



# NASD Overview

Federal Energy Regulatory Commission

Technical Conference

December 9, 2005

## Introduction to NASD: Who We Are

- For more than 60 years, NASD has helped bring integrity to the markets and confidence to investors
- NASD is the world's leading private-sector provider of financial regulatory services
- Under mandate of federal law, most securities firms doing business with the U.S. public are NASD members
- NASD is subject to U.S. Securities and Exchange Commission oversight
- NASD has roughly 2,300 full time employees and an annual budget of over \$500 million
- Membership of (and jurisdiction over) roughly 5,200 broker dealers and their 660,000+ registered representatives

# Introduction to NASD: Why We Exist

- Stock Market Crash of 1929 resulted from a pervasive lack of confidence in the market.
- Major Legislation in the 1930s, which responded to the Crash, reinforced the need for market surveillance and regulation.
  - Securities Act of 1933
  - Securities Exchange Act of 1934
  - Maloney Act of 1938
- NASD was established in 1939.
- Several events of the last 30 years have had a major impact on NASD.
  - Nasdaq Stock Market – 1971
  - CRD
  - Current NASD organizational re-alignment



## Introduction to NASD: What We Do

- Register member firms;
- Write rules to govern their behavior;
- Examine them for compliance;
- Discipline those that fail to comply;
- Provide education to industry professionals and investors;
- Provide services to members to support their compliance efforts;
- Play an important role in promoting international discourse;
- Bring transparency to markets by operating the Alternative Display Facility (ADF) and the Trade Reporting and Compliance Engine (TRACE);
- Operate the largest securities dispute resolution forum – with arbitration and mediation programs – in the world; and
- Pursue other strategic priorities in option markets and global equities.

## Introduction to NASD: Membership

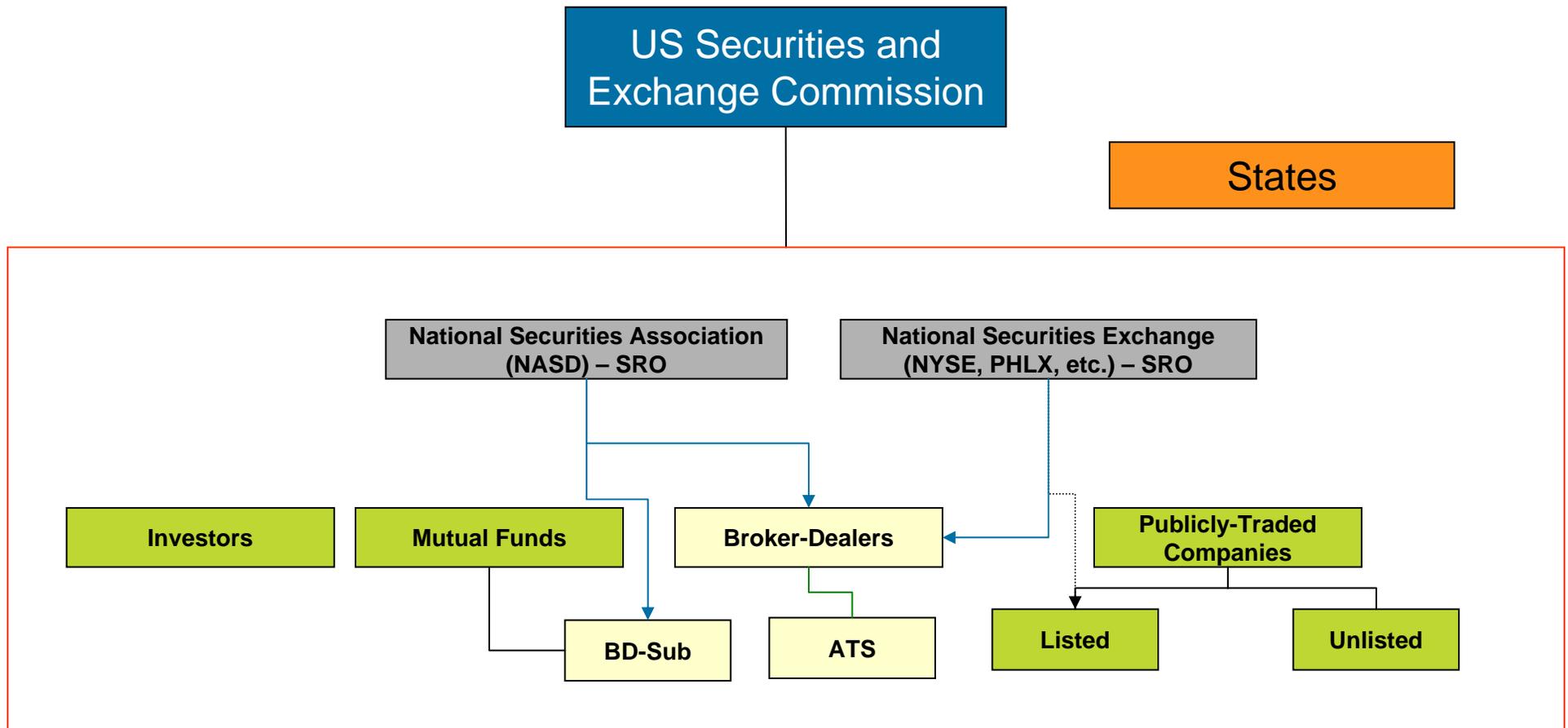
- **Clearing Firms** – handle settlements
- **Self Clearing Firms** – hold funds
- **Introducing Firms** – introduce accounts; do not receive/hold funds/securities
- **Market Makers** – maintain firm bid & offer prices
- **Mutual Fund Dealers** – deal in shares of registered investment companies
- **Variable Contracts Dealers** – sell variable annuities and variable life insurance policies
- **Government Securities Dealers** – deal in government-issued securities
- **Mergers and Acquisition Firms** – handle mergers & acquisitions
- **Direct Participation Program Firms** – handle partnership agreements

# The Role of Self-Regulatory Organizations

- SEC delegates significant authority to securities industry member-owned and operated organizations, called “self-regulatory organizations” or “SROs.”
- SROs oversee the securities markets and the member firms participating in those markets.
- SROs include NASD, NYSE, the American Stock Exchange (AMEX), the Chicago Board Options Exchanges (CBOE), regional exchanges, and the Municipal Securities Rulemaking Board.
- NASD and NYSE are the two largest SROs.
- NASD collaborates with the SEC, NYSE, and regional exchanges, particularly when making rules.



