Securities Industry Association

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Belinda Blaine
Senior Special Counsel
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Ms. Blaine:

Thank you for giving the Securities Industry Association ("SIA")[1] the opportunity to respond to the study by the Securities and Exchange Commission (the "Commission") of disparate state licensing requirements for associated persons of broker-dealers and methods by which states may achieve greater uniformity in registering securities professionals. SIA believes that this study, which was mandated by the National Securities Markets Improvement Act of 1996 ("NSMIA") [2], presents a unique opportunity to review the fundamental purposes of registering or licensing agents and how those purposes might best be accomplished in the context of the modern securities marketplace.

The securities industry would not exist without the trust of investors, and we therefore are second to no one in believing in the importance of a strong and comprehensive regulatory scheme to punish and deter fraud. State regulators are an important element of the system that protects both investors and honest securities professionals from the tremendous damage that a relatively few wrongdoers in the industry can inflict. SIA believes that to fulfill this important function effectively, state regulation of broker agents should be uniform and transparent, and focused directly on the expeditious protection of investors rather than regulatory convenience. We see a number of areas for improvement and believe the SEC's study can play an important role.

The purpose of this letter is to provide a narrative discussion of the benefits and the problems that SIA perceives in the current scheme of state registration requirements for broker-dealer agents. Concrete empirical data on many of the points raised is difficult to come by for two related reasons. First, state registration standards and licensing processes generally invest a great deal of discretion in state administrators, resulting in many *de facto* requirements and practices that are difficult to identify and challenge. Second, while we in no way question the good intentions and important roles of state securities administrators, we have found that many broker-dealers are reluctant to document specific problems that they have encountered with

some state administrators, largely because they do not want to imperil their working relationship with those state administrators. Despite these obstacles, we have been able to collect information supporting many of our concerns, and we are in the process of collecting additional information which we intend to submit in about two weeks. [3]

Background

This study is very timely given recent developments in the regulation of the securities industry on the federal and state levels. In enacting NSMIA, the Congress recognized that certain securities markets activities are fundamentally national in scope, and as such should be primarily or exclusively regulated by the Commission. For example, NSMIA

- requires that securities traded on national markets should be regulated primarily or even exclusively at a national level through the Commission, while states should continue to require registration of offerings that are local or regional in nature;
- bars states from setting books and records or capital, margin or bonding requirements that are different from, or in addition to, SEC or SRO requirements;
- seeks to facilitate the ability of brokers to provide uninterrupted service to existing customers who relocate, temporarily or permanently, outside the state of their residence;
- eliminates the overlap of state and federal oversight of investment advisers and investment adviser representatives by making a clear delineation between those regulated primarily by the Commission aAt the same time, Congress recognized the importance or preserving a role for states in policing against fraud by preserving their general anti-fraud authority. Thus, the thrust of the changes made by NSMIA is to try to achieve more efficient regulation of participants in the national markets, while preserving the role of states as the "local cop on the beat" policing against fraud and focusing on regulatory issues of local import. With the movement away from state-by-state registration and regulation of some securities offerings and investment advisers, SIA believes it is appropriate and necessary to consider a new approach to registration of broker-dealer agents. [5] It is in this context that we review state registration requirements for broker-dealer agents.

Many of the problems of inconsistent state practices in agent registration are reflected in Table A. This table is based on a confidential survey of 10 firms, and reflects the average number of weeks that certain states take to process initial applications and transfer applications for broker agents, from the time that the broker agent's application is approved by the NASD. The table indicates delays across the board of a week or more in 29 states and the District of Columbia. Moreover, there are great variations among these states even for broker agents with no disciplinary history. As discussed below, these blanket delays in registration disadvantage customers as well as broker agents and their firms. Particularly in connection with transfers of agent registration from one firm to another, the delays appear to be largely a matter of state administrative convenience, and may work at cross-purposes to investor protection and the interests of a broker's customers.

The CRD System.

