HANDOUT 2

Stephens

David A. Knight
Executive Vice President
General Counsel
Stephens Inc.

Jackson T. Stephens, 1923-2005
Chairman Emeritus in Perpetuity

January 16, 2014

Senator Jane English
Representative Terry Rice
Co-Chairs
Joint Performance Review Committee
State Capital
Little Rock, Arkansas 72201

Dear Senator English and Representative Rice:

Stephens Inc. would like to supplement the information it has already provided to the Joint Performance Review Committee with the following analysis of the contributions made by various states to the North American Securities Administrators Association (NASAA). All of these contributions represent a sharing by the subject states of fines, penalties and other similar payments collected through settlement proceedings. The raw data from which this analysis was prepared was obtained from the Controller of NASAA and is set forth on pages 43 through 48 of the packet of information Securities Commissioner Heath Abshure presented to the JPR Committee.

As an initial observation, only 10 states made any contribution of settlement funds to NASAA during the five year period from 2009 through 2013. Obviously, the other 40 states made no such contribution to NASAA during that period, including states with some of the largest financial services industries such as New York, California, and Massachusetts.

The following table ranks the contributions made by each of the 10 states during that period by size and percentage of the total amount:

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	Amount[1]	Percentage
Arkansas	$172,358	33.53%
Alabama	144,200	28.05%
Florida	40,000	7.78%
Iowa	32,500	6.32%
Colorado	30,000	5.84%
Texas	25,000	4.86%
Washington	25,000	4.86%
Maine	20,000	3.89%
North Carolina	15,000	2.92%
New Jersey	10,000	1.95%
Totals	$514,058	100.00%

The $514,058 received by NASAA came in the form of 32 individual payments. Thirty of those payments were less than or equal to $25,000, and 23 were less than or equal to $15,000. There was only one payment of $50,000, and there was no other single payment greater than that amount other than the $150,000 payment related to the Crews Order.

In short, during the subject five year period, Arkansas contributed more than any other state to NASAA from the settlement payments it received, made the largest single contribution, and its contributions constituted more than one-third of the contributions received by NASAA from all states. All such contributions were sent to NASAA by Commissioner Abshure during his term as NASAA's president. Further, while we have not been able to obtain data regarding the total amounts of settlement payments received by the above-listed states, we believe it is reasonable to assume that the amount of such revenue received by Arkansas is relatively small when compared to that received by states with much larger financial services industries such as Texas, Florida and New Jersey.

The simple conclusion we have drawn from this analysis, and the other evidence presented to the JPR Committee, is that pursuant to Commissioner Abshure's directions,

[1] The computations reflected in this chart do not reflect a single settlement based contribution of $250,000 received by NASAA on February 27, 2013 because it is not attributed to any state. This is described as relating to "Form D," which is a federal disclosure filing made with respect to private placements of securities that is made available to all states. The NASAA Comptroller suggested in his email transmitting the subject information to Commissioner Abshure that it would be appropriate to back out that contribution because it was "done by the [NASAA] corp. office," (see Exhibit L, page 43, of the information packet provided by Commissioner Abshure).

Arkansas has contributed to NASAA a disproportionately large amount of the settlement payments it collects through Securities Department enforcement activities, without any legislative oversight.

Finally, we also note with respect to the states that did make settlement based contributions to NASAA, we do not know whether such contributions were authorized by statute or approved pursuant to legislative appropriations or budgetary approval processes.

Thank you for your consideration of these matters.

Very truly yours,

David A. Knight

David A. Knight

DAK/jcr

Prepared Remarks of David Knight,
General Counsel of Stephens Inc.
for the
Arkansas Joint Performance Review Committee Hearing
Regarding the Operations of the Arkansas Securities Department

January 22, 2014

Senator English, Representative Rice, and other members of this Committee,

I am David Knight, General Counsel of Stephens Inc., and with me today are my associates, Kim Fowler and Kevin Burns. The three of us represented Stephens with respect to the matters to be discussed in today's hearing. And we appreciate this opportunity to comment on the operations of the Arkansas Securities Department, especially with respect to certain conflicts of interest we have experienced in our recent dealings with Securities Department personnel. I asked Ms. Fowler and Mr. Burns to accompany me today in case you have questions regarding their involvement in these matters.

To facilitate our presentation, we had a court reporter prepare a transcript of Commissioner Abshure's testimony before the Committee on January 8th. And I will be referring to it during the course of my remarks. We also prepared for your consideration an analysis of information provided to the Committee by Commissioner Abshure related to settlement income from states received by NASAA.

