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Broker-Dealer Supervision and Surveillance

by:

Paul B. Uhlenhop
LAWRENCE, KAMIN, SAUNDERS & UHLENHOP, L.L.C.
Chicago, Illinois

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By: Paul B. Uhlenhop, Esq.[1]
Lawrence, Kamin, Saunders & Uhlenhop, L.L.C.
Chicago, Illinois

BROKER-DEALER SUPERVISION AND SURVEILLANCE

I. **Introduction**

The purpose of this panel and the accompanying outline is to focus on broker-dealer supervision, including the following:

1. supervisory responsibilities, in general;
2. top down compliance; and
3. conflicts of interest.

II. **Supervisory Responsibilities**

A. In General

The supervisory responsibility of broker-dealers and persons who may be supervisors is spelled out in the Securities Exchange Act of 1934 ("'34 Act")[2] in Sections 15(b)(4)(E) and 15(b)(6), New York Stock Exchange ("NYSE") Rule 342 and National Association of Securities Dealers, Inc. ("NASD") Conduct Rule 3010.

The '34 Act indirectly mandates a supervisory requirement. Under the '34 Act, a broker-dealer and its supervisory personnel are at absolute liability for a violation by a subordinate that they supervise unless the broker-dealer has adequate written supervisory procedures that have been reasonably implemented. Section 15(b)(4)(E) of the '34 Act provides for liability of a broker-dealer or an associated person who has violated the securities or commodities laws or who "has

[1] Mr. Uhlenhop is a member of the bars of the states of Illinois and of New York and is a Senior Member of Lawrence, Kamin, Saunders & Uhlenhop, L.L.C., Chicago, Illinois.
[2] 15 U.S.C. §78a *et seq.*

failed reasonably to supervise, with a view to preventing violations of the provision of such statutes, rules and regulations, another person who commits such a violation if such person is subject to his supervision." Subsection (E) further provides that

> "no person shall be deemed to have failed reasonably to supervise any other person if:
>
> (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such person, and
>
> (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and systems without reasonable cause to believe that such procedures and systems were not being complied with." (emphasis added)

NASD Rule 3010 is similar to Section 15 of the '34 Act in structuring its requirements around the concept of reasonable supervision. Rule 3010 requires that

> "Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of this Association. Final responsibility for proper supervision shall rest with the member."

In particular, each member firm shall establish, maintain and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of its registered representatives and associated persons in a manner reasonably designed to achieve compliance with the securities laws and regulations and with the applicable rules of the NASD. Rule 3010 establishes a number of requirements including, but not limited to, the following:

1. Written supervisory procedures.
2. Designation of registered principals with authority to carry out the supervisory responsibilities.
3. Designation of an OSJ for each location that meets the requirements. Each OSJ must supervise branches and other sites where business is conducted.

4. Designation of one or more registered principals at each OSJ, including the main office, and one or more registered representatives or principals at each non-OSJ branch office, with authority to carry out supervisory responsibilities assigned to that office.

5. The assignment of each registered person to an appropriately registered representative or principal.

6. Qualified supervisory personnel.

7. Annual compliance review.

8. Annual review of supervisory procedures.

Rule 3010(b) requires that the written supervisory procedures set forth the titles, registration status and location of the supervisory personnel and <u>the specific responsibilities</u> of each supervisory person. A member must maintain internal records regarding all such persons and the date when their responsibilities become effective. Last, but not least, each member must maintain written supervisory procedures at each OSJ and each location where supervisory activities are conducted. In addition to the annual review of supervisory procedures required by Rule 3010(a), Rule 3010(b) requires further that these procedures be changed <u>any time</u> there is a material change in the business of the member. This in essence means that a broker-dealer should review its procedures whenever it offers new products or acquires new offices. Since such changes in business are frequent, most broker-dealers should review procedures more frequently than annually. At many firms, review of procedures is conducted on a quarterly basis.

Rule 3010(c) requires that each member conduct an internal inspection of all of its operations on an annual basis. This includes all offices, including branch offices. Rule 3010(d) sets forth certain on-going requirements which may be paraphrased as follows:

1. A registered principal must be responsible for the review and endorsement of all transactions and incoming and outgoing correspondence and electronic

correspondence. Not all correspondence need be reviewed, but there must be a reasonable supervisory procedure.

