

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2005003054901**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: **Wachovia Capital Markets, LLC**, Respondent
CRD No. 126292

Pursuant to Rule 9216 of the FINRA Code of Procedure, Wachovia Capital Markets, LLC ("Wachovia," "Respondent" 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 below. Wachovia submits this AWC to FINRA on the condition that, if accepted, FINRA will not bring any future actions against Wachovia alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Wachovia 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 FINRA, or to which FINRA 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 FINRA:

BACKGROUND

Wachovia has been a registered member of FINRA (f/k/a NASD or National Association of Securities Dealers), since May 29, 2003. The Firm's principal offices are located in Charlotte, North Carolina. The Firm operates Wachovia Corporation's institutional brokerage and capital markets businesses and publishes investment research reports. Wachovia is a prominent firm and its equity research reports reach a wide audience. The Firm publishes over 5,000 equity research reports per year, including more than 200 initiation reports. Wachovia has over 900 institutional clients and more than 5,500 registered subscribers to its research website. The Firm also distributes its research through Wachovia Securities, LLC, its retail affiliate, as well as through various financial information services.

RELEVANT PRIOR DISCIPLINARY HISTORY

On July 5, 2006, Wachovia agreed to pay \$25 million in penalties (to be divided among 50 states) to settle allegations by state securities regulators that Wachovia failed, among other things, to supervise its employees in connection with potential conflicts of interest between the Firm's equity research department and its investment banking division. Under the terms of the settlement, Wachovia paid \$20 million in penalties for failing to supervise its employees, \$1.65 million in penalties for failing to preserve required books and records, \$3 million to be used for investor education and \$350,000 for costs associated with the investigation.

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OVERVIEW

From June 2004 to May 2006, Wachovia published 40 equity research reports that omitted a total of 56 disclosures required by NASD research analyst conflict of interest rules. The Firm omitted disclosures required by NASD Rule 2711(h)(1) (ownership of shares of the subject company), Rule 2711(h)(2) (compensation from investment banking services), and Rule 2711(h)(8) (making a market in the securities of the subject company). Accordingly, the Firm omitted disclosures concerning its remunerative relationship with subject companies, thus depriving the investing public of critical information regarding the Firm's actual and potential conflicts of interest. In these cases, the Firm failed to ensure that applicable disclosure information was included in its initiation and other research reports, prior to publication.

Moreover, from March 2004 to July 2007, Wachovia included in over 15,000 equity research reports (all such reports published during that time period), a disclaimer stating that the Firm and its affiliates "may" own an interest in the securities of the subject company without stating affirmatively whether or not it held such an interest. This disclaimer was made in addition to and conflicted with the required disclosure regarding the Firm's ownership interest as required by Rule 2711(h)(1)(B). The Firm's use of this disclaimer contradicted express guidance to the industry set forth in Notice to Members 04-18, published in March 2004, concerning the use of disclaimers that contradict or are inconsistent with disclosures required by SRO rules.

Wachovia also failed to adequately implement procedures reasonably designed to ensure compliance with NASD Rule 2711 disclosure requirements. Accordingly, Wachovia violated NASD Rules 2711(h), 2711(i) and 2110.

FACTS

1. Wachovia Violated NASD Rule 2711(h) by Omitting Required Conflict of Interest Disclosures and by Using Indefinite Language Regarding Wachovia's Ownership Interest in Subject Securities

NASD Rule 2711 was intended in part to address conflicts of interest arising from investment bankers who pressured research analysts to manipulate research and issue positive recommendations of covered stocks to help the firms obtain lucrative investment banking business. Rule 2711 was further designed to restore investor confidence and to provide a more reliable basis upon which to make investment decisions. The rule accordingly requires members and research analysts to disclose clearly and prominently in research reports information concerning potential conflicts of interest. Wachovia's failure to include required conflict of interest disclosures in 40 equity research reports, and the Firm's use of indefinite disclaimer language concerning the Firm's ownership interest in the securities of subject companies in over 15,000 of these reports, strikes at the very heart of FINRA's research disclosure program.

a. Wachovia Omitted Multiple Conflict of Interest Disclosures from Widely Distributed and High Profile Initiation and Other Research Reports

Wachovia failed to ensure that critical information regarding the Firm's financial and compensation relationships with the subject companies had been included in its initiation and other research reports. The Firm's failure to include these required disclosures in its research reports deprived the investing public of important information regarding the Firm's actual and potential conflicts of interest.

From June 2004 to April 2006, Wachovia omitted from 40 equity research reports a total of 56 required conflict of interest disclosures. Five of the 40 research reports omitted all of the required conflict of interest disclosures. The Firm failed to include these required disclosures in its research as follows:

- Managed/Co-Managed: Wachovia failed to disclose in twenty research reports that the Firm managed or co-managed a public offering of securities for the subject company in the last 12 months in violation of NASD Rule 2711(h)(2)(A)(ii)(a);
- Ownership of Subject Securities: Wachovia failed to disclose in two research reports that the Firm owned one percent or more of the common equity securities of the subject company (as of the end of the month immediately preceding publication) in violation of NASD Rule 2711(h)(1)(B);
- Compensation for Investment Banking Services: Wachovia failed to disclose in nine research reports that the Firm received compensation for investment banking services from the subject company in the last 12 months in violation of NASD Rule 2711(h)(2)(A)(ii)(b);
- Anticipated Compensation for Investment Banking Services: Wachovia failed to disclose in five research reports that the Firm expected to receive or intended to seek compensation for investment banking services from the subject company in the next three months in violation of NASD Rule 2711(h)(2)(A)(ii)(c);
- Compensation for non-Investment Banking Services: Wachovia failed to disclose in three research reports that the Firm had received compensation for products or services other than investment banking services from the subject company in the last 12 months in violation of NASD Rule 2711(h)(2)(A)(iii)(a);
- Investment Banking Services for Clients: Wachovia failed to disclose in nine research reports that the subject company was a client of the Firm (or had been in the last 12 months) and failed to disclose that it had provided investment banking services for clients in violation of NASD Rule 2711(h)(2)(A)(iii)(b);

