

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. CAF 030023

TO: Department of Enforcement
NASD

RE: Bear, Stearns & Co. Inc., Respondent, CRD No. 79

Pursuant to Rule 9216 of the NASD Code of Procedure, Respondent Bear, Stearns & Co. Inc. ("Respondent," "Bear Stearns" or the "Firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against Respondent alleging violations based on the same factual findings.

Respondent understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council ("NAC"), pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
3. If accepted:
 - a. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against Respondent;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Respondent's disciplinary record;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any allegation in this AWC or creating the impression that the AWC is without factual basis. Nothing in

this provision affects the testimonial obligations or right of Respondent to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

Respondent also understands that its experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC:

Bear Stearns is a registered broker dealer and has been a member of the NASD since 1936. It is a Delaware corporation with its principal place of business in New York, New York. Bear Stearns is a subsidiary of The Bear Stearns Companies, Inc. and provides equity research, sales, and trading services; merger and acquisition advisory services; venture capital services; and underwriting services.

Bear Stearns has no relevant disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against it;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission ("Commission") and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudice of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of

this AWC, including its acceptance or rejection.

II.

ACCEPTANCE AND CONSENT

Bear Stearns hereby accepts and consents, without admitting or denying the allegations or findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NASD:

A. Overview

During the time period July 1, 1999 to June 30, 2001 (the “relevant period”), Bear Stearns sought and did investment banking (“IB”) business with many companies covered by its research. Research analysts were encouraged to participate in IB activities, and that was a factor considered in the analysts’ compensation system. In addition, the decision to initiate and maintain research coverage of certain companies was in some cases coordinated with the IB Department and influenced by IB interests.

As a result of the foregoing, certain research analysts at the Firm were subjected to IB influences and conflicts of interest between supporting the IB business at the Firm and publishing objective research.

The Firm had knowledge of these IB influences and conflicts of interest yet failed to establish and maintain adequate policies, systems and procedures that were reasonably designed to detect and prevent the influences and manage the conflicts.

B. Research Analyst Participation in Investment Banking Activities

Research analysts were responsible for providing analyses of the financial outlook of particular companies in the context of the business sectors in which those companies operated and the securities market as a whole.

Research analysts evaluated companies by, among other things, examining financial information contained in public filings, questioning company management, investigating customer and supplier relationships, evaluating companies’ business plans and the products or services offered, building financial models and analyzing competitive trends.

After synthesizing and analyzing this information, analysts produced research in the form of full reports and more abbreviated formats that typically contained a recommendation, a price target, and a summary and analysis of the factors relied upon by the analyst.

The Firm distributed its analysts' research internally to various departments at the Firm and externally to the Firm's retail and institutional investing clients. In addition, the Firm sold some of its research directly to non-clients, disseminated it through distribution agreements with other broker dealers, made it available to third party subscription services such as First Call, and offered it for sale via market websites such as MultexInvestor.

In addition to performing research functions, certain research analysts participated or assisted in IB activities. These IB activities included identifying companies as prospects for IB services, participating in "pitches"¹ of IB services to companies, attending "road shows"² associated with underwriting transactions, and speaking to investors to generate interest in underwriting transactions.

In preparation for each "pitch" the bankers, with the analyst's input, prepared a "pitch book" which was distributed at the meeting and contained a summary of the Firm's presentation.

The pitch books, in some instances, identified the covering analyst by name, provided information about that analyst's background and reputation, sometimes characterizing the analyst as the "ax" in his or her coverage sector, and highlighted the success of Bear Stearns' underwritten IPOs covered by the analyst. The pitch books also highlighted such factors as the number of lead and co-managed IPOs that the Firm currently had under research coverage. This information was intended to convey to the issuer that such treatment would be accorded to it if Bear Stearns received the mandate for the IB transaction.

The analyst's reputation played a role in pitching the Firm's IB services to potential clients. Issuers often chose an investment bank because of the reputation of the analyst that would cover the company's stock.

The pitch to an issuer by the research analyst contributed to Bear Stearns' ability to win investment banking deals and receive investment banking fees from that and subsequent investment banking relationships.