There has been significant progress toward uniformity with respect to agent registration over the years. There have been two central elements of this evolution toward uniformity. First, a uniform

examination for state licensing was implemented and administered by the National Association of Securities Dealers ("NASD"). Second, the NASD, with the cooperation of state securities administrators and the securities industry, developed the Central Registration Depository ("CRD") to provide some relief from the patchwork of state registration requirements for broker-dealers and agents. CRD has served as a useful "one stop" filing system for registration of agents, as well as a depository for registration information.

The CRD has improved the registration process for securities industry professionals who are increasingly involved in conducting business with clients in other jurisdictions. States have helped this process by amending their securities laws to allow for registration through CRD. Instead of taking different examinations and filing separate applications for registration in multiple states, an agent can now become registered in any number of states by filing one application with the CRD and checking boxes indicating the states in which he or she wishes to register.

Improving uniformity and streamlining the process for filing applications for registration, however, has not eliminated the problem for agents whose profession requires them to register in multiple jurisdictions. As discussed below, the differences among states in approving registrations, and in interpreting and enforcing laws that are semantically identical make the goals of "uniformity" and "one stop" filing elusive.

Unnecessary Delays in Initial Registration Approval.

Although states receive substantial revenues from fees assessed to the securities industry, relatively little of the revenue is dedicated to oversight of the industry in the states. This reallocation of resources away from oversight has resulted in, among other things, unnecessary delays in approval of registration applications. As Table A reflects, after filing an application for state registration with CRD, an agent may have to wait for weeks before having a registration approved and being able to service his or her clients in that state.[6] This is an inconvenience not only for the firm and the agent, but for the clients.

Many state securities administrators have a limited time, frequently 30 days, within which to consider an application. It is a common complaint that requests for additional information from securities administrators are received as a deadline approaches rather than when the application is submitted.[7] While this may be attributable to the limited resources of the administrator, it causes great difficulty for the securities professional trying to serve his or her clients.

The problem of delays is exacerbated for agents who put down a "yes" response to any part of Question 22 of Form U-4, which is part of the CRD registration system. Question 22 seeks disclosure of an agent's "disciplinary history," ranging from criminal convictions to unresolved customer complaints. Despite recent proposed changes to question 22, disciplinary history would still include unsubstantiated complaints and old information that may be of marginal, if any, relevance to a person's qualifications or fitness to be a broker-dealer agent. The catch-all nature of Question 22 can lead to unwarranted delays, particularly if state administrators fail to distinguish between disciplinary histories involving adjudicated findings of serious wrongdoing and a "history" consisting of an unverified and possibly specious customer complaint.[8] This makes it possible for any investor with a grudge and a 32-cent stamp (or e-mail capability) to

inflict real harm on a securities professional.

The magnitude of the problem is illustrated by Table A. There are 14 states that take at least four weeks, and three states that take as long as eight weeks, *on average*, to approve applications made by agents who have a "yes" answer to any part of Question 22. Thus, in fourteen states an unsubstantiated customer complaint against a broker agent may prevent that agent from serving his or her clients for one to two months when changing employers. Moreover, these delays may not be not attributable to a regulatory need for time to look into past disciplinary history. Officials in at least one state (Hawaii) have told securities firms that applications for agents who have a "yes" answer to any part of Question 22 will no longer even be considered until sixty days after submission. SIA can think of no legitimate regulatory reason for such a policy.[9]

Unnecessary Delays in Registration of Transferring Agents.

Agents moving from one firm to another can face problems similar to those of agents applying for initial application with a state. Delays in processing applications can leave an agent unable to service his or her clients merely because the agent is employed by a different firm. As with the system for initial registration, the system for transferring agents is unnecessarily slow and inequitable. Moreover, these delays inconvenience customers just as much as broker agents or their firms. Broker agents often have strong bonds of trust and confidence with their clients. Therefore, when brokers move to new firms, customers often wish to follow them. The customer's accounts can easily and quickly be electronically transferred from the books of the agent's former firm to his or her new firm. However, due to unnecessary delays in transferring registration, the agent whom the customer has followed to the new firm may be unable to service the newly transferred account for weeks.

