**VIA ELECTRONIC MAIL**

May 20, 2005

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary
NASD, Inc.
1735 K Street, NW
Washington DC 20006-1500

Dear Ms. Sweeney:

The Financial Services Institute[1] (Institute) appreciates the opportunity to comment on the NASD's proposal in Notice to Members 05-25 to amend Conduct Rule 2210 to require, among other things, pre-use filing with NASD Advertising Regulation Department of (i) advertisements and sales literature for any new types of securities that the member has not previously offered; and (ii) all television, video (including member web site video), radio, or similar broadcasts of 15 seconds or longer.

The Institute supports the NASD's continuing efforts to ensure investor protection to enhance market integrity and instill in investors confidence that the investment advice they receive will always be accurate and balanced. Nevertheless, we are extremely concerned that the proposed rule change would merely add another layer of regulation where adequate remedies currently exist without sufficient empirical data to justify the change. The proposed rule amendment will have the unintended consequences of dramatically increasing our members' operating expenses while at the same time giving larger, more traditionally structured broker-dealers a competitive advantage over our members. It will also prevent investors from receiving important, current market updates and economic information in a timely fashion.

**Background on Institute Members**

The Institute was conceived in 2003 and launched in 2004 as an advocacy voice for independent broker-dealers. Our 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 fixed and variable insurance products; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives.

[1] The Financial Services Institute, Voice of the Independent Broker-Dealer, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, that serve registered representatives who are independent contractors. The Institute has 106 member firms, with more than 124,000 registered representatives and over $8.3 billion in Total Revenues.

Our members' registered representatives are independent contractors, rather than employees of our member broker-dealers. These registered representatives are typically located in communities where they know their clients personally and provide investment advice to their clients on a face-to-face basis. Our members generally do not concentrate their retail business on the sale of individual stocks and bonds; engage in active trading strategies; make markets; carry inventories; engage in investment banking services; or prepare and issue research to retail customers. We believe our members have a strong incentive to keep their clients' interests paramount because they take a comprehensive, holistic approach to their clients' financial needs and objectives.

Unlike broker-dealers that own their branch offices and treat their registered representatives as W-2 employees, our members do not for the most part require their registered representatives to use exclusively advertising and sales literature created by the member. It is more likely the case that our members' registered representatives will create their own advertising, including advertising used in the electronic broadcast media such as market commentaries, and sales literature and have it approved by their member in advance of use. Unlike more traditionally structured broker-dealers, our members' registered representatives pay the cost (including the cost of expedited review) of filing, if required, the advertising and sales literature with the Department.

**Summary Comments**

We have carefully reviewed and analyzed Notice to Members 05-25. Following are summaries of our comments, each of which will be discussed in more detail below:

- NASD has provided no empirical evidence to show that public investors are currently being harmed by improper "launch material" for products members have not previously offered. NASD provides no indication of whether the cost of requiring the filing of "launch material" will outweigh the potential benefits to investors who may be misled by the material. The term "security" is a term of law that has over many years been subject to numerous complex, fact-based interpretations by state and federal courts. It is likely that our members and NASD staff will continually disagree on when a product constitutes as "security" for purposes of the rule.
- NASD fails to provide any empirical evidence that investors are currently being harmed by the current rule that does not require members to file all electronic advertising with the Department or to withhold use of the material until all changes prescribed by the Department have been implemented. NASD provides no indication of whether the cost of filing all electronic advertising will outweigh the potential benefits to investors who may be misled by the advertising. NASD has not shown that its existing enforcement tools, including Rules 2210 and 2110, are or have been ineffective in protecting investors from misleading electronic advertising. NASD has not taken into consideration, as it must, the fact that the rule proposal will have an anti-competitive effect on Institute members.

**Detailed Comments**

1. **Pre-Use Approval of New Types of Securities** – The rule proposal would require members to file the initial advertisement or sales literature pertaining to a "type of

security that the member has not previously offered" 10 business days prior to first use or publication and all subsequent advertisements and sales literature used for this type of security for 90 calendar days following the initial filing. NASD justifies this portion of the proposal on the basis that it would serve two important purposes. First, it would alert NASD when the industry promotes a new type of security to retail investors. NASD includes as new types of securities non-conventional investments such as new types of asset-backed securities, distressed debt, or derivative products. Second, it would subject the sales material for new types of securities to review by the Department. The member could not use the material until it incorporates all of the changes requested by the Department.

