December 9, 1998

Mr. Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 5th Street, N.W.
Washington, DC 20549

Re: Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934
Release No. 34-40518
File No. S7-26-98

Dear Secretary Katz:

Please accept this comment letter on behalf of the North American Securities Administrators Association, Inc. ("NASAA")[1] in response to the release by the Securities and Exchange Commission (the "SEC" or the "Commission") of the re-proposed books and records requirements as amendments to Rules 17a-3 and 17a-4 of the Securities Exchange Act of 1934 (the "1934 Act"). NASAA welcomes this opportunity to provide input on this very important subject.

I. INTRODUCTION AND BACKGROUND

NASAA congratulates the Commission, and the Division of Market Regulation, in particular, on re-proposing the books and records amendments in a balanced and flexible manner to accommodate the needs of both regulators and industry. The U.S. securities markets are the strongest and most vibrant in the world in large part due to the effective and efficient regulations that guide them. The re-proposal is further evidence of the well-considered positions set forth by the SEC in establishing and amending its regulations. This letter outlines some minor revisions NASAA recommends to the amendments to provide even clearer guidance to those who are regulated under the rules and more efficient regulations by which regulators may police the securities markets. NASAA urges the Commission to adopt the re-proposed rules, with the minor revisions outlined later in this letter, as quickly as possible to establish the clear and important guidance that is necessary in this area.

NASAA also commends the Commission on re-proposing the rules in a manner that does not create any new concerns regarding year 2000 compliance issues for those

[1] In the United States, NASAA is the national voice of the 50 state securities agencies responsible for investor protection and the efficient functioning of the capital markets at the grassroots level.

who will be subject to the rules. The amendments contain alternative means by which firms may comply with the requirements of the re-proposed rules. Firms need not modify computer systems but rather, may establish separate cross-referenced documents to meet their obligations under the re-proposed rules. As a result, the Commission has proposed amendments that can be implemented almost immediately, with the benefits to investors, regulators and industry to follow.

As noted in that release, state securities regulators, through NASAA, began working toward a model uniform books and records proposal in 1993.[2] After years of meetings with representatives of the industry and vetting draft versions among the states, in 1995 the NASAA Broker Dealer Operations Committee[3] presented a proposal to the NASAA membership for approval. At that meeting, Chairman Levitt requested of NASAA that we postpone adopting our own model rule and instead work with the SEC to revise the federal record requirements to meet state needs[4].

In 1996, while the states and the SEC continued to work on this project, the National Securities Markets Improvement Act ("NSMIA")was into law. NSMIA precluded the states from adopting books and record requirements "different from or in addition to" those maintained at the federal level. Additionally, Congress recommended that the SEC work with the states to assure sufficient records exist to meet regulatory needs.[5] The states, through NASAA, continued to work with the SEC to revise the federal books and records rules to identify and require the creation and maintenance of minimum "core" records for the benefit of all regulators, as well as to meet the supervisory needs of the firms. Specifically, revisions to the rules were necessary to require records that would identify sales practice violations in an effective and efficient manner.[6]

In addition, as recognized by Congress through language included in NSMIA and under a Memorandum of Understanding among regulators[7], federal and state regulators

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[2] Books and Records requirements for Brokers and Dealers under the Securities Exchange Act of 1934. Release No. 34-40518 (to be codified at 17 C.F.R. pt. 240) (re-proposed Oct. 2, 1998).

[3] NASAA would like to thank the members of the Broker Dealer Operations Committee for their hard work on this issue. Specifically, NASAA wishes to thank the following individuals: Ralph Lambiase (CT), William Reilly, Jr. (FL), Richard Barry (NJ), John Moore, Jr. (AR), Ronald Rubach (MI), Susan Smiley (SC), and Roger Walter (KS). In addition, NASAA thanks Don Saxon (FL) and the many other representatives from other states that provided valuable information and assistance over the past few years on this matter.

[4] See Exhibit A, Arthur Levitt Chairman, SEC at the NASAA Fall 1995 Conference, Vancouver, B.C. (Oct. 23, 1995).

[5] See, H.R. 3005, 104th Cong., 2nd Sess. (1996) at 49.

[6] In the past ten years, there has been heightened awareness of the increasing number of sales practice abuses. See Exhibit B, Division of Market Regulation and Division of Enforcement, SEC, The Large Firm Project, A Review of Hiring, Retention and Supervisory Practices (May 1994); Exhibit C, Penny Stocks Regulatory Actions to Reduce Potential for Fraud and Abuse. U.S. General Accounting Office, Feb. 1993, GAO/GGD-93-59.

[7] Pub.L. No. 104-290, 110 Stat. 3416 (1996). "NASAA will encourage state examination authorities to utilize examination resources where they are most needed, with respect to firms and branch offices of firms that may not receive frequent examinations by the Commission and SROs. See Exhibit D, Memorandum of Understanding: The SEC, AMEX, CBOE, NASD, NYSE and the NASAA concerning

need to work together to make the revisions to the books and records rules because they often have different priorities and objectives when doing an examination or investigation. For example, the SEC and the self-regulatory organizations ("SROs") generally examine broker dealers' home or principal office locations where most, if not all, records are available or can be made readily available. In contrast, state securities regulators focus a far greater percentage of their examination efforts on branch office locations[8] within their states and need the same ready access to records to conduct them effectively.

As most aptly put by the SEC in the release, "[The] re-proposed record keeping requirements are intended to enable [all] securities regulators to conduct more efficient and effective broker-dealer examinations primarily for compliance with sales practice requirements."[9] Further, "[s]ome of the reproposed rules may be duplicative of SRO record keeping rules; nevertheless, the Commission is reproposing the rules because it believes certain record keeping requirements should be directly enforced by the Commission and should be available for states to include under their own laws".[10] In addition, NASAA recommends that the Commission clarify in the adopting release that these rules, even as amended, do not obviate the need to create and maintain any and all records necessary to meet a firm's obligation, under either state or SRO rules, to "know your customer." This point, as more fully explained later in this letter, is especially important as it relates to single associated person locations under the re-proposal.

II. STATUTORY CONSIDERATIONS FOR ESTABLISHING AND AMENDING SEC REGULATIONS:

"PROTECTION OF INVESTORS" AND "THE PROMOTION OF EFFICIENCY, COMPETITION AND CAPTIAL FORMATION".