The transfer problem is alleviated somewhat by the Temporary Agent Transfer (TAT) system whereby an agent with no disciplinary history is given what amounts to a conditional registration, pending final approval. However, the TAT system has significant limitations. The TAT process is generally not available for agents who are hired by a new firm more than seven days after leaving their previous employer. Moreover, like agents filing an application for initial registration, any disciplinary history will preclude an expedited approval of the application. Again, disciplinary history can include unsubstantiated customer complaints as well as regulatory violations, even if they were minor in nature and date back many years.[10]

A major part of the problem is that state securities administrators typically do not take notice of disciplinary action taken against an agent at the time such action is taken by another regulator. Because of the limitations of the CRD and choices that states make in allocating their limited resources, state administrators usually do not review an agent's Form U-4 until the agent transfers from one firm to another. This results in a system in which a transferring agent may be denied a registration because of a relatively minor violation that may have occurred years earlier, and for which the agent has already been disciplined. At the same time, another agent who may have a lengthy disciplinary record of recent and serious violations can continue to conduct business unnoticed by state regulators as long as he or she remains with the same firm. This process is not well suited to optimum investor protection.

We do not mean to suggest that state regulators are indifferent to these concerns. Regulators

and the industry have worked together to address some of these concerns through the redesign of the CRD, but the redesign has been delayed. We are left with a system of agent registration that has developed not because it is in the interest of investor protection, nor because it is fair to agents. Rather, it is a system that has developed out of expediency. Designed as a registration system, the CRD has come to be utilized by state regulators as an enforcement tool - - a purpose which was not intended, and for which it has little capability.

The Effect of State-by-State Registration and the Current System of Enforcement.

State regulators have the authority to deny, suspend or revoke a registration for any number of violations from very serious to very minor. For example, state administrators can take action against an agent's registration based on action taken by another regulatory agency, including other state securities regulators. This authority can usually be exercised regardless of the nature of the underlying activity for which the agent was disciplined, even if the activity would not constitute a violation in the state relying on the action of the other regulatory agency.[11] In contrast to this open-ended authority, state regulators have recognized in other contexts some outer limits to the extent to which one state should penalize a broker agent for conduct that was the subject of regulatory action by another state. [12]

There are several concerns that this registration and disciplinary system raise. Although these actions are ostensibly licensing or registration actions in nature, the effect is to inflict multiple disciplinary actions imposing multiple punishments on an agent for the same violation(s). This problem is exacerbated by the fact that the punishments can be vary greatly in degree, be imposed consecutively, and be imposed years after the precipitating event and even years apart.

This system also can erode due process protections. When an agent is faced with a denial, suspension or revocation of his or her registration, due process is supposed to be afforded, including proper notification, opportunity to be heard, and an appeals process. In practice however, state regulators frequently request that an application for registration be withdrawn. This process is often preferred by regulators who, as a result, need not conduct a hearing and prove allegations which will then be subject to appellate review. Regulators have enormous leverage in getting firms and their agents to accede to such requests, because of the exponential collateral consequences described above that could result from a denial of an application in one state. SIA believes that the open-ended consequences flowing from denial of registration results in a system that is neither an effective way to protect investors nor a fair way to discipline agents.

"State Law" and "State Policy"

In many states there is a hidden second tier of regulation: in addition to that state's written securities laws and regulations there are also unwritten policies and interpretations applied by state regulators. The policies and interpretations of law pose problems with which practitioners, but few others, are aware because they often do not even rise to the level of written policy and are not subject to public scrutiny through the legislative or regulatory process. The unwritten nature of this "desk drawer" regulation also makes it difficult or impossible to publicly identify.

Most states, as far as we are able to determine, have informal policies prohibiting any solicitation of clients by any firm or agent without prior registration with the state. This

"interpretation" or "policy" has been opposed by SIA when states have sought to impose it through regulation or policy statement because it is inconsistent with the plain language of the Uniform Securities Act of 1956 and the law of most states. The Uniform Act and most state laws prohibit "transact[ing] business in this state as a broker-dealer or agent," without being registered. But an "agent" is defined as one "effecting or attempting to effect **purchases or sales of securities**" *[emphasis added]* on behalf of a broker-dealer. State policy requiring registration of persons merely soliciting clients is inconsistent with the law of most states.

