



# **NASD Member Regulation: Overview**

Federal Energy Regulatory Commission

Technical Conference

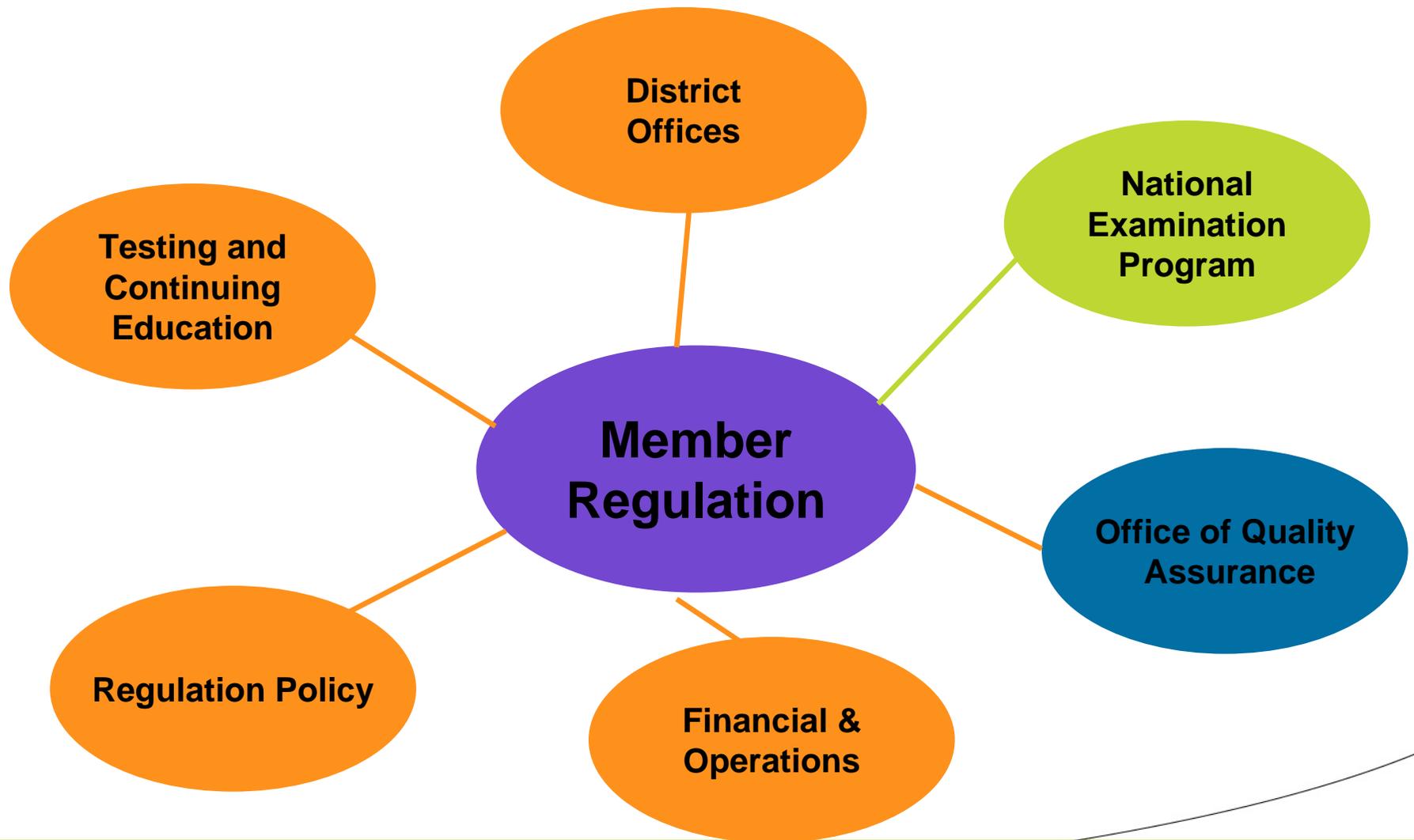
December 9, 2005



## Member Regulation Profile

- 855 Employees
- 15 District Offices
- Member Firms - 5,170 (8/31/2005)
- Branch Offices - 104,117 (8/31/2005)
- Registered Representatives approx. 660,960 (8/31/2005)

# Department of Member Regulation Organizational Structure



# Member Regulation Approach

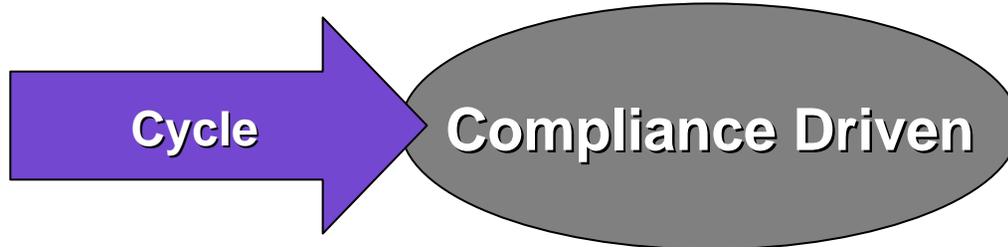
## Promoting Preventive Compliance

- NASD Institute for Professional Development
- Annual Securities Conferences
- Regulatory & Compliance Workshops
- Notice to Members
- Investor Alerts
- Investor Education
- WWW.NASD.COM

