



## Securities Industry Association

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July 2, 1998

Thomas E. Geyer  
Commissioner  
Ohio Division of Securities  
77 South High Street, 22nd Floor  
Columbus, OH 43215

Dear Commissioner Geyer:

The Securities Industry Association ("SIA") appreciates the opportunity to provide its views on NASAA's Revised Proposed Model Rules for Sales of Securities at Financial Institutions (the "Model Rules"). It is evident from first glance that a great deal of thought and effort went into revising the Model Rules, resulting in a marked improvement.

We applaud your decision to pattern the Model Rules after NASD Conduct Rule 2350 ("NASD Rule") and the Interagency Statement ("Interagency Statement"), as well as your decision to remove the areas of general applicability (i.e., the sharing of confidential customer information, etc.) and refer the same to the NASAA Broker-Dealer Sales Practices Committee. However, we wish to point out that your decision to harmonize the Model Rules with the prior regulation on point could be undermined by any future changes to the NASD Rule, or by the public comment and review process surrounding any effort to formalize the Interagency Statement in regulation form, as has been recently rumored. Either of these actions would require each state which enacted the Model Rules to alter them accordingly, or worse, if left unaltered, could result in inconsistent regulation. Given the fact that the overwhelming majority of broker-dealers are regulated by the NASD, it is SIA's primary recommendation that NASAA issue no new model rules on this subject, and instead allow the NASD Conduct Rule 2350 to be the controlling regulation on point. In the alternative, we advocate the inclusion of a provision in the Model Rules which would provide for a "safe harbor" for those broker-dealers in compliance with the NASD Rule. Such a provision, as employed in other cases, should eliminate the risks associated with inconsistent regulation.

### **Discussion of Substantive Points**

In light of our second recommendation above, we offer the following comments on the text of the Model Rules. We wish to note with appreciation at the outset that this version of the Model

Rules shows reflection upon, and integration of, previous comments made by industry members. As a general comment, we believe that provisions of the Model Rules that address the same subject matter of the NASD Rules should mirror those rules to the maximum extent possible. For the most part, our comments here are limited to points of clarification which we believe will simply make compliance and enforcement easier.

## **Section (A)--Applicability**

The second paragraph of Section (A) contains the term "non-retail customers," as well as a footnote reference to "institutional investor." This language raises two potentially confusing scenarios: the first results when neither term is defined under state law, and the second results from inconsistent definitions of either or both terms between the various states. Both scenarios would result in an increased compliance burden for broker-dealers, especially those with multi-state sales activities. As the first sentence of this section dictates that these Model Rules apply exclusively to services provided where retail deposits are taken (emphasis added), the last sentence of Section (A) is unnecessary and should be deleted. In the alternative, for consistency, we advocate that NASAA include formal definitions for both terms in the Model Rules, to be used only in this particular regulation, so as to avoid conflict with any existing definitions of these terms in state law.

## **Section (B)--Definitions**

Subsection (B)(2) of the Model Rules omits the term "brokerage affiliate arrangement." As written, it would exclude firms that differentiate between a "networking arrangement" and a "brokerage affiliate arrangement." In some firms, a so-called "networking arrangement" is used only in situations when broker-dealer services are performed "off-site." The term "brokerage affiliate arrangement" is used by these firms to refer to situations when broker-dealer services are provided on the premises of the financial institution and under the terms of a leasing agreement. Therefore, firms operating under "networking arrangements" would be excluded as defined in the Model Rules. We believe definition (B)(2) should conform to the NASD Rule. Accordingly, the NASD Rule definition of "Affiliate" should also be added to Model Rule Section (B) as the term affiliate is used in NASD Rule (b)(2).

## **Section (C)--Standards For Broker-Dealer Conduct**

### **Subsection (1)--Setting**

We are concerned that the use of the term "conducts its services" in the last line of Subsection (C)(1) could lead to ambiguous interpretation, especially in the case of broker-dealers which do not have exclusively on-premises relationships with banks. We recommend amending the last sentence to read as follows: "The broker-dealer's name shall be clearly displayed in the physical location where broker-dealer services are provided." (italics added)

### **Subsection (2)--Networking Arrangements and Program Management**

First, we are confused by the potential application of the second sentence of this section, especially in light of the current efforts to revise the books and records keeping requirements enforced by other regulators. If this section were interpreted to simply allow access to premises, then its purpose is agreeable. However, we believe that this section can be

interpreted to require that certain, or all, books and records be kept at certain, or all, locations. This opens the door for the possibility of an interpretation inconsistent with the books and records keeping requirements that are finally adopted by the Securities and Exchange Commission. If that does indeed occur, this sentence could conflict with provisions of the National Securities Markets Improvements Act, which dictates that the states cannot adopt more stringent requirements in this regard than what is required under federal law. We respectfully request that this section be amended to simply refer to current NASD, federal and state law requirements. This can be achieved by replacing the second sentence with the following:

Networking arrangements must provide that supervisory personnel of the broker-dealer and representatives of state securities authorities, where authorized by state law, will be permitted access to the financial institution's premises in order to inspect books and records in accordance with NASD regulation and state law.

#### Subsection (4)(a)(iii)--Communications with the Public

We recognize that the original version of the Interagency Statement contains on page 9 a provision which is designed to eliminate confusion between the names of investment products and the financial institution in which they are sold. However, we recommend that the corresponding provision in the Model Rules be removed altogether, or amended appropriately, for two reasons.

First, interpretations issued by the Federal Reserve Board since the issuance of the Interagency Statement have retracted this point of guidance. In particular, we draw your attention to FRB Interpretation ¶80-258 (February 13, 1998), which granted Firststar Corporation the ability to act as an investment adviser to a series of investment companies with the name "The Firststar Funds," as long as the standard disclosure requirements are met. We support the Board's viewpoint that the standard disclosure statements, first set forth in the Interagency Statement and appropriately duplicated in the Model Rules, eliminate any possible confusion arising from common names.

Second, you will note that the Interagency Statement limits the restriction upon names "similar to that of the depository institution", with the implied reference to the depository institution in which the investment products are sold. However, the Model Rules extend the restriction to names "similar to that of a financial institution," implying any and all such institutions. We believe that this burden is overbroad and not in proportion to the intended regulatory benefit, and together with our previous reasoning, suggests that this Subsection (4)(a)(iii) be removed in its entirety.

In conclusion, we wish to reiterate our gratitude for the Committee's efforts on this issue, which are all the more impressive in light of the financial modernization process currently being played out on the federal level. While we maintain that these rules are made unnecessary by NASD Conduct Rule 2350, we offer the above comments in hopes of making any final result less confusing and a smaller enforcement and compliance burden.

In the hope of achieving a result that is beneficial to both NASAA and industry, we ask that you contact us should you seek any further industry input. Thank you again for the opportunity to provide our views.

Sincerely,

J. Edward Diamond  
Chairman, Bank Retail Broker-Dealer Committee

Brewster M. Ellis  
Chairman, Financial Institutions Services Steering Committee

John Wurth  
Chairman, State Regulation and Legislation Committee

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