The tremendous growth of commerce over the Internet has heightened the industry's concerns about the disparity between what the Uniform Act says is the jurisdictional threshold and what state administrators actually apply as a threshold. As more and more investors access broker-dealers through Internet web sites, the unwritten and vague *ad hoc* nature of these policies is going to become even more troublesome. While we appreciate that a number of state administrators have recognized the problem and tried to make some accommodations to communications over the Internet, this issue still needs to be comprehensively addressed.

Another "policy" is the requirement in some states that an application for registration be accompanied by what is typically called an "affidavit of compliance" which essentially requires an applicant to affirm that he or she has not done business in the state in violation of state law (i.e., has not done any business in the state because it obviously would have been prior to registration).[13] This creates a serious problem when coupled with the policy stated above regarding solicitation. This is also a problem in the situation of an agent who unwittingly conducts business in the state when a client vacations or moves to that state without notifying the agent (a problem that has been mitigated, though not resolved, by NSMIA). Agents are forced to either withdraw an application and never do business in that state, or expose themselves, and their firms, to disciplinary action by the state (and other states) and civil liability.

These, like many other state registration requirements, do little, if anything, to appreciably enhance investor protection or to guard against unscrupulous brokers. Instead, for the administrative convenience of state administrators, they impose unnecessary and excessive burdens on the securities industry and criminalize otherwise innocent behavior by legitimate professionals making every effort to conduct business lawfully.

Addressing Some State Concerns

As with other professions, both states and the broker-dealer community have a strong interest in ensuring that a securities professional is competent to practice in his or her state. The securities industry and state regulators have both strongly supported the development of the current uniform testing system, as well as a national continuing education regime. Because of these efforts, all states can be assured that a securities industry professional is competent. Separate and non-uniform registration requirements imposed by each state in which that professional's customers resides in our view adds no additional "quality control."

We understand that another concern for states is the itinerant "professional" without an identifiable location of business. However, with agent registration and annual renewal, even through the CRD, and state registration of the broker-dealer employing the agent, SIA does not believe registration of agents in every state in which they conduct business is required "to keep

track of" them. Securities professionals, perhaps more than any other professional regulated by states, are called upon to serve clients in multiple states. Yet other professionals that are likely to service clients in other jurisdictions, such as lawyers and doctors, can do so in any number of ways without meeting onerous registration requirements prior to providing such services.

Possible Solutions

1. National Registration. This study presents a unique opportunity to comprehensively review state registration of broker-dealer agents. Rather than adopting a piecemeal approach of narrowly addressing problems, SIA recommends that the Commission consider taking a broad prospective approach to registration. That is, we suggest that the Commission explore what type of system would best serve the interests of investors, regulators and the industry starting from a blank slate. Merely making minor adjustments to the current system is likely to be as tedious as it will be ineffective in correcting problems facing regulators and the industry. [14] The problems with the current system are a result of the underlying scheme of state registration and discipline. While improvements to the CRD and limited exclusions and exemptions from state registration can mitigate some of the problems, SIA believes that this is an appropriate time to reconsider the fundamental approach to state registration of agents.

SIA suggests creation of a "national registration" system for agents as the best solution to the problems facing regulators and the industry. We believe that a national registration system can be designed in a way that can preserve a state's right to preclude an agent from conducting business in the state. We also believe such a system could be designed to preserve state revenues at their current level.

Under a national registration system, a qualified agent would be eligible to conduct business in any state in which the employing broker-dealer is registered. As with investment adviser representatives of federal covered advisers, all states would retain anti-fraud authority over the nationally registered agent. A state would also be able to preclude an agent from doing business in the state, after a hearing, if the agent were found to have engaged in certain specified conduct.

SIA firmly believes that a national registration system is appropriate and in the best interests of investors, regulators and the securities industry. Given the recent national approach to registration of securities and investment advisers, as well as the ongoing redesign of the CRD, we believe that this is the most appropriate time to undertake this effort. We strongly encourage the Commission to endorse this approach.

