NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. E9A2005005701

TO: Department of Enforcement
NASD

RE: Hornor, Townsend & Kent, Inc., BD No. 4031

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

HTK understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;

2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against HTK; and

3. If accepted:

   a. this AWC will become part of our permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against HTK;

   b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about our disciplinary record;

   c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and

   d. HTK may not take any action or make or permit to be made any public statement, including in our regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects our testimonial obligations or right to take legal or factual positions in litigation or other legal proceeding in which NASD is not a party.

HTK also understands that its experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

HTK has been an NASD member since June 1969 and conducts a general securities business. HTK has no relevant disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

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

A. To have a Formal Complaint issued specifying the allegations against us;

B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;

C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and

D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission ("SEC") and a U.S. Court of Appeals.

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

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

II.

ACCEPTANCE AND CONSENT

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

Summary

This matter involves violations of NASD Conduct Rule 2830(k), which prohibits member firms from favoring or disfavoring the sale or distribution of mutual fund shares on the basis of brokerage commissions received by the firm and prohibits member firms from recommending the purchase of mutual fund shares on the basis of brokerage commissions received or expected to be received by the firm from any source.

During the period from at least 1999 to 2004 (the "relevant period"), HTK maintained programs in which participating mutual fund companies and other financial services' companies paid HTK fees and in return received preferential treatment from the firm. The programs were named the "Preferred Sponsor Program" from 1999 through 2004 and were renamed "the Marketing Partners Program" at the end of 2004 (also referred to hereafter as the "shelf space programs"). The preferred treatment HTK provided the participating companies through the Preferred Sponsor and Marketing Partners Programs included exclusive listings on HTK's internal web site, the use of "blast" e-mails to HTK's representatives, including HTK internal newswires, participation in conference calls, and both space and speaking arrangements at various HTK meetings and tradeshows.

Between 2001 and 2004, the mutual fund and other companies participating in the Preferred Sponsor and Marketing Partners Programs paid HTK fees of at least $844,077. During this period, nine mutual fund companies participated in the shelf space programs and paid fees of at least $623,460. Moreover, in 2002 and 2003, at least two of the mutual fund companies paid for their fees by directing a minimum of $90,790 in brokerage commissions to HTK. HTK's receipt of directed brokerage commissions violated NASD Conduct Rules 2830(k) and 2110. In 2004, HTK determined to end its directed brokerage arrangements.

During the relevant period, HTK violated the recordkeeping requirements of NASD Rule 2830(l)(3) by failing to make and keep adequate records concerning the compensation HTK received from the offerors who participated in the shelf space programs, including any records reflecting whether the firm received brokerage commissions for recommending the purchase of mutual fund shares in 1999 and 2000. As a result, the total amount of payments that HTK received during the relevant period, including all directed brokerage commissions, is unknown.

The Preferred Sponsor and Marketing Partners Programs

The Preferred Sponsor and Marketing Partners Programs were developed by HTK to enable mutual fund and other financial services' companies with which HTK had selling agreements *to obtain preferential treatment in return for the payment* of fees. The marketing brochures that HTK developed for the shelf space programs listed several different potential benefits that participating companies could receive, described below:

- Events: The opportunity for participating companies to attend HTK conference and education events at which they could promote their products and services.

- Teleconferences: The right for participating companies to serve as a host for one of HTK's six bi-monthly teleconferences during which the companies could promote their products, services, and sales ideas to an audience of HTK representatives. HTK promoted teleconferences through the use of email blasts and web postings and recorded the teleconferences and posted them to the firm's web site.

- Print Publications: The opportunity for participants to submit full-page articles about the products and services and receive priority placement in HTK's quarterly publication, *Newsline*. Also, the participants would be promoted in a brochure that HTK distributed to its sales force describing its shelf space programs, which provided pertinent information about the companies.

- Internet and e-mail communications: Participants had the option of designing and placing "banner ads" in a prominent position on the front page of HTK's web site for a period of one month or receiving front-page coverage in a special section of the web site. In addition, the companies could use exclusive text e-mail blast messages to highlight products and services participating companies were offering, including providing a hyperlink to their web site.

- HTK contact information: Participating companies had the opportunity to receive updated address and phone listings of all HTK representatives along with a listing of the top 100 producers on a quarterly basis.