The Institute opposes this portion of the proposal for two fundamental reasons. First, NASD offers no empirical data to support the need for a new rule of this type. NASD already has rules, including 2210 (d) and (e), 2110 and 2120 that enable NASD to discipline members that issue advertisements or sales literature that material false or misleading information. NASD seeks to justify its proposal by stating that the pre-use filing with the Department will protect members who have little or no experience with the new type of security being offered for the first time. NASD also states that it has found that "so-called 'launch' material for products that a firm has not previously offered often presents significant compliance issues under NASD advertising rules." Although technically not required to do so, NASD has obviously done no type of cost/benefit analysis to determine if the cost to members of this part of the proposal will outweigh its real benefit to investors. Similarly, NASD has not shown that investors have been harmed by the form of advertising and sales literature the proposed rule is intended to prohibit.

We agree with NASD that the term "type of security that the member has not previously offered" requires revision and clarification. NASD gives several examples of its interpretation of this language. NASD states that it could refer to a situation where the firm has traditionally sold only mutual funds and now wants to offer hedge funds to its retail clients. NASD would apply the proposed rule in this situation. Our concern is that there is no definition of the term "security" either in the proposed rule or in the NASD By-Laws, which govern the interpretation of the proposed rule. It is a term of law that has over the years been subject to numerous complex interpretations by state and federal courts. Therefore, it is likely that members and NASD staff will disagree on when something the member wants to start offering constitutes a "security" for purposes of the proposed rule. Our members offer insurance products that NASD has from time to time indicated may be securities. If this proposed rule is adopted as written, our members will be subject to being second guessed by NASD staff on this issue, unless they submit every new product to the Department for review. We believe that, if the NASD adopts the proposed rule, NASD should change the above-referenced term to "type of business referred to in Item 12 of Form BD in which the member has not previously engaged." We believe the businesses described in Item 12 are sufficiently clear so that there will be little chance for confusion over matters of interpretation and are sufficiently encompassing so that NASD will capture most, if not all of the securities products about which it says it is concerned.

2. **Television, Video, and Radio Advertisements** – The second amendment to Rule 2210 would require members to file **all** television, video (including web site video),

radio, or "similar broadcasts" of 15 seconds or longer at least 10 business days prior to the date of first use or broadcast. NASD would permit members to meet this requirement for television and video by filing draft versions, "story boards", or scripts, as long as the member files the final filmed version within at least 10 business days of first use. The member would be required to withhold use of the advertisement until changes specified by the Department have been made. NASD also points out that it does not expect pre-use filing requirements to apply to call in shows or unscripted appearances. However, the proposed rule would require pre-use filing of any portion of such shows that are scripted. NASD justifies this rule proposal on the basis that "in the past some members used broadcast advertisements that raised regulatory issues." NASD states that "several years ago television advertisements for day trading and electronic brokerage firms presented regulatory concerns, which could not be fully addressed until those advertisements were filed with the Department." This is an interesting contrast to a speech that Mary Schapiro gave in 1999 regarding day trading issues, including advertising. We provide the pertinent language from that speech:

***"Advertising Regulation***

*When speaking of shaping investor expectations, advertising can not be ignored. Advertising should not attempt to seduce investors into the perception that easy access to the markets and market information, somehow transforms one into a professional trader. Nor should they be led to believe that on-line trading portends quick and easy profits. In this regard, I am deeply concerned by advertisements that suggest fabulous wealth simply through electronic access to the markets or aggressive trading strategies. Some of those ads are made by firms with well-known brand names. Major firms that have spent a lot of years building those brand names seem to be risking much of their goodwill by appeals to the get-rich-quick mentality. What's more, many of these ads don't appear to meet our published guidelines requiring balance and disclosure of risks. Whatever happened to John Houseman, and doing business the old-fashioned way? Maybe I'm a little old-fashioned myself on this issue, but I hope we don't lose the message that the best investors are those who* ***think*** *before they click.*

