

**ARKANSAS SECURITIES DEPARTMENT**

|                                |   |                                      |
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| In the Matter of               | ) |                                      |
|                                | ) |                                      |
| DEUTSCHE BANK SECURITIES, INC, | ) | [ <b>Matter No. S-05-023-05-CO01</b> |
|                                | ) |                                      |
| Respondent.                    | ) | <b>ADMINISTRATIVE CONSENT ORDER</b>  |
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WHEREAS, DEUTSCHE BANK SECURITIES, INC. (“Deutsche Bank”), CRD No. 2525, is a broker-dealer registered in the state of Arkansas;

WHEREAS, a coordinated investigation into Deutsche Bank activities concerning securities research analysts’ conflicts of interest and investment banking business practices during the period of approximately 1999 through 2001 has been conducted by a multi-state task force and the U.S. Securities and Exchange Commission (“SEC”);

WHEREAS, the California Department of Corporations conducted an investigation (with the assistance of the District of Columbia Securities Bureau and the State of Maryland Attorney General's Office) into the practices at Deutsche Bank;

WHEREAS, Deutsche Bank has cooperated with the above securities regulators during the investigation;

WHEREAS, Deutsche Bank has agreed to resolve the aforementioned investigation;

WHEREAS, Deutsche Bank agrees to adopt and implement certain changes to securities research analysts’ conflicts of interest and investment banking business practices and to make certain payments as set forth herein;;

WHEREAS, Deutsche Bank voluntarily elects to permanently waive any right to a hearing and appeal under the Ark. Code Ann. §§ 23-42-210 and 23-42-308 with respect to this Administrative Consent Order (the “Order”);

WHEREAS, The Arkansas Securities Department (the “Department”) has jurisdiction over this matter pursuant to Ark. Code Ann. §§ 23-42-103 and 23-42-308;

WHEREAS, The Arkansas Securities Commissioner finds the following relief appropriate

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WHEREAS, The Arkansas Securities Commissioner finds the following relief appropriate

and in the public interest; and

NOW, THEREFORE, the Arkansas Securities Commissioner (the "Commissioner"), as administrator of the Arkansas Securities Act, Ark. Code Ann. § 23-42-101 *et seq.* (the "Act"), hereby enters this Order:

**I. ALLEGATIONS OF FACT**

1. Deutsche Bank admits the jurisdiction the Commissioner, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order, and consents to the entry of this Order by the Commissioner.

2. The Commissioner finds the following facts applicable to this action:

**A. General Findings Of Fact:**

3. From July 1999 through 2001 ("the relevant period"), Deutsche Bank engaged in acts and practices that created and/or maintained inappropriate influence by investment banking over research analysts, thereby creating conflicts of interest for its research analysts. Deutsche Bank failed to manage these conflicts in an adequate manner. During this time period, Deutsche Bank offered research coverage in order to gain investment banking business and receive investment banking fees. It received over \$1 million from other investment banks to provide research coverage of their investment banking clients, and made payments of approximately \$10 million to other securities firms primarily for research coverage for its investment banking clients. In addition, Deutsche Bank compensated its research analysts based in part upon their contributions to Deutsche Bank's investment banking business. These relationships and activities constituted substantial conflicts of interest for Deutsche Bank's research analysts.

4. Deutsche Bank failed to establish and maintain adequate policies and procedures reasonably designed to manage these conflicts of interest.

5. Deutsche Bank also failed to promptly produce copies of e-mail communications that had been requested by the staff during the investigation. Despite repeated inquiries from the staff and state investigators, Deutsche Bank insisted during the investigation that its production of the e-mail was complete. In fact, Deutsche Bank had produced less than one-fourth of the responsive e-mail by April 2003. Over the next year, Deutsche Bank produced another 227,000 e-mail, more

than tripling its original production and delaying completion of the investigation for over a year.

## **DEFENDANT**

6. Deutsche Bank Securities Inc. is a Delaware corporation with its headquarters and principal executive offices in New York, New York. It has branch offices throughout the U.S., including Washington, D.C., San Francisco, Los Angeles, and Baltimore. Deutsche Bank is a broker-dealer registered with the Commission pursuant to Section 15(b) [15 U.S.C. § 78o(b)] of the Exchange Act and is a member of NASD and NYSE. Deutsche Bank provides a comprehensive range of advisory, financial, securities research, and investment services to corporate and private clients. Deutsche Bank's clients include both institutional investors and individual investors (often referred to as "retail customers"). Deutsche Bank also provides investment banking services to corporate clients.

7. Deutsche Bank is currently registered with the Department as a broker-dealer, and has been so registered since January 5, 1984.

## **FACTUAL ALLEGATIONS**

### **I. BACKGROUND**

#### **A. The Role of Research Analysts at Deutsche Bank**

8. Deutsche Bank has a securities research department called the "equity research department," which provides its investment clients and the public with research reports on certain public companies. Research analysts at Deutsche Bank are generally assigned to review the investment outlook of specific public companies within a certain industry or sector, such as technology or biosciences. This is called "covering" a company's stock. In their research reports, analysts typically review the performance of the covered companies, evaluate their business prospects, and provide analysis and projections regarding the future prospects of the company. They also provide a rating or recommendation as to whether the company presents a good investment opportunity, and often provide a price target (the market price at which the analyst expects the stock to trade within a given time).

9. During the relevant period, Deutsche Bank analysts made themselves available via telephone, electronic mail, and in person to the firm's institutional and retail sales force to answer

questions about industry sectors and companies covered by the analyst. In addition, analysts provided periodic research updates to the sales forces through “morning calls” held before the start of trading.

10. During the relevant period, Deutsche Bank had a four-point rating system: “Strong Buy”; “Buy”; “Market Perform”; and “Market Underperform.” According to the firm’s policy, a “Strong Buy” or “1” rating meant that “DBSI expects, with a high degree of confidence, that the securities will significantly outperform the market time frame and that the time to buy the securities is now.” A “Buy” or “2” rating meant that “DBSI expects that the securities will outperform the market by 10% or more over the next 12 months.” A “Market Perform” or “3” rating meant that “DBSI expects that the securities will broadly perform in line with the local market over a 12-month period and the share price is likely to trade within a range of +/- 10%.” A “Market Underperform” or “4” rating meant that “DBSI expects the securities to underperform against the local market by 10% or more over the next 12 months.”

11. During the relevant time period, a substantial majority of the companies covered by Deutsche Bank’s analysts in the technology, biotechnology, media, and telecommunications sectors received a Buy or Strong Buy rating. In contrast, only one of the more than 250 companies covered by Deutsche Bank during the time period had lower than a Market Perform. Accordingly, what Deutsche Bank held out as a four-point rating system for stocks in the above sectors was effectively a three-point system.

12. Deutsche Bank distributed its analysts’ research reports internally to various departments at the firm, made the reports available to its institutional and retail customers, and disseminated the reports to subscription services such as First Call and Bloomberg. The firm’s customers received the research reports through the firm’s website and also through electronic mail or postal mail if they were on the firm’s mailing lists. Analysts’ recommendations were also reported in the U.S. financial news media.

13. Deutsche Bank held out its research analysts as providing independent, objective and unbiased information, reports, and recommendations upon which investors could rely in making informed investment decisions.

**B. Investment Banking at Deutsche Bank**

14. Deutsche Bank's investment banking division assists companies with raising capital through initial public offerings ("IPOs"), "follow-on" offerings (subsequent offerings of stock to the public), and private placements of stock. It also assists companies with negotiating and brokering other corporate transactions, such as mergers and acquisitions. During the relevant period, investment banking was an important source of revenue for Deutsche Bank, accounting for approximately 29.2% of its total revenues.

15. Deutsche Bank generally competes with other investment banks for selection by issuers and other sellers of securities as lead underwriter or "bookrunner" on securities offerings. The lead underwriters receive the largest portion of the investment banking fees, called underwriting fees; accordingly, there are significant financial rewards to being selected as the lead underwriter. The lead underwriters also establish the allocation of shares in a securities offering and typically retain the greatest number of shares for themselves. The typical IPO generates significant investment banking fees for the lead underwriters. During the relevant period, Deutsche Bank was the ninth largest underwriter in the U.S. securities market, receiving about \$1.15 billion in investment banking fees.

16. In addition to their research responsibilities, analysts assisted investment bankers in performing due diligence on investment banking transactions.

**II. DEUTSCHE BANK'S RESEARCH STRUCTURE  
CONTAINED CONFLICTS OF INTEREST**

17. Because Deutsche Bank does not charge for its research, the Americas Equity Research Department at Deutsche Bank was a "cost center." Its costs were substantially funded by the firm's departments responsible for institutional clients and investment banking. During the relevant period, the equities department funded 50% of the research department's expenses, the investment banking department funded 43%, and the retail department funded 7%.

18. Investment banking considerations were an important factor in deciding what research to provide and how much research analysts were paid. As stated below, Deutsche Bank's compensation structure rewarded analysts for investment banking deals consummated in their

sectors. Investment banking interests also played a role in determining which companies would be covered by the firm's analysts and which would be dropped.

**A. Analysts' Compensation Was Determined In Part By  
The Analysts' Contribution to Investment Banking Revenues**

19. In order to "align" the interests of the analysts with the interests of the other departments at the firm whose revenues funded the research department, Deutsche Bank created an "analyst performance matrix" that ranked all of Deutsche Bank's analysts based upon several criteria. Beginning in 2000, Deutsche Bank determined bonuses for its research analysts based upon this matrix. These bonuses, which ranged from hundreds of thousands to millions of dollars, made up the vast majority of most analysts' compensation.

20. In 2000, under the matrix, one-third of an analyst's ranking was based upon the analyst's contribution to investment banking, one-third upon his or her contribution to the institutional investor franchise, and one-third upon the research director's subjective assessment. In 2001, a fourth equally-weighted category – the analysts' ranking in independent surveys, such as the All American Institutional Investor Poll – was added to the matrix.

21. Analysts received "credit" for all investment banking deals in their sector (regardless of whether they worked on the deal), as well as deals outside their sector to which they contributed personally. This amount was then adjusted upward or downward by 25-30% based upon the reviews provided by the investment bankers who worked with the analyst. Thus, if an analyst was helpful to investment bankers in the analyst's sector by, for example, generating deals for his sector, the analyst could get a high rating from the investment banker and thus increase his rating in the matrix and, potentially, the size of the analyst's bonus.

22. Investment bankers rated analysts based on a scale of 1 ("Analyst Extremely Important To A Majority Of Investment Banking Revenue. Without The Analyst, Our Revenue Would Have Been More Than 50% Below What We Generated.") to 5 ("Analyst Had A Negative Impact On Investment Banking Revenue."). Analysts at the top of the matrix – and thus who received the largest bonuses – typically received all 1's or 2's from investment bankers, as well as scored highly in other areas of the matrix.

