

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. C9A050032

TO: Department of Enforcement
NASD

RE: Hornor, Townsend & Kent, Inc., Respondent
CRD No. 4031

Pursuant to Rule 9216 of NASD's Code of Procedure, Respondent Hornor, Townsend & Kent, Inc. ("HTK") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of posing 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 us alleging violations based on the same factual findings.

We understand 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 the 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 us; and
3. If accepted:
 - a. this AWC will become part of our permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against us;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about our 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. We 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 allegations in this AWC or

create the impression that the AWC is without factual basis. Nothing in this provision affects our testimonial obligations or right to take legal positions in litigation in which NASD is not a party.

We also understand that our experience in the securities industry and our disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

HTK has been an NASD member since June 1969 and conducts a general securities business. HTK has no relevant disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

We specifically and voluntarily waive the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against us;
- 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, we specifically and voluntarily waive 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.

We further specifically and voluntarily waive 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

A. We hereby accept and consent, without admitting or denying the alleged violations, 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 adjudication of any issue of law or fact, to the entry of the following findings by NASD:

SUMMARY

During 2001-2003, HTK conducted national and branch office sales contests for its brokers and managers to promote the sale of selected variable life and variable annuity products. Several of those contests included only variable products offered by HTK's parent company, Penn Mutual. Moreover, in determining contest winners, sales of Penn Mutual variable life products were given exclusive or greater weight than Penn Mutual variable annuity products or they were given greater weight than variable products offered by other companies. HTK offered or awarded various forms of non-cash compensation for the winners of six national contests, including weekend trips to New York City, New Orleans and Las Vegas, with a total value of over \$200,000. As prizes for thirteen branch contests, the firm offered and awarded such items as golf trips, tickets to sporting events and other entertainment, dinners, high-definition television sets and other expensive electronic goods. The contests violated NASD rules because they favored the sale of particular products.

From at least August 1, 2001 through March 31, 2003, HTK failed to maintain and preserve all e-mail communications as required by SEC Rule 17a-4. Specifically, HTK failed to retain e-mail communications for its non-registered employees and for a number of registered persons, including its President and two other senior managers, with jobs that did not require customer contact. Three of those senior managers each approved at least some of the violative national sales contests.

During 2001-2003, HTK failed to have a supervisory system and procedures that were reasonably designed to achieve compliance with the NASD's non-cash compensation rule.

SALES CONTESTS

Regulatory Background

On July 15, 1998, the SEC approved an amendment to NASD Conduct Rule 2820¹ to regulate non-cash compensation arrangements for the sale and distribution of variable contracts. The rule, among other things, prohibits non-cash compensation arrangements

¹ The SEC also approved amendments to the non-cash compensation arrangements relating to the sale and distribution of mutual funds (Rule 2830).

between members and their associated persons for sales of variable contracts that are not based on concepts of "total production" and "equal weighting." In enacting the amendments related to non-cash compensation, both NASD and the SEC recognized that the increased use of non-cash compensation for the sales of variable contracts heightened the potential for loss of supervisory control over sales practices and increased the perception of inappropriate practices, which could result in a loss of investor confidence. *See Notice to Members 98-75 and 99-55.* Further, both NASD and the SEC were concerned that the increased use of non-cash compensation created significant incentives and conflicts of interest that might compromise the requirement to meet the investment needs of the customers.

NASD Rule 2820(g)(4), which involves member compensation for variable contracts, provides that "[n]o member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision." Under that Rule, non-cash compensation arrangements are permitted if they are between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member. Such arrangements, however, must be based on the total production of associated persons with respect to all variable contract securities distributed by the member. Moreover, the credit received for each variable contract must be equally weighted.

HTK's Sales Contests

Over the fourth quarters of 2001, 2002 and 2003, HTK conducted six national sales contests involving variable life and variable annuity products, all of which were sponsored by Penn Mutual. The national contests conducted in 2001 and 2002 were based only on the sale of Penn Mutual variable products. Moreover, in determining the winners for those contests, Penn Mutual variable life products were given exclusive or greater weight than variable annuity products. The 2003 national contest for producers included all variable products (proprietary and non-proprietary), but equal weight was not always assigned for the sale of all products. The 2003 national contest for field managers included only proprietary variable life insurance products.

HTK offered and awarded substantial non-cash compensation to the winners of the national sales contests. The prizes included weekend trips to New York City, New Orleans and Las Vegas, vouchers worth \$400 or \$800 that could be used to purchase personal entertainment or education, and "your choice" gift cards that could be used to purchase items from name-brand merchants such as Bose, Brooks Brothers, Williams-Sonoma and Lands' End. The total value of the national sales contest awards exceeded \$200,000.

