

- "In addition, any firm that does not conduct pre-use review of correspondence (whether electronic or manual) would be required to regularly educate and train employees about the organization's policies and procedures governing review of communications, documents with such education and training, and conduct surveillance to ensure compliance with such procedures."[18]

- "The NASD's proposed approach is designed to be consistent with the one proposed by the NYSE."[19]

- *"Under the proposal, review of each item of correspondence no longer will be required.* Instead firms could use reasonable sampling techniques, such as random spot-checking."[20]

- "While *the proposed rule does not require review of all correspondence*, any member that does not conduct electronic or manual pre-use review of each item of correspondence will be required to [educate, train, monitor and document the activities of its registered reps]."[21]

- "NASD regulation has determined to amend the rule as proposed in NTM 96-82 explicitly to require the review of incoming correspondence. The proposed rule *provides a firm with flexibility to develop procedures for the review of correspondence tailored to its structure and the nature of its business.* Also the proposed changes lessen the regulatory burden by *eliminating the requirement to review and endorse each piece of correspondence.*"[22]

- "NASD regulation believes that a review of incoming correspondence is a valuable method for early detection of problems and believes that [the] rule *provides insurance-affiliated members with the needed flexibility to devise appropriate procedures for reviewing correspondence.*"[23]

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[17]*Id.* at 4.

[18]*Id.* at 4.

[19]*Id.* at 4.

[20]*Id.* at 11 [emphasis added].

[21]*Id.* at 11 [emphasis added].

[22]Id. at 11 [emphasis added].

[23]*Id.* at 12 [emphasis added].

Again, the unequivocal substance and context of the SEC's invitation for comment on the NASD's proposed rule amendment clearly communicated that *all correspondence did not have to be reviewed.* The SEC explained the NASD's initiative as a flexible approach to design supervisory procedures that were appropriate under the unique circumstances of each broker/dealer

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3. Exchange Act Release No. 39510 (January 8, 1998); Order of Granting Accelerated Approval of Proposed NASD Rule Change Concerning Supervision and Record Retention Rules

The life insurance industry and their affiliated broker/dealers found the initial NASD and SEC initiatives noted above largely unobjectionable because they instituted reasonable procedures and introduced flexibility allowing the creation of custom tailored supervisory requirements that would be appropriate under the unique circumstances of each broker/dealer and its locations. In contrast, the SEC's accelerated approval order in Release No. 34-39510 was *exactly opposite* the positions unequivocally explained in the SEC and NASD proposals concerning the review of incoming correspondence. According to the release:

> The Commission notes that the [NASD] Notice to Members mandates that Rule 3010(d) will continue *to require review of all incoming non-electronic* correspondence directed to registered representatives.[24]

The release further explains in that footnote 18 that "the requirement to review all incoming non-electronic correspondence directed to registered representatives is *not specified in the text of the rule language.*" The release surprisingly indicates, however, that "the NASD's requirement is set forth only in its Notice to Members which was submitted by NASDR as an amendment to the original rule filing; therefore, NASD member firms must comply with this additional requirement."[25] This significant reversal of the substance and explanation of the proposed rule change approved by accelerated order was never an item on which interested parties could comment before the rule amendment and its interpretative notice to members were published and adopted by the SEC

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[24]Exchange Act Release No. 39510 (December 31, 1997) 63 Fed. Reg. 63 at 1133 [emphasis added].

[25]*Id.* at 1134 [emphasis added].

4. NASD Notice to Members 98-11 (January 1998) Noting SEC Approval of Rule Amendments Concerning Supervision, Review and Record Retention of Correspondence

This brief Notice to Members which contains a February 15, 1998 effectiveness date also states a position *exactly contrary* to that stated in Notice to Members 96-82 and the SEC's proposal on the rule amendments. According to NTM 98-11, "the current requirement in Rule 3010(d) to review all correspondence of registered representatives will be retained to require review of all incoming correspondence received in non-electronic format directed to registered representatives and related to a member's investment banking or securities business."[26] While the NASD largely recites a facts and circumstances approach for the review of electronic correspondence, the release completely contradicts the NASD's proposed position in NTM 96-82 concerning the review of incoming written correspondence.

NTM 98-11 also engages in revisionist history by suggesting that the review of all incoming sales literature is simply the continuation of the current requirement in Rule 3010(d) to review all incoming non-electronic correspondence of registered representatives. The unamended prior version of this rule states that broker/dealers must have "procedures for the review and endorsement by a registered principal in writing, on an internal record of all transactions and correspondence of its registered representatives pertaining to the solicitation or execution of any securities transaction." [27] Under an objective reading of this language, the rule was focused on *outgoing* registered representative correspondence involving securities transactions. Indeed, the NASD itself supports this interpretation. In its own *NASD Compliance Checklist*, the NASD highlights supervisory procedures under the prior (unamended) version of Rule 3010 and makes three separate references to review of *outgoing* correspondence.[28] There is nothing, however, in the compliance checklist to implicitly or explicitly suggest that all *incoming* correspondence must be reviewed.