To participate in the shelf space programs during the relevant period, the mutual fund and other financial services' companies were required to pay fees, which increased in proportion to the level of access the companies were seeking. For example, in 2004, the shelf space programs offered two tiers of fees: $35,000 for a "Gold Preferred Sponsor" and $25,000 for a "Silver Preferred Sponsor." Fifteen companies were asked to participate. Six companies participated, with four of those companies participating as Gold Preferred Sponsors. As a Gold Preferred Sponsor, the participating company was able to have more significant participation in HTK's meetings and conferences and a more advantageous placement in HTK's marketing materials and on the firm's web site compared to the level of access being offered to a Silver Preferred Sponsor.

Use of Directed Brokerage Commissions

Mutual fund companies generally use a variety of unaffiliated broker-dealers with institutional trading facilities to execute transactions in the portfolios of the mutual funds they distribute and manage. The selection of executing brokers is generally within the discretion of the mutual fund advisor, subject to the requirement of obtaining best execution.

At least two of the mutual fund companies participating in the Preferred Sponsor and Marketing Partners Programs paid their shelf space fees through directed brokerage arrangements. For the directed brokerage arrangements with one mutual fund company, an account was established at HTK's clearing firm with HTK listed as the broker of record and the mutual fund company would then call a trade directly into the clearing firm's trading desk to generate commissions for HTK. For the other mutual fund company, the trades would be called to a firm of its choice with instructions to credit the commissions to HTK. In turn, HTK credited the commission revenue from these directed brokerage transactions to the payment obligations the two mutual fund companies had for the shelf space programs. As a result, this allowed the mutual fund companies to avoid using their own funds to pay the fees. Through these directed brokerage arrangements, HTK received at least $90,790 in shelf space payments.

Conduct Rule 2830(k) is designed to prevent arrangements in which brokerage commissions, which are fund assets, are used to compensate member firms for selling fund shares. The rule is also designed to ensure that execution of portfolio transactions by brokerage firms is guided by the principle of "best execution" and not by other considerations.[1] The rule provides, in pertinent part:

> (1) No member shall, directly or indirectly, favor or disfavor the sale or distribution of shares of any particular investment company or group of investment companies on the basis of brokerage commissions received or expected by such member from any

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[1] Proposed Rule Change, file SR-NASD-2004-027, 2004 SEC LEXIS 2488 (Oct. 29, 2004); *Notice to Members 84-40*

source, including such investment company, or any covered account.

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(6) No member shall, ... (B) recommend specific investment companies to sales personnel, or establish "recommended," "selected," or "preferred" lists of investment companies..., if such companies are recommended or selected on the basis of brokerage commissions received or expected from any source ... .

As described above, in 2002 and 2003, HTK arranged for and accepted a minimum of $90,790 in directed brokerage commissions from two mutual fund companies as payment for their participation in the shelf space programs. These mutual fund companies received several benefits by participating in the shelf space programs, including preferential marketing and distribution access, including enhanced access to the firm's sales force and hyperlinks to those funds' websites on the firm's internal website. By arranging for and accepting brokerage commissions to pay for the mutual fund companies' participation in the shelf space programs, HTK violated NASD Conduct Rules 2830(k) and 2110.

Recordkeeping Violations

During the relevant period, HTK did not maintain adequate records reflecting the payments it was receiving from offerors of investment company securities involved with the shelf space programs. For example, in 1999 and 2000, HTK was administering its Preferred Sponsor Program, but did not maintain records of the payments being made by offerors, including any directed brokerage payments. In addition, during the period 2001 through 2004, HTK failed to maintain complete records concerning directed brokerage or other payments that it received from the offerors involved with the shelf space programs. As a result, the total amount of payments that that HTK received during the relevant period, including directed brokerage commissions, is unknown.

NASD Rule 2830(l)(3) requires member firms to keep records of compensation received by the member or its associated persons from the offerors. The rule requires the records to include the names of the offerors, the names of the associated persons, the amount of cash, the nature and, if known, the value of non-cash compensation received.

As described above, during the relevant period, HTK failed to make and keep adequate records of the compensation it received from offerors of investment company securities involved with the shelf space programs. As a result, HTK violated NASD Conduct Rules 2830(l)(3) and 2110.

B. HTK also consents to the imposition, at a maximum, of the following sanctions:

1. A censure; and

2. A fine of $50,000.

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

III.

OTHER MATTERS

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

B. HTK agrees to pay any monetary sanctions imposed on it upon notice that this AWC has been accepted and that such payments are due and payable and have attached a Election of Payment Form showing the method by which HTK proposes to pay any fine imposed.

C. HTK specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

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

Hornor, Townsend & Kent, Inc.

1/31/07
Date:

By:
Richard J. Miller
President

Accepted by NASD:

February 26, 2007

Signed on behalf of the Director of ODA, by delegated authority

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