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AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

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December 23,2003

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
Room 6507
450 Fifth Street, N.W.
Washington, D.C. 20549

By e-mail

RE: Substantive submission and request for comment period extension on Release No. 34-48897; File No. SR-NASD-2003-104; *Proposed **NASD** definition of broker-dealer "branch office."*

Dear Mr. Katz:

The American Council of Life Insurers respectfully requests that the comment period on Release No. 34-48897 be extended for 75 days to provide an opportunity for careful analysis and constructive comment on the NASD proposal. The Release invited comment on proposed changes to the NASD definition of broker-dealer "branch office," and appeared in the Federal Register Vol. 68 No. 241 on December 16,2003, and contains a 21-day comment period expiring January 6, 2004.

The American Council of Life Insurers ("ACLI") is a national trade association with 399 members representing 72 percent of all United States life insurance companies. Many of our member companies offer and distribute variable annuities, variable life insurance and mutual funds directly or through affiliated and independent broker-dealers. Our member companies and their broker-dealer affiliates have concerns with the NASD's proposed revisions to the "branch office" definition. The initiative would have a significant, unique impact on our industry.

SEC oversight of SRO rule proposals ensures balanced regulations in the public interest, and provides an important protection against SRO rules that may impede competition. The full execution of SEC oversight and public comment is fundamental to sound rulemaking and robust Competition. We have actively addressed the scope of the "branch office" definition since 1989 with the NASD, and since 1993 with the North American Securities Administrators Association.

Brief Background

- Over 50% of the 662,311 NASD registered representatives work for broker-dealers affiliated with life insurance companies. Many of these salespersons work out of smaller, geographically

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dispersed "non-branch" locations pursuant to existing NASD rules. Insurance affiliated broker-dealers have constructed their structure and operations based on the NASD's current branch office definition.

The proposed rule change would replace the current function-based threshold in the NASD's branch office definition with a strictly numerical yardstick of salespersons per office. While this approach may not present issues for full service broker-dealers, it provokes significant financial and structural impediments to limited purpose broker-dealers. The proposed rule's burden on this large segment of the NASD universe has been disregarded. Disparities in the rule's impact may have profound anti-competitive consequences.

Timing Considerations

Several time-related considerations warrant extension of the comment period. The proposed rule changes are significant and have been evolving since 1993 in several different proposals. The proposal amendments merit thorough discussion and analysis. Procedurally, several aspects of the proposal raise significant concerns under the Administrative Procedure Act. Additionally, the proposal will have an anticompetitive impact on limited purpose broker-dealers.

The 21-day comment period is insufficient to address the issues raised in the release. As a practical matter, most observers will have significantly fewer than 21 days to digest the proposal after accounting for time consumed in postal delivery of the Federal Register following its December 16, 2003, printing date. Moreover, some of the changes and cost considerations appeared for the first time in the release, and will require substantial time to analyze.

Most significantly, the 21-day comment period occurs over the last two weeks of 2003 and the first week of 2004, a time period when many businesses are closed and individuals are out of the office. Consequently, the already unacceptably brief comment period is rendered nearly meaningless.

Industry trade associations 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 difficult to execute in 21 days.

The NASD itself spent over 13 months (approximately 400 days) analyzing and revising the proposal after the October 21, 2002 comment period ended. In light of this lengthy time period for **NASD** review of the proposal, industry commentators should be entitled to a reasonable comment period longer than 21 days. The SEC staff itself has been reviewing the **NASD** filing since July 1, 2003, when the NASD initially submitted its proposal for SEC approval. Given these lengthy periods for NASD and SEC review, a 75-day extension to the comment period is quite reasonable.

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 infomiation 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.'

A meaningful comment period on the NASD's proposed rulemaking is important. The 21-day comment period is dysfunctional on several levels. The NASD filing indicates that over 137 letters of comment were filed on the NASD's circulation to its members that raised a variety of concerns. Not all of the concerns were addressed in the NASD filing and digest of comments. Some were ignored completely. A 21-day comment period during the peak of the holiday season is inadequate to flesh out the NASD's responsiveness to the letters of comment.