# Overview of Regulatory Jurisdiction



## Legend

-  Jurisdiction to conduct inspections
-  Jurisdiction to request information and to enforce listing requirements
-  All entities within red box are subject to SEC jurisdiction; the SEC examines SROs, mutual funds, and broker dealers
-  Type of broker-dealer subject only to NASD jurisdiction

# NASD Mission



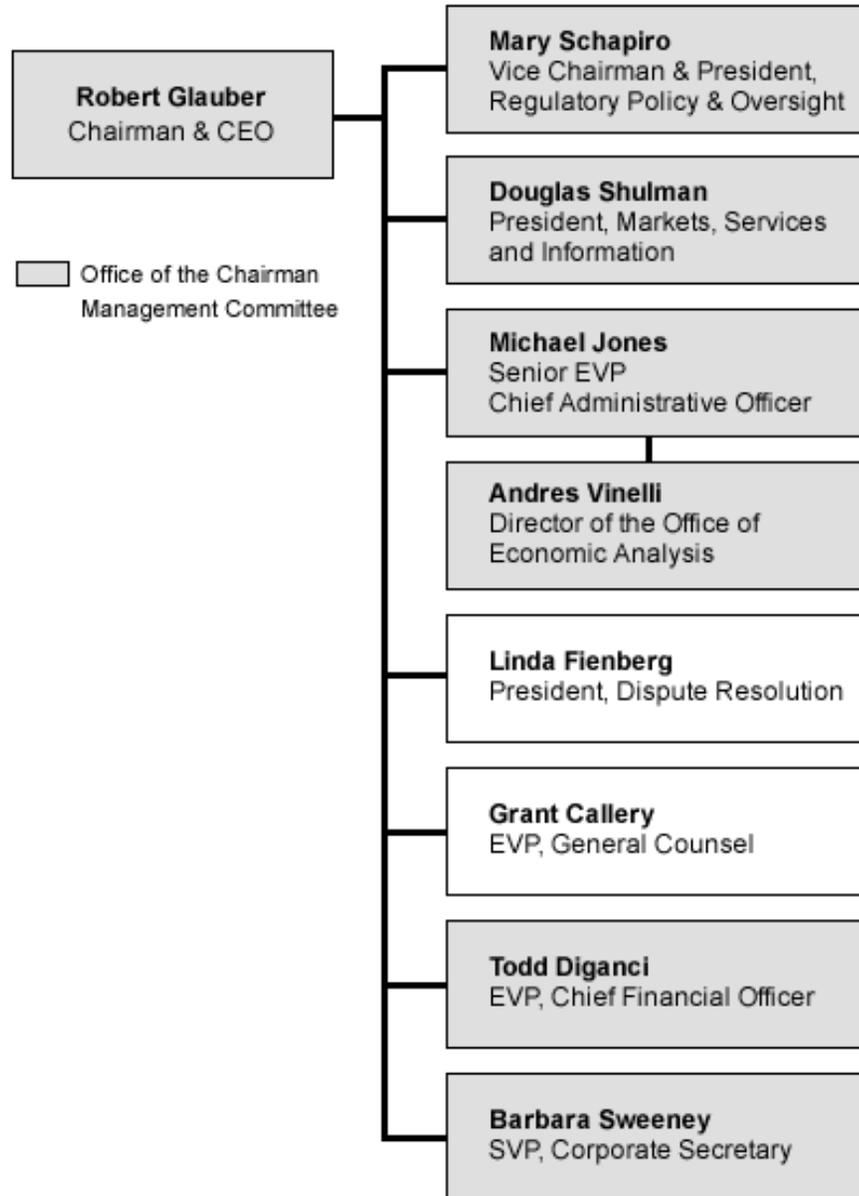
**Protect investors**

**Ensure  
market integrity**

**Facilitate  
market efficiency**

**Support members'  
commitment to  
honest and fair  
markets**

# NASD Organizational Structure



# NASD's Operating Divisions

## Regulatory Policy and Oversight

- \* Tests and qualifies brokers
- \* Surveils market makers
- \* Makes rules
- \* Examines firms
- \* Reviews advertising & underwritings
- \* Disciplines members

