

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20080146206**

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

RE: Frost Brokerage Services, Inc.

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Frost Brokerage Services, Inc. ("Frost," "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. 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

Respondent 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

Frost is a full service brokerage firm headquartered in San Antonio, Texas. Frost has been a member of FINRA (f/k/a National Association of Securities Dealers or NASD) since 1986. The Firm is a wholly owned subsidiary of The Frost National Bank.

RELEVANT DISCIPLINARY HISTORY

The Firm has no relevant disciplinary history.

OVERVIEW

During periods from approximately 2003 to September 2010, the Firm failed to retain numerous emails sent or received by the Firm's registered representatives and retained an unknown number of emails with timestamps that differed, in some instances by a matter of seconds, from the time Frost registered representatives sent or received those emails.

Additionally, from approximately 2003 to September 2010, Frost failed to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with federal securities laws and NASD Rules regarding

the retention and review of electronic communications, including messages sent via Blackberry devices and emails and instant messages sent via the Bloomberg system, as required by the federal securities laws and NASD and FINRA rules.

As a result of problems with its email retention system and its failure to have a supervisory system reasonably designed to preserve and review emails, Frost failed to retain an unknown number of emails and was unable to produce certain of those emails to FINRA when requested to do so.

By virtue of the conduct set forth herein, Frost violated Section 17(a) of the Securities Exchange Act of 1934, Rule 17a-4 thereunder, NASD Rules 3110, 2110 and 3010 and FINRA Rule 2010.¹

FACTS AND VIOLATIVE CONDUCT

Failure to Retain Communications in Conformity with Exchange Act Section 17(a), SEC Rule 17a-4 thereunder, NASD Rules 3110 and 2110, and FINRA Rule 2010

NASD Rule 3110(a) provides in pertinent part, "Each member shall make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations, and statements of policy promulgated thereunder and...[t]he record keeping format, medium and retention period shall comply with Rule 17a-4 under the Securities Exchange Act of 1934."

Rule 17a-4 requires that every broker dealer preserve for a period of not less than three years, the first two years in an accessible place, "originals of all communications received and copies of all communications sent by such member, broker or dealer (including inter-office memoranda and communications) relating to its business as such." The Rule further provides that when using electronic storage media for the retention of communications, "[t]he electronic storage media must: (A) Preserve the records exclusively in a non-rewriteable, non-erasable format."

The Frost Retention System Did Not Retain Internal Email for Three Years and Did Not Retain Email in a Non-Erasable, Non-Rewriteable Format

From approximately 2003 to February 2007, Frost did not retain internal emails sent or received by Frost registered representatives ("Internal Email") for three years. During that period, Frost used an internally created email retention system (the "Frost Retention System") that retained email between Frost registered representatives and individuals outside the Firm, but did not retain Internal Email. Instead, Frost retained Internal Email through the use of backup tapes, which were archived by the Firm for less than the required three year period.

¹ See FINRA Regulatory Notice 08-57, which describes certain changes to FINRA's rules including the change of NASD Rule 2110 to FINRA Rule 2010, effective December 15, 2008.

During that same period, the Frost Retention System did not retain email in a non-erasable, non-rewriteable format.

Therefore, from approximately 2003 to February 2007, Frost did not retain and preserve Internal Email for the required three-year period and did not retain email in a non-erasable, non-rewriteable format in violation of Exchange Act Section 17(a), SEC Rule 17a-4 thereunder, and NASD Rules 3110 and 2110 and FINRA Rule 2010.

The New Frost Retention System Did Not Retain an Unknown Number of Emails

In March 2007, Frost implemented a new email retention system created by an outside vendor ("the New Email Retention System") to retain registered representatives' email. Frost used the New Email Retention System to retain email through September 2010.

For an unknown number of emails, there was a difference in the time the email was sent from or received by the Frost registered representative and the timestamp on the email as saved in the archive of the New Email Retention System. In some instances, the difference was a matter of seconds. As a result, the timestamps on an unknown number of emails in the archive of the New Email Retention System differed from the times those emails were sent or received by the Frost registered representatives.

