Securities Industry Association

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November 3, 1997

Margaret H. McFarland
Deputy Secretary
Securities and Exchange Commission
450 Fifth Street N.W., Stop 6-9
Washington, D.C. 20549

Re: Amendments to New York Stock Exchange Rule 382 (SEC Release No. 34-39, 200, File No. SR-NYSE 97-25)

Dear Ms. McFarland:

The Clearing Firms Committee, the Local Firms Committee and the Ad Hoc Clearing Subcommittee (the "Committees") of the Securities Industry Association ("SIA"), appreciate the opportunity to comment on proposed amendments to New York Stock Exchange, Inc. ("NYSE") Rule 382 which were filed with the Commission in accordance with Rule 19b-4 under the Securities Exchange Act of 1934.

The amendments which are set forth in new sub-sections (d), (e) and (f) of NYSE Rule 382, among other things, would require that:

- clearing broker/dealers ("CB's") furnish both its introducing broker/dealer ("IB") and the IB's designated examining authority with copies of customer complaints it receives relating to activities for which the IB is responsible pursuant to the clearing agreement, and contemporaneously inform the IB's customer that the customer has the right, at his discretion to transfer the account to another broker-dealer.
- CB's inform IB's of the exception and other reports it offers to enable the IB to supervise activities the IB is responsible for pursuant to the clearing agreement. CB's would also have certain reporting and recordkeeping requirements with respect to such reports provided to the IB.
- where the IB is permitted to issue negotiable instruments directly to its customers on the CB's account, the IB must represent in writing to the CB that it maintains and will enforce supervisory procedures with respect to the issuance of such instruments, that are satisfactory to the CB.

A. Overview

Subject to certain qualifications, the Committees support the goals of the amendments to Rule 382. We commend the NYSE for taking measures to better enable self-regulatory organizations

(SRO's) to perform their oversight responsibilities with respect to investigating potential sales practice abuses. While the vast majority of IB's comply with existing SRO complaint reporting requirements and work diligently to fairly and promptly respond to customer complaints, new sub-section (d) of the rule will help assure that the appropriate SRO becomes aware of the complaint in those rare instances where such is not the case. We also believe that sub-section (e) of the rule will heighten IB awareness of the reports that are available to them to assist them in performing their supervisory responsibilities, and encourage such IB's to maximize their use of such reports.

We further believe that in order to prevent misinterpretation or misapplication of the amendments, certain aspects of the amendments should be clarified in the SEC Adopting Release and/or NYSE Information Circular issued in conjunction with adoption of the amendments in their final form.

Set forth below are the Committee's comments on specific aspects of the proposed amendments.

B. Customer Complaints

The Committees note that the majority of SIA members clear through another member, and most of these fit within the definition of "local firm". In many cases these firms have provided valuable investment services to generations of investors and have diligently and properly handled customer complaints when they arose. Therefore, it seems grossly unfair to force the CB to stigmatize the IB by requiring that upon receipt of a complaint relating to the IB, the CB send a letter to the IB's customer informing such customer that "you, the customer, retain the right, at your discretion, to transfer your account to another broker-dealer of your choice." The receipt of a letter from a third-party, whether it be a CB or regulator, containing such a statement, might well cause the customer to infer wrongdoing and take his or her business elsewhere, regardless of the merit of the complaint or underlying circumstances, particularly since customers are already well aware that they can do business with whomever they wish. It should be noted that while the NASD-R has recently filed similar amendments to its companion clearing rule (Conduct Rule 3230) pursuant to SEC Rule 19b-4, in its submission the NASD-R Board expressed concern "that the requirement that the customer be notified by the clearing firm that he or she has the right to transfer his or her account to another firm may unfairly single out a particular category of complaints, create an unfair implication that each such complaint would warrant the customer's transferring his account, or otherwise operate inappropriately to distinguish this class of complaints from others." In fact NASD-R's concerns regarding this and certain other issues are so great that they specifically suggest that they be the subject of public comment, and that approval of the NYSE rule amendments be deferred until the NASD-R and the SEC have received and considered such comments.