2. Interim Solutions. Short of a national registration system, SIA believes that certain specific problems must be addressed. As discussed above, we believe that the Commission's study should include the following recommendations, which would substantially benefit the broker agent registration process without any harm (and in some instances clear benefit) to investor protection:nd those regulated primarily by the states. [4]

- Non-uniform filings, particularly the affidavit of compliance, should be eliminated.
- Some restrictions should be placed on the ability of a state to take duplicative enforcement action against an agent based merely on disciplinary action taken by another state, based on conduct that either (i) occurred within the other state, (ii) that is not independently a violation of the law of the sanctioning state, or (iii) that occurred beyond a

fixed period of time.

- Continuing to improve the CRD system, while simultaneously encouraging all states to take prompt and coordinated action when violations occur, rather than focusing primarily on the point in time when broker agents switch firms.
- Clearer and more uniform state policies on issues that arise out of solicitation of business, transient clients and inadvertent violations of registration requirements.

Thank you for this opportunity to provide our input regarding state registration of broker-dealer agents, an area that has long concerned us and effects investors, regulators and industry alike. We are confident that continued cooperation will lead to significant improvements over the current system of registration. As noted above, we are preparing additional information on many of the points that we raise. If you have any questions about this letter or would like more information on any of the points discussed, please contact the undersigned or George R, Kramer, Vice President and Associate General Counsel, at 202/296-9410, or Daniel J. Barry, Director of State Regulation and Legislation, at 212/608-1500.

Sincerely,

Stuart J. Kaswell
Senior Vice President and General Counsel

cc:
The Honorable Arthur Levitt, Chairman
The Honorable Steven M.H. Wallman, Commissioner
The Honorable Isaac C. Hunt, Commissioner
The Honorable Norman S. Johnson, Commissioner
Dr. Richard Lindsey, Director, Division of Market Regulation
Robert L. D. Colby, Deputy Director, Division of Market Regulation
Ann L. Velcek, Attorney Adviser, Division of Market Regulation

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Table A

This table represents the results of a survey of 10 firms regarding their experiences with delays in particular states in registering broker agents and transferring registration of broker agents not eligible for the Temporary Agent Transfer system.

State	WITHOUT Disciplinary Hearing	WITH Disciplinary Hearing
ARIZONA	2 WEEKS	4 WEEKS
ARKANSAS	1 WEEK	1 WEEK
D.C.	1 WEEK	2 WEEKS
FLORIDA	1 WEEK	2-3 WEEKS
HAWAII	4 WEEKS	UP TO 8 WEEKS
IOWA	4 WEEKS	6 WEEKS
KENTUCKY	1 WEEK	2 WEEKS
LOUISIANA	1 WEEK	3 WEEKS
MAINE	4 WEEKS	8 WEEKS
MICHIGAN	1 WEEK	4 WEEKS
MINNESOTA	1 WEEK	2 WEEKS
MISSOURI	1 WEEK	3 WEEKS
MISSISSIPPI	1 WEEK	2 WEEKS
NORTH CAROLINA	1 WEEK	3 WEEKS
MONTANA	1 WEEK	3 WEEKS
NORTH DAKOTA	1 WEEK	3 WEEKS
NEW JERSEY	2 WEEKS	8 WEEKS
NEW MEXICO	1 WEEK	5 WEEKS
OHIO	1 WEEK	2 WEEKS
OKLAHOMA	1 WEEK	2 WEEKS
RHODE ISLAND	2 WEEKS	5 WEEKS
SOUTH CAROLINA	1 WEEK	3 WEEKS
SOUTH DAKOTA	2 WEEKS	4 WEEKS
TENNESSEE	1 WEEK	4 WEEKS
TEXAS	2 WEEKS	4 WEEKS
VIRGINIA	1 WEEK	2 WEEKS

VERMONT	2 WEEKS	5 WEEKS
WISCONSIN	1 WEEK	4 WEEKS
WEST VIRGINIA	1 WEEK	4 WEEKS
WYOMING	1 WEEK	3 WEEKS

Footnotes

1 The Securities Industry Association is the leading proponent of capital markets, bringing together the shared interests of about 700 securities firms throughout North America to accomplish common goals. SIA members -- including investment banks, broker-dealers, specialists, and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the U.S. SIA members collectively account for approximately 90 percent of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans.