The federal securities laws were enacted in reaction to widespread instances of fraud and self-dealing prevalent in the 1920's that culminated in the stock market crash of 1929. State securities laws, although in existence, were not as effective in stopping fraudulent actions as they could have been because those engaging in the illegal activities, even if stopped in one state, would just move across state lines. In order to reinvigorate the securities markets, it was necessary to regain investor confidence that principles of fairness and open access generally would guide individual securities transactions and the securities markets. The United States Congress recognized this need for intervention and passed four major securities acts. In conjunction with the subsequent adoption of federal securities regulations, the continued development of SROs and revisions to both federal and state securities laws from time-to-time to acknowledge changes in the securities marketplace, the U.S. securities markets have flourished. Laws

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consultation and coordination of the Regulatory Examination of Broker-Dealers; NASAA Reports (CCH) ¶2352 (Nov. 28, 1995).

[8] SEC Annual Report 1997, Program Areas and Footnotes.

[9] Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934 at 3.

[10] Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934 at 7.

and regulations, however, must be kept in check as well or they will stifle the generation of new business opportunities and growth. Sections 3(f) and 23(a) of the 1934 Act emanate from this philosophy.

At Section 23(a) of the 1934 Act, the SEC is required "…to consider any impact on competition and to not adopt a rule that would impose a burden on competition not necessary or appropriate in furtherance of the Act".[11] In addition, it is required at Section 3(f) of the 1934 Act, that when the Commission "considers whether an action is necessary or appropriate in the public interest, the Commission consider[s] whether the action will promote efficiency, competition, and capital formation, in addition to the protection of investors." Such considerations must be applied to the proposed amendments to Rules 17a-3 and 17a-4. However, unlike most proposals relating to either a new or amended SEC rule, the re-proposed amendments to Rules 17a-3 and 17a-4, pursuant to a directive by Congress, must also reflect the needs of the state securities regulators as well as those of the federal regulators.

A. THE RULES, AS RE-PROPOSED, ARE VITAL TO THE PROTECTION OF INVESTORS.

The re-proposed amendments to the rules are vital to the protection of investors. As demonstrated by the stock market crash of 1929 and more recently by the micro-cap sweeps of the 1990s, the securities markets need oversight to protect those who participate in the markets.[12] Without sufficient laws and regulations to deter improper activity, investors are left to the mercy of "caveat emptor". In the laws and regulations that cover the securities markets, clear guidance on what is expected from those who participate in the markets must be set forth. In turn, this has an impact on what participants in the markets can expect.

For example, in the amendments to Rules 17a-3 and 17a-4, the SEC sets forth in greater detail and therefore, more clearly, the type of records securities firms should make and maintain. As a result of requiring such records, investors can expect the documentation of a securities transaction by a firm to reflect more accurately and clearly how the transaction actually transpired and thus, document their rights in the event of any improper activity. In addition, documentation, as required under the amendments, is essential for regulators to take action against individuals committing violations. As the sole licensing authorities of individual agents, states rely upon records to assist them in their licensing decisions and their enforcement efforts. Without the records necessary to

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[11] Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934 at 26.

[12] See Mark Griffin, NASAA President and Director, Utah of Securities, Announcement of Multi-state Sweep of Micro-cap Firms, May 29, 1997 (available at http://www.nasaa.org/whoweare/speeches/remarks.html) and Feb. 6, 1998, letter to Congressman John Dingell from Denise Voigt Crawford, NASAA President and Texas Securities Commissioner (available at http://www.nasaa.org/dingell2.html). See also, NASAA Press Release; "State Securities Cops Turn Up Heat On Investment Boiler Rooms", July 23, 1998 (available at http://www.nasaa.org/investoredu/investoralerts/finalboil.html).

bring effective and efficient administrative and civil injunctive actions, and criminal prosecutions against violators, the deterrent effect of the laws will be diluted and investors will be harmed.

The level of detail contained in the records, under the re-proposed amendments, is also essential because no single record documents an entire transaction. In many instances, it is in the cross-referencing of different records that improper conduct is demonstrated. For example, a review of a firm's internal communications file and its commission runs for agents could demonstrate that someone at a branch office was creating a financial incentive for agents to increase their sales of a particular proprietary product at the end of a month by providing a higher pay out on such products. Those records could then be compared to the contents of the customer complaint file to determine whether the firm promoted unsuitable investments to investors.[13] Without all the documentation required in the re-proposed rules, it may be at least much more difficult, if not impossible, to discover whether improper conduct by either a firm or its agents has occurred.

B. THE RULES, AS RE-PROPOSED, SERVE THE PUBLIC INTEREST BY BEING EFFICIENT, FOSTERING COMPETITION AND PROMOTING CAPITAL FORMATION.

If the only purpose for the rules was to protect investors at all costs, such high barriers could be established to participating in the marketplace that the end result would be that investment opportunities would disappear. The cost of attracting investments would be too high. In our laws and regulations, we must balance the need to protect investors with the need to foster competition and promote capital formation. With the adoption of the re-proposed rules, the SEC will do just that.

1. Efficiencies Created by the Amended Rules.

Pursuant to Section 17 of the 1934 Act and existing Rules 17a-3 and 17a-4 promulgated thereunder, broker dealers are required to make and preserve records. In the re-proposal, amendments to those record keeping requirements are set forth to address needs of regulators when examining local offices, and records that were not previously identified in the rules are described that are helpful in tracking sales practices within a firm. Efficiencies for the firms are created in three ways.

First, the types of records and the level of detail in those records that must be kept by broker dealers are clarified. As a result, firms will have better guidance on what records are required under the rules and thus, what records regulators will be looking for during examinations. This guidance will take the "guess work" out of records' management for firms and will promote more efficient examinations by regulators. In other words, firms will be able to manage their records more efficiently and, if in compliance with the rules and no evidence of improper activity is identified, regulators will be able to conduct their examinations far more quickly, reducing any inconvenience

[13] Cite to Hibbard Brown, L.C. Wagard, 1st Jersey (Dingall Ltr)

to the firm. In addition, better guidance is provided in the amended rules on what records are necessary to facilitate good supervisory practices. In recent years, there has been a heightened awareness by governmental officials of the dramatic increase in securities violations tied to improper sales practices.[14] Among the best method of monitoring sales practices and thus preventing sales practice abuses is the creation and maintenance of records such as those identified in the re-proposal. Of course, although the records outlined in the amended rules mirror some of industry's "best practices", the rules do not provide a safe harbor for meeting supervisory requirements. Firms need to create, maintain and review those records deemed necessary under the circumstances to perform adequately their supervisory and compliance functions.

