

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54411; File No. SR-NASD-2004-171)

September 7, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order  
Approving Proposed Rule Change Relating to Rule 2340 Concerning Customer Account  
Statements

I. Introduction

On November 2, 2004, the National Association of Securities Dealers, Inc. (“NASD”), filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (“Act”)<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> a proposed rule change to amend NASD Rule 2340, which relates to customer account statements. On February 2, 2005, NASD filed Amendment No. 1 to the proposed rule change.<sup>4</sup> The proposed rule change, as amended, was published for comment in the Federal Register on February 16, 2005.<sup>5</sup> The Commission received fifteen comment letters in response to the proposed rule change.<sup>6</sup> This order approves the proposed rule change, as amended.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 15 U.S.C. 78a et seq.

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> In Amendment No. 1, NASD changed the proposed effective date from 30 days following Commission approval to 180 days following Commission approval, and changed the reference to “each customer” to “the customer” in the sentence proposed to be added as the second sentence to paragraph (a) of Rule 2340.

<sup>5</sup> Securities Exchange Act Release No. 51181 (Feb. 10, 2005), 70 FR 7990 (Feb. 16, 2005) (“Notice”).

<sup>6</sup> See letter dated February 17, 2005 from Christopher Charles, President, Wulff, Hansen & Co. (“Wulff, Hansen”); email dated April 21, 2005 from Geraldine Genco (“Genco”); eight letters (dated February 28, 2005 from Lisa Roth, President, ComplianceMax Financial, LLC, dated March 2, 2005 from Candy J. Lee, NCM, CFP, President, Financial Services International Corp., dated March 7, 2005 from Rod P. Michel, World Trade Financial Corporation, dated March 4, 2005 from Robert L. Savage, President, Leonard Securities,

## II. Description of the Proposal and Comment Summary

### A. Description

Currently, clearing firms may include language in customer account statements advising customers to immediately report to the firm any discrepancies in balances or positions. However, these advisories may not necessarily direct customers to report discrepancies in writing, nor are the advisories required to be included on customer account statements. In 2001, the U.S. General Accounting Office (“GAO”) recommended, among other things, that self-regulatory organizations (“SROs”), such as NASD, seek to inform investors that they should document any unauthorized trading in their accounts in writing.<sup>7</sup> Written documentation is important because, in the event a firm goes into liquidation, SIPC and the trustee generally will assume that the firm’s records are accurate unless the customer can prove otherwise.<sup>8</sup>

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Inc., dated March 7, 2005 from Robert J. Schoen, President, Quest Securities, Inc., dated March 2, 2005 from Matthew S. Merwin, CFP, President, FMN Capital Corporation, dated March 7, 2005 from Warner Griswold, Chief Operating Officer, Green Street Advisors, Inc., and dated March 11, 2005 from Craig Biddick, President, Mission Securities Corporation) that were versions of a form letter that the National Association of Independent Broker Dealers posted on its website and encouraged its members to submit (“NAIBD”); letter dated March 2, 2005 from John Miller (“Miller”); letter dated March 9, 2005 from Rosemary J. Shockman, President, Public Investors Arbitration Bar Association (“PIABA”); letter dated March 8, 2005 from Andrew C. Small, General Counsel, Scottrade, Inc. (“Scottrade”); letter dated March 9, 2005 from John Polanin, Jr., Chairman, Self Regulation and Supervisory Practices Committee, Securities Industry Association (“SIA”); and letter dated April 4, 2005 from Josephine Wang, General Counsel, Securities Investor Protection Corporation (“SIPC”).

<sup>7</sup> See GAO, Securities Investor Protection: Steps Needed to Better Disclose SIPC Policies to Investors, GAO-01-653 (May 25, 2001). See also GAO-03-811 (July 11, 2003); GAO-04-848R Follow-Up on SIPC (July 9, 2004). GAO has since been renamed the Government Accountability Office.