¹ A "pitch" is a presentation made by bankers and research analysts to a potential IB client in order to obtain the mandate for an upcoming IB transaction. In competing for an IB mandate, the Firm typically sent bankers and the analyst to meet with company management to persuade the company to select the Firm as one of the investment bankers in a contemplated transaction. At these "pitch" meetings Firm bankers would present their level of expertise in the company's sector and discuss their previous experience with other such companies, as well as their view of the company's merits and likelihood of success.

² A "road show" is a series of presentations made to potential investors in conjunction with the marketing of an upcoming underwriting.

The investment banking division at Bear Stearns advised corporate clients and helped them execute various financial transactions, including the issuance of stock and other securities. Bear Stearns frequently served as the lead or as a co-lead underwriter in initial public offerings ("IPOs") -- the first public issuance of stock of a company that has not previously been publicly traded -- and follow-on offering of securities.

During the relevant period, investment banking was an important source of revenues and profits for Bear Stearns. In 2000, investment banking generated more than \$965 million in net revenues, or approximately eighteen percent of Bear Stearns' total net revenues.

The IB activities in which analysts participated also included participating in commitment committee³ and due diligence activities in connection with underwriting transactions and from time to time assisting the IB Department in providing merger and acquisition ("M&A") and other advisory services to companies.

The Firm encouraged research analysts to support the IB and other businesses of the Firm. With regard to IB, research analysts were encouraged to work in partnership with the IB Department by participating in the foregoing IB activities, and the level of certain research analysts' participation in these IB activities was sometimes significant.

- On September 23, 1999, the Head of Research provided research analysts with guidelines to follow in drafting their business plans. The guidelines stated they were "designed to help [the research analysts] focus on executing and delivering [their] goals, improving [their] overall contribution to the firm and enhancing [their] relationships with [their] partners throughout the firm." These guidelines requested the research analysts to describe their contributions to nine separate areas of the Firm's business. With respect to the area identified as "Banking," the guidelines stated: "After your business plan meeting with your bankers please discuss any ideas you have generated for deal origination and timing of coverage for existing or proposed corporate relationships. Include or attach to your business plan a list of stocks you and your corporate finance team have agreed upon as priorities. Include plans to help market transactions or to introduce M&A activity. Discuss any plans to drop coverage where there is no longer a strategic fit."
- In her 1997/1998 business plan, an analyst stated, "If I were any more aggressive in the banking area, my office would be on the third floor [location of IB offices of the Firm]."

³ The "commitment committee" was responsible for, among other things, evaluating and determining the Firm's participation in IPOs and other IB transactions.

In connection with their participation in IB activities, certain research analysts and investment bankers ("bankers") communicated, in various frequency and extent, through meetings and via telephone and electronic mail ("e-mail").

The IB department at the Firm was organized into industry groups that corresponded to certain research sectors. Research analysts were aware that, in certain circumstances, their positive and continued coverage of particular companies was an important factor for the generation of investment banking business. Thus, some research analysts and investment bankers coordinated the initiation and maintenance of research coverage, based upon, among other things, investment banking considerations.

- On February 9, 2000, two bankers and an analyst submitted a joint business plan to the co-heads of the IB technology group. The stated purpose of the memorandum was to "describe a strategy for investment banking and research coverage and coordination of companies which provide Internet enabling technologies. The near-term goal is to establish an organized and prioritized calling effort with an emphasis on cultivating fewer and deeper, lead managed relationships." [Emphasis in original.]

C. Participation in Investment Banking Activities was a Factor in Evaluating and Compensating Research Analysts

The compensation system at the Firm provided an incentive for research analysts to contribute to all areas of the Firm's business, including participating in IB activities and assisting in generating IB business for the Firm. Research analysts' participation in IB activities was one of several factors considered in determining their compensation. Notes of staff meetings reflect the following statements by the Head of Research to analysts:

- "I'd like to remind everyone how you get paid at Bear Stearns. It is based on your contribution to your team and your contribution to the firm . . . Notice that being a partner with banking is part of the analyst job description. You are not compared or matrixed or in any way paid on a formula. Working on transactions is not incremental to your compensation, it is an expected part of it."
- "I need to remind you that investment banking revenues are not incremental to your bonus. Being a partner to banking is part of your job. You are paid on performance and based on your contribution to the firm."

The performance of research analysts was evaluated through an annual review process. Where not set by contract, the research analyst's salary and annual bonus were also determined through this process.