2. Each member must develop written procedures for the review of incoming and outgoing electronic correspondence with the public relating to its securities business.

3. Each member must provide for the review and retention of correspondence.

Rule 3010(e) requires the investigation of the background business qualifications and experience of each registered person. The SEC Books and Records Rule 17a-3(a)(12) also requires a full history of each person who is employed by a firm or associated with handling funds, securities or soliciting customers. Rule 3010(f) also provides as follows:

> Any applicant for registration who receives a request for a copy of his or her Form U-5 from a member pursuant to this Rule shall provide such copy to the member within two (2) business days of the request if the Form U-5 has been provided to such person by his or her former employer. If a former employer has failed to provide the Form U-5 to the applicant for registration, such person shall promptly request the Form U-5, and shall provide it to the requesting member within two (2) business days of receipt thereof. The applicant shall promptly provide any subsequent amendments to a Form U-5 he or she receives to the requesting member.

Rule 3010(g) defines Office of Supervisory Jurisdiction and Branch Office, which is discussed further below in Section II.B.

Establishment of written supervisory procedures is a complex and continuing task. Appropriate procedures cannot be taken from a book or downloaded from the internet. Boilerplate alone is not adequate. While “canned” procedures may provide a useful starting point, supervisory procedures have to be tailored to each broker-dealer and its business. NASD Notice to Members (“NTM”) 99-45 and NTM 98-96 provide an excellent statement of what the NASD expects in this regard. One needs to consider the customer base, product lines, and geographic locations of offices and personnel. Further, the broker-dealer’s current systems, operating units and organizational structures need to be considered. Likewise, experience of personnel and their background is important in developing procedures. The applicable regulatory requirements are constantly changing and business is constantly changing, so it is a never-ending chase to keep written supervisory procedures current. Most important, supervisory procedures must be practical and tailored to the business. Supervisory procedures that are too complex are generally not followed. If they are not followed, there is almost automatic liability. Complex procedures that are not followed are, in many cases, worse than no procedures at all.

B. <u>OSJs and Branch Offices</u>

1. <u>NASD Rule 3010</u>

NASD Rule 3010(g)(1) defines an Office of Supervisory Jurisdiction as follows:

> "Office of Supervisory Jurisdiction" means any office of a member at which any one or more of the following functions take place:
> (A) order execution and/or market making;
> (B) structuring of public offerings or private placements;
> (C) maintaining custody of customers' funds and/or securities;
> (D) final acceptance (approval) of new accounts on behalf of the member;
> (E) review and endorsement of customer orders, pursuant to paragraph (d) above;
> (F) final approval of advertising or sales literature for use by persons associated with the member, pursuant to Rule 2210(b)(1); or
> (G) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

The NASD is reviewing the definition of OSJ in light of the recent changes in the business, particularly with respect to trading firms. The NASD has granted limited relief in this area for offsite proprietary trading locations where the trading system has real time monitoring capability at an office of an OSJ or the electronic trading system at the OSJ has approval control or limits on executions. This relief has been granted only in connection with proprietary trading transactions.

The NASD has not permitted such relief in the case of any type of customer transactions where the office is held out to the public as an office of the firm.

Rule 3010(g)(2) defines the term Branch Office as "any location identified by any means to the public or customers at a location at which the member conducts an investment banking or securities business", <u>excluding</u> the following:

> (A) any location identified in a telephone director line listing or on a business card or letterhead, which listing, card, or letterhead also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly supervised;
> (B) any location referred to in a member advertisement, as this term is defined in Rule 2210, by its local telephone number and/or local post office box provided that such reference may not contain the address of the non-branch location and, further, that such reference also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch location are directly supervised; or
> (C) any location identified by address in a member's sales literature, as this term is defined in Rule 2210, provided that the sales literature also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly supervised.
> (D) any location where a person conducts business on behalf of the member occasionally and exclusively by appointment for the convenience of customers, so long as each customer is provided with the address and telephone number of the branch office or OSJ of the firm from which the person conducting business at the non-branch location is directly supervised.