<sup>8</sup> SIPC advises investors who discover an error in a confirmation or statement to immediately bring the error to the attention of their brokerage firm in writing and to keep a copy of any such writing. See SIPC, “Documenting Unauthorized Trading” (available at

Consistent with GAO's recommendation, the proposed rule change would amend NASD Rule 2340 to require general securities firms to include in monthly account statements an advisory indicating that a customer should report promptly any inaccuracy or discrepancy in its account to its clearing firm and (if it is a different firm) its introducing firm. The advisory statement also would inform customers that any oral communications should be re-confirmed in writing to further protect customers' rights, including rights under SIPA. The proposed disclosure requirement would not impose any limitation on a customer's right to raise concerns regarding inaccuracies or discrepancies in his or her account at any time, either in writing or orally. Further, a customer's failure to promptly raise such concerns, either in writing or orally, would not preclude a customer from reporting an inaccuracy or discrepancy in his or her account during any SIPC liquidation of his or her brokerage or clearing firm.<sup>9</sup>

The 180-day delay in the rule's effectiveness requested in Amendment No. 1 to the proposal is intended to give NASD member firms time to make necessary changes to their customer documentation and systems.

#### B. Comment Summary

The Commission received fifteen comments in response to the proposed rule change.<sup>10</sup> Four commenters generally supported the proposal.<sup>11</sup> Eleven generally opposed it.<sup>12</sup>

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<http://www.sipc.org/how/unauthorized.cfm>); SIPC, "How SIPC Protects You" (available at <http://www.sipc.org/how/brochure.cfm>).

<sup>9</sup> See Notice at 70 FR 7991. The NYSE has proposed a similar rule change. See initial proposed rule change and Amendment No. 1 thereto in File No. SR-NYSE-2005-09 (available on the NYSE's website).

<sup>10</sup> See footnote 6, *supra*.

<sup>11</sup> Genco; Scottrade; SIA; and SIPC.

### Impact on Investors

Three commenters argued that the proposal could lead to claims that customers who do not promptly report errors or document them in writing would give up rights to assert claims against brokerage firms, or that brokerage firms could misuse the proposed advisory statement by arguing that customers who fail to follow it are barred from bringing claims.<sup>13</sup>

### Contact Information

Four commenters suggested that the advisory statement direct customers to address reports to a specific area within a firm where responses could be managed and supervised, rather than to an address or phone number that might cause a report to be received initially by the registered representative handling the account of the customer making the report.<sup>14</sup>

### Including Advisory Statement on Confirmations

Three commenters suggested requiring that the proposed advisory statement be included not only in account statements, but also in trade confirmations.<sup>15</sup>

### Scope of Statement

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- <sup>12</sup> Miller, NAIBD (eight commenters submitted letters based on the NAIBD form letter), PIABA, and Wulff, Hansen. Wulff, Hansen suggested abandoning the proposal or, in the alternative, modifying it to require the new advisory statement only at account opening and annually thereafter, to reduce printing costs and other burdens.
- <sup>13</sup> Miller, PIABA, and Wulff, Hansen. Miller recommended clarifying that a customer's failure to make a report does not limit the customer's right to raise concerns regarding account inaccuracies or discrepancies at any time, including during a SIPC liquidation. PIABA also recommended clarifying that the proposed additional statement shall not be used to defend against a customer claim.
- <sup>14</sup> Genco, Miller, PIABA, and SIPC. Miller also recommended that the statement identify a person at a clearing firm to whom errors should be reported, if the clearing and introducing firms for the account are different.

