SR-NASD-2002-162

#85

PACIFIC SELECT DISTRIBUTORS

October 3,2003

Jonathan G. Katz
Secretary
United States Securities and Exchange Commission
450 Fifth Street, NW
Washington DC 20549-0609

RE: Amendments to Proposed Rule Change Regarding Supervisory Controls

Dear Mr. Katz:

Please accept this letter in response to the request for comments with respect to SEC Release 34-48298 and file no. SR-NASD-2002-162. We appreciate the opportunity to comment further on the proposed NASD amendments relating to Supervisory Controls.

Pacific Select Distributors, Inc. ("PSD") is a broker-dealer member firm of the National Association of Securities Dealers, Inc ("NASD") and is a subsidiary of Pacific Life Insurance Company. PSD has an affiliate relationship and directly or indirectly owns majority control of six retail NASD member firms. As pointed out below, PSD also serves as a distributor of variable contracts offered by Pacific Life Insurance Company, as well as investment company shares issued by Pacific Funds.

First, we appreciate the NASD recognizing the initial proposal did not advance investor protection with respect to the need for reviews of independent branch offices to be performed by "independent" examiners. As many commentators pointed out, the "independent" requirement could have diminished the effectiveness of many firms' supervisory systems. Further, most firms already have compliance departments that are independent from sales and marketing activities. Such departments are more familiar with firm practices and procedures and can bring important experience to the examination process. It would be a waste of these valued resources if firms were forced to hire or contract with completely independent examiners.

While we agree with the majority of the proposed new rule, many of the comments we made in our letter of December 18, 2002 (incorporated here by reference) are still not reflected in the amendments provided by the NASD. Further, we are concerned about two new concepts introduced by the amendment: the proposed inspection requirement of non-branch business locations and the requirement for additional forms of review with respect to producers accounting for more than 20% or more of the income for a branch office manager.

As mentioned above, PSD serves as distributor for Pacific Life investment and insurance products. Most insurance and investment companies utilize a similar arrangement; distributing product through wholly owned subsidiaries ("distributor B/Ds").

A common practice in the industry is for distributor B/Ds to employ individuals ("wholesalers") throughout the United States. Those individuals typically meet with retail brokers within a specified geographic region to provide information regarding the life and investment products. Such individuals typically work from their homes and do not meet with brokers or retail investors at their homes. In most cases, the wholesalers on their business cards provide contact information of a local telephone number and an address of either the main or regional office. These individuals do not maintain books and records on behalf of the broker-dealer.

In addition, such individuals are subject to supervision by a designated principal. Such face to face supervision typically consists of either meetings in the home office or travel to meet with retail broker-dealers. Correspondence and other communications are directed to the home office.

Further, we believe that any office of a retail broker-dealers at which records are retained or regular operations occur are currently required to register as branch offices. Just because a registered representative occasionally meets customers at home or other locations does not justify requiring that such locations be subject to inspection requirements.

We would ask that section (1)(c) be stricken from the proposal or that more specific detail be provided to clarify what records and/or type and level of activity must be involved before inspections of a "non-branch" location are required.

With respect to the 20% threshold, we do not disagree with the concept that a broker-dealer should take overrides and other forms of compensation into consideration in determining that their branch examination program is adequate. We are troubled by the proposal to create an absolute number for the following reasons:

1. Compensation can take many forms; hence the number can be easily manipulated by those not willing to take additional steps;
2. Providing an absolute number can create the impression of a "safe harbor" for inspections done by a manager with some lesser amount of financial dependence on the branch they are responsible;
3. The time period for review with respect the 20% requirement is not defined in the proposal. As such, an office may have "a good month" and then call into question whether such additional supervision is necessary.

We suggest that the NASD drop the proposed 20% threshold and, instead, provide written guidance to members (perhaps in a separate Notice to Members or in the form of an article in the Regulatory and Compliance Alert). This Notice will suggest that members take into consideration the dependence of managers on income generated from branch offices, under their supervision, when assessing the adequacy of their branch office inspection program and supervisory systems.

We appreciate the opportunity to comment. Please let us know if you have any questions.

Sincerely,

S. Kendrick Dunn

S. Kendrick Dunn
Assistant Vice President

Cc: John L. Dixon, President, PSD