

## VIA ELECTRONIC MAIL

May 27, 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<sup>1</sup> (Institute) appreciates the opportunity to comment on the NASD's proposal in Notice to Members 05-27 to require pre-use approval of member correspondence, including e-mail, under certain circumstances.

The Institute supports the NASD's continuing efforts to ensure investor protection to enhance market integrity and instill in investors 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 depriving investors of the ability to receive more information by electronic means.

### 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.

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

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<sup>1</sup> 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

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 the broker-dealer's networked e-mail system. Our members also do not typically approve advertising and sales literature at the OSJ level; rather it is sent to the home office for approval. E-mail is also typically sent to the home office for review on a post-use basis.

### **Summary Comments**

We have carefully reviewed and analyzed Notice to Members 05-27. Following are summaries of our comments, each of which will be discussed in more detail below:

- Our members typically do not have a networked e-mail system that will enable them to stop outgoing e-mail for approval before it is sent. Under NASD's proposal our members will have to develop and install e-mail systems that will permit electronic pre-use review of all e-mail. The cost to establish such a system will be staggering given the fact that most of our members have hundreds and sometimes thousands of registered representatives whose offices are in remote locations throughout the country. NASD has not provided any empirical data that abuses discussed in Notice to Members 05-27 are so pervasive that the only effective way to protect investors is to reengineer the data systems of a substantial segment of the securities industry.
- Enforced literally, the proposed rule amendment will have adverse unintended consequences to investors. First, at a minimum the proposed rule amendment will cause a substantial delay in the transmission of e-mail to investors. In cases where the e-mail contains important market or product information the investor may be disadvantaged or even harmed financially or otherwise by this delay. Second, we are certain that most of our members will be forced to curtail entirely their e-mail communications with investors at a time when investors are demanding more electronic access to account information, trading systems and to their financial advisors.
- Correspondence should not be subject to pre-use approval unless it otherwise constitutes sales literature and contains a recommendation to purchase or sell a security.
- Pre-use approval of correspondence should not be imposed on members unless the member has previously been determined to have used correspondence improperly to encourage investors to invest in securities. Once imposed, pre-use approval of correspondence should be required only for a reasonable time. Thereafter, such approval should be terminated unless the member again uses correspondence improperly.

### **Detailed Comments**

1. **Pre-Use Approval of E-Mail** – As written, Notice to Members 05-27 would require, among other things, pre-use principal approval of any correspondence sent by a member to 25 or more existing retail customers within any 30-calendar-day period.

This would include principal pre-use approval of e-mail. NASD justifies this proposal on the basis that it has determined that many members already require principal pre-use approval of correspondence that is widely distributed. NASD's assessment may be accurate with respect to written correspondence. However, our members do not currently require principal pre-use approval of e-mail correspondence. Our members do not have networked e-mail systems to which all of their registered representatives must subscribe. As independent broker-dealers, our members permit their registered representatives to use their personal computers to send e-mail and to select their individual e-mail ISP. Copies of e-mail are sent by registered representatives to the broker-dealer for an after-the-fact principal review consistent with Rule 3010(d). NASD staff has advised the Institute that they will not interpret the proposed rule as written. Rather, the staff intends to apply the rule only to form correspondence (such as form letters) with identical content sent by one or several registered representatives generally located in the same office. However, the proposed rule is not written with these limitations. If NASD adopts this proposal as written and enforces it as written, which it certainly has authority to do, our members will be required to spend substantial amounts of money to develop and install networked e-mail systems and to subscribe all of their registered representatives to the system. They will also have to develop some type of gate keeping feature to ensure that all e-mail is stopped for review and principal approval before it is released to the recipient. The Institute does not oppose in theory NASD's proposal for members to obtain principal approval prior to use of form or pattern correspondence sent by one or a small number of registered representatives and intended to encourage existing customers to purchase a security or service offered by the member, although we do not fully appreciate NASD's justification for this rule proposal. Therefore, in an effort to make the proposed rule effective and to ensure that our members can comply without expending extraordinary amounts of money and human resources to comply, we suggest NASD revise the language of the first sentence of Section (A) to read as follows: "(A) Correspondence. Correspondence need not be approved by a registered principal prior to use, unless each piece of such correspondence constitutes a form letter or form e-mail with identical subject matter content, is clearly intended to influence the recipient to purchase a security or service from the member and is distributed by one or more registered representatives of the member to 25 or more existing retail customers of those registered representatives within any 30 calendar-day period."

