



Securities Industry Association

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April 16, 1997

Ms. Denise Voigt Crawford
State Securities Board
P.O. Box 13167
Austin, TX 78711-3167

Re: Proposed Rules for Sales of Securities at Financial Institutions

Dear Ms. Crawford:

INTRODUCTION

The Securities Industry Association¹ ("SIA") appreciates the opportunity to present its comments on the North American Securities Administrators Association's ("NASAA") proposed Model Rules for Sales of Securities at Financial Institutions (the "Model Rules"). Comments on NASAA's Model Rules were submitted by SIA's State Regulation and Legislation Committee, Bank Retail Broker-Dealer Committee, and Financial Institutions Services Steering Committee.

The Model Rules outline certain regulatory principles for service arrangements between broker-dealers and financial institutions. The Model Rules include definitions of confidential information, financial institution, and participating broker-dealer; sets parameters when a broker-dealer may employ a person who is also employed by a financial institution; and proposes rules regarding required disclosures, physical setting, advertising, product names, unregistered employee compensation, confidentiality and duties of participating broker-dealers.

GENERAL COMMENTS

SIA believes that concepts set forth in the Interagency Statement on Retail Sales of Nondeposit Investment Products ("Interagency Statement") provide uniform guidance to depository institutions engaged in the sale of securities. In addition, the Securities and Exchange Commission's ("SEC") November 24, 1993 no-action letter to Chubb Securities Corporation ("Chubb") provides guidance to broker-dealers providing securities services on the premises of financial institutions through networking arrangements. Also, the National Association of Securities Dealers ("NASD") has revised its proposed rules for members operating on bank premises ("NASD bank broker-dealer rule") so they are consistent with the principles found in the Interagency Statement and Chubb. Taken together, these guidelines, interpretations and proposed rules provide a sound regulatory framework for broker-dealers and financial institutions, and serve the interests of investors and our members alike.

In reviewing the proposed Model Rules, SIA believes that where they are not duplicative of existing securities regulations, they conflict with existing Federal and state law. Most are impractical or excessively costly. If adopted, the Model Rules would create a confusing and burdensome regulatory scheme that would, in effect, "turn back the clock" on efforts to modernize the regulatory framework for the financial services industry. SIA urges that NASAA forego release of any Model Rules for Sales of Securities at Financial Institutions. Alternatively, SIA recommends that NASAA promote that state regulators follow the guidelines of the Interagency Statement, the Chubb Letter and the proposed NASD bank broker-dealer rule. At best, the Model Rules present the opportunity for adoption of one uniform rule unacceptable to broker-dealers in the fifty states. In the worst case, investors and broker-dealers would be faced with fifty differing interpretations of this unworkable proposal.

SPECIFIC COMMENTS

Absent NASAA's withdrawal of the Model Rules from consideration by state securities regulators, SIA offers the following specific comments that will make the Model Rules consistent with current and proposed regulations, and increase both firm and regulatory efficiencies.

Scope

The scope of the Model Rules is much broader than that of the Interagency Statement and the NASD's proposed rules. The Interagency Statement applies to the sale of non-deposit investment products "occurring on the premises of the institution." The revised NASD bank broker dealer rule applies to broker-dealer services conducted by members "on the premises of a financial institution where retail deposits are taken." The intent of this rule should be to minimize the chance for customer confusion in settings where insured and uninsured investment products are offered and where federal law or regulations require advertising of federal deposit or share insurance. SIA recommends that the words "on the premises of a financial institution where retail deposits are taken" be added after the word "services" in the first sentence.

Several members also expressed concern that the term "broker-dealer services" was not defined. SIA recommends that the term "broker-dealer services" shall mean the investment banking or securities business as defined in paragraph (1) of Article I of the NASD By-Laws.

Definitions

SIA suggests that (c) "Participating Broker-Dealer" be clarified by adding the words "on the premises of the financial institution where retail deposits are taken" after the word "services" to make the Model Rule consistent with existing and proposed regulations.

Dual Employees

The preamble should be amended to provide that only an employee of the financial institution who is a registered person can perform any broker-dealer services which can be performed by a registered person of a broker-dealer.

