

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2005002217001

TO: Department of Enforcement
NASD

RE: Equity Services, Inc., Respondent
CRD No. 265

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

ESI 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 ESI; and
3. If accepted:
 - a. this AWC will become part of ESI's permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against ESI;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about ESI's disciplinary record;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. ESI may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise,

denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects ESI's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

ESI 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:

ESI has been an NASD member since 1969. The firm currently has 506 branch offices, 49 of which are designated as Offices of Supervisory Jurisdiction ("OSJ"). At this time, ESI has approximately 950 registered representatives. The firm's business is comprised primarily of the sale of mutual funds, variable life insurance and annuities, and investment advisory services. The firm is a wholly-owned subsidiary of NLV Financial Corporation and is headquartered in Montpelier, Vermont. ESI has no relevant disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

ESI 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 ESI;
- 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 and a U.S. Court of Appeals.

Further, ESI 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.

ESI 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

ESI 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

Between January 1, 2004 through August 22, 2005 (the "relevant period"), ESI failed to properly supervise non-cash compensation provided to its associated persons. Further, ESI's supervisory system and written policies and procedures did not adequately ensure compliance with NASD Conduct Rules 2820 and 2830 relating to the payment or reimbursement of non-cash compensation.

ESI associated persons received from Beneficial Life Insurance Company ("Beneficial Life") and National Life Insurance Company ("National Life") non-cash compensation in connection with the sale of variable annuities and investment company securities that violated NASD Conduct Rules 2820(g)(4) and 2830(l)(5). Contrary to these Rules, and the published guidance thereunder, ESI approved or failed to detect non-cash compensation in the form of noncompliant sales incentive trips, some of which included trips to exotic locations and that also included guest and entertainment expenses, paid for by Beneficial Life but incurred by ESI associated persons. ESI also failed to detect a limited number of non-cash compensation programs that included noncompliant sales incentive trips, computer rebates, reimbursement of personal expenses, and website design expenses, paid for by National Life but incurred by ESI associated persons. By reason of the foregoing, ESI violated NASD Conduct Rules 2820(g)(4), 2830(l)(5), 3010(a) and (b), and 2110.

In addition, during the relevant period, ESI failed to properly preserve e-mail from its home office. This problem was limited to e-mail that was deleted and purged from the trash folder prior to the nightly backup. ESI remedied this problem beginning March 2004, when the firm began utilizing a different system. However, until December 2005, ESI's new system failed to capture some blind carbon copy ("bcc") data for home office custodians. From January 2004 through approximately October 2004, ESI also failed to properly journal e-mail for custodians in the Salt Lake City OSJ. As a result of these e-mail retention problems, ESI violated NASD Conduct Rules 3110 and 2110 and SEC Rule 17a-4.

**NASD Rules Prohibit the Payment of Guest and
Entertainment Expenses in Connection with Training and Education
Meetings and Also Prohibit Preconditioning the Attendance
at Such Meetings on the Achievement of a Sales Target**

The use of non-cash compensation in connection with the sale and distribution of variable contracts and investment company securities is regulated by NASD Conduct Rules 2820(g)(4) (variable contracts) and 2830(l)(5) (investment company securities). One of the purposes of the non-cash compensation rules is to prevent point-of-sale incentives that may compromise the associated person's obligation to match the investment needs of the customer with a suitable investment product. As it relates to meetings held for training and education, offerors, which include insurance companies and distributors, must comply with a series of special requirements in order to pay for meals, lodging and travel expenses of attendees. Those requirements are:

- a. certain records must be kept;
- b. approval of the member with whom each attendee is associated;
- c. attendance cannot be preconditioned on the achievement of a sales target;
- d. the location must be appropriate;
- e. guest expenses may not be paid for or reimbursed;
- f. entertainment must not be provided (and paid for);¹
- g. the meeting must occupy substantially all of the work day; and
- h. extended stays, *i.e.*, days of extra lodging, can only be provided if justified by actual cost savings (for example, by savings on airfare when a Saturday night stay is involved).²

¹ The prohibition on entertainment is set forth in a NASD Summer 2000 Compliance Alert: "[R]eimbursement or payment for golf outings, tours or other forms of entertainment while at a location for purposes of training or education would not be permissible" (p. 13). This prohibition was restated in an NASD Interpretive Letter, dated March 7, 2001, which reiterated the foregoing guidance and further explained that associated persons could engage in such entertainment "*provided that* the offeror does not pay for or reimburse the costs of these events." (Emphasis in original.)