*Firms that place ads that make specific or identifiable claims need to be able to back them up. Our advertising and public communication rules prohibit exaggerated statements and require that firms be able to substantiate their claims. Firms can't describe themselves as "best" or "fastest" unless they can factually and objectively support those statements. In times of heavy volume, fast moving markets and volatility, we know speed and accessibility can't be promised. In fact, account access and speed of order execution is one of the fastest growing areas of customer complaints. Even complaints that do not lead to a regulatory action tend to show a mismatch between investor expectations and reality.*

*To address the growing concerns over the types of advertisements I mentioned I have directed our Advertising Regulation Department to carefully scrutinize all advertisements that exaggerate opportunities or make service claims like instant access that simply cannot be delivered. Where violations are found, aggressive enforcement will follow. For the twelve-month period ending May 1st 1999, we stopped the use of 811 misleading public communications by our members. During*

*this period we also announced 23 formal disciplinary actions against member firms and individuals for violations of our advertising rules."*

Clearly, NASD believed its existing enforcement rules, such as Rules 2210 and 2110, were sufficient in 1999 to adequately protect investors from misleading advertisements related to day trading. We are not aware of any epidemic of day trading advertising existing today. Unless NASD can provide empirical data that shows it cannot deal with current advertising regulatory issues through existing enforcement tools, we cannot support this rule proposal. We believe strongly that the promulgation of a new rule each time NASD staff perceives some potential investor protection issue is a costly misuse of NASD's regulatory authority, places unnecessary burdens on members and will not provide investor protection at a level that will outweigh the cost of implementing the new rules. Although technically NASD has no obligation to conduct a cost benefit analysis before it issues a rule proposal, we believe that NASD staff should at least give some consideration to the financial and human resources burdens proposed rules will have on members versus the tangible benefits the proposed rules will provide to investors.

NASD in its discussion of the scope of the proposal states that it does not intend to apply the rule to "short sponsorship announcements, internet banner advertisements, and similar communications." However, these limitations are not detailed in the language of the rule proposal. In reality NASD can apply the proposed rule to anything that would meet the definition of "advertisement." We also believe, based on conversations with our members, that the 15 second threshold is much too short. Our members have registered representatives that currently use 15 to 30 second radio spots for general market commentary and discussions of current economic conditions. We see no reason for these to be filed with NASD. That is why Rule 2210 requires pre-use filing only for advertisements that promote certain products. We can see no justification for applying pre-use filing requirements to all television, video, and radio advertisements of 15 seconds or more, regardless of their content.

3. **Electronic Advertising Proposal is Anti-Competitive** – NASD has an obligation to determine whether its rule proposals are anti-competitive. It has not made any attempt to do so in this situation. Clearly, the proposed rule will be anti-competitive with respect to Institute members. Members that submit to the Department advertisements covered by the proposed rule will be required to pay the standard advertising filing fee in effect at the time of the submission. This fee will not be a burden for large, traditionally structured broker-dealers because these members create the advertisements used by all of their registered representatives and pay the filing fees directly. However, it will be a significant burden for independent broker-dealers because advertisements are created by their individual registered representatives and, as such, filing fees are assessed directly to these individual registered representatives. Since most of these advertisements will be extremely time sensitive it is likely that registered representatives of Institute members will be required to pay the extra assessment for expedited review, which will add substantially to the review cost. As a result, registered representatives of Institute members will be unable to continue using electronic advertisements that involve time sensitive issues regarding market conditions and current economic issues.

The Institute acknowledges NASD's concerns that some members may use advertisements and sales literature improperly to deceive investors or merely because the firm does not fully understand or appreciate the risks associated with a product it offers for the first time. Nevertheless, we believe NASD needs to conduct a more thorough evaluation of the pervasiveness of the perceived problem and the actual, realistic costs associated with the implementation before it adopts the proposed rule. We appreciate the opportunity to share the views of our members with NASD on NtM 05-25. We will be pleased to work with NASD staff to craft a rule that will protect investors without placing such unjustified and substantial financial burdens on our members. Please feel free to contact me at 770 980-8487 with any questions or to discuss further any of our comments.

Respectfully submitted,

Dale E. Brown, CAE
Executive Director and CEO