Information on the analyst's job performance was gathered through annual self-evaluations, analyst's business plans, surveys of management, and trading and institutional sales department personnel, e-mail and oral feedback from employees in the IB and other departments at the Firm, and the Firm's institutional clients.

The research analysts' annual business plans contained, among other things, their contributions to various areas of the Firm, including IB, for the past year, and their plans for improving their contribution to these areas of the Firm, including IB, in the coming year.

In their self-evaluations, which were used to communicate their accomplishments to and petition management for increased compensation analysts discussed such areas as their rankings in independent research polls, the scope of their research coverage, their participation in industry conferences, and the Firm's Autex rankings in stocks they covered. Certain research analysts provided extensive information regarding their assistance to IB, including accomplishments, goals, and participation in lead- and co-managed underwritings, and sometimes also including the revenues to the Firm associated with the IB transactions on which the analyst worked. In addition, analysts were occasionally requested to inform research management of fees generated by the IB transactions on which they worked.

- In an October 24, 2000 e-mail to the Head of Research, a senior analyst summarized his nine key accomplishments during fiscal year 2000. The first and largest point, which dealt with his contributions to IB, stated as follows: "*Corporate finance: generated over \$23 million in fees to the firm in nine separate transactions: *Storage networking: identified a new financial opportunity for the firm, which resulted in six transactions... I should be designated as a finder for Ancor [Ancor Communications], JNI [JNI Corp.] and Vixel [Vixel Corp.]. *iAppliances: identified a new industry category ...which was a source of two IPOs... *Agilent [Agilent Technologies]: I should be designated as a finder -- or at least a save for Agilent. BS pitched the business and lost. I went in and re-won the business, generated fees of around \$2.5 million to the firm." The e-mail to the Head of Research included a spreadsheet listing the IB transactions on which he had worked and the associated revenues to the Firm. The Head of Research praised the format of the summary and suggested she might have all research analysts submit theirs in the same form.
- In a June 21, 2001 e-mail from a member of the research management staff, the research analysts were requested to submit information regarding all banking transactions that had closed or that were pending in their sectors during the prior 6 month period.

Certain research analysts perceived that the amount of their bonus would be influenced by their contribution to and impact on the firm's IB business, and the fees generated by IB transactions on which they worked.

Research analysts were encouraged to support and assist all areas of the Firm and to participate in IB activities and activities that enhanced the reputation of the Firm's IB business. Based upon statements by research management indicating that partnership with banking was part of their job as research analysts, the inclusion of a "Banking" section in their annual business plans, information regarding IB transactions in their self-evaluations, and requests from research management for specific information regarding IB transactions in their coverage sectors, certain research analysts believed that the revenues generated by their participation in IB activities was an important factor in their evaluations and compensation. Accordingly, some research analysts were encouraged to participate in IB activities, increase IB revenues, and enhance the reputation of the Firm, including its IB business.

Research Analysts' salaries and bonuses were determined by a multiple factor-based approach. Among other things, analysts were judged for compensation purposes based on the performance of their stock picks, their impact on the buy-side accounts as measured by votes, the Firm's market share in trading volume in the stocks they covered, their participation in IB activities, and the fees and secondary trading commissions generated from those activities were considered.

D. Investment Banking Interests Influenced the Firm's Decisions to Initiate and Maintain Research Coverage

In general, the Firm determined whether to initiate and maintain research coverage based upon institutional investors' interest in the company, and the company's importance to the sector or IB considerations, such as attracting companies to the Firm to generate IB business or maintaining a positive relationship with existing IB clients.

The nature and duration of research coverage were important criteria for a company's choice of a broker dealer for IB services. The pitch books typically contained information stating, among other things, that: "an important element to successfully executing an IPO is having an assurance that the Firm will provide research coverage to the IPO candidate in the offering and in the aftermarket."

The Firm generally initiated coverage on companies that engaged the Firm in an IB transaction. In pitching for IB business, the Firm sometimes represented to the company the frequency with which reports would be issued.

The Firm's ratings system, which was intended to reflect the long-term prospects of a rated stock, allowed research analysts to assign one of five ratings to a stock: (1) "Buy" - Expected to outperform the local market by 20% in the next 12 months. Strong

conviction and typically accompanied by an identifiable catalyst; (2) "Attractive" - Expected to outperform the local market by 10% or more, it is usually more difficult to identify the catalyst; (3) "Neutral" - Expected to perform in line with the local market; (4) "Unattractive" - Expected to underperform the local market; and (5) "Sell" - Avoid the stock.

