

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20070094638**

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FINANCIAL INDUSTRY REGULATORY AUTHORITY

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

RE: J.J.B. Hilliard, W.L. Lyons, LLC, Respondent
FINRA Member
Organization CRD No. 453
Organization SEC No. 8-33133

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, J.J.B. Hilliard, W.L. Lyons, LLC ("Hilliard Lyons" 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. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against the Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The Firm 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

Hilliard Lyons is a FINRA member headquartered in Louisville, Kentucky, and maintains approximately 75 offices located across the United States. During the period December 1, 1998 to March 31, 2008, Hilliard Lyons was a subsidiary of The PNC Financial Services Group, Inc., and Hilliard Lyons served as the clearing broker-dealer for PNC Investments LLC ("PNC Investments"), an affiliated introducing broker. PNC Investments is a subsidiary of PNC Bank, N.A. ("PNC Bank"). On March 31, 2008, Hilliard Lyons was acquired by HL Financial Services, LLC, a company owned by employees of Hilliard Lyons and their financial partner, Houchens Industries, Inc., a non-member.

OVERVIEW

During the period beginning April 21, 1999 through December 31, 2005 (the "Relevant Period"), Hilliard Lyons had inadequate procedures related to its receipt of funds from customers of its affiliated introducing broker, PNC Investments. As a result, the Firm did not timely identify certain customers whose checks were deposited in the Firm's account at PNC Bank via various PNC Bank branches, which resulted in the untimely posting of deposits in numerous customer accounts. When the Firm was unable to identify the proper customer accounts in which to credit customer check deposits within 60 days, the Firm moved the funds into an abandoned property account for potential future escheatment to the Commonwealth of Kentucky (the "Escheatment Account"). The funds remained in the Escheatment Account while the Firm continued its efforts to identify the proper customers. The majority of the unidentified customer check deposits were resolved and credited to the appropriate customer account. However, approximately \$133,616.65 of customer deposits were never properly identified and credited to the appropriate customer account. These funds were escheated by Hilliard Lyons to the Commonwealth of Kentucky.

The improper accounting of customer check deposits also adversely affected the Firm's ability to: (i) maintain accurate books and records; (ii) prepare accurate customer statements; (iii) maintain possession and control of customer fully paid and excess margin securities; and (iv) properly service customer cash and margin accounts.

The Firm also did not prepare certain required inter-company, bank, clearing and depository reconciliations and failed to have adequate procedures to ensure that unresolved aged differences related to these reconciliations were accurately included in its net capital computation.

In addition, the Firm failed to have adequate procedures to ensure that research analysts: (i) received specific approval from a designated supervisor prior to making public appearances; (ii) identified the disclosures provided to media outlets during public appearances; and (iii) identified to media outlets the nature of any financial interests the analysts or their household members had in a subject company.

The Firm also failed to have adequate procedures related to its issuance of research reports, which caused certain research reports to: (i) improperly include indefinite "may" language regarding future investment banking services that the Firm expected to provide; (ii) omit the required analyst certifications on the front page; (iii) fail to specify on the front page the specific page(s) in the research report on which each certification was found; and (iv) improperly include the analyst certification as part of the important disclosures.

FACTS AND VIOLATIVE CONDUCT

1. Failure to Supervise Adequately the Receipt and Timely Posting of Customer Deposits and the Related Net Capital, Customer Reserve Formula, and Books and Records Violations

Section 15 of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 15c3-1 provide the rules related to the calculation of net capital by firms. Pursuant to Exchange Act Rule 15c3-1(c)(2)(iv)/02, the Firm was required to properly account for suspense items that were seven business days or older in calculating its net capital.

Under Exchange Act Rule 15c3-3, firms are required to ensure that customer assets are available to satisfy customer withdrawal requests at all times. Exchange Act Rule 15c3-3(d)(1)/01 requires that firms determine the quantity of fully-paid securities and excess margin securities in its possession or control. Moreover, under Exchange Act Rule 15c3-3(b)(2)/03, firms are prohibited from delivering or removing securities if doing so would create or increase a deficiency in the quantity of securities by class and issuer required to be in the firms' possession or control. Additionally, pursuant to Item 8 of Exhibit A in Exchange Rule 15c3-3, firms are required to properly account for credits and debits to customer accounts in making their Customer Reserve Formula computations.

