

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT**

NO. 20070094878 and 20070114046

RECEIVED

DEC - 3 P 4: 14

REGISTRATION & DISCLOSURE

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

**RE: Robert W. Baird & Co. Incorporated, Respondent
BD No. 8158**

Pursuant to Rule 9216 of FINRA Code of Procedure, Robert W. Baird & Co. Incorporated ("Baird" 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. Baird 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

Baird is currently, and was during all times relevant hereto, a member of FINRA and registered as a broker/dealer with the United States Securities and Exchange Commission. Baird has been a member since 1971 and is headquartered in Milwaukee, Wisconsin. Baird has no relevant disciplinary history.

OVERVIEW

Baird introduced a non-advisory fee-based brokerage account program called Fee-in-Lieu of Commission in 1996. In 2001 the program was renamed 360/One ("360/One"). Customers with 360/One accounts paid Baird a fee based on the total value of Eligible Assets (*i.e.*, contractually specified assets upon which account fees would be calculated) in the account.

During the period January 1, 2002 to December 31, 2005 ("the Review Period") in which Baird's 360/One program grew from approximately 7,000 accounts to over 11,000 accounts, Baird violated NASD Conduct Rules 3010 and 2110 by failing to establish and maintain an adequate supervisory system, including written procedures, reasonably designed to review and monitor its fee-based brokerage business. As a result of deficiencies in Baird's systems and procedures, Baird allowed 101 household customers to continue in 360/One without adequately reassessing whether the accounts remained appropriate for them despite their conducting no trades for at least eight consecutive quarters. These customers paid over \$269,000 in fees during the inactive quarters after the first four consecutive quarters with no trades. In traditional commission-based accounts, these customers would not have paid the Firm any commissions during the period of inactivity.

The Firm also failed to have a supervisory system in place to automatically credit certain customers with breakpoint discounts that were specified in the Firm's 360/One Account Agreements ("Account Agreements") used to open new accounts from Spring 1999 to Spring 2001. As a result of its supervisory failures, from June 2001 to September 2007, approximately 53 customers were charged fees higher than those indicated on the Baird standard fee schedule in an amount totaling approximately \$165,193.

In addition, during the time period May 1999 through January 2005, the Firm failed to adequately disclose that assets held on margin and short sales were included in Eligible Assets for purposes of determining the fee charged to customers.

FACTS AND VIOLATIVE CONDUCT

Background

Fee-based brokerage accounts are an alternative to traditional commission-based accounts. The primary difference is that fee-based customers are charged a fee based on the assets held in the account rather than on a transaction basis.

In 1995, in response to concerns about potential conflicts of interest in the brokerage industry, the Securities and Exchange Commission released its Report of the Committee on Compensation Practices, commonly known as the "Tully Report." This report described fee-based accounts as a "best practice" in the industry because they align the customer's and registered representative's interests. In this arrangement, the registered representative and customer both are motivated to build the assets in the customer's account. This is in contrast to the traditional commission-based account, in which there is always the risk of temptation for the income-seeking registered representative to attempt to increase the trading activity in a customer's account. The report further advised that a fee-based account also might be appropriate "for investors who prefer a consistent and explicit monthly or annual charge for services received, and whose level of trading activity is moderate." But the report also pointed out that small and low-activity accounts would endure higher costs as a fee-based account than as a commission-based account because of the imposed fees.

As a result of regulatory initiatives by the SEC in 1999 granting a "safe harbor" from the registration requirements of the Investment Advisers Act of 1940 for broker-dealers based on the form of compensation received,¹ FINRA member firms began offering customers fee-based accounts as an alternative to traditional commission-based charges for brokerage services.²

In November 2003, FINRA released *Notice to Members 03-68* ("NTM 03-68"), which "remind[ed] members that they must have reasonable grounds for believing that a fee-based program is appropriate for a particular customer, taking into account the services provided, cost, and customer preferences."

NTM 03-68 recommended that supervisory procedures for fee-based accounts include a periodic review to determine whether the fee-based accounts remain appropriate for their respective customers.³ NTM 03-68 cautioned that a finding that a customer would have been billed less in a commission-based account than in a fee-based account would not be conclusive that the account was inappropriate for that customer. But, in such a case, the firm should give careful scrutiny to the account.