The NASD's internal rulemaking process does not reflect the makeup of the NASD's membership, because full-service broker-dealers dominate the NASD governance and committee structure. Some limited-purpose broker-dealers, therefore, question the fairness of internal NASD rule proposals, and instead rely on trade association representatives to voice objections during the SEC approval process. This role cannot be reasonably conducted during a 21-day comment period.

Anti-Competitive Consequences

Several aspects of the rule amendment would impose unreasonable burdens on competition. The NASD requires broker-dealers to submit a filing fee for all "branch offices." The proposed rule would elevate most current "non-branch" locations to "branch offices," that would trigger NASD filing fees. Broker-dealers affiliated with life insurers tend to have numerous "non-branch" locations and will face significant added NASD filing fees and structural burdens as a consequence. In contrast, full-service broker-dealers predominately operate out of branch offices rather than "non-branch" locations.

Several commentators suggested that the NASD reduce its registration fees so that the rule change is revenue neutral, and its financial burden on broker-dealers is minimized. The release and the NASD's filing failed to respond to these comments completely. Nothing in the release quantifies how many of the "non-branch" locations will be converted to branch offices with filing fee requirements.

Incredibly, the NASD asserts that the "it does not believe the proposed rule change, as amended, would result in ***any*** burden on competition that is not necessary or appropriate in furtherance of the" Securities Exchange Act of 1934. The Exchange Act demands more than hollow, unsubstantiated proclamations.

When it amended the Exchange Act in 1975, Congress specifically charged the SEC with the responsibility to evaluate competitive burdens of SRO rules and rule changes. The Senate report on the legislation stated that:

> Sections 6(b)(8), 19(b) and 19(c) of the Exchange Act would obligate the Commission to review existing and proposed rules of the self-regulatory organizations and to abrogate any present rule, or to disapprove any proposed rule, having the effect of a competitive restraint it finds to be neither necessary nor appropriate in furtherance of a legitimate regulatory objective.*

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[1] ***See, A Guide to Federal Agency Rulemaking,*** Administrative Conference of the United **States** (1983) at 124 [revised and republished in 19901.

[2] S. Rep. 94, 94th Cong., 1st Sess. **(April 14, *1975)*** at 12.

Section 23(a) of the Exchange Act was also added in 1975, and requires the SEC to consider the anti-competitive effects of rule changes, and to balance any impact against the regulatory benefit to be obtained.[3] Similarly, Sections 15A(b)(6) and (9) of the 1934 Act require 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.[4]

The antitrust immunity created by Congress contemplates active oversight by the SEC in executing its responsibilities to ensure consistency with the securities laws, and to blunt the anticompetitive behavior 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 be active, and must result in a ruling by the SEC that is judicially reviewable.[5] 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 proposed rule amendments fail the statutory safeguards to competition set forth above.

In a different context, former SEC Chairman Levitt emphasized the importance of reviewing the impact of rulemaking on competition when he stated:

> In response to the National Securities Markets Improvement Act of 1996 (NSMIA), the Commission has rededicated itself to considering how rules affect competition, efficiency, and capital formation as part of its public interest determination. Accordingly, the Commission intends to focus increased attention on these issues when it considers rulemaking initiatives. In addition, the Commission measures the benefits of proposed rules against possible anti-competitive effects, as required by the Exchange Act.[6]

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[3] *Id.* at 12.

[4] *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''].

[5] *Id.*

[6] *See* testimony of Arthur Levitt, SEC Chairman, concerning appropriations for fiscal year 1998 before the Subcommittee on Commerce, Justice, and State, the Judiciary, and Related Agencies of the House Committee on Appropriations (Mar 14, 1997), which appears at http://www.sec.gov/news/testimony/testarchive/1997/tsty0497.txt

The NASD's rule request for SRO rule approval does not fulfill the important SEC and statutory goals to protect ***both*** competition and investors. The NASD should fully quantify the economic impact the proposed amendments impose on broker-dealers affiliated with life insurers that have distribution through "non-branch" locations. The aggregate number of changed locations and new filing fees should be clearly stated and balanced against the amendments' purpose. The SEC should not approve the NASD initiative without modifications to remedy the rules' anticompetitive impact.