23. Deutsche Bank research management circulated draft quarterly investment banking deal reports to analysts to verify the investment banking deals for which analysts were to receive credit. Analysts were encouraged to, and did, respond to these reports with additional examples of deals in their sector or on which they had worked.

24. In these responses and in the yearly performance self-evaluations that analysts completed, many analysts identified the importance of their work in bringing investment banking business to Deutsche Bank and the value of that work to the firm. For example, analysts stated in their self-evaluations:

- (a) “Won two lead managed IPO mandates ... Won one secondary offering ... as a result of relationship with management team (our investment bankers did not have any previous relationship with the Company). ... DBAB generated a \$400K (roughly) fee. Participated in winning mandate on ... convertible debt offering despite previous ... analyst leaving DBAB. ... DBAB earned a \$10M (roughly) fee.... My previous management relationships allowed the firm to make equity investment in a number of promised private communications equipment companies.”;
- (b) Completed 8 banking deals ..., generating an estimated \$8-10 million in fees; 7 of the 8 were either research driven or solely research driven ... Were invited to pitch ... the \$2-3 billion [company] IPO; I started the ball rolling.”

25. In certain instances, research management requested that analysts complete “business plans,” such as when transitioning coverage from one analyst to another. Analysts discussed the investment banking imperatives that they had addressed through coverage of certain areas or companies or otherwise. For example, in an April 2001 e-mail exchange between two analysts, one analyst said that he was told one of his goals for the year was to “generate at least as much in banking fees as he did last year.”

26. Research management based promotion decisions in part upon the analyst’s assistance to the firm’s investment banking business.

27. In sum, research analysts at Deutsche Bank were compensated millions of dollars in part for their contribution in winning the business of investment banking clients, for whom they issued reports, ratings and recommendations.



**B. Investment Banking Interests Influenced Coverage Decisions**

28. The research department at Deutsche Bank made decisions about the stocks on which its analysts would initiate and maintain coverage based in part upon investment banking concerns. According to the director of research, investment banking opportunities were a factor in determining research coverage. For example, one analyst testified that he agreed to maintain coverage of certain companies he would otherwise drop until the banker had the opportunity to “close” the transactions the banker was hoping to win.

29. In another example, an analyst expressed her disappointment in a February 2001 e-mail that Deutsche Bank had not been included in an offering by Charlotte Russe Holding Inc. The analyst stated that “the only reason we picked up coverage of the stock [Charlotte Russe Holding Inc.] was to be involved in IB flow.” The analyst had just rated the company a “Buy” on December 21, 2000.

30. Analysts also routinely identified to their investment banking counterparts private companies that might go public. Often, it was the research analyst’s relationship with the company that convinced the company to use Deutsche Bank’s investment banking services. If the company did indeed use Deutsche Bank for its investment banking business, the analyst would typically cover the company for Deutsche Bank. The fact that the analyst had originated Deutsche Bank’s investment banking transaction with the company that he covered presented a potential conflict of interest.

31. In July 2000, a banker in the Hong Kong office of Deutsche Bank sent an e-mail to the director of research stating that “the lack of coverage [of Pacific Century Cyberworks] continues to be a major problem in our relationship, and we have been categorically assured that none of [the company owner’s] (very substantial) deal flow will come our way until we make good on our promise . . . .” The director of research later sent an e-mail to his assistant stating “we need to have active, co-coverage of this name in the US. been [sic] a big fee paying customer of ours that we have promised US coverage that past US research management agreed to.”

32. In addition to initiating positive coverage on investment banking clients, Deutsche Bank research analysts at times maintained favorable ratings on investment banking clients’ stocks, even

in the face of precipitous declines in the stocks' prices.

33. For example, Deutsche Bank acted as a lead underwriter for the Webvan IPO in November 1999 and initiated coverage with a Strong Buy rating and \$50 price target shortly thereafter. At the time, the stock was trading at \$24.69. In a series of reports issued in April-July 2000, although the new analyst covering the stock recognized and discussed significant risk factors facing the company in his reports, he maintained the Strong Buy rating (with no price target) even as the stock dropped to the \$6-9 range. On September 15, 2000, with the stock trading at \$3.47, the analyst downgraded Webvan to a Buy. On January 10, 2001, with Webvan at \$0.44, the analyst downgraded it to Market Perform, and held that rating on July 9, 2001, when Webvan declared bankruptcy.

34. Similarly, in March 2000, Deutsche Bank had a Strong Buy recommendation on the stock of Peregrine Systems. At the time, the stock was trading at over \$70. In April 2000, although the stock had dropped to \$24.50, Deutsche Bank maintained its Strong Buy recommendation. Deutsche Bank continued its Strong Buy recommendation until the stock price hit \$0.24 in September 2002.

**C. Deutsche Bank Implicitly Promised Potential  
Investment Banking Clients Favorable Research Coverage**

35. To win investment banking business for a public company, securities firms typically put together a presentation (soliciting an issuer's investment banking business is called "pitching the company"). Investment banks make "pitches" for any kind of investment banking business, most frequently for initial public offerings ("IPOs") and follow-on offerings. The presentation material is referred to as a "pitchbook." The pitchbooks were presented to the company's management by Deutsche Bank investment bankers.

36. During the relevant period, Deutsche Bank implicitly promised in its pitchbooks that its research analysts would cover the company if the company gave it investment banking business. Deutsche Bank pitchbooks spoke of the firm's "commitment to research" and to the company, stating that Deutsche Bank's "commitment doesn't end with the IPO" and that Deutsche Bank would "be [the company's] leading advocate." Analysts prepared one section of the pitchbooks,

entitled “Research Positioning.” Deutsche Bank analysts typically prepared this section after completing some due diligence on the company and discussed in the section how the analyst would market the company to investors in research reports. Generally, the research positioning section of the pitchbook made a variety of positive statements about the company. For example, the pitchbook would sometimes state that Deutsche Bank analysts would promote the company’s “compelling business model,” its action in “rebuilding supply chains to provide superior value to producers and customers,” or its “huge market opportunity.” Pitchbooks described analysts as the “key ‘Champion’” of the pitched companies.

37. In other pitchbooks, the promise of positive research coverage was suggested by reference to Deutsche Bank’s positive coverage of other companies. Deutsche Bank described how the analyst had covered another company – and how the analyst’s favorable ratings of the stock corresponded with the stock’s rise in price. For example, the December 11, 2001 pitchbook for LeapFrog Enterprises, Inc. (“LeapFrog”) similarly promoted the analyst’s reports on another company – his Buy and Strong Buy ratings of that company in frequent research reports – and graphed them against the stock price of the company to suggest that the analyst’s ratings and reports assisted in the increase in the stock’s price. Several months later, Deutsche Bank was selected as a co-manager for LeapFrog and received investment banking fees.

38. Deutsche Banks’ pitchbooks also typically discussed the “research commitment” of the firm, stating that the analyst would engage in various activities in connection with the IPO, including pre-marketing, marketing, initial coverage, ongoing coverage, industry reports, sponsorship of visits, dinners with key investors, and investor presentations. The analyst also assisted the investment bankers in performing due diligence on the company, and had a say in whether the firm would participate in the offering. If the analyst did not support the deal, the firm typically would not proceed with the offering.

39. In addition to preparing part of the pitchbook, research analysts often accompanied investment bankers on the pitches to the company. After the pitch and once Deutsche Bank was selected as the underwriter, the analyst typically worked together with the investment banker to (among other things) perform additional “due diligence” on the offering and participated in so-

called “roadshows” to meet institutional investors.

40. It was understood by all parties involved - the analyst, the underwriters, and the issuer - that the analyst would speak favorably about the issuer when initiating coverage. Indeed, at least one pitchbook implied that Deutsche Bank would provide favorable coverage. In October 1999, Deutsche Bank marketed a European-based company called Autonomy for its U.S. IPO. (At the time, Deutsche Bank had an analyst in London covering the company for the European markets.) The pitchbook for Autonomy showed a timeline for the deal and indicated that after the “quiet period” (statutorily-mandated period of time after an offering during which the underwriting firms cannot publish research), the analyst would “Raise Rating and Estimates.” After the pitch, Deutsche Bank became the lead underwriter. The analyst who was involved in the pitch began covering the company in the U.S. after its U.S. IPO at the same Buy rating that his European counterpart had used prior to the U.S IPO.

41. In another example, an analyst sent an e-mail to an issuer stating the analyst would provide bi-monthly research coverage on the issuer “if [Deutsche Bank were] meaningfully included in [the issuer’s] financing activities.” The analyst also stated that she would present the issuer to Deutsche Bank’s sales force once a week and to publish several in-depth reports to send out to Deutsche Bank’s institutional base.

42. The foregoing all contributed to Deutsche Bank’s ability to win investment banking deals and receive investment banking fees from such offerings and subsequent investment banking relationships.

**D. Deutsche Bank Knew That Research Was An Important Factor In Winning Investment Banking Business**

43. Deutsche Bank knew that companies expected the firm to commit to provide them with research coverage before they would award the firm investment banking business. For example, in an e-mail from Deutsche Bank’s Asia office, a banker reported that a company told them that “for any future business, [they] had to have research coverage and it had to be from a U.S. analyst ... the lack of coverage continues to be a major problem in our relationship, and we have been categorically assured that none of deal flow will come our way until we make good on our

promise”. Thus, in at least some cases, companies often demanded research coverage before selecting an investment banker.

44. Indeed, at least one company conditioned payment of its investment banking fee to Deutsche Bank upon receiving research coverage after the transaction. Proxima ASA withheld payment to Deutsche Bank of approximately \$6 million in investment banking fees relating to its merger with another company in 2000 because Deutsche Bank had not published research on the company. After Deutsche Bank subsequently issued a September 21, 2001 research report on the company, the fee was paid.

45. In some instances, Deutsche Bank analysts also internally suggested conditioning the continuation of research coverage upon whether the company gave Deutsche Bank its investment banking business. One analyst e-mailed the director of research in April 2000 and asked whether he should tell a company whom he believed had misled him about its earnings report that he would drop coverage, unless they brought their recently announced financing transaction to Deutsche Bank. The director of research responded, “I think that is EXACTLY [*sic*] what you should do.” The firm ultimately did not drop coverage.

### **III. IN CERTAIN INSTANCES, THE FIRM PUBLISHED EXAGGERATED OR UNWARRANTED RESEARCH**

46. In some instances, Deutsche Bank analysts gave advice to institutional clients or others that conflicted with their published ratings on particular stocks, thus indicating that in those instances, Deutsche Bank published research that was exaggerated, unwarranted, or unreasonable.