Two commenters believed that the proposed statement is overbroad and suggested narrowing it to apply only to unauthorized trades.<sup>16</sup>

#### Role of Clearing Firms

Two commenters sought clarification as to the role clearing firms would have in connection with disputed transactions.<sup>17</sup>

#### Method of Delivering Notice

One commenter recommended amending the proposal to allow brokers to deliver the proposed advisory statement “with” (rather than “in”) account statements, which the commenter believes would better accommodate certain click-through processes for delivering regulatory disclosures to customers.<sup>18</sup>

#### Time for Reporting Discrepancies

Two commenters recommended setting a specified period within which investors should report discrepancies to avoid customer abuses, such as using post-settlement market information to undo transactions.<sup>19</sup>

#### Level Playing Field

One commenter maintained that the proposal would subject brokerage firms to a standard not applicable to commercial banks.<sup>20</sup>

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<sup>15</sup> Miller, PIABA, and SIPC. Miller and PIABA also suggested requiring that the statement be presented in bold type. PIABA recommended requiring that the statement be presented in plain language on the first page of account statements.

<sup>16</sup> Miller and PIABA.

<sup>17</sup> Genco and NAIBD. For example, Genco asked whether the proposal is intended to require clearing firms to escalate a complaint to the proper party in the executing firm.

<sup>18</sup> Scottrade.

### Similar NYSE Proposal

One commenter<sup>21</sup> recommended that, in the interest of regulatory consistency, the proposal be conformed to a similar proposed NYSE rule change.<sup>22</sup>

### III. Discussion and Findings

The Commission finds that the proposed rule change is consistent with the Act, and in particular, with Section 15A(b)(6) of the Act,<sup>23</sup> which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The Commission believes that the proposed rule change is consistent with the provision of the Act noted above because it will help investors understand procedures for preserving their rights in the event of erroneous or unauthorized transactions in their accounts.

While the Commission believes that the proposal would improve NASD's current customer account disclosure requirements, we believe that the disclosure would be more beneficial to investors if it required NASD members to include on account statements both introducing and clearing firm contact information sufficient to allow investors to timely report unauthorized transactions or other account discrepancies to both firms (if the firms are different). We believe such disclosure would be consistent with current Commission guidance on this

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<sup>19</sup> NAIBD and SIPC.

<sup>20</sup> Wulff, Hansen.

<sup>21</sup> SIA.

<sup>22</sup> See footnote 9, *supra*.

<sup>23</sup> 15 U.S.C. 78o-3(b)(6).

issue.<sup>24</sup> We also believe that such disclosure would address the concerns of some commenters that the current proposal could be enhanced to ensure that a customer's concern is delivered to the most appropriate person at the firm.<sup>25</sup> The Commission therefore encourages NASD to issue a Notice to Members regarding the proposed change to Rule 2340 that reminds member firms of their current obligations with respect to customer account statements.<sup>26</sup>

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<sup>24</sup> See Securities Exchange Act Release No. 31511 (Nov. 24, 1992), 57 FR 56973 (Dec. 2, 1992) (amending the SEC's net capital rule and explaining the staff's interpretation that to avoid more stringent capital requirements under the rule, an introducing firm must have in place a clearing agreement with a registered broker-dealer that, among other things, contains "the name and telephone number of a responsible individual at the clearing firm whom a customer can contact with inquiries regarding the customer's account."). See also NYSE Interpretation Handbook at 4105 (carrying organization phone number may appear on the back of the customer account statement, but, if so, it must be in "bold" or "highlighted" text).

<sup>25</sup> See footnote 14, supra.

<sup>26</sup> See footnote 24, supra.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act<sup>27</sup> that the proposed rule change (SR-NASD-2004-171), as amended, be, and hereby is, approved,<sup>28</sup> effective 180 days from the date of this order. NASD has committed to announce the effective date of the proposed rule change in a Notice to Members to be published no later than 30 days following approval of the proposal.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>29</sup>

Nancy M. Morris  
Secretary

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<sup>27</sup> 15 U.S.C. 78s(b)(2).

<sup>28</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule change's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f). In particular, the Commission considered and granted NASD's request to delay effectiveness of the proposal by 180 days to allow NASD member firms sufficient time to implement the change required by the proposal.

<sup>29</sup> 17 CFR 200.30-3(a)(12).