Further, under Exchange Act Rule 17a-3(a)(1), firms are required to make and keep current daily records of all receipts and disbursements of cash and all other debits and credits. NASD Rule 3110 requires that firms make and preserve books, accounts, records, memoranda, and correspondence in conformity with applicable laws, rules, regulations, and statements of policy promulgated thereunder and with the Rules of this Association and as prescribed by Exchange Act Rule 17a-3.

According to NASD Rule 3010, firms are responsible for establishing and maintaining a supervisory system, including written supervisory procedures related to the firm's business.

NASD Rule 2340 requires that firms send an account statement to each customer, on at least a quarterly basis, containing a description of any securities positions, money balances, or account activity.

NASD Rule 2110 requires that a member, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

A. Impact on the Firm's Customers

Customer Deposits That Were Deposited Untimely to the Appropriate Customer Accounts

During the Relevant Period, the Firm allowed customers introduced to it by PNC Investments to deposit funds into their accounts through PNC Bank branches. The checks and cash given to PNC Investments or PNC Bank personnel were deposited into an omnibus bank account maintained by Hilliard Lyons at PNC Bank (the "Account"). During the Relevant Period, the Firm did not have adequate policies and procedures to properly identify deposits into the Account by PNC Investments on behalf of its customers. As a result, the Firm did not timely identify the correct customer recipient for certain deposits, which caused the Firm to experience delays in crediting customer accounts with the deposited funds. In a small number of instances, the Firm failed to credit the deposits to any customer account.

At the end of each business day during the Relevant Period, the cumulative total of funds deposited into the Account at each PNC Bank branch was transferred to Hilliard Lyons as a total net deposit amount. At that time, Hilliard Lyons utilized a manual process that occasionally failed to capture identifying customer information with each check deposit. Because of this deficiency, the Firm was unable to timely identify every customer whose check had been deposited into the Account. During the Relevant Period, Hilliard Lyons received approximately 880,000 customer checks via deposits into the Account. Of these, a total of at least 8,921 customer checks totaling \$133,776,405 were deposited into the Account but not timely posted to the appropriate customer accounts, as follows:

- 2,298 customer deposits totaling \$39,459,751 were posted to the appropriate customer account between one to three business days late;
- 3,563 customer deposits totaling \$58,183,021 were posted to the appropriate customer account between four to seven business days late;
- 1,398 customer deposits totaling \$18,459,629 were posted to the appropriate customer account between 8 to 12 business days late;
- 674 customer deposits totaling \$7,387,703 were posted to the appropriate customer account between 13 to 17 business days late;
- 486 customer deposits totaling \$6,139,688 were posted to the appropriate customer account between 18 to 25 business days late;
- 226 customer deposits totaling \$1,607,836 were posted to the appropriate customer account between 26 to 33 business days late;
- 216 customer deposits totaling \$2,337,316 were posted to the appropriate customer account between 34 to 61 business days late;

- 48 customer deposits totaling \$161,345 were posted to the appropriate customer account between 62 to 93 business days late;
- 9 customer deposits totaling \$13,382 were posted to the appropriate customer account between 94 to 137 business days late; and
- 3 customer deposits totaling \$26,734 were posted to the appropriate customer account between 265 and 275 business days late.

The Firm engaged in an ongoing review process to attempt to identify the correct customer account into which the unidentified check deposits should have been posted. When the Firm was not able to determine the identities of the customers whose checks were deposited into the Account within 60 days, the Firm transferred the funds into the Escheatment Account. Once in the Escheatment Account, the Firm continued to research these unidentified deposits in order to locate the correct customer accounts to which the funds should be credited.