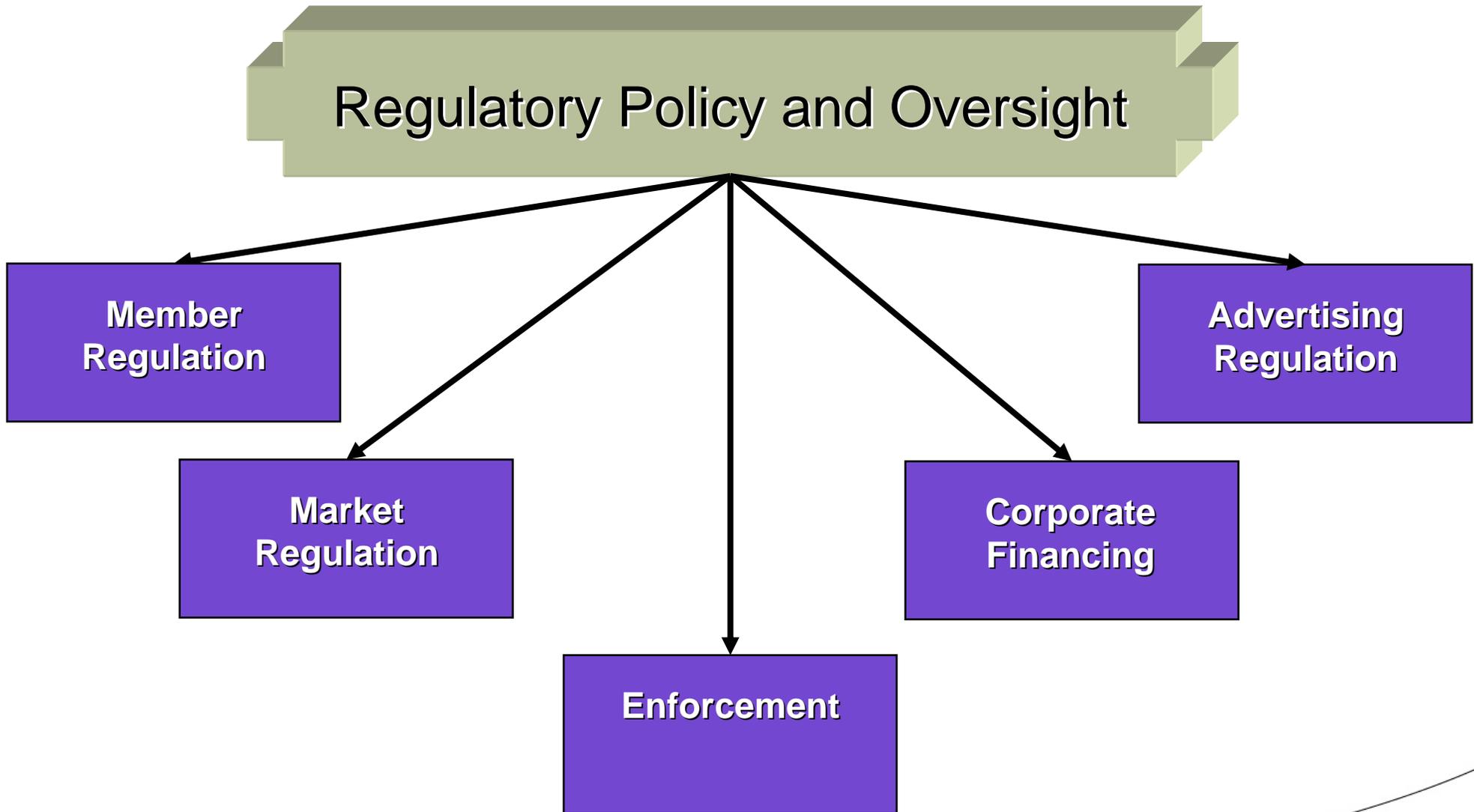
## Markets, Services and Information

- \* Provides information to investors
- \* Educates and trains industry professionals
- \* Runs centralized systems
- \* Provides tools and services to member firms
- \* Provides innovative technology such as ADF and TRACE

## Dispute Resolution

- \* Operates arbitration and mediation programs
- \* Assists in the resolution of monetary and business disputes

# Regulatory Policy and Oversight



# Member Regulation

Overview	Staff	Strategic Priorities
<ul style="list-style-type: none"> <li>• Performs routine and cause-based examinations of member firms that include equities, mutual funds, variable insurance products, municipal securities, government securities, options, and financial and operational issues.</li> <li>• Maintains the regulatory administration process and statutory disqualification program.</li> <li>• Administers continuing education programs and the examinations that brokers must pass to qualify to work in the securities industry.</li> </ul>	<ul style="list-style-type: none"> <li>• 856 employees located in the Washington, DC headquarters and the 15 District Offices across the country.</li> </ul>	<ul style="list-style-type: none"> <li>• Introduce a new business model for conducting NASD's member regulation examinations.</li> <li>• Launch a centralized approach to cause examinations.</li> <li>• Enhance the financial and operational examination programs.</li> </ul>

Intensive training program to make new examiners productive quickly and effectively.

- Instill 'best practices'
- Ensure new examiners have the support they need
  - Phase course work
  - Mentoring program
  - On-the-job training activities

# Member Regulation Examiner University Components



- **Phase I**
  - Six week program focuses on basics of securities products and rules; examination procedures and techniques; and NASD Systems.
- **Phase II**
  - Two-week program focused on other business processes
- **Phase III**
  - Two-week program focused on more advanced examination skills
- **Phase IV**
  - Two-week program focused on advanced analytic and communication skills

# Member Regulation Approach

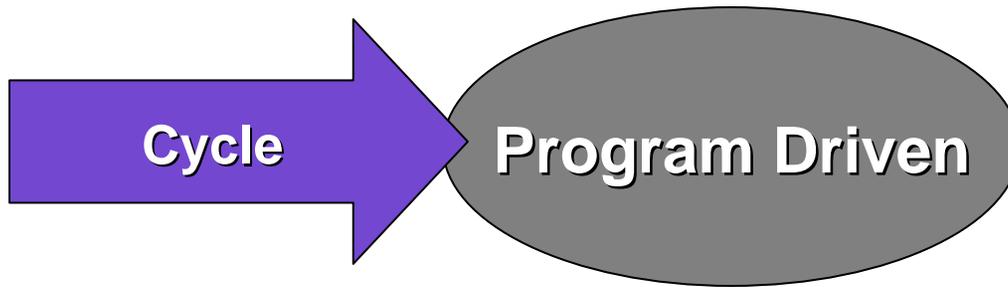
## Preventive Compliance

- Regulatory & Compliance Workshops
- Member focus groups
- Roundtable discussions

## Rigorous Examinations & Enforcement

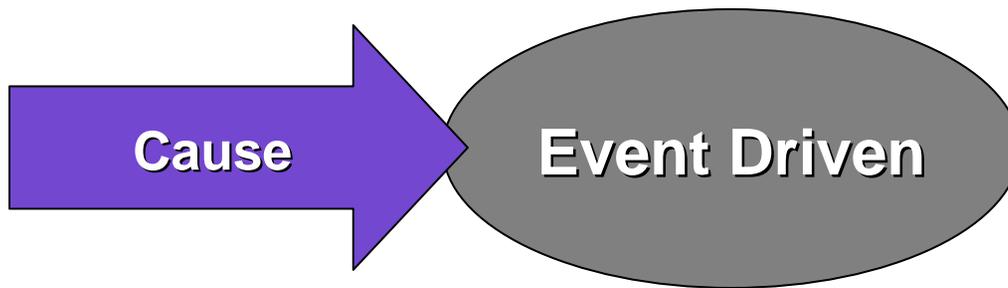
- Creates and monitors rule changes and proposals
- Creates and maintains exam training and procedures
- Conducts surveillance

# Member Regulation Statistics/Accomplishments



- New members
- Routine main & branch office
- Municipal broker dealers
- Options
- Statutory disqualified representatives

**2,500 cycle exams per year**



- Customer complaints
- Regulatory Tips
- Termination for Cause
- Reporting Disclosures
- Arbitration Claims
- Surveillance Triggers
- Trend Analysis
- Referrals