A second efficiency created by the amendments relates to their recognition of the changing technology being used within the securities industry. The amendments permit flexible methods for the creation and maintenance of records. Some firms, large and small, may have advanced technology that provides computer-generated records and an internet e-mail system for transferring records to, and receiving records from, various offices in many locations. Other firms, mostly likely smaller or those with less capital, may still maintain paper records and archive records on micro fiche' or by CD-ROM, and records may be transferred to, or received from, other locations via facsimile. Either method, however, would permit the firms to meet their obligations regarding local office records or the maintenance of certain other records. Therefore, some firms, although less technologically oriented, are still able to comply with the requirement to make records "readily available", yet need not maintain records on premises. This "alternative approach" method used to revise and update the rules, rather than a "one size fits all" requirement, accommodates the great diversity of firms that are obligated to create and maintain records under these rules, while recognizing the importance of the information requested under the rules for investor protection purposes.

A third efficiency created by the re-proposed rules is the establishment of uniform books and records requirements across state lines, as well as at the federal level. Until NSMIA, states had various books and records requirements and, although similar to the SEC and SRO requirements, differences did exist that needed to be tracked and complied with by firms. By establishing a single set of requirements, firms can streamline their record keeping, which will result in significant cost savings. In addition, in many instances, information required by the re-proposed rules may be consolidated into a single record. For example, a common industry practice is for an agent to keep a customer book which would include all the pertinent customer identification information, including investment objectives, and all trading information for each customer. Similarly, a firm's personnel files could contain a log that lists each agent with their CRD number and any other employment-related identification number, identifies the office location from which each agent operates, lists the states where each agent is licensed to do business, a general outline of the terms of each agent's employment with the firm, and whether a particular agent requires special supervision. Thus, the number of distinct

[14] See the following recent actions brought by Florida Securities: Royal Alliance Associates (File No. 3-9223) and NYLIFE Securities, Inc. (File No. 3-9712). See also Exhibit "?" Letter from Lori A. Richards, SEC Office of Compliance Inspections and Examinations (April 8, 1998).

records required to be created or maintained as "core" records under the re-proposal, in practice, may be met by the existence of very few documents.

As demonstrated above, the amendments to Rules 17a-3 and 17a-4 clearly create efficiencies for firms obligated to comply with the record keeping requirements.

2. The Amendments to the Rules Permit, if not Generate, Competition.

By allowing firms to create and maintain records by alternative means, some broker dealers may elect to allocate resources to advanced technology that results in cost savings related to the regeneration or maintenance of records. Similarly, firms not having the resources to allocate to technology are able to still comply with the rules. In addition, the amendments promote flexible working arrangements, which in this day are more common. For example, if a husband and wife brokerage team want to relocate to a sun belt region for the winter months, they can still meet their obligations to maintain records by having such records made readily available via their computer modem or facsimile machine from any number of locations such as their full-time office, the office of supervisory jurisdiction or even the compliance department.

Competition among broker dealers is facilitated by the amendments to the rules.

3. The Re-Proposed Rules Promote Capital Formation.

Brokerage firms provide capital formation by underwriting offerings and providing liquidity to the markets by trading securities on behalf of investors or for proprietary reasons. Broker dealer firms or agents that would otherwise drain confidence from the markets from the sale of unsuitable investments or by out right defrauding investors, must be identified quickly and stopped. The alternative can be devastating to a market, as evidenced by the inability to raise capital in the Denver securities market as a result of the penny stock scams that made all investments skeptical.[15] An important source for "tracking down" such unscrupulous firms or individuals are the records kept by firms. Documented complaints, inconsistent trades evidenced by customer account information, sales scripts, all provide the roadmaps to regulators that improper activity may be occurring. Quick action by regulators to preserve confidence in the markets and foster capital formation is far more likely if regulators have the tools necessary to identify problems early on. The tools regulators need to perform this service include the requirement for detailed minimum "core" records to be maintained by the firms.

For the reasons outlined above, it is apparent that the amendments to Rules 17a-3 and 17a-4 strike the appropriate balance between protecting investors and promoting efficiency, competition and capital formation.

III. THE RE-PROPOSED AMENDMENTS TO RULES 17a-3 AND 17a-4.

[15] Cite to Denver Penny Stock problems.

We now turn to examining the specific amendments proposed for Rules 17a-3 and 17a-4. To better evaluate the consequences of the amendments, we will identify the impact on regulators, investors, as well as the industry, related to each of the proposed amendments.

A. INFORMATION CONTAINED ON ORDER TICKETS FOR AGENCY AND PRINCIPAL TRANSACTIONS, 17A-3(A)(6) AND (7).

The amendment to these provisions adds a requirement for order tickets or electronic memorandum to include not only the identity of the associated person who is "responsible for the account" but also the identity of any person who has "accepted or entered the order" on behalf of the customer. Such information is necessary to ensure the reliability and integrity of the information on the order tickets and will lead regulators to identifying problems such as unregistered activity or other sales practice violations in a more expedient manner. The additional information will document the transaction as it actually occurred and not just identify a "responsible person". It is expected that this phrase would capture those persons who accept instructions from a customer regarding a trade although another person (presumably the agent responsible for the account) may receive the commission for the transaction or may actually enter the order.

The value of this additional information is found under several different scenarios, some legitimate and some not. For example, under NSMIA, a de minimis exemption from state licensing requirements was created to permit, under certain limited circumstances, unregistered agents to accept orders from customers. One such circumstance is when a registered agent assigns his customers to another agent, who may not be registered in the states where all such customers reside, in order to accommodate those customers while the responsible agent for such accounts is on vacation. This is a good example of when documentation that another person either accepted or entered a particular order, separate from the agent "responsible for the account", would be important to accurately reflect the acceptance and execution of the trade. If a problem develops with the trade, it would be helpful to the investor, the firm and the agents to know that the other agent was involved in the transaction. Therefore, the tracking of legitimate assignments of agents that qualify for the federally established de minimis exemption from state registration is one way in which the additional information would be useful and perhaps, necessary.

Another scenario when required recordation of another person's involvement in a trade would be a very helpful enforcement tool relates to the use of cold callers. Through both for-cause examinations by various states and the "sweep" efforts coordinated by NASAA, it has been discovered that firms have employed numerous cold callers who not only solicit interest from investors in investing with the firm, but make sales and record them as if made by a registered agent with the firm.[16] For example, in the case against

[16] Cite to cases of cold callers using others numbers. One state case and at least one case from sweep.

Investors Associates, it was determined that approximately 100 cold callers were used by the firm to solicit investors using the license number of one of the only 40 registered agents with the firm.[17] The sheer volume of transactions supposedly handled by only the registered agents and not the cold callers gave the regulators a hint that something was amiss. Of course, it would not be expected that persons willing to violate regulations would document unlicensed persons' conducting activity that would otherwise establish violations for regulators. However, even despite the noncompliance with the recordation requirement, it still serves two purposes.