It is my understanding that the Stephens matter arose when the Securities Department received a complaint from one of our customers that a former employee had engaged in unauthorized trading with respect to the customer's brokerage accounts. The Securities Department opened an investigation into this alleged violation, interviewed the customer and the broker, and obtained information from Stephens about trading activity in the customer's accounts. During the course of the investigation, the Securities Department expanded its inquiry to include the broker's handling of a small number of customer accounts. And in addition to investigating unauthorized trading, it also looked into sales by the broker of certain exchange traded funds (the "ETF's").

Stephens subsequently received a notice from the Securities Department's staff signed by attorney Scott Fredyl stating that the staff intended to file a complaint against the broker and Stephens for violating the Securities Act (see Attachment 1). The notice stated the staff had determined that (i) the broker had engaged in unauthorized trading and sales of unsuitable

securities (the ETF's) in the accounts of the customers, and (ii) Stephens had failed to reasonably supervise the broker with respect to both of those activities.

The notice also stated that the broker and Stephens had the opportunity to submit evidence rebutting these findings, and that the staff was willing to discuss the possibility of settling the matter through a consent order.

This brings us to the point alluded to by Senator Westerman at the last hearing (Transcript, p. 30). When the staff files a complaint against a brokerage firm in an administrative proceeding, the case is tried before the Securities Commissioner as judge. There is no jury. The Commissioner makes the factual findings, decides if there are violations of the Securities Act and determines the appropriate sanctions, including whether to impose a fine. It is not a level playing field. Further, although the brokerage firm can appeal the Commissioner's ruling to Circuit Court, the Commissioner's factual findings are presumed to be correct. Finally, as a practical matter, no firm wants to sue the Securities Department because, even if it wins, the Securities Department will remain as its regulator.

Continuing on, Stephens submitted a 25 page letter, authored by Mr. Burns, defending our position that we had not failed to supervise the broker with respect to the alleged violations and offering to meet with the staff to address the matter further.

Then, on August 1, 2013, Mr. Fredyl emailed Ms. Fowler advising her that Commissioner Abshure wanted to meet with Stephens' representatives and members of his staff "[i]n an effort to reach a resolution of this matter." (See Attachment 2.)

At this point things got complicated because we were going to meet with the head of the Securities Department acting in the role of prosecutor to discuss the settlement. But he would also serve as judge and jury in any administrative proceeding if we were unable to agree upon an acceptable settlement. In preparing for our presentation, Ms. Fowler observed that Mr. Fredyl seemed somewhat responsive to our position that we did not fail to supervise the broker with respect to the alleged unauthorized trading, but did not agree with our position that we had adequately supervised the broker with respect to the ETF sales. He had pointed out to her that the Securities Department had fined other firms for the same activity. So we reviewed the Department's prior orders, and identified the Morgan Keegan case. There the brokerage firm was fined $15,000 for both failing to supervise the sales of the same types of ETF's and the inappropriate switching of mutual funds in customer accounts (two different violations).

If settlement appeared necessary, our strategy was to try and get the unauthorized trading charge dismissed and agree to a consent order just for failure to supervise the ETF sales with a fine of $15,000 or less, which was clearly supported by the Morgan Keegan case.

At the meeting, we presented our case, and then the Securities Commissioner took over and spoke for the Securities Department. He surprised us somewhat by proposing a consent order with a single charge entirely different from those stated in the letter we received from Mr. Fredyl. There would be no failure to supervise charges whatsoever, or mention of unauthorized trading. Instead, Stephens would agree to a simple finding that we had failed to implement and enforce appropriate policies and procedures regarding the sales of the ETF's. I generally liked this approach because I viewed it as a lesser, single violation, and would be able to explain to our other regulators that we had implemented supervisory policies and procedures in late 2009 before the Securities Department had arrived on the scene, even though we had initially experienced difficulties in programming our computers to detect any future problems.

The difficulty was that the Securities Commissioner proposed a $30,000 fine to go along with this order, which was twice what Morgan Keegan had to pay for what we viewed as two more serious violations. Consequently, I cited the Morgan Keegan case to the Commissioner and proposed a $15,000 fine. (This is described in paragraph 4 of Ms. Fowlers' affidavit – page 125 of our original materials).