47. In the spring of 2001, one of Deutsche Bank’s analysts met with a large institutional client of the firm to discuss the stocks that analyst covered. One of those stocks was Oracle, on which the analyst had Buy recommendations in his published research on March 1, 2001, March 15, 2001, and April 30, 2001. After meeting with the analyst in the spring of 2001, the institutional investor placed an order with Deutsche Bank to sell more than a million shares of its position in the stock. Immediately after the sale, the Deutsche Bank institutional salesperson responsible for the account sent an e-mail to the director of research, commending the analyst’s performance and stating that the client would be sending its *Institutional Investor* votes to the analyst. (Subscribers

vote for analysts that have provided information in an annual poll of the most influential research analysts conducted by *Institutional Investor* magazine.) Other institutional salespeople also commented about the analyst's helpfulness to them, stating that he had put a "great sell on Oracle."

48. In another example, an analyst in the software application sector e-mailed an investment banker in April 2001 on another stock he covered, Eprise Corp., with a "request to drop coverage," stating that the "stock continues to trade below \$1 and these guys are permanent toast." The analyst had a January 5, 2001 Market Perform rating on the stock at the time.

49. In April 2002, an analyst communicated to an executive officer of Deutsche Bank's investment banking client, Getty Images, Inc., about the price target he had given the company in and April 5, 2002 report. He told the executive not to worry about his current price target, because he would consider raising it at another time:

I thought my approach was appropriately supportive of my favorite company [the client], but still realistic.... My best guess is the stock stays in a trading range pending another quarter's evidence of [the client's] superior operating skills, [sic] leveraged by further improvements in the ad market. This leaves me room to boost the target price in conjunction with future increases in the earnings estimates [sic]. I certainly wouldn't want to put you under any near-term pressure by raising the bar too high. After all, I'm only thinking about you!

#### **IV. DEUTSCHE BANK RECEIVED AND MADE PAYMENTS FOR SERVICES THAT INCLUDED THE PROVISION OF RESEARCH**

50. During the relevant time period, Deutsche Bank received over \$1 million from other investment banks for services that included research coverage of those firms' banking clients. In addition, it directed payments of more than \$10 million to other brokers for services that included research coverage of Deutsche Bank's banking clients. These payments were made from the underwriting proceeds of the transaction, and in certain instances, were directed by the issuers.

51. In a January 2000 e-mail discussing the "norm" on Wall Street, a banker stated that for transactions above \$75 million, "there are plenty of gross spread dollars to be allocated for future research coverage in the management fee."

##### **A. Deutsche Bank Received Payments for Research**

52. During the relevant time period, Deutsche Bank received payments on at least four deals for which it was not the lead or co-lead manager. Internal documents at the firm reflect that

these payments were made for research.

53. For example, in the spring of 2001, Deutsche Bank was covering Transkaryotic Therapeutics, Inc. with a “Strong Buy” and was pitching for the company’s investment banking business. When the company selected another investment bank, the research analyst called Transkaryotic and expressed his displeasure that Deutsche Bank had not been selected to do the deal. The analyst told the company that he had spent his morning on the phone supporting the deal and that it was the analyst’s upgrade of the stock from a Market Perform to a Strong Buy several weeks before that had increased the stock price and helped make the deal a success. The company directed that Deutsche Bank receive a payment of \$300,000 from the underwriting proceeds. The analyst recorded in his self-evaluation form for that year that the firm had been “paid for our research” on this and one other deal.

54. Similarly, in October 1999, a company called Emisphere, which was not being covered by Deutsche Bank, decided to do a follow-on offering. Although Deutsche Bank did not participate in the deal, it received an \$87,500 payment from the proceeds of the deal. The deal sheet and the \$87,500 check from the lead manager both reflected that the payment was made “for research.” In fact, the deal sheet specifically stated “Not in Deal / Received \$87500.00 for research.” Moreover, a contemporaneous internal e-mail from Deutsche Bank states that “[t]here was talk about us participating in the deal but b/c of the small size, proposed economics, etc we opted to pass. However, we did agree to pick up research coverage and a[s] result we will be getting the sales credit on 10% of the institutional pot.” (During an offering, whenever the sale of shares to large institutional clients cannot be attributed to the selling efforts of any one firm, the commissions for the sales are placed into an “institutional pot.” The credits are then divided among the firms as selling concessions). Deutsche Bank initiated research coverage of Emisphere with a Buy recommendation on November 17, 1999, after the end of the quiet period. The research report did not disclose the \$87,500 payment.

55. Deutsche Bank also received a payment of \$150,000 in March 2000 for research on United Therapeutics, Inc. and a payment of \$375,764 in December 2001 for covering Trimeris, Inc.

56. In each of the four instances where Deutsche Bank received a payment for research,

Deutsche Bank was not a member of the underwriting syndicate. (In several of the instances, Deutsche Bank was considered a member of the “selling group;” however, the selling group members do not retain any underwriting risk and Deutsche Bank did not acquire or sell any shares in these offerings). The payments were made from the underwriting proceeds of the offerings. The payments totaled over \$900,000.

57. In each instance, Deutsche Bank issued research reports recommending the stocks of the issuers involved in the offerings. Emisphere was initiated at a “Buy”; the ratings of the three stocks already covered by Deutsche Bank did not change. However, in all four instances, Deutsche Bank failed to disclose in its research reports that the firm had received the payments and the source and amount of the payments.

**B. Deutsche Bank Made Payments To Other Firms for Coverage**

58. During the relevant period, Deutsche Bank made payments to other investment banking firms to have them, among other things, provide research coverage of Deutsche Bank’s investment banking clients. A senior executive in Deutsche Bank’s Equity Capital Markets department testified that, during the relevant time period, these payments were made on “one out of four” deals for which Deutsche Bank was the lead or co-lead manager.

59. Although in many instances the payments were made at the issuer’s direction, Deutsche Bank actively participated in the process. In its pitches for the business, Deutsche Bank advised the issuer that it would select members for the underwriting syndicate based upon that firm’s ability to provide research coverage. In at least one instance, Deutsche Bank advised its client that it would be possible to “attract specific additional Research Analysts” by offering them free retention shares.

60. During the relevant period, Deutsche Bank made these payments in at least 25 offerings where it was the lead or co-lead manager. The payments, which came from the underwriting proceeds, were made to at least 35 other broker-dealers who either were not part of the underwriting syndicate or who received a payment significantly in excess of their underwriting fee on the transaction. In many of these instances, Deutsche Bank’s internal e-mail and other internal documents recorded these payments as “research payments.”



61. For example, Deutsche Bank was the lead manager for U.S. Aggregates' follow-on offering of 5.475 million shares of stock in August 1999. The dealer book (the document used by Deutsche Bank to track firms' involvement in the deal) noted under one firm's name: "RESEARCH FOR \$\$ ADDL 100M SHARES OF CREDIT." The dealer book made similar notations for other firms.

62. Similarly, Deutsche Bank was the lead manager for Endwave Corporation's follow-on offering of 6.9 million shares of stock in October 2000. Deutsche Bank's dealer book reflected that another firm would receive payment as part of the deal and notes that the Deutsche Bank deal captain "spoke to Jan – their going rate is \$100,000 – no less for research, she will follow with [ ] analyst..." On January 12, 2001, Deutsche Bank sent a \$100,000 check to the firm. The accompanying statement reflected that the payment was a "Research Payment."

63. Although not all of the firms appear to have issued research after receiving the payments, internal e-mails indicate that Deutsche Bank policed the other firms to ensure that research was in fact issued. For example, in connection with Deutsche Bank's lead-managed follow-on offering for Align Technologies, Inc. in January 2001, one of the deal captains wrote, "They [another firm] owe us on a past deal for which they promised and got paid on research but lost the analyst prior to rollout. They are picking this up regardless with no fees associated."

64. In all, Deutsche Bank made payments totaling over \$10 million on at least 50 deals in order to have other firms provide research coverage of Deutsche Bank's investment banking clients. These payments were not disclosed in the prospectus or other publicly available documents disclosing the terms of the underwriting deal. Deutsche Bank did not take steps to ensure that these firms disclosed in their research reports that they had been paid to issue research. Further, where applicable, Deutsche Bank did not disclose or cause to be disclosed in the offering documents or elsewhere the details of these payments.

**V. DEUTSCHE BANK FAILED TO REASONABLY SUPERVISE RESEARCH ANALYSTS' ACTIVITIES AND TO ESTABLISH PROCEDURES TO GUARD AGAINST IMPROPER CONDUCT**

65. Deutsche Bank failed to establish and maintain adequate policies and procedures to ensure the objectivity and independence of its research reports and recommendations. Although

Deutsche Bank had written policies governing the preparation and distribution of research during the relevant period, these policies were not reasonably designed to prevent or manage conflicts of interest that existed between research and investment banking.

66. In addition, at least several analysts were unfamiliar with or did not comply with the policies. Deutsche Bank's written policies in effect after May 2001 prohibited research analysts from sending issuers draft reports containing the analysts' recommendations and price targets. At least one analyst was unaware of this policy; other analysts admitted that even though they knew of the policy, they violated it by sending draft reports with recommendations and price targets to issuers for comment before the reports were published.

## **VI. DEUTSCHE BANK FAILED TO PROMPTLY PRODUCE ALL ELECTRONIC MAIL**

67. In April 2002, state and federal regulators requested that Deutsche Bank produce all e-mail for a two-year period for certain employees in its research and investment banking departments. At the same time, Deutsche Bank was asked to not delete e-mail or overwrite e-mail backup tapes. Deutsche Bank agreed to the requests, sent out such instructions, and began producing e-mail. State regulators joined in the investigation in coordination with the federal regulators.

68. In their review of Deutsche Bank's production, the SEC and California state regulators noticed apparent discrepancies in the volume of e-mail that was being produced for various individuals. The regulators also believed that anticipated responses to certain e-mails were missing and the production appeared to be incomplete. These discrepancies were immediately brought to the attention of Deutsche Bank. Deutsche Bank repeatedly assured the regulators that its e-mail production was complete. Responding to the issues raised by the regulators, the firm stated that the variance in the volume of emails for particular individuals was attributable to a) individual practices (that is, that some people received and kept more e-mail than others), b) the fact that different entities that now comprised Deutsche Bank had differing historical e-mail retention practices, or c) Deutsche Bank's failure to maintain all of its e-mail for the required three-year time period, for which the firm had been fined \$1.65 million in joint actions by the SEC, the NASD, and

the NYSE in December 2002.

69. The regulators continued to examine the production discrepancies. One discrepancy involved Deutsche Bank's production of e-mails for only twelve of the twenty-four months for the e-mail server located in its San Francisco office. Ultimately, on the eve of the Global Settlement in April 2003, Deutsche Bank, based on inquiries by California state regulators, determined that one or more e-mail backup tapes had not been restored to retrieve available e-mail, and so informed the regulators. Deutsche Bank subsequently learned, and informed the regulators, that in numerous instances, their production retrieval process had failed.

