

May 20, 2005

Ms. Barbara Z. Sweeney  
Office of the Corporate Secretary  
NASD  
1735 K Street, N.W.  
Washington, DC 20006-1500

Re: New Products Sales Material and Television, Video and Radio Advertisements

Dear Ms. Sweeney:

Harrisdirect LLC (“Harrisdirect”) is submitting this comment letter in response to NASD Notice to Members 05-25 (April 2005), which proposes to require pre-use filing of advertisements and sales literature for new products and for television, radio and Web site video (and similar advertising). Harrisdirect has been active in working with the NASD to facilitate e-commerce and other initiatives in a manner consistent with the NASD’s regulatory mandate and appreciates the opportunity to comment on this proposal.

We understand the NASD is seeking to prevent or forestall certain member firm marketing practices and to enhance its regulatory oversight of member firm advertising and sales literature of new products and mass marketing. Its simple solution is to require that member firms file all such advertising and sales literature with the NASD for comment and obtain NASD permission before publication. We strongly oppose such pre-use filing and review processes for seasoned firms, primarily because they impose significant and unjustified burdens on both member firms and the NASD staff and less drastic alternatives are available.

The following summarizes some of our reasons for objecting to the proposal, and we conclude with alternatives that would still address regulatory concerns.

**Pre-Use Filing Unnecessary for Most Firms.** We oppose pre-use filing and approval of new product advertising and TV, radio or Web video for all member firms, particularly seasoned firms, as contrary to sound regulatory policy and principles of self-regulation. Pre-use filing requirements and pre-use “approvals” for advertising are time-consuming, costly and unnecessary for most member firms.

Consistent with the concept of self-regulation is the obligation of member firms to take initial responsibility for compliance with SEC and SRO rules. Most firms are aware of their regulatory responsibilities when proposing or offering new products and have marketing principals and legal and compliance professionals who are responsible for monitoring compliance with NASD advertising rules.

In this regard, the NASD already has provided substantial guidance to member firms to help in meeting compliance expectations. NASD (and SEC) advertising rules include general and specific standards for firms to follow and apply to all new products and mass marketing campaigns. Those rules also prohibit fraud or misleading statements in any advertising. The NASD recently has issued several Notices to Members that address member firm advertising and promotional material requirements involving traditional products (such as mutual funds/variable annuities), hedge funds, non-conventional investments and other new products.<sup>1</sup> The NASD also has issued a series of guidelines that remind member firms in how they should meet product-related compliance issues, covering topics such as appropriate sales practice, disclosure, due diligence, suitability, supervision, training, risk management, internal controls, and best practices.<sup>2</sup>

We believe the overwhelming majority of member firms are, or at least should be, able to follow these guidelines and craft appropriate advertising and related sales practices for new products and other forms of mass TV, radio and Web advertising without a new pre-use filing requirement.

**Inadequate Justification.** The reasons cited in NASD NtM 05-25 fall way short of justifying the need for a dramatic shift in NASD regulation, *i.e.*, through pre-use filing and approval of all member firm new product and mass media advertising. For new products, the only reasons cited are to provide the NASD with some advance notice of new products being sold by member firms generally, and to provide the staff some comfort that firms are considering significant compliance issues under NASD advertising rules. Imposing a pre-use filing requirement for new products on all member firms just to alert the NASD staff on breaking developments is not a reasonable justification for the proposal. As noted above, the NASD recently has reminded member firms in several ways of the range of compliance issues firms should consider when selling new products.

The justification cited for requiring pre-use filing of TV or mass media advertising involves examples, over “several” years old, of one or more day trading and electronic brokerage firms that presented unspecified “regulatory concerns.” We understand that, in these examples, focus group studies of investors at the time indicated that they were not misled by any such advertising. The NASD does not cite to any cases finding fraud or misleading statements in a member firm ad that caused injury to investors who relied on such statements. Using the broad net of pre-use filing to prevent ads that may contain possible objectionable statements, while taxing member firms and the NASD staff, is clearly excessive. Most firms engage in relatively “plain vanilla” advertising, and are not seeking to push the envelope with inappropriate

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<sup>1</sup> See NASD Notices to Members 05-26 (Apr. 2005); 03-71 (Nov. 2003); 03-07 (Feb. 2003); and 99-35 (May 1999).