Even though Commissioner Abshure denied it in response to a question from Representative Lowery (Transcript, page 70), he then countered with a proposal that Stephens pay $20,000 and offered to allow us to make the payment in the form of a contribution to NASAA instead of a fine. I admit that I was offended by this. As a former SEC regulator myself, I had a real problem with his proposal because I knew that he was the President of NASAA. Consequently, I indicated to him that I did not like the idea of contributing to NASAA.

He then offered to allow Stephens to make the contribution to Economics Arkansas. I was unfamiliar with that organization, and asked him if either he or the Securities Department were affiliated with it. He responded that he was on its board of directors. However, keeping in mind that he was the Securities Commissioner, I simply said that I thought it would be better if Stephens just paid a fine.

The meeting broke up shortly after that with a general understanding as to the wording of the proposed order, but disagreement as to the amount of the fine, with the Commissioner offering to accept $20,000 and Stephens offering to pay $15,000. And the Commissioner directed Stephens and his staff to try to work that out.

About a week later, Ms. Fowler came into my office and said that she had received an email from Mr. Fredyl transmitting a proposed consent order; and that, while the wording of the order was generally acceptable, the amount of the fine had increased to $25,000 (see Attachment

3). As the email plainly states, this was an increase from $20,000 to $25,000, not a decrease from $30,000 to $25,000 as Commissioner Abshure testified (Transcript, p. 71).

I told Ms. Fowler that his was probably just a bargaining tactic to get us to agree to the Commissioner's earlier $20,000 offer, and to contact Mr. Freydl and tell him that we were prepared to pay the $20,000.

A few days later we received two emails from Mr. Fredyl rejecting the $20,000 offer (see Attachment 4). The first email said that "As for the fine amount, the Commissioner stated that $25,000 is his current offer to Stephens," and then acknowledged that this was an "increase in the fine amount. . . ." The second email demonstrates even more clearly that the Commissioner had put a $20,000 offer on the table, even though he flatly denied that in response to a question from Representative Lowery (see Transcript, p. 70). In the opening sentence of that email, Mr. Fredyl acknowledges that the "the increase of $5,000 may cause issues for you." He then goes on to say that "[i]f Stephens cannot accept the new amount of $25,000, which is the commissioner's new offer, then the staff shall make arrangements for a much larger exam of this issue, which he predicted would result in liability for Stephens "much higher than $25,000."

Faced with this threat, I told Ms. Fowler to go ahead and advise Mr. Fredyl that we would pay the $25,000 fine.

I subsequently signed the order and had it delivered to the Securities Department for execution by Commissioner Abshure. Within an hour or so, I was contacted by my associate, Frank Thomas, who reported that he had been contacted by Gwen Moritz of Arkansas Business about a $25,000 fine imposed on Stephens by the Securities Department. I told him that I had just signed the order and questioned how Arkansas Business had learned about it so quickly. I also asked him to contact Ms. Moritz and determine what information she had received from the Securities Department. In response to this request, she forwarded to Mr. Thomas an email she had received from Mr. Freydl attaching a fully executed copy of the order signed by Commissioner Abshure. The time reflected on the Arkansas Business email established that the Securities Department had sent a copy of the fully executed order to the newspaper before it was even delivered by email to Stephens.

This entire sequence of events led us to conclude that Commissioner Abshure was retaliating against Stephens because of our unwillingness to agree to his $20,000 settlement offer, including the proposed contribution to NASAA.

It also highlights other inconsistencies in Commissioner Abshure's testimony before this Committee. He stated that in situations where there was only one monetary payment by the settling firm, he would require that a contribution be larger than the fine it replaced. (Transcript,

pp. 69-70). However, in our situation, he offered to reduce his initial $30,000 demand to $20,000 in conjunction with his offer to allow us to pay that money to NASAA as a contribution.

Commissioner Abshure's actions were also inconsistent with his testimony in response to a question from Senator Teague (Transcript, p. 87) that it is typically the firm being charged that asks for the right to make a contribution instead of paying a fine. That certainly did not happen in our situation, and based on my years of experience in dealing with multiple securities regulators, it is hard for me to believe that firms would routinely put forward that suggestion. If I were to say to an SEC or FINRA enforcement attorney during settlement discussions, "I tell you what, if you will agree not to fine us I will make arrangements for a contribution to a non-profit of your choosing – even one that you're affiliated with," I would be lucky if that agency didn't try to have me indicted for attempted bribery. And it's not any better if such an offer comes from the other side of the table. It's worse. You're dealing with a public official.

We would also like to correct the statement made by Law Professor Steinbuch in the Arkansas Democrat Gazette article on January 9th. He said:

> Defendants prefer making charitable donations instead of having to pay fines because they don't have to report them to their federal regulators.