During the relevant period, there was a sharp downturn in the stock market and stocks in selected sectors performed poorly. During this period, the Firm did not issue ratings of "Unattractive" or "Sell" in connection with any covered companies in the selected sectors.

Research management communicated with IB management to ensure that research opportunities were appropriately aligned with identified IB opportunities.

The Stock Selection Committee was ultimately responsible for making the determination to initiate coverage of a given company. The Head of Research was ultimately responsible for making the determination to maintain research coverage. Nonetheless, IB considerations sometimes influenced the decision to initiate and maintain coverage.

Some research analysts and bankers actively coordinated the initiation and maintenance of research coverage based upon, among other things, IB considerations. This coordination consisted of meetings and communications by telephone and e-mail.

In some circumstances, research coverage was initiated based on IB considerations.

- In an April 19, 2000 e-mail from a member of his staff, the head of the IB Technology Group communicated the following to the Heads of Research and IB as well as numerous analysts and bankers: "[Analyst A] and [Analyst B] agree that [Analyst B] will be the analyst covering CacheFlo [Cacheflow]. [Banker] and [Analyst B] will discuss with CacheFlo what the planned timing of their offering will be so as to insure that if we initiate coverage in advance of the transaction we will not be prohibited from being an underwriter. [Analyst B] and [Banker] will also stress to the company that if we initiate coverage we expect our position in the company's future financing and strategy actions to be materially improved."

Given that research analysts participated in determining in which IB transactions in their sectors the Firm would participate, if the Firm determined to participate in an equity offering for a company, it was expected the company would qualify for an initial "Buy" rating.

An analyst who anticipated initiating coverage of such a company with less than a "Buy" rating informed IB in advance as follows.

- In a February 8, 2000 e-mail to bankers and the Head of Research, this analyst stated: "Just wanted to be sure that everyone knows that we will be using an Attractive rating on go.com. If anyone has any comments or issues, please let me know."
- In a March 17, 2000 e-mail to research analysts, an associate analyst stated: "I talked to [the liaison between research and IB] and we have the go ahead to initiate on IPET [Pets.com] with an Attractive rating. According to [the liaison] we should explain somewhere in the text, why our opinion about the company's prospects have changed from the time we initiated coverage."⁴
- In his annual evaluation, this analyst was criticized as follows: "Has been working poorly w/bankers - in changing opinions after the firm has committed to co. mgmts". The analyst testified that he believed the statement related to his communicating his opinions regarding companies to bankers in a timely manner, and that if his opinion regarding a company changed from a more positive opinion to a more negative opinion about a company after a banker had already made some sort of commitment to a company, it made life difficult for the banker and was not ideal from his standpoint. He went on to testify that, particularly in his highly volatile sector, companies often changed a lot between the time of the first organizational meeting and the date of the IPO.

In some circumstances, the determination to maintain research was influenced by IB considerations.

- Due to IB influences a supervisory analyst perceived and communicated to others that IB approval was required before coverage could be dropped. In response to an inquiry by an associate analyst regarding dropping coverage of 2 companies, a supervisory analyst stated in an April 19, 2002 e-mail: "[The Head of Research] says before dropping coverage, you need to get permission from both: 1. the market makers on the trading desk, 2. the bankers."
- In an April 3, 2000 e-mail to the Heads of Research and IB as well as numerous members of both departments, a banker discussed a company's decision to exclude the Firm from a follow-on offering. He

⁴ In fact, Bear Stearns had not yet initiated coverage on IPET at the time this e-mail was sent.

stated: "I expressed significant disappointment with the fact that they neglected to discuss this issue with us prior to this time and that they left us no choice but to drop research coverage and trading, since they obviously did not value our support to date. [Analyst] - As we discussed, feel free to drop at any time. I told the CFO that you would likely put out a note, but did not know when." In a follow-up e-mail the Head of Research stated that she agreed with the decision to drop coverage. The analyst ultimately determined not to drop coverage.

E. Research Analysts Were Visible on Stocks to Generate Investment Banking Business

Issuers also considered investment banks' aftermarket trading support as a factor in selecting an investment bank. The Firm's trading volume and trading rank were factors it promoted to IB clients in pitch presentations.