<sup>2</sup> See *Id.* See also, NASD Notices to Members 05-18 (Mar. 2005); 04-71 (Oct. 2004); 03-29 (June 2003); 01-23 (Apr. 2001); 00-44 (July 2000); 99-92 (Nov. 1999); and 96-86 (Dec. 1996).

humorous or member firm comparison advertising and should not be penalized by the few who may try a novel approach.

We also believe the NASD's justifications for the proposal falls well short of constitutional standards which the NASD should strive to adhere to regardless of its quasi-governmental status. In this regard, new NASD rules that propose to impose significant restrictions on protected commercial speech should, at a minimum, be narrowly designed to address a substantial interest, such as clear pattern of fraud or significant examples of abuse across the membership, and where less drastic means are not available. Imposing pre-use filing restrictions on broadcast advertisements of all member firms (the vast majority of which are truthful and not misleading) with the hope of finding some potentially misleading advertisement is not justifiable. Subjecting all member firm ads to pre-use filing and approval based on several years old day trading or electronic firm ads, none of which were found to be fraudulent or misleading, fails any test that the proposals are narrowly tailored to address identifiable regulatory concerns or member firm abuses.

**Pre-Use Filing Magnifies Production Costs and Impedes Prompt Investor Education.** The NASD proposal does not appear to consider member firm costs and other commitments in launching new advertising, especially in the absence of a clear regulatory need or benefit. TV, radio and Web video are expensive endeavors; some ads can run into millions of dollars. Member firms and their marketing consultants devote substantial time and expense over a long period of time to launch a marketing campaign. The process can involve inside and outside marketing experts, focus group surveys, and tight scheduling of actors, writers, producers, editors, camera crews and support personnel. As TV or video ads approach a filming stage, firms are committed to paying for a large crew and tight scheduling to finalize the advertising. Injecting NASD staff comments at this stage could subject firms to significant cost overruns, delays and other expense. Also, due to market developments and/or creative marketing ideas, many of these advertising campaigns must be adjusted last minute, which could require a second submission to the NASD staff for approval of last minute changes. As noted, member firms currently rely on experienced marketing, legal and compliance personnel to craft appropriate ads and approve final changes.

We also are concerned that the proposed regulations would result in a great disservice to member firms and to investors. Many firms, including ours, develop TV, radio and/or Web site video in response to fast moving markets, economic developments or competing services. Several studies show a strong correlation between message awareness and the performance of the market. To provide information that will help our customers assess the market, we need to ensure our messages are relevant to what is happening now. An estimated 88% of our trading volume is equity based, which is highly responsive to daily market movement. Maintaining investor confidence is an important theme in member firm advertising. While we hope it will never happen again, the 9/11 attacks left many customers concerned about the safety of their savings. Many financial institutions responded by producing advertising overnight that reassured our customers and provided information to facilitate the flow of information. The current environment forces us to make the assumption that some outside disruption impacting the

markets will eventually happen. At times like these, people turn to the media for information.

Therefore, in response to a another possible "9-11" situation, firms may need to broadly advertise to customers quickly about their investments and alternatives. Even in today's markets when the Dow falls 500-1000 points in a week, firms may want to reach out to many investors publicly on short notice (including customers using a Web video). A pre-use filing and approval process would likely deter firms from providing useful information to investors because the information would be stale by the time an approval process is complete. Firms also need to offer suitable products (including new products) to investors, and existing products to new classes of investors, in response to changing markets, investment objectives or customer profiles, without NASD filing and approval delays. Therefore, a pre-use filing requirement can actually result in a real disadvantage or harm to customers and investors.

**Terms Subject to Inconsistent Use and Application.** We agree with questions raised in NtM 05-25 that there may be interpretation difficulties as to what constitutes a "new product" not previously sold by the member firm. Similarly, we would oppose any NASD pre-use filing process before offering securities previously sold to one class of investors to any new "class of investors." Investor classes can differ based on internal firm policies and categories of customer profiles, objectives, account types or assets, and firms should not need permission before selling securities to the multitude of investor definitions or classes in SEC, NASD, CFTC, NFA and other regulatory schemes. Both terms will subject firms to interpretive problems in deciding how or what to market and to whom.

Lack of clarity in both issues also may raise competitive issues; one member firm may decide to launch a new product or expand to other clients while another firm may feel compelled to file with the NASD. For example, one firm may view authority to sell private placements to include all Reg. D equity or debt offerings, hedge fund or other limited partnership interests, DPP securities, 1031 exchanges, etc.; whereas, another firm may seek approval for each specific product.

