



VIA ELECTRONIC MAIL

March 26, 2007

Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
1735 K Street, NW  
Washington, D.C. 20006-1506

RE: Proposed Amendments to Rules 3010(g)

Dear Ms. Sweeney:

On February 22, the NASD issued Notice to Members 07-12<sup>1</sup> (NtM 07-12) which proposed amendments to NASD Conduct Rules 3010(g) and 2711 in furtherance of the rules harmonization project with the NYSE. If adopted, the amendment to Rule 3010(g) would eliminate the definition of "Office of Supervisory Jurisdiction" (OSJ) and adopt definitions for a "supervisory branch office," a "limited supervisory branch office," a "non-supervisory branch office," and "non-branch office." The proposed amendment to Rule 2711 would define the term "initial public offering" consistent with the definition of the term in NYSE Rule 472. The Financial Services Institute<sup>2</sup> (FSI) appreciates this opportunity to comment on the NASD's proposed changes to these rules.

#### Background on FSI Members

The proposed amendment to Conduct Rule 3010(g) 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, such as mutual funds and variable insurance products, by "check and application"; take a comprehensive approach to their clients' financial goals and objectives; 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

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<sup>1</sup> See NtM 07-12 at

[http://www.nasd.com/RulesRegulation/NoticestoMembers/2007NoticestoMembers/NASDW\\_018692](http://www.nasd.com/RulesRegulation/NoticestoMembers/2007NoticestoMembers/NASDW_018692).

<sup>2</sup> The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed in 2004. Our members are broker-dealers, often dually registered as federal investment advisors, and their independent contractor registered representatives. FSI's 102 Broker-Dealer members have more than 128,000 registered representatives serving more than 14 million American households and generating in excess of \$11.3 billion in annual revenues. FSI also has more than 5,900 Financial Advisor members.

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.

The vast majority of FSI member firms do not employ research analysts or produce research reports. As a result, the proposed amendments to Conduct Rule 2711 would have little impact on our members if implemented. However, if adopted, the amendment to NASD Conduct Rule 3010(g) would harm IBDs, affiliated financial advisors, and their clients by:

- Introducing unnecessary complexity into the rule in an effort to resolve a relatively minor discrepancy.
- Subjecting firms and advisors to conflicting rules and requirements by failing to coordinate this amendment with state regulators.
- Requiring costly updates to compliance, operations, and marketing materials, training programs, computer systems, business processing procedures and forms, and other documents and materials. These costs would inevitably be passed on to clients.

As a result of these concerns, FSI cannot support the proposed amendment to NASD Conduct Rule 3010(g).

#### Detailed Comments

FSI has carefully reviewed NtM 07-12’s proposed amendment to NASD Conduct Rule 3010(g). As a result of this review, we have the following comments:

1. The Proposal is Needlessly Complex – According to NtM 07-12, the proposed amendment seeks to resolve a simple discrepancy between the NYSE and NASD’s classification of locations where the only activity being conducted is principal review and approval of research reports. Application of the NASD’s definition of an OSJ to such locations necessitates their registration as branch offices. The NYSE currently does not require branch office registration for such locations. Resolving this discrepancy in an effort to harmonize the rules of the NASD and NYSE is a laudable goal. However, the NASD’s proposed solution appears unnecessarily complex in that it will replace the current OSJ definition with four (4) newly defined terms. A search of the NASD Manual indicates that the term “Office of Supervisory Jurisdiction” appears in one (1) interpretative memorandum and fifty-one (51) Notices to Members, in addition to Rule 3010(g).<sup>3</sup> In addition, the recently adopted Form BR includes at least six (6) references to the term OSJ. As a result, the elimination of the OSJ definition has the potential to have wide ranging unintended consequences for the existing NASD regulatory system.

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<sup>3</sup> This search was performed by entering the search term “Office Supervisory Jurisdiction” into the NASD Manual Online’s search functionality at <http://nasd.complinet.com/nasd/display/index.html>.

