

2004 Electronic Messaging Survey Results

Background

SEC and NASD have imposed stringent record preservation and supervision requirements on broker/dealers and exchange members. SEC Rule 17a-4 and NASD Rule 3110 state that firms must preserve all electronic communications relating to their business in a non-rewritable, non-erasable format for three years, two of which must be in an easily attainable place. NASD Rule 3010 states that broker/dealers must implement a supervisory system to review messages between their salespeople and customers. In order to gauge how securities firms are addressing these regulations, Arc Partners, Inc. conducted a survey in May 2004. The survey that contained 16 questions was mailed to over 180 Compliance and Compliance-IT officers representing 125 unique banks and broker/dealer firms.

Key Findings

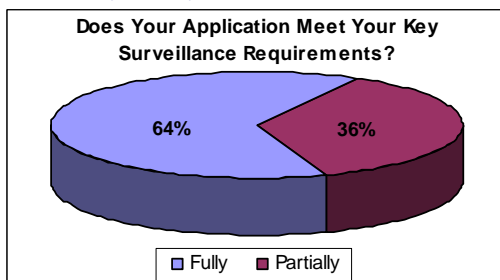
About 92% of the participating firms reported to have finalized their policies and procedures to address the requirements related to archiving and surveillance of electronic messages. The remaining 8% of the firms were in the process of doing so.

76% of the respondent firms indicated that they have fully identified all applications capable of generating electronic messages such as e-mail, IM, etc.

Of the 60% of the respondent firms that reported uncovering non-compliant applications, close to 32% were able to make them compliant, while 38% permanently blocked access to such applications.

87% of the respondent firms reported having a compliance solution in place to address the regulatory requirements. Of these, 59% stated that they have multiple tactical applications in place to address archiving, surveillance and discovery requirements, while 41% indicated addressing these requirements via a single strategic solution. Firms with a single solution in place typically reported greater satisfaction with their product.

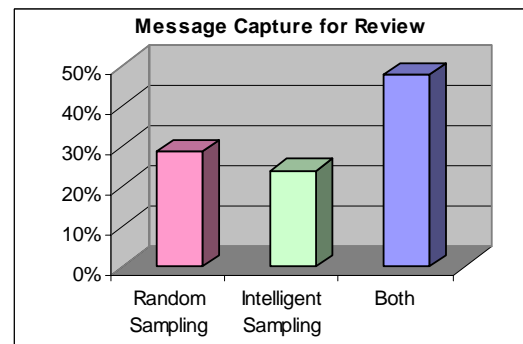
When asked if the existing solution addressed the key requirements for surveillance of employee messages either partially or fully, the firms responded as follows:



Surprisingly, only 51% of the respondent firms reported an above average level of satisfaction with their existing compliance solution.

With regard to message review methodology (pre vs. post-review), 100% of the firms reported using the post-review method, i.e. the review of messages after they have been received by the recipient.

When asked about the procedure used to capture messages for periodic review of e-mail and IM, respondent firms reported as follows:



Of firms that do not currently have a compliance solution fully implemented, 86% indicated using a hybrid "buy and build" methodology. The remaining 14% plan to exclusively build their own solution. A majority of these firms have an aggressive timeframe for the implementation of their compliance solution. 57% would like to have the solution in place in less than 6 months, while the remaining 43% indicated a timeframe between 6 to 12 months. None of the respondent firms reported an implementation timeframe greater than a year. With regard to planned software expenditure for the compliance solution, 77% reported their budget not to exceed \$500K, while 23% indicated it to be within the \$500 to \$1M range. None reported their planned software expenditure greater than a million dollars.

Conclusion

While the majority of the securities firms have already implemented policies and procedures to address the SEC and NASD requirements, the survey results indicate that there is a need for more comprehensive and robust compliance solutions to address specific surveillance and discovery issues. Additionally, firms that did successfully identify and implement a single strategic solution experienced a higher level of satisfaction.