David Smith, Securities chief defends fines as gifts (January 9, 2014), Arkansas Democrat Gazette, pp 1D, 2D.

This is not true. FINRA reporting obligations require the public disclosure of significant regulatory actions, including the details of the sanctions and other remedies imposed. In fact, both Commissioner Abshure and Crews reported to FINRA the $150,000 contribution made pursuant to that consent order. Consequently, there is no significant benefit to a firm from making a contribution as opposed to a fine.

Finally, with respect to the conflicts issue, this is not just an "apparent" conflict. It's a real conflict. As Securities Commissioner, Mr. Abshure is entrusted with the handling of public funds in accordance with applicable laws. As president of NASAA, he has a fiduciary duty to ensure that the organization operates properly and remains financially secure. In my experience, and as suggested by Representative Rice (Transcript, pp.65-66), that would include helping NASAA raise revenues through contributions and other means. So when you represent both the State of Arkansas and NASAA, you are not in a position to determine whether or how settlement funds should be divided between the two. You should consult with and obtain the approval of an appropriate independent party, such as an appropriations committee. And if you don't do that, you shouldn't be surprised that people will question why Arkansas has contributed more money to NASAA from settlements during the last five years than any other state.

STATUTORY ISSUES

The next issue is the legality of the contributions. As Section 213 clearly states: "all fines imposed and collected or moneys collected in lieu of a fine" are to be deposited as special revenues in the state treasury. And the statute goes on to say that the first $150,000 collected each fiscal year is to be deposited in the Investor Education Fund, with the balance to be deposited in the Securities Department Fund.

This is a very clear, straightforward requirement intended to make sure that anything in the nature of a fine that the Commissioner imposes gets paid into the state treasury. And the Commissioner gave several examples of payments in lieu of a fine, such as penalties, costs of investigation, witness fees, etc. Common legal understanding dictates that this would not include restitution payments. Those payments are not in the nature of a fine. As Representative Lowrey stated, they are two separate things (Transcript, p. 76). Restitution payments are intended to reimburse losses incurred by customers and others as a result of securities law violations, and are consequently paid directly to such persons. Fines are intended to punish people for such misconduct and deter future wrongdoing. Section 213 simply does not apply to, or in any way restrict, the Commissioner's authority to impose restitution as a remedy or require that restitutionary payments be deposited in the state treasury as Commissioner Abshure testified (Transcript, pp. 75-76). Appropriations are not needed for restitution.

What is clear is that Section 213 prohibited the Commissioner from entering into the arrangement whereby Crews made a $150,000 contribution to NASAA. The Crews Order states that its firm was not fined, at least in part, because it agreed to make a contribution to NASAA. As Representative Lowrey observed (Transcript, p. 74), this is fundamentally a payment in lieu of a fine; and Section 213 requires that such money be paid to the treasury and not directed to a third party. Contrary to Commissioner Abshure's testimony (Transcript, p. 34), there is nothing in the Arkansas Securities Act that expressly authorizes him to enter into these types of arrangements.

Commission Abshure puts forward two arguments in support of his position that Section 213 did not prohibit the Crews' contribution.

The first is that his general authority under Section 308(h) authorizes him to craft consent orders providing for the payment of contributions to third parties, and that Section 213 does not apply in such situations. However, as the opinion of the Rose Law Firm that we previously provided to the committee states, a general statutory provision such as Section 308(h) must yield to a specific statutory provision involving the particular subject matter, such as Section 213 (citing the Arkansas Supreme Court Case, Board of Trustees v. Stodola, 942 S.W.2d 255

(1997)). I would also note that there is no conflict between these two statutory provisions. The Commissioner does have broad discretionary authority under Section 308(h) to structure settlements, including the nature of the charges described in the order, the parties to be named, restitutionary payments, and the amount of any fines or penalties. However, once the parties to the consent order agree to the amount of a fine or payment in lieu of a fine, that money is required to be paid into the treasury by Section 213.

Also, and this is very important, the vast majority of fines imposed by regulatory agencies come through the settlement process rather than litigation or administrative proceedings. As I said earlier, firms do not want to litigate with their regulators. So accepting Commission Abshure's argument that under Section 308(h) he can send contributions paid in lieu of fines to third parties would virtually gut Section 213's requirement that fines be paid into state treasury.