The Firm distributed to sales and trading personnel and research analysts the "Trading Focus List," which contained stocks of companies from which the Firm was seeking or with which the Firm had IB business.

A research analyst actively marketed companies on the Trading Focus List in order to obtain IB business.

- In a December 10, 1999 e-mail, an analyst wrote the following to Equity Trading copied to the Heads of Research and IB: "Subject: Pls make the trading of Packeteer a top priority. I spent two days with Packeteer ('PKTR') management this week visiting investors. Management are extremely happy with our research coverage and banking services. But they have repeatedly indicated to me that our trading stat. is not satisfactory...CEO hinted to me many times that we have a chance for the books for the secondary if we improve the trading...They are likely to do a secondary in Q1 - mostly likely late January/early February; could be as much as \$200 MM deal. Please help us in improving our trading immediately. We will do whatever it takes from the research side."
- In a September 14, 2000 e-mail to Equity Trading the same analyst wrote the following regarding banking client SonicWall ("SNWL"): "We need help in boosting our trading stat for SNWL. Both management and their VC called me yesterday complaining about our trading - #2 in August and #3 so far in September. More importantly, they argued that we are not supporting the stock when it is weak...I made a positive call on Monday but am not getting much support. Pls help us here since this important technology client indicated to me that if we do not improve, it will hurt our banking relationship with the company."

- In a March 8, 2001 e-mail the same analyst again wrote to Equity Trading regarding two IB clients he covered: "Subject: MUSE [Micromuse] and ISSX [Internet Security Systems] autex - both on focus list. On MUSE - we dropped from #3 or 4 in 2000 to #10 in Feb and March to date. I just called the trader to see what we can do. I have been extremely active on the name- took management to Boston, Denver, Minneapolis and KC in February alone. Do not quite understand. Pls follow up. ISSX - we dropped from #2 or #3...to #11 in March. I am very active on ISSX also. Thanks for your help on this." Equity Trading responded: "What do you want me to do? Get some orders on the stock yourself. Generate some order flow!!" The analyst replied: "I am trying...but are the traders on these two stocks good?"

In order to raise or maintain the Firm's visibility on stocks with which the Firm wanted to do IB business, certain research analysts nominated companies to participate at Firm sponsored conferences, took company managements on non-deal road shows, hosted field trips for institutional investors to companies' headquarters and arranged other meetings between institutional investor clients and companies.

Research analysts were visible on stocks of companies with which the Firm wanted to do IB business in order to generate IB business.

F. Research Analysts Were Subject to Pressure by Covered Companies

Certain research analysts communicated regularly with employees of the companies that they covered, including executive and senior management of those companies. These communications occurred through telephone and e-mail exchanges, company-sponsored events, and analyst calls.

Research analysts were sometimes subject to pressure from companies they covered to issue better ratings and recommendations. Research analysts understood that negative ratings and recommendations could adversely affect the Firm's ability to attract and retain IB business from those companies.

- On November 2, 2000, in his 2000 self-evaluation an analyst wrote in a section entitled "Areas to Improve: We want our banking clients to know that our research is objective and independent but always sensitive to their best interests. There have been instances in my career where certain banking clients felt that our research and public comments weren't sensitive to their interests. This is a very important issue for us and we take it most seriously. We will continue to make every effort to be sensitive to our clients and our banking partners."

When research analysts downgraded or issued a negative comment on a banking client, they sometimes received direct feedback from high-ranking company officials.

- In an August 24, 2000 e-mail, a banking client responding to a downgrade of his company wrote: "Your earnings estimates are on track, however, given the downgrade, I sure would have liked to see you give us a lower bar on revenue...[W]hile we affirmed the revenue estimate, they were definitely a stretch. Seems a shame to waste a downgrade by not buying the opportunity for us both to over-perform going forward..."

G. In Certain Instances, the Firm Published Exaggerated or Unwarranted Research

On several occasions, the conflicts of interest discussed above resulted in analysts publishing recommendations and/or ratings that were exaggerated or unwarranted, and/or contained opinions for which there was no reasonable basis. The following are examples of how these conflicts affected the research.