Other Issues Raised by the Proposal

There are several additional reasons that a comment extension should be granted in this instance.

- The 21-day comment period is excessively short, and occurs during the peak of the year-end holiday season. Absent an extended comment period, the proposal amounts to stealth regulation.

- The release does not identify any emergencies or rapidly moving market developments associated with this regulatory matter. The subject of the initiative has been under consideration by NASAA and the NASD for many years in various stages. In light of the slow pace at which the matter has already proceeded, an extension of the brief 21-day comment period for 75days is reasonable.

- In the definition of "branch office," the new changes implement a one-size-fits-all approach patterned after fill-service NYSE broker-dealers that could cause unnecessary disruption for broker-dealers that are not NYSE members or full-service broker-dealers. The rule changes would have a greater total impact on smaller broker-dealers compared to larger full service broker-dealers.

- Release No. 34-48897 seeks "commentators' specific views on the primary residence exception and the divergent proposals by the NASD and the NYSE's proposed annual 50-business day limitation on engaging in securities activities from a primary residence." A 21-day comment period during the peak of the year-end holiday season is insufficient to address these important questions.

- The genesis of the amendments occurred in proposals over the years that were designed to give state securities commissions new or better inspection tools. In most states, variable insurance products are excluded from the definition of "security" and are, therefore, outside the scope of state securities regulation. The substantial expense and burden of the proposed amendments are not justified for limited purpose broker-dealers whose securities activities are limited to variable products excluded from state securities regulation. In addition, NASAA has not demonstrated its inability to gain efficient access to broker-dealer records.

- The regulatory changes will have a significant negative impact on limited purpose broker-dealers, such as those affiliated with life insurance companies, and would unreasonably burden competition.

Conclusion

An extended comment period will not unduly lengthen this regulatory matter, and will foster constructive, thoughtful input on the issues raised by the Commission. For these reasons, we respectfully request that the Commission extend the comment period on Release No. 34-48897 for a

longer period as permitted under the APA. The regulatory process and the public interest will be better served by a deliberative, not rushed, review of the NASD's rule amendments. These regulatory modifications are too important to miss full exposure to public scrutiny.

We greatly appreciate your attention to our concerns. If any questions develop, please call.

Sincerely,

Carl B. Wilkerson

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cc: William H. Donaldson, Chairman
Paul Atkins, Commissioner
Cynthia A. Glassman, Commissioner
Harvey Goldschmid, Commissioner
Roel Campos, Commissioner
Annette L. Nazareth, Director, SEC Division of Market Regulation
Robert L. D. Colby, Deputy Director, SEC Division of Market Regulation

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The proposed rule change would replace the current function-based threshold in the NASD's branch office definition with a strictly numerical yardstick of salespersons per office. While this approach may not present issues for full service broker-dealers, it provokes significant financial and structural impediments to limited purpose broker-dealers. The proposed rule's burden on this large segment of the NASD universe has been disregarded. Disparities in the rule's impact may have profound anti-competitive consequences.

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insurers tend to have numerous "non-branch" locations and will face significant added NASD filing fees and structural burdens as a consequence. In contrast, full-service broker-dealers predominately operate out of branch offices rather than "non-branch" locations.

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cc: William H. Donaldson, Chairman
Paul Atkins, Commissioner
Cynthia **A.** Glassman, Commissioner
Harvey Goldschmid, Commissioner
Roel Campos, Commissioner
Annette L. Nazareth, Director, SEC Division of Market Regulation
Robert L. D. Colby, Deputy Director, SEC Division of Market Regulation