It is important to remember that the terms "Branch Office" and "OSJ" are not synonymous. Because the differences in supervisory requirements between Branch Office and OSJ can be confusing, the terms need to be reviewed carefully when, for example, determining whether an office really is an OSJ or whether a Branch Office falls within the subparagraph (g)(2) definition. Further, one needs to consider the branch office exclusions of Rule 3010(g)(2). These exclusions offer a variety of helpful relief for remote offices and representatives. Further relief may be found in subsection (g)(3) of Rule 3010, which permits a member to substitute a central office address and telephone number for the supervisory branch office or OSJ under certain conditions, the most important of which is that a supervisory program exists to review complaints and to see that they are followed up with the local office.

C. NASD Proposed Rules and Changes Regarding Supervision

The NASD has recently proposed to amend Rule 3010 in material respects and proposes to adopt other rules.

The NASD and New York Stock Exchange have filed with the SEC proposed supervisory control amendments to their rules.[3] These amendments would do the following:

1. The proposed amendments would amend NASD Rule 3010(c) to require that office inspections be conducted by independent persons and include, at a minimum, the testing and verification of certain supervisory procedures.

2. Rule 3010 would be expanded and require additional member supervisory and recordkeeping requirements with respect to changes in customer account name or designation in connection with order executions.

3. The NASD would adopt a new interpretation IM-3110 that would provide guidance as to when a member may hold mail for customer who will be out.

4. There would be clarifications in Rule 2510(d) with respect to time limit on time and price discovery.

In addition, a new Rule 3012 would be adopted to require members to develop general and specific supervisory control procedures that independently test, verify and modify where necessary the member's supervisory procedures. This would require members to identify risk in connection with all of its operations, including sales practice, trading, financial and back office. These risk would have to be covered by supervisory procedures and updated on a regular basis. In addition, the member would need to test these risk control procedures from time to time and correct deficiencies.

[3] SEC File No. SR-NASD-2002-162.

The NASD has also proposed an amendment to Rule 3010 to require member's chief executive officer and chief compliance officer to certify to the adequacy of the member's compliance and supervisory policies and procedures.[4] This rule has not been filed with the SEC.

The NASD recently proposed in Notice to Members 03-49 that Rule 3010 be amended to require that firms adopt special supervision plans to be approved in writing for representatives who had three or more customer complaints, arbitrations, regulatory actions or investigations within the last five years or who have had two or more terminations or internal reviews involving wrong doing.

D. New York Stock Exchange Rule 342

NYSE Rule 342 is applicable to New York Stock Exchange member firms and is quite different than NASD Rule 3010. Rule 342 of the New York Stock Exchange is not as far-reaching or as particularized as Rule 3010. While Rule 342 does not define a branch office, it does require prior NYSE consent for each office "other than a main office." Thus, under the literal wording of the rule, when a registered representative operates from home or remote location, each such location is considered an office. However, the NYSE has supplemented Rule 342 so that the rule similar in concept, if not wording, to the NASD Rule. For that reason, NYSE Rule 342 is not discussed at length in this paper.

E. Anti-Money Laundering Compliance

Each broker-dealer as a member of the New York Stock Exchange or the NASD is required to develop and implement a written anti-money laundering program. The NASD and the New York Stock Exchange provisions[5] are similar and require the following:

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[4] Notice to Members 3-29, July 11, 2003.
[5] NASD Rule 3011; NYSE Rule 445.

1. Establish and implement policies and procedures that can be reasonably expected to detect and cause reporting the transactions required under the Bank Secrecy Act[6] and implementing regulations.

2. Establish and implement polices, procedures and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementation regulations thereunder.

3. Provide for independent testing for compliance to be conducted.

4. Designate and identify to the NASD the compliance person responsible for implementing and monitoring day-to-day operations and internal controls of the program and to provide notification to the NASD regarding any change in such designations.

F. Compliance Officers

Over the past 10 years, the SEC enforcement staff and various self-regulatory organizations have brought proceedings against compliance officers for failure to supervise. The SEC has clearly stated that legal and compliance personnel are not automatically supervisors for purposes of the '34 Act. The SEC and other regulators, when determining whether a compliance officer has supervisory responsibility, will focus on the degree of responsibility, ability, or authority to affect the conduct of the broker whose behavior is at issue. *See In re Gutfreund*, 52 S.E.C. 2849, 1992 SEC Lexis 293 (Dec. 3, 1992). A more basic test is whether the compliance officer has the ability to hire or fire an employee. *See In re Arthur James Huff*, 50 S.E.C. 524, 1991 WL 296561 (Mar. 28, 1991). However, since *Gutfreund*, this later test is not definitive. Under *Gutfreund*, a compliance officer will be deemed to be a supervisor if it is shown that he or she was in a unique position in relationship to the wrongful conduct such that he or she has the ability to stop it and that the employer has authorized the particular compliance personnel to go beyond his usual compliance and legal duties to supervise a particular employee or operation.