During 2001-2003, HTK's branch offices conducted additional sales contests. Nine of those contests were based only on the sale of Penn Mutual variable products. In four other branch office contests, sales of Penn Mutual variable products were given greater

weight than other variable products. The branch office contest prizes included such items as golf trips, tickets to sporting events and other entertainment, dinners, high-definition television sets and other expensive electronic goods.

The HTK national and branch sales contests, as set forth in more detail in Attachment A and incorporated herein by reference, were not based on the concepts of “total production” and “equal weighting” as required by Rule 2820. For example, the 2001-2002 national sales contests, and some branch contests, violated the “total production” requirement by including only Penn Mutual variable products. Moreover, the national sales and branch contests violated the “equal weighting” requirement in that Penn Mutual variable contracts were given exclusive weight in determining award winners or all variable life products were given exclusive weight or greater weight than variable annuity products. Essentially, HTK’s contests favored the sale of particular products. The non-cash compensation that HTK provided to its sales force was also substantial enough to provide the improper incentives that NASD’s non-cash compensation rules were designed to prevent. Accordingly, this conduct constitutes separate and distinct violations of NASD Conduct Rules 2820 and 2110.

E-MAIL RETENTION

SEC Rule 17a-4 requires that brokerage firms maintain and preserve, for a period of not less than three (3) years, originals of all communications received and copies of all communications sent by such brokerage firm (including inter-office memoranda and communications) relating to its business as a broker-dealer. From at least August 1, 2001 through March 31, 2003, HTK did not maintain and preserve all e-mail communications as required by SEC Rule 17a-4. Specifically, HTK failed to retain e-mail communications for approximately 80 non-registered employees. HTK also failed to retain e-mail communications for at least three registered persons, including its President and two other senior managers, with roles that did not require customer contact. Three of those senior managers each approved at least some of the violative national sales contests. This conduct constitutes separate and distinct violations of SEC Rule 17a-4 and NASD Conduct Rules 3110 and 2110.

SUPERVISION

During 2001-2003, HTK failed to have a supervisory system and procedures that were reasonably designed to achieve compliance with the NASD’s non-cash compensation rule. Specifically, HTK failed to maintain, update and enforce reasonable internal policies, systems and procedures in, among other things, the following respects:

- HTK did not have a supervisory system in place reasonably designed to achieve compliance with the non-cash compensation provisions of NASD Conduct Rule 2820. This Rule, however, has been in effect since January 1, 1999, and NASD has released several notices related to these provisions, including *Notice to Members 98-75* and *99-55* and *NASD Regulatory and Compliance Alert, Short*

Takes (Summer 2000).

- HTK did not have any written supervisory procedures (“WSPs”) regarding NASD Conduct Rule 2820 until April 2003.

This conduct constitutes separate and distinct violations of NASD Conduct Rules 3010 and 2110.

B. We also consent to the imposition, at a maximum, the following sanctions:

HTK shall be censured and fined \$325,000.

In addition, HTK shall comply with the following undertakings within the time periods specified below (unless the time periods are otherwise modified by agreement between NASD staff and HTK):

1. Within 90 days after issuance of the AWC, an officer of HTK shall certify to NASD that the firm has reviewed its procedures relating to (i) compliance with the non-cash compensation provisions of NASD Conduct Rule 2820, and (ii) the preservation of electronic mail communications; and that the firm has established systems and procedures reasonably designed to achieve compliance with the laws, regulations, and rules concerning those areas.
2. Within 60 days after issuance of this AWC, HTK shall (a) amend its WSPs to designate a registered principal, in each of its business areas, who will be responsible for developing, amending, and maintaining WSPs that are reasonably designed to achieve compliance with the laws, regulations and rules that govern the firm’s activities; and (b) provide NASD with a written description detailing the initial and on-going education and training those registered principals will receive. HTK shall sponsor or otherwise provide the initial education and training to those designated principals within 90 days after issuance of this AWC.
3. For three years from the date that this AWC is issued, HTK shall prohibit any sales contests to promote the sale of variable life and variable annuity products.

III.

OTHER MATTERS

- A. We understand that we may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future

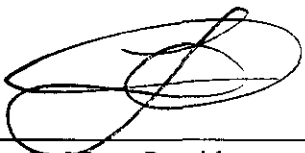
misconduct. We understand that we may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.

- B. We agree to pay any monetary sanctions imposed on us upon notice that this AWC has been accepted and that such payments are due and payable and have attached an Election of Payment form showing the method by which we propose to pay any fine imposed.
- C. We specifically and voluntarily waive any right to claim that we are unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

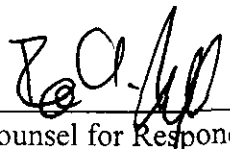
We certify that we have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce us to submit it.