The Commissioner's second legal argument hinges on the meaning of the word "collected" in Section 213. His position is that contributions paid to third parties are not "collected" by him because they do not pass through his hands. If correct, this very narrow interpretation allows him to circumvent the clear legislative intent of Section 213, which is to ensure that all fines or payments in lieu of fines imposed as a result of Securities Department enforcement activities be paid to the state legislature. This is a tortured interpretation of the word "collected." I can assure you that when he negotiates a contribution in lieu of a fine using his enforcement powers and documents it through a formal consent order, he has "collected" it within the common sense meaning of that term. He has just directed that it be paid to a third party without express statutory authorization. And it is certainly doubtful that the firms that agree to such contributions truly consider them to be voluntary.

Suggested Legislative Reforms

In considering the various issues raised by our recent interaction with the Securities Department, we have identified the following legislative reforms that we recommend to this Committee:

- Even though we have demonstrated that the language of Section 213 prohibits the Commissioner's practice of using his enforcement powers to obtain contributions on behalf of third parties, given his continued assertions to the contrary, clarifying language should be added to the Securities Act restricting the ability of the Securities Commissioner to direct enforcement related contributions to third parties instead of the state treasury. We do not dispute the value of services that NASAA provides to Arkansas, but any compensation or other payments directed

to it by the Securities Commissioner should be approved through normal legislative appropriations processes.

- Section 213 should be revised to eliminate the deposit of fines and payments in lieu of fines to the Securities Department Fund. This creates a conflict of interest for securities department personnel. Decisions on whether to impose a fine, and the amount of the fine, should be based on the nature of the misconduct in question and not the budgetary needs of the department. Also, budgetary requests and approvals should not be based upon, or related to, the department's success in imposing and collecting fines. In the case of the SEC, the fines it collects are simply paid to the treasury without further designation. Then the SEC must go to congress to get approval for its budget just like other agencies. That is a far better model.
- The Arkansas Securities Act provides that the staff of the Securities Department may investigate alleged violations and then bring an action against the alleged violators in an administrative proceeding before the Securities Commissioner. In practice, the Securities Commissioner is actively involved in the decision whether to bring the action, the investigation process, the nature of the charges to be brought, the parties to be named, the amount of the fines or other sanctions to be sought, and any settlement negotiations. In the case at hand, if Stephens had elected not to settle, we were faced with the fact that he had already decided the outcome of the case, as opposed to having the case heard before an impartial judge; and, as noted, we would have been disadvantaged in any appeal because of the statutory provision stating the Commissioner's factual findings are presumptively correct. To correct these inequities and provide respondents with appropriate due process rights, the Commissioner should be required to bring enforcement actions in court before an impartial judge.
- The Arkansas Securities Act should be amended to insert a provision comparable to Section 602(d) of the Uniform Securities Act that permits a respondent to apply for judicial relief, such as an injunction, in the event that the Securities Department's investigative efforts appear to be undertaken in bad faith or for harassment purposes. Because there is no such provision in the Arkansas Securities Act, a person subject to an investigation by the Commissioner would likely be unable to get a hearing in court until the issuance of a final order by the Commissioner. Comparable relief is available under federal law with respect to investigations undertaken by agencies such as the IRS and SEC.

In closing, I would like to say that Stephens recognizes the need for strong state securities departments. All of our regulators play a critical role in protecting investors and ensuring the integrity of our financial markets. And we do not believe that the legislative changes we have proposed would interfere in a material way with the ability of the Securities Department to do its

job. On the other hand, it is also critical to eliminate conflicts of interest and even the appearance of conflicts of interest from the operations of our state agencies. In that regard, we appreciate the dedication that the members of this Committee have shown to ensuring that our public officials are held to a high standard of professionalism, honesty and integrity. Thank you for your service and consideration of the issues we have presented.

ATTACHMENT 1

ATTACHMENT 1

MIKE BEEBE
GOVERNOR

A. HEATH ABSHURE
COMMISSIONER

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ARKANSAS SECURITIES DEPARTMENT

May 21, 2013

Ms. Becky Brown
Vice President/Compliance Officer
Stephens, Inc.
111 Center Street
Little Rock, AR 72201-3507

William Wayne LaRue
3290 Marlsgate
Conway, AR 72032

RE: Notice of intention to file Complaint against:
Stephens, Inc., CRD No. 3496, and
William Wayne LaRue, CRD no. 1279279

Dear Ms. Brown and Mr. LaRue:

The Staff of the Arkansas Securities Department (Staff) is conducting an examination of Stephens, Inc. (Stephens) and its former agent, William Wayne LaRue (LaRue). As is required by Rule 607.01 of the Rules of the Arkansas Securities Commissioner (Rules) and by Ark. Code Ann. § 25-15-211, this letter serves as notice of the following:

(i) The Staff has determined that Stephens and LaRue have violated the Arkansas Securities Act (Act) and Rules as is briefly and generally discussed below.
(ii) The Staff intends to file a complaint seeking appropriate remedies for these violations with the Arkansas Securities Commissioner (Commissioner) and/or a court of competent jurisdiction.
(iii) Stephens and/or LaRue may submit evidence of compliance with the Act and Rules before the Staff files a complaint with the Commissioner. Such evidence should be submitted to the Staff on or before June 19, 2013.

I. Unauthorized Securities Transactions

LaRue violated Ark. Code Ann. § 23-42-308(a)(2)(G) and Rule 308.01(o), when he engaged in unauthorized securities trading in the accounts of his clients, Diana Kirkland (Kirkland), David L. Branscum (Branscum), Ray and Donna Hambuchen (Hambuchens), and Bobby Spradlin (Spradlin). These clients stated that LaRue usually made trades in their accounts

without ever contacting them. Branscum gave LaRue verbal permission or authority to make discretionary trades in Branscum's account. Therefore, LaRue did not contact Branscum before every trade in order to get Branscum's authorization to make the trade. The Hambuchens stated that LaRue repeatedly made trades in their accounts without contact them first.

Although these clients did sign new account forms with boxes checked applying for margin trading, and in one case signed a separate margin trading agreement, all of these clients told LaRue to not engage in or stop margin trading in their accounts. Kirkland and Spradlin specifically told LaRue they either did not want margin trading in their accounts or to stop margin trading in their accounts, once the margin trading was discovered by these clients. However, LaRue continued to engage in margin trading in their accounts. Most of these clients were social friends of LaRue. They trusted LaRue. Clients said that whenever they would raise their concerns or objections to the margin trading, LaRue would say "don't worry" or "I'll take care of it".

II. Unsuitable Securities Sales

LaRue violated Ark. Code Ann. § 23-42-308(a)(2)(G) and Rule 308.01(d), when he sold inverse or leveraged exchange traded funds (ETFs) to his clients, Kirkland, Branscum, and Doug and Andrea McConnell (McConnells). Between May 2008 and September 2009, LaRue solicited and sold all of these clients inverse or leveraged ETFs. All of these inverse or leveraged ETFs were issued by ProShares. Although the various ProShares prospectuses clearly stated that these inverse or leveraged ETFs were designed to be held for only one day, LaRue held these ETFs in the margin accounts of said clients for days, weeks, and months. The ProShares prospectuses further stated that the funds "may not be suitable for all investors and should be used only by knowledgeable investors who understand the potential consequences of seeking daily leveraged investment results. Shareholders should actively monitor their investments". None of the aforementioned clients had experience with or full understanding of the inverse or leveraged ETFs LaRue sold to them. In addition, none of these clients monitored these inverse or leveraged ETFs on a daily basis.

On three occasions between November 10, 2008 and February 2, 2010, LaRue sold Kirkland various inverse or leveraged ProShares ETFs that were held on margin for weeks or months. Also, on at least 11 occasions between May 30, 2008 and September 15, 2009, LaRue sold Branscum various inverse or leveraged ProShares ETFs that were held in Branscum's margin account usually for days, weeks, and months. Finally, twice during July 2009 the McConnells were sold inverse or leveraged ProShares ETFs that were held in a margin account for weeks.

III. Stephens's Failure to Supervise

In violation of Ark. Code Ann. § 23-42-308(a)(2)(J), Stephens failed to reasonably supervise its agent, LaRue, in order to detect or prevent LaRue from repeatedly engaging in unauthorized trading in his Arkansas client's accounts as detailed in paragraph I. In addition, Stephens failed to reasonably supervise LaRue in order to detect or prevent LaRue from repeatedly selling unsuitable securities to his Arkansas clients as detailed in paragraph II. The supervisory failings of Stephens were the result of either a lack of an adequate written

compliance policy concerning the sales of inverse or leveraged ETFs or a failure by Stephens to enforce its existing written compliance policy.

a. Unauthorized Trading

Although section 22.03.04 of Stephens' written compliance manual prohibits all employees from engaging in unauthorized trading, all of the clients listed in paragraph I stated that LaRue repeated made trades in their accounts without obtaining authorization from the client prior completing the trades. These clients were friends of and trusted LaRue. However, LaRue abused their trust by repeatedly engaging in unauthorized trading, including unauthorized margin trading. In addition, LaRue made many of these trades against to the express verbal instructions of these clients. Also, as detailed in paragraph I, LaRue violated section 22.03.04 and 3.18 of Stephens' written compliance manual, when he engaged in discretionary trading in Branscum's account without obtaining proper written authorization.

