



JOHN ELIAS BALDACI
GOVERNOR

STATE OF MAINE
DEPARTMENT OF PROFESSIONAL
AND FINANCIAL REGULATION
OFFICE OF SECURITIES
121 STATE HOUSE STATION
AUGUSTA, ME
04333-0121

MICHAEL J. COLLERAN
Securities Administrator

MEMORANDUM

TO: Maine Licensed Broker-Dealers (Attn: Compliance)
FROM: Michael J. Colleran, Securities Administrator
DATE: October 12, 2006
RE: Broker-Dealer Examinations – Common Deficiencies

I would like to apprise all of our licensees of the most common problems and deficiencies noted by our examiners during fiscal year 2006, which ended on June 30, 2006. During the year we conducted sixteen broker-dealer examinations. Twelve of these examinations were of branch offices. The examinations spanned the state and included one examination conducted out of state. Only one of these exams has resulted in enforcement action. It is our hope that sharing our observations with you will encourage you to re-examine your business practices, re-familiarize yourself with the applicable law and our B-D rule (Maine Rule Chapter 504, available at www.investors.maine.gov), and help you avoid common compliance deficiencies.

1. Written Supervisory Procedures

The most common deficiency we found, occurring on fifteen of sixteen examinations, was a failure to enforce written supervisory procedures (“WSPs”). This deficiency typically was secondary to an underlying deficiency that the firm allowed to exist. Additionally, on four exams we found a failure to maintain accurate WSPs, and on two examinations branch personnel did not know how to access the firm’s WSPs. Under Maine Rule Chapter 504, § 7(1)(A) and NASD Rule 3010(b), firms are required to “establish, maintain, and enforce” written supervisory procedures. Although in most cases the firms we examined had very good written supervisory procedures, they frequently were not enforcing the procedures.

2. Client Account Information

The second most frequent deficiency we observed was a failure to maintain client account information, which we observed on ten of sixteen examinations. On three other examinations, we observed a failure to furnish the account information to clients periodically. Under SEC Rules 17a-3(a)(17)(i) and 17a-4(e)(5), broker-dealers are required to maintain account information for each account held by a natural person for at least six years after the earlier of the date the account was closed or the information was replaced or updated. This information must include, among other things, the customer’s occupation, annual income, net worth, and investment objectives (in plain English). The record must be signed by the agent responsible for the account and approved or accepted by a principal of the broker-dealer. In general, the account information must be provided to the customer when the account is opened, when customer information changes, and at least once every 36 months. Firms are required to keep written records of when the account information was furnished. *See also* 32 M.R.S.A. § 16411(3)(A)(2); NASD Rule 3110.



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3. Correspondence

The third most common deficiency we observed was a failure to maintain records of all incoming and outgoing correspondence, including e-mails and faxes. We noted this deficiency on nine of sixteen examinations. Under SEC Rule 17a-4(b)(4), firms are required to maintain originals of all incoming communications and copies of all outgoing communications (and any approvals thereof) for at least three years (the first two in a readily accessible location). *See also* 32 M.R.S.A. § 16411(3)(A)(2); NASD Rule 3110.

4. Licensing

Common licensing deficiencies were a failure to update Form U-4 as required by 32 M.R.S.A. § 16406(2), observed on five examinations; a failure to submit fingerprints in violation of SEC Rule 17f-2, also observed on five examinations; and a failure to register branch offices pursuant to Maine Rule Chapter 504, § 3(5), observed on four examinations.

5. Client Privacy

On five exams, we observed a failure to take steps to protect the privacy of client financial information. This failure generally consisted of a failure to password protect computerized information or to physically secure paper documents (e.g., in a locked filing cabinet), thereby creating a risk that unauthorized persons could access the information. *See* 32 M.R.S.A. § 16411(9).

6. Approval of Advertising

Four exams revealed a failure to maintain records of all advertising and sales literature, with approvals, for a period of at least three years. *See* NASD Rule 2210.

7. Mutual Fund Disclosures

Although not the most commonly found deficiency, one of the most troubling was the failure to adequately disclose the availability of different mutual fund share classes and the advantages and disadvantages of each class (including breakpoints, if applicable). *See* NASD NTM 02-85 and 95-80. We observed this deficiency on three examinations. A failure to disclose such information, if material, may constitute securities fraud under 32 M.R.S.A. § 16501(2).

8. Internal Audits

The final common deficiency we observed was a failure to conduct internal audits as required by the Maine Rule Chapter 504, §7(4) and NASD Rule 3010, which we observed on three examinations. Maine Rule Chapter 504, §7(4) requires such audits to be performed at least annually.

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Our goal in the on-site examination process is to increase licensee awareness and compliance. If you have any questions or concerns about our examinations or about the common deficiencies cited in this letter, please do not hesitate to contact me or my staff.