70. Deutsche Bank failed to ensure that it was producing all responsive e-mail. Deutsche Bank relied upon the statements of low level supervisory and information technology personnel that all available e-mail had been produced, without confirming that such assurances were accurate. The information technology personnel who retrieved the email data from backup tapes and other storage media did not have sufficient guidance and had not been adequately trained on how to respond to regulatory or other requests for e-mail. Despite Deutsche Bank's assurances to regulators that e-mail would not be overwritten or deleted, a number of electronic backup tapes containing e-mail were discarded during the production period by an employee who believed that they contained no recoverable e-mail. Internal or external third parties with forensic data retrieval expertise were not consulted to confirm that the tapes were corrupted and to assess whether restoration was possible using different technology.

71. In certain instances, Deutsche Bank neglected to restore backup tapes to determine whether they contained responsive e-mail. In other instances, Deutsche Bank incorrectly identified as "unavailable" backup tapes that were, in fact, available or in offsite storage facilities, and also stated that certain tapes had been overwritten when that turned out not to be the case. Deutsche Bank also discovered, after continued questioning by the regulators, that a large volume of e-mail still existed on file servers, an offline help desk server, and backup tapes that had been scrapped but not yet overwritten. Once the tapes were restored and data retrieved from them, Deutsche Bank found certain e-mail for analysts for whom Deutsche Bank had previously stated that no e-mail existed. After Deutsche Bank had informed the regulators that it was close to completing its

production, Deutsche Bank determined that it had the ability to retrieve certain previously-deleted e-mail which had not been retrieved by Deutsche Bank's original restoration process.

72. Deutsche Bank's inability to reliably locate and produce e-mail in response to regulatory requests and subpoenas, which resulted from a lack of guidance to information technology personnel, a lack of adequate procedures, and a lack of proper supervision, delayed the completion of the investigation into analyst conflicts of interest at Deutsche Bank by over a year. As the investigation continued, the regulators were forced to invest considerable time and resources to probe Deutsche Bank's e-mail production failures, including taking testimony from numerous information technology personnel. In response to the problems that were identified by the regulators in April 2003, Deutsche Bank took steps to ensure that the previously overlooked e-mail was restored and produced to regulators, and revised its procedures and protocol for gathering and producing historical e-mail. Ultimately, however, the failure of Deutsche Bank to fully and completely respond to the initial requests of the regulators significantly delayed the completion of the investigation for an unreasonable length of time.

73. Over the course of the following year, Deutsche Bank produced an additional 227,000 e-mail -- more than three times the volume that it produced during the investigation as of December 2002.

74. By failing to timely produce e-mail, Deutsche Bank breached its obligation to comply with a reasonable regulatory request for documents that it is required by law to maintain and produce for inspection to the Commission staff and state regulators.

## **VII. CONCLUSIONS OF LAW**

1. The Department has jurisdiction over this matter pursuant to Ark. Code Ann. §§ 23-42-103, 23-42-201, and 23-42-308.

2. The Commissioner finds that the above conduct is in violation of Ark. Code Ann. §§ 23-42-308(a)(2)(G) and 23-42-308(a)(2)(J) in that Deutsche Bank engaged in dishonest and unethical practices in the securities business and failed reasonably to supervise its agents.

3. The Commissioner finds the following relief appropriate and in the public interest.

## **VIII. OPINION**

It is the opinion of the Commissioner that the provisions of the Act contemplate that broker-dealers give accurate information to their customers. When activities such as those set forth above take place, the integrity of the securities markets are undermined and investors lose faith in the securities markets. Such activity is of the most serious nature and strong measures are necessary to assure investors that it does not recur. The penalties and the undertakings contained herein will help assure investors of the integrity of the securities markets and those broker-dealers with whom they deal.

## **IX. ORDER**

On the basis of the Findings of Fact, Conclusions of Law, and the consent to the entry of this Order by Deutsche Bank , for the sole purpose of settling this matter, prior to a hearing and without admitting or denying any of the Findings of Fact or Conclusions of Law,

### **IT IS HEREBY ORDERED:**

1. This Order concludes the investigation by the Department and any other action that the Department could commence under the Act on behalf of the State of Arkansas as it relates to certain research practices at Deutsche Bank described herein, provided, however, that the Department may enforce any claims against defendant arising from or relating to any violation of the “Order” provisions herein.
2. Respondent Deutsche Bank will CEASE AND DESIST from engaging in acts in violation of the Act in connection with the research practices referenced in this Order and will comply with the undertakings of Addendum A, incorporated herein by reference.
3. As a result of the Findings of Fact and Conclusions of Law contained in this Order, Deutsche Bank shall pay a total amount of \$87,500,000.00. This total amount shall be paid as specified in the final judgment in the related action by the SEC against Deutsche Bank (“SEC Final Judgment”) as follows:

- a) \$28,750,000 to the states (50 states, plus the District of Columbia and Puerto Rico), which amount includes the states' portion of the penalty for violating Section 17(b) of the Exchange Act as specified in the SEC Final Judgment and related state law (Deutsche Bank's offer to the state securities regulators hereinafter shall be called the "state settlement offer"). Upon execution of this Order, Deutsche Bank shall pay the sum of \$287,500.00 of this amount to the Department as a civil monetary penalty pursuant to Ark. Code Ann. § 23-42-308(h), to be deposited in the Special Revenue Account known as the Arkansas Securities Department Fund. The total amount to be paid by Deutsche Bank to state securities regulators pursuant to the state settlement offer may be reduced due to the decision of any state securities regulator not to accept the state settlement offer. In the event another state securities regulator determines not to accept Deutsche Bank's state settlement offer, the total amount of the Department payment shall not be affected, and shall remain at \$287,500;
- b) \$25,000,000 as disgorgement of commissions, fees and other monies as specified in the SEC Final Judgment;
- c) \$25,000,000, to be used for the procurement of independent research, as described in the SEC Final Judgment;
- d) \$5,000,000, to be used for investor education, as described in Addendum A, incorporated by reference herein;
- e) \$3,750,000 to the SEC, as a penalty for violating Section 17(b) of the Exchange Act, as specified in the SEC Final Judgment.

4. Deutsche Bank 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 all penalty amounts that Deutsche Bank shall pay pursuant to this Order or Section II of the SEC Final Judgment, regardless of whether such penalty amounts or any

part thereof are added to the Distribution Fund Account referred to in the SEC Final Judgment or otherwise used for the benefit of investors. Deutsche Bank further agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with regard to any state, federal or local tax for any penalty amounts that Deutsche Bank shall pay pursuant to this Order or Section II of the SEC Final Judgment, regardless of whether such penalty amounts or any part thereof are added to the Distribution Fund Account referred to in the SEC Final Judgment or otherwise used for the benefit of investors. Deutsche Bank understands and acknowledges that these provisions are not intended to imply that the Department would agree that any other amounts Deutsche Bank shall pay pursuant to the SEC 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 state, federal or local tax.

5. If payment is not made by Deutsche Bank or if Deutsche Bank defaults in any of its obligations set forth in this Order, the Commissioner may vacate this Order, at his sole discretion, upon 10 days notice to Deutsche Bank and without opportunity for administrative hearing and Deutsche Bank agrees that any statute of limitations applicable to the subject of the Investigation and any claims arising from or relating thereto are tolled from and after the date of this Order.

6. This Order and any dispute related thereto shall be construed and enforced in accordance with, and governed by, the laws of the state of Arkansas without regard to any choice of law principles.

7. This Order is not intended by the Department to subject any Covered Person to any disqualifications under the laws of any state, the District of Columbia or Puerto Rico (collectively, "State"), including, without limitation, any disqualifications from relying upon the State registration exemptions or State safe harbor provisions. "Covered Person" means Deutsche Bank, or any of its officers, directors, affiliates, current or former employees, or other persons that would otherwise be disqualified as a result of the Orders (as defined below.).

8. The SEC Final Judgment, the NYSE Stipulation and Consent, the NASD Letter of Acceptance, Waiver and Consent, this Order and the order of any other State in related proceedings

against Deutsche Bank (collectively, the “Orders”) shall not disqualify any Covered Person from any business that they otherwise are qualified, licensed or permitted to perform under the applicable law of the state of Arkansas and any disqualifications from relying upon this state’s registration exemptions or safe harbor provisions that arise from the Orders are hereby waived.

9. The Orders shall not disqualify Deutsche Bank from any business that they otherwise are qualified or licensed to perform under applicable state law.

10. For any person or entity not a party to this Order, this Order does not limit or create any private rights or remedies against Deutsche Bank including, without limitation, the use of any e-mails or other documents of Deutsche Bank or of others regarding research practices, or limit or create liability of Deutsche Bank, or limit or create defenses of Deutsche Bank to any claims.

11. Nothing herein shall preclude the state of Arkansas, its departments, agencies, boards, commissions, authorities, political subdivisions and corporations, other than the Department and only to the extent set forth in paragraph 1 above, (collectively, “State Entities”) and the officers, agents or employees of State Entities from asserting any claims, causes of action, or applications for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive relief against Deutsche Bank in connection with securities research analysts’ conflicts of interest and investment banking business practices at Deutsche Bank.

12. Deutsche Bank agrees not to take any action or to make or permit to be made any public statement denying, directly or indirectly, any finding in this Order or creating the impression that this Order is without factual basis.

13. This Order shall be binding upon Deutsche Bank and its successors and assigns. Further, with respect to all conduct subject to Paragraph 2 above and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions, events, and conditions, the terms “Deutsche Bank” and “Deutsche Bank’s” as used herein shall include Deutsche Bank’s successors and assigns which, for these purposes, shall include a successor or assign to Deutsche Bank’s investment banking and research operations, and in the case of an affiliate of Deutsche



Bank, a successor or assign to Deutsche Bank's investment banking or research operations.

Dated this 23<sup>rd</sup> day of June, 2005.

ARKANSAS SECURITIES DEPARTMENT

By 

MICHAEL B. JOHNSON, COMMISSIONER

**CONSENT TO ENTRY OF ADMINISTRATIVE ORDER**

**BY DEUTSCHE BANK SECURITIES, INC.**

DEUTSCHE BANK SECURITIES, INC. hereby acknowledges that it has been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

DEUTSCHE BANK SECURITIES, INC. admits the jurisdiction of the Arkansas Securities Commissioner, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order by the Arkansas Securities Commissioner as settlement of the issues contained in this Order.

DEUTSCHE BANK SECURITIES, INC. states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

DEUTSCHE BANK SECURITIES, INC. understands that the State of Arkansas may make such public announcement concerning this Order and the subject matter thereof as the State of Arkansas may deem appropriate.

I, Robert Khzami represent that I am General Counsel of DEUTSCHE BANK SECURITIES, INC. and that, as such, have been authorized by DEUTSCHE BANK SECURITIES, INC. to enter into this Order for and on behalf of DEUTSCHE BANK SECURITIES, INC.

Dated this 25 day of May, 2005.

DEUTSCHE BANK SECURITIES, INC.

By: Robert Khzami  
Title: General Counsel

SUBSCRIBED AND SWORN TO before me this 25 day of May, 2005.

