

Newsletter

MAY 2005

BROKER  **DEALER**
COMPLIANCE

REMINDERS!!

- **April 29, 2005** — Series 11 and 55 Exams revised
- **May 1, 2005** — NASD amends rule on pre-dispute arbitration agreements with customers (See NTM 05-09)
- **May 1, 2005** — Time limits for submission of arbitration claims amended (See NTM 05-10)

BDC NEWS

Steve Sussman, Karen Hagan and Sharon Imhoff attended the Small Firms Conference in New York on March 30th. Comments are included in the FYI section.

BDC will be an exhibitor at the Nuts and Bolts conference on 6/20-21 in New York. If you are attending please introduce yourself to Lisa, Karen or Sarah.

Laura Crosby-Brown will be attending the Spring Securities Conference in Chicago.

UPCOMING ITEMS

We are pleased to announce a compliance service designed specifically to meet the needs of Investment Advisors. If you would like more information regarding this service, please contact Karen Hagan at 603-437-8797 or sales@bdcompliance.com. In addition, this IA service will be publishing their own unique newsletter. If you would to be included in the distribution, please let me know.

Anti-Money Laundering (AML)

For firms that utilize automated searches utilizing tab-delimited (.txt) files for FINCEN requests, please note the following. Beginning on March 1, 2005, FINCEN inserted an extra "tab" at the end of each record in the ".txt" files. If your firm utilized software to automatically search the 314a case information, this extra "tab" may have caused inaccurate search results. To correct this situation on May 10th FINCEN will upload from March 1 – April 26th on SISS for re-download the format without the extra "tab". The uploads for May 10, May 24 and June 7 will contain two versions – one with the tab one without. Starting June 21, FINCEN will only post the files not containing the extra tab. If your firm does a manual search, or if your firm utilizes an automated search using excel or word files no action is needed.

Web CRD

Firms are reminded that when they terminate an employee the firm is required to file a U5 within 30 days. The NASD will assess a monetary **penalty** for failure to file timely.

- ◆ NASD is recommending changes to the Taping Rule to require member firms that are seeking an exemption to submit their request within 30 days of receiving notice or obtaining actual knowledge that they are subject to taping and clarify that firms that trigger the taping rule requirement for the first time can elect the "one-time" opt out provision or seek an exemption but NOT both.
- ◆ For net capital computations, in order for a Broker Dealer's clearing deposit to be considered an allowable asset, a PAIB agreement is required between the B/D and the clearing firm. There is a proposal from the SEC to eliminate the requirement for a PAIB agreement.
- ◆ NASD is proposing a rule change to 3110 to extend the time period for delivery of a copy of a customer account agree-

ment containing a pre-dispute arbitration clause from the time of signing to within 30 days of signing.

- ◆ There is a proposal to require that account statements include a statement that advises each client to promptly report any inaccuracy or discrepancy in their account to the brokerage firm and clearing firm.
- ◆ NASD proposes revising the definition of a public arbitrator. Employees of firms linked with securities firms would be excluded from serving as a public arbitrator.
- ◆ NASD proposes banning of most cash sales contests that award brokers cash for selling a particular security or type of security in preference to another. The ban already included non-cash prizes such as cruises, concert tickets, etc.

NOTICE TO MEMBERS (NTM's)

NTM 05-34 – The SEC has approved changes to Rule 2711 to prohibit Research Analysts from participating in a road show and from communicating with customers in the presence of investment banking personnel or co-management about an investment banking services transaction. Analysts are permitted to educate investors and internal personnel about an investment banking services transaction provided that communications are "fair, balanced, and not misleading."

NTM 05-33 – On 1/3/05 and 4/15/05 the SEC issued 1 No-Action letters granting relief from the order-making requirements under Regulation SHO in certain circumstances. Firms using their own proprietary or vendor order management systems and accept and execute short sales in Reg SHO pilot securities are responsible for making appropriate system changes to ensure proper handling of pilot securities. Firms are encouraged to test their readiness for the 5/2 effective date.

NTM 05-32 – Rule 3110 (use of pre-dispute arbitration agreements) extended from May 1 to June 1. Firms must begin using the disclosure required by 6/1/05. As amended this rule requires members to provide customers who request a copy of any pre-dispute arbitration clause or client agreements a copy within 10 business days of the request.

NTM 05-31 – Effective 3/30/05, a pilot program approved to increase position and exercise limits for equity options and new reverse collar strategy added to equity option hedge exemptions. The rules provides that the position limits for equity options are determined according to a five-tiered system in which more actively traded stocks with larger public floats are subject to higher position limits.