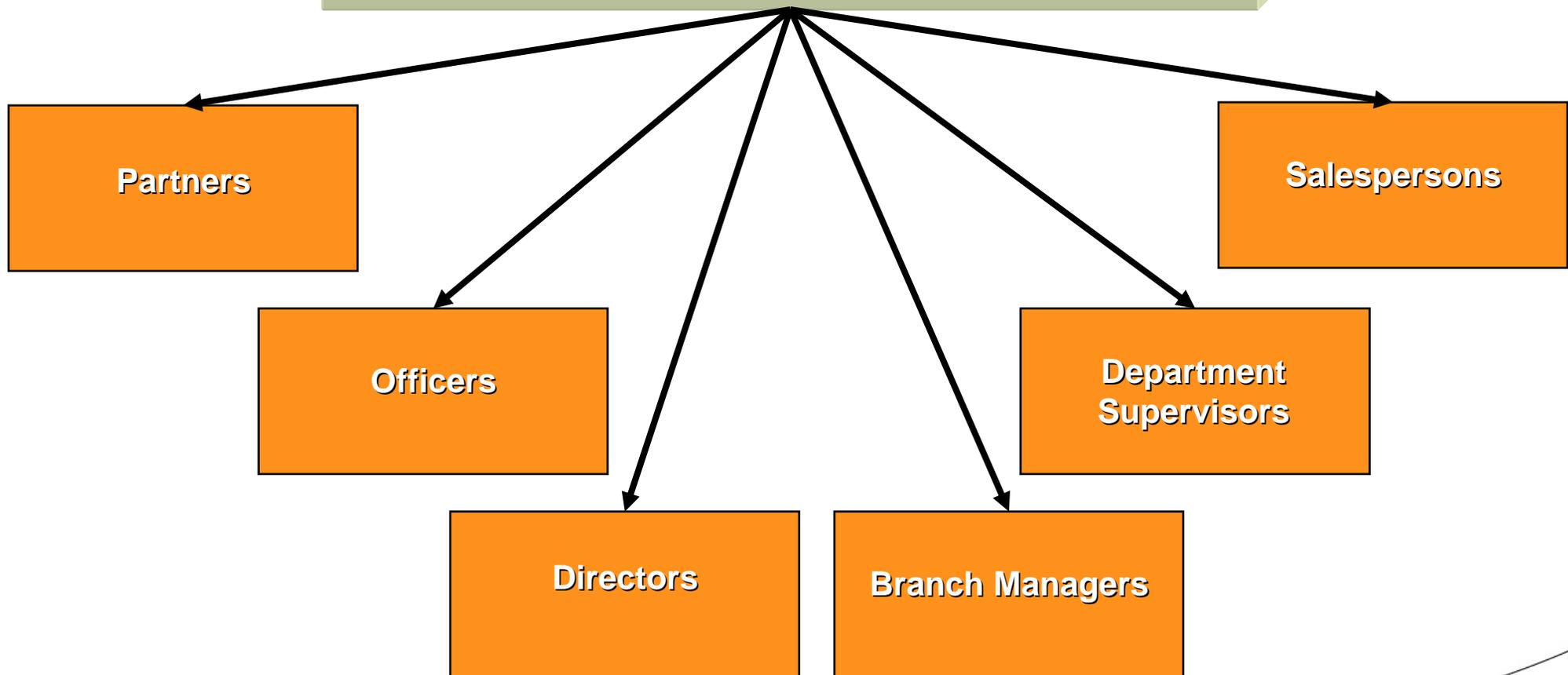
**25,000 event reviews per year**

**4,500 investigations per year**

# NASD Registration and Qualification Requirements



Who must register with NASD?



# Continuing Education

Two-part mandatory Continuing Education Program administered in conjunction with other SROs and the Securities Industry/Regulatory Council on Continuing Education.

## Regulatory Element

- All persons must take computer-based training in industry rules and regulations
- Taken on second anniversary of initial securities registration
- Taken every three years thereafter

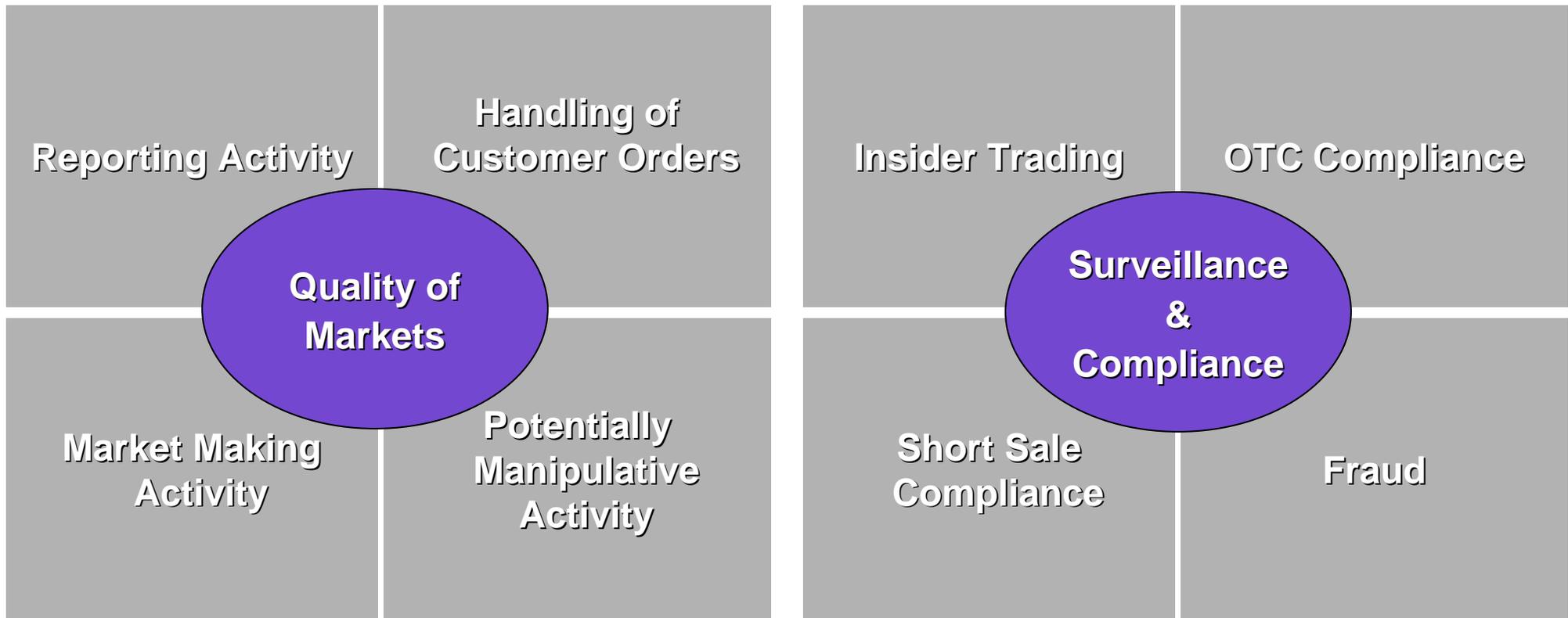
## Firm Element

- Broker-dealers must keep their covered persons up to date
- Done through annual firm-developed and administered training programs