In September of 2011 Stephens' compliance office was made aware of unauthorized trading in Spradlin's account. After further investigation into this matter, Stephens backed out or cancelled six trades made by LaRue for six clients in July of 2011. The compliance office's memoranda and email all list unauthorized trading as the reason for the backing out or cancelling these trades. The fact that Stephens failed to detect and prevent LaRue's unauthorized trading until September of 2011 is a clear indication that Stephens failed to take reasonable steps to enforce its existing written compliance policy.

b. Unsuitable Securities Sales

As stated in paragraph II, between May 2008 and February 2010, LaRue repeatedly sold and held inverse or leveraged ETFs in three of his client's margin accounts. It was clearly unsuitable to buy and hold these inverse or leveraged ETFs in margin accounts for days, weeks, and months. Until August 7, 2009, Stephens had no written compliance policy that specifically addressed transactions in inverse or leveraged ETFs. Once it was enacted, Stephens' written compliance policy explicitly stated that "leveraged or inverse ETFs are not marginable securities. Any trade executed in a margin account will be cancelled and corrected to a cash account". In spite of this compliance policy prohibition against buying and holding inverse or leveraged ETFs in margin accounts, Stephens allowed inverse or leveraged ETFs to be sold and held in the margin accounts of Kirkland and the McConnells. Finally, in violation of Stephens' written compliance policy concerning the sale of inverse or leveraged ETFs, on September 15, 2009 LaRue solicited and sold an inverse or leveraged ETF to Kirkland. This transaction is listed as solicited in Stephens' own records.

Stephens failed to supervise LaRue by not having any written compliance policy specifically addressing the sale of inverse or leveraged ETFs until August 7, 2009, while allowing the sale of inverse or leveraged ETFs by LaRue. After August 7, 2009, Stephens failed to enforce its own written compliance policy by allowing the sale and holding of inverse or leveraged ETFs in the margin accounts of two of LaRue's clients, as well as listing one of these trades as solicited instead of unsolicited.

IV. Conclusion

As is provided in Rule 607.01 and in Ark. Code Ann. § 25-15-211, Stephens and/or LaRue have the opportunity to submit evidence of compliance with the Act and Rules before the Staff files a complaint with the Commissioner. Such evidence should be submitted to the Staff on or before June 19, 2013. Should you wish to discuss a submission of evidence, a hearing schedule, or the possibility of a consent order, please do not hesitate to contact me.

Sincerely,

Scott Freydl

Scott Freydl
Attorney Specialist

ATTACHMENT 2

ATTACHMENT 2

Kim (Keller) Fowler

From: Scott Freydl <scott@securities.arkansas.gov>
Sent: Friday, August 02, 2013 9:01 AM
To: Kim (Keller) Fowler
Cc: Heath Abshure
Subject: RE: Stephens, Inc. and Wayne LaRue; ASD case no S-12-0067

Thursday, August 8th at 2:30 p.m. would be fine.

From: Kim (Keller) Fowler [mailto:kim.fowler@stephens.com]
Sent: Thursday, August 01, 2013 4:50 PM
To: Scott Freydl
Subject: RE: Stephens, Inc. and Wayne LaRue; ASD case no S-12-0067

Thank you for the invitation to meet with us. Would Thursday afternoon August 8th at 2:30 be a convenient time?

Kim Fowler
Sr. Vice President
Associate General Counsel
Stephens Inc.
111 Center St.
Little Rock, AR 72201
(501) 377-2546
Kim.fowler@stephens.com

From: Scott Freydl [mailto:scott@securities.arkansas.gov]
Sent: Thursday, August 01, 2013 2:39 PM
To: Kim (Keller) Fowler
Subject: RE: Stephens, Inc. and Wayne LaRue; ASD case no S-12-0067

The Staff of the Arkansas Securities Department (Staff) has completed its review of the written response of Stephens, Inc. to the Staff's Notice of Intent Letter. In an effort to reach a resolution of this matter, the Arkansas Securities Commissioner would like to meet with you and/or other representatives of Stephens, Inc. as well as members of the Staff. The Commissioner would like to have this meeting sometime during the week of August 6th through August 9th. Please contact me as soon as possible concerning a specific date and time for this meeting.

