

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2937 (WHP)

BEAR, STEARNS & CO. INC., :

Defendant. :

**RESPONSE OF NASD  
INVESTOR EDUCATION  
FOUNDATION TO  
COMMENTARY OF  
INVESTOR PROTECTION  
TRUST**

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2938 (WHP)

JACK BENJAMIN GRUBMAN, :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2939 (WHP)

J.P. MORGAN SECURITIES INC., :

Defendant. :

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UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2940 (WHP)

LEHMAN BROTHERS INC., :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2941 (WHP)

MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2942 (WHP)

U.S. BANCORP PIPER JAFFRAY INC., :

Defendant. :

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UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2943 (WHP)

UBS SECURITIES LLC, :

f/k/a UBS WARBURG LLC, :

Defendant. :

----- X

SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2944 (WHP)

GOLDMAN, SACHS & CO., :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2945 (WHP)

CITIGROUP GLOBAL MARKETS INC., :

f/k/a SALOMON SMITH BARNEY, :

Defendant. :

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UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2946 (WHP)

CREDIT SUISSE FIRST BOSTON LLC, :  
f/k/a CREDIT SUISSE FIRST BOSTON :  
CORPORATION, :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2947 (WHP)

HENRY McELVEY BLODGET, :

Defendant. :

----- X

SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- :

03 Civ. 2948 (WHP)

MORGAN STANLEY & CO. INCORPORATED, :

Defendant. :

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**RESPONSE OF NASD INVESTOR EDUCATION FOUNDATION  
TO COMMENTARY OF INVESTOR PROTECTION TRUST**

Third Party NASD Investor Education Foundation (“NASD Foundation” or “Foundation”) hereby submits this Response to the filing of the Investor Protection Trust (“IPT”) dated June 2, 2005.

**I. INTRODUCTION**

The purpose of this submission is twofold, and supplements the NASD Foundation materials submitted to this Court on June 3, 2005. *See* Certification of NASD Investor Education Foundation Business Records (“Certification”), dated June 2, 2005, and exhibits attached thereto. IPT has raised two principal questions about the NASD Foundation: its independence from the securities industry, and its experience in awarding grants for investor education. The NASD Foundation will address both of these questions.

First, the NASD Foundation is in the process of changing the composition of its Board of Directors to require that a majority of the members of the Foundation Board be members of the public who are not employed by a securities regulator, and who have no material business relationship with the securities industry. The changes, which would amend the Foundation’s Certificate of Incorporation and By-Laws, have been submitted for approval to the Foundation’s Board and the Executive Committee of the Board of Governors of NASD. Upon receipt of these approvals, and upon receipt of the Court’s approval of the Securities and Exchange Commission’s (“SEC”) proposed Order directing that funds be transferred and in the future paid to the NASD Foundation under the terms of the proposed Order, the Foundation is prepared to file the necessary documents in Delaware within one business day.

Second, the NASD Foundation will describe its nationwide grant program, which is aimed at investor groups who may have been underserved by previous investor education programs. This

information will demonstrate that, although the NASD Foundation was formed more recently than IPT<sup>1</sup>, the NASD Foundation awarded over \$1.1 million in grants in 2004 alone, has already conducted significant and publicly important activity in the area of investor education, and is well situated to carry out the responsibilities entrusted to the Foundation by the proposed SEC Settlement.

IPT misunderstands the character of NASD and the Foundation. IPT characterizes the Foundation as “the creation not of regulators or other actors in the public interest, but rather of the securities industry” (IPT Commentary at 7). NASD is not the securities industry; it is a body formed under the authority of federal law to regulate the securities industry. The Foundation is a legal entity separate from NASD, and was created for the sole purpose of investor education. Far from being “of the securities industry,” the NASD Foundation’s funding comes from disciplinary fines levied by NASD against securities firms for violation of securities laws and regulations.

From its inception, the Foundation has been prohibited from granting any funds to any person or organization affiliated with the securities industry. Moreover, as set forth below, the NASD Foundation’s Board of Directors will, upon this Court’s approval of the Settlement, be composed of a majority of public Directors who are not regulators and who have no material business relationship with the securities industry, and are not employed by NASD itself. And, while IPT states that there is a “problem of how the NASD Foundation is likely to be perceived by the public” and that it is “more difficult for the NASD Foundation to present itself as a neutral actor in the public interest” (*id.*), it provides no support for those statements. Indeed, it has been clear since the Foundation’s formation that it is exactly what it is created to be – an entity devoted exclusively to serving the public interest through investor education.

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<sup>1</sup> IPT was formed in 1993, but began awarding investor education grants in 2004 at about the same time the NASD Foundation started awarding grants.