NTM 05-30 – SEC approves granting the NASD the authority to receive and review complaints against NASD market participants that claim denial of access to their quotes in the Alternative Display Facility.

NTM 05-29 – Guidance regarding Rule 3012 (requirement to test and verify a member's supervisory policies and procedures) is provided. This rule requires each member to designate one or more principals to establish, maintain, and enforce a system of supervisory control policies and procedures that **tests** the member's supervisory procedures and **verifies** that they are reasonably designed to comply with laws and regulations.

NTM 05-28 – The TRACE reporting period will be reduced to 15 minutes on 7/1/05 and is rescinding the NASD interpretive guidance regarding the re-submission of rejected TRACE transaction reports. As of 7/1/05 regardless of the reporting mechanism utilized a member must identify any rejected transaction report and correct and resubmit it to TRACE within 15 minutes of the time of execution. Reports submitted after the 15 minutes timeframe are late and treated as any other type of late transaction report.

NTM 05-27 – Comments are requested by 5/27/05 on a proposal to require principal pre-use approval of member correspondence to 25 or more existing retail customers within a 30-day calendar period. Correspondence includes any written letter or e-mail message. This is a significant change to Rule 2211 which currently does not require principal approval.

NTM 05-26 – NASD is urging firms to be proactive in reviewing and improving their procedures when developing and vetting new products. These procedures should include clear, specific guidelines for determining what constitutes a new product, ensure proper question are raised before a new product is offered, and provide for post-approval follow-up and review. There are an increasing number of complex products being offered in response to the demand for higher returns or yield. Concerns have been raised that these products are not understood by the investor or registered reps and may pose suitability and conflict of interest issues.

NTM 05-25 – NASD is requesting comments on a proposal to require pre-use filing of advertisements and sales literature for new types of securities and of television, video and radio advertisements. Comments are required by 5/20/05. The filing must occur at least 10 days prior to the first use of publication and continue to do so for the following 90 calendar days. Television (including web-site video) radio or similar broadcasts of 15 seconds or longer require filing 10 days prior to first broadcast.

NTM 05-24 – Rule 1050 has been amended to provide an exemption from the research analyst qualification requirements for certain research analysts employed by member foreign affiliates in jurisdictions that the NASD and NYSE have determined have acceptable qualification standards and conflict of interest rules. The exemption is currently available in: UK, China, Hong Kong, Singapore, Thailand, Malaysia, and Japan.

NTM 05-23 – This NTM further clarifies the Trading Activity Fee (TAF) on what is defined as "Trace-eligible" securities. Guidance on applying the TAF to debt securities based on questions submitted to the NASD is provided as well as guidance on the application of the TAF on other covered security transactions.

NTM 05-22 – As of 5/1/05 the NASD is eliminating the manual reporting of Large Options Positions Reports since SIAC now has this ability on an electronic basis. All members must successfully test with the SIAC to ensure they have the ability to report large options positions in the required format. Testing must be complete by 5/6/05.

NTM 05-21 – The NASD is requesting comments on a proposed rule requiring members to provide additional disclosures for transactions in debt securities. The comment period ends 4/19/05. These new disclosures would include a statement referring customers to NASD education materials and bonds that will be located on the NASD website.

The SEC is still working on a permanent exemption for B/D audits not requiring a PCAOB firm. They are considering this requirement for clearing firms only. No decision has been made to date. We will keep monitoring this requirement.

Real time access to your firm's advertising account fee statements will be available on the Advertising Regulation Electronic Fees (AREF) System. Users need to obtain additional entitlements to access AREF from their Regulation Filing administrator.

To our M&A Advisory Firms: At the NYC small firms conference, we raised the question of whether B/D customers have to apply Customer Identification Program (CIP) requirements to their M&A clients. Per Bob Kaplan, Associate VP and Deputy Director of the NASD NY District Office, the answer is "YES". There was NO distinction made between services rendered; i.e. whether or not the advisory services involve assets or stock sales. (However, as you know, if the client is a public entity, a federally-regulated financial institution, or an "existing" customer, CIP does not apply.)

The NASD has established 10 new hearing locations for dispute resolutions so that location is now established in all 50 states. In addition a new rule allows NASD Dispute Resolution to serve American investors abroad by allowing the parties to conduct the arbitration abroad. Parties need to agree to a foreign location and pay an additional honorarium to each arbitrator.

The Mutual Fund Task Force has submitted their report. Recommendations include:

- ◆ a new “profile plus” which is a two page document that provides basic information about a Mutual Fund including its investment objectives, risks, performance, fees and expenses and information regarding possible conflicts of interest.
- ◆ Requirement that B/D’s post a profile-plus for each mutual fund that they sell on the B/D’s website, and
- ◆ Require every B/D when recommending a Mutual Fund refers to the Profile Plus on the B/D’s website unless the investor opted out of website delivery.

