



Securities Industry Association

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November 13, 2000

Margaret H. McFarland
Deputy Secretary
Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549

Re: File No. SR-NASD-00-51; Delivery Requirements of a Margin Disclosure
Statement to Non-Institutional Accounts

Dear Ms. McFarland:

The Self-Regulation and Supervisory Practices Committee (the "Committee") of the Securities Industry Association ("SIA")¹ appreciates this opportunity to comment on the above referenced Notice of Proposed Rule Filing. The Notice sets forth the NASD Regulation Inc.'s ("NASDR") proposal to implement a new Rule 2341 that would require all member firms to deliver, in a separate document, a margin risk disclosure statement to non-institutional customers prior to, or at the opening of, a margin account (the "Rule Proposal").

As proposed, the mandated statement must be delivered to clients individually, either in writing or electronically, in a separate disclosure document, irrespective of substantially identical disclosure language in a margin agreement. In addition to the initial disclosure, the specified disclosure must be repeated on an annual basis to non-institutional customers with margin accounts. Finally, the Rule Proposal requires delivery of the disclosure to existing margin customers, which may be made in an annual statement to such customers, not to exceed 180 days from the effective date of the rule change.

I. OVERVIEW

SIA applauds NASDR's efforts to promote investor disclosure regarding the operation and risks associated with margin trading. As a general matter, the Committee believes that, as a means of ensuring public trust and confidence in our markets, investors who choose to trade on margin should fully understand the risks involved with that activity. Accordingly, the Committee supports meaningful disclosure of margin risk. Nevertheless, the Committee opposes a mandate that elevates such risk disclosure above

other regulatory disclosure requirements so as to warrant a separate disclosure document --- particularly when firms already provide substantially similar margin risk information in some other form, such as the margin account agreement. Such a requirement is unnecessary, duplicative and potentially confusing to investors. Moreover, it will create economic burdens without significantly enhancing customer protection. Indeed, the new requirement has legal implications that could expose firms to liability and could serve as a predicate to damage claims. In light of these concerns, we urge the SEC to reconsider that portion of the Rule Proposal that would require a separate disclosure document.

Instead, firms should be given maximum flexibility to develop a method of effective disclosure that best accommodates their businesses and clients in the context of the information already supplied to customers. Of course, firms may be directed to consider including specific disclosure information, as recommended by the Proposed Rule. Not only is such an approach more effective, but entirely consistent with other regulatory risk disclosure requirements.

Of particular significance is newly adopted NASD Rule 2361 which governs day-trading risk disclosure statements. There, NASDR requires firms that promote day-trading strategies to furnish all non-institutional clients with a risk disclosure document prior to the opening of the account. As with the proposed margin disclosure rule, Rule 2361 requires delivery of the risk disclosure statement to each non-institutional customer individually, by mail or electronic means. Absent from Rule 2361, however, is any requirement that the risk disclosure be contained in a separate document. Rather, NASDR acknowledges that it is sufficient for firms to have written procedures in place for delivery of the document and to be able to identify those procedures to examiners. Any abuses of the delivery requirement could be detected during routine examinations. The same approach should be adopted in the case of margin risk disclosure since it achieves the desired result of educating investors without many of the problems raised by the Proposed Rule.

II. DETAILED COMMENT

A. Requiring Disclosure in a Separate Disclosure is Unnecessary, Duplicative and Unduly Burdensome

In response to the apparent rise in customer complaints relating to margin practices, NASDR proposes that all member firms provide a uniform mandatory disclosure statement to all non-institutional clients who trade in a margin account.² As drafted, the Rule Proposal requires that the disclosure statement be made “in a separate document, even if a member chooses to deliver the disclosure as part of or within the margin agreement or other account opening documents.” Citing a recent report issued by

the U.S. General Accounting Office (the “GAO”), NASDR points in particular to the realm of on-line trading, where automatic margin account opening practices, coupled with inadequate margin risk disclosures, has led to investor misconceptions about margin requirements and underestimation of margin risks. Thus, to ensure uniformity, NASDR proposes that all firms furnish all non-institutional clients with a stand-alone disclosure statement, irrespective of substantially similar disclosure language in another customer document.

As aptly noted in the Rule Proposal, many firms already furnish investors with extensive risk disclosure documentation.³ Therefore, to cause firms to deliver essentially duplicative documents at additional expense as a means of addressing the apparent practices of a narrow group within the industry is unnecessary and unduly burdensome. Moreover, if the goal is to provide adequate information to investors of margin risk factors, bombarding investors with separate pieces of paper that contain discrete disclosure statements is no assurance that this goal will be met. On the contrary, this proposed method of delivery would increase cost without significantly enhancing the quality of disclosure in a meaningful way.