## II. NASD FOUNDATION'S GOVERNANCE CHANGES

IPT has raised an issue about the governance of the NASD Foundation and its purported “ties” to the securities industry. At the outset, the NASD Foundation notes that the National Association of Securities Dealers, Inc. (“NASD”) is a not-for-profit self-regulatory organization registered with the SEC as a national securities association pursuant to Section 15A of the Securities Exchange Act of 1934. NASD’s securities regulatory activities have been noted by numerous judges in this Court, and by the Second Circuit. *D.L. Cromwell Investments, Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 157 (2d Cir. 2002); *Datek Securities Corp. v. National Association of Securities Dealers, Inc.*, 875 F. Supp. 230, 232 (S.D.N.Y. 1995); *American Benefits Group, Inc. v. National Association of Securities Dealers, Inc.*, No. 99 Civ. 4733 (JGK), 1999 U.S. Dist. LEXIS 12321 (S.D.N.Y. Aug. 10, 1999). NASD is governed by a Board of Governors, the majority of whom are not affiliated with the securities industry. NASD By-Laws, Art. VII, Sec. (4)(a), NASD Manual (CCH).

The NASD Foundation is a separate Delaware nonstock corporation, with a separate Board of Directors that alone determines the funding priorities and grants made by the Foundation. The extensive Foundation Grant Guidelines (Certification, Exhibit D. p. 4) specifically prohibit awards of NASD Foundation money to, *inter alia*, securities firms or foundations affiliated with securities firms; individuals or entities affiliated with current members of the Foundation Board or NASD Board of Governors; and securities regulators, securities self-regulatory organizations, and securities trade associations. The Foundation’s By-Laws prohibit the NASD Foundation from donating money for political purposes, or allowing the name or facilities of the NASD Foundation to aid any political party or candidate. Certification, Exhibit A, NASD Foundation By-Laws, Article IX. The Foundation is funded by disciplinary fines levied by NASD against securities firms who violate securities laws and NASD Rules.

As shown in Section III below, the NASD Foundation, with its present governance structure and strict grant guidelines, has established a track record of independent grant making to benefit the public investor. The NASD Foundation presently has five Directors: Robert R. Glauber, Chairman & CEO, NASD; David W. Hunter, Chairman, Hunter Associates, Inc.; Dallas L. Salisbury, President & CEO, Employee Benefit Research Institute; Mary L. Schapiro, Vice Chairman & President, Regulatory Policy & Oversight, NASD; and Elisse B. Walter, Executive Vice President, Regulatory Policy & Programs, NASD.

To administer the funds contemplated by the SEC settlement, the NASD Foundation has agreed to amend its Board composition so that the Foundation will be governed by a majority of public Board members who are not regulators and not part of the securities industry. This will be accomplished in three steps:

- The number of Board members will be increased from five to seven.
- Elisse B. Walter, who is an NASD employee, will resign from the Board, leaving open her position and the two new positions.
- The Foundation will add three new public Board members, who along with current public Board member Dallas Salisbury will form a majority of public Board members on the Foundation Board.

These proposed changes have been approved in principle by the Foundation Board. Certification, Exhibit C, Unanimous Written Consent Forms executed by each Foundation Director. The necessary changes to the Foundation Certificate of Incorporation and By-Laws have been submitted for approval to the Foundation Board, and to the Executive Committee of the NASD Board of Governors, and approval is expected within several days. Upon receipt of the approvals and the Court's Order approving the proposed SEC Settlement, the Foundation will file an amended Certificate of Incorporation with the State

of Delaware. All of the necessary corporate documents have been drafted and await only this Court's approval. The Foundation is in the process of identifying and approaching possible public Board members, and anticipates that the reconstituted Board will be appointed no later than 30 days following the entry of the Court's Order.

The addition of public members to the NASD Foundation's Board of Directors will enhance the Foundation's already solid reputation for making independent grants and benefiting the cause of investor education. Exhibits 1-3, attached hereto.

### **III. NASD FOUNDATION'S INVESTOR EDUCATION ACTIVITIES**

The NASD Foundation was formed in December 2003 with an initial endowment from NASD of \$10 million. The NASD Foundation is a Delaware nonstock corporation registered with the IRS pursuant to Section 501(c)(4) of the Internal Revenue Code. Certification, Exhibits A and B. The Foundation's mission is "to provide investors with high-quality, easily accessible information and tools to better understand investing and the markets." Certification, Exhibit D, NASD Investor Education Foundation Grant Guidelines, p. 1. The NASD Foundation achieves its mission by making grants for "unique or creative programs that respond to unmet investor education or protection need for a target audience," and "funding for research that expands the body of knowledge in the area of investor education and protection." *Id.* at p. 2. In its Grant Guidelines (*id.* at p. 8), the Foundation directs grant writers to "explain how the completed project can be replicated to serve this [target] population on a large (preferably national) scale." In its first year, the NASD Foundation awarded over \$1.1 million in investor education grants to recipients in Massachusetts, Virginia, Washington, DC, New York, Iowa, Louisiana,