# Market Regulation

Overview	Staff	Strategic Priorities
<ul style="list-style-type: none"> <li>• The examination unit executes its regulatory program through field examinations at the nation’s largest market-making firms to determine compliance with specific market-making and trading rules.</li> <li>• The investigative unit monitors activity in the marketplace by utilizing sophisticated surveillance technology.</li> <li>• The two units work in tandem with three other operational units that provide legal, technical and business support to guarantee effective, efficient, and consistent regulation.</li> </ul>	<ul style="list-style-type: none"> <li>• 236 analysts, attorneys, and examiners based in Rockville, New York, and Chicago.</li> </ul>	<ul style="list-style-type: none"> <li>• Ensure the protection of investors and the integrity and fairness of the NASDAQ Stock Market and other markets.</li> <li>• Serve investors and all market participants by being a fair, efficient, and effective regulator.</li> <li>• Administer regulatory programs to determine compliance with specific NASD rules and regulations and federal securities laws.</li> <li>• Develop technology that permits reconstruction of market activity using quote and trading information captured during the trading day.</li> </ul>

# Market Regulation Approach



# Market Regulation Statistics/Accomplishments

## Accomplishments

- **Advanced Detection System (ADS):** break detection and discovery tool that uses artificial intelligence mechanisms to identify activity of regulatory concern based on pattern recognition across many trade and quotation records in NASDAQ's database, Market Data Server (MDS).
- **Sweeps:** quarterly reviews of member firms trade or quote activity based on violations of specific rules.
- **Securities Observation, News Analysis, and Retrieval (SONAR):** provides thorough surveillance of issues for potential insider trading and potential fraud by combining evidence of potential violations in price and volume data, news stories, and SEC EDGAR filings.
- **Compliance Report Cards:** reflect alerts generated by our surveillance systems for trade reporting, OATS reporting, best execution, firm quote compliance and locked/crossed markets and allows firms to gauge their performance relative to their peers and the industry at large.

# Advertising Regulation

Overview	Staff	Strategic Priorities
<ul style="list-style-type: none"> <li>• Reviews members' communications with the public to ensure that they are fair and not misleading.</li> <li>• Provides written comments to members on filings submitted pursuant to NASD rule requirements or voluntarily.</li> <li>• Investigates customer complaints involving members' communications with the public and conducts periodic spot checks of material that is not required to be filed on a routine basis.</li> <li>• Involved in rule-making as it relates to communications with the public.</li> </ul>	<ul style="list-style-type: none"> <li>• Staff consists of 60 employees.</li> </ul>	<ul style="list-style-type: none"> <li>• Timely review of filed materials.</li> <li>• Support other departments in advertising-related formal actions.</li> <li>• Deploy an electronic filing system to all member firms.</li> <li>• Draft rules to prohibit misleading national advertising campaigns.</li> </ul>

# Advertising Regulation Statistics/Accomplishments

	2004	2003	2002
Advertisements and Sales Literature Reviewed	88,301	85,737	87,861

# Corporate Financing

Overview	Staff	Strategic Priorities
<ul style="list-style-type: none"> <li>• Reviews securities offerings managed by NASD member firms to see that the underwriting compensation is within the NASD guidelines and that the terms and arrangements are just and equitable.</li> <li>• Provides written comments to members on filings submitted pursuant to NASD Conduct Rules 2710, 2720, and 2810.</li> <li>• Actively engaged in industry policy development and rule modernization relating to the capital formation process.</li> </ul>	<ul style="list-style-type: none"> <li>• Staff consists of 23 employees.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Timely verification, upload, and review of COBRADesk filings.</li> <li>▪ Provide subject matter expertise in connection with underwriting exams and investigations.</li> </ul>

# Corporate Financing Statistics/Accomplishments

	2004	2003	2002
Total Filings	1,080	753	765
Filing Fees Received (\$ mil)	16.1	10.46	10.3
Offering Proceeds (\$ tril)	.662	.545	.482
Opinions Issued	2,485	1,387	1,597
Exemptive Requests	5	3	2