We also believe a "15-second" cut off provides no benefit for most useful TV advertising. Some firms will play games with the exemption, but our concerns above demonstrate that pre-use filing requirements are not appropriate or necessary for most firms, even for longer ads. Also, we believe a 90-day post-use filing time period for new products is too long for seasoned firms.

**Burdens on NASD Staff Resources.** We believe a rule that would require NASD staff pre-screening of all member firm new product advertising and TV, radio and Web site video would place an enormous strain on the budget, resources and staffing at the NASD. Our concerns are real. Currently, our experience is that it may take the NASD staff five days to approve a standard mutual fund ad for print. It may take an additional three to five days to revise the ad for resubmission. A ten-day lag can result under current NASD staffing for ordinary advertising. If the NASD were to add on top of this a pre-use filing requirement for all member firm advertisements for new products and mass marketing (which may require greater staff time to evaluate), the NASD simply will not be able to provide effective or timely input without more than doubling its staff and resources to keep pace. The online medium, in particular, moves very

quickly and the prevalence of blogs and constantly updated news means issues can reach critical mass in a matter of hours or days. The delay of five to ten days for video information on the Web site does not allow us to quickly address any topical issues that may come up.

**Subjective, Merit Review.** Finally, we believe the proposal will require the NASD staff to engage in a merit review and approval process under SEC and NASD rules. To the extent an ad's tone or presentation is not covered specifically by a rule or guideline, the NASD staff will necessarily need to make subjective judgments between or among member firms and their competitive marketing choices. We believe the NASD staff should not be in this position; rather, it is better for the NASD to step in on a post-use basis as an independent arbitrator.

Moreover, notwithstanding any disclaimer the NASD may seek to include as part of the pre-use filing process, any firm airing an advertisement pre-filed with the NASD, and thereafter obtaining NASD permission to publish the ad, can legitimately say that the ad had been reviewed and approved by the NASD. The general public will come to know that firms may not advertise on TV or radio without NASD permission and will assume the NASD would not permit the ad unless it complied with applicable rules. There simply is no way to avoid direct NASD responsibility and liability for all mass market advertising by its membership, and the NASD will bear the brunt of all investor and member firm complaints about any published TV, radio or Web video ad. We note that the NASD, possibly for similar reasons, abandoned proposals to pre-file Investment Analysis Tools with the NASD.

**Regulatory Alternatives.** There are several alternatives that we believe will achieve the objectives sought by the NASD and are more appropriate from a cost/benefit analysis. As mentioned, we believe the NASD should place initial responsibility on member firms for advertising compliance. The NASD has detailed advertising rules, and has issued a series of guidelines and other interpretations on related compliance topics that firms should be able to follow. If the NASD still finds firms have difficulty in complying, it can deal with such firms on a case-by-case basis. We also encourage the NASD to continue to issue guidelines and other interpretations about new products or other advertising practices that will help internal compliance and legal personnel meet NASD and industry expectations. To the extent firms want NASD guidance for expensive launch products or advertisements, the NASD can make it known that firms can still file such material voluntarily. This approach would enable firms and the NASD to experiment with or factor in an NASD comment process, while giving NASD staff further experience in this area without having to double its resources to meet expected demand. The NASD can still review all member firm advertising on a post-use basis, which would not interfere with member firm marketing efforts during their production stages.

If the NASD has concerns about new firms getting into business lines or products that may require greater SRO oversight, the NASD is able to place restrictions on such expansion in new member Membership Agreements. When the NASD has experienced problems with specific firms and for which NASD input is necessary, it has been able to do so effectively.

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In sum, we strongly disagree with any proposal requiring any existing member firm to file and obtain advance NASD approval for new product or TV, radio or Web video advertisements or sales literature. The NASD has provided no reasonable justification for such an expansion of regulation of member firm commercial speech. The proposal provides no cost/benefit rationale to address a need, but would tax member firm and NASD resources and place the NASD in the position of giving its subjective seal of approval to all member firm mass media advertising. We recommend the use of clearly defined guidelines and other alternatives noted above, as opposed to an approval process which requires significant new resources on both sides, and potentially slows the flow of information the consumer needs to make better investing decisions.

Once again, thank you for your consideration of and the opportunity to comment on these important industry measures. Please feel free to contact me if you have any further questions.

Sincerely,

/s/

Michael J. Hogan  
Chief Operating Officer

cc: Michael J. Metzger, Esq.  
Katten Muchin Rosenman LLP