Maryland, Illinois, New Jersey and California. Certification, Exhibit H. That number is expected to increase to over \$3.5 million for grant year 2005, not counting any funds flowing from this litigation.<sup>2</sup>

In 2004, promptly after its formation and partnership with the National Endowment for Financial Education (NEFE)<sup>3</sup>, the NASD Foundation made more than \$1.1 million in grants to the following entities:

<b>Boston College Center for Retirement Research</b>		<b>Chestnut Hill, MA</b>
<b>Empowering Women: Impediments and Solutions in Financial Decision Making</b>		
Develop an interactive game-based educational program to provide investor education, with an emphasis on retirement planning, primarily to 45-60 year old women. The project is to be completed in collaboration with Northeastern University Education Technology Center and Matthew Greenwald & Associates.		
<i>Grant Amount:</i> \$150,000	<i>Year:</i> 2004	<i>Type:</i> Education
<b>Consumer Federation of America</b>		<b>Washington, DC</b>
<b>Consumer Knowledge of Mutual Fund Products and Information Services</b>		
Using feedback from experts, identify knowledge required for sound mutual fund investment decision making. Research and analyze investor knowledge levels about mutual fund products and examine educational resources currently available to the investing public. Reconvene experts to discuss the research findings, the ways consumers wish to receive the information and the resulting implications for educating investors.		
<i>Grant Amount:</i> \$73,760	<i>Year:</i> 2004	<i>Type:</i> Research

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<sup>2</sup> In addition to the \$3.5 million in grants budgeted for 2005, the Foundation expects to award additional unspecified amounts of grant money to further investor education of military personnel. These grants will come from \$6 million paid in a disciplinary fine by First Command Financial Planning to NASD in settlement of a disciplinary complaint involving the firm and members of the military who were the firm's customers. See p. 9, *infra*.

<sup>3</sup> All grant money was awarded from the NASD Foundation. NEFE's role was to assist in implementing a grant process, and to provide expertise to reviewing the grant proposals to identify projects that would fit within the investor education mission of the NASD Foundation.

<b>Education and Research Foundation of The Better Business Bureau Serving Metropolitan New York</b>	<b>New York, NY</b>
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**More Money Now: Better Credit & Longer-Lasting Dollars**

Create a national education project that will provide simple tools, in English and Spanish, to guide financial decision making. Material will discuss investment issues in a way that appeals to people who may not be seeking investment advice.

<i>Grant Amount: \$75,000</i>	<i>Year: 2004</i>	<i>Type: Education</i>
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<b>First Nations Development Institute</b>	<b>Fredericksburg, VA</b>
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**Building Native Communities: Investment Skills for Families**

Build upon the organization's culturally-appropriate financial education model to add investment education for Native American populations. In the context of development of a national model, create a curriculum and train an initial pool of Native Americans to deliver the new material.

<i>Grant Amount: \$92,070</i>	<i>Year: 2004</i>	<i>Type: Education</i>
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<b>Iowa State University</b>	<b>Ames, IA</b>
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**Understanding Significant Factors that Explain Gender Differences in Investments**

Analyze gender roles in investment behavior through a national survey examining personal, environmental, and cultural impact. Identify "teachable moments", key topics, and educational strategies and develop a set of recommendations for educators and practitioners with the goal of promoting wise investment behaviors in women.

<i>Grant Amount: \$202,708</i>	<i>Year: 2004</i>	<i>Type: Research</i>
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<b>Louisiana State University Agricultural Center</b>	<b>Baton Rouge, LA</b>
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**A Saving and Education Model for Elementary and Secondary School Employees**

Develop, implement and test a model for delivery of workplace investor education tailored to specific occupations. The initial model will be developed for and tested on K-12 school system employees, primarily women, in Louisiana.

<i>Grant Amount: \$74,492</i>	<i>Year: 2004</i>	<i>Type: Education</i>
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<b>Maryland Public Television</b>	<b>Owings Mills, MD</b>
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**Public Television Investor Education Broadcast and Outreach Initiative**

Produce 24 investor education segments to be aired weekly on Wall Street Week with FORTUNE. Also reach consumers through online investment education resources, the creation of a non-credit, adult investment curriculum, and replicable community outreach forums targeted to key underserved audiences.