2 Pub. L. No. 104-290, Section 510(d).

3 However, neither this letter nor the impending supplement are intended to duplicate the SEC's own study. As part of its study, we understand that the SEC is surveying a large number of securities broker-dealers. While we are not privy to the results of that survey, we believe that those results are likely to provide further support for many of our concerns. We understand that a number of large retail firms employing thousands of registered agents have responded to the SEC survey. The number of broker-dealer agents is quite concentrated in a relatively small number of large firms. Therefore, the results could be statistically significant even if the response rate from smaller firms (which have fewer resources to devote to matters such as survey responses) is low. For example, just six SIA members employ over 50,000 registered representatives, or approximately 10 per cent of all registered representatives. Because of their large number of employees and the national scope of their business, larger firmsuch as these are well-positioned to identify problems with irregular state requirements.

4 Pub. L. No. 104-290, Sections 303 and 304.

5 NASAA has also recognized that there are certain circumstances in which a less onerous registration procedure may be appropriate when it adopted the Limited Registration of Canadian Broker-Dealers and Agents Blue Sky L. Rep. (CCH) ¶ 5521.

6 Moreover, some states, such as Florida, have a separate registration process for branch locations. If a securities firm seeks to get an agent registered in Florida so that he or she can work as an independent contractor or staff a new branch office, the agent's registration and the branch location are separately considered by different state personnel. We understand that it takes approximately 3-5 weeks to register a branch location in Florida.

7 For example, we have been told that Massachusetts administrators often sends as many as two or three consecutive information request letters for one application. This results in a deferral of registration well beyond the 30 day limit in the statute.

8 Our members have told us that at least two states, Maine and Florida, often delay approval because of matters that are shown on the CRD as non-disclosable. For example, customer complaints or misdemeanor items such as traffic violations that have been dropped from CRD

can cause delays in those states. One member has told us of an instance in which Maine authorities asked for all documents regarding a 15-year old item.

9 The arbitrary nature of registration approvals in some states is also illustrated by the way states handle re-registrations. Often a broker agent will drop a registration in a particular state because he or she no longer has clients there, and later apply for re-registration in that state. It is not uncommon for a state to grant license registration the first time, but deny or delay it the second time, because of a disciplinary history item that was already on the agent's record when he or she initially registered.

10 The net result is that, according to information given to us by two major firms, approximately one-third of broker agents are not eligible for the TAT system when they move to a new firm.

11 Many states do require that such action be taken within ten years of the underlying activity for less serious violations, but in many instances, action against a registration can be taken at any time. Another limitation on this authority is an estoppel provision precluding such action more than thirty days subsequent to registration for violations known to the state regulator at the time of registration. This provision appears to be less uniformly adopted and there is some dispute as to whether actual or constructive knowledge is required.

12 For example, most states have enacted provisions in accordance with the state version of the SEC's Regulation D (generally known as ULOE -- Uniform Limited Offering Exemptions), which provide for automatic waiver of provisions barring broker agents with regulatory violations from participating in limited public offerings if the state which cited the agent renews the agent's license. See e.g., Code of Mass. Regulation Sec. 14.402(f)(7) and (8).

13 We have been advised by our members that the following states generally require such compliance affidavits: Connecticut, Iowa, Massachusetts, Maryland, Maine, Pennsylvania, Rhode Island, and Vermont. We also understand that other jurisdictions, such as Ohio and the District of Columbia, have less extensive requirements for compliance affidavits. Other states also require unrelated affidavits on matters such as whether state taxes are up-to-date. All such requirements detract from the goal of a uniform registration process.

14 It is worth noting that it took two years for the NASD, state regulators and industry to negotiate amendments to question 22(I) concerning customer complaints on Form U-4 and agree on a formula for deletion of certain information. Simultaneously, the NASD has been working on a redesign of the CRD, a project that continues to run into problems and delays.