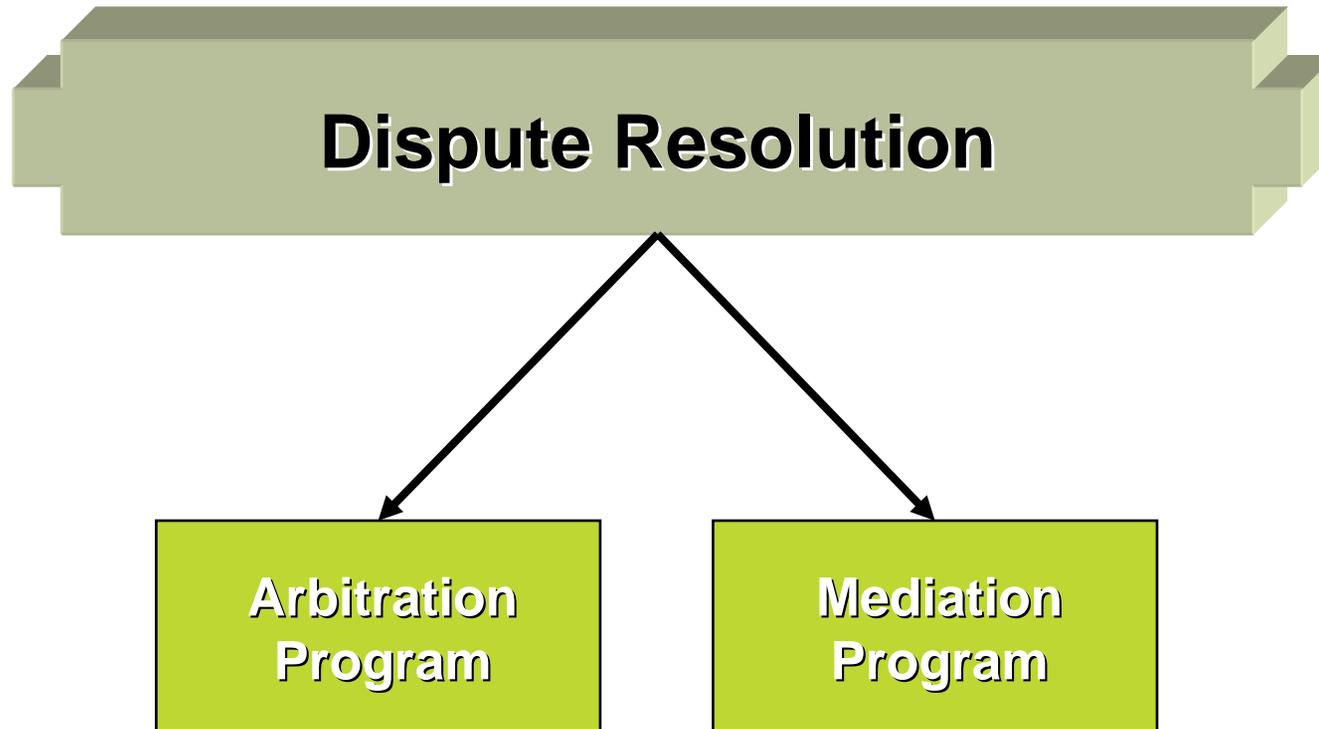
# Enforcement

Overview	Staff	Strategic Priorities
<ul style="list-style-type: none"> <li>Investigates and prosecutes fraudulent activities and other egregious activity by member firms or associated persons.</li> <li>Prosecutes securities violations uncovered through Member Regulation’s examinations and cause programs.</li> <li>Works with the SEC, other SROs, state securities regulators, and criminal authorities to coordinate enforcement efforts in national priority areas.</li> <li>Sources of cases: other NASD departments, SEC, state regulators, and members of the public.</li> </ul>	<ul style="list-style-type: none"> <li>195 employees located in Washington, DC, and in the 15 District Offices around the country.</li> </ul>	<ul style="list-style-type: none"> <li>Respond to high profile issues and new rules by developing mutual fund market timing cases, payment for shelf space cases and hedge fund trading cases.</li> <li>Respond to sales practices in popular high profile products by developing cases in variable products, mutual funds and fixed income products.</li> <li>Work closely with other NASD departments, district offices, criminal prosecutors and international securities regulators.</li> </ul>

# Enforcement Statistics/Accomplishments

Regulatory Actions	2004	2003	2002
<u>Formal Actions:</u>			
- Complaints Filed	270	278	256
- AWCs Accepted (Resolved)	1043	1034	895
<u>Formal Actions Resolved:</u>			
- Panel Decisions	149	153	131
- Offers Accepted	126	137	103
Fines Collected	\$102 million	\$33.3 million	\$68.2 million
Firms Expelled (excluding failure to pay fines)	22	12	8
Firms Suspended	4	2	2
Individuals Barred	452	494	440
Individuals Suspended	379	333	374

