

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55692 / May 2, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12624

_____	:	ORDER INSTITUTING ADMINISTRATIVE
In the Matter of	:	PROCEEDINGS, MAKING FINDINGS,
	:	AND IMPOSING REMEDIAL SANCTIONS
A.G. EDWARDS &	:	PURSUANT TO SECTION 15(b) OF THE
SONS, INC.,	:	SECURITIES EXCHANGE ACT OF 1934
	:	
Respondent.	:	
_____	:	

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”) against A.G. Edwards & Sons, Inc. (“AG Edwards” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings, Making Findings, and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that:

¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Respondent

1. AG Edwards is a Delaware corporation with headquarters located in St. Louis, Missouri. AG Edwards has been registered with the Commission as a broker-dealer pursuant to Section 15 of the Exchange Act since 1967 and is a member of the National Association of Securities Dealers, Inc. (“NASD”) and the New York Stock Exchange (“NYSE”). It has approximately 730 offices staffed by approximately 6,824 registered representatives, referred to at AG Edwards as “financial consultants” (“FCs”), that provide retail brokerage services throughout the United States, Switzerland and the United Kingdom. AG Edwards is the principal operating subsidiary of A.G. Edwards, Inc., a Delaware corporation whose stock is traded on the NYSE under the symbol AGE.

Background

2. Between at least January 2001 and September 2003, AG Edwards failed reasonably to supervise certain of its registered FCs with a view to preventing their violations of the federal securities laws. During the relevant time period, registered FCs in several of AG Edwards’ branch offices engaged in illegal market timing schemes on behalf of customers, including several large hedge funds.² These FCs defrauded over 200 mutual funds from approximately 50 different mutual fund companies and their shareholders by engaging in deceptive practices designed to circumvent restrictions that the mutual funds imposed on market timing. Through these activities the FCs violated the antifraud provisions of the federal securities laws.

3. AG Edwards failed reasonably to supervise its FCs with a view to detecting and preventing their illegal market timing schemes. AG Edwards failed to adopt reasonable policies, procedures or systems to monitor market timing in order to detect and prevent its FCs’ misconduct. In particular, AG Edwards failed to develop reasonable policies, procedures or systems for monitoring and responding to red flags indicating that its FCs were using deceptive practices. In addition, AG Edwards failed to implement reasonable policies, procedures or systems to monitor whether its FCs discontinued their abusive trading in response to requests by mutual fund companies.

The FCs’ Misconduct

4. Between at least January 2001 and September 2003, certain of AG Edwards’ registered FCs opened accounts for customers who planned to place market timing trades.

5. The majority of these accounts were fee-based accounts in AG Edwards’ Fund Navigator program, later called the Preferred Fund Advisor program. Customers with

² “Market timing” refers to (a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal *per se*, can harm other mutual fund shareholders because it can dilute the value of their shares if the market timer is exploiting pricing inefficiencies, disrupt the management of the mutual fund’s investment portfolio or cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer.

fee-based accounts did not pay commissions to AG Edwards and its FCs for each transaction placed in their accounts. Instead, these customers paid AG Edwards a quarterly fee ranging from 1% to 1.5% of the total assets in the account. During the relevant time period, AG Edwards received approximately \$1.93 million in fees from certain market timing customers.

6. Between at least January 2001 and September 2003, certain of AG Edwards' FCs placed tens of thousands of trades on behalf of their market timing customers. Most of these trades were in mutual funds that prohibited or specifically limited the number and frequency of trades in an effort to prevent market timing.

7. Over time, AG Edwards received hundreds of telephone calls, letters, e-mails and canceled trade notices (collectively "restriction notices") from mutual fund companies objecting to market timing trades placed by AG Edwards' FCs. The restriction notices informed AG Edwards that the fund companies rejected particular trades or restricted particular accounts, customers or FCs, either by FC name or by FC identification number, because they appeared to be market timing. Some restriction notices also warned AG Edwards that particular customer accounts were close to reaching their limits for trading. Many of the mutual fund companies who sent restriction notices to AG Edwards requested AG Edwards' assistance in helping them prevent further market timing by particular FCs, FC identification numbers, customers or accounts.

8. The majority of the written restriction notices were sent to the mutual fund order room at AG Edwards' headquarters in St. Louis, Missouri. As the restriction notices came in, employees in the order room updated AG Edwards' trading system to reflect canceled trades and then sent copies of the restriction notices to the FCs and branches involved in the trading and maintained the originals. AG Edwards, however, failed to develop reasonable policies, procedures or systems to monitor whether its employees followed up on the mutual fund companies' restriction notices and requests for assistance in preventing further market timing by particular FCs, customers or accounts.