[6] 31 U.S.C. 5318(g).

In the 21(a) Report accompanying the *Gutfreund* consent order, then-Commissioner Mary L. Schapiro stated as follows:

> There are three critical messages in this report concerning who may be deemed to be a 'supervisor.' First, employees who have legal or compliance responsibilities do not become 'supervisors' solely because of their positions. In other words, the Commission will analyze each case on the basis of its unique facts and circumstances, taking into account the managerial structure of the particular firm and the devolution of responsibility within the firm. Second, the determination of whether a particular person is a supervisor depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employees whose behavior is at issue. Again, the facts and circumstances are crucial, as is an analysis of responsibility and control, to making the determination. And third, it is possible, to <u>become</u> a supervisor under a particular set of facts and circumstances, even if formerly you did not have 'direct supervisory responsibility for <u>any</u> of the activities of the employee.'
>
> * * * * *
>
> In my view, the facts and circumstances which may make you 'become' a supervisor vis-à-vis a particular employee, when formerly you were not, are (1) your knowledge and awareness of allegedly improper conduct, and (2) being so situated within a firm that you have some ability to affect the conduct at issue.

Remarks of Commissioner Mary L. Schapiro, *Broker-Dealer Failure to Supervise: Determining Who is a "Supervisor,"* at 14-15, SIA Compliance and Legal Seminar (Mar. 24, 1993).

Most large wirehouses consider their compliance officers to be staff personnel, not line supervisors, and their procedures make it clear that the compliance officers do not supervise specific registered representatives or principals. Compliance staff provide compliance advice to line supervisors but the decision as to whether to hire, fire, discipline or carry out the advice remains with the line supervisors. However, if the written supervisory procedures, particularly the designations of supervisors, are not clear regarding who has responsibility for supervision of a particular person, the compliance officer may be charged as supervisors. <u>The SEC and the self-regulatory organizations' basic principle seems to be that if the written supervisory procedures do not clearly delineate the line of supervision, all persons dealing with a violator will be charged for</u>

failure to supervise. It appears that the SEC is reaching in some cases beyond its past acknowledged standard to name compliance personnel if (1) they are very senior persons; (2) they can, by reason of their influence within the firm, cause a person to be terminated or stop the violative conduct. This could create troublesome precedent due to its fact-intensive nature and the difficulty of application. If continued, ultimately, the courts and the SEC are going to have a difficult time dealing with the potentially arbitrary nature of this standard.

It is critically important that compliance officers establish a supervisory chain of command which does not include compliance personnel. Furthermore, supervisory procedures should not specifically assign supervisory responsibilities to compliance professionals. If they do, then the compliance personnel may have supervisory responsibilities. Of course, the fact that compliance personnel review actions or activities of others will not necessarily amount to direct supervision.

III. Top Down Compliance Culture

A. General

Late last winter, the SEC announced its new "top down culture of compliance" program designed to create a culture of compliance from the top to bottom of broker-dealers and investment advisers. The program was announced by Lori A. Richards, Director of the Office of Compliance, Inspections and Examinations ("OCIE") at several compliance programs. Shortly thereafter, John Walsh, Chief Counsel of OCIE, also discussed top down compliance. Since then, a number of senior SEC staff and Commissioners have articulated the concept that compliance starts at the top and that firms will be required to have a compliance culture. Deficiencies in top down compliance will mean that the firm will be subject to closer examination and scrutiny on an on-going basis by self-regulatory organizations and the SEC.