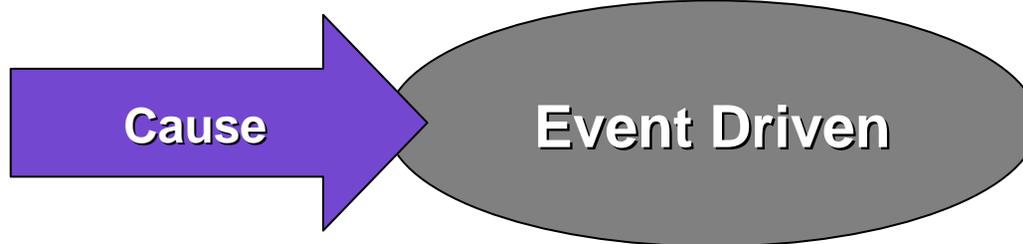
## Regulating Member Firms

- Examination Program
  - Cycle Exams (including Municipal & Options)
  - Financial Surveillance and Exams
  - Cause Investigations
  - Special Initiative & Sweeps
- Pre-Member Application Review
- Statutory Disqualification
- Testing and Qualification
- Continuing Education
- Rulemaking

# Member Regulation, Examination Program



Approx. 2,500 compliance exams per year



Approx. 25,000 event reviews per year

Approx. 6,000 investigations per year

- High Priority & Cycle Exams
- Municipal Broker Dealers
- Options
- Statutory Disqualification
  - Firm Surveillance
  - Branch Exams
  - Sweeps
  - Special Examinations
  - Problem Brokers
  - Late U4 & U5
  - Trend Analysis
- Customer Complaints
- Regulatory Tips
- Termination for Cause
- Reporting Disclosures
- Arbitration Claims

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# Member Regulation, Examination Program (cont'd)



## Cycle Examination Program:

- On site examination of firms including branch offices – annual (Level 1), 2 year (Level 2), or 4 year (Level 3) cycles
- Frequency of examination varies depending on scope of business at firms and dealings with customers (e.g. self clearing vs introducing)
- Firms examined annually are those that pose the greatest regulatory risk based on scope of business and customer exposure
- Firms conducting municipal business are subject to a two year examination requirement per MSRB
- Off-site / Alternative Municipal Exam (AME) - Firms which appear to be conducting a non-public financial business asked to fill out a questionnaire designed to assess compliance with applicable municipal rules and regulations

# Member Regulation, Examination Program (cont'd)



## Cause Program:

### Front End Cause

- Centralized review of regulatory inputs, analysis, and information
- 25,000 reviews per year
- 4,500 customer complaints (2004)
- 1,100 Regulatory Tips(2004)
- 12,100 terminations for cause (2004)
- 6,600 Arbitrations and Litigations (2004)

### District Offices

- Conduct investigations for cause
- 6,000 investigations per year

### Triggers and Reviews

- Problem Brokers/Heightened Supervision
- Late U4 & U5
- Trend Analysis
- Customer Complaints
- Regulatory Tips
- Termination for Cause
- Reporting Disclosures
- Arbitration Claims
- Other investigations

# Member Regulation, Examination Program (cont'd)



## NASD Examination Priorities

- Mutual Fund Share Sales Practices
- Mortgage Proceeds Used to Finance Investments
- Anti-Money Laundering (AML)
- Variable Insurance Products
- Heightened Supervision and Supervisory Controls
- Business Continuity Planning
- Regulation SHO—Short Sales
- Gifts and Gratuities
- New Products and Non-Conventional Instruments
- Internal Communications

# Member Regulation, Six - Year Statistical Review



<b>NASD</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>8/31/05</b>
<b>Member Firms</b>	<b>5,579</b>	<b>5,499</b>	<b>5,392</b>	<b>5,272</b>	<b>5,191</b>	<b>5,170</b>
<b>Branch Office</b>	<b>82,126</b>	<b>88,168</b>	<b>91,473</b>	<b>92,861</b>	<b>96,970</b>	<b>104,117</b>
<b>Cycle Exams Conducted</b>	<b>2,396</b>	<b>2,631</b>	<b>2,660</b>	<b>2,645</b>	<b>2,351</b>	<b>2005 Projected 2,385</b>
<b>Registered Representatives</b>	<b>672,489</b>	<b>673,822</b>	<b>662,311</b>	<b>653,311</b>	<b>659,212</b>	<b>660,960</b>