First, if through other means it could be established that another person or persons was involved in a transaction by "accepting or entering an order", the lack of record could help to establish intentional conduct to deceive. Secondly, because cold callers are generally not just unregistered, but are also uneducated, documentation of their involvement in the transaction will assist in reconstructing a trade for an enforcement case, which might be impossible without accurate records on how the transaction actually occurred. Uneducated cold callers of today may be high-pressure sales persons of tomorrow and therefore should be tracked for regulatory purposes to better police the industry. By requiring recordation of other persons participating in the acceptance or entering of an order, it is more likely that a record demonstrating an unlicensed individual's propensity to violate the securities laws will come to the attention of a state regulator and if that individual submits a licensing application, the state may deny the license based upon such past activities. "Rogue" cold callers should not be allowed to become licensed as "rogue" brokers.

Just as regulators benefit from accurate records of securities activities, so do firms and investors. Firms can do a better job of performing their supervisory functions if they are fully aware of all individuals who are involved in a transaction. In addition, investors can protect their rights in the event of a disagreement regarding a transaction if they can discover how the transaction actually occurred and who was involved.

1. Flexibility of Meeting Requirement to Include Additional Information.

As noted in the re-proposing release, a broker-dealer would have flexibility in the method they choose to record the identity of any person "entering or accepting an order".[18] For broker dealers that have computerized their order tickets, they may enter the identity of the person as part of the electronic order ticket or may create a separate record to identify such person. Similarly, if a paper-based system did not lend itself to adding the additional information, a separate record could be created. In either instance, however, whether supplementing a computerized system or a paper-based system, the separate record and the primary record should be easily cross-referenced to each other or the usefulness of the separate record will be extremely limited. In addition, NASAA urges the Commission to require that all systems be amended to accommodate the

[17] Cite to Investor Associates case.

[18] Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934 at 8.

additional information within a specific time frame or at such earlier time if the existing system is altered for other purposes by the broker dealer on its own.

2. Exception for Electronic-Trading Without the Services of a Natural Person:

The SEC specifically requests comment on the need to recognize the changing industry and how requiring the inclusion on the order ticket, or an auxiliary log, of any person's name who is either responsible for, or assigned to, the account and the identity of any person who "enters or accepts" an order would apply to electronic trading or "non-traditional" (not paper-based) orders. Common practice in the industry is to include the name of the person responsible for the account when it is a traditional ticket based trade, but not when the order is taken over the phone through a central phone bank or by e-mail through a discount brokerage firm or electronic trading market. Generally, these orders are "unsolicited" and sometimes no natural person is involved in the order. The order is processed automatically with no human intervention or oversight. If a natural person is responsible for review all electronic orders for example, for the previous day, that person should be identified with the accounts he or she reviews.

NASAA recommends a simple test be applied to all accounts regardless of what medium the order is transmitted by to the firm or regardless of whether the order is "solicited" or not:

TEST:

- If a natural person is responsible or assigned to an account, that person's name must be identified on the order ticket or electronic memorandum.

- If there is no specific natural person designated to be "responsible or assigned to" an account, but a natural person, who is a registered person, "accepts or enters the order", the person's name should be on the order ticket or memorandum. However, if the natural person who only "accepts or enters the order" is not registered and only accepted or entered the order for a registered person, the unregistered person's name should be included on the order ticket or electronic memorandum unless the inclusion of the name would be very difficult or costly, and then it should be included on an easily traceable and cross-referenced auxiliary log. If an auxiliary log is permitted, the SEC should require firms to include such names in the actual order tickets by a definitive date or such earlier time if the firm revises their system for other purposes.

3. Time stamping of ALL order tickets:

NASAA supports the re-proposed requirement that order tickets be time stamped when the broker dealer receives them, even when the order is subsequently executed.

Investigations of many over-the-counter firms have historically revealed patterns of trading that suggest a firm, relative to its trading activity in the secondary market of a specific security, may hold customer orders (perhaps trading ahead of the customer), prearrange the price for trading in the after-market of that security and then give priority to the orders of insiders, nominees and other persons with whom they have parked stock.[19] Requiring time stamping when orders are received would be an important tool in helping to uncover and prosecute this type of conduct. In addition, as noted in the release, time stamping could be used as a method to demonstrate compliance with "best execution" requirements and that a broker dealer had not traded ahead of its customers.[20]

B. ADDITIONAL RECORDS CONCERNING "ASSOCIATED PERSONS"

The next category of records discussed in the re-proposal generally relates to personnel information.

1. Licensing and Identification Records.

Another type of record, however, that is not included in those records itemized above and the Commission proposes not to require to be maintained by broker dealers (either in the main office or the local offices) is the licensing records. Broker dealers, as separate entities, as well as individuals who work for or with broker dealers must be licensed to conduct securities activities by each state in which or into which either do such business. The SEC requires only the registration of the firm, not the individuals. The SROs require qualification, not registration of both. The Uniform Forms used to license individuals with the states and to report changes relating to a license include Forms U-4 and U-5. Examples of just a few categories of information reported on such forms include whether a customer complaint was received about an agent, any settlements an agent may have entered into with a customer, whether an agent has any financially-related criminal history, and the reason for an agent's termination with a firm. Without access to such forms, regulators will not know whether unregistered activity may be occurring. Although some have suggested that regulators could "pull down" agent CRD records prior to visiting a firm, the regulators may not necessarily know what individuals work from a particular location and therefore would not know what individuals' records to access.

The SEC suggests in its release that such forms would not be required to be maintained by the broker dealers because the forms are readily available on the Central Registration Depository ("CRD"). To the extent that the Forms are readily available through access to CRD while at a firm on an examination, NASAA agrees that copies of such Forms need not be maintained. However, the necessary access to the CRD is not available at every firm. Access to CRD can be achieved in several different manners.

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[19] Cite to SEC and or state cases demonstrating such practices.

[20] Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934 at 9 and NASDR conduct rules 2110 and 2320 on best execution and prohibit on trading ahead.

One method is that firms have designated CRD terminals in their offices. Another method of access to CRD is through the Internet. A modernization of the CRD has been ongoing for the past eight years. A decision was made in the past few years to provide access to CRD not only through designated terminals but also through the Internet to facilitate electronic filings. Therefore, if a firm has Internet access, a regulator should be able to access the CRD and thus, the Forms through that method. One final method of access could become more prevalent over time and that is regulators that perform their examinations using computerized modules, if their laptop computers have Internet service, will be able to access the CRD from their portable work station. However, resources for such equipment are limited and therefore examiners generally do not have such ready access at this time.