Nyree A. McAllister  
Notary Public

My Commission expires: July 31, 2006

## Addendum A

### Undertakings

The firm shall comply with the following undertakings:

#### **I. Separation of Research and Investment Banking**

1. Reporting Lines. Research and Investment Banking will be separate units with entirely separate reporting lines within the firm – i.e., Research will not report directly or indirectly to or through Investment Banking. For these purposes, the head of Research may report to or through a person or persons to whom the head of Investment Banking also reports, provided that such person or persons have no direct responsibility for Investment Banking or investment banking activities.
  - a. As used throughout this Addendum, the term “firm” means the Defendant, Defendant’s successors and assigns (which, for these purposes, shall include a successor or assign to Defendant’s investment banking and research operations), and their affiliates, other than “exempt investment adviser affiliates.”
  - b. As used throughout this Addendum, the term "exempt investment adviser affiliate" means an investment adviser affiliate (including, for these purposes, a separately identifiable department or division that is principally engaged in the provision of investment advice to managed accounts as governed by the Investment Advisers Act of 1940 or investment companies under the Investment Company Act of 1940) having no officers (or persons performing similar functions) or employees in common with the firm (which, for purposes of this Section I.1.b, shall not include the investment adviser affiliate) who can influence the activities of the firm's Research personnel or the content of the firm's research reports; provided that the firm (i) maintains and enforces written policies and procedures reasonably designed to prevent the firm, any controlling persons, officers (or persons performing similar functions), or employees of the firm from influencing or seeking to influence the activities of Research personnel of, or the content of research reports prepared by, the investment adviser affiliate; (ii) obtains an annual independent assessment of the operation of such

policies and procedures; and (iii) does not furnish to its customers research reports prepared by the investment adviser affiliate or otherwise use such investment adviser affiliate to do indirectly what the firm may not do directly under this Addendum.

- c. As used throughout this Addendum, the term “Investment Banking” means all firm personnel engaged principally in investment banking activities, including the solicitation of issuers and structuring of public offering and other investment banking transactions. It also includes all firm personnel who are directly or indirectly supervised by such persons and all personnel who directly or indirectly supervise such persons, up to and including Investment Banking management.
- d. As used throughout this Addendum, the term “Research” means all firm personnel engaged principally in the preparation and/or publication of research reports, including firm personnel who are directly or indirectly supervised by such persons and those who directly or indirectly supervise such persons, up to and including Research management.
- e. As used throughout this Addendum, the term “research report” means any written (including electronic) communication that is furnished by the firm to investors in the U.S. and that includes an analysis of the common stock, any security convertible into common stock, or any derivative thereof, including American Depositary Receipts (collectively, “Securities”), of an issuer or issuers and provides information reasonably sufficient upon which to base an investment decision; provided, however, that a “research report” shall not include:
  - i. the following communications, if they do not include (except as specified below) an analysis, recommendation or rating (e.g., buy/sell/hold, under perform/market perform/outperform, underweight/market weight/overweight, etc.) of individual securities or issuers:
    - 1. reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index;

2. reports commenting on economic, political or market (including trading) conditions;
  3. technical or quantitative analysis concerning the demand and supply for a sector, index or industry based on trading volume and price;
  4. reports that recommend increasing or decreasing holdings in particular industries or sectors or types of securities; and
  5. statistical summaries of multiple companies' financial data and broad-based summaries or listings of recommendations or ratings contained in previously-issued research reports, provided that such summaries or listings do not include any analysis of individual companies; and
- ii. the following communications, even if they include information reasonably sufficient upon which to base an investment decision or a recommendation or rating of individual securities or companies:
1. an analysis prepared for a current or prospective investing customer or group of current or prospective investing customers by a registered salesperson or trader who is (or group of registered salespersons or traders who are) not principally engaged in the preparation or publication of research reports; and
  2. periodic reports, solicitations or other communications prepared for current or prospective investment company shareholders (or similar beneficial owners of trusts and limited partnerships) or discretionary investment account clients, provided that such communications discuss past performance or the basis for previously made discretionary investment decisions.

- f. As used throughout this Addendum, the term “technical research report” means any written (including electronic) communication that is furnished by the firm to investors in the U.S. and that includes an analysis of the Securities of an issuer or issuers, that is based solely on prices and trading volume and not on the issuer's financial information, business prospects, or contact with issuer management, and that provides information reasonably sufficient upon which to base an investment decision.
  - g. As used throughout this Addendum, the term “quantitative research report” means any written (including electronic) communication that is furnished by the firm to investors in the U.S. and that includes an analysis of the Securities of an issuer or issuers, that relies solely on the systematic application of statistical or numerical techniques to publicly available data, that does not include a qualitative assessment of an issuer's business prospects or contact with issuer management, and that provides information reasonably sufficient upon which to base an investment decision.
  - h. As used throughout this Addendum, the term “Institutional Customer” means an entity other than a natural person having at least \$10 million invested in securities in the aggregate in its portfolio and/or under management.
  - i. As used throughout this Addendum the term “Small Institutional Customer” means an entity other than a natural person having less than \$10 million and more than \$1 million invested in securities in the aggregate in its portfolio and/or under management.
2. Legal/Compliance. Research will have its own dedicated legal and compliance staff, who may be a part of the firm’s overall compliance/legal infrastructure.
3. Budget. For the firm’s first fiscal year following the entry of the Final Judgment in the SEC’s action against Defendant (“Final Judgment”) and thereafter, Research budget and allocation of Research expenses will be determined by the firm’s senior management (e.g., CEO/Chairman/management committee, other than Investment Banking personnel) without input from Investment Banking and without regard to specific revenues or results derived from Investment Banking, though

revenues and results of the firm as a whole may be considered in determining Research budget and allocation of Research expenses. On an annual basis thereafter, the Audit Committee of the firm's holding/parent company (or comparable independent persons/group without management responsibilities) will review the budgeting and expense allocation process with respect to Research to ensure compliance with this requirement.

4. Physical Separation. Research and Investment Banking will be physically separated. Such physical separation will be reasonably designed to prevent the intentional and unintentional flow of information between Research and Investment Banking.
5. Compensation. Compensation of professional Research personnel will be determined exclusively by Research management and the firm's senior management (but not including Investment Banking personnel) using the following principles:
  - a. Investment Banking will have no input into compensation decisions.
  - b. Compensation may not be based directly or indirectly on Investment Banking revenues or results; provided, however, that compensation may relate to the revenues or results of the firm as a whole.
  - c. A significant portion of the compensation of anyone principally engaged in the preparation of research reports (as defined in this Addendum) that he or she is required to certify pursuant to the U.S. Securities and Exchange Commission's Regulation Analyst Certification ("Regulation AC") (such person hereinafter a "lead analyst") must be based on quantifiable measures of the quality and accuracy of the lead analyst's research and analysis, including his or her ratings and price targets, if any. In assessing quality, the firm may rely on, among other things, evaluations by the firm's investing customers, evaluations by the firm's sales personnel and rankings in independent surveys. In assessing accuracy, the firm may use the actual performance of a company or its equity securities to rank its own lead analysts' ratings and price targets, if

any, and forecasts, if any, against those of other firms, as well as against benchmarks such as market or sector indices.

- d. Other factors that may be taken into consideration in determining lead analyst compensation include: (i) market capitalization of, and the potential interest of the firm's investing clients in research with respect to, the industry covered by the analyst; (ii) Research management's assessment of the analyst's overall performance of job duties, abilities and leadership; (iii) the analyst's seniority and experience; (iv) the analyst's productivity; and (v) the market for the hiring and retention of analysts.
- e. The criteria to be used for compensation decisions will be determined by Research management and the firm's senior management (not including Investment Banking) and set forth in writing in advance.
- f. Research management will document the basis for each compensation decision made with respect to (i) anyone who, in the last 12 months, has been required to certify a research report (as defined in this Addendum) pursuant to Regulation AC; and (ii) anyone who is a member of Research management (except in the case of senior-most Research management, in which case the basis for each compensation decision will be documented by the firm's senior management).

On an annual basis, the Compensation Committee of the firm's holding/parent company (or comparable independent persons/group without management responsibilities) will review the compensation process for Research personnel. Such review will be reasonably designed to ensure that compensation decisions have been made in a manner that is consistent with these requirements.

- 6. Evaluations. Evaluations of Research personnel will not be done by, nor will there be input from, Investment Banking personnel.
- 7. Coverage. Investment Banking will have no input into company-specific coverage decisions (i.e., whether or not to initiate or terminate coverage of a particular company in research reports furnished by the firm), and investment banking revenues or potential revenues will not be taken into



account in making company-specific coverage decisions; provided, however, that this requirement does not apply to category-by-category coverage decisions (e.g., a given industry sector, all issuers underwritten by the firm, companies meeting a certain market cap threshold).

8. Termination of Coverage. When a decision is made to terminate coverage of a particular company in the firm's research reports (whether as a result of a company-specific or category-by-category decision), the firm will make available a final research report on the company using the means of dissemination equivalent to those it ordinarily uses; provided, however, that no final report is required for any company as to which the firm's prior coverage has been limited to quantitative or technical research reports. Such report will be comparable to prior reports, unless it is impracticable for the firm to produce a comparable report (e.g., if the analyst covering the company and/or sector has left the firm). In any event, the final research report must disclose: the firm's termination of coverage; and the rationale for the decision to terminate coverage.
9. Prohibition on Soliciting Investment Banking Business. Research is prohibited from participating in efforts to solicit investment banking business. Accordingly, Research may not, among other things, participate in any "pitches" for investment banking business to prospective investment banking clients, or have other communications with companies for the purpose of soliciting investment banking business.
10. Firewalls Between Research and Investment Banking. So as to reduce further the potential for conflicts of interest or the appearance of conflicts of interest, the firm must create and enforce firewalls between Research and Investment Banking reasonably designed to prohibit all communications between the two except as expressly described below:
  - a. Investment Banking personnel may seek, through Research management (or an appropriate designee with comparable management or control responsibilities ("Designee")) or in the presence of internal legal or compliance staff, the views of Research personnel about the merits of a proposed transaction, a potential candidate for a transaction, or market or industry trends, conditions or developments. Research personnel may respond to such inquiries on these subjects through Research management or its Designee or in the

presence of internal legal or compliance staff. In addition, Research personnel, through Research management or its Designee or in the presence of internal legal or compliance staff, may initiate communications with Investment Banking personnel relating to market or industry trends, conditions or developments, provided that such communications are consistent in nature with the types of communications that an analyst might have with investing customers. Any communications between Research and Investment Banking personnel must not be made for the purpose of having Research personnel identify specific potential investment banking transactions.