# Member Regulation, Examination Program (cont'd)



## Training, Examiner University:

- Examiner University is a one-year training program for new NASD examiners
- Four phases of classroom training for a total of 12 weeks of on-site training at our Rockville campus
- Following each phase of classroom training, each examiner is mentored and coached by a designated senior examiner during on-the-job training in an NASD District Office
- NASD successfully launched Examiner U on the initially targeted date of October 25, 2004
- NASD has conducted four full sessions of the six-week Phase I (“The Basics”) program training a total of 81 examiners and four participants from the Saudi government. 40 newly hired examiners are registered for class starting October 3.
- Conducted Phase II (“More basics”) sessions training a total of 52 examiners
- Conducted Phase III (“Intermediate Analysis”) sessions with 40 examiners
- Initial Phase IV session is scheduled for September and addresses, among other things, SEC Oversight and Sarbanes-Oxley. Estimated attendance of 21 examiners

# National Examination Program FEC, Customer Complaints - 2<sup>nd</sup> Qtr 2005



## Complaints Received By NASD

Products				Allegations					
	Q2 05 Ranking		Q1 05 Ranking	Q2 05 #		Q1 05 Ranking	Q2 05 #		
<b>MOST</b>	1	Common Stock	1	324	1	Misrepresentations	1	330	<b>MOST</b>
	2	Mutual Funds	2	179	2	Suitability	3	268	
	3	Variable Products	3	151	3	Operational Problems	2	253	
	4	Listed Options	5	33	4	Unauthorized Activity	4	156	
	5	Fixed / Equity Annuities	6	26	5	Account Transfers	5	97	
	6	Corporate Bonds	7	24	6	Poor Service	6	87	
	7	Municipal Bonds	4	21	7	Churning	10	49	
	8	Limited Partnership	8	15	8	Administrative Fees	8	33	
	9	Private Placement	10	13	9	Best Execution	11	31	
	10	Insurance—no securities	13	12	10	Manipulation	10	28	
	11	Money Market	9	7	10	Firm Quote	12	28	
	12	Unit Investment Trust	14	6	12	Firm Employee Dispute	13	26	
	13	Promissory Notes	11	5	12	Conversion	15	26	
	13	REITs	12	5	14	Limit Order	16	25	
	13	ADRs	16	5	15	Fail to discl Commission	23	22	
	13	US Treasury	23	5	16	Margin	14	21	
	17	Exchange Traded Funds	15	4	17	Lost / Stolen Securities	50	19	
	17	Foreign Securities	17	4	18	Breakpoint	17	18	
	17	IRA – Extended Stretch	27	4	19	Fail to Exec Sell Order	24	17	
	20	Certificates of Deposit	18	3	19	Supervision Failure	33	17	
	20	Futures	33	3	21	Non Reporting	7	16	
	22	Preferred Convertible	20	2	22	Excessive Commission	28	15	
	22	Hedge Funds	28	2					
<b>FEWEST</b>									<b>FEWEST</b>

## Financial and Operations (“FINOP”)

- NASD is responsible for about 5,200 firms from a financial surveillance perspective.
- As part of this program, NASD District Office Staff review and assess about 43,000 financial filings (FOCUS Reports and annual audits) per year, this review is generally referred to as *financial surveillance*. FOCUS Reports are reviewed via Centralized FOCUS, annual audits are reviewed manually.
- In addition to on-going financial surveillance activities, NASD reviews for compliance with key financial and operational rules (SEC Rule 15c3-1 and SEC Rule 15c3-3) during (1) routine exams and (2) through the conduct of special financial exams, using the examination tools of NASD.
- FINOP assists the District Staffs in handling any complex issues that arise as a result of the surveillance and examination reviews but is not involved in ongoing surveillance activities and does not conduct routine financial examination reviews.



## Office of Quality Assurance

- SEC Oversights
- Monitor & Help Resolve Open Audit Issues
- Internal Audit Reviews
- Monitor Regulatory Functions
- Coordinate Between Various Departments in RPO and Office of the President
- Peer Reviews
- District Reports
- Training
- REG Expert Program
- Quality Review Program
- Conduct Targeted Audits

# Office of Regulation Policy

## Membership Application Program:

MAP is a program which is conducted in the various district offices, but is coordinated through Regulation Policy. Members submit to district offices either new member applications (NMA) or continuing member applications (CMA). MAP is run by a MAP Coordinator whose primary objectives are to foster consistency in application of procedures and policies and provide consultation and guidance to district office staff and applicants regarding either specific MAP applications or the general process.

## MAP Statistics for 2004-2005 (through August 31, 2005)



Year	NMA		CMA	
	Received	Decided	Received	Decided
<b>2004</b>	330	298	919	632
<b>2005</b>	203	185	513	435

# Testing and Continuing Education (“T&CE”)

## T&CE is organized into two areas:

### Policy and Content

- Responsible for creation and revision of content for exams, continuing education and waivers processing.

### Business Services & Operations

- Responsible for Proctor system support, delivery vendor oversight, and customer support to firms, candidates, and clients.