Customer Deposits that the Firm Was Unable to Identify Properly and Were Never Posted to the Appropriate Customer Accounts

The Firm eventually identified the correct customer accounts for nearly all the funds that PNC Investments deposited on behalf of its customers into the Account. However, the Firm was unable to determine the proper customer accounts for approximately \$133,816.65 in deposits. The Firm ultimately escheated \$83,616.65 of these funds to the Commonwealth of Kentucky in accordance with its policy of handling abandoned property.¹ The remaining \$50,000 represents debits from the Escheatment Account that the Firm was unable to reconcile with any of its books and records. While the Firm maintains that the \$50,000 in debits represents funds that were credited to customer accounts, the Firm has been unable to provide any documentation evidencing such credits.

Subsequent Remedial Measures to Address Failed or Untimely Customer Account Credits

In response to the problems described above, the Firm subsequently refunded on a voluntary basis \$13,230 to customers who improperly accrued fees, charges or losses based upon the Firm's failures to timely identify customer deposits (i.e., shares sold incorrectly, margin fees incorrectly charged, possible losses on initial sales due to the higher costs associated with repurchasing shares at higher per share prices). The Firm also voluntarily reimbursed customers for interest associated with the delayed crediting of the subject deposits where the total interest amount was \$10 or more per account, resulting in total interest

¹ These funds were not "abandoned" or "unclaimed" property in the traditional sense but rather, because the Firm's procedures were deficient during the Relevant Period, the Firm could not determine the correct customer account to credit certain deposited funds.

reimbursements of \$84,447. In addition, the Firm designed and implemented a fully-automated system to accept and post deposits into PNC Investments customer brokerage accounts carried by the Firm. FINRA took into account the voluntary remedial steps already performed by Hilliard Lyons to compensate customers for delays associated with the Firm's failure to timely post certain deposits in customer accounts, and to enhance its relevant systems and procedures.

Based upon the foregoing conduct, the Firm violated NASD Conduct Rule 3010 by failing to have an adequate supervisory system, including written supervisory procedures and a supervisory control system, to properly and timely identify customer checks deposited at PNC Bank branches and to ensure that all customer check deposits were duly credited to the appropriate customer accounts. The foregoing violative conduct also constitutes a violation of NASD Conduct Rule 2110.

B. Impact on the Firm's Net Capital and Customer Reserve Calculations and its Books and Records

As a result of the unidentified customer check deposits that were recorded in the Escheatment Account, the Firm failed to make and keep accurate daily records of all receipts and disbursements of cash and all other debits and credits in its books and records, including entries to the Escheatment Account. The Firm also understated its net capital charges and incorrectly calculated its Customer Reserve Formula.

In addition, the above-described deficiencies caused the Firm to produce inaccurate month-end customer account statements, incorrectly liquidate certain customer fully paid securities, and fail to segregate some customer fully paid securities, which resulted in intra-day possession or control deficits.

Based upon the foregoing conduct, the Firm violated Sections 15 and 17 of the Exchange Act and Rules 15c3-1, 15c3-3 and 17a-3(a)(1) thereunder, and NASD Conduct Rules 2340, 3010 and 3110 for its net capital computation errors, Customer Reserve Formula calculation errors, inaccuracies in its books and records, and inaccurate account statements sent to customers. The foregoing violative conduct also constitutes a violation of NASD Conduct Rule 2110.

2. Failure to Perform Required Inter-Company, Bank, Clearing and Depository Reconciliations and Take Applicable Net Capital Charges

Section 15 of the Exchange Act and Rule 15c3-1(c)(2)(iv) sets forth the deductions related to fixed assets and assets which cannot be readily converted into cash that are required in calculating a firm's net worth. Pursuant to Rule

15c3-1(c)(2)(iv)/021, firms are required to compute net overall unfavorable bank account, correspondent account, clearing corporation, and securities depository reconciliation differences and, if not resolved within a specified number of business days, deduct the aged unfavorable reconciliation differences from its net capital position.

The Firm did not have adequate procedures related to its review of inter-company accounts. The Firm relied on its parent company to perform the inter-company reconciliations between the Firm and its affiliates. During 2005, the Firm had unreconciled differences with its affiliates, including instances where an affiliate booked a payable but the Firm failed to book the corresponding receivable, and where the Firm booked a payable but an affiliate failed to book the corresponding receivable. The Firm also failed to timely record these aged inter-company differences in a suspense account and failed to record the applicable net capital charges.