FINRA member firms are required to tailor their supervisory procedures to their business. For fee-based accounts, firms should have implemented supervisory procedures that include a periodic review to determine whether the fee-based accounts remained appropriate for their customers.

Baird's 360/One Program

Baird introduced its non-advisory fee-based brokerage business, known as the "Fee-in Lieu of Commission" program, in 1996. In June 2001, the firm changed the name of the program to "360/One." The 360/One program grew from approximately 7,070 accounts at year-end 2002 to approximately 11,120 accounts at year-end 2005.

In Baird's 360/One accounts, the Firm charged customers an annual fee based on the total value of the Eligible Assets⁴ held by the customer. The fee schedule in the Account Agreement was a sliding scale that billed clients 2.0% annually for Eligible Assets valued at \$100,000 to \$249,999, 1.5% annually for assets valued at \$250,000 to \$499,999, and 1.25% annually for assets valued at more than \$500,000. Initial account fees were based on the value of Eligible Assets in an account as of the date the account agreement was executed by the client and accepted by Baird. Customers and registered representatives were free to adjust the fee schedule upward or downward, or to negotiate a fixed fee to be assessed on all Eligible Assets, depending on the circumstances of a particular account.

¹ See SEC Rel. No. 34-42099, Nov. 4, 1999, *Certain Broker-Dealers Deemed Not to Be Investment Advisers*.

² See SEC Rel. No. 34-50980, Jan. 6, 2005, *Certain Broker-Dealers Deemed Not to Be Investment Advisers*.

³ Absent unusual circumstances, NASD recommends conducting such a review annually. NTM 03-68, n. 8.

⁴ "Eligible assets" are those assets, as defined by BAIRD in the 360/One Client Services Agreement, on which a fee will be assessed if held in a 360/One account.

Prior to March 2001, Baird's fee-based program had an annual 52-trade limit for individual accounts. Thereafter, the 360/One account agreement prohibited "excessive trading activity" as determined by Baird, but did not specify a particular number of trades permitted without incurring additional fees. The Firm promoted the 360/One program as an asset-based pricing alternative to traditional brokerage commissions, that provided "access to unlimited trading in eligible securities" for one quarterly fee as a benefit of the program.

Baird ceased opening new 360/One accounts effective July 13, 2007, and terminated the 360/One program on September 30, 2007.¹

Baird Failed to Establish and Maintain an Adequate Supervisory System, Including Written Procedures, Reasonably Designed to Review and Monitor its Fee-Based Business

NASD Conduct Rule 3010(a) requires firms to establish, maintain and enforce a supervisory system, including written procedures, to supervise the activities of its registered representatives and associated persons, that is reasonably designed to achieve compliance with applicable securities laws and regulations and NASD Rules. Written supervisory procedures required by NASD Conduct Rule 3010(b) are one part of the overall supervisory system required of members. They must be established, maintained and enforced to supervise the type of business in which the member engages. Baird violated NASD Conduct Rules 3010(a) and (b) and 2110 by failing to establish and maintain an adequate supervisory system, including written procedures, reasonably designed to review and monitor its fee-based brokerage business to determine whether 360/One accounts continued to be appropriate for its customers.

Baird did not implement a supervisory system or written procedures specifically tailored to its 360/One accounts until March 2004. Instead, Baird relied on its existing supervisory system and written procedures to supervise its fee-based brokerage accounts. The Firm's systems and procedures were insufficient to determine whether 360/One accounts remained appropriate for its 360/One customers on an ongoing basis. During this period, the Firm did not maintain exception reports to monitor fee-based brokerage accounts for inactivity, and did not have sufficient procedures requiring registered representatives to consider whether fee-based accounts remained appropriate for particular customers in light of the services provided, the projected cost to the customer, alternative fee structures that were available, or the customer's fee structure preferences and investment objectives.

In March 2004, the Firm began implementing a supervisory system and procedures specifically for the 360/One program, including procedures regarding the opening of accounts, ongoing monitoring of accounts, and customer contact. However, the Firm had no automated systematic means of monitoring its fee-based accounts for low activity, or specific exception reports, until October 2005, when it implemented an automated system to identify inactive accounts and began to send monthly "low activity" exception reports to its branch offices. Even after the creation of

¹ In January 2005, the SEC sought to codify the safe harbor in a new provision under the Investment Advisers Act of 1940, section 202(a)(11)-1. See SEC Rel. No. 34-50980, Jan. 6, 2005, *Certain Broker-Dealers Deemed Not to Be Investment Advisers*. In March 2007, however, a federal court struck down the final version of that SEC rule leading firms, including Baird, to discontinue offering such accounts.

these exception reports, the Firm did not have an adequate system or procedures in place to ensure appropriate follow-up with customers identified by the exception reports.