Therefore, NASAA would recommend a slight modification to the Commission's re-proposal in this area. NASAA suggests that the rule make clear that firms shall make all licensing forms available at the offices to which they relate and that availability could be by maintaining hard copies, a CRD terminal that can "pull down" the forms, an e-mail capability to receive the forms from another location or Internet access to the CRD through one of the firm's computers at that location.

In addition, NASAA strongly supports the inclusion in the re-proposal of the requirement that broker dealers maintain a list containing both the CRD numbers and any other employment-related identification number for associated persons "working at, out of, or being supervised at or from each local office".[21] The non-CRD identification numbers are important to document activities of unregistered personnel. Without both such identification numbers, it would be very time consuming and difficult to track the various activities (e.g., commissions paid, complaints, trading activity) of persons operating at or from a particular location.

2. Agreements Between Broker Dealers and Associated Persons, Commission Runs and Related Trading Information and Customer Complaint Information; 17a-3(a)(12), (17) and (18).

Agreements between an associated person and the broker dealer, customer complaint information and commission runs and the related trading information represent three categories of information that are critical to monitoring the securities activities of agents. Not only is each individual category of information important, but the records interrelate with each other to provide regulators with the documentation they need to quickly identify sales practice violations such as: 1) churning, 2) manipulation, 3) lack of supervision, 4) unregistered activity, and 5) unauthorized activity.[22] Once identified, regulators can take quick action to force the discontinuance of any improper conduct that may cause further harm to investors.

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[21] Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934 at 10.

[22] Cite to FD Roberts case, 1st Montock, 3 bank cases, sweep cases, ftnts in Jt. Sweep reprt

For example, employment or compensation agreements between an agent and firm help evidence who is employed or associated with the firm (independent contractor relationships) and under what terms. Customer complaint information directs regulators to problem areas or problem personnel. The commission runs and related trading information of associated persons document the amount of compensation paid, what the compensation is based upon, and when payment is made. A suggested refinement to the provision on commission runs [(a)(18)] is to require the "record" to include the date, some identification of the account for which the commission was paid, the number of shares or units and the dollar amount of the trade. Without this level of specificity, much of the benefit and the efficiency expected to be gained by requiring this record will be lost.[23] Money is a powerful motivator. Adequate detail regarding any commissions paid to a broker and for what activity is necessary documentation to "follow the money".

In addition, requiring the creation and maintenance of compensation records is likely to add no extra cost to broker dealers who pay compensation tied to production because these records are needed for operational purposes to calculate compensation to their agents and to help supervise the activity of their agents.

Although it can be argued that federal rules already require the maintenance of compensation records (either as records of expenses or communications with employees where copies are distributed to them) many micro-cap firms have historically not maintained these records claiming that federal rules only require a summary of expenses. Proving certain facts without commission records (such as the firm engaging in a pattern of paying unusual incentives for certain products) can require the issuance of subpoenas, the taking of testimony and, as has been demonstrated in the past, litigation and debate to enforce subpoenas and convince a court to require production of records and testimony needed to obtain this information.[24] An important function of the re-proposal is to clarify what records must be created and maintained for ease of compliance as well as oversight. Based on state experiences, a clarification regarding the maintenance of commission records is necessary.

A common practice associated with fraud schemes, especially involving the area of the micro-cap and penny stock markets, has been the ability of the principals of these firms to control the efforts of their sales forces in order to direct their efforts toward the sale of specific securities (e.g., stocks or warrants) during specific time periods.[25] For example, firms will sponsor a sales contest over a very short period of time thus encouraging the sale of products paying higher commissions.

These records are not just important to "reel in" micro-cap fraud. The cases relating to the sale of limited partnerships in the 1980's were also based upon cross-referencing these records to demonstrate that improper activity was not just the conduct of certain "rogue" employees, but rather, a firm-wide initiative.[26]

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23 Cite here or in this paragraph to parts (as marked) in Levitt's Compensation Cttee report.

24 Cite Ask Rick Barry

25 Cite to Hibbard Brown, Olde Discount, 1st Jersey

26 Cite to Prudential and PaineWebber cases

Customer complaint information serves as the "red flag" or "early warning system" to regulators. Customer complaints generally document a pattern of improper activity by either an individual agent or firm wide. They are also key to evaluating a firm's supervisory practices. If repeat complaints go unaddressed, a regulator may be able to establish that an individual or a particular location has not been given proper supervision. Due to the importance and value of customer complaint records, NASAA requests the Commission clarify the provisions of the rules that relate to customer complaints (e.g., 17a-3(a)(17)(i), 17a-3(f), 17a-4(b)(4), and 17a-4(k)) to assure that all originals of customer complaints are kept in some location and not just a log.

NASAA supports the deletion of the proposed definition of associated person with these rules. NASAA agrees that a separate definition of that term in these rules in addition to the definitions already existing in the 1934 Act would cause confusion. The basis for good compliance is clarity of the rules. Existing SEC guidance and court cases in this area should be sufficient to clarify what persons are covered under these rules.[27]

C. CUSTOMER ACCOUNT RECORDS, 17A-3(A)(16).

Without investors there is no securities market. Similar to other retail sales industries, "knowing your customer" is the key to success. However, customers who are investors can lose much more than their shirt if wrong decisions are made or deception invoked. Customer account records for investors gather critical general identification and background information necessary for firms and their representatives to know, as well as guide, their customers. It is the customer information upon which much of the relationship between an agent and the investor is based. For example, a registered agent must have such information to determine the suitability of any investment for a customer. In addition, a firm needs such information to comply with SRO rules, such as the NYSE "know your customer" rule. NASAA recommends the Commission include as part of the required customer account information whether the customer has had any investment experience. Such information would be helpful in evaluating the customer's expectations and general knowledge about investing. NASAA agrees, for security purposes, with the suggestion that social security numbers not be required to be included on an updated account card sent to a customer.

The maintenance of customer account records does not impose any additional cost to the industry because such information is necessary for agents to conduct daily business. The amendments provide that these records may be maintained in either hard copy or in electronic form. NASAA concurs that such information should only be required for accounts with natural persons as the beneficial owners. However, if the account is a joint account composed of natural persons, NASAA urges the Commission to require the information be maintained on behalf of each beneficial owner.

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[27] Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934 at 11.

