

OMB APPROVAL

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2006 - 124
Amendment No. 1

Proposed Rule Change by National Association of Securities Dealers
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial ☐ Amendment ☒ Withdrawal ☐

Section 19(b)(2) ☒ Section 19(b)(3)(A) ☐ Section 19(b)(3)(B) ☐

Rule

Pilot ☐ Extension of Time Period
for Commission Action ☐ Date Expires

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document
☐

Exhibit 3 Sent As Paper Document
☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
Title
E-mail
Telephone Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date

By
(Name)

(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

PATRICE GLINIECKI,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit Sent As Paper Document

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Exhibit 3 - Form, Report, or Questionnaire

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit Sent As Paper Document

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Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

On November 9, 2006, NASD filed with the Commission proposed rule change SR-NASD-2006-124 (proposed NASD Rule 2342), which would require members to advise all new customers, in writing, at the opening of an account, and all customers at least once each year that they may obtain information about the Securities Investor Protection Corporation (“SIPC”), including the SIPC brochure, by contacting SIPC, and to provide such customers with SIPC’s telephone number and Web site address.

On December 13, 2006, the Commission published for comment the proposed rule change in the Federal Register.¹ The comment period closed on January 3, 2007. NASD is filing this Partial Amendment No. 1 to SR-NASD-2004-124 to respond to the comments received in response to the publication of the proposed rule change in the Federal Register and to amend the proposed rule text in response to comments. NASD is also asking for accelerated approval of Partial Amendment No. 1.

I. Response to Comments

NASD hereby responds to the nine comment letters² received by the Commission in response to the publication in the Federal Register of Notice of Filing of SR-NASD-2006-124 relating to proposed Rule 2342.³ Attached as Exhibit A to this Partial Amendment No. 1 is one additional comment letter that was received by NASD.⁴ NASD is responding to all ten comment letters.

¹ See Securities Exchange Act Release No. 54871 (December 5, 2006), 71 FR 74970 (December 13, 2006) (Notice of Filing of Proposed Rule Change Relating to Proposed Rule 2342 Requiring Members to Provide New Customers, and All Customers Annually, Specific Information About the Securities Investor Protection Corporation (“SIPC”)) (SR-NASD-2006-124).

² E.C. Blitz (December 22, 2006); Noland Cheng, Chairman, SIFMA Operations Committee (January 12, 2007); Kenneth M. Cherrier, JD, FLMI, Chief Compliance Officer, Fintegra (December 22, 2006); Frederick G. Ferrara, CFA, Chief Compliance Officer, Panattoni Securities, Inc. (December 20, 2006); John Harris, Chief Executive Officer, BondMart, Inc. (December 30, 2006); Philip C. McMorro, CFP, President, Cantella Co., Inc. (December 21, 2006); Michael A. Pagano, JD, CFCP, CLU, 1st Global Capital Corp. (December 22, 2006); Christine E. Saccente, Vice President, Chief Compliance Officer, Operations Manager, Maxwell Noll Inc. (December 27, 2006); William R. Sykes, CFP, President, Sykes Financial Services LLC (December 28, 2006).

³ See supra note 1. The SEC recently approved a similar amendment to NYSE Rule 409 (Statements of Accounts to Customers). See Securities Exchange Act Release No. 54904 (December 8, 2006), 71 FR 75600 (December 15, 2006) SR-NYSE-2005-09.

⁴ Judith Alderete, Amerest Securities Inc. (December 28, 2006).

One commenter supports the proposal on the basis that the disclosure required by NASD Rule 2342 would remind clients that they are buying a product that is not directly underwritten or supported by a bank or covered by the Federal Deposit Insurance Corporation (“FDIC”).⁵ A second commenter supports the proposal on the basis that public customers will benefit from broader dissemination of information about SIPC.⁶

The remaining eight commenters generally oppose proposed NASD Rule 2342.⁷ Five commenters question the need for disseminating the required information.⁸ Among other things, these commenters question whether investors need, or are interested, in information about SIPC.⁹ One commenter suggests that customers will be made aware of SIPC at such time as they need the coverage.¹⁰ Another commenter suggests that investors are unlikely to read the disclosure. This commenter also questions the cost of

⁵ Kenneth M. Cherrier, JD, FLMI, Chief Compliance Officer, Fintegra (December 22, 2006). As discussed below, this commenter also contends that firms that are excluded from SIPC membership should be exempt from the requirements of the proposed rule change.

⁶ Noland Cheng, Chairman, SIFMA Operations Committee (January 12, 2007). As discussed below, this commenter also believes that institutional customers should be exempt from the requirements of the proposed rule change.