- b. In response to a request by a commitment or similar committee or subgroup thereof, Research personnel may communicate their views about a proposed transaction or potential candidate for a transaction to the committee or subgroup thereof in connection with the review of such transaction or candidate by the committee. Investment Banking personnel working on the proposed transaction may participate with the Research personnel in these discussions with such committee or subgroup. However, the Research personnel also must have an opportunity to express their views to the committee or subgroup outside the presence of such Investment Banking personnel.
- c. Research personnel may assist the firm in confirming the adequacy of disclosure in offering or other disclosure documents for a transaction based on the analysts' communications with the company and other vetting conducted outside the presence of Investment Banking personnel, but to the extent communicated to Investment Banking personnel, such communication shall only be made in the presence of underwriters' or other counsel on the transaction or internal legal or compliance staff.
- d. After the firm receives an investment banking mandate, or in connection with a block bid or similar transaction, Research personnel may
  - (i) Communicate their views on the pricing and structuring of the transaction to personnel in the firm's equity capital markets group, which group's principal job responsibility is the pricing and structuring of transactions;

- (ii) Provide to personnel in the firm's equity capital markets group information obtained from investing customers relevant to the pricing and structuring of the transaction;
- (iii) Participate with the equity capital markets group, or independently, in efforts to educate the firm's sales force regarding the transaction, including assisting in the preparation of internal-use memoranda (including presentations in electronic format) and communicating with the firm's sales force, provided that Research personnel may not appear jointly with management of the issuer or Investment Banking personnel other than members of the equity capital markets group in such communications with the firm's sales force, and provided that the following conditions are satisfied:
  - 1) Such oral communications by Research personnel with the firm's sales force personnel regarding the transaction in which a recommendation or view, whether or not labeled as such, is expressed by such Research personnel regarding the transaction must have a reasonable basis;
  - 2) Such oral communications to a group of ten or more of the firm's sales force must be "fair and balanced", as such phrase is generally understood under NASD Rule 2210(d)(1) and after taking into consideration the overall context in which such communications are made (hereinafter referred to as the "fair and balanced standard"). In addition, all such oral communications to a group of ten or more of the firm's sales force must be made in the presence of internal legal or compliance personnel;
  - 3) All internal-use memoranda (or portions thereof) regarding such transaction that are identified as being the views of Research personnel (such memoranda or portions thereof hereinafter referred to as "internal Research memoranda") must comply with the fair and balanced standard;
  - 4) Internal Research memoranda that are distributed to a group of ten or more of the firm's sales force must be

reviewed in advance by internal legal or compliance personnel;

- 5) A written log of all oral communications described in (2) above must be maintained; and
- 6) All written logs and all internal Research memoranda described in (4) above must be retained for the period required by Rule 17a-4(b)(4).

e. Research personnel may attend or participate in a widely-attended conference attended by Investment Banking personnel or in which Investment Banking personnel participate, provided that the Research personnel do not participate in activities otherwise prohibited herein.

f. Research and Investment Banking personnel may attend or participate in widely-attended firm or regional meetings at which matters of general firm interest are discussed. Research management and Investment Banking management may attend meetings or sit on firm management, risk or similar committees at which general business and plans (including those of Investment Banking and Research) and other matters of general firm interest are discussed. Research and Investment Banking personnel may communicate with each other with respect to legal or compliance issues, provided that internal legal or compliance staff is present.

g. Communications between Research and Investment Banking personnel that are not related to investment banking or research activities may take place without restriction.

#### 11. Additional Restrictions on Activities By Research and Investment Banking Personnel.

- a. Research personnel are prohibited from participating in company- or Investment Banking-sponsored road shows related to a public offering or other investment banking transaction.
- b. Investment Banking personnel are prohibited from directing Research personnel to engage in marketing or selling efforts to investors with respect to an investment banking transaction.
- c. After the firm receives an investment banking mandate relating to a public offering of securities, Research personnel may communicate

with investors regarding such offering provided that Research personnel may not appear jointly with management of the issuer or Investment Banking personnel in such communications, and provided that the following conditions are satisfied:

- 1) Such oral communications by Research personnel with investors regarding the offering in which a recommendation or view, whether or not labeled as such, is expressed by such Research personnel regarding the offering must have a reasonable basis;
- 2) Such oral communications to a group of ten or more investors regarding such offering must comply with the fair and balanced standard;
- 3) All such oral communications to a group of ten or more investors must be made in the presence of internal legal or compliance personnel;
- 4) A written log of all oral communications described in (2) above must be maintained; and
- 5) All written logs must be retained for the period required by Rule 17a-4(b)(4).

12. Oversight. An oversight/monitoring committee or committees, which will be comprised of representatives of Research management and may include others (but not personnel from Investment Banking), will be created to:

- a. review (beforehand, where practicable) all changes in ratings, if any, and material changes in price targets, if any, contained in the firm's research reports;
- b. conduct periodic reviews of research reports to determine whether changes in ratings or price targets, if any, should be considered; and
- c. monitor the overall quality and accuracy of the firm's research reports;

provided, however, that Sections I.12.a and I.12.b of this Addendum shall not be required with respect to quantitative or technical research reports.

## II. Disclosure/Transparency and Other Issues

1. Disclosures. In addition to other disclosures required by rule, the firm must disclose prominently on the first page of any research report and any summary or listing of recommendations or ratings contained in previously-issued research reports, in type no smaller than the type used for the text of the report or summary or listing, that:
  - a. “[Firm] does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report.”
  - b. With respect to Covered Companies as to which the firm is required to make available Independent Research (as set forth in Section III below): “Customers of [firm] in the United States can receive independent, third-party research on the company or companies covered in this report, at no cost to them, where such research is available. Customers can access this independent research at [website address/hyperlink] or can call [toll-free number] to request a copy of this research.”
  - c. “Investors should consider this report as only a single factor in making their investment decision.”
2. Transparency of Analysts’ Performance. The firm will make publicly available (via its website, in a downloadable format), no later than 90 days after the conclusion of each quarter (beginning with the quarter that commences on January 1, 2005), the following information, if such information is included in any research report (other than any quantitative or technical research report) prepared and furnished by the firm during the prior quarter: subject company, name(s) of analyst(s) responsible for certification of the report pursuant to Regulation AC, date of report, rating, price target, period within which the price target is to be achieved, earnings per share forecast(s) for the current quarter, the next quarter and the current full year, indicating the period(s) for which such forecast(s) are applicable (e.g., 3Q03, FY04, etc.), and definition/explanation of ratings used by the firm.

3. Applicability. Except as specified in the second and third sentences of this Section II.3, the restrictions and requirements set forth in Section I [Separation of Research and Investment Banking] and Section II [Disclosure/Transparency and Other Issues] of this Addendum will only apply in respect of a research report that is both (i) prepared by the firm, and (ii) that relates to either (A) a U.S. company, or (B) a non-U.S. company for which a U.S. market is the principal equity trading market; provided, however, that such restrictions and requirements do not apply to Research activities relating to a non-U.S. company until the second calendar quarter following the calendar quarter in which the U.S. market became the principal equity trading market for such company. Notwithstanding the foregoing, Section I.7 [Coverage] of this Addendum will also apply to any research report (other than the Independent Research made available by the firm pursuant to Section III [Independent, Third-Party Research] of this Addendum) that has been *furnished* by the firm to investors in the U.S., but not prepared by the firm, but only to the extent that the report relates to either (A) a U.S. company, or (B) a non-U.S. company for which a U.S. market is the principal equity trading market. Also notwithstanding the foregoing, Section II.1 [Disclosures] of this Addendum will also apply to any research report (other than the Independent Research made available by the firm pursuant to Section III of this Addendum) that has been *furnished* by the firm to investors in the U.S., but not prepared by the firm, including a report that relates to a non-U.S. company for which a U.S. market is not the principal equity trading market, but only to the extent that the report has been furnished under the firm's name, has been prepared for the exclusive or sole use of the firm or its customers, or has been customized in any material respect for the firm or its customers.
- a. For purposes of this Section II.3, the firm will be deemed to have furnished a research report to investors in the U.S. if the firm has made the research report available to investors in the U.S. or has arranged for someone else to make it available to investors in the U.S.
  - b. For purposes of this Section II.3, a "U.S. company" means any company incorporated in the U.S. or whose headquarters is in the U.S.

- c. For purposes of this Section II.3, the calendar quarter in which a non-U.S. company's "principal equity trading market" becomes the U.S. market is a quarter when more than 50% of worldwide trading in the company's common stock and equivalents (such as ordinary shares or common stock or ordinary shares represented by American Depositary Receipts) takes place in the U.S. Trading volume shall be measured by publicly reported share volume.

4. General.

- a. The firm may not knowingly do indirectly that which it cannot do directly under this Addendum.
- b. The firm will adopt and implement policies and procedures reasonably designed to ensure that its associated persons (including but not limited to the firm's Investment Banking personnel) cannot and do not seek to influence the contents of a research report or the activities of Research personnel for purposes of obtaining or retaining investment banking business. The firm will adopt and implement procedures instructing firm personnel to report immediately to a member of the firm's legal or compliance staff any attempt to influence the contents of a research report or the activities of Research personnel for such a purpose.

5. Timing. Unless otherwise specified, the restrictions and requirements of this Addendum will be effective within 30 days of the entry of the Final Judgment, except that Section III [Independent, Third-Party Research] of this Addendum will be effective within 180 days of the entry of the Final Judgment.

6. Review of implementation.

- a. The firm will retain, at its own expense, an Independent Monitor acceptable to the Staff of the SEC, the NYSE, the NASD, the President of NASAA, and the New York Attorney General's Office to conduct a review to provide reasonable assurance of the implementation and effectiveness of the firm's policies and procedures designed to achieve compliance with the terms of this Addendum. This review will begin on April 30, 2005. The Independent Monitor will produce a written report of its review, its



findings as to the implementation and effectiveness of the firm's policies and procedures, and its recommendations of other policies or procedures (or amendments to existing policies or procedures) as are necessary and appropriate to achieve compliance with the requirements and prohibitions of this Addendum. The report will be produced to the firm and the Staff of the SEC, the NYSE and the NASD within 30 days from the completion of the review, but no later than October 31, 2005. (The SEC Staff shall make the report available to the President of NASAA and the New York Attorney General's Office upon request.) The Independent Monitor shall have the option to seek an extension of time by making a written request to the Staff of the SEC.

- b. The firm will have a reasonable opportunity to comment on the Independent Monitor's review and proposed report prior to its submission, including a reasonable opportunity to comment on any and all recommendations, and to seek confidential treatment of such information and recommendations set forth therein to the extent that the report concerns proprietary commercial and financial information of the firm. This report will be subject to the protections from disclosure set forth in the rules of the SEC, including the protections from disclosure set forth in 5 U.S.C. § 552(b)(8) and 17 C.F.R. § 200.80(b)(8), and will not constitute a record, report, statement or data compilation of a public office or agency under Rule 803(8) of the Federal Rules of Evidence.
- c. The firm will adopt all recommendations contained in the written report of the Independent Monitor; provided, however, that as to any recommendation that the firm believes is unduly burdensome or impractical, the firm may demonstrate why the recommended policy or procedure is, under the circumstances, unreasonable, impractical and/or not designed to yield benefits commensurate with its cost, or the firm may suggest an alternative policy or procedure designed to achieve the same objective, and submit such explanation and/or alternative policy or procedure in writing to the Independent Monitor and to the Staff of the SEC. The firm and the Independent Monitor shall then attempt in good faith to reach agreement as to any policy or procedure as to which there is any dispute and the Independent Monitor shall reasonably evaluate any alternative policy or procedure proposed by the firm. If an agreement on any issue is not reached, the

firm will abide by the determinations of the Staff of the SEC (which shall be made after allowing the firm and the Independent Monitor to present arguments in support of their positions), and adopt those recommendations the Staff of the SEC deems appropriate.