What is a top down compliance culture? The SEC's goal is that broker-dealers and investment advisers will have the support of the top executives of the firm in creating at all levels a culture of compliance. The SEC expects that the chief compliance officer will be a senior executive of the firm reporting to the chief executive officer and that the compliance department will have the resources in qualified personnel, budget and systems to carry out its compliance functions. Equally important, compliance must be part of the business's priorities at all levels and all levels of personnel must be educated regarding compliance. This is a very worthy goal. The SEC staff knows that it will be difficult to achieve and that firms will need to devote money, time and effort to creating a culture of compliance.

B. Implementation of Compliance Culture

The SEC began the top down compliance culture program development several years prior to its introduction. The SEC discussed with the self-regulatory organizations, principally the NASD and the NYSE, its concepts of a compliance culture. The program was developed by OCIE with the self-regulatory organizations. To implement the program for broker-dealers, the inspection staffs of the NASD, the NYSE and other self-regulatory organizations needed to implement the program within their individual organization. This meant not only developing the program but also developing materials for the program and training examiners. To some extent this was and will continue to be by a trial and error method. The program as it is currently being rolled out will obviously be modified as results come in from inspections of broker-dealers over the next several years. If the SROs and the SEC, after inspection, conclude that a broker-dealer has a high level compliance culture within the firm, the firm will be subject to less inspections and oversight. Conversely if the firm has a low level compliance culture within the firm, the broker-dealers will be subject to more frequent inspections and oversight.

C. The New Document Request Format

Broker-dealers that are subject to inspection by their SROs or subject to SEC oversight will receive a list of documents to be produced to examiners that is somewhat different than in the past. The new list will have a section dealing with compliance culture. There will also be the more traditional document request. The compliance culture request will request documents regarding the following areas:

1. The structure of the firm as a whole and where compliance fits into that structure.

2. The structure of compliance department and how it fits in with the structure of the firm as a whole.

3. Budgets for the compliance department to determine what financial resources are being devoted to compliance.

4. The compliance department personnel, their qualifications and the compensation.

5. Resources devoted to systems for surveillance and compliance, including hardware, software and facilities for the compliance department.

6. Descriptions of compliance systems, software and hardware devoted to compliance and the nature of the exception reports that are created and how the exception reports are used.

7. Risk identification, management and assessment within the firm and the compliance department.

8. Results of compliance audits of operational units and correction of deficiencies.

9. Stress testing of the compliance system and implementation of changes.

10. Recognition of conflicts of interest.

D. The SEC's or SROs' Review

The SRO will review the documents requested and conduct interviews with a view to determining the compliance culture. The SRO will be attempting to answer the following:

1. Does the compliance department fit into the structure of the firm as a whole so that it is capable of being effective?

2. Does the compliance department have access to the chief executive officer and other top management?

3. Is the compliance department accorded the same status as other major departments, such as marketing and operations?

4. Is the pay of the compliance personnel at all levels, including the chief compliance officer adequate and reasonably comparable to other similar managers of the firm?

5. Does the compliance department have the resources that it needs in the way of trained and qualified personnel, systems, hardware and other facilities?

6. Do the chief executive officer and other senior officials of the firm give adequate support and assistance to the compliance department?

7. Is the structure of the compliance department within the structure of the firm appropriate?

8. Is the structure of the compliance department adequate in relationship to the type of activities of the firm?

9. Does the compliance culture reach down to the lowest levels of the firm so that compliance is a way of life and the compliance function is considered an integral part of the business?

10. Does the compliance department identify perceived risk in sales practice, trading operations, financial reporting and other operational areas of the firm?

11. Are these risks evaluated, monitored and contained on a regular basis?

12. Is top management aware of any substantial risk perceived by the compliance department?

13. Are operational units audited on a regular basis and are deficiencies promptly corrected?

14. Are the supervisory systems, including electronic systems, being used effectively?

15. Are exception reports being followed up and corrections made?

16. Does the broker-dealer test its supervisory procedures and systems on an on-going basis, at least once a year, and make modifications to correct deficiencies?

Based on the answers to the above questions and others that may be appropriate under the circumstances, the examining authority will rate the broker-dealer and prepare a list of deficiencies from its total inspection. As is current practice, the firm will receive a list of deficiencies with requested follow up and requested response of corrective procedures and appropriate follow up. The broker-dealer may also be told that it did not rate well or it did rate well.