- Bear Stearns lead managed the IPO and secondary offerings for SonicWall in November 1999 and March 2000 respectively. An analyst rated the stock a "Buy" from the IPO until April 2002. In January 25, 2001 while they were participating in a SonicWall conference call the analyst stated to his associate: "I am trying to make them look good...on the dso and the growth etc." A few minutes later he added: "we got paid for this...and I am going to Cancun tomorrow b/c of them!"
- Bear Stearns initiated coverage of MUSE with an "Attractive" rating in September 1999, raised the rating to a "Buy" in January 2000 and maintained a "Buy" rating on the stock until July 2002. While listening to a MUSE analyst call on July 18, 2001, an analyst suggested to his associate that he was going to downgrade his rating on the stock to "Attractive". The associate disagreed with the suggestion and the analyst responded that the stock was "dead money!" However, the analyst did not downgrade his rating on the stock, instead issuing research the same day maintaining his "Buy" rating.
- Bear Stearns lead managed the IPO for CAIS Internet, Inc. in May 1999. The analyst rated the stock a "Buy" from the IPO through his last report on the company in November 2000. On January 24, 2001, in response to an e-mail reporting extensive service failures at CAIS the analyst stated: "Any other scoop on this piece of shit?" A few days later, in response to an institutional client's request for his thoughts on CAIS' 4th quarter, the

analyst stated: "It's up a lot year to date...don't overstay your welcome on this one."

- Bear Stearns co-managed the IPO and secondary offerings for Digital River in August and December 1998 respectively. The Firm, via three successive analysts, rated the stock a "Buy" from the IPO until April 2002. In an April 1, 2002 e-mail to his IB counterpart an analyst stated: "I have to tell you, I feel a bit compromised today. I have told every client on the phone that they should avoid or short the stock over the last few months. I have been fairly hands-off on DRIV [Digital River, a stock under his coverage], primarily because of the banking prospect that you and [Another Banker] have noted. Today, clearly the stock is down a lot. The artificial Buy rating on the stock, while artificial, still makes me look bad. In the future, I'd like to have more leeway with the ratings, even for companies like Digital River, where we have a relationship on the banking side. I trust it would benefit all of us."

H. The Firm Made Payment for Research

In August 2000, as part of an offering that took place in May 2000, the Firm made a payment of \$102,750 to another broker-dealer in connection with research coverage it provided for Andrx Corp. ("ADRX"), a Bear Stearns' investment banking client in connection with an underwriting transaction for which Bear Stearns was a lead manager.

Bear Stearns did not take steps to ensure that this broker-dealer disclosed in its research that it had been paid to issue research on ADRX. Further Bear Stearns did not disclose or cause to be disclosed the details of this payment.

I. Bear Stearns Failed to Adequately Supervise Its Research and Investment Banking Departments

While the role of the research analysts was to produce objective research, the Firm also encouraged them to participate in IB activities. As a result of the foregoing, research analysts were subject to IB influences and conflicts of interest between supporting the IB business at the Firm and publishing objective research.

The Firm had knowledge of these IB influences and conflicts of interest yet failed to manage them adequately to protect the objectivity of its published research.

Bear Stearns failed to establish and maintain adequate policies, systems and procedures reasonably designed to ensure the objectivity of its published research. Although Bear Stearns had some policies governing research analyst activities during

the relevant period, these policies were inadequate and did not address the conflicts of interest that existed.

J. Violations

Violation of NASD Conduct Rules Due to Conflicts of Interest Resulting from Investment Banking Influence over Research Analysts. NASD Conduct Rule 2110 requires members to observe high standards of commercial honor and just and equitable principles of trade. As described above, during the relevant period, Bear Stearns engaged in acts and practices that created and/or maintained inappropriate influence by investment banking over research analysts and therefore imposed conflicts of interest on its research analysts. Bear Stearns failed to manage these conflicts in an adequate or appropriate manner. By reason of the foregoing, Bear Stearns violated NASD Conduct Rule 2110.

Violation of NASD Conduct Rules by Publishing Exaggerated or Unwarranted Research. NASD Conduct Rules 2210 (d)(1) and (2) prohibit members from making exaggerated or unwarranted claims in public communications and requires members to have a reasonable basis for all recommendations made in advertisements and sales literature. As described above, in several instances Bear Stearns issued certain research reports for companies that were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts, contained exaggerated or unwarranted claims about these companies, and/or contained opinions for which there was no reasonable basis. By reason of the foregoing, Bear Stearns violated NASD Conduct Rules 2110, 2210(d)(1) and 2210(d)(2).

