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VIA ELECTRONIC MAIL AND FEDERAL EXPRESS

June 3, 1997

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

RE: File Number SR-NASD-97-24: Proposed Rule Change by NASD Regulation, Inc. to NASD Conduct Rules 3010 (Supervision) and 3110 (Books and Records)

Dear Mr. Katz:

PSA The Bond Market Trade Association ("PSA")¹ is pleased to comment on the above-referenced rule changes proposed by NASD Regulation, Inc. ("NASDR") with the Securities and Exchange Commission ("SEC") on April 25, 1997 (Release No. 34-38548, 62 Fed. Reg. 24147 (May 2, 1997)).

In February 1997, PSA submitted a comment letter to the NASDR supporting the adoption of these rules as originally proposed.² For reasons outlined below, PSA reaffirms its support and urges prompt adoption of these rules by the SEC in the amended form proposed by the NASDR.

SUMMARY OF PROPOSED RULE CHANGES

NASDR proposes to amend its current Rule 3010(d)(1) to provide that a member firm must establish written procedures for the review of incoming and outgoing written and electronic correspondence of its registered representatives with the public relating to the investment banking or securities business of the member. These procedures must be designed to provide reasonable supervision of each registered representative. Member firms must be able to evidence implementation and execution of these procedures.

Amendments to Rule 3010(d)(2) would require each member to develop appropriate written procedures for the review of incoming and outgoing written and electronic correspondence based on the nature and size of its business and customer base, among other factors. Members which do not require pre-use review of all correspondence must provide education and training on a regular basis to associated persons regarding the firm's procedures governing correspondence, document such training, and conduct ongoing monitoring to ensure implementation and adherence to such procedures.

Finally, amended Rule 3010(d)(3) would require each member firm to retain correspondence in accordance with Rule 3110. NASDR proposes amending Rule 3110 to

specify that members make and preserve records in the manner prescribed by Rule 17a-3 under the Securities and Exchange Act of 1934 (the "Exchange Act"), and that the format, medium and retention period for such records comply with Rule 17a-4.

DISCUSSION

As noted in previous correspondence with the SEC³, PSA favors an electronic communications supervisory approach that allows individual firms flexibility in developing procedures to meet regulatory goals. Advancements in electronic communications technology are occurring at rapid pace. These advancements will continue to have widespread economic and practical impacts on the way NASD member organizations and their registered representatives conduct business, and on the methods they choose to communicate with each other, their customers and the general public. Adoption of a flexible and functional regulatory framework for electronic communications, such as that set forth by the NASDR, enables firms to employ increasingly powerful and sophisticated communications media in a manner that best responds to their business needs. A flexible and functional approach such as this can help member firms increase their efficiency and improve productivity in an increasingly competitive global market.

The proposed NASDR rule amendments -- similar to pending New York Stock Exchange rule proposals regarding supervision of electronic communication⁴ - directly respond to SEC's request that industry self-regulatory organizations adapt their supervisory rules to accommodate electronic communications. PSA agrees with NASDR's proposed approach, which is designed to be consistent with the one proposed by the NYSE, thereby helping to ensure a coordinated regulatory framework for supervision of manual and electronic communications. Development of consistent approaches among the SEC and the various SROs relating to the use of communications technology promotes market efficiency, by establishing common guidelines applicable to the use and supervision of electronic communications among market participants.

In February 1997, PSA submitted a detailed comment letter to NASDR in response to its request for comment regarding changes to NASD Conduct Rules 3010 and 3110. In that letter, PSA supported the NASDR's proposed rule changes, as they would enable firms to tailor reasonable procedures for review of correspondence based upon the nature and size of their business and customer base, and eliminate the requirement that firms review each item of correspondence. PSA believes that this approach allows firms the ability to integrate electronic communications into their business activities in a manner that is best calculated to meet their own unique business needs. The proposal simultaneously provides NASDR with effective regulatory oversight by establishing appropriate, general standards for supervisory review and monitoring of members' communications with customers and the public. This approach is preserved in the current rule proposal, and PSA accordingly reaffirms its general and specific support.

PSA also supports NASDR's efforts to clarify, in the current proposal, the scope of correspondence that is subject to supervisory review under Rule 3010(d)(1). By limiting

supervisory review to correspondence with the public relating to the investment banking or securities business of the member, the NASDR requirements appropriately circumscribe the types of communication that should be the subject of regulatory attention. The revised proposal continues to provide for adequate customer protection associated with supervisory review process, while exempting internal communications or correspondence between members and non-customer third parties, which do not raise similar supervisory concerns. In this regard, however, PSA believes that it would be helpful for NASDR to clarify further, perhaps by providing illustrative examples, the types of communications that would be considered to relate to the "investment banking or securities" business of a member.