9. In order to continue market timing on behalf of their customers after receiving copies of the restriction notices, certain FCs engaged in a series of acts and practices designed to conceal their customers' market timing activity from mutual fund companies that prohibited or restricted the trading. These acts and practices included: 1) using multiple account numbers for the same customer; 2) opening accounts in the names of multiple entities affiliated with the same customer; 3) opening accounts at different branch offices for the same customer; 4) placing trades using multiple FC identification numbers; and 5) transferring assets between related accounts.

10. By using these acts and practices, certain FCs disguised their own identities and the identities of their market timing customers and disguised the fact that multiple short-term trades were attributable to the same customers. Through these deceptive tactics, certain FCs enabled their market timing customers to continue trading with mutual funds that previously restricted their market timing activities.

AG Edwards' Supervisory Failures

11. At all relevant times, AG Edwards required its branch managers to approve FCs' requests to open new accounts for customers. Branch managers in several of AG Edwards' branches regularly approved the opening of new accounts for AG Edwards' market timing customers. These customers had multiple accounts through which AG Edwards' FCs were able to place the customers' market timing trades and evade restrictions imposed by mutual fund companies.

12. AG Edwards issued each of its registered FCs one unique identification number through which to place trades on behalf of customers. However, FCs could obtain additional FC identification numbers with which they could place trades by entering into a "split" with one or more other FCs. At all relevant times, AG Edwards required its FCs to submit requests for new split FC numbers to its registrations department in St. Louis, Missouri. A legitimate reason for an FC to request a new split FC number was to share commissions and fees with one or more additional FCs who serviced the same client.

13. In contrast, certain of AG Edwards' FCs regularly obtained additional split FC numbers not for the purpose of legitimately sharing commissions and fees with other FCs for servicing particular customer accounts, but instead to continue market timing mutual funds that previously restricted them from trading under other FC numbers and split FC numbers. Because many mutual fund companies restricted further trading by FC numbers rather than by FC names, these FCs were able to evade restrictions imposed by mutual fund companies by obtaining new split FC numbers.

14. During the Fall of 2002, a senior vice president in AG Edwards' operations department learned about the existence of the restriction notices from employees in AG Edwards' order room. At this time, this senior vice president and other officers and employees convened a working group to research whether AG Edwards should allow market timing to continue to occur at AG Edwards.

15. Between October 2002 and April 2003, the working group gathered restriction notices and identified many of the customers, FCs and branches that placed market timing trades through accounts at AG Edwards. In April 2003, the working group issued a report to members of AG Edwards' senior management detailing the extent of the continuing market timing at the firm and recommending that AG Edwards take steps to prevent any further market timing from occurring.

16. Notwithstanding the working group's report, AG Edwards did not develop or implement any policies or sufficient procedures to address the market timing activity at the firm until at least September 2003.

17. Starting in September 2003, AG Edwards began taking certain remedial actions to address market timing, including: adopting a policy to prohibit market timing activity through AG Edwards; and adopting and implementing new supervisory and operational procedures designed to detect and prevent mutual fund market timing.

18. Thus, between at least January 2001 and September 2003, AG Edwards failed reasonably to supervise certain of its FCs with a view to detecting and preventing their violations of the antifraud provisions of the Securities Act of 1933 (“Securities Act”) and the Exchange Act. In particular, AG Edwards failed to adopt or implement reasonable supervisory and compliance policies, procedures or systems that could have detected or prevented its FCs’ deceptive market timing schemes. AG Edwards failed to have reasonable policies, procedures or systems to monitor whether multiple accounts and multiple split FC numbers were used for legitimate purposes, rather than to conceal the FCs’ identities and the identities of their market timing customers from mutual fund companies that restricted their market timing. In addition, AG Edwards failed to have reasonable policies, procedures or systems in place for employees to respond to red flags and warnings of improper conduct in the form of hundreds of restriction notices from mutual fund companies objecting to the market timing activity. If AG Edwards had had in place reasonable policies, procedures or systems to monitor its FCs’ use of multiple account numbers and split FC numbers and provided guidance to its employees on responding to restriction notices, it is likely that AG Edwards could have detected and prevented the FCs’ violations of the antifraud provisions of the Securities Act and the Exchange Act.

Violations

19. As a result of the conduct described above, certain of AG Edwards’ FCs willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder which prohibit fraudulent conduct in connection with the offer, purchase or sale of securities.

Failure to Supervise

20. Section 15(b)(4)(E) of the Exchange Act provides for the imposition of a sanction against a broker or dealer who “has failed reasonably to supervise, with a view to preventing violations of the securities laws, another person who commits such a violation, if such other person is subject to [its] supervision.” As a result of the conduct described above, AG Edwards failed reasonably to supervise its FCs with a view to preventing their willful violations of the federal securities laws.