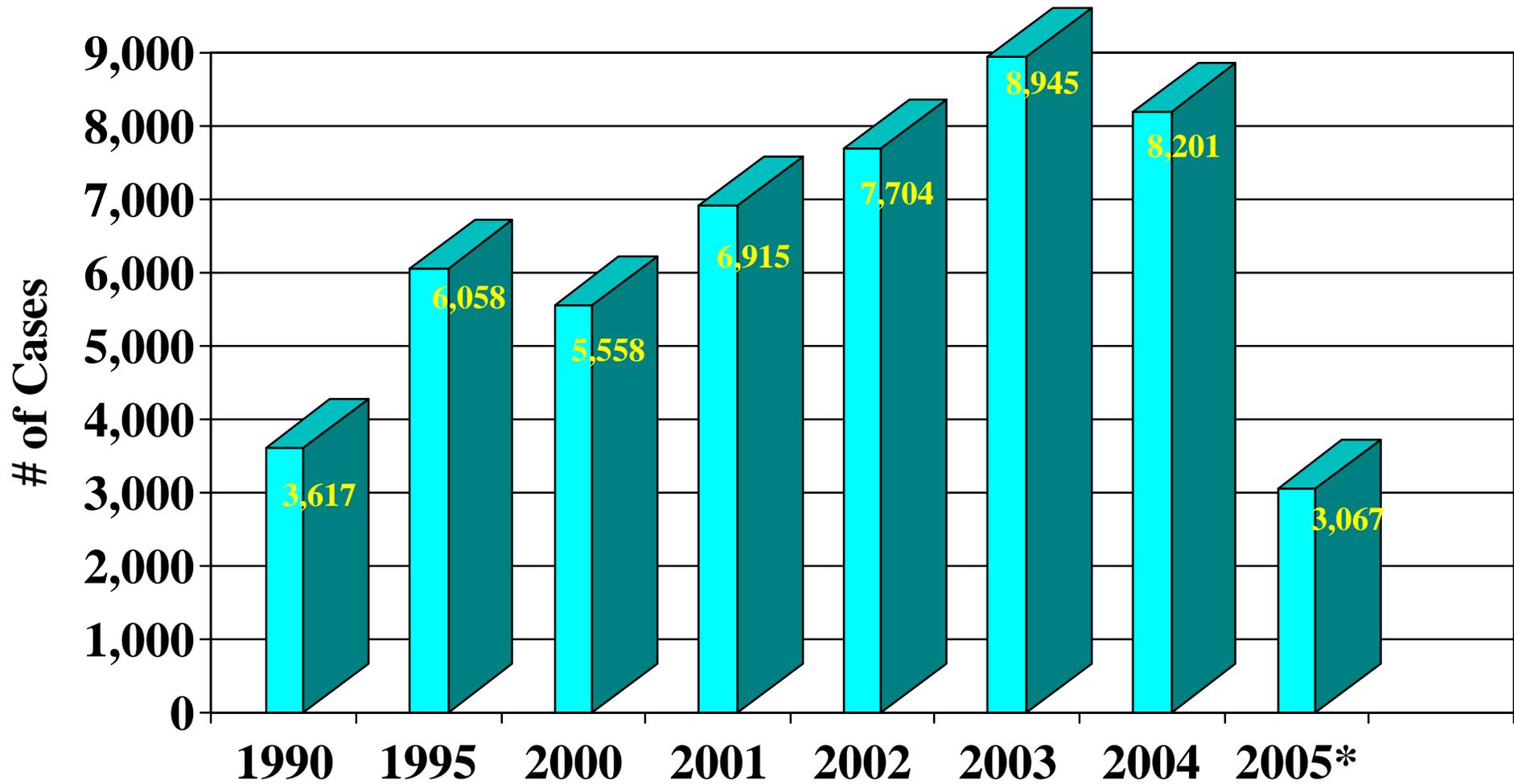
# Dispute Resolution



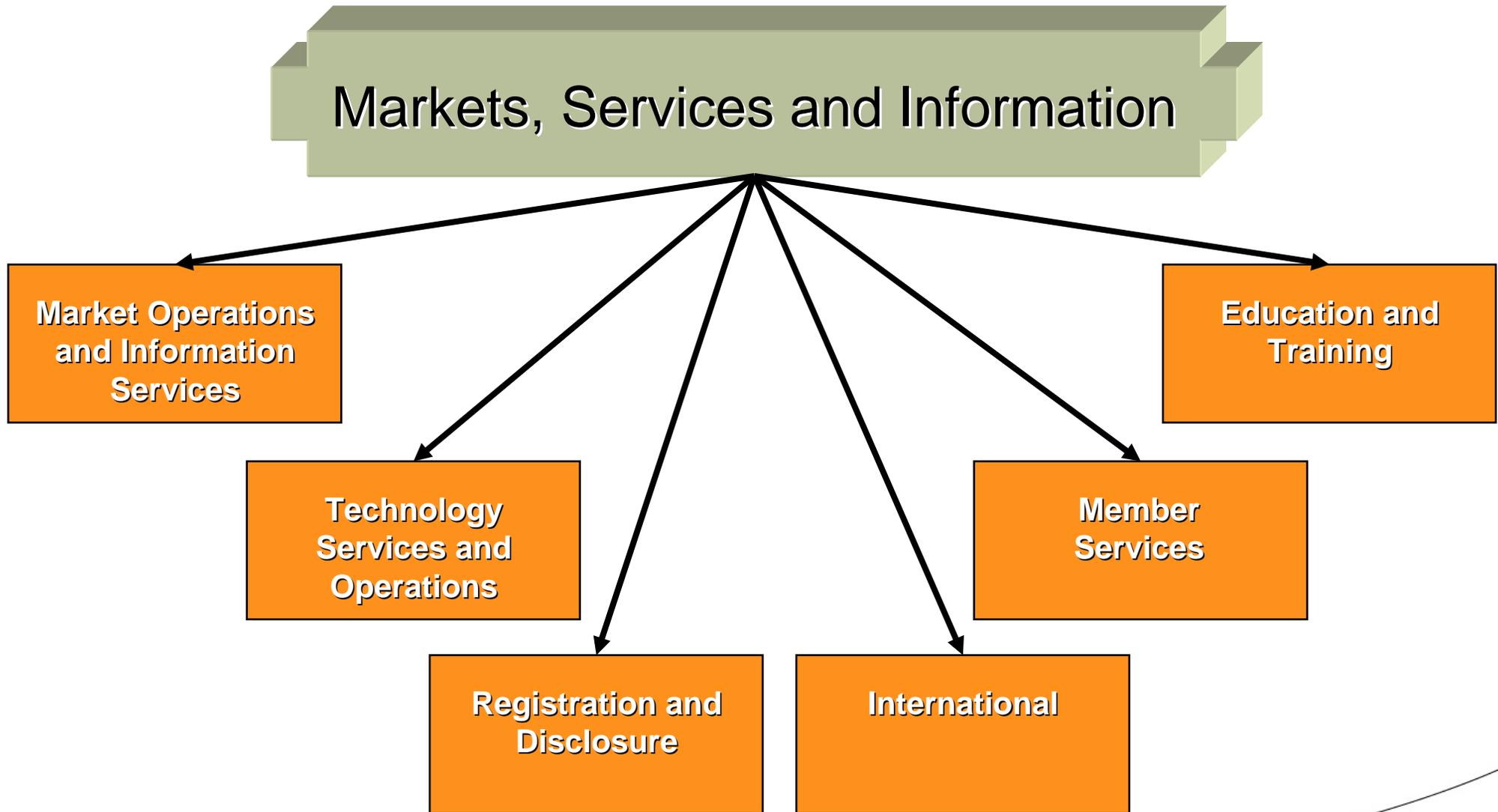
# Dispute Resolution

Overview	Staff	Strategic Priorities
<ul style="list-style-type: none"> <li>Assists in the resolution of monetary and business disputes between investors and securities firms.</li> <li>The largest securities dispute resolution forum in the world, including both arbitration and mediation programs, handling 90% of all arbitrations and mediations in the United States.</li> <li>Handles employment and business disputes within the industry, as well as a wide variety of investment disputes involving stocks, bonds, options, mutual funds and other types of securities.</li> </ul>	<ul style="list-style-type: none"> <li>Approx. 224 permanent and eight temporary employees in Dispute Resolution in five regional offices.</li> <li>More than 6,626 arbitrators and 900 mediators.</li> </ul>	<ul style="list-style-type: none"> <li>To be the forum of choice for the resolution and management of disputes arising in the global securities markets.</li> <li>To provide impartial professional staff, and highly trained arbitrators/mediators who are committed to delivering fair, expeditious, and cost effective dispute resolution services.</li> </ul>

# Case Statistics



# Markets, Services and Information



# Technology Services and Operations

M

Overview	Staff	Strategic Priorities	Statistics/ Accomplishments
<ul style="list-style-type: none"> <li>• Responsible for all technology for the entire NASD organization, including:               <ul style="list-style-type: none"> <li>- Project Management,</li> <li>- Architecture and Re-architecture, and</li> <li>- Maintenance of all servers, hardware, and software.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Staff consists of over 100 full-time employees, in addition to contractors from EDS and other vendors. There are four (4) technology program managers who provide the business units with technology support services.</li> </ul>	<ul style="list-style-type: none"> <li>• Meet critical processing demands as defined by technical service level agreements (SLAs) with business.</li> <li>• Establish a technical strategy that improves architecture and enables delivery to markets/customers.</li> <li>• Reduce operating expenses.</li> <li>• Continuously enhance our technical systems to support business objectives.</li> </ul>	<ul style="list-style-type: none"> <li>• NASD has over 150 applications in its portfolio.</li> <li>• Over 70MM market transactions are scrutinized every day.</li> <li>• NASD systems run at better than 99.9% availability.</li> </ul>