In 2008, approximately 183,000 emails were archived to the New Email Retention System without certain header information ("To," "From," "CC," "BCC," "Delivery Date," and "Time" headings). Approximately 93,000 of those emails were sent or received during the period relevant to an ongoing FINRA investigation. While attempting to gather emails in response to a FINRA investigation, Frost discovered that, due to a problem with the New Email Retention System, certain emails were being held in a database of the New Email Retention System and were not moving to the archive portion of the New Email Retention System. Working with the outside vendor from which Frost purchased the New Email Retention System, Frost performed certain upgrades to the New Email Retention System in an attempt to move those emails from the database to the archiving portion of the New Email Retention System. Prior to performing the upgrade on the New Email Retention System, Frost did not copy the contents of the database where the emails were being held. During the upgrade, a default configuration superseded the customized server configuration that the outside vendor had originally utilized for the New Email Retention System, resulting in the loss of certain header information when those emails were moved from the database to the archiving portion of the New Email Retention System. In a November 26, 2008 statement submitted to FINRA, Frost reported the problem that resulted in email being ingested in the New Email Retention System without certain header information.

The New Email Retention System also malfunctioned during parts of 2008, which led to gaps in the Firm's email retention during 2008 and the loss of emails that were responsive to FINRA's investigation. As a result, Frost was unable to produce an unknown number of emails that were responsive to FINRA's investigation. Neither Frost, nor the outside vendor from which it purchased the New Email Retention System was able

to determine the cause of the malfunction or the total number of emails that were lost as a result of the malfunction.

In addition, from April 2007 through February 9, 2010 the Firm did not retain or review emails sent by Frost registered representatives from Frost-issued Blackberry devices to individuals outside the Firm.

Therefore, during the periods referenced above, the Firm did not retain an unknown number of emails, retained an unknown number of emails with timestamps that differed, in some instances by a matter of seconds, from the time Frost registered representatives sent or received those emails, and did not retain or review emails sent via Blackberry device, in violation of Exchange Act Section 17(a), SEC Rule 17a-4 thereunder, and NASD Rules 3110 and 2110 and FINRA Rule 2010.

Frost Did Not Establish and Maintain a Supervisory System, Including Written Supervisory Procedures, Reasonably Designed to Preserve and Review Electronic Communications

NASD Rule 3010 requires each member firm to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with the federal securities laws and NASD Rules.

During periods from approximately 2003 to the present, Frost did not establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to retain email sent to or from Frost registered representatives for the required three-year period, to retain emails sent by Frost registered representatives from Frost-issued Blackberry devices to individuals outside the Firm, and to review electronic communications. In addition, from March 2008 to the present, Frost did not establish a supervisory system, including written supervisory procedures, reasonably designed to detect and prevent malfunctions in the New Email Retention System.

Because its supervisory system, including written supervisory procedures, was not reasonably designed to achieve compliance with NASD Rules and federal securities laws, Frost violated NASD Rules 3010 and 2110 and FINRA Rule 2010.

SANCTIONS

Respondent also consents to the imposition of the following sanctions:

1. A censure;
2. A fine in the amount of \$200,000; and

Respondent agrees to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are due and payable. Respondent has submitted an

Election of Payment form showing the method by which it proposes to pay the fine imposed.

Respondent 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.

3. Frost shall comply with the following undertaking within the time period specified (unless that time period is extended by FINRA staff following a written request by Frost):

Within 120 calendar days of the acceptance by FINRA of this AWC, the President of Frost will certify to FINRA in writing that Frost currently has in place systems and procedures reasonably designed to achieve compliance with the requirements of Section 17(a) of the Securities Exchange Act of 1934, Rule 17a-4 thereunder and NASD Conduct Rule 3110 concerning the preservation of electronic communications. The certification, along with the current procedures, must be submitted to FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent 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 the Firm;
- 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, Respondent 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.

Respondent 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

Respondent 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 Respondent'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; and
 - 3. 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 Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent 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.

Respondent 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 Respondent to submit it.

Date

7/15/2011

Respondent

Frost Brokerage Services, Inc.

By:

Karen Banks

Karen Banks
President

Accepted by FINRA:

8/1/11
Date

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

Thomas B. Lawson

Thomas B. Lawson
Vice President
FINRA Department of Enforcement