Undertakings

21. AG Edwards undertakes the following:

a. AG Edwards shall retain, within 60 days of the date of entry of this Order, the services of an Independent Consultant not unacceptable to the staff of the Commission. AG Edwards shall exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant. AG Edwards shall retain the Independent Consultant to: 1) conduct a review to determine whether the changes AG Edwards has adopted and implemented to its policies and procedures to

correct the activities described in this Order are reasonably designed to detect and prevent any future market timing by AG Edwards' registered FCs on behalf of their customers and to ensure compliance with Section 15 of the Exchange Act; 2) determine whether and to what extent there is a need for additional or amended policies and procedures to detect and prevent market timing by AG Edwards' registered FCs on behalf of their customers and to ensure compliance with Section 15 of the Exchange Act; and 3) recommend that AG Edwards adopt such additional policies and procedures as the Independent Consultant believes are necessary to provide reasonable assurances that AG Edwards can detect and prevent market timing by AG Edwards' registered FCs on behalf of their customers.

b. AG Edwards shall cooperate fully with the Independent Consultant and provide the Independent Consultant with access to its files, books, records and personnel as reasonably requested for the Independent Consultant's review.

c. AG Edwards shall further retain the Independent Consultant to, at the conclusion of the review, which in no event shall be more than 180 days after the date of entry of this Order, submit to AG Edwards and to the Commission's staff a written Report regarding AG Edwards' compliance with its policies and procedures and the adequacy of those policies and procedures. The Report shall include a description of the review performed, the conclusions reached and, if necessary, recommendations for changes in or improvements to the policies and procedures and a procedure for implementing the recommended changes or improvements.

d. Within 30 days of receipt of the Independent Consultant's Report, AG Edwards shall adopt all recommendations contained in the Report and remedy any deficiencies in its policies and procedures; provided, however, that as to any recommendation that AG Edwards believes is unnecessary or inappropriate, AG Edwards may, within 30 days of receipt of the Report, advise the Independent Consultant and the Commission's staff in writing of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that AG Edwards considers unnecessary or inappropriate, AG Edwards shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose.

e. With respect to any recommendation with which AG Edwards and the Independent Consultant do not agree, AG Edwards shall attempt in good faith to reach an agreement with the Independent Consultant within 45 days of receipt of the Report. In the event that AG Edwards and the Independent Consultant are unable to agree on an alternative proposal acceptable to the Commission's staff, AG Edwards will abide by the original recommendation of the Independent Consultant.

f. Within one year after the date of entry of this Order, AG Edwards shall submit an affidavit to the Commission's staff stating that it has implemented any and all recommendations of the Independent Consultant, or explaining the circumstances under which it has not implemented such recommendations.

g. To ensure the independence of the Independent Consultant, AG Edwards: 1) shall not have the authority to terminate the Independent Consultant without the prior written approval of the Commission's staff; 2) shall compensate the Independent Consultant, and persons engaged to assist the Independent Consultant, for services rendered pursuant to this Order at their reasonable and customary rates; and 3) shall not be in and shall not have an attorney-client relationship with the Independent Consultant and shall not seek to invoke the attorney-client privilege or any other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports or documents to the Commission or the Commission's staff.

h. To further ensure the independence of the Independent Consultant, AG Edwards shall require the Independent Consultant to enter into an agreement that provides that for the period of the engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with AG Edwards, or any of its present or former affiliates, directors, officers, employees or agents acting in their capacity. This agreement shall also provide that the Independent Consultant will require any firm with which the Independent Consultant is affiliated or of which the Independent Consultant is a member, and any person engaged to assist the Independent Consultant in performance of his or her duties under this Order shall not, without prior written consent of the Commission's staff, enter into any employment consultant, attorney-client, auditing or other professional relationship with AG Edwards, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

22. For good cause shown, and upon a timely application from AG Edwards or the Independent Consultant, the Commission's staff may extend any of the procedural dates set forth above.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in AG Edwards' Offer.

Accordingly, pursuant to Section 15(b) of the Exchange Act, it is hereby ORDERED that:

A. AG Edwards is hereby censured.

B. IT IS FURTHER ORDERED that:

1. AG Edwards shall, within 30 days of the entry of this Order, pay disgorgement of \$1,930,000, prejudgment interest of \$430,000 and a civil money penalty of \$1,500,000, for a total payment of \$3,860,000 to the United States Treasury. Such

payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies AG Edwards as a Respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Merri Jo Gillette, Regional Director, Midwest Regional Office, Securities and Exchange Commission, 175 West Jackson Boulevard, Suite 900, Chicago, IL 60604.

C. AG Edwards shall comply with the undertakings enumerated in Section III.21 above.

By the Commission.

Nancy M. Morris
Secretary