NASAA strongly supports the requirement to send the account information to the customer for verification within 30 days of first opening the account and thereafter each time a change to the information is made. If an agent has a misunderstanding regarding a customer's financial status or risk tolerance, it would be best for the agent, as well as the customer, for such misunderstanding to be corrected as soon as possible and certainly before the agent acts on the misinformation. Confirmation of such information by the customer is the only way, and the least expensive way in the long run, to prevent future complaints or even arbitration claims over trades based on inaccurate information. It would also seem to be a "best practice" and a preventative measure to update the information on the account record on a regular basis to avoid disputes.

The Commission should make clear that the 36-month updating requirement is a minimum requirement and NOT a safe harbor for updating account information. As noted in the comment letter submitted by the Association for Investment Management and Research ("AMIR"), the primary professional organization for securities analysts, investment managers, and others related to the investment decision-making process since 1990, "[u]nder the AIMR Standards of Professional Conduct, AIMR members must make reasonable inquiry into a client's financial situation, investment experience, and investment objectives prior to making any investment recommendations. This requires the more than 30,000 AIMR members to update this information as necessary, but no 'less frequently than annually to allow the members to adjust their investment recommendations to reflect changed circumstances'".[28]

A suggestion has been made that updating account forms every three years would be very costly. Securities firms spend money to market new products to customers. They also send notices to customers and charge fees for the maintenance of dormant accounts. Some firms include investment objectives on their monthly statements. It would appear from these three practices that allocating resources to confirm periodically the accuracy of the information about customers upon which the firm trades would be a good allocation of resources that otherwise might have to be used to defend the firm.

D. REGULATORY COMPLIANCE RECORD AND FIRM CONTACT INFORMATION.

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NASAA supports the requirement in the re-proposal that broker dealers create a record noting whether it is in compliance with applicable regulatory requirements relating to the information required when opening or updating a customer account. NASAA also recommends that the SEC monitor SRO rules on an ongoing basis, and in consultation with the states, to determine whether additional record requirements should be specifically included in Commission books and records rules. As noted earlier, by including SRO rules directly in SEC rules, all the regulators (the SEC, the SROs and the states) are able to effectively police compliance with the rules.

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[28] Cite to AIMR comment letter dated November 30, 1998 to SEC.

In addition, NASAA strongly supports the retention of any exception reports that may be generated by a firm for the proposed 3-year period. NASAA would urge firms to produce exception reports to monitor activities in the firm and as a supervisory tool. Good compliance requires proactive methods to assure rules and regulations are being followed and exception reports have proven to be a very good tool. Furthermore, by self-policing securities activities within the firm, the firm can contain damages and preclude any future harm to investors, while demonstrating to regulators an active program to assure compliance with regulations.

NASAA supports the creation of a record indicating that investors have been notified of an address and phone number they may use to submit a complaint. This requirement could be easily accommodated by inclusion of such information on customer account statements. In addition, the requirement would encourage firms to convey such information, because although in most instances such information is already required to be conveyed, regulators would be checking the record to establish compliance. Furthermore, many branch offices, specifically independent contractors, operate under a "Doing Business As" ("dba") name, different from the name of the supervisory firm. This makes it difficult for investors to know whom to call, apart from their broker, with a problem.

E. DEFINITION OF LOCAL OFFICE [17A-3(G)], WHAT ARE LOCAL OFFICE RECORDS AND WHAT IS THE RETENTION REQUIREMENT [17A-4(K)(1) AND (2)]:

The provisions of the re-proposed rules that relate to the definition of "local office" are of significant interest to NASAA. Pre-NSMIA, states could rely upon their own books and records requirements to police the brokerage firms in their states. Now, states must rely upon a uniform set of record requirements that must meet the needs at both the state and federal level.

1. Industry and Regulatory Practices That Define Why Books and Records Are Critical to Investor Protection.

Although securities sales activity and record keeping practices by the industry may be similar nationwide, differences occur based on the diversity of the industry and the legitimacy of the firm. Some firms have very good compliance and supervisory procedures, others do not. Some firms have nationwide practices, others do not. Some firms have mostly small or single person offices, others do not. Some firms are associated with an extensive number of independent contractors, others are not. Some firms intend to defraud their investors, the overwhelming majority do not.

Similarly, broker dealer examination programs among the states vary depending upon several factors including, for example, the location of the state, the population of the state (density and demographics), and the staffing available to the state securities office. The location of the state is relevant because states in the northeastern United

States, where a single state's borders can touch many other states' borders, generally have a significant amount of cross-border sales transactions. Under these circumstances, a state would need to track activity and retrieve records from across state lines. States that have large concentrations of retirement communities with significant savings may require more active examination programs to assure that if a problem firm or agent arises, they are discovered right away to limit the amount of financial harm that could be caused in only a short period of time. Thus, ready access to books and records would be critical. States that are sparsely populated tend to have a higher concentration of one and two person offices located throughout the state and covering more territory. Such arrangements are more burdensome for states to oversee because physical examinations, which provide the greatest insight to the activity that is occurring at the location, are time consuming and costly. Finally, some states have limited staffing and therefore their broker dealer examination programs may have to be tailored to address that issue. For example, a state may conduct only for-cause examinations and no "routine" examinations. However, because most states respond to every customer complaint, which might prompt a for-cause exam, even conducting only "for cause" exams might entail a significant number of staff hours. Another method that may be followed by a state with limited staff to send out on examinations would be to conduct only announced and scheduled examinations to more readily assure that the necessary records and personnel will be available on-site when the examiner arrives. Alternatively, the state may conduct a "desk" audit, where the records are sent to the examiner's office.

In order for states to continue to police local brokerage offices within their state and provide the level of investor protection necessary to maintain confidence in the local markets, the diversity of the industry as well as the unique state factors discussed above must be recognized and addressed within the uniform set of books and records rules established by the SEC in consultation with the states.

2. Trends in the Industry: Sales Practice Abuses.

Another important factor that must be taken into account in the amended rules is the need to address sales practice abuses. In the past ten years, significant attention has been given to the ever increasing number of securities violations tied to sales practice abuses.[29] Such abuses were highlighted in the examination of the penny stock market which culminated in Congress enacting the Penny Stock Reform Act of 1990. In 1993, the U.S General Accounting Office ("GAO") issued a report to Congress as a result of their review of the NASD's efforts to reduce fraud and abuse in the penny stock market."[30] The GAO reported that penny stock fraud often involved branch offices.[31] The GAO found that a primary method for the NASD to identify penny stock abuse 'is to

[29] Cite to Penny Stock Act, GAO Report on Penny Stocks Feb 3, 1993, SEC's Large Firm Report May 1994, Chairman Levitt's Remarks to NASD May 19, 1994, Joint Regulatory Sales Practice Sweep, May 1996,GAO Report to Congress, "Actions Needed to Better Protect Investors Against Unscrupulous Brokers", Sept. 14, 1994, NASD Notice to Members 97-19 April 15, 1997, Hearings by the Permanent Subcommittee on Investigations, Sept. 22, 1997, NASD Notice to Members 98-48(?), and the GAO Report "SEC Enforcement" September 1998.