2. The Failure to Coordinate the Proposal with State Regulators May Result in Other Unintended Consequences – A March 12, 2007 *InvestmentNews* article<sup>4</sup> indicates that the NASD failed to consider the potential impact of this rule change upon the branch office definitions incorporated into the rules and/or statutes of approximately one third of the states. Mr. Don Saxon, commissioner of Florida’s Office of Financial Regulation was quoted in this article as saying “It was an unexpected surprise to hear [about] the release...States have not had an opportunity to discuss this with the [NYSE] or NASD.” The failure to coordinate this rule change with the state regulators is significant in that it is likely to lead to conflicting rules and requirements relating to the categorization of office locations. Since this is contrary to the NASD’s stated desire to “streamline regulation,” through adoption of this amendment to Rule 3010(g)<sup>5</sup>, another solution is needed.
  
3. The Proposal Imposes Unreasonable Expenses on IBD Firms and Financial Advisors – The proposed amendment will require broker-dealers to make extensive changes and updates to the following:
  - Compliance procedures, including written supervisory procedures and other compliance and operations manuals, guides, and materials,
  - Marketing materials, including business cards and letterhead, print advertising, web sites, and other related items,
  - Staff and financial advisor training materials and programs,
  - Internal computer systems,
  - Internal filing systems,
  - Form BR filings for numerous office locations,
  - Business processing forms and procedures, and
  - Other documents and materials.

The proposed amendment would also directly impact financial advisors by requiring them to make changes to:

- Business cards and letterhead,
- Print advertising,
- Web sites,
- Office signage,
- Other marketing materials,
- Computer and filing systems,
- Business processing procedures, and
- Other documents and materials.

The proposal will also necessitate extensive additional training of home office staff, financial advisors, and sales office staff in order to insure familiarity with the new office classifications. Despite these training efforts, confusion is likely to lead to

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<sup>4</sup> “NASD wants to supplant OSJ category,” *InvestmentNews*, March 12, 2007. See the article at <http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20070312/FREE/70312009/1009/TOC&ht=>

<sup>5</sup> See NtM 07-12 at page 3.

inadvertent violations of the firm's compliance policies and procedures or NASD rules.

The costs associated with making these changes, implementing the necessary training programs, and resolving inadvertent compliance lapses will be significant. Certain business realities will lead firms and their affiliated financial advisors to pass the costs on to their clients. Nevertheless, IBD firms and their affiliated financial advisors would accept this burden if the resulting regulatory scheme would, in fact, eliminate duplicative rules and streamline the regulations for all members. However, this rule proposal is designed to benefit NYSE firms who utilize non-branch locations for the final principal approval of research reports. Since it is unreasonable to unintentionally burden the vast majority of NASD member firms with significant additional costs of doing business in order to resolve this minor problem for a small minority of dual registrant firms, another solution must be found.

#### An Alternative Solution

In light of the cost associated with achieving compliance with the proposed amendments, the possible conflicts with state rules and regulations, and potential for significant unintended consequences, FSI recommends that the NASD consider an alternative approach which will achieve the NASD's stated objective in a far simpler fashion. FSI proposes that the definition of branch office contained in NASD Conduct Rule 3010 be amended as follows:

- (2)(A) A "branch office" is any location where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security, or is held out as such, excluding...
- (iv) The Floor of a registered national securities exchange where a member conducts a direct access business with public customers;~~or~~
- (iiv) A temporary location established in response to the implementation of a business continuity plan;or
- (iiiv) Any location used solely by a qualified supervisory analyst(s) for the principal review and approval of research reports.

This proposal provides NYSE member firms with the relief they seek from branch office registration requirements without burdening other firms with the substantial expense, potential liability, and aggravation associated with the current proposal. It is also likely to reduce the potential for inconsistencies with state requirements by leaving much of the existing regulatory structure in place.

FSI is committed to constructive engagement in the rulemaking process and, therefore, would welcome the opportunity to work with you to find solutions to these concerns that achieve your objectives of eliminating duplicative rules and streamlining regulation without the unintended consequences we have outlined above.

Again, thank you for the opportunity to comment on the proposed amendment to NASD Conduct Rule 3010(g). Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Dale E. Brown', written in a cursive style.

Dale E. Brown, CAE  
Executive Director & CEO

pc: Mary L. Schapiro  
Elisse B. Walter  
Marc Menchel