



VOICE OF THE INDEPENDENT CONTRACTOR BROKER-DEALER

VIA ELECTRONIC MAIL

March 21, 2006

Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

RE: SEC File Number SR-NASD-2006-011

Dear Ms. Morris:

On April 14, 2005, the NASD issued Notice to Members 05-27<sup>1</sup> which proposed an amendment to NASD Conduct Rule 2211. In response to industry comment, the NASD amended the proposed rule change and submitted it to the SEC for approval. If adopted, the amended rule would require pre-use principal approval of all non-clerical correspondence sent by an NASD member to twenty-five or more existing customers within a thirty calendar day period.<sup>2</sup> The SEC has now published a notice to solicit comments on the NASD's amended proposed rule change.<sup>3</sup> The Financial Services Institute<sup>4</sup> (FSI) appreciates this opportunity to comment on the NASD's proposal.

FSI supports the NASD's continuing efforts to enhance investor protection, insure market integrity, and instill within investors confidence that the advice they receive is fair and unbiased. FSI acknowledges the NASD's concerns that some members may use correspondence improperly to avoid compliance with the pre-use approval requirements of Rule 2210 that apply to advertising or sales literature. Nevertheless, FSI believes the NASD needs to document more clearly the pervasiveness of the perceived problem and the actual, realistic costs associated with their proposal. FSI is also concerned that the proposal will serve as an unjustified sanction of all NASD member firms for the wrongdoing of a few. Further, the proposal will interfere with member firms' ability to allocate their compliance resources efficiently. Finally, FSI believes that the proposed rule will damage financial advisor-client relationships by significantly limiting or entirely curtailing e-mail, and other communications, with investors. As a result, FSI urges the SEC not to approve the proposed NASD rule amendment.

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<sup>1</sup> See NtM 05-27 at [http://www.nasd.com/web/idcplg?ldcService=SS\\_GET\\_PAGE&ssDocName=NASDW\\_013813](http://www.nasd.com/web/idcplg?ldcService=SS_GET_PAGE&ssDocName=NASDW_013813).

<sup>2</sup> "Correspondence" includes e-mail and instant messaging communications, as well as more traditional forms of correspondence.

<sup>3</sup> Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Principal Pre-Use Approval of Member Correspondence to 25 or More Existing Retail Customers Within a 30 Calendar-Day Period, 71 Fed. Reg. 10090 (February 28, 2006).

<sup>4</sup> The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisors, and their independent contractor registered representatives. FSI has 100 member firms, with more than 124,000 registered representatives and over \$8.3 billion in total revenues. FSI also has more than 2,900 individual members.

### Background on FSI Members

The proposed interpretive guidance is of particular interest to FSI and its members. Our independent broker-dealer (IBD) members have a number of similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products by “check and application”; take a comprehensive approach to their clients’ financial goals and objectives; offer primarily packaged products such as mutual funds and variable insurance products; and provide investment advisory services through either affiliated registered investment advisor firms or such firms owned by their registered representatives.

Our registered representative members are independent contractors, rather than employees of the IBD firms. These financial advisors are typically located in communities where they know their clients personally and provide them investment advice in face-to-face meetings – often times over the client’s kitchen table. Most of their new clients come through referrals from existing clients or other centers of influence. Due to their close ties to the community in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients’ investment objectives their primary goal.

If adopted, this amendment to NASD Conduct Rule 2211 would harm IBDs, affiliated financial advisors and their clients by:

- Consuming resources that otherwise would be used by IBDs to improve customer service, develop innovative solutions to investor needs, or facilitate efforts to operate more effectively and efficiently.
- Punishing all IBDs for the bad acts of a few NASD member firms.
- Interfering with IBDs’ ability to allocate their compliance resources in the most efficient and effective manner possible.
- Interfering unnecessarily with the financial advisors’ ability to communicate with their clients in an effective and efficient manner.

Because of these concerns, FSI cannot support the proposed amendment to NASD Conduct Rule 2211.

### Detailed Comments

1. NASD Failed to Provide Sufficient Justification for the Rule Amendment – FSI believes that regulatory provisions that require the adoption of costly policies and procedures must be rigorously supported by the information, analysis, and assumptions that underpin them. The NASD states in NtM 05-27, and its SEC filing, that the proposed rule is needed because the NASD has found “some member correspondence” to multiple existing customers that raises the same sorts of issues as member advertisements and sales literature. The NASD states that in some cases correspondence that had already been sent to customers required substantial revisions. In certain cases, the NASD explains that it took informal disciplinary action against the member that distributed the correspondence. However, the NASD does not provide any statistics to document the pervasiveness of the problem that would justify the cost and additional manpower demands on members that will accrue from the adoption of the proposed rule. The NASD’s own acknowledgement that it uncovered correspondence that did not meet the applicable NASD and SEC advertising standards and took disciplinary action against the member that distributed the correspondence demonstrates that the current regulatory system sufficiently governs this activity. The NASD’s assertion that “many firms already

