

November 1, 2004

Katherine A. England  
Assistant Director  
Division of Market Regulation  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-1001

**Re: File No. SR-NASD-2004-171 - Amendments to Rule 2340 (Customer Account Statements)**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Shirley H. Weiss, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844; e-mail shirley.weiss@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Marc Menchel  
Executive Vice President  
and General Counsel

Enclosures

File No. SR-NASD-2004-171  
Consists of 13 Pages  
November 1, 2004

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C.

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Form 19b-4

Proposed Rule Change

by

**NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.**

Pursuant to Rule 19b-4 under the  
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), the National Association of Securities Dealers, Inc. ("NASD") is filing with the Securities and Exchange ("SEC" or "Commission") a proposed rule change to amend NASD Rule 2340 to require that account statements include a statement that advises each customer to promptly report any inaccuracy or discrepancy in that person's account to his or her brokerage firm and clearing firm (where these are different firms) and to re-confirm any oral communications in writing. Below is the text of the proposed rule change. Proposed new language is underlined.

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**2340. Customer Account Statements**

(a) General

Each general securities member shall, with a frequency of not less than once every calendar quarter, send a statement of account ("account statement") containing a description of any securities positions, money balances, or account activity to each customer whose account had a security position, money balance, or account activity during the period since the last such statement was sent to the customer. In addition, each general securities member shall include in the account statement a statement that advises each customer to report promptly any inaccuracy or discrepancy in that person's account to his or her brokerage firm. (In cases where the customer's account is serviced by both an introducing and clearing firm, each general securities member must include in the advisory a reference that such reports be made to both firms.) Such statement also shall advise the customer that any oral communications should be re-confirmed in

writing to further protect the customer's rights, including rights under the Securities Investor Protection Act (SIPA).

(b) through (d) No change

\* \* \* \* \*

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on January 21, 2004, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on January 22, 2004. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

On May 25, 2001, the U.S. General Accounting Office ("GAO") issued *Securities Investor Protection: Steps Needed to Better Disclose SIPC Policies to Investors* (GAO-01-653). In that report, the GAO made recommendations to SEC and the Securities Investor Protection Corporation ("SIPC") about ways to improve the information available to the public about SIPC and the Securities Investor Protection Act ("SIPA").<sup>1</sup> Among other things, the GAO recommended that self-regulatory organizations ("SROs") explore actions to include information on periodic statements or trade confirmations to inform investors that they should document any unauthorized trading in writing. This is important because, in the event a firm goes into SIPC liquidation, SIPC and the trustee generally will assume that the firm's records are accurate unless the customer is able to prove otherwise.<sup>2</sup> Currently, clearing firms may include language in customer account statements advising customers to immediately report to the firm any discrepancies in balances or positions, but these advisories may not necessarily direct customers to do so in writing, nor are they required to be included on the statements.

Therefore, NASD is proposing to amend Rule 2340, which specifies disclosures required to be made on customer account statements. The proposed amendment to Rule 2340 would require general securities firms to include in monthly account statements a statement advising

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<sup>1</sup> In July 2003, the GAO issued *Securities Investor Protection: Update on Matters Related to the Securities Investor Protection Corporation*, in which the GAO noted that the Commission was working with self-regulatory organizations to explore ways in which the GAO's recommendations could be implemented.

<sup>2</sup> The *SIPC Brochure* advises customers that if they ever discover an error in a confirmation or statement, they should immediately bring the error to the attention of the brokerage firm in writing and keep a copy of this writing. SIPC advises that if there is something wrong with the brokerage firm's records, the customer will have to prove that the records are inaccurate, or SIPC and the trustee will assume that the firm's records are correct.

each customer to report promptly any inaccuracy or discrepancy in that person's account to his or her brokerage firm. In cases where the customer's account is serviced by both an introducing and clearing firm, each general securities member would be required to include in the advisory a reference that such reports be made to both firms. Such statement also would advise customers that any oral communications should be re-confirmed in writing to further protect the customer's rights, including rights under SIPA. The proposed disclosure requirement would not impose any limitation whatsoever 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, does not act to estop 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.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, 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. NASD believes that the proposed rule change is consistent with the provisions of the Act noted above because each customer will be advised to promptly report any discrepancies or inaccuracies in his or her account to his or her brokerage firm (both the clearing firm and introducing firm, where the customer's account is serviced by both) and to re-confirm any oral communications in writing, thereby further protecting the customer's rights, including rights under SIPA.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on

competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD

BY: \_\_\_\_\_  
Marc Menchel, Executive Vice President and  
General Counsel, NASD, Regulatory Policy and Oversight