² "[O]fferors may consider allowing an additional night's stay for associated persons of a member when the additional night actually reduces the meeting's net lodging and transportation expenses." *Id.*

ESI Associated Persons Received Improper Non-Cash Compensation from Beneficial Life

Beneficial Life is unaffiliated with ESI. It is a life insurance company and underwriter (offeror)³ whose agents may be registered with ESI as representatives. Pursuant to NASD Conduct Rules 2820(g)(4)(C) and 2830(l)(5)(C), Beneficial Life, as an unaffiliated offeror, was only allowed to sponsor and pay non-cash compensation to ESI associated persons in the form of training or education expenses.

During the relevant period, Beneficial Life sponsored and paid for noncompliant non-cash compensation in the form of six sales incentive trips for ESI associated persons. These incentive trips impermissibly were preconditioned upon the achievement of a sales target and included payment of guest and entertainment expenses. Further, the trips were held in inappropriate locations, *i.e.*, Maui, Hawaii, Banff, Canada, and a cruise on the Baltic Sea. Although over 90 percent of credits used to determine qualification for these trips were based on sales of fixed products, some associated persons qualified based, in part, on sales of securities. Nonetheless, the trips were in violation of Rules 2820 and 2830.

ESI Failed to Maintain Adequate Records of Non-Cash Compensation from Other Offerors

ESI also failed to maintain adequate records of other offeror non-cash compensation – *i.e.*, training or education meetings attended by ESI associated persons. ESI's failure to maintain records of this non-cash compensation resulted in the firm's failure to properly ensure that: (1) guest expenses were not paid by the offeror; (2) entertainment was not provided by the offeror; (3) the location was appropriate to the purpose of the meeting; (4) attendance was not preconditioned upon the achievement of a sales target; and (5) lodging on days when no training or education was scheduled had sufficient cost justification.

ESI Associated Persons Received Improper Non-Cash Compensation from National Life

In a few instances, ESI failed to ensure that non-cash compensation paid or reimbursed to ESI associated persons by National Life complied with the sales contest criteria of NASD Conduct Rules 2820(g)(4)(D) and 2830(l)(5)(D). For example, three of the sales contests sponsored by National Life were not based upon a limited number of the qualifying associated person's "total production." In addition, the credits received for securities sales in these contests were not "equally weighted." In 2004, National Life also paid for or provided reimbursement for other non-cash compensation benefits, for which certain qualification aspects were noncompliant with respect to the equal weighting of securities (such as: computer equipment reimbursements, marketing material reimbursements, and website design reimbursements).

³ See definitions of "offeror" found in NASD Conduct Rules 2820(b)(3)(E) and 2830(b)(1)(E).

**ESI Supervisory System and Written Policies and
Procedures Regarding Non-Cash Compensation Were Inadequate**

During the relevant period, ESI's written procedures contained a non-cash compensation section, which stated, "In general, representatives may **not** receive non-cash compensation directly from securities product sponsors." The procedures did not address the issue of the receipt of non-cash compensation from unaffiliated insurance companies and/or distributors (such as Beneficial Life) that did not offer securities products. Although Beneficial Life did not offer securities products, the qualification criteria for ESI associated persons to participate in sales incentive trips sponsored and paid for by Beneficial Life included securities products (variable annuities and/or mutual funds), thereby mandating the application of NASD's non-cash compensation Rules 2820 and 2830. In fact, prior to March 2004, Beneficial Life's incentive trips were not submitted for pre-approval to ESI compliance personnel. The firm's written procedures also did not provide adequate guidelines for reviewing, approving, and monitoring the offer or receipt of cash or non-cash compensation from Beneficial Life.

In March 2004, when ESI's main OSJ became aware that Beneficial Life's incentive programs included securities products, it ensured that the qualification criteria equally weighted securities products that were both proprietary and non-proprietary to ESI and that the programs were based on total production. However, because these trips were sponsored by an offeror, they should have been limited to training or education programs. Instead, the six Beneficial Life trips at issue were incentive, entertainment-based trips, attended by spouses or guests.

On November 14, 2005, the firm updated its written supervisory procedures, specifically revising the procedures relating to cash and non-cash compensation to address the responsibility, resources, frequency, action, and recordkeeping requirements of the policy. The revised procedures also redefined non-cash compensation as, "any form of compensation received in connection with the sale and distribution of securities," instead of limiting the policy to the receipt of non-cash compensation from securities product sponsors, as in the previous version of the procedures (April 2002). However, the revised procedures stated that "Non-cash sales incentive programs may be preconditioned on achieving a sales goal provided they are pre-approved in-house incentive programs sponsored by ESI, National Life or **Beneficial Life** and meet the following criteria" (Emphasis added.) This statement was inaccurate with respect to Beneficial Life because, as an unaffiliated life insurance company and underwriter, Beneficial Life's programs were required to adhere to the "offeror" criteria of NASD Conduct Rules 2820(g)(4)(C) and 2830(l)(5)(C) and could not be preconditioned on the achievement of a sales target. In this respect the revised procedures did not conform to NASD "offeror" rules. ESI has not, however, approved any program sponsored by Beneficial Life where the qualification criteria included securities products since the procedures were revised in 2005.

