

Notice to Members

DECEMBER 2006

SUGGESTED ROUTING

Individual Investors
Legal & Compliance
Operations
Registered Representatives
Senior Management

KEY TOPICS

Clearing Firms
Customer Account Statements
Introducing Firms
NASD Rule 2340
SIPA (Securities Investor
Protection Act)
SIPC (Securities Investor
Protection Corporation)

GUIDANCE

Customer Account Statements

Amendments to Rule 2340 Requiring Customer Account Statements to Include a Statement Reminding Customers to Report Inaccuracies in Their Accounts in Writing;
Revised Effective Date: May 31, 2007

Executive Summary

NASD is issuing this *Notice* to supersede *NASD Notice to Members (NTM) 06-60* and replace the guidance provided in that *Notice*. On September 7, 2006, the Securities and Exchange Commission (SEC) approved amendments to Rule 2340 requiring customer account statements to include a statement advising customers to promptly report any inaccuracy or discrepancy in their account to the introducing firm and clearing firm (where these are different firms) and to re-confirm any oral communication in writing.¹ *NTM 06-60* announced the effective date of that rule change as March 6, 2007. On December 5, 2006, the SEC approved NASD's request to change the effective date of this requirement to May 31, 2007.²

Additionally, this *Notice* clarifies an interpretation of the SEC's Division of Market Regulation under the net capital rule and SEC Rule 15c3-3 that requires clearing firms to include in customer account statements a telephone number at the clearing firm that a customer may use to contact the firm with inquiries regarding the customer's account.³

As revised, the effective date of this rule change is May 31, 2007. Included with this *Notice* is Attachment A, the text of amended Rule 2340.

Questions/Further Information

Questions concerning this *Notice* may be directed to Susan M. DeMando, Associate Vice President, Financial Operations, Department of Member Regulation, at (202) 728-8411.

Background and Discussion

In May 2001, the GAO (the U.S. General Accounting Office, now known as the Government Accountability Office) issued a report in which it made recommendations to the 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). Among other things, the GAO recommended that self-regulatory organizations, such as NASD, explore actions to include information on periodic statements to inform investors that they should document any unauthorized trading in writing.⁴ 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. In this regard, the SIPC brochure states that if customers ever discover an error in a confirmation or account statement, they should immediately bring the error to the attention of the brokerage firm in writing and keep a copy of such writing.⁵ The SIPC brochure also advises customers that if there is something wrong with the brokerage firms' records of their accounts, the customer will have to prove that, or SIPC and the trustee will assume that the firm's records are accurate.

Consistent with GAO's recommendation, NASD has amended Rule 2340 to require general securities firms to include in account statements required by Rule 2340 a statement advising each customer to report promptly any inaccuracy or discrepancy in that person's account to his or her brokerage firm. Where the customer's account receives services from both an introducing and clearing firm, the advisory must state that the reports be made to both firms. This statement must also advise customers that any oral communications should be re-confirmed in writing to further protect the customer's rights, including rights under SIPA. Where account statements are delivered electronically, this statement may also be delivered electronically, provided it is on the same screen as the account statement, and the customer is not required to use a "click-through process" to bring it up on the screen. This statement will emphasize to customers the importance of promptly reporting, in writing, any suspected inaccuracy or discrepancy in their accounts and will remind customers of the importance of creating the written documentation that could prove helpful in the event of a SIPC liquidation to further evidence an assertion that the broker-dealer's records are inaccurate.

The statement required by Rule 2340, as amended, does 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, and to bring these concerns to his or her brokerage and/or clearing firm or, in the course of a liquidation proceeding, to SIPC. Further, although firms that issue account statements are required by this amendment to advise customers to "promptly" report their concerns to their firm(s) and reconfirm any conversations with their firms in writing, Rule 2340 does not impose any time limit during which customers may report inaccuracies in their accounts.

NASD reminds its members that an SEC interpretation requires them to include in each account statement the pertinent telephone number at the clearing firm that a customer may use to contact the firm with inquiries regarding his or her account.⁶ In addition, the SEC, in approving the rule change, noted that it would be more beneficial for firms 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).⁷

Endnotes

- 1 See Exchange Act Release No. 54411 (Sept. 7, 2006) 71 FR 54105 (Sept. 13, 2006) (Order Granting Approval of Proposed Rule Change Relating to Rule 2340 Concerning Customer Account Statements; File No. SR-NASD-2004-171) (SEC Approval Order), as corrected by Exchange Act Release No. 54411A (Oct. 6, 2006).
- 2 See Exchange Act Release No. 54872 (December 5, 2006) (Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Relating to Establishing an Effective Date for Amendments to NASD Rule 2340); File No. SR-NASD-2006-128). NASD notes that the effective date of May 31, 2007 is consistent with the effective date of a substantially similar New York Stock Exchange LLC requirement. See SR-NYSE-2005-09.
- 3 See *infra* note 6.
- 4 See Securities Investor Protection: Steps Needed to Better Disclose SIPC Policies to Investors (GAO-01-653).
- 5 The SIPC brochure, entitled *Understanding the Securities Investor Protection Corporation*, is published on SIPC's Web site at www.sipc.org. The brochure provides a basic explanation of SIPC and SIPA and answers questions about SIPC liquidations.
- 6 In its November 24, 1992 release announcing "Final Rule Amendments" to its net capital rule, the SEC's Division of Market Regulation stated that it has interpreted the net capital rule and SEC Rule 15c3-3 to require that, among other things, clearing firms must issue account statements directly to customers, and that each statement must contain 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 Exchange Act Release No. 31511 (Nov. 24, 1992), 57 FR 56973 (Dec. 2, 1992) (S7-28-89). See also *supra* note 1, 71 FR at 54107, footnote 24, as corrected by Exchange Act Release No. 54411A.

NASD noted in *NTM 93-46* (July 1993) that SEC staff subsequently clarified this requirement. The *Notice* stated that SEC staff had reconsidered its interpretation concerning customer account statements that a clearing firm must send directly to the customers of an introducing firm. In reviewing its position that each account statement had to include the name and telephone number of a responsible clearing firm employee that a customer could contact with inquiries regarding the customer's account, SEC staff noted that individuals may assume different responsibilities at their firms or may leave their employment altogether. Hence, requiring firms to name a specific individual on customer account statements, which are often pre-printed, may lead to confusion for customers inquiring about their accounts. For this reason, SEC staff determined

that it is sufficient for firms to include just the pertinent telephone number. This requirement became effective as of October 1, 1993. NASD advised its members in the *Notice* that the following language is acceptable to SEC staff for use on customer account statements for purposes of meeting the requirements of the SEC's net capital rule and SEC Rule 15c3-3:

[Name of clearing firm] carries your account and acts as your custodian for funds and securities deposited with us directly by you, through [name of introducing firm] or as a result of transactions we process for your account. Inquiries concerning the position and balances in your account may be directed to our Client Service Department: [telephone number]. All other inquiries regarding your account or the activity therein should be directed to [name of introducing firm].

- 7 See *supra* note 1, 71 FR at 54107. Firms that are members of both NASD and the New York Stock Exchange should also review the requirements of NYSE Rule 409 in the NYSE Interpretation Handbook at 4105, which states that "Statements of accounts to customers must clearly and prominently disclose on the front of the statement...the identity of the introducing and carrying organization and their respective phone numbers for service[.]" The Handbook further advises that the phone number of the carrying organization may appear on the back of the statement, but if it does, it must be in "bold" or "highlighted" letters.

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ATTACHMENT A

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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 the 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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