- Non-Securities Services for Clients: Wachovia failed to disclose in two research reports that the subject company was a client of the Firm (or had been in the last 12 months) and failed to disclose that it had provided non-securities services to the subject company in violation of NASD Rule 2711(h)(2)(A)(iii)(b);
- Making a Market in the Securities of the Subject Company: Wachovia failed to disclose in six research reports that the Firm was making a market in the securities of the subject company in violation of NASD Rule 2711(h)(8).

Member Regulation first discovered Wachovia's research disclosure deficiencies during a routine district examination of the Firm's research disclosure practices in July 2005. During this examination, Member Regulation discovered that the Firm omitted disclosures from a number of its initiation reports. As a matter of Firm policy, Wachovia initiates coverage of a company whenever it acts as a manager or co-manager of a public equity offering involving that company. Initiation reports, like those at issue in this matter, typically reach a larger segment of the investing public than other research reports and thus have a greater impact on investment decisions.

b. Wachovia used Conditional or Indefinite Disclaimer Language in its Research that was Inconsistent with Required Disclosure Concerning the Firm's Ownership of Subject Securities

Additionally, from March 2004 to July 2007, Wachovia included in over 15,000 research reports (all such reports published during this period), a disclaimer containing language concerning the Firm's ownership interest in the securities of subject companies that contradicted or was inconsistent with its disclosure regarding its ownership interest. This disclaimer was made in addition to and conflicted with the required disclosure regarding the Firm's ownership interest as required by Rule 2711(h)(1)(B). This disclaimer, which appeared in a section of Wachovia's equity research reports titled "Additional Disclosures," stated as follows:

Wachovia Capital Markets, LLC, and its affiliates *may* from time to time provide advice with respect to, acquire, hold, or sell a position in, the securities or instruments named or described in this report. (Emphasis supplied.)

In March 2004, NASD issued Notice to Members 04-18 setting forth industry-wide guidance concerning the use of disclaimers in research reports. In particular, Notice to Members 04-18 provides that members may not use general or specific disclaimers that contradict or are inconsistent with required disclosures. Despite this guidance, Wachovia continued for over three years to use a disclaimer in its research reports that contradicted or was inconsistent with required disclosure concerning the Firm's ownership of a subject company's securities. Wachovia's use of this disclaimer violated NASD Rules 2711(h)(10), which requires that research disclosures be "clear, comprehensive and prominent," and 2110.

2. Wachovia Failed to Adequately Implement Supervisory Procedures Concerning the Review and Approval of Equity Research Reports that were Reasonably Designed to Ensure Compliance with NASD Research Disclosure Rules

Wachovia also failed to adequately implement supervisory procedures concerning compliance with Rule 2711(h). Wachovia failed to implement its written procedures concerning the research disclosures described above by failing to (1) compile accurate and complete disclosure information for the subject companies; and (2) check whether all appropriate disclosure information was entered into the Firm's online publication system and included in the research reports prior to publication.

Moreover, in the period leading up to the July 2005 examination by Member Regulation, the Firm's compliance efforts regarding research disclosures were insufficient. While the Firm performed quarterly compliance reviews of its research reports, it failed to identify certain failures in its online publication system or to timely resolve certain identified issues that resulted in the violations described above. During some of these reviews, the Firm analyzed an inadequate sample of research, in some instances as few as 10 research reports.

Despite having supervisory procedures in place concerning research disclosures, the Firm failed to adequately implement these procedures during the relevant period. Accordingly, Wachovia violated NASD Rules 2711(i) and 2110.

B. Wachovia also consents to the imposition of the following sanctions:

1. Censure; and
2. Fine in the amount of \$300,000.

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

II.

WAIVER OF PROCEDURAL RIGHTS

Wachovia specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against it;
- 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 National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Wachovia specifically and voluntarily waives any right to claim bias or prejudice 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.

Wachovia 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.

III.

OTHER MATTERS

Wachovia understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Wachovia's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8310 and IM-8310-2; and
 - 4. Wachovia 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. Wachovia may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC.

Nothing in this provision affects the Firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. Wachovia may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Wachovia 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 FINRA, nor does it reflect the views of FINRA or its staff.

Wachovia 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; that it has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce it to submit it.

4/26/07
Date

[Signature]
Wachovia Capital Markets, LLC
Respondent

By: William P. Hayden
CCO, WCM, LLC

Reviewed by: <u>Edward G. Rosenblatt</u> Edward G. Rosenblatt Vice President Assistant General Counsel Counsel for Respondent Wachovia Corporation Legal Division One Wachovia Center 301 South College Street Charlotte, NC 28288 Tel: 704-383-7425	Accepted by FINRA: <u>11/28/07</u> Date Signed on behalf of the Director of ODA, by delegated authority <u>[Signature]</u> James E. Day, Chief Counsel FINRA Department of Enforcement 1801 K Street, NW Washington, DC 20006 Tel: 202-974-2917 Fax: 202-974-2805
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