For the aforementioned reasons, we strongly urge that the statement regarding the right to transfer an account be deleted from the final amendments.

C. Certain Matters Requiring Clarification

SIA has had discussions with the NYSE regarding certain matters in the amendments, generally of an operational or procedural nature, which appear to need clarification. One area which requires clarification relates to the scope of "reports" which would be subject to the notification

and record retention requirements under subsection (e) of the Rule 382 amendments. Given the panoply of reports routinely furnished or available to IB's which are utilized solely for general information or operational purposes, we believe that subsection (e) should be interpreted as applying only to exception reports relating to the IB's supervision of sales practice or similar compliance related activities. Also, with respect to customer complaints received by the CB, it should be made clear that the reporting requirement applies where the complaint is received from the customer or his agent, and not from a regulatory or self-regulatory agency that is merely forwarding it on to the CB. Since a major objective of the rule is to assure the complaint comes to the attention of the regulatory authorities, no purpose is served by forwarding to the self-regulatory agency a complaint which has already come to its attention.

Similarly, we urge that it be made clear that subsection (e) only applies to identifiable exception reports, and not to information which an IB can retrieve on an *ad hoc* basis from the CB's database. We believe that these and certain other matters requiring clarification, which we have brought to the attention of the NYSE, can best be addressed through the Information Circular that the NYSE will issue in conjunction with the final adoption of the current or a revised version of the amendments. We hope that the NYSE is prepared to render such clarification.

D. Introducing Broker Authority to Issue Negotiable Instruments

Subsection (f) of the amendments relates to situations in which a CB has given an IB authority to issue checks to customers on the CB's account. Generally, the decision to grant such authority is based on a number of business and customer service considerations including the size of the IB, the amount of its clearing deposit and the existence of CB policies and controls which may, among other things, place limitations on the IB issuance of third-party checks or checks exceeding certain amounts. One requirement under the subsection (f) amendments is that the granting of check issuance authority to the IB be conditioned on the IB providing a written representation to the CB that the IB maintains and shall enforce supervisory procedures with respect to check issuance. We support this requirement, and believe that many CB's already require such representations through the clearing agreement or a separate document. However, the subsection would go further to require that the written procedures of the IB be "satisfactory to the carrying organization."

This language could be construed as placing a supervisory responsibility for the check issuance procedures (as opposed to maker or drawer liability) on the CB. This is in direct contradiction to the language of Rule 382(b)(4) which specifically permits the responsibility for the "receipt and delivery of funds (emphasis added)" to be allocated in accordance with the clearing agreement.

The NASD-R apparently recognized this contradiction and deleted this language from its proposed parallel amendments to Conduct rule 3230. The Committee urges that this language, therefore, be deleted from subsection (f) of the final Rule 382 amendments.

E. Role of the Clearing Firm

The proposed amendments appear to be a reaction to sales practice abuses, alleged or real, that have recently been covered in the media and which have received substantial regulatory attention. It is nevertheless important that the role of the CB and the critical public policy considerations supporting the allocation of responsibility between IB's and CB's be clearly understood. IB's are often the innovators in the securities industry. Novel ideas, such as

discount brokerage, would not exist unless, at least at their start, a CB were willing to provide a safe depository for customer assets and a means of order execution. Likewise, IB's offering specialized services, local contacts or boutique research may lack the resources or expertise to become self clearing. CB's provide these services and allow for innovation in the IB community.