Date: November 1, 2004

**EXHIBIT 1**

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

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Amendments to Rule 2340 (Customer Account Statements)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on , the National Association of Securities Dealers, Inc. ("NASD"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD is proposing to amend Rule 2340 to require that account statements include a statement that advises each customer to promptly report any inaccuracy or discrepancy in that person's account to his or her brokerage firm and clearing firm (where these are different firms) and to re-confirm any oral communications in writing. Below is the text of the proposed rule change. Proposed new language is in italics.

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

<sup>2</sup> 17 CFR 240.19b-4.

**2340. Customer Account Statements**

(a) General

Each general securities member shall, with a frequency of not less than once every calendar quarter, send a statement of account ("account statement") containing a description of any securities positions, money balances, or account activity to each customer whose account had a security position, money balance, or account activity during the period since the last such statement was sent to the customer. In addition, each general securities member shall include in the account statement a statement that advises each customer to report promptly any inaccuracy or discrepancy in that person's account to his or her brokerage firm. (In cases where the customer's account is serviced by both an introducing and clearing firm, each general securities member must include in the advisory a reference that such reports be made to both firms.) Such statement also shall advise the customer that any oral communications should be re-confirmed in writing to further protect the customer's rights, including rights under the Securities Investor Protection Act (SIPA).

(b) through (d) No change

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II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

On May 25, 2001, the U.S. General Accounting Office ("GAO") issued *Securities Investor Protection: Steps Needed to Better Disclose SIPC Policies to Investors* (GAO-01-653). In that report, the GAO made recommendations to SEC and the Securities Investor Protection Corporation ("SIPC") about ways to improve the information available to the public about SIPC and the Securities Investor Protection Act ("SIPA").<sup>3</sup> Among other things, the GAO recommended that self-regulatory organizations ("SROs") explore actions to include information on periodic statements or trade confirmations to inform investors that they should document any unauthorized trading in writing. This is important because, in the event a firm goes into SIPC liquidation, SIPC and the trustee generally will assume that the firm's records are accurate unless the customer is able to prove otherwise.<sup>4</sup> Currently, clearing firms may include language in

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<sup>3</sup> In July 2003, the GAO issued *Securities Investor Protection: Update on Matters Related to the Securities Investor Protection Corporation*, in which the GAO noted that the Commission was working with self-regulatory organizations to explore ways in which the GAO's recommendations could be implemented.

<sup>4</sup> The *SIPC Brochure* advises customers that if they ever discover an error in a confirmation or statement, they should immediately bring the error to the attention of the brokerage firm in writing and keep a copy of this writing. SIPC advises that if there is something wrong with the brokerage firm's records, the customer

customer account statements advising customers to immediately report to the firm any discrepancies in balances or positions, but these advisories may not necessarily direct customers to do so in writing, nor are they required to be included on the statements.

Therefore, NASD is proposing to amend Rule 2340, which specifies disclosures required to be made on customer account statements. The proposed amendment to Rule 2340 would require general securities firms to include in monthly account statements a statement advising customers to report promptly any inaccuracy or discrepancy in their account to their clearing firm and the introducing firm (where these are different firms). Such statement also would need to advise 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 whatsoever 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, does not act to estop 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.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, 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. NASD believes that the proposed rule change is consistent with the provisions of the Act noted above because each

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will have to prove that the records are inaccurate, or SIPC and the trustee will assume that the firm's records are correct.

customer will be advised to promptly report any discrepancies or inaccuracies in his or her account to his or her brokerage firm (both the clearing firm and introducing firm, where the customer's account is serviced by both) and to re-confirm any oral communications in writing, thereby further protecting the customer's rights, including rights under SIPA.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change [as amended] is consistent with the act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-NASD-2004-171. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Margaret H. McFarland  
Deputy Secretary