Subsection (c) would prohibit a dual employee involved with broker-dealer services from identifying him or herself as an employee of, or implying that he or she is operating on behalf of the financial institution or its affiliate, unless the affiliate is a registered broker-dealer. There is

currently no requirement in any regulation to "segregate" functions of registered persons between securities and non-securities activities. This requirement would be impossible for a broker-dealer to monitor and supervise. This requirement does not appear to be rationally related to any specific risk or concern and conflicts with current licensing practice and policy. In addition, SIA believes Subsection (d) should be revised to conform with the language found on page 4 of the Chubb Letter, which holds that the amount of any transaction-related compensation paid to dual employees under a networking agreement will be determined solely by the broker-dealer.

Disclosures

The Model Rules include additional disclosures that are not required by the Interagency Statement or the proposed NASD bank broker-dealer rule. Specifically, subsections (c), (e) and (f) are new disclosures that are redundant and unnecessary. Subsection (a) should be revised to conform to the language adopted by the banking regulators and the NASD. NASAA should also adopt the abbreviated disclosure format adopted by the banking regulators and the NASD. The introduction of a disclosure requirement for SIPC insurance is unnecessary as it is repetitive of the provision set forth in subsection (a). The disclosure, as stated, would be insufficient under SIPC rules which require a much more detailed explanation of SIPC. In addition, some would argue that this requirement is discriminatory and prejudicial to broker-dealers affiliated with a financial institution because broker-dealers who are not affiliated with a financial institution would not be required to make this disclosure.

The requirement in subsection (f) is unnecessary and duplicative of existing disclosures. Mutual fund companies and variable insurance providers have a myriad of disclosures regarding fees and charges. These disclosures are required under existing federal law. Placing the responsibility for these disclosures on the broker-dealer would represent an additional burden without any commensurate increase in consumer protection.

Ministerial Duties

This section can be simplified by providing that an unregistered person may not engage in any activity for which registration as a representative of the broker-dealer would be required. Prohibited activities are listed in the Chubb letter. Further, registration as a representative is not required to perform the activities listed in subsections (c), (e) and (f) of section 2 under current NASD regulations.

Physical Separation of Brokerage Activities

This requirement should be deleted as it is practically impossible to enforce. For many broker-dealers operating on the premises of a financial institution noninsured and insured products are sold at the same desk. In addition, NASAA's language with respect to a broker-dealer's "heightened responsibility to distinguish its services from those of the financial institution" is so vague that it is subject to broad interpretation and virtually unenforceable. SIA urges NASAA to adopt the NASD's proposed language that sales of non-deposit products should be conducted in a physically distinct location "wherever practical."

Advertising

The requirements for disclosures in advertising and promotional material have been well established by the NASD in Rule 3310 and various interpretations. These interpretations have given substance and predictability to Rule 3310, which would be sorely lacking under this proposal. In addition, the NASD expressly amended their proposed bank broker-dealer rules because certain requirements were duplicative of existing NASD rules. The proposed NASAA rules differ significantly from existing regulations in certain regards. SIA urges NASAA to review the necessity of adopting Model Rules given the extensive regulation which already exists. Also, the Model Rules should be amended to include the abbreviated disclosure format adopted by the banking regulators and the NASD.

Restricted Products

SIA believes this paragraph should be revised to conform with the Interagency Statement. A non-deposit investment product must not have a name that is identical to the name of the financial institution. Appropriate steps consistent with the rationale of the Interagency Statement should be taken to assure that the issuer of the product has complied with applicable requirements established by the Securities and Exchange Commission regarding the use of similar names.

Unregistered Employee Compensation

Both the NASD and the Interagency Statement recognize the use of employee referral programs with certain limits. The prohibition contained in the Model Rules is contrary to the existing regulations that permit the payment of a one-time nominal cash referral fee by the financial institution. SIA suggests that NASAA revise this section as follows:

"No broker-dealer or person associated with a broker-dealer shall give or permit to be given cash or non-cash compensation to any person (other than persons registered with the broker-dealer and other broker-dealers) in connection with locating, introducing, or referring prospective brokerage account customers to the broker-dealer."