- d. The firm will cooperate fully with the Independent Monitor in this review, including making such non-privileged information and documents available, as the Independent Monitor may reasonably request, and by permitting and requiring the firm's employees and agents to supply such non-privileged information and documents as the Independent Monitor may reasonably request.
- e. To ensure the independence of the Independent Monitor, the firm (i) shall not have the authority to terminate the Independent Monitor without the prior written approval of the SEC staff; and (ii) shall compensate the Independent Monitor, and persons engaged to assist the Independent Monitor, for services rendered pursuant to this Order at their reasonable and customary rates.
- f. For the period of engagement and for a period of three years from completion of the engagement, the Independent Monitor shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with the firm, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Any entity with which the Independent Monitor is affiliated or of which he/she is a member, and any person engaged to assist the Independent Monitor in performance of his/her duties under this Order shall not, without prior written consent of the Staff of the SEC, enter into any employment, consultant, attorney-client, auditing or other professional relationship with the firm, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of three years after the engagement.
- g. On October 31, 2008, the firm shall certify to the Staff of the SEC, the NYSE, the NASD, the President of NASAA, and the New York Attorney General's Office, that the firm has complied in all material respects with the requirements and prohibitions set forth in this Addendum or, in the event of material non-compliance, will describe such material non-compliance.

7. Superseding Rules and Amendments. In the event that the SEC adopts a rule or approves an SRO rule or interpretation with the stated intent to supersede any of the provisions of this settlement, the SEC or SRO rule or interpretation will govern with respect to that provision of the settlement and such provision will be superseded. In addition, each of the SEC, NYSE, the NASD, the New York Attorney General's Office and any State that incorporates this Addendum (or equivalent document) into its settlement of related proceedings against the Defendant agrees that the SEC Staff may provide interpretive guidance with respect to the terms of the settlement as requested by the firm and that, subject to Court approval, the SEC and the firm may agree to amend or modify any term of the settlement, in each case, without any further action or involvement by any other regulator in any related proceeding. With respect to any term in Section I or II of this Addendum that has not been superseded (as set forth above) on or before October 1, 2008, it is the expectation of Defendant, the SEC, NYSE, NASD, New York Attorney General's Office and the States that the SEC would agree to an amendment or modification of such term, subject to Court approval, unless the SEC believes such amendment or modification would not be in the public interest.
8. Other Obligations and Requirements. Except as otherwise specified, the requirements and prohibitions of this Addendum shall not relieve the firm of any other applicable legal obligation or requirement.

### **III. Independent, Third-Party Research**

1. Obligation to Make Available. Each year, for the period ending five years after the effective date of this Section III (as set forth in Section II.5 [Timing] of this Addendum), the firm will be required to contract with no fewer than three independent providers of research ("Independent Research Providers") at a time in order to procure and make available Independent Research (as defined below) to the firm's customers in the U.S. as set forth below. The firm may satisfy this requirement by contracting with a consolidator that provides access to the Independent Research of at least three Independent Research Providers. There is, however, no requirement that there be at least three Independent Research Providers for the Common Stock of each Covered Company (as those terms are defined below):

- a. For common stock and equivalents (such as ordinary shares or common stock or ordinary shares represented by American Depositary Receipts) listed on a U.S. national securities exchange or quoted in Nasdaq (such securities hereinafter, collectively, “Common Stock”) and covered in the firm’s research reports (other than those limited to quantitative or technical research reports) (an issuer of such covered Common Stock hereinafter called a “Covered Company”), the firm, through an Independent Consultant (as discussed below) will use its reasonable efforts to procure, and shall make available to its customers in the U.S., Independent Research on such Covered Company’s Common Stock. (If the Independent Research Providers drop coverage or do not timely pick up coverage of the Common Stock of a Covered Company, the firm will not be in violation of any of the requirements in this Section III, and may continue to disseminate its own research reports on the Common Stock of the Covered Company without making available any Independent Research on the Common Stock of the Covered Company, if the firm takes reasonable steps to request that the Independent Consultant procure such coverage promptly.)
  - i. For purposes of this Section III, the firm’s research reports include research reports that have not been prepared by the firm, but only to the extent that such reports have been furnished under the firm’s name, have been prepared for the exclusive or sole use of the firm or its customers, or have been customized in any material respect for the firm or its customers.
  - ii. A non-U.S. company for which a U.S. market is not the principal equity trading market shall only be considered a Covered Company if, in the calendar quarter ended March 31, 2004, or in any subsequent calendar quarter during the period that the firm’s obligations to procure and make available Independent Research under this Section III are effective, the publicly reported, average daily dollar volume of U.S. trading in such company’s Common Stock (measured by multiplying the publicly reported, average daily share volume of U.S. trading

during the quarter by the closing price per share of the Common Stock on the last day of the quarter), exceeded \$2.5 million, and (b) the outstanding total public float of the Common Stock as of the last day of such calendar quarter exceeded \$150 million, or, if the data necessary to calculate the outstanding total public float is not readily available, the market capitalization of the Common Stock as of the last day of such calendar quarter exceeded \$150 million. Further, the firm's obligation to procure and make available Independent Research with respect to such company shall become effective at the later of: (a) 90 days after the end of the calendar quarter in which the company met the foregoing trading and public float tests; or (b) the effective date of this Section III.

- b. For purposes of this Section III, Independent Research means (i) a research report (other than technical research reports) prepared by an unaffiliated person or entity, or (ii) a statistical or other survey or analysis of research reports (including ratings and price targets) issued by a broad range of persons and entities, including persons and entities having no association with investment banking activities, which survey or analysis has been prepared by an unaffiliated person or entity.
- c. The firm will adopt policies and procedures reasonably designed to ensure that, in connection with any solicited order for a customer in the U.S. relating to the Common Stock of a Covered Company, and if Independent Research on the Covered Company's Common Stock is available, the registered representative will have informed the customer, during the solicitation, that the customer can receive Independent Research on the Covered Company's Common Stock at no cost to the customer (the "Notice Requirement").
- d. Notwithstanding the foregoing, the Notice Requirement will not apply to (i) the solicitation of an Institutional Customer unless such Institutional Customer, after due notice and opportunity, has advised the firm that it wishes to have the Notice Requirement apply to it ("Participating Institutional

Customer”). Any Institutional Customer who has not so advised the firm is hereinafter referred to as a “Non-Participating Institutional Customer”; (ii) orders as to which discretion was exercised by the firm, pursuant to a written discretionary account agreement or written grant of trading authorization; or (iii) a solicitation by an entity affiliated with the Defendant if such entity does not furnish to its customers research reports under the firm’s name, prepared by the firm or for the exclusive or sole use of the firm or its customers, or research reports that have been customized in any material respect for the firm or its customers.

- e. For the purposes of the notice, confirmation, and account statement disclosure requirements with respect to orders as to which discretion was exercised by an investment adviser pursuant to a written discretionary account agreement or written grant of trading authorization, the firm must treat the investment adviser as (regardless of whether the investment adviser is an institutional entity or a natural person): (i) a natural person, if such adviser has \$1 million dollars or less invested in securities in the aggregate in its portfolio and/or under management; (ii) a Small Institutional Customer if such investment adviser has less than \$10 million and more than \$1 million invested in securities in the aggregate in its portfolio and/or under management; and (iii) an Institutional Customer if such investment adviser has at least \$10 million invested in securities in the aggregate in its portfolio and/or under management. Notwithstanding the foregoing, nothing precludes the firm from providing disclosure in addition to the foregoing required minimum.
- f. With respect to a Participating Institutional Customer, the firm may satisfy the Notice Requirement by providing the Participating Institutional Customer with, instead of notice at the time of each solicited order, annual written notice of the availability of Independent Research on Covered Companies’ Common Stock.
- g. With respect to a Small Institutional Customer, the firm may satisfy the Notice Requirement by providing the Small

Institutional Customer with, instead of notice at the time of each solicited order, annual written notice of the availability of Independent Research on Covered Companies' Common Stock, if such Small Institutional Customer advised the firm that it wishes to receive such annual written notice instead of receiving notice at the time of each solicited order.

- h. Each trade confirmation sent by the Defendant to a customer with respect to an order as to which the Notice Requirement applies will set forth (or will be accompanied by a separate statement, which shall be considered part of the confirmation, that will set forth), as of the time the trade confirmation is generated, the ratings, if any, contained in the firm's own research reports and in Independent Research procured for the firm with respect to the Common Stock of the Covered Company that is the subject of the order (the "Trade Confirmation Disclosure Requirement").

Notwithstanding the foregoing, the Defendant may provide a Small Institutional Customer with, instead of trade-by-trade ratings information on each confirmation, annual written notice of the website(s) where Independent Research ratings information and the firm's ratings information can be found, if such Small Institutional Customer has advised the Defendant that it wishes to receive such annual written notice instead of trade-by-trade ratings information on each confirmation. With respect to the Common Stock of a Covered Company, the website(s) shall make available separate lists setting forth (with respect to each of the firm's research reports and each Independent Research report of each Independent Research Provider) the date of each research report issued by the firm and each IRP, respectively, the name of the issuer covered in such report, and the rating contained therein (if any) over the preceding twelve months ("Qualifying Website(s)").

If customers of the firm (other than Institutional or Small Institutional Customers) have access to the Qualifying Website(s), the Qualifying Website(s) must also provide access, via hyperlink, to the full text of each Independent Research report (regarding the Common Stock of a Covered Company)

of each Independent Research Provider over the preceding twelve months.

With respect to a Participating Institutional Customer, the Defendant may satisfy the Trade Confirmation Disclosure Requirement by providing the Participating Institutional Customer with, instead of trade-by-trade ratings information on each confirmation, annual written notice of the Qualifying Website(s) where Independent Research ratings information and the firm's ratings information can be found.

- i. Each periodic account statement sent by the Defendant to a customer in the U.S. that reflects a position in the Common Stock of a Covered Company will set forth (or will be accompanied by a separate statement, which shall be considered part of the periodic account statement, that will set forth), as of the end of the period covered by the statement, the ratings, if any, contained in the firm's own research reports and in the Independent Research made available by the firm on the Common Stock of each such Covered Company ("Periodic Account Statement Disclosure Requirement"); provided, however, that this requirement will not apply to Non-Participating Institutional Customers or discretionary accounts, and provided further that, with respect to Participating Institutional Customers, the Defendant may satisfy the Periodic Account Statement Disclosure Requirement by providing Participating Institutional Customers with, instead of ratings information in periodic account statements, annual written notice of the Qualifying Website(s) where Independent Research ratings information and the firm's ratings information can be found.