Arc Partners Compliance Capabilities

Sarbanes Oxley *(Section 404)*

- Establish project governance and organizational structure
- Develop detailed project plan
- Develop reporting metrics and periodic reports to track/monitor project progress and issues
- Facilitate the “proof of concept” for completing the documentation requirements for SOX 404
- Deliver board-level management presentations and communications that allow the SOX team to marshal resources

Patriot Act Compliance *(Customer Reference Data)*

- Develop single source application for Global Customer Reference Data to comply with Patriot Act, KYC and other regulatory/reporting requirements
- Provide project management expertise in developing applications to capture, rationalize, and cross-reference customer reference data from multiple source systems
- Act as liaison between IT and business owners to define conversion and business rules for data usage and coding rules

Business Continuity Planning

- Assist with review and assessment of technology and staffing issues related to Fed guidelines on BCP
- Develop an integrated implementation plan that satisfies needs of business & technology managers for DR & BCP
- Prepare a cost-benefit assessment for reconfiguring data centers
- Estimate costs for relocating hardware resources to regions outside of NY metropolitan area

Electronic Messaging Compliance *(SEC 17a-3 & 17a-4 and NASD 3010 & 3110)*

- Conduct current state assessment and identify all applications (E-mail, IM, etc.) capable of electronic communication. Assess “compliance state” of each application with respect to archiving and surveillance regulations
- Act as a liaison between Legal & Compliance (LCD) and IT division. Define and implement processes to address operational issues
- Assist LCD with analysis and execution of ad-hoc discovery requests
- Develop a comprehensive Request for Proposal for a compliance solution and manage the vendor evaluation and selection process

Record Retention / Document Management

- Member of Records Retention Steering Committee
- Conduct current state assessment to identify all categories of services capable of generating messages for collaboration (e.g. Web Content; Voice Recording; Streaming Media; Digital Fax; PDA's; SWIFT; etc.) and assess record retention requirements of each service
- Assist with development of policies for use of collaborative services

2004 Electronic Messaging Survey – Detailed Results

1. Do you have policies and procedures in place to address SEC and NASD regulations (i.e. SEC 17a-3, SEC 17a-4, NASD 3110 and NASD 3010) pertaining to archiving and surveillance of electronic messages?

Yes	92%
Partially	8%
No	0%

2. How many registered representatives do you have in your organization?

< =250	64%
251-500	20%
501-1000	4%
> 1000	12%

3. Have you identified all applications capable of generating any form of electronic messaging (i.e. E-mail, IM, Messaging via Trading Applications, Bulletin Boards, etc.)?

Yes	76%
Partially	24%
No	0%

4. Have you assessed the compliance state of these applications with regards to the above regulations?

Yes	80%
Partially	20%
No	0%

5. Did you identify any non-compliant applications?

Yes	60%
No	40%

6. If yes, what action did you take?

Made application compliant	31.3%
Blocked access permanently	37.5%
Temporarily suspended	6.3%
Other	24.9%



7. If your firm is global, are your electronic communication records stored in a centralized location or are they stored locally within each region?

Regionally	33.3%
Centrally	29.2%
Not Applicable	37.5%

8. Do you have a compliance technology solution in place to address the SEC and NASD regulations (i.e. SEC 17a-3, SEC 17a-4, NASD 3110 and NASD 3010) with regards to archiving and surveillance?

Yes	87.5%
No	12.5%

If **No**, please proceed to question 14.

9. What is your level of satisfaction with the existing compliance solution?

<i>Highest</i>	5	4.1%
	4	46.5%
	3	39.6%
	2	9.8%
<i>Lowest</i>	1	0.0%

10. Do you have a single solution in place that addresses your archiving, surveillance and discovery requirements or are these requirements met by multiple point solutions?

Single Solution	40.9%
Multiple Solutions	59.1%

11. Does your compliance solution address all of your key requirements with regards to surveillance (or supervision) of employee messages?

Yes	63.6%
Partially	36.4%
No	0%

12. What type of message review policy do you currently have in place at your firm?

Pre-Review: review of a message prior to the message being received by the recipient.

Post-Review: review of a message after it has been received by the recipient.

Pre-Review	0%
Post-Review	100%



13. For the periodic supervisory review of employee messages, do you randomly capture a percentage sample for review or do you capture messages utilizing certain keyword/hotword searches?

Random samplings based on a percentage capture	28.6%
Intelligent sampling based on keyword/hotword searches	23.8%
Both (random and intelligent sampling)	47.6%

14. Are you planning to buy and/or build your compliance solution?

Buy	0.0%
Build	14.3%
Buy & Build	85.7%

15. What is your timeframe for implementation of the compliance solution?

< 6 Months	57.1%
6 Months - 1 Year	42.9%
> 1 Year	0%

16. What is your expected software expenditure for the compliance solution?

< \$500K	76.9%
\$500K – 1M	23.1%
> 1M	0%

All individual responses will remain confidential and no personal details will be passed on to any third party.