The Firm also did not have adequate procedures to ensure that it reduced its net capital position for aged unfavorable reconciliation differences relative to bank accounts with overdraft balances. In addition, the Firm did not conduct adequate supervisory reviews of various month-end reconciliations of Firm and customer positions maintained at various depositories and clearing organizations.

Accordingly, the Firm violated Sections 15 and 17 of the Exchange Act and Rules 15c3-1(c)(2)(iv) and 17a-3(a)(1) thereunder, and NASD Rules 3010 and 3110 by failing to prepare certain inter-company account reconciliations, failing to properly record certain aged unfavorable reconciliation differences and failing to conduct supervisory reviews of certain reconciliations and accounts. The foregoing violative conduct also constitutes a violation of NASD Conduct Rule 2110.

3. Failure to Have Adequate Procedures Related to Public Appearances and Required Disclosures by Research Analysts

NYSE Rule 472(l)² requires that firms establish specific written supervisory procedures which include provisions that require prior approval of employees' communications activities that include interviews with the media, writing books, conducting seminars or lecture courses, writing newspaper or magazine articles, or making radio/TV appearances.

NASD Rule 2711(h)(1)(A) requires that firms disclose in research reports and research analysts disclose in public appearances any financial interest that

² NYSE Rule 472 has been incorporated by reference into the FINRA Manual. At the time of this violation, there was no corresponding NASD Rule in effect.

individual research analysts or firms and their households have in the securities of the subject company, and the nature of the financial interest.³ NASD Rule 2711(h)(9) requires that firms and their research analysts provide any disclosures in research reports and public appearances that are required by other applicable laws or regulations, including NASD Rule 2210. NASD Rule 2711(h)(12) requires that firms maintain records of public appearances by research analysts sufficient to demonstrate compliance with the applicable disclosure requirements under paragraph (h) of NASD Rule 2711. NASD Rule 2711(i) requires firms to adopt and implement written supervisory procedures reasonably designed to ensure that the firms and their employees comply with the provisions of NASD Rule 2711.

NASD Rule 2210(d)(1)(A) requires that all firm communications with the public be based on principles of fair dealing and good faith, be fair and balanced and provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service. It also prohibits firms from omitting any material fact or qualification if the omission, in light of the context of the material presented, would cause the communication to be misleading.

During 2004 and 2005, the Firm's supervisory procedures did not adequately ensure that its research analysts: (i) received specific approval from a designated supervisor prior to participation in public appearances; (ii) always identified the disclosures provided to the media outlet; and (iii) identified to the media outlet the nature of any financial interest in the subject company that they held for themselves and their household members.

Specifically, the Firm's procedures did not require specific approval for each public appearance. Instead, the Firm permitted its Director of Research to provide a written blanket approval for all public appearances by the Firm's research analysts. As a result, in at least three instances during the year 2005, research analysts failed to obtain specific approval from a designated supervisor. Also, in at least one instance during the same year, a research analyst failed to adequately identify the disclosures provided to the media outlet, and on at least four occasions, research analysts failed to identify to the media outlet the nature of any financial interest in the subject company that they held for themselves and their household members.

Therefore, the Firm violated NYSE Rule 472(l) and NASD Rules 2210(d)(1)(A), 2711(h)(1)(A), 2711(h)(9), 2711(h)(12) and 2711(i) by failing to have adequate

³ Pursuant to NASD Rule 2210(a)(5), public appearances by a firm's research analysts are considered communications with the public and, therefore, must adhere to the standards applicable to all communications with the public set forth in NASD Rule 2210(d)(1)(A).

procedures to ensure that its research analysts obtained the required approval for public appearances and provided proper disclosures during such public appearances. The foregoing violative conduct also constitutes a violation of NASD Conduct Rule 2110.

4. Failure to Comply with Rules Governing Analyst Certifications and Required Disclosures in Research Reports

NASD Rule 2711(h)(10) states that the disclosures required by paragraph (h) of NASD Rule 2711 must be presented on the front page of research reports, or the front page must reference the page(s) on which the disclosures are found. Disclosures, and references to disclosures, must be clear, comprehensive and prominent. NASD Notice to Members 04-18, pgs. 239-242 (March 2004) further states that such references to disclosures are required to point to a specific page number or a specific section of the report.