Additionally, the NASD Notice to Members also establishes a new requirement outside the scope of the SEC and NASD proposals that would

> "prohibit registered representatives' and other employees' use of electronic correspondence to the public unless such communications are subject to supervisory and review procedures developed by the firm. For example, NASD regulation would expect members to prohibit correspondence with customers from employees' home computers or through third party systems unless the firm is capable of monitoring such communications."[29]

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[26]NASD Notice to Members 98-11 (January 1998) at 60.

[27]*Id.* at 61.

[28]*See*, NASD Compliance Checklist at 20-22 (1992).

[29]*Id.* at 61.

This newly enunciated position also appeared for the first time in NTM 98-11 without any prior notice or opportunity for comment. The legitimate use of electronic mail by insurance salespersons may be burdened because it occurs in a structure different from full service broker/dealers. The NASD did not evaluate competitive differences or burdens in this extension of the rule amendment. Further, the NASD's NTM is defective because it does not reflect a logical extension of the formal amendments approved by the SEC under the APA.

B. Other Administrative Procedure Issues

We challenge the procedural fairness and authority of an NASD Notice to Members that states a regulatory position going beyond the APA approved SRO rule from which it draws authority. The release acknowledges in footnote 18 that "the requirement to review all incoming non-electronic correspondence directed to registered representatives is not specified in the text of the rule language." Issuance of the release without input from limited purpose broker/dealers creates the untenable situation where broker/dealers fulfilling the literal substance of an SRO rule could be held in violation of an *informal* SRO interpretation that is more restrictive than the source SRO rule as *formally* approved under the APA. This is contrary to the spirit and purpose of the APA.

It was unorthodox under the APA for the SEC to request comment on Amendment No. 1 and the NASD NTM after the SEC has already granted accelerated approval. Further, the NASD Notice to Members was issued before the end of the comment period. Comments offered on a NASD proposal that was published before the end of the comment period appear superfluous. This raises additional questions under the APA, and regrettably tarnishes the validity of SEC administrative procedures. The rush to approve by accelerated order is troubling. There is no compelling justification for the short 21 day period inviting comment on actions the SEC has already approved in the amendment and NTM.[30]

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[30]By letter dated January 9, 1998, the ACLI submitted a request that the comment period be extended for 45 days to provide an opportunity for careful analysis and constructive comment on the proposal. The Commission failed to respond to this request. The 21-day comment period was insufficient to address the issues raised in the release. As a practical matter, most observers had significantly fewer than 21 days to digest the proposal after accounting for time consumed in postal delivery of the Federal Register following its January 8 printing date. As of the release's issue date, neither the SEC's internet web page nor the SEC Docket contain the release. These factors supported a reasonable extension to the comment period. Industry groups like our trade association circulate regulatory proposals, elicit membership input, develop a consensus, and circulate a draft letter of comment before submission. This is a worthwhile but time intensive process that is even more difficult to execute in less than 21 days.

Additional latitude beyond 21 days is provided in Section 19(b) of the Securities Exchange Act of 1934, which governs the Commission's review of self-regulatory rule proposals. Section 19(b)(2) provides that the Commission shall approve self-regulatory rule proposals or institute an administrative proceeding within 35 days of the publication notice date or "within such longer period as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents."

This initiative has been under consideration by the NASD since 1996 and under review by the SEC since April 1997. The release does not identify any emergencies or rapidly moving market developments associated with this regulatory matter.

II. The SEC's Accelerated Approval Conflicts with §15A(b)(6) of the Securities Exchange Act of 1934 by Fostering Anticompetitive Consequences

This 1934 Act provision requires the SEC to evaluate carefully the competitive impact of proposed SRO rules and amendments. The Securities Act Amendments of 1975 significantly expanded the SEC's oversight and regulatory powers concerning SRO rules, and specifically directed the SEC to carefully evaluate competitive factors in exercising its SRO oversight. Importantly, Congress did not intend to confer general antitrust immunity on SRO rulemaking that was subject to the SEC's oversight review.[31]

The antitrust immunity created by Congress contemplates active oversight by the SEC in executing its responsibilities to ensure consistency with the securities laws, and blunts the anticompetitive activity inherent in self regulatory conduct. Otherwise, a Congressional grant of substantial regulatory authority to private organizations without federal regulatory oversight would violate the constitutional prohibition against the delegation of legislative powers.

