

May 28, 1999

Joan C. Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500

Re: Proposed Rules Regarding Approval Procedures for Day Trading Accounts

Dear Ms. Conley:

The North American Securities Administrators Association's Project Group on Day Trading appreciates this opportunity to comment on the proposed rules.

We welcome NASDR's attention to the issues raised by the growth of the day trading industry. The proposed rules relate to suitability and risk disclosure, two matters that are vitally important to investors.

We believe that NASDR's existing rules and policies concerning suitability and risk disclosure already create obligations concerning the day trading industry. Further, we believe that practices of some firms in the day trading industry have violated these existing rules and policies. Nonetheless, we support the issuance of the proposed rules, which explicitly specify the industry's obligations, and we respectfully offer the following comments.

Application to New and Existing Customers

We believe the rules should apply to both new and existing customers, particularly in view of the abuses that have occurred to date. Firms should be required to ensure that day trading is suitable for both categories of customers, and they should be required to disclose the risks to both new and existing customers.

Application to "Non-Institutional Customers" Rather than Only "Natural Persons"

The application of the rules should not be limited to "natural persons," but should include "non-institutional customers" as defined in NASD Conduct Rule 2310(c). Many day traders have opened accounts under partnership or corporate names, sometimes on the recommendation of the brokerage firm. These customers typically are no more sophisticated than customers who open their accounts under their own names.

Further, many purported partnership accounts have actually been devices for customers to trade the funds of third parties. This has led to suitability problems and other abuses.

Firms have not necessarily obtained financial information from these third parties, and the third parties often have not understood the risks to which their funds have been exposed.

*Application to All Non-Institutional Customers, Not Only Those to Whom Firms
"Recommended" Day Trading*

We believe the broad application of the rules, included as an alternative approach in the proposal, should be adopted. Specifically, the rules should explicitly apply to all non-institutional customers of brokerage firms that market themselves as offering day trading services, or otherwise promote day trading.

Even under the proposal's broad interpretation of the term "recommendation," the rules apparently would not cover certain situations where a firm's duties respecting suitability and disclosure should apply. For instance, certain customers could be referred to a firm by other customers, rather than specifically drawn by the firm's promotional activities. The application of the rules to all non-institutional customers would avoid the uncertainty and hair-splitting that otherwise can be expected to result.

Determination of Source of Funds

Item 8 of the Request for Comment asks, among other things, whether firms should be required to determine the source of funds used for day trading. We believe the current NASD suitability rule and policies require firms to make inquiries as to the source of funds under certain circumstances. For instance, if a customer reports a net worth of \$20,000, but deposits a check for \$100,000, the firm should inquire as to the source of the funds.

Nonetheless, we believe it is appropriate for the rules to include an explicit requirement that day trading firms' suitability obligations include a determination of the source of funds to be used. Certain day trading firms have encouraged customers to use borrowed funds and the funds of third parties. Adoption of this requirement would help stem the abuses that have occurred.

In addition, the rules, or commentary issued with the rules, should make it clear that firms' suitability obligations are applicable to all investors whose accounts or funds are traded by a third party.

Execution and Retention of Disclosure Statement

We believe the disclosure statement should be signed by the customer, with the firm required to retain a copy of the signed form.

Expansion of Content of Disclosure Form

We suggest that the disclosure under "Day trading is extremely risky" should caution against the use of any borrowed funds, not just the use of student loans and second mortgages.

In addition, the disclosure concerning short selling should caution that short selling exposes the customer to the risk of loss beyond the value of the account, thereby exposing the customer's other assets to the risk of loss. This risk, which is theoretically unlimited, is often not understood by non-institutional customers.

The disclosure should also include a warning that parties that trade the accounts of others, whether through trading authorizations, partnership agreements, or otherwise, or who trade with funds furnished by others, whether through pooled fund arrangements or otherwise, may be required to register under state or federal law and subject to the laws and regulations governing investment advisers. Further, the disclosure should be provided to all investors whose funds or accounts are being handled by the third party.

Representations as to Profitability

Finally, we would like to respond to the Item 3 of the Request for Comment, which asks whether the proposed rules should "require that any representations as to the profitability of an intra-day trading strategy be reasonably based on actual prior historical results." We believe that this issue is covered by existing NASDR rules and policies prohibiting deceptive marketing, and that some firms in the industry have violated these rules and policies. Nonetheless, just as we support the issuance of the proposed rules in order to make firms' obligations explicit with respect to suitability and risk disclosure, we also support the explicit requirement that representations concerning the profitability be based on facts.

Thank you for this opportunity. Please let me know if you have any questions, or if the Project Group can be of any assistance.

Very truly yours,

/s/David E. Shellenberger
Chief of Licensing
Massachusetts Securities Division
Chairman, NASAA Project Group on Day Trading