Due to its inadequate systems and procedures for ongoing monitoring of accounts, during the Review Period, Baird failed to adequately monitor the activity in 360/One accounts to ensure that they remained appropriate for its customers. A number of 360/One accounts conducted no trades for at least eight consecutive quarters during the Review Period. Of these, FINRA identified 101 household customers in fee-based accounts that are entitled to restitution as described herein. After these customers went four consecutive quarters without trading, the Firm's system and procedures were not reasonably designed to determine whether they remained appropriate for 360/One. Consequently, without an adequate supervisory review of their particular circumstances, these 101 customers remained in 360/One for at least an additional four quarters, in which they incurred an additional \$269,317 in fees without conducting any trades. If Baird had discussed with these customers whether 360/One remained appropriate for them after they had four consecutive quarters without trading activity, and the customers had elected to change to a commission-based account, the customers would not have incurred any commission charges in subsequent quarters in which they did not trade.

Among the buy-and-hold customers who continued in 360/One accounts during the Review Period without having the firm adequately reassess the appropriateness of their accounts were:

- Customer A opened a 360/One account in September 2000, and conducted no trades in the 360/One account for 16 consecutive quarters from January 2002 through December 2005. Customer A paid Baird \$19,482 in 360/One fees during the period of inactivity. In a traditional commission-based account, Customer A would not have paid the firm any commissions during those four years.
- Customer B opened a 360/One account in February 1997, and conducted no trades in the 360/One account for 15 consecutive quarters from January 2002 through November 2005. Customer B paid Baird \$14,571 in 360/One fees during the period of inactivity. In a traditional commission-based account, Customer B would not have paid the firm any commissions during this approximately 4-year period.

As set forth above, Baird violated NASD Conduct Rules 3010(a) and (b) and 2110 by failing to establish and maintain a supervisory system, including written procedures, reasonably designed to review and monitor its fee-based brokerage business.

Baird Failed to Implement Breakpoint Discounts On Non-Advisory Fee-Based Accounts

The fee-based Account Agreement utilized by the Firm for accounts opened from May 1999 through June 2001, which remained in effect through September 2007, stated that the fee was calculated by applying the following fee schedule to the total Eligible Assets:

<u>Account Asset Value</u>	<u>Equity and Fixed Income Assets</u>
\$100,000 - \$249,999	2.00%
\$250,000 - \$499,999	1.50%
Over \$500,000	1.25%

Initial account fees were based on the value of Eligible Assets in an account as of the date the Account Agreement was executed by the client and accepted by Baird. Despite the fee schedule, customers and registered representatives were free to adjust the fee schedule upward or downward, or to negotiate a fixed fee to be assessed on all Eligible Assets, depending on the circumstances of a particular account.

On occasion, Baird registered representatives handwrote on the Account Agreement a percentage of assets (different than the fee indicated on the standard fee schedule) to be assessed as fees on the initial Eligible Assets deposited in accounts, without indicating whether such a percentage fee was fixed and therefore applicable to all subsequent Eligible Assets, or if the percentage fee applied to the initial deposit only, with subsequent fees to be assessed according to the standard fee schedule (including breakpoint discounts) or some other negotiated fee schedule. As a result, the Firm was unable to provide sufficient contemporaneous evidence of the specific fee applicable for certain customer accounts.

In addition, once the initial fee was determined, the Firm did not have an adequate system or procedure in place to award discounts to certain customers who reached higher breakpoints. In many instances, breakpoint discounts were not provided in accordance with the standard fee schedule, and Baird could not provide sufficient contemporaneous evidence that the customers negotiated a fixed fee or some other negotiated fee schedule. As a result of its supervisory failures, which continued through September 2007, 53 customers paid fees higher than those indicated on the Baird fee schedule, resulting in an overpayment by customers of approximately \$165,193.