require registered principal pre-use approval of...correspondence”<sup>5</sup> is unsupported by NtM 05-27 or the release. The NASD has apparently reached this conclusion during the brief twenty-one month period<sup>6</sup> from the time of the announcement of the current correspondence review requirements in NtM 03-38<sup>7</sup> to the publication of the current proposal in NtM 05-27. However, many of our members do not currently require principal pre-use approval of e-mail or other correspondence. Our members do not have networked e-mail systems to which all of their financial advisors must subscribe. As IBDs, our members permit their financial advisors to use their personal computers to send e-mail and to select their individual Internet service provider. Financial advisors send copies of e-mail to the broker-dealer for an after-the-fact principal review consistent with Rule 3010(d). As a result, the NASD’s statement that it “does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate”<sup>8</sup> is inaccurate when applied to IBD firms. The assertion also rings hollow with our members in light of the fact that they are currently under siege from new regulations, regulatory sweeps, and massive document requests from the NASD and SEC.<sup>9</sup> Based on the foregoing, FSI believes the NASD has not provided sufficient justification for approval of the proposed rule. Therefore, FSI cannot support the NASD’s attempt to impose a new layer of costly regulation over an already existing regulatory framework that has been shown to be effective in detecting and preventing abuse.

2. Proposal Punishes All Member Firms for the Bad Acts of a Few – FSI believes that the fact that the NASD discovered some member correspondence that did not meet regulatory standards and, thereafter, took disciplinary against the member indicates clearly that the system is working. In other words, NASD Conduct Rule 3110(d) is being used effectively by the NASD to protect investors from improper correspondence, even without principal pre-use approval. Unfortunately, the NASD now proposes to replace this effective regulatory scheme with a new rule that treats all members as if they are engaged in inappropriate conduct by requiring them to engage in the pre-use principal approval of non-clerical correspondence sent by a member to twenty-five or more existing customers within a thirty calendar day period. Instead, the NASD should apply the correspondence review requirements as a sanction on those members who have been found by the NASD to allow the use of correspondence that does not meet the applicable NASD standards. The pre-use approval requirement should apply to these violators for some reasonable period (e.g., twelve months) and then terminate. If the NASD finds evidence that the firm has again sent correspondence that fails to meet applicable advertising rules, it should then impose more severe sanctions. FSI believes that this approach would impose the burdens of pre-use approval on those firms who have demonstrated a need for more careful scrutiny while allowing other firms to operate without interference. As a result, FSI urges the SEC not to approve the proposed rule.
3. Proposal Interferes with Member’s Ability to Allocate Compliance Resources Efficiently – FSI believes that regulators should limit the unintended consequences of proposed regulation and allow market participants to direct their resources efficiently. In this case, the NASD’s rule proposal seeks to insert a mandate calling all members to dedicate significant assets to the review of correspondence that may or may not be a significant compliance concern for individual member firms. This proposal will likely result in NASD

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<sup>5</sup> Fed. Reg., *supra* note 3, at 10091.

<sup>6</sup> NtM 03-38 was posted to the NASD web site on 07/07/03. NtM 05-27 was posted on 04/13/05.

<sup>7</sup> See NtM 03-38 at [http://www.nasd.com/web/idcplg?ldcService=SS\\_GET\\_PAGE&ssDocName=NASDW\\_003230](http://www.nasd.com/web/idcplg?ldcService=SS_GET_PAGE&ssDocName=NASDW_003230). It is interesting to note that the NASD concluded at that time that “Rule 3010(d) provides the most effective means of supervising form letters and group e-mails sent to existing and a limited number of prospective retail customers.”

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

<sup>9</sup> See the SIA’s “The Costs of Compliance In the U.S. Securities Industry Survey Report” at <http://www.sia.com/surveys/pdf/CostofComplianceSurveyReport.pdf>.

member firms adopting one of three approaches: (a) performing pre-use principal review of correspondence with existing staff, thus distracting them from other compliance tasks or resulting in the delay of important client communications, (b) hiring staff sufficient to perform pre-use principal review of correspondence in a timely manner and thus draining assets that could be directed by the member firm to areas of greater compliance concern, or (c) prohibiting forms of correspondence that meet the threshold requirements for pre-use approval, thus depriving clients of a convenient method of timely communication. None of these scenarios is desirable. As a result, FSI cannot support the amended rule proposal.

4. Proposal Unnecessarily Interferes with Customer Relationships – FSI believes that timely communication is essential to inspiring trust between financial advisors and their clients and providing quality customer service to investors. The NASD’s proposal would require pre-use approval of all non-clerical outgoing correspondence, including e-mail, that meets the threshold criteria. Many of our members have not previously required pre-approval of e-mail. This is primarily because most of our members do not have networked e-mail systems. Many IBDs permit their registered representatives to use their own e-mail account and ISP and simply provide copies of e-mail sent to customers or prospective customers after the fact. Therefore, this proposal will delay a financial advisor’s ability to communicate critical information to his clients in a timely manner. We believe that investors will not understand why, especially during periods of market instability or at times when investors want information quickly to help them make a time sensitive decision, they cannot receive helpful e-mail communications from their financial advisor immediately. More problematic is the fact that our members will likely curtail entirely the use by registered representatives of e-mail rather than expend the sums necessary to create systems that will enable them to comply with the NASD’s proposal. It seems incongruous that the NASD would implement rule proposals that will discourage electronic communications in an era when technological advances in computing and data transmission are evolving rapidly and virtually everyone has some type of device that will send and receive e-mail. This interference with customer relationships is unjustified.

We wish to express our gratitude for your consideration of our comments and to assure the Commission and the NASD of our support for comprehensive and effective broker-dealer compliance programs.

Again, thank you for the opportunity to comment on the proposed rule. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,



Dale E. Brown, CAE  
Executive Director & CEO