The full report is available at: www.nasd.com/web/groups/rule_regs/documents/rules_regs/nasdw_013690.pdf

The NASD has established a Task Force, headed by Mary Shapiro, to review the current net capital rule. We will keep you posted on any proposals that develop as a result of this review.

NOTES: From the NYC small firm’s conference:

- ◆ Producing Managers (as defined under Rule 3012) are deemed such if they produce any revenues AT ALL, including investment banking revenues.
- ◆ A good way of justifying/explaining supervisory appointments or exemptions is to use an organization chart.
- ◆ NASD discourages firms from using outside consultants to do “testing and verification” of supervisory systems, required under new Rule 3012.
- ◆ The new transmittal of funds guidelines can be summarized as “monitor, approve, validate”...1) blotter for checks received and disbursed; 2) wire transfer requests when funds are going to addresses NOT of the customer; have written request by customer and have principal review and approve (initial) them; 3) follow up with confirmation of wire sent to primary address of customer – or call or e-mail the customer.
- ◆ SEC talking about enhancing rules related to outside (part-time) FINOPS: enhanced tracking of these part-timers; better educating members as to responsibilities of FINOPS; and enhancement of 1022c – which requires more onsite visits; use Sarbanes-type certification (vouch for accuracy of all books and records and net capital computation).
- ◆ Unlisted REITS are subject of scrutiny: make sure disclosures of illiquidity are made; review volume discounts applied – ensure accuracy.

For firms that must comply with 2711 and/or Reg AC, we have available a “Research Review Checklist” which includes all of these requirements.

For various discounts see NASD member benefits at <http://memberbenefits.nasd.com>.

The NASD Investor Education Foundation invites non-profit groups and researchers to apply for funding for projects that help provide investors with information and tools to better understand investing and the markets. Proposals must be submitted by 6/3/05.

In reviewing the NASD’s disciplinary actions, common violations cited continue to include:

- ◆ inadequate written supervisory procedures
- ◆ failure to notify of outside business activities
- ◆ suitability issues
- ◆ failure to maintain an accurate U4
- ◆ failure to respond to an NASD request
- ◆ failure to retain e-mail

A web cast entitled “Understanding Variable Annuities: Exchange Suitability Issues” is now available. The webcast is approximately 10 minutes and can be accessed at www.nasd.com/webcasts/variableannuities.

MEETINGS & SEMINARS

- ◆ The **2005 NASD Spring Securities Conference** is May 24-26 in Chicago. John Brennan, Chairman and CEO of the Vanguard Group will deliver the keynote address. 15 workshops and a 2 day pre-conference will be offered. Registration is now available. NASD Member Benefits has special discounts on airfare, sedan services, and rental cars for attendees. See memberbenefits@nasd.com
- ◆ **Nuts and Bolts Compliance Conference** June 20-21 in New York – Conference sessions cover establishing, expanding, and maintaining a securities firm, dealing effectively with customer complaints, and working through the exam and disciplinary process. Other sessions are available on basic financial operations. Register before 5/24 for early bird rates.
- ◆ **Securities Regulation Fundamentals: Phase I** May 1-5 San Francisco, CA – Develop skills in securities law, regulatory structures and compliance frameworks.
- ◆ **Branch Office Conference** July 11 Boston, MA – Topics include branch manager and management issues, branch office case studies, exam programs, supervisory controls and Q&A.
- ◆ For **Small Firm Conferences** see <http://www.nasd.com/conferences/smallfirm04.asp> The series schedule includes 9/23 in Chicago
- ◆ The NASD is hosting a two day conference in NY 6/20-21 on essential securities industry knowledge, compliance matters, and ethical standards. Sessions include information on expanding and maintaining a securities firm, dealing effectively with customer complaints and understanding the examination and disciplinary process.
- ◆ **NASD Compliance and Technology Conference** – April 27 Ft. Lauderdale FL Sessions include case studies on electronic media and mutual funds, a discussion of on-line fraud and data security, overview of supervisory controls and technological impacts as well as a round table and solutions forum.
- ◆ For **District events** see http://www.nasdr.com/2660_districts.asp
NASD Education and Training seminars listing found at <http://www.nasd-institute.com/seminars.asp>
- ◆ **NASD Seminars** offered, include:
Regulatory Inquiries and Conducting Internal Investigations 5/12-13 NY
Basics of Internal Audit and Internal Control 5/9 Woodbridge, NJ
AML 5/11 LA, CA