[30] Cite to 1993 GAO Report at page 5.

[31] Cite to report page 8.

examine broker-dealers' sales practices".[32] The report indicated that NASD officials stated that "NASD does not routinely visit branch offices because it reviews records of branch office transactions during the main office examination."[33] One of the recommendations of the report addresses the need for improvements in the NASD's program of examination of branch offices.[34] Specifically, the report states, "With periodic on-site visits to the branch offices … NASD could (1) better detect sales practice violations, (2) determine whether the branches have conducted business independent of the main office, and (3) determine whether branch employees are properly registered with NASD and supervised by the broker-dealer.

The applicability of the GAO Report is two fold. First, it is the beginning of many findings by government and quasi-government entities that branch offices of firms have a high incidence of sales practice abuses that are best uncovered by on-site examinations.[35] Although the report was issued 5 years ago, many of the same findings were made in the micro-cap area in the past two years.[36] Secondly, it clearly demonstrates the need for sufficient books and records to be on premises at all offices of broker dealers, especially branch offices, for regulators to be able to identify violations effectively and efficiently and to contain any further potential harm to investors.

Pursuant to the CRD, currently there are approximately 5,573 licensed broker dealer firms and 73,201 NASD registered branches, 16,570 of which are designated as an Office of Supervisory Jurisdiction ("OSJ") under NASD Conduct Rules. These numbers, however, do not reflect the number of additional locations where broker dealer sales activities occur that do not qualify as a branch office under the NASD's definition of branch office. It is clear, even acknowledging only the large number of identified locations, that monitoring activities at all, or even many of such locations, is a huge task that requires efficient use of regulatory resources. The re-proposed rules should prove very helpful to regulators in meeting that challenge because they will establish uniform, well-defined records from which regulators may plan their examinations, whether announced or unannounced.

2. <u>The Proposed Definition of "Local Office".</u>

The re-proposed amendments define the term "Local Office" to include locations where two or more associated persons regularly conduct a securities business. A definition based upon a location having a minimum of two licensed persons makes a significant difference to the states because states' have traditionally required <u>all</u> offices to maintain minimum books and records and states conduct the vast majority of branch

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[32] Cite to 1993 GAO Report on page 5

[33] Cite to report page 9.

[34] Cite to GAO letter dated Feb 3, 1993 attached to report and report at pages 10, 33-41 (highlighting pages 38,39 and 40) and 48.

[35] Cite to footnote 28. Include in this footnote quotes from Levitt's speech to the NASD and the GAO report in Sept 1994.

[36] Cite to NASAA press release and Joe's testimony pages 3 and 4 and the GAO report Sept. 1998.

examinations.[37] As is reported by many states in their comment letters[38] and the attached chart[39], by increasing the number of associated persons to two before minimum "core" records are required to be kept on premises, state examination programs will be dramatically impacted. The number of offices states will be able to perform unannounced examinations on and request the required records, in many instances, will be reduced by 25 to 75%. When this statistic is compared to the high percentage of violations that states report generate from one and two person offices[40], including criminal actions[41], it could be asked why one-person offices is not how the definition of local office should be adopted.

Minimum records on-site, otherwise necessary for good business practices, permit regulators to conduct unannounced examinations and inspections and quickly discern if improper activity is being conducted. **Cite cases in micro-cap sweep?** Without the requirement for records to be kept on site, regulators will be able to obtain such records but will have to request that the records be retrieved by the firm from another site, regulators can go to the off-site location and review the records or the regulator can submit a subpoena when they arrive on-site. None of these options are as efficient as having the records readily available except serving the subpoena, which requires that the regulators have sufficient information already in hand for the request for the subpoena to be granted.

The retention of minimum "core" records on-site also permits regulators to review records and view the actual location and conduct at the sales office in a single visit. Without required records on premises, a regulator must request records from another location and still visit the actual sales location to view the work environment. This is costly because it requires two actions that could otherwise be accomplished in one. It may result in fewer exams being conducted.[42]

3. On-Site Records are Needed for Industry Supervisory Practices.

Minimum records must be maintained on-site for adequate supervisory practices to be conducted by firms. How can firms determine whether satellite offices and the associated persons in those offices are complying with the applicable rules and regulations if sufficient records are not available to evaluate activity at the location? Also, how can a branch location determine if a pattern of activity may be developing if no historical records are maintained at the location?

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[37] Cite to SEC annual report statistics and NASD report and statement by NASD official and state statistics or previous footnote.

[38] See Connecticut, comment letter at 5.

[39] See Exhibit M, chart of four states depicting impact of increasing the number of associated persons before core records are required to be kept on premises.

[40] See state comment letters from: FL, ME, VA, CO, CT, ID, KS, SD, IL, PA, HI, TX, UT, NC, RI, AR.

[41] See state comment letters from: NC, ME, VA, CT, AL, OH, HI, NY, TX, UT, NC.

[42] See state comment letters from: FL, NC, WA, VA, CO, IN, ID, KY, SD, DE, SC, PA, AL, ND, WY, TX, NE, NC, RI, AR.

One of the first lines of defense against improper activity is for firms to self-police. Internal oversight not only provides the firm the ability to address improper activity quickly; it creates a strong deterrent effect for other employees and agents. Currently, industry practice relies heavily upon the concept of an OSJ to supervise associated persons in branch offices. As the statistics from the CRD demonstrate, that would dictate that approximately 16,570 OSJ offices are responsible for supervising approximately 74,138 branch offices. The disparity between the number of branch offices and the number of supervisory offices is not limited to the traditional brokerage firms. For example, Metlife Securities reports 750 branch offices with about 50 offices designated as OSJ offices; Citicorp Investment Services reports 450 NASD branch offices, with approximately 35 designated as OSJ offices; and Edward D. Jones reports 4,119 total NASD offices, with only 15 offices designated as OSJ offices. In addition, violations for lack of supervision have been instituted against both traditional brokerage firms[43] and other financial service providers. For example, various states and the SEC have brought actions for lack of supervision against three different banks over the past few years.[44] Local office records will assist regulators and industry alike in conducting effective and efficient oversight of broker dealers and their associated persons.