⁷ Judith Alderete, Amerest Securities Inc. (December 28, 2006); E.C. Blitz (December 22, 2006); Frederick G. Ferrara, CFA, Chief Compliance Office, Panattoni Securities, Inc. (December 20, 2006); John Harris, Chief Executive Officer, BondMart, Inc. (December 30, 2006); Philip C. McMorrow, CFP, President, Cantella Co., Inc. (December 21, 2006); Michael A. Pagano, JD, CFCP, CLU, 1st Global Capital Corp. (December 22, 2006); Christine E. Saccente, Vice President, Chief Compliance Officer, Operations Manager, Maxwell Noll Inc. (December 27, 2006); William R. Sykes, CFP, President, Sykes Financial Services LLC (December 28, 2006).

⁸ John Harris, Chief Executive Officer, BondMart, Inc. (December 30, 2006); Philip C. McMorrow, CFP, President, Cantella Co., Inc. (December 21, 2006); Michael A. Pagano, JD, CFCP, CLU, 1st Global Capital Corp. (December 22, 2006); Christine E. Saccente, Vice President, Chief Compliance Officer, Operations Manager, Maxwell Noll Inc. (December 27, 2006); William R. Sykes, CFP, President, Sykes Financial Services LLC (December 28, 2006).

⁹ Michael A. Pagano, JD, CFCP, CLU, 1st Global Capital Corp. (December 22, 2006).

¹⁰ William R. Sykes, CFP, President, Sykes Financial Services LLC (December 28, 2006).

implementing the proposed disclosure.¹¹ Two commenters suggest that the proposed rule be revised to mandate that firms include a link to SIPC in their Web sites.¹²

As NASD noted in its rule filing, the genesis of proposed Rule 2342 was the May 25, 2001 report of the U.S. General Accounting Office (“GAO”) (now the U.S. Government Accountability Office) entitled *Securities Investor Protection: Steps Needed to Better Disclose SIPC Policies to Investors* (GAO-01-653) (“GAO Report”). In the GAO Report, the GAO made recommendations to the SEC and SIPC about ways to improve the information available to the public about SIPC and the Securities Investor Protection Act of 1970 (“SIPA”). Among other things, the GAO recommended that self-regulatory organizations (“SROs”) explore ways to encourage broader dissemination of the SIPC brochure to customers so that they can become more aware of the scope of coverage of SIPA. 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 SEC was working with SROs to explore ways in which the GAO’s recommendations could be implemented.

After considerable discussion with members regarding the costs of providing customers with a copy of the SIPC brochure, NASD determined that the most cost effective way of making customers aware of the SIPC brochure was to provide them with the information they would need to obtain a copy of the brochure, *i.e.*, by giving them SIPC’s address and telephone number so they could call or write SIPC to order a copy of the brochure and by giving them SIPC’s Web site address, so they could read the SIPC brochure online. NASD believes that requiring firms to provide customers with SIPC’s address, telephone number and Web site at account opening and yearly thereafter will help to further educate customers regarding SIPC and will encourage customers to review the SIPC brochure.

Two commenters state their belief that introducing firms should not be subject to proposed Rule 2342.¹³ NASD notes that, as proposed, where both an introducing firm and clearing firm service an account, the firms may assign the requirements of proposed Rule 2342 to one of the firms. NASD believes that this accommodation addresses these commenters’ concerns.

Five commenters express the view that, as proposed, Rule 2342 is too broad. One of these commenters contends that institutional customers should be exempt from the

¹¹ Michael A. Pagano, JD, CFCP, CLU, 1st Global Capital Corp. (December 22, 2006).

¹² Michael A. Pagano, JD, CFCP, CLU, 1st Global Capital Corp. (December 22, 2006); Christine E. Saccente, Vice President, Chief Compliance Officer, Operations Manager, Maxwell Noll Inc. (December 27, 2006).

¹³ E.C. Blitz (December 22, 2006); Michael A. Pagano, JD, CFCP, CLU, 1st Global Capital Corp. (December 22, 2006).

proposed rule,¹⁴ two of these commenters contend that firms that only sell investment products (such as direct placement products) that are not covered under SIPC should be exempt from the proposed rule,¹⁵ and two commenters contend that NASD firms that are excluded from coverage under SIPC should be exempt from the proposed rule.¹⁶

In support of the position that institutional customers should be exempt from the requirements of proposed NASD Rule 2342, the commenter states that institutional customers are sophisticated investors that are well aware of SIPC and the protections it affords. The commenter notes that institutional customers generally settle transactions in delivery versus payment/receive versus payment (“DVP/RVP”) accounts and are likely to opt out of receiving customer account statements, the most likely vehicle for the required disclosures. This commenter contends that receiving the required disclosures annually from each broker-dealer through which an institution executes transactions would create a flood of unnecessary and redundant disclosures that institutional customers would simply discard.