Indeed, such a requirement goes well beyond other existing disclosure requirements. Currently, firms are obligated to provide a multitude of investor disclosures covering such subjects as privacy promise, options trading, payment for order-flow, day trading and extensions of credit.⁴ While these disclosures are equally significant in the purpose they serve, rarely are they required in the form of a discrete document. As noted above, newly adopted NASD Rule 2361 governing day-trading risk disclosure statements only requires firms to adopt written procedures for the delivery of a written or electronic risk disclosure statement to each client. There is no requirement to make the disclosure separately. Nor is there such a directive in SEC Rule 10b-16, which governs the disclosure of credit terms in margin transactions. Rather that rule only requires that, prior to extending credit to its customers, firms must establish procedures to assure that each customer is given or sent a written disclosure statement. Here too, NASDR should not compel a stand-alone disclosure statement, particularly where firms already provide adequate disclosure in some other form.

B. The New Requirement May Lead to Customer
Confusion and Potential Legal Liability to Firms

Moreover, mandating a separate, and potentially duplicative, disclosure document is also problematic in that it may lead to investor confusion and misperceptions about the heightened importance of this disclosure as compared to others. Furthermore, since existing margin agreement disclosure language may address more specific issues or provide broader debt collection rights beyond that of the proposed disclosure, the new

requirement also may lead to investor uncertainty as to which document governs the parties' relationship and contract rights.

In that regard, the new disclosure requirement is of concern in that it could potentially expose firms to various contract-based or disclosure claims. For example, investors could conceivably claim that the separate document somehow modified or limited their rights under the original margin agreement. Conversely, firms seeking to exercise their rights under a written margin agreement may be subject to a potential investor claim that the original margin agreement is ineffective since it was somehow amended by the additional margin disclosure statement. Notwithstanding proper disclosure of all appropriate risks in the margin agreement, investors -- in response to any disappointing results -- might use additional disclosure as basis for a damage claim against the firm. Regardless of the ability or likelihood of ultimately prevailing on the merits, firms may settle the lawsuits at substantial cost to avoid an expensive and protracted discovery process or the expected business distraction. Given the negative implication this would have on the sanctity of contracts and the notion of individual accountability, this new regulatory burden is seemingly misplaced.

C. Firms Should be Given Maximum Flexibility to Develop
the Method of Disclosure Appropriate for Their Businesses

While the Committee appreciates the NASDR's attempt to create uniformity in the substance and delivery of margin risk information, the proposed one-size-fits-all approach does not sufficiently take into account the diverse nature of member firms' businesses and existing communications with customers. A better alternative would allow firms to develop their own method of delivering such information as is best suited to their business, size, structure and customer relations (e.g. on-line customers may prefer to receive all communications on the member's web-site). This could include providing the appropriate disclosure language in bold within the client margin agreement or other account opening documents, a rider to other important disclosure information, a single disclosure booklet or, as recommended in the GAO study, on the member firm's web-site. Unlike the proposed approach, this will offer optimal disclosure without unduly burdening firms and will avoid unnecessary confusion.

III. CONCLUSION

SIA appreciates the opportunity to provide comments on this Rule Proposal. While the Committee commends the NASDR's efforts to improve the quality and usefulness of margin risk disclosure, the proposed requirement is fraught with difficulties. The Committees believe that the regulator's need for flexibility must be balanced against the need for consistency. We believe NASDR should eliminate the

separate disclosure document requirement as outlined above, rather than adopt the rule as proposed.

If you have any questions or would like to discuss our comments further, you can contact the undersigned or Amal Aly, Staff Advisor to the Self-Regulation and Supervisory Practices Committee, at (212) 618-0568 .

Sincerely,

Christopher R. Franke
Chairman
Self-Regulation and Supervisory Practices
Committee

CC: Annette Nazareth, Director, Division of Market Regulation
Robert L.D. Colby, Deputy Director, Division of Market Regulation
Katherine A. England, Assistant Director, Division of Market Regulation
Joseph P. Corcoran, Division of Market Regulation
Alden S. Adkins, Senior Vice President and General Counsel, NASDR

Endnotes

¹ The Securities Industry Association brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50-million investors directly

and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals. (More information about the SIA is available on its home page: <http://www.sia.com>.)

² It is unclear whether a “debit” is required to trigger the disclosure requirement or merely “opening a margin account.” If opening an account is the triggering event, the rule seemingly will apply to all brokerage accounts with check writing and/or debit card functions whether or not a debit exists. Essentially, those accounts are margin accounts only for purposes of overdraft protection.

³ Notably, the GAO report observes that all broker-dealers that were contacted provided customers with some type of information on margin trading. Moreover, GAO’s ultimate recommendation is much narrower than the Rule Proposal in that it does not require firms to prepare a separate disclosure document. Rather, GAO proposed that firms with on-line trading systems include accurate and complete margin information on their web-sites.

⁴ See e.g. 17 CFR 240.11Ac1-3 (1999)(disclosure of payment of order flow); Gramm-Leach-Bliley Act Sections 248.5 and 248.6, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (privacy policy); 17 CFR § 240.10b-16 (1997)(disclosure of credit term transactions).