# Transparency Services

M

Overview	Staff	Strategic Priorities	Statistics/ Accomplishments
<ul style="list-style-type: none"> <li>• Develops and operates:               <ul style="list-style-type: none"> <li>- The Alternative Display Facility (ADF);</li> <li>- Trade Reporting and Compliance Engine (TRACE);</li> <li>- OTC Bulletin Board/OTC Equity Trade Reporting (<i>After SEC Approval</i>);</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Approximately 25 full-time employees working in the Washington, DC, headquarters, Rockville, MD, and New York City offices plus dozens of people in Technology, Market Regulation, Office of General Counsel that also support Transparency Services.</li> </ul>	<ul style="list-style-type: none"> <li>• Transfer responsibility of OTC Bulletin Board/OTC Equity trade reporting to NASD.</li> <li>• Provide investors with improved capabilities for monitoring bond performance.</li> <li>• Implementation of Regulation NMS on ADF</li> <li>• Determine strategy for ADF/TRACE/OTC platforms.</li> </ul>	<ul style="list-style-type: none"> <li>• ADF - Operated seamlessly for more than three years with peak volumes three million quotes and 200k trades per day.</li> <li>• TRACE - disseminate 30,000+ publicly traded corporate bonds; 15 minute reporting; distribution of broad market info to retail investors (e.g. <i>NY Times</i>).</li> <li>• TRACE disseminates approx. 22,000 trades per day representing \$17 billion par value.</li> <li>• Implemented SEC's Reg. SHO Threshold list for OTC securities.</li> </ul>

# Registration and Disclosure

M

Overview	Staff	Strategic Priorities	Statistics/ Accomplishments
<ul style="list-style-type: none"> <li>• Maintains the Central Registration Depository (Web CRD®), an automatic, web-based, electronic database that maintains qualification, registration, employment, and disclosure histories of 660,000+ registered securities employees and 5,200+ member firms.</li> <li>• Maintains BrokerCheck - NASD's public disclosure program, which provides to the investing public information that is required to be reported on the Uniform Forms.</li> <li>• Maintains the Investment Adviser Registration Depository (IARD), an automatic, web-based, electronic registration database of 19,000+ IA firms and 125,000+ IA representatives used by the SEC and states.</li> </ul>	<ul style="list-style-type: none"> <li>• 166 full-time employees and several long-term temporary staff located at the Rockville, MD, offices (Discoverly Building).</li> </ul>	<ul style="list-style-type: none"> <li>• Provide service excellence to members in support of investor protection.</li> <li>• Provide high quality, cost-effective, and timely mission-critical technology.</li> <li>• Bring state-of-the-art registration services to other industries.</li> </ul>	<ul style="list-style-type: none"> <li>• BrokerCheck Program – Finalizing requirements for enhancements to the current method of electronic delivery of reports.</li> <li>• RAD operates an Annual Renewal Program - All BD and IA firms pay a renewal fee for currently registered individuals and investment adviser representatives.</li> <li>• New business is focused on implementing an online version of Form ADV, Part II, in IARD and a new form, Form BR, which will link registered individuals to the branch office from which they are supervised.</li> </ul>

# Compliance and Information Services

M

Overview	Staff	Strategic Priorities	Statistics/ Accomplishments
<ul style="list-style-type: none"> <li>• Provide tools and services to members to promote and enable strong “self-compliance.”</li> <li>• Department created in 2003 (previously called Member Services).</li> </ul>	<ul style="list-style-type: none"> <li>• Seven full-time employees located in Washington and New York.</li> </ul>	<ul style="list-style-type: none"> <li>• Design and launch new self-compliance tools.</li> <li>• Continue to support member feedback and outreach program.</li> </ul>	<ul style="list-style-type: none"> <li>• Launched Do Not Call service for members in 2003.</li> <li>• With RPO, developed Breakpoint tools: interest refund calculator; broker checklist; training outline; &amp; breakpoint look up tool.</li> <li>• Developing other issue-specific tools (AML, BCP).</li> <li>• Developing NASD Report Center, secure web site for disseminating compliance data.</li> <li>• Re-launched the NASD Manual Online.</li> <li>• Launched NASD Webcast series</li> </ul>

# International

M

Overview	Staff	Strategic Priorities	Statistics/ Accomplishments
<ul style="list-style-type: none"> <li>Works with international securities markets, regulators and officials to expand the use of NASD's regulatory expertise and services around the world; promote sound, consistent regulatory policies and practices worldwide</li> </ul>	<ul style="list-style-type: none"> <li>Fourteen full-time employees located in New York, Washington, DC, and London.</li> </ul>	<ul style="list-style-type: none"> <li>Develop European Market</li> <li>Continue to focus on potential projects in Asia and Latin America</li> <li>Execute follow on work for two Middle Eastern Regulators</li> </ul>	<ul style="list-style-type: none"> <li>Exceeded revenue projections; fifteen completed and/or ongoing projects.</li> <li>- Developed manuals for Enforcement, Market Surveillance, Inspections, Corporate Finance, and Firm Registration Departments, the rules and technology for a prudential regulatory regime, and delivered extensive staff training staff for a Middle Eastern regulator.</li> <li>- Developed a comprehensive implementation program for capital markets reform for an Asian Regulator.</li> </ul>

# Education and Training

M

Overview	Staff	Strategic Priorities	Statistics/ Accomplishments
<ul style="list-style-type: none"> <li>• Complements NASD’s regulatory mission by arming industry professionals with the knowledge they need to comply with rules and regulations</li> <li>• Supports industry by providing consistent, high-quality, cost-effective education programs in a variety of formats to meet firm and individual professional development needs:               <ul style="list-style-type: none"> <li>– Conferences</li> <li>– Classroom Learning</li> <li>– Online Learning</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• 15 full-time employees located in Washington and New York</li> </ul>	<ul style="list-style-type: none"> <li>• Continue expansion of current programs to become the place industry professionals go for compliance and regulatory education.</li> </ul>	<ul style="list-style-type: none"> <li>• Provided programs, in a timely way, that have been responsive to industry need and addressed the latest regulatory and compliance matters.</li> <li>• Increased member participation from 13% in 2003 to 23% in 2004.</li> <li>• More than doubled individual participation from 7,664 in 2003 to 15,606 in 2004.</li> <li>• Attracted interest of larger firms and established a niche with small firms.</li> </ul>

# Education and Training Overview

## NASD Education and Training

*...the place securities professionals go for regulatory updates, compliance education and professional development.*

### Conferences

- Conferences on the latest developments in regulatory matters and industry best practices:

**Securities Conferences**

**Small Firm Conferences**

**Branch Office Conferences**

**Specialty Conferences**

### Classroom Learning

- Classroom education on compliance, regulation and related securities industry issues:

**Elective Courses**

**Certified Regulatory and Compliance Professional (CRCP) at the NASD Institute at Wharton**

### Online Learning

- Online learning in two formats, designed to help firms meet their ongoing compliance and continuing education needs:

**E-Learning courses** developed through the E-Learning Exchange.

**Webcasts**