Notwithstanding the foregoing, the Defendant may satisfy the Periodic Account Statement Disclosure Requirement by providing a Small Institutional Customer with, instead of ratings information in periodic account statements, annual written notice of the Qualifying Website(s) where Independent Research ratings information and the firm's ratings information can be found, if such Small Institutional Customer has advised the Defendant that it wishes to receive such annual written



notice instead of ratings information in periodic account statements.

- j. The Independent Research rating(s) disclosed on trade confirmations and periodic account statements as set forth in Section III.1(h) and (i) above shall be chosen by the Independent Consultant. If only one rating is disclosed by Defendant with respect to a particular Covered Company, it cannot be a consensus rating.
- k. Notice of the availability of Independent Research on Covered Companies' Common Stock will also be included prominently in the periodic account statements of the Defendant's customers in the U.S., in the firm's research reports, and on the firm's website.
- l. The firm will make the Independent Research available to its customers in the U.S. using, for each customer, the means of dissemination equivalent to those it uses to provide the customer with the firm's own research reports, unless the firm and customer agree on another means of dissemination; provided, however, that nothing herein shall require or authorize the firm to comply with the Notice Requirement or make available or disseminate Independent Research at a time when doing so would violate Section 5 of the Securities Act of 1933 or the other provisions of the federal securities laws or the rules and regulations thereunder. If and to the extent the firm is able to make available or disseminate its own research reports on the Common Stock of a Covered Company pursuant to Rule 137, Rule 138(a) or Rule 139(a) under the Securities Act of 1933 and in reliance on Regulation M under the Securities Exchange Act of 1934, then the firm is also authorized and required to make available or disseminate Independent Research on the Common Stock of such Covered Company (even if the Independent Research does not meet the requirements of such Rule). Notwithstanding this Section III.1.1, if the firm determines, because of legal, compliance or similar concerns, not to furnish or make available its own research reports on the Common Stock of a Covered Company for a limited period of time, it shall not be required to make

available the Independent Research on such Covered Company for such period of time.

- m. If, during the period that the firm's obligations to procure and make available Independent Research under this Section III are effective, the firm terminates coverage of the Common Stock of a Covered Company, the firm, through its Independent Consultant, will make reasonable efforts to continue to procure and make available Independent Research on the Common Stock of such company for a period of at least 18 months after termination of coverage (subject to expiration of the firm's obligations under this Section III).
- n. The firm will not be responsible or liable for (i) the procurement decisions of the Independent Consultant (as discussed in Section III.2 [Appointment of Independent Consultant to Oversee the Procurement of Independent Research] of this Addendum) with respect to the Independent Research, (ii) the Independent Research or its content, (iii) customer transactions, to the extent based on the Independent Research, or (iv) claims arising from or in connection with the inclusion of Independent Research ratings in the firm's confirmations and periodic account statements or on the Qualifying Websites(s), to the extent such claims are based on those ratings. The firm will not be required to supervise the production of the Independent Research procured by the Independent Consultant and will have no responsibility to comment on the content of the Independent Research. The firm may advise its customers of the foregoing in its discretion.
- o. The Independent Consultant will not be liable for (i) its procurement decisions, (ii) the Independent Research or its content, (iii) customer transactions, to the extent based on the Independent Research, or (iv) claims arising from or in connection with the inclusion of Independent Research ratings in the firm's confirmations and periodic account statements or on the Qualifying Websites(s), to the extent such claims are based on those ratings, unless the Independent Consultant has carried out such duties in bad faith or with willful misconduct. The firm will indemnify the Independent Consultant for any

liability arising from the Independent Consultant's good-faith performance of its duties as such.

2. Appointment of Independent Consultant to Oversee the Procurement of Independent Research. Within 30 days of the entry of the Final Judgment, an Independent Consultant acceptable to the SEC Staff, the NYSE, the NASD, the President of NASAA, the New York Attorney General and the firm shall be named to oversee the procurement of Independent Research from Independent Research Providers. The Independent Consultant will have the final authority (following consultation with the firm and in accordance with the criteria set forth in Section III.3 [Selection of Independent Research Providers] of this Addendum) to procure the Independent Research. The Independent Consultant will not have had any significant financial relationship with the firm during the prior three years and may not have any financial relationship with the firm for three years following his or her work as the Independent Consultant. The Independent Consultant's fee arrangement will be subject to the approval of the Staff of the SEC, the NYSE, the NASD, the President of NASAA, and the New York Attorney General's Office. In the event that an Independent Consultant must be replaced, the replacement shall be acceptable to the Staff of the SEC, the NYSE, the NASD, the President of NASAA, the New York Attorney General's Office and the firm, and shall be subject to these same conditions.
3. Selection of Independent Research Providers. The Independent Consultant will seek to procure research reports on the Common Stock of all Covered Companies from Independent Research Providers. Independent Research Providers may not perform investment banking business of any kind and may not provide brokerage services in direct and significant competition with the firm. In addition, the Independent Consultant will use the following criteria in selecting and contracting with Independent Research Providers to provide Independent Research.
  - a. whether and to what extent the Independent Research Provider or any of its affiliates or associated persons is engaged in activities (including, but not limited to, activities involving Covered Companies or their securities), or has a business or other relationship with the firm or any of its affiliates or associated persons, that may conflict or create the appearance of

conflict with its preparation and publication of the Independent Research;

- b. the desirability of multiple coverage of certain Covered Companies (e.g., by size of company, industry sector, companies underwritten by the firm, etc.);
  - c. the extent to which the Independent Research Provider has a client base and revenue stream broad enough to ensure its independence from the firm;
  - d. the utility of the Independent Research Provider's Independent Research to the firm's customers, including the inclusion of ratings and price targets in such research and the extent to which the firm's customers actually use the research; and with respect to surveys or analyses described above in Section III.1.b(ii), the extent to which the Independent Research provides customers with a means of comparing the firm's research reports to those published by other persons and entities, including persons and entities having no association with investment banking activities;
  - e. the quality and accuracy of the Independent Research Provider's past research, including during the term of the Independent Consultant's tenure;
  - f. the experience, expertise, reputation and qualifications (including, as appropriate, registrations) of the Independent Research Provider and its personnel; and
  - g. the cost of the Independent Research, especially in light of the five-year period set forth in Section III.1 above for the firm to make Independent Research available to its investing customers.
4. Disclosure Language. Language substantially to the effect set forth below may be used by the firm and its registered representatives to inform the firm's customers of the availability of Independent Research:

- a. {Disclosure to customers as required by Section III.1.c [Obligation to Make Available subpart c] of this Addendum.}

“There is also independent, third-party research available on this company, which you can get at no cost [from our website/hyperlink] or by calling [toll-free number], or which I can arrange to send to you if you would like.”

- b. {General website and periodic customer account statement disclosure as required by Section III.1.k. [Obligation to Make Available subpart k] of this Addendum.}

“Independent, third-party research on certain companies covered by the firm’s research is available to customers of [firm] in the United States at no cost. Customers can access this research at [our website/hyperlink] or can call [toll-free number] to request that a copy of this research be sent to them.”

5. Annual Reporting. The Independent Consultant will report annually to the Staff of the SEC, the NYSE, the NASD, the President of NASAA, and the New York Attorney General’s Office on its selection of Independent Research Providers, the Independent Research it has procured, the cost of the Independent Research it has procured to date, and the Independent Consultant’s fees and expenses to date.

#### **IV. Investor Education**

1. General. The firm will pay a total of \$5,000,000, payable in five equal installments on an annual basis (with the first payment to be made 90 days after the entry of the Final Judgment), to funds earmarked for investor education. Of this money, a total of \$2,500,000 shall be paid pursuant to the firm’s agreement with the SEC, NYSE and NASD. The remainder of the funds earmarked for investor education, in the amount of \$2,500,000, shall be paid to the Investor Education Fund at the Investor Protection Trust, a Wisconsin charitable trust, pursuant to agreement with the Board of Directors of NASAA, to be used for the purpose of investor education as described in Section IV.3.

2. Payments to the Investor Education Fund.

- a. As referenced in Section IV.1 above, the firm shall pay the amount of \$2,500,000 in five equal annual installment payments as designated by the NASAA Board of Directors to the Investor Education Fund (“the Fund”) to be held as a separate fund by the Investor Protection Trust, 411 East Wisconsin Avenue, Milwaukee, WI 53202-4497, c/o Quarles & Brady. The amount for investor education to be paid by the firm to the Fund may be reduced due to the decision of any state(s) not to enter into a settlement with the firm.
- b. The firm shall make the first such installment payment within ninety (90) days after the entry of the Final Judgment. This payment shall be made by wire transfer to the Investor Protection Trust at US Bank NA, Milwaukee, WI, ABA #075000022 for credit for the Trust Division Account 112-950-027, for further credit to the Investor Protection Trust Account Number 000012891800 together with a cover letter identifying the firm as a defendant in this action and the payment designated for the Investor Education Fund. The firm shall simultaneously transmit photocopies of its payment and letter to the President of NASAA, 10 G Street NE, Washington, DC 20002. By making this payment, and those payments referenced in Section IV.2.c. below, the firm relinquishes all legal and equitable right, title, and interest in such funds, and no part of the funds shall be returned to the firm. The Fund shall be administered in accordance with the terms of the investor education plan.
- c. The firm shall make subsequent installment payments annually on or before the month and day of the entry of the Final Judgment. Such payments shall be made into the Fund at the Investor Protection Trust as described in Section IV.2(b).

3. Purpose of and Limitations on the Use of the Fund.

- a. The Fund (including all installment payments) shall be used to support programs designed for the purpose of investor education and research and education with respect to the protection of investors, and to equip investors with the knowledge and skills

necessary to make informed investment decisions and to increase personal financial literacy. The Investor Protection Trust, in cooperation with NASAA, shall establish an investor education plan designed to achieve these purposes.

- b. No principal or income from the Fund shall:
  - (i) inure to the general fund or treasury of any State;
  - (ii) be utilized to pay the routine operating expenses of NASAA; or
  - (iii) be utilized to pay the compensation or expenses of state officials or state employees except such expenses as are necessary to fulfill the purposes of the Fund.
- c. Monies in the Fund may also be used to pay any taxes on income earned by such Fund. The firm shall provide the Investor Protection Trust with relevant information and otherwise cooperate with the Investor Protection Trust in fulfilling the Fund's obligations under applicable law.
- d. All fees, costs, and expenses incurred by the Investor Protection Trust in connection with and incidental to the performance of its duties under this Addendum, including the fees, costs, and expenses of any persons engaged to assist it and all administrative fees, costs, and expenses related to the investor education plan shall be paid out of the Fund.