Baird violated NASD Rule 3010 and NASD Conduct Rule 2110 by (i) failing to clearly identify the specific fee applicable to each customer; and (ii) failing to implement a system to automatically credit certain customers with breakpoint discounts specified in the fee schedule in Baird's 360/One Account Agreements.

Baird Failed To Adequately Disclose Inclusion of Margin Activity And Short Sales In Fee Calculations For Fee-Based Accounts

In determining a customer's fee for fee-based accounts during the time period May 1999 through January 2005, Baird included assets purchased on margin and short sales without adequately disclosing to customers their inclusion as "Eligible Assets" for purposes of fee calculation.

Prior to January 2005, Baird disclosed to 360/One customers that the fee was calculated based on Eligible Assets, defined to include broad categories of assets such as equities and fixed income products. Baird included on its quarterly statement to the customer the quarterly fee charged and the asset value upon which the fee was based. Baird did not, however, adequately disclose in its account agreement that assets purchased on margin, for which the customer may already be paying margin interest, and short sales, would be treated as Eligible Assets to establish an account asset value for purposes of fee calculation.

After the margin and short sale disclosures were added, the Firm did not send these disclosures

to customers who had previously opened fee-based accounts with the Firm. Only new accounts opened after January 2005 received these disclosures.

The Firm generated revenues by calculating Eligible Assets in this manner, without adequately disclosing this practice to its customers.

Baird violated NASD Rule 2110 by failing to adequately disclose the impact of margin activity and short sales on fee calculations for its fee-based accounts.

SANCTIONS

The Firm consents to the imposition of the following sanctions:

1. A censure;
2. A fine of \$500,000; and
3. The payment of restitution in the aggregate amount of \$434,510, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code (26 U.S.C. § 6621) as set forth below. The underlying restitution amounts:
 - a. ~~101 household customers that conducted no trades in~~ their 360/One accounts for at least 8 consecutive quarters, in the total amount of \$269,317 plus interest from January 1, 2006 until the date this AWC is accepted by the NAC; and
 - b. 53 customers who paid fees higher than those indicated on the fee schedule in the 360/One Account Agreement, in the total amount of \$165,193 plus interest from October 1, 2007 until the date this AWC is accepted by the NAC.

Baird 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 manner.

Baird has identified for FINRA the customers to whom restitution payments will be made, and satisfactory proof of payment of the restitution or of reasonable and documented efforts undertaken to effect restitution shall be provided to FINRA staff no later than 120 days after acceptance of this AWC by the NAC. If for any reason Baird cannot locate any of the identified customers after reasonable and documented efforts within such period, or such additional period agreed to by the staff, Baird shall forward any undistributed restitution to the appropriate escheat, unclaimed property, or abandoned property fund for the state in which the customer is last known to have resided.

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

II.

WAIVER OF PROCEDURAL RIGHTS

Baird 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, Baird 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.

Baird further specifically and voluntarily waives any right to claim that a person violated the *ex parte* prohibitions of NASD Rule 9143 or the separation of functions prohibitions of NASD 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 NASD Rule 9216;

- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Baird; and
- C. If accepted:
1. This AWC will become part of Baird's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Baird;
 2. This AWC will be made available through FINRA's public disclosure program in response to public inquiries about Baird's disciplinary record;
 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 4. Baird 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. Baird may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Baird 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.

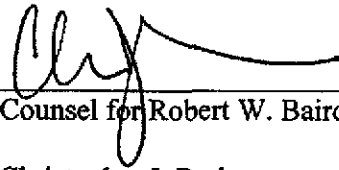
Baird certifies that it has read and understood all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that it has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Baird to submit it.

11/7/08
Date

Robert B. Baird & Co. Incorporated

By: 
Jeffrey F. Freiburger
Managing Director
Director of Compliance

Reviewed by:



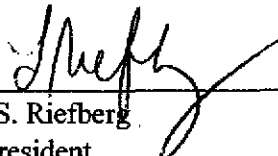
Counsel for Robert W. Baird & Co. Incorporated

Christopher J. Barber
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115 S. LaSalle Street, Ste. 3100
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(312) 577-1230

Accepted by FINRA:

12-3-08
Date

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



Linda S. Riefberg
Vice President
FINRA Department of Enforcement
14 Wall Street
New York, NY 10005