PSA also supports the addition of language which clarifies that a member's supervisory obligations apply to both incoming and outgoing communications. Firms may thus use reasonable sampling or spot-checking techniques rather than review every item of correspondence, whether or not that correspondence is internally or externally generated. Furthermore, while written approval of correspondence is no longer mandated, firms are required maintain evidence (such as electronically recording evidence of supervisory review of e-mail) that these supervisory procedures have been implemented and carried out. As PSA previously stated in its letter to the NASDR, we believe that these requirements strike an appropriate balance between facilitating the use of electronic communications, and the need for reasonable supervision, monitoring and record keeping requirements related to such activities.

Similarly, amended Rule 3010(d)(2) would, in requiring firms to develop written procedures regarding correspondence review, nevertheless allow firms to implement either uniform procedures or customized procedures that address the functions, offices or locations, individuals, groups or persons or specific registration categories. For firms whose procedures do not require pre-use review of each item of correspondence, education and training of associated persons relating to the firm's procedures governing review of correspondence would be required on a regular basis. Where appropriate, firms may consider incorporating this education and training requirement into continuing education training program. PSA agrees that reasonable written supervisory procedures should be developed in a manner that is relevant to the business structure and operations of the firm. This approach is far more efficient and effective than one which relies upon a single set of specific, detailed requirements that may be inappropriate for many firms, or that may quickly prove outmoded or obsolete.

PSA specifically wishes to commend NASDR for its efforts to harmonize the requirements of its supervisory review and recordkeeping requirements governing electronic and other communications with those of the SEC and NYSE. We hope that other regulatory organizations will follow this example. The efficiency that is achieved by such a uniform and coordinated approach far outweighs any policy rationale that might support a fragmented or individualized approach among the SEC and the various SROs. In this regard, we specifically endorse the NASDR's goal of achieving consistency between its proposed amendments to Rules 3010, and proposed amendments to the NYSE's Rules 342 and 472. We also support NASDR's proposed amendments to Rule

3110(a) which, in a manner similar to amended NYSE Rule 440, would specify that records must be made and preserved consistent with Rules 17a-3 and 17a-4 under the Exchange Act.

PSA wishes to note, however, that its support for *consistency* between and among SRO and SEC record keeping and retention rules should not be equated with universal support for all *substantive* aspects of those rules. For example, we continue to believe that the SEC should revisit its rules to eliminate unnecessary and burdensome recordkeeping requirements with respect to electronic communications.⁵ Imposition of the entire complement of recordkeeping requirements traditionally associated with paper-based communications is inappropriate and unnecessary in the case of certain informal electronic communications. For example, much e-mail usage is more akin to oral communications, to which record retention requirements have never applied. For this reason, PSA believes that the SEC's recent interpretive guidance regarding e-mail record retention, which requires broker-dealers to retain e-mail and Internet communications (including inter-office communications) that relate to a broker-dealer's "business as such" is problematic⁶. The usage and volume of e-mail and other forms communications are increasing, and significant burdens and costs are associated with indexing, storing and retrieving this information. The regulatory benefits derived from recordkeeping requirements that are triggered whenever an electronic communication relates to a member's "business as such" in PSA's view are outweighed by the costs associated with such a broad, undifferentiated standard. As a practical matter, this standard may dictate that all e-mails be retained. Moreover, in some cases (for example, where proprietary, third-party systems are used for e-mail transmissions), broker-dealers may be frustrated in their attempts to obtain and capture those messages for records retention and supervisory purposes. PSA therefore continues to believe it important for the SEC and the SROs to work together to develop more refined and realistic record retention requirements for electronic forms of communication, especially e-mail messages. We intend to pursue this matter separately with appropriate staff of the SEC, NASDR and NYSE in the near future.

CONCLUSION

For the reasons expressed above, PSA supports the adoption of these rule proposals, and we appreciate the opportunity to provide the views expressed herein. We commend NASDR and the SEC for their timely actions in this important area. Should you have any questions or desire any clarification of the issues discussed in this letter, please contact the undersigned, or George Miller, Vice President and Deputy General Counsel of PSA at (212) 440-9403, or Paul Saltzman, Senior Vice President and General Counsel of PSA at (212) 440-9459.

Sincerely,

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Chairman, PSA Fixed Income Practices
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1 PSA represents approximately 220 securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. PSA's member firms account for in excess of 95% of all primary issuance and secondary trading activity in domestic debt capital markets. More information about PSA can be obtained from our website at <http://www.psa.com>.

2 See PSA letter dated February 7, 1997 to Ms. Joan Conley of NASDR in response to NASDR Request for Comment 96-82.

3 PSA letter to Jonathan G. Katz, dated October 16, 1996, concerning Use of Electronic Media by Broker Dealers, Transfer Agents and Investment Advisers for Delivery of Information (File No.S7-13-96).

4 SEC Release No. 34-37941; File No. SR-NYSE-96-26, 61 Fed. Reg. 58919 (November 19, 1996).

5 See, for example, Exchange Act Rule 17a-4(b)(4), which applies recordkeeping and retention requirements to "originals of all communications received and copies of all communications sent by such member, broker or dealer (including inter-office memoranda and communications) relating to his business as such."

6 See SEC Release No. 34-38245; File No. 57-21-93, 62 Fed. Reg. 6469 (February 12, 1997).