Although there will be a scorecard for each firm, the scorecard will not be shared with the broker-dealer at least as the program is currently structured. Depending upon the results of the examination, the firm will be rated and its rating will determine the frequency, level and nature of future SRO or SEC inspections. If the score is high, the annual inspections may be limited to one or two areas and in some cases the annual inspection may not involve a visit to the premises but only a review of documents off-premises or similar limited review. If the firm scores low, the broker-dealer will have a much higher frequency of inspection and closer monitoring. If certain departments of the firm or branches score low, those will be targeted for further review and more frequent inspection. In some cases, the firm will be asked to conduct special internal inspections and present the results to the SRO or SEC who may do a further oversight review. Depending upon the nature of deficiencies, the regulatory organizations may conduct surprise examinations of one or more departments or one or more branches. If the scores are reasonably high but there are deficiencies, the deficiencies will be noted and the firm will be told to correct the deficiencies and provide a description of the corrections to the regulator. In addition to correcting the deficiency, there may be a request for documents or continuing updates on the progress toward compliance.

IV. Conflicts of Interest

As a result of a number of scandals resulting from conflicts of interest that were not disclosed to customers, the SEC has commenced a campaign requiring broker-dealers to find and disclose material conflicts of interest in connection with their activities. The conflicts resulting from investment banking and/or issuer influence with respect to reports of research analyst have focused the SEC's enforcement and inspection activities in the area of conflicts resulting from multiple activities of broker-dealers.

SEC Enforcement Director, Stephen Cutler at the National Regulatory Services meeting in Charleston, South Carolina delivered a watershed address stating that the SEC staff and the SROs would search out material conflicts of interest that were not disclosed. He encouraged broker-dealers to search for, identify and disclose all material conflicts of interest. Mr. Cutler warned that firms should conduct a systematic on-going search for conflicts of interest, particularly full service firms that have both investment banking and investment advisory services together with retail and institutional business. He recommended not only reviewing investment banking relationships with issuers and their senior executives, but proxy voting by the firm. If the firm has an affiliated investment adviser or money management activity, substantial conflicts may exist with respect to directing brokerage, allocating executions, obtaining best execution and soft dollars. Mr. Cutler specifically identified conflicts that may exist between a broker-dealer providing investment banking, M and A or other services to an issuer when an affiliated investment adviser places its clients' investments in the stock or bonds of the same issuer. Mr. Cutler also focused on conflicts and giving preferences to particular customers which may not be disclosed.

Mr. Cutler pointed out that the anti-fraud provisions of both federal and state law require that full disclosure be made with respect to material conflicts in connection with the purchase or sale of securities. In informal comments, the SEC staff has emphasized that even under the basic law of agency, an agent (broker) has a duty of loyalty to his principal (the client) requiring that the agent forego activities contrary to the interest of its principal without disclosure to and consent of the client. Consent after disclosure may be implied for certain conflicts but for most material conflicts consent generally requires in the view of the SEC written consent after full disclosure.

Because of the potential for regulatory and private civil actions, broker-dealers need to establish procedures to uncover material conflicts of interest that currently exist as well as on-going procedures to discover conflicts as they develop in the future. The discovery of conflicts by the compliance department is particularly difficult because often compliance personnel are not in contact with third parties from which conflicts develop. Relationships with parties by marketing, investment banking or other departments are where the conflicts develop. In seeking investment banking business from an issuer, investment banking personnel must necessarily interact with its senior executives and other decision makers. This may inadvertently lead to possible conflicts if the senior executives are given privileged status at the broker-dealer in connection with IPOs, other investments or special treatment. This preferential treatment may not necessarily be inappropriate but it must be carefully examined because on the other hand, the broker-dealer may have obligations to customers that purchase and sell securities through the firm based on recommendations of the broker-dealer. In such case, if the broker-dealer is recommending a particular issuer with which it does investment banking securities, it will have an obligation to disclose any material conflicts to its customers. Conflicts abound with persons who may direct brokerage or investment banking business to the firm. These are only a few of the examples that have surfaced recently. These conflict relationships need to be identified, the extent of the conflict identified and appropriate disclosures made in one form or another. In some cases, required consents may not be obtainable. Consequently, the activities must cease or be changed to eliminate the conflict. The best way for the compliance department to effectively identify conflicts is by education of the business personnel of the potential for conflicts and require that they be brought to the attention of the compliance department at an early date before business activities are undertaken.

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