- 2. Unintended Consequences to Investors** – Proposals to protect investors often provide more protection on paper than they do when fully implemented. Often regulatory agencies do more harm than good attempting to protect investors because they do not fully appreciate the actual, as opposed to the theoretical, implications of their actions. That is clearly going to be the case with this proposal as drafted. Currently, investors demand that broker-dealers provide electronic access to their accounts and to certain trading facilities. They also expect to be able to communicate with their financial advisor by the same means they use to transmit most of their other daily correspondence, e-mail. However, NASD's proposal, if enforced in accordance with its terms, will slow down the flow of e-mail between financial advisors and investors. We believe that investors will not understand why, during periods of market instability or at times when investors want information quickly to help them make a time sensitive decision, they cannot receive e-mail 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 the systems

that will enable them to comply with the NASD's proposal. It seems incongruous that NASD prefers written over electronic correspondence 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.

3. **Lack of Justification for the Amendment** – NASD attempts to justify the proposed rule amendment by suggesting that it has found “some member correspondence” to multiple existing customers that raises the same sorts of issues as member advertisements and sales literature. NASD states that it has reviewed “form letters” that encourage “existing” customers to invest in various securities and that do not meet applicable advertising standards of NASD and SEC. NASD concludes that some of this correspondence that had already been sent to customers “required substantial revisions” and that NASD took informal disciplinary action against the member that distributed the correspondence. NASD offers no specific empirical data to indicate how widespread this perceived abuse may be, the level of severity of the perceived abuse and how many members were actually disciplined for the perceived abuse. We believe that the fact that NASD discovered some member correspondence that did not meet NASD and SEC standards and thereafter took disciplinary against the member indicates clearly that the system is working and that Rule 3110(d) is being used effectively by NASD to protect investors from improper correspondence, even without principal pre-use approval. As evidenced by NtM's 05-25 and 05-27, NASD appears to believe that it must write a new, specifically focused rule to counteract each fact situation that it deems inappropriate even though the perceived inappropriate activity may be clearly covered by an existing rule. It assumes that all members intend to violate NASD rules and punishes all members for the limited acts of a few members. We do not believe there is sufficient justification for this approach.
4. **Pre-Use Approval Not Tied to Prior Violations** – NASD's proposal as written requires members to begin principal pre-use approval once the member has, in the aggregate, sent correspondence in any form to 25 “existing” retail customers within each rolling 30-calendar-period. Institute believes that it is patently unfair to impose such onerous obligations on members that have not evidenced a previous violation of Rule 3110(d) involving the transmission of misleading form letters that did not meet current advertising standards of NASD and the SEC. FSI is convinced that the proposal, if adopted, should be applied only to NASD members that have been found by NASD or SEC to have sent form letters that did not meet current applicable NASD or SEC advertising standards. FSI also believes that, if the proposal is adopted, principal pre-use approval should extend only for some reasonable time (such as 12 months) and then should terminate until NASD finds the member again violated current applicable NASD or SEC advertising standards in connection with the transmission of form letters.
5. **Pre-Use Approval Not Tied to Recommendations** – According to NASD staff, the proposed rule is intended to apply to all correspondence regardless of whether it constitutes a recommendation to purchase a security or service from the member. For example, NASD staff would apply the proposed rule as written to a form e-mail sent to 25 or more existing retail customers in a 30-calendar-day period that merely holiday or birthday greetings. This is unreasonable in light of the magnitude of the effort and costs our members will expend to create the e-mail monitoring systems necessary to comply with the proposed rule. The proposal should be limited to form letters that

clearly attempt to influence existing retail customers to purchase a security or service from the member.

We appreciate the opportunity to share the views of our members with NASD on NtM 05-27. 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,

A handwritten signature in black ink, appearing to read "Dale E. Brown". The signature is fluid and cursive, with the first name "Dale" being the most prominent.

Dale E. Brown, CAE  
Executive Director and CEO