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ATTACHMENT 3

ATTACHMENT 3

Kim (Keller) Fowler

From: Scott Freydl <scott@securities.arkansas.gov>
Sent: Friday, August 16, 2013 1:25 PM
To: Kim (Keller) Fowler
Subject: Proposed Consent Order for Stephens, Inc.
Attachments: LaRue - Stephens.docx

I have attached a copy of the Consent Order, which I drafted in settlement of the violations of the Arkansas Securities Act and Rules of the Arkansas Securities Commissioner committed by Stephens, Inc. (Stephens). I am willing to discuss any reasonable and minor changes or alterations to the language of this order that you may feel are beneficial to Stephens. As you will see, the fine amount has actually increased to $25,000. This fine amount is appropriate in this case for the following reasons:

1. The Morgan Keegan order, which you referred to during our meeting, required Morgan Keegan to pay a fine of $15,000 and restitution of over $44,000.

2. The Morgan Keegan order only covered the failure of Morgan Keegan to supervise one agent's handling of one client's accounts. The Stephens order is not as narrowly worded.

Hopefully, the fine amount will not prevent this settlement. Nevertheless, the Staff cannot agree to a lesser amount. I look forward to discussing this matter further.

ATTACHMENT 4

ATTACHMENT 4

Kim (Keller) Fowler

From: Scott Freydl <scott@securities.arkansas.gov>
Sent: Wednesday, August 21, 2013 1:59 PM
To: Kim (Keller) Fowler
Subject: RE: Consent Order for Stephens Inc.

I understand that the increase of $5,000 may cause issues for you. However, it is the result of the scope of the order that the Commissioner did not realize at the time of our meeting. I don't think an additional meeting would be of any use. If Stephens cannot accept the new amount of $25,000, which is the Commissioner's new offer, then the Staff shall make arrangements for a much larger exam of this issue. If the management of Stephens does not feel that they may have greatly liability than $25,000 for this issue, then I guess the Staff will need to look at the inverse and/or leveraged ETF sales for every Stephens agent in Arkansas. After such an exam, I would anticipate the potential liability for Stephens will be much higher than $25,000. While the staff usually tries to be flexible, the circumstances of this case make this fine amount of $25,000 non-negotiable.

From: Kim (Keller) Fowler [mailto:kim.fowler@stephens.com]
Sent: Wednesday, August 21, 2013 1:25 PM
To: Scott Freydl
Subject: RE: Consent Order for Stephens Inc.

I do not want to be irritating or difficult, but please understand that the increase to $25,000 has put David Knight, Kevin Burns and I, as lawyers, in an awkward situation with Stephens top management. Based on our meeting with the Commissioner, we told them the fine was expected to be $15,000- $20,000. We will now have to go back to them and tell them the amount has increased. Would it be appropriate for David to call the Commissioner directly or for us to meet with him again?

Kim Fowler
Sr. Vice President
Associate General Counsel
Stephens Inc.
111 Center St.
Little Rock, AR 72201
(501) 377-2546
Kim.fowler@stephens.com

From: Scott Freydl [mailto:scott@securities.arkansas.gov]
Sent: Wednesday, August 21, 2013 9:01 AM
To: Kim (Keller) Fowler
Subject: RE: Consent Order for Stephens Inc.

I included all but one of your changes in this final version of the Consent Order. Although I did make some slight adjustments to the language of your changes. Unfortunately, the Commissioner will not sign an order that includes the changes "or the conclusions of law". This change is frequently requested and always refused. As for the fine amount, the Commissioner stated that $25,000 is his current offer to Stephens. The increase in the fine amount was necessary in view of the scope of the order. However, should Stephens still be able to agree to this amount, then the Staff shall be directed to open a full examination of all agents of Stephens that sold inverse and/or leveraged ETFs in Arkansas. It is likely that after such an examination, the Staff would request a substantially higher fine amount.

From: Kim (Keller) Fowler [mailto:kim.fowler@stephens.com]
Sent: Tuesday, August 20, 2013 5:04 PM

To: Scott Freydl
Subject: Consent Order for Stephens Inc.

Scott,

Per our conversation attached are Stephens suggested revisions to the Consent Order. I did nothing with the amount of the fine, but am hoping we can change that. Please call me if we can discuss this.

Kim Fowler
Sr. Vice President
Associate General Counsel
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111 Center St.
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(501) 377-2546
Kim.fowler@stephens.com

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