<i>Grant Amount: \$100,000</i>	<i>Year: 2004</i>	<i>Type: Education</i>
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<b>Northwestern University, Bluhm Legal Clinic</b>		<b>Chicago, IL</b>
<b>Investor Protection Clinic</b>		
Establish the first securities arbitration clinic in the Midwest to provide legal representation for small investors, with limited income. Provide the framework for development and refinement of a model for the establishment, operation, and funding of arbitration clinics at law schools throughout the nation.		
<i>Grant Amount:</i> \$120,000	<i>Year:</i> 2004	<i>Type:</i> Education
<b>Princeton University, Department of Psychology</b>		<b>Princeton, NJ</b>
<b>Overcoming Psychological Biases to Promote Wise Investing</b>		
Examine psychological biases that play a role in poor investment decisions and develop and test a set of interventions to promote wise investing by mitigating these biases.		
<i>Grant Amount:</i> \$77,400	<i>Year:</i> 2004	<i>Type:</i> Research
<b>Rutgers University School of Business</b>		<b>Camden, NJ</b>
<b>Exploring Solutions to the Fund Assortment Problem</b>		
Examine the correlation between fund assortment and the quality of investment decisions. Through a national survey imitative of a 401(k) fund enrollment process, determine the role demographic, attitudinal and decision-making styles play in decision quality. Identify those investors most susceptible and test solutions to mitigate the problems created by large fund assortments in 401(k) plans.		
<i>Grant Amount:</i> \$73,404	<i>Year:</i> 2004	<i>Type:</i> Research
<b>WISE Senior Services</b>		<b>Santa Monica, CA</b>
<b>Off the Hook Again: Understanding Why the Elderly are Victimized by Economic Fraud Crimes</b>		
Conduct a series of focus groups and surveys with victims and nonvictims to learn more about why the elderly are more frequently victimized by investment fraud. Use these findings to determine if a fraud vulnerability profile exists for the elderly and, if it does, develop practical marketing messages to increase investment fraud awareness among seniors. The project is to be completed in collaboration with AARP.		
<i>Grant Amount:</i> \$127,729	<i>Year:</i> 2004	<i>Type:</i> Research

In 2005, the NASD Foundation has created four separate grant programs, which are described in more detail in NASD's June 3 submission to this Court. All of the grant programs are aimed at investor education:

- **Investor Education for the Nation's Young Adults RFP (Certification, Exhibit F)**  
Eligible organizations are invited to submit competitive grant proposals for research projects and/or educational programs that empower young adults that are about to enter the workforce to better prepare for retirement and to meet other investing goals.
- **2005 General Grant Program (Certification, Exhibit D)**  
Eligible organizations are invited to submit competitive grant proposals for research projects and/or educational programs that address the Foundation's investor education and investor protection priorities.
- **Improving Disclosure to Investors RFP (Certification, Exhibit G)**  
Eligible organizations are invited to submit competitive grant proposals for research projects that comprehensively examine what constitutes effective and meaningful disclosure to investors.
- **Investor Education for Military Personnel (not previously identified)**  
This grant program arose as a result of a joint settlement with the SEC and NASD and a securities firm, First Command Financial Planning, Inc., which was fined for securities violations to customers, most of whom were active duty and retired U.S. military personnel. Six million dollars of the fine has been directed to develop investor education programs, materials and research aimed at members of the military community. These grants will be made on a directed basis.

See Exhibit 4, attached hereto.

The SEC's proposed Order establishes strict guidelines for the use of the funds from the Settlement. These guidelines, plus the guidelines and limitations already in place at the NASD Foundation, will ensure that, if this Court approves the SEC proposed Order, the funds from the settlement will be used to fund grants that fall within the investor education target areas identified in the proposed Order.

In sum, the NASD Foundation has taken steps to change its Board of Directors so that the Foundation grant process is free of the "securities industry connections" perceived by IPT. At any rate, its history of grants and ongoing grant programs show the NASD Foundation to be precisely the "neutral, unbiased" source of investor education funds that IPT believes necessary to administer the SEC Settlement funds.<sup>4</sup> The NASD Foundation takes its mission of investor education very seriously, and will

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<sup>4</sup> Indeed, some of IPT's own education programs were developed in partnership with NASD before the Foundation was formed. IPT and NASD jointly developed The Financial Literacy 2001 and Financial Literacy 2010 programs referred to by IPT at p. 5 of its Commentary, to teach the basics of finance to high

take all necessary steps to ensure the wise and effective use of the settlement funds to promote financial intelligence and investor education.

**IV. CONCLUSION**

The NASD Foundation hopes that this information will assist the Court in making its determination concerning the proposed SEC settlement. Members of the NASD Foundation Board and Staff will attend the June 9 hearing on this matter to answer any further questions of this Court.

Dated: Washington, D.C.  
June 7, 2005

Respectfully submitted,

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school students across the country, as IPT itself acknowledges on its website. Exhibit 5, Screen prints from [www.investorprotection.org](http://www.investorprotection.org), printed June 7, 2005, and press releases concerning Financial Literacy 2001.