Violation of NASD Conduct Rules by Paying Underwriting Fees to Another Broker-Dealer for Research. As described above, Bear Stearns failed to disclose or cause to be disclosed in offering documents or elsewhere a payment for research to another broker-dealer in connection with an underwriting transaction. By reason of the foregoing, Bear Stearns violated NASD Conduct Rules 2110 and 2210(d)(1)(A).

Violation of NASD Conduct Rules by Failing to Supervise. NASD Conduct Rule 3010(a) requires members, among other things, to “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” NASD’s own Rules. As described above, Bear Stearns failed to establish and maintain adequate policies, systems, and procedures for supervision and control of its Research and Investment Banking Departments reasonably designed to detect and prevent the foregoing investment banking influence and manage the conflicts of interest, including a separate system of follow-up and review to assure compliance with applicable NASD Rules. By reason of the foregoing, Bear Stearns violated NASD Conduct Rule 3010(a).

L. Sanctions

Bear Stearns consents to the imposition, at a maximum, of the following sanctions:

- a. a censure and
- b. a total payment of \$80,000,000, as specified in the Final Judgment ordered in a related action filed by the Securities and Exchange Commission ("Final Judgment"), as follows:
 - (1) \$25,000,000, as a fine;
 - (2) \$25,000,000, as disgorgement of commissions, fees and other monies;
 - (3) \$25,000,000, to be used for the procurement of Independent Research, as described in Addendum A: Undertaking to the Final Judgment ("Addendum A"); and
 - (4) \$5,000,000, to be used for investor education as described in the Final Judgment.

The monetary sanctions imposed by NASD shall be reduced by the amounts paid by Respondent pursuant to the Final Judgment. Addendum A and the payment provisions of the Final Judgment are incorporated herein by reference.

Respondent agrees that it shall not seek or accept, directly or indirectly, reimbursement or indemnification, including but not limited to payment made pursuant to any insurance policy, with regard to any fine/penalty amounts that Respondent shall pay pursuant to Section II of the Final Judgment, regardless of whether such fine/penalty amounts or any part thereof are added to the Distribution Fund Account or otherwise used for the benefit of investors. Respondent further agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with regard to any federal, state, or local tax for any fine/penalty amounts that Respondent shall pay pursuant to Section II of the Final Judgment, regardless of whether such fine/penalty amounts or any part thereof are added to the Distribution Fund Account or otherwise used for the benefit of investors. Respondent understands and acknowledges that these provisions are not intended to imply that NASD would agree that any other amounts Respondent shall pay pursuant to the Final Judgment may be reimbursed or indemnified (whether pursuant to an insurance policy or otherwise) under applicable law or may be the basis for any tax deduction or tax credit with regard to any federal, state, or local tax.

The sanctions imposed herein shall be effective on a date set by NASD staff.

III.

OTHER MATTERS

Respondent understands that it may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. It understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.

Respondent certifies that it has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce Respondent to submit it.

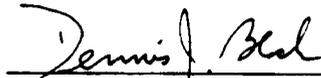
Bear, Stearns & Co. Inc.

Date: April 21, 2003



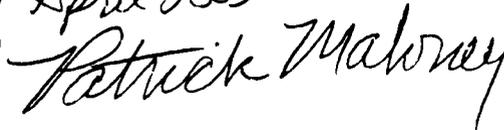
Mark E. Lehman
General Counsel

Reviewed by:



Dennis J. Block, Esq.
Cadwalader, Wickersham & Taft
100 Maiden Lane
New York, New York 10038

Sworn before me this 21st day
of April 2003

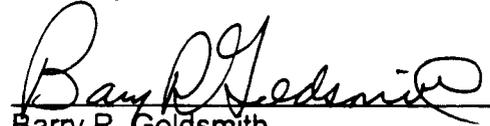


PATRICK B. MALONEY
Notary Public, State of New York
No. 02MAS011777
Qualified in Westchester County
Certificate Filed in New York County
Commission Expires: 6/15/03

Accepted by NASD:

On behalf of the Director of the Office of
Disciplinary Affairs, through delegated
authority,

4/24/03
Date



Barry R. Goldsmith
Executive Vice President
Department of Enforcement
NASD
1801 K St. NW
Washington, DC 20006