This language is similar to the NASD's rule proposed in Notice to Members 97-11. SIA believes that the NASD needs to clarify its proposed rule with respect to indirect compensation, which may be interpreted as intending to control incentive programs for unregistered person by the financial institution. SIA reserves the right to revisit this issue until we have had sufficient time to review and comment on the NASD proposed rule. Nevertheless, SIA believes it is unnecessary for NASAA to regulate the payment of referral fees by a financial institution to its employees.

Confidentiality

SIA believes that the section on confidentiality conflicts with existing federal law and some state privacy laws. The NASD removed its language on confidentiality from its proposed bank broker-dealer rules because Congress was considering the sharing of customer information between financial institutions and their affiliates and subsidiaries at the time the NASD rule was proposed for comment. The NASD wisely refrained from issuing guidelines on privacy until Congress had an opportunity to develop a federal policy on the issue. NASAA, in fact, expressed support for this approach in its comment letter to the NASD.

Since the close of the comment period on the NASD's proposed bank broker-dealer rules, the

Fair Credit Reporting Act (FCRA) was amended to permit members of the same corporate family to share non-experience consumer information (e.g. information contained in credit applications or reports from credit bureaus, demographic firms, or other third parties) without being subject to FCRA requirements. In particular, the amendments allow affiliates to share non-experience information, either directly or through a central data base, so long as it is clearly and conspicuously disclosed to the consumer that information may be shared among the affiliates, and the consumer is given the opportunity, before the information is initially communicated, to opt out of the sharing arrangement. This approach was adopted by the NASD in Notice to Members 97-12. In the NASD proposal, prior "written" consent is required only when the information is released to a person other than a business affiliate. In addition, some would arg that this requirement is discriminatory and prejudicial to broker-dealers affiliated with a financial institution because broker-dealers who are not affiliated with a financial institution would not be required to comply with this rule. Recognizing this, the NASD revised its proposed rule governing the use and release of confidential information so it would apply to all members. SIA reserves the right to revisit this issue until we have had sufficient time to review and comment on the NASD proposed rule.

Participating Broker-Dealer Duties

Several of the duties enumerated in this section, specifically subsections (c), (d), (e), (f), and (h), attempt to regulate the activities of the financial institution and as such are without jurisdictional basis. They should be deleted. Subsection (b) should be revised to clarify that state securities regulators will be allowed access to the broker-dealer's branch office. SIA suggests the following language:

"A broker-dealer's personnel and state securities regulators can access the broker dealer's branch offices and the premises where the broker-dealer's books and records are located;"

Subsection (g) should be clarified. It would be virtually impossible and excessively costly for a broker-dealer to conduct on-site inspections at least annually at every branch office, walk-up window, kiosk or other location were investment products may be offered.

Conclusion

The proposed Model Rules are redundant, excessive and ultimately confusing to investors and broker-dealers alike. Broker-dealers operating on bank premises must comply with the Interagency Statement, the Chubb Letter and NASD regulations. Additional rules governing standards of broker-dealer conduct, setting, networking and brokerage affiliate agreements, customer disclosure and written acknowledgment, communications with the public and notifications of terminations have been filed with the SEC. In addition, new rules governing the use of confidential information and referral fees have been exposed for comment by the NASD. Clearly, there already exists a regulatory framework governing broker-dealer activity on the premises of a financial institution. It is the opinion of SIA and the undersigned Committees that NASAA would better serve the interests of investors by withdrawing its proposed Model Rules in light of the current and developing regulatory environment.

Thank you for the opportunity to comment on these Model Rules.

Sincerely,

Brewster M. Ellis
Chair
Financial Institutions Services Steering Committee

Dwight Moody
Chair
Bank Retail Broker-Dealer Committee

John Wurth
Chair
State Regulation and Legislation Committee

cc: Robert Burrow, Thomas E. Geyer, Dorothy Sanford, William Verant, Patty Labarthe, David Cohen, Melanie Senter Lubin, Suzanne Sarason, Diana Jackson, Clark R. Hooper, NASD

Footnotes

1 The Securities Industry Association brings together the shared interests of more than 760 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, or \$100 billion, 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.