ESI's deficient supervisory system, including its written policies and procedures, failed to detect and prevent the substantive non-cash compensation violations relating

to Beneficial Life's sales incentive trips, as discussed above, as well as the other noncompliant non-cash compensation violations relating to National Life's sales incentive trips. In addition, ESI's written procedures were themselves flawed because, as written, they could improperly permit Beneficial Life's non-cash compensation programs to be preconditioned on the achievement of a sales target. Due to these collective supervisory failures, ESI violated NASD Conduct Rules 3010(a) and (b) and 2110.

ESI's E-mail Retention Violations

Between January 2004 and December 2005, ESI failed to maintain and preserve a limited amount of e-mail in its home office in Montpelier, Vermont and in the Salt Lake City OSJ. ESI failed to properly preserve home office e-mail that was deleted and purged from the trash folder prior to the nightly backup. ESI remedied this problem beginning March 2004, when the firm began utilizing a different system. However, until December 2005, some bcc data for ESI's home office custodians was not captured on the firm's new system. From January 2004 through approximately October 2004, ESI also failed to properly journal e-mail for custodians in the Salt Lake City OSJ. By failing to retain all e-mail as required, ESI violated NASD Conduct Rules 3110 and 2110 and SEC Rule 17a-4.

Conclusion

As described above, ESI violated the requirements of NASD Conduct Rules 2820(g)(4)(C) and 2830(I)(5)(C) and 2110 by allowing Beneficial Life to sponsor noncompliant sales incentive trips, which included payment for guest and entertainment expenses, and which were held in inappropriate locations. The trips also were preconditioned, improperly, on the achievement of a sales target. In addition, ESI did not maintain adequate records of other non-cash compensation expenses associated with training or education meetings. ESI further violated NASD Conduct Rules 2820(g)(4)(D) and 2830(I)(5)(D) with respect to non-cash compensation paid or reimbursed in connection with some of National Life's sales incentive trips, which were based on criteria that did not equally weight proprietary and non-proprietary products and/or were not based on total production. Moreover, ESI violated NASD Conduct Rules 3010(a) and (b) and 2110 by failing to properly supervise its non-cash compensation matters and by failing to have an adequate supervisory system, including written procedures, reasonably designed to ensure compliance with NASD's non-cash compensation rules and guidance.

In addition, ESI violated NASD Conduct Rules 3110 and 2110 and SEC Rule 17a-4 by failing to retain all e-mail, as required.

Sanctions

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

1. a censure;
2. a fine of \$350,000; and
3. ESI further consents to undertake a comprehensive review of its policies and procedures concerning non-cash compensation and, within 90 days of Notice of Acceptance of this AWC, the Chief Executive Officer and Chief Compliance Officer of ESI shall certify in writing to the staff that: (1) the firm has engaged in a comprehensive review of its policies and procedures concerning non-cash compensation; (2) as of the date of the certification, the firm has in place sufficient written policies and procedures reasonably designed to ensure compliance with Rules 2820(g)(4) and 2830(l)(5); and (3) as of the date of the certification, the firm has in place sufficient policies and procedures to reasonably ensure that all spending on non-cash compensation is adequately supervised.

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

III.

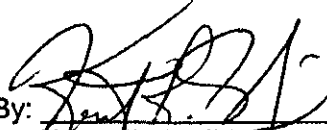
OTHER MATTERS

- A. ESI 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. ESI 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. ESI 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 has attached an Election of Payment form showing the method by which it proposes to pay any fine imposed.
- C. ESI 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.

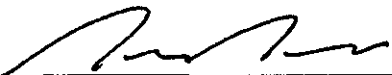
ESI certifies that it has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce ESI to submit it.

April 10, 2007
Date

Equity Services, Inc.
Respondent

By: 
Kenneth R. Ehinger
Chief Executive Officer

Reviewed by:


Jonathan A. Shapiro
WilmerHale
60 State Street
Boston, MA 02109
Counsel For ESI

Accepted by NASD:

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

May 29, 2007
Date


Samuel L. Israel
Director and Chief Counsel
NASD – Department of Enforcement