NASD believes, however, that the benefit to institutional investors of receiving the SIPC disclosures at account opening and yearly thereafter outweighs any inconvenience that might be incurred. Although many institutional investors are likely to be sophisticated investors, there are those that are not. To the extent that the required disclosures may make institutional investors more aware of SIPC and the protections it affords, NASD believes that the dissemination of the required information is worthwhile. Therefore, NASD has determined not to exempt institutional investors from the requirements of proposed Rule 2342.

With respect to exempting firms on the basis of whether the products being sold are covered under SIPA, NASD notes that SIPA excludes certain categories of registered brokers and dealers from membership in SIPC, including “persons whose business as a broker or dealer consists exclusively of ...the distribution of shares of registered open end investment companies or unit investment trusts...the sale of variable annuities...the business of insurance, or...the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts.”¹⁷ SIPA provides that all other persons registered as brokers or dealers under Section 15(b) of the Securities Exchange Act of 1934 [15 USC § 78o(b)] are required to be members of

¹⁴ Noland Cheng, Chairman, SIFMA Operations Committee (January 12, 2007).

¹⁵ Judith Alderete, Amerest Securities Inc. (December 28, 2006); Frederick G. Ferrara, CFA, Chief Compliance Office, Panattoni Securities, Inc. (December 20, 2006).

¹⁶ Kenneth M. Cherrier, JD, FLMI, Chief Compliance Officer, Fintegra (December 22, 2006); William R. Sykes, CFP, President, Sykes Financial Services LLC (December 28, 2006).

¹⁷ See 15 U.S.C. § 78ccc(a)(2)(A).

SIPC. NASD believes that firms that are SIPC members should also be required to make the disclosures required by proposed NASD Rule 2342, regardless of the products currently being sold. Therefore, NASD proposes not to exempt any SIPC members from the requirements of proposed NASD Rule 2342.

However, NASD agrees with the commenters who contend that NASD firms that are excluded from membership in SIPC, and who have not become SIPC members, should not be subject to the proposed rule. As provided in Exhibit 5 to this Partial Amendment No. 1, NASD proposes to exclude such firms from the requirements of proposed NASD Rule 2342.

* * * * *

Exhibit A

-----Original Message-----

From: Judith Alderete [mailto:eamerest@hotmail.com]

Sent: Thursday, December 28, 2006 11:41 AM

To: NASD Corporate Notification

Subject: RE: NASD Weekly Update - 12/27/06

Re: Rule 2342 would require members to advise all new customers in writing of the SIPC. I would hope that there is an exemption for the DPP firms. We pay the annual SIPC membership and have none of the coverage. We are not allowed to use the SIPC logo or imply that we are members. This would be most confusing and create a difficult situation if we were required to provide SIPC information to our clients when in fact they are not covered.

Please consider this exemption. We are already burdened with enough that has no application to us. Judith L. Alderete/Amerest Securities Inc.

* * * * *

II. Amended Rule Text

Exhibit 5

Proposed new language in Partial Amendment No. 1 is underlined; proposed deletions in Partial Amendment No. 1 are [bracketed.]

* * * * *

2000. BUSINESS CONDUCT

* * * * *

2300. Transactions with Customers

* * * * *

2342. SIPC Information

All members, except those members that pursuant to Section 3(a)(2)(A)(i) through (iii) of the Securities Investor Protection Act of 1970 (SIPA) are excluded from membership in the Securities Investor Protection Corporation (SIPC) and that are not SIPC members, shall advise all new customers, in writing, at the opening of an account, that they may obtain information about SIPC, including the SIPC brochure, by contacting SIPC, and also shall provide the Web site address and telephone number of SIPC. In addition, members shall provide all customers with the same information, in writing, at least once each year. In cases where both an introducing firm and clearing firm service an account, the firms may assign these requirements to one of the firms.

III. Request for Accelerated Approval of Amendment No. 1

NASD requests that the Commission find good cause pursuant to Section 19(b)(2) of the Securities Exchange Act of 1934 to approve Partial Amendment No. 1 prior to the 30th day after publication in the Federal Register. NASD is proposing an effective date of May 31, 2007, in order to give members sufficient time to make necessary changes to their customer documentation and systems. The proposed effective date coincides with the effective date of recent amendments to NASD Rule 2340, which also require SIPC-related disclosures consistent with recommendations set forth in the GAO Report, as well as the effective date of a similar NYSE rule change recently approved by the SEC.¹⁸

¹⁸

See supra note 3.