In order for SEC review to provide immunity for self regulatory conduct, the review must

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Under the circumstances and in view of the flexibility permitted under Section 19(b), a nominal 21 day comment period is unnecessarily short. The Commission itself expended a considerably longer period of time evaluating the NASD's proposed rule change after it was filed. In light of the modifications added to the proposal, industry commentators should be entitled to a reasonable, lengthened period of comment. The special time burdens confronting regulated industries and large organizations in digesting regulatory proposals were explicitly recognized by the Administrative Conference of the United States in its publication entitled *A Guide to Federal Agency Rulemaking* which observes:

> The 60-day period established by Executive Order 12044 for significant regulations (and no longer in effect unless adopted by agency rule) is a more reasonable *minimum* time for comment. However a longer time may be required if the agency is seeking information on particular subjects or counter-proposals from regulated industry. "Interested persons" often are large organizations and they need time to coordinate and approve an organizational response or to authorize expenditure of funds to do the research needed to produce informed comments. *See, A Guide to Federal Agency Rulemaking* (1983) at 124.

[31] *See*, Smythe, *Government Supervised Self-Regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation*, 62 N.C. L. Rev. 475 (1984) at 504 [the SEC has an obligation in reviewing SRO conduct to "weigh the competitive impact in reaching regulatory conclusions"].

be active, and must result in a ruling by the SEC that is judicially reviewable.[32] Section 25 of the 1934 Act states that the SEC's actual findings are conclusive if supported by substantial *evidence*, and that its decisions should be overturned only if "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law, the excess of statutory jurisdiction, authority, or limitations, or short of statutory right, or without observance of procedures required by law." The SEC's analysis of the amendments' competitive impact was not supported by substantial, or any, evidence.

The regulatory changes will have a significant negative impact on limited purpose broker/dealers that are not New York Stock Exchange members. Notwithstanding the release's assertion in footnote 13 that the Commission has considered the rule's impact on competition, the amended rule as approved by accelerated order will severely and unreasonably burden competition by requiring review of all incoming registered representative correspondence, as noted above.

How extensive is the competitive burden created by the NASD's failure to consider the impact of the amendments on limited purpose broker/dealers? Over half of all the registered representatives licensed by the NASD work for broker/dealers affiliated with life insurance companies. This degree of unnecessary disruption is unfounded.

There is no evidence that the SEC or the NASD considered these burdens on competition at all. As such, the SEC failed to fulfill the full mandate of its SRO oversight under the Exchange Act.

IV. CONCLUSION AND RECOMMENDATION

The NASD's amendment to Rule 3010, as interpreted in NTM 98-11 and explained in the release, is defective and disregards a significant segment of broker/dealers. The NASD's attempted application of amended Rule 3010 fosters anticompetitive consequences.

Several aspects of the SEC's accelerated approval of the NASD's Rule violate the Administrative Procedure Act. The final NASD rule and its accompanying Notice to Members include provisions exactly opposite the SEC and NASD proposals concerning the review of incoming written communications and other matters. There was no opportunity for comment on these significant deviations. The development of the Rule 3010 amendments in this fashion is discordant with the spirit and purpose of the APA.

In solution to the deficiencies discussed above, we strongly recommend the following actions:

- The SEC should immediately suspend its order approving the amendments to Rule 3010.
- The SEC and the NASD should immediately withdraw Notice to Members 98-11 until Rule 3010, as interpreted in NTM 98-11 and explained in the release, can be

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[32] *Id.*

- The SEC and the NASD should immediately withdraw Notice to Members 98-11 until Rule 3010, as interpreted in NTM 98-11 and explained in the release, can be properly revised under the APA to treat all segments of the broker/dealer industry even handedly, and to eliminate the anticompetitive impact of Rule 3010.[33]

- The NASD should issue a replacement Notice to Members that provides firms with *flexibility* in developing appropriate supervisory procedures to review incoming and outgoing customer correspondence.

- The NASD should make every effort to include representatives of insurance affiliated broker/dealers in all of its regulatory actions that have an impact on this segment of the industry.

We greatly appreciate your attention to our views. Thank you for your consideration

Sincerely,

Carl B. Wilkerson

Carl B. Wilkerson

CBW/pm

cc: Richard Lindsey, Director, SEC Division of Market Regulation
Robert L. D. Colby, Deputy Director, SEC Division of Market Regulation
Howard Kramer, Associate Director, SEC Division of Market Regulation
Katherine A. England, Assistant Director, SEC Division of Market Regulation
Elise B. Walter, NASDR Chief Operating Officer
Mary N. Revell, NASDR Associate General Counsel

[33] §201.430 of the SEC's Rules of Practice authorizes petitions for review of actions taken by the Commission pursuant to delegated authority. In addition to establishing standards for review procedure, this rule also provides a means to exhaust administrative remedies so that regulatory actions are ripe for judicial review. Although we reserve our options under rule 201.430 at this time, we hope the SEC and the NASD fully address our concerns under the release's invitation for comment.