Hornor, Townsend & Kent, Inc.

6/02/05
Date

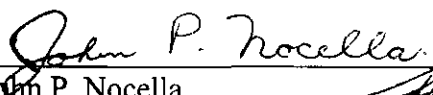
By: 
Larry L. Mast, President

Reviewed by:


Counsel for Respondent

Accepted by NASD:

July 6, 2005
Date


John P. Nocella
Senior Vice President and District Director

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

**Attachment A: Hornor Townsend & Kent, Inc.
Violative Sales Contests**

Name of Contest and/or Location	Date of Contest	Criteria	Non-Cash Compensation
"Touchdown 2001" – Case Agency System (CAS)	Producer Contest 9/24/01-11/2/01	Only Penn Mutual variable products	Weekend trip to New York City
	Sales Manager and General Agent Competition 9/24/01-12/14/01	Variable life products given greater weight than variable annuity products	Vouchers worth \$400 or \$800 that could be used to purchase personal entertainment A gift from a selection of Tiffany and Company, The Sharper Image or free activity certificate at the 2002 Leadership Conference
Independence Financial Network (IFN) Challenge	Regional Directors and Managers Contest 9/1/01-12/31/01	Only Penn Mutual variable products Variable life products given exclusive weight	Weekend trip to Las Vegas
"Success 4 You in 2002" - CAS	Producer Contest – 10/1/02-11/15/02	Only Penn Mutual variable products	Weekend trip to New Orleans
	Sales Manager and General Agent Competition - 9/16/02-12/31/02	Variable life products given exclusive weight or greater weight than variable annuity products	Vouchers worth \$400 or \$800 that could be used to purchase personal entertainment or education A "Choice Gift Card" in amounts ranging from \$50 to \$250 that could be

			used to purchase merchandise at brand-name stores such as Bose, Brooks Brothers, Williams-Sonoma and Lands' End.
"IFN EX'Sell'ebration" - IFN	Regional Manager and Regional Director Competition 9/16/02-12/31/02	Only Penn Mutual variable contracts Variable life products given exclusive weight	Weekend trip to New Orleans Vouchers worth \$400 or \$800 that could be used to purchase personal entertainment or education
"Sales Challenge 2003"	CAS Producer Contest 9/29/03-11/14/03 CAS Sales Manager and General Agent Competition 9/15/03-12/31/03 IFN Regional Manager and Regional Directors Competition 9/15/03-12/31/03	Penn Mutual variable contracts given exclusive weight (CAS Sales Manager and IFN Regional Manager Competitions) Variable life products given exclusive weight or greater weight than variable annuity products (CAS Producer Contest)	A weekend trip to New York City Vouchers worth \$400 or \$800 that could be used to purchase personal entertainment or education A Choice Gift Card in amounts ranging from \$50 to \$250
Branch #183 – Grand Rapids, MI	1/1/01-2/26/01 1/102-2/28/02	Penn Mutual variable products given greater weight than other variable products	One hour at the indoor "NASCAR Silicon Motor Speedway," an electronic racing venue at a local shopping mall

Branch #330 – Tulsa, Oklahoma	9/24/01-11/2/01 9/16/02- 12/31/02	Penn Mutual variable products given greater weight than other variable products	Mall gift certificates \$100 reimbursement of continuing education or licensing expenses
Branch #064 – San Diego, CA	1/1/02-3/31/02 1/1/03-3/1/03 6/1/03-7/14/03	Only Penn Mutual variable products	Weekend trip to Indian Wells, CA A ride on the General Agent's boat with dinner for two at an ocean- front restaurant Golf in Baja, Mexico
Branch #170 – Scottsdale, Az	1/1/01 - 2/28/01 6/1/02-8/31/02	Only Penn Mutual variable products	Two Tickets to a Phoenix Coyote hockey game (NHL) including pre-game snacks Dinner at the Hard Rock Café and tickets to an Arizona Diamondbacks baseball game
Branch #999 – Conshohocken, PA	1/1/02-3/31/02 10/1/02- 11/15/02 2/1/03-3/31/03	Only Penn Mutual variable products	Two High- Definition TVs, tickets to the “Chocolate Symphony”; a Palm 500 and Palm 125; \$100 Scholarships for Continuing Education course at the American College, Premier School

			Two tickets to an Eagles or Flyers game with limousine service and dinner for two HD Laser Jet Printer; Mobile DVD Entertainment System
Branch #080 – Burlington, MA	7/22/02-9/23/02	Only Penn Mutual variable products	Red Sox tickets, Patriots tickets, airline tickets, dinner for two, plays/shows in Boston were offered