An economically viable clearing function has allowed for the growth of IB's while providing their customers with the stability and technological innovation the usually larger CB's can offer. Overall, the system has worked extremely well and it appears that IB's have no greater incidence of customer dissatisfaction than other firms. In addition, NYSE Rule 382, NASD-R Conduct Rule 3230 and a substantial body of case law recognize that it is appropriate to allocate responsibility between CB's and IB's. The result is cost efficiency, innovation in the industry, and stability for customer assets. Any regulatory initiatives which create CB responsibility for sales practices and other activities normally allocated to IB's will fundamentally alter the nature of the clearing function by significantly increasing the economic cost and legal risk of serving as a CB. The end result will be at a minimum, a substantially increased cost for clearing services, which may effectively make them unavailable to many potential new firms which do not have the capital resources to support their own back-office and execution services. Had such barriers to entry existed a generation ago, numerous former and current IB's, who are today leading members of the NYSE in areas such as underwriting, discount brokerage and retail brokerage services to small investors, might not exist. The ever increasing complexity of operational services due to technology, globalization, product sophistication and other factors only make barriers to entry greater in the absence of a viable clearing function.

F. Conclusion

The Committees generally support the NYSE amendments to the extent they will enhance the ability of SROs to perform their regulatory functions, without altering the ability of CB's and IB's to allocate responsibility for the activities set forth in Rule 382(b). Furthermore, the Committees strongly condemn the micro-cap stock fraud in which a few IB's allegedly engaged. However, the solution to addressing this problem does not lie in placing supervisory responsibilities on CB's which contract to perform operational services, and which have little or no control over the sales or hiring practices of IB's. All that such an approach will accomplish is to stunt the growth of the securities business, adversely impact capital formation and diminish protection of customer assets.

The real solution is to strengthen the regulatory process so as to prevent those who would perpetrate stock fraud from gaining a foothold in the industry, or, at least once discovered, being denied the opportunity to repeat their improper activities. In that regard, we would respectfully suggest that regulatory initiatives be directed at matters such as heightened scrutiny of the registration process with respect to broker-dealers, issuers and individuals, providing meaningful protection to broker-dealers with respect to Form U-5 disclosures, more frequent inspections of new broker-dealers or those with recent histories of regulatory problems, and re-examination of penny stock regulations, particularly with regard to spreads on such securities.

We trust these comments will be helpful and will be carefully considered by the NYSE and the Commission. A viable clearing function, unimpaired by misplaced supervisory burdens, is critical to the growth of the securities industry and the well-being of public investors.

Thank you for the opportunity to comment. If you have any questions regarding the content of this letter, or if we can otherwise be of assistance please contact Michael D. Udoff, staff advisor to SIA's Ad Hoc Clearing Committee at (212) 618-0509.

Sincerely,

Thomas J. Berthel, Chairman, Local Firms Committee

Edward Schlitzer, Chairman, Clearing Firms Committee

Thomas A. Franko, Ad Hoc Clearing Subcommittee

cc:

Hon. Arthur Levitt - SEC; Dr. Richard Lindsey - SEC; Richard Walker - SEC; Michael Macchiaroli - SEC; Edward Kalwasser - NYSE; Sal Pallante - NYSE; Ray Hennessy - NYSE; Donald Van Weezel - NYSE; Mary Schapiro - NASD; Elise Walter - NASD; Mary Alice Brophy - NASD; Alden Atkins - NASD; Elliot R. Curzon - NASD

Footnotes:

[1] Local firms are generally defined as broker-dealers serving one geographic area and having less than 50 employees. Local firms comprise more than half of SIA's membership and virtually all such firms clear through others.

[2] The Securities Industry Association is the trade association representing more than 780 securities firms headquartered throughout North America. Its members include securities organizations of all types-investment banks, brokers, dealers, specialists, and mutual fund companies. SIA members are active in all markets, and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of investment services and account for approximately 90% of the securities industry's revenue in the United States.

[3] See SEC File No. SR-NASD-97-76 at p. 7,8 October 14, 1997

[4] See Norman S. Poser, Broker-Dealer Law and Regulation, Section 2.4.2.(Broker-Dealers, as Clearing Agents) (1995)