4. One-year Retention Period.

A minimum one-year retention period by local offices of "core" records is essential for states to evaluate the type of sales activity that occurs in an office. Even with records for the past year being maintained on-site, it will be difficult for regulators to determine whether a pattern of activity has occurred that is undesirable and harmful to investors. Many times investors do not discover problems with their accounts until well after improper activity has occurred. By the time the investor writes a letter of complaint, many of the records that would document the improper activity may no longer be at the local office and would have to be requested. This extra step of requesting the information from the home or principal office where such records are stored makes supervisory practices for the branch manager, as well as an examination by state regulators, more time consuming and burdensome. NASAA recommends that a minimum one-year retention period be adopted, because any shorter time period would be almost totally ineffective to "flag" violations for regulators, and the SEC, upon consultation with the states, revisit the retention period in two years to determine if it should be lengthened.

5. Clarification Requested and Support of Specific Local Office Records.

NASAA supports the inclusion of correspondence as a local office record. States have reported that, many times, copies of correspondence raise an inquiry that leads to other records documenting improper conduct. In addition, NASAA strongly supports the SEC's proposal to require that all audit or examination reports requested or required by a securities regulatory authority and any securities regulatory authority examination reports be maintained for at least three years. These reports are important for two specific reasons.

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[43] Cite to Dean Witter Reynolds case and Fla case.

[44] Cite to cases against Nations bank, Barnett bank, and First Union bank.

First, states periodically will require firms to obtain an examination by a state approved outside auditor for a period of time when, as a result of a state examination or investigation, a firm has demonstrated a need for outside supervision. If the state requires such reports for investor protection purposes in an effort to preclude previous improper conduct, it would be unacceptable that the state would not be able to request to examine the report results to determine whether the firm had corrected prior violations. Secondly, because, as previously noted, the total number of locations where securities sales activity occurs is quite large, regulatory resources are stretched thin and reliance upon other regulators' actions creates enormous efficiencies. If a state examines a branch office and produces an examination report and subsequently the SEC or a SRO examine that same branch as an outcome of a principal office exam, the review of the state exam report will permit the other regulatory body to conduct a more efficient exam, creating less disturbance to the firm. NASAA agrees with the SEC that the requirement for the retention of these reports would help avoid unnecessary duplication in examinations. Furthermore, state laws include confidentiality provisions for investigatory and other privileged materials. In most instances the states may not even ant to retain a copy of the other regulator's exam report, but will review it on-site.

NASAA recommends that the re-proposed rules be clarified to clearly indicate that sales scripts, if found in a local office, are required to be maintained as a local office record under 17a-4(b)(10) and 17a-4(k). The cross-referencing among the provisions makes 17a-4(k) unclear on this particular record. NASAA recommends that language be included in 17a-4(k) that specifically references "sales scripts" as included in 17a-4(b)(10) are local office records. As noted in several state comment letters and governmental reports, sales scripts are an effective tool to demonstrate improper activity.[45] The retrieval of sales scripts from broker dealer offices has allowed states to bring enforcement actions quickly. If present in a local office, clearly such a document must be included as a local office record.

NASAA supports the concept of a state record depository. If all offices conducting sales activity are not to maintain certain core records under the re-proposed rules, the records must at least be maintained in the same state where the sales activity took place. Agents do not sell securities only to residents located in the state where the agent conducts business. Due to the cross-border nature of the securities business, states have local citizens that invest with agents associated with broker dealers located not only across the border, but across the country as well. For this reason, it is important to have minimum records kept within a state to meet jurisdictional issues encountered by state regulators when trying to obtain access to records that document how a securities transaction actually transpired. By allowing firms to maintain a single location within a state for storage of records relating to single-person offices located in that state as an alternative to at each individual site, some firms may save storage costs. However, any records so stored must be easily identifiable to permit quick access and review by states.

6. Records Currently Exist in Local Offices.

[45] Cite to stste lettes and GAO reports or Dingall ltr etcr

As noted in many comment letters submitted by state regulators on the re-proposal, as well as at least one other private organization (AIMR), the records proposed under the rules are currently being maintained by most broker dealers. State regulators reported that, during their examinations records similar to those included under the re-proposed rules were available on-site. As previously indicated, AIMR reported in their comment letter that their members are required to maintain and update certain records regularly to meet their Standards of Conduct and customer account records, specifically, are required to be updated much more frequently than proposed under the SEC amendments. No rules will satisfy all broker dealers completely. The SEC should strive to set forth "best practices" for the industry. There are costs associated with doing business. However, based upon the findings of the states, it appears that the cost to industry to comply with the amended rules as re-proposed should be minimal in that most of the records are kept currently by industry.

7. Waiver Provisions and State Access Rules.

The SEC specifically requests comment on "whether state securities regulators should have authority to waive the requirement that a broker-dealer keep local office records at local offices within their respective states". In addition, the SEC seeks comment on "whether, to what extent, and under what circumstances a state should be permitted to waive the state record depository requirement for broker-dealers conducting business in its state". States have their own individual discretionary authority to waive requirements pursuant to meeting public interest obligations. There is no need to grant states such authority specifically under the re-proposed rules. Furthermore, broker-dealers, although physically present in one state, generally sell into many other states and any grant of such authority could compromise access to records by another state. NASAA strongly recommends that no waiver provisions be included in the rules.

The SEC also seeks comment on "whether the Commission rules should provide for state regulator access to books and records". Again, each state has its own rule or regulation regarding access to documents required to be created and maintained under that state's laws. A universal access law on behalf of all states may confuse and otherwise prove unhelpful for individual state access issues. In addition, NSMIA required the establishment of uniform books and records rules and did not address access to such records. NASAA urges the Commission not to include an access rule.

IV. CONCLUSION.

With an ever increasing number of individuals investing in the securities markets[46] and with talks of permitting the investment of social security proceeds into the securities markets[47], this is not the time to reduce the tools available to regulators necessary to protect investors. Those tools are records. If required and kept, they are the road map. If required and not kept, they are the violation that prompts further

[46] Cite most recent statistics.

[47] Cite to recent news articles

investigation that exposes perhaps more egregious violations. The key is requiring the records be kept and made readily available. Of course, just any records will not serve the purpose. The required records must allow regulators to track a securities transaction from beginning to end and discern that all the pertinent parts of the transaction are accurately reflected.

NASAA urges the Commission to review the comments included in this letter and incorporate them into the re-proposed rules and adopt the rules as expeditiously as possible. If the Commission has any questions regarding this letter, please call me at (603) 271-1463 or Ralph Lambiase, Chair of the Broker Dealer Operations Committee, at (860)240-8230 or Karen O'Brien, NASAA General Counsel at (202)737-0900.

Sincerely,

Peter C. Hildreth, President
NASAA