

William C. Alsover, Jr.
Chairman

NASD Small Firm Advisory Board

Dear Small Firm Member,

On behalf of NASD's Small Firm Advisory Board (SFAB), I am writing to update you on some of the key issues we faced in 2004, and what is on the horizon for 2005.

The SFAB continues to be a vigorous voice for small firms along with NASD and other regulators. We believe it is critical that regulators and policy-makers understand the costs and burdens associated with the robust regulation taking place right now. Every important rule at NASD is reviewed by the SFAB.

It struck me some time ago that changes in regulations for small firms bear a striking similarity to the formation of hurricanes. Somewhere out in the regulatory sea an abnormal weather system is spotted. When first seen, it's hard to tell whether it will develop into a tropical storm, some class of hurricane, or nothing at all. To ignore it, however, would be foolhardy.

Small firms faced several hurricanes last year, some of them severe. Mutual Funds started out as a hurricane, tapered off to a tropical storm, then gathered strength again to make it back to a category five, the most powerful storm class. Said another way, the industry worked hard to voluntarily comply with the recommendations of the Mutual Fund Breakpoint Task Force, and small firms began to develop and implement new procedures to try to eliminate missed breakpoints. NASD did a great job managing the process, and had confidence in the industry to do what was right for our clients.

Unfortunately, with the publicity that resulted from late and rapid trading, and inadequately disclosed direct and indirect payments to firms by mutual funds, the confidence of investors was shaken again. Most small firms were not directly involved, but our customers were troubled by the news.

Variable annuities never seem to hit with as much force as other storms, but if they are part of your product mix, now is the time to review and test your controls and make improvements where necessary. Don't wait for the bad weather to hit before you act.

Part of this year's forecast includes a new "storm" that has been spotted. Index annuities have come under scrutiny, due to the advertising promoting them, and complexity of the product. No matter what product members are advertising, it is a best practice to follow NASD rules.

Issues related to non-discretionary fee based brokerage accounts (fee in lieu of commission accounts) are waiting offshore. Whether they develop into something bigger will become apparent soon. We need to help clear the skies on this issue, and give guidance to firms on the appropriateness of this type of arrangement.

The SFAB continues to be a strong proponent of supplementing new rules and regulations with worksheets, checklists, and templates. The staff at NASD has worked hard to provide these, and you'll find them all listed on Small Firm Web Pages at NASD.com. Additionally, NASD has put together workshops, call-ins, and FAQs to help small firms meet the requirements of new rules and rule changes. This is the second year for the Small Firm Best Practices seminars. These are one-day meetings designed for small firms, and attended by small firms. The dates are listed on the Small Firm Web Pages.

Finally, another hurricane may be brewing. The recent SEC Concept Release on Self Regulation and its companion rule Fair Administration and Governance of Self-Regulatory Organizations could have an impact on small firms. I am sure we would all agree that having industry voices as part of NASD's governance is critical to the success and health of the industry. The SFAB is closely tracking this issue and will keep you informed on developments.

Vice Chair Lou Denton and I, along with other SFAB Members, will be attending NASD member events and workshops around the country again this year. We will also be hosting dinners for a group of Small Firm CEOs in conjunction with these events. We want to hear from you about your issues, so do not hesitate to contact us at anytime.

Regards,

A handwritten signature in black ink that reads "Bill Alsover". The signature is fluid and cursive, with a long horizontal stroke at the end.

Bill Alsover

Chairman
Small Firm Advisory Board