Rule 501(a) of Regulation AC requires that brokers or dealers or covered persons that publish, circulate, or provide research reports prepared by research analysts to persons in the United States shall include in the research reports clear and prominent certifications by the research analysts containing the following: (1) A statement attesting that all of the views expressed in the research reports accurately reflect the research analysts' personal views about any and all of the subject securities or issuers; and (2)(i) A statement attesting that no part of the research analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the research analysts in the research reports, or (ii) A statement (A) attesting that part or all of the research analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the research analysts in the research reports; (B) identifying the sources, amounts, and purposes of such compensation; and (C) further disclosing that the compensation could influence the recommendations or views expressed in the research reports.⁴

Between January 2005 and June of 2005, the Firm issued certain research reports to the public that did not comply with the requirements of Rule 501(a) of Regulation AC and NASD Rules 2210(d)(1)(A), 2711(h)(9) and 2711(h)(10) in that:

- (i) Two research reports contained indefinite "may" language regarding future investment banking services that the Firm expected to provide.
- (ii) Five research reports did not include any analyst certifications on the front

⁴ Pursuant to NASD Rule 2210(a)(2), research reports issued to the public by members are considered communications with the public and, therefore, must adhere to the standards applicable to all communications with the public set forth in NASD Rule 2210(d)(1)(A).

page.

- (iii) Five research reports contained front pages that did not specify the page or pages in the research report on which the analyst certifications were to be found.
- (iv) One research report incorrectly included the analyst certification information as part of the important disclosures.

Based upon the foregoing, the Firm violated Rule 501(a) of Regulation AC and NASD Rules 2210(d)(1)(A), 2711(a)(9), 2711(h)(10) and 2711(h)(12) by failing to ensure that research reports issued to the public contained required disclosures and analyst certifications. The foregoing violative conduct also constitutes a violation of NASD Conduct Rule 2110.

B. *The Firm also consents to the imposition of the following sanctions:*

A censure and a fine in the amount of \$200,000 and a requirement that the Firm place an amount of \$133,817 into a segregated account (interest-bearing) for a period of five years (the "Reimbursement Period"). The funds in the segregated account must be used to reimburse customers who can reasonably demonstrate that they made deposits to their Firm accounts at a PNC Bank branch and that the Firm failed to properly credit the deposits to their accounts. The Firm must establish a claims process that provides a reasonable opportunity for such customers to demonstrate that they made deposits that were not credited to their accounts. Any payments to these customers must include all accrued interest from the date of the initial attempted deposit with the Firm to the date that the Firm reimburses the customers. During the entire Reimbursement Period, the Firm must place a notice on the main page of its website announcing that certain customer deposits made at PNC Bank branches during the period April 21, 1999 through December 31, 2005 were not properly credited to the appropriate customer accounts. The website notice must also include a toll-free number to be used by customers who wish to submit claims to the Firm related to the failure to properly credit deposits to their account, along with instructions for customers to submit claims that provide a reasonable opportunity for such customers to seek reimbursement from the Firm. The Reimbursement Period shall commence no later than 30 days after the Firm receives notice that this AWC has been accepted by FINRA. At the end of the Reimbursement Period, the Firm shall regain possession and control over any remaining funds (including interest earned on the funds deposited in the segregated account) that have not been claimed by customers.

The Firm agrees to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are due and payable. The Firm has submitted an Election of Payment form showing the method by which it proposes

to pay the fine imposed.

The Firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

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

II.

WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Complaint issued specifying the allegations against the Firm;
- B. To be notified of the 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, the Firm 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.

The Firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA 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

The Firm 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 the Firm; and
- C. If accepted:
 - 1. this AWC will become part of the Firm'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 8313; and
 - 4. the Firm 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. The Firm 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. The Firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm 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.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm 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 the Firm to submit it.

10/29/09

Date

J.J.B. Hilliard/W.L. Lyons, LLC

By:

James R. Allen
James Allen
Chief Executive Officer

Reviewed by:

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Accepted by FINRA:

11-16-09

Date

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



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