STATE OF ILLINOIS
SECRETARY OF STATE
SECURITIES DEPARTMENT

IN THE MATTER OF: PHILLIP R. ZANONE JR.	)	**FILE NO. 0400397**

NOTICE OF HEARING

TO THE RESPONDENT:

Phillip R. Zanone Jr.
(CRD #2135221)
460 Williamsburg Lane
Memphis, Tennessee 38117

c/o Wunderlich Securities, Inc.
6305 Humphreys Boulevard
Suite 210
Memphis, Tennessee 38120

You are hereby notified that pursuant to Section 11.F of the Illinois Securities Law of 1953 [815 ILCS 5] (the "Act") and 14 Ill. Adm. Code 130, subpart K, a public hearing will be held at 69 West Washington Street, Suite 1220, Chicago, Illinois 60602, on the 4th day of May, 2005, at the hour of 10:00 a.m., or as soon as possible thereafter, before James G. Athas, Esq. or such other duly designated Hearing Officer of the Secretary of State.

Said hearing will be held to determine whether an Order shall be entered revoking Phillip R. Zanone Jr.'s (the "Respondent") registration as a salesperson in the State of Illinois and/or granting such other relief as may be authorized under the Act including, but not limited to, censure and the imposition of a monetary fine in the maximum amount pursuant to Section 11.E(4) of the Act, payable within ten (10) business days of the Order.

The grounds for such proposed action are as follows:

1. That at all relevant times, the Respondent was registered with the Secretary of State as a salesperson in the State of Illinois pursuant to Section 8 of the Act. He also serves in the capacity as one of his firm's Designated Illinois Principals.

2. That on may 13, 2004 NASD entered a Letter of Acceptance, Waiver and Consent (AWC) submitted by the Respondent regarding File No. CAF040034 which sanctioned the Respondent as follows:

    a. jointly and severally fined along with other parties the sum of $30,000;

    b. suspended from acting as a principal with an NASD member firm for a period of 15 business days; and

    c. requalify as a Series 24 (principal) prior to acting as a principal with an NASD member firm after the suspension.

3. That the AWC listed the following background information:

    a. Wunderlich Securities, Inc. ("Wunderlich" or the "Firm") at all relevant times was and currently is a financial advisory and investment banking firm with its principal offices located in Memphis, Tennessee. Wunderlich or a predecessor has been registered with NASD and the Securities Exchange Commission (SEC) since 1984. Wunderlich has four main divisions: Private Client Services, Equity Research, Institutional Fixed Income Group and Investment Banking. Since 1997, Wunderlich has been majority owned by the Wunderlich Investment Company. In November 2001, Wunderlich acquired the assets of J. Michael-Patrick ("JMP"), an equity research and trading broker dealer. As of March 1, 2004, Wunderlich has branch offices in St. Louis, Missouri; Chicago and Springfield, Illinois; and Houston, Texas and had 103 registered personnel. Wunderlich has no relevant prior disciplinary history.

    b. The Respondent, 36 years old, is and during the relevant time period was, the President of Wunderlich. He, since 1997 has been a part-owner of Wunderlich, began his employment in the securities industry with Morgan Keegan & Co. Inc. where he became registered as a General Securities Representative in 1991. He became registered as a General Securities Principal in 1998. He has no prior disciplinary history.

4. That the AWC found:

    a. After Wunderlich acquired the assets of, and hired some of JMP's former employees in November 2001, Wunderlich failed

to properly integrate its new institutional research and trading activities in St. Louis into its on-going business, leading to numerous violations of NASD rules and federal securities laws. Patrick Forkin, III ["Forkin"], hired as Wunderlich's head of Institutional Equity Research, unlawfully shared unpublished research with institutional customers prior to release of the research to the investing public. Joel C. Rolla ["Rola"], hired as Wunderlich's head of trading, became aware of the pending research report. Without determining whether it had in fact been released to the public, he unlawfully traded ahead of the report by selling short over $6,500 of the subject company's securities in Wunderlich's inventory account prior to publication of the report. Furthermore, Forkin and Wunderlich failed to disclose in four research reports that Wunderlich was a market maker in the subject company's securities and, for several months, Wunderlich failed to disclose in trade confirmations sent to customers trading the securities of nine companies that Wunderlich was a market maker in those securities. Wunderlich also failed to retain e-mails pertaining to the activities in St. Louis as required by SEC and NASD rules. The Respondent and Patricia D. Hester ["Hester"], respectively President and Chief Compliance Officer, were principally responsible for the integration of the new trading and research activities. However, with respect to the new activities, they failed in their supervisory responsibilities because they did not establish or enforce reasonably designed policies and procedures to achieve compliance with respect to the regulatory requirements imposed on Wunderlich.

b. In November 2001, Wunderlich acquired the assets of JMP, a small broker dealer in St. Louis, Missouri that had focused on providing research and brokerage services to institutional clients. Wunderlich also hired some of the former owners and employees of JMP, intending to expand Wunderlich's research and brokerage business by integrating some of JMP's former institutional business activities with the Firm's. Wunderlich kept those operations in St. Louis, Missouri, while the Respondent and Hester operated out of the Firm's headquarters in Memphis, Tennessee. To expand its research activities, Wunderlich hired Forkin, a part-owner and Vice President/Chief Investment Officer of JMP, as Wunderlich's Managing Director of Institutional Equity Research. In addition to managing the research activities of Wunderlich's nine-person research department, Forkin researched publicly traded companies and

occasionally wrote research reports based on his research. Usually the Firm's research was undertaken at the request of one or more of the Firm's institutional clients and distributed only to the Firm's institutional clients. However, from time to time, research reports were prepared for and distributed to the Firm's institutional clients, and such reports, including research ratings and recommendations were distributed to the public through financial news services such as Bloomberg LP and others.

Wunderlich also hired Rolla, a JMP Vice President/Chief Financial *Officer*, trader and part-owner of JMP, as Wunderlich's head trader. As such, Rolla was responsible for the Firm's trading activities on behalf of its clients and for trading in the Firm's proprietary accounts for the benefit of the Firm. Rolla was also responsible for Wunderlich's market making activities, which Wunderlich started after hiring Rolla.

The Respondent, as President, of Wunderlich and Hester, as Chief Compliance Officer, were principally responsible for integrating the Firm's new and expanded trading and research activities into the Firm's existing supervisory and compliance policies, procedures and systems. Further, they were responsible for either reasonably supervising those activities or effectively delegating supervisory responsibilities to other supervisors at Wunderlich.

c. Wunderlich, through Forkin, Unlawfully Shared Unpublished Research and Ratings by Selectively Giving Advance Notice of His Unpublished Rating on TALK and Copies of His TALK Research Report to Certain Institutional Customers Prior to Release of the Report to the Public in Violation of NASD Conduct Rule 2110.

In early August 2002, Forkin, at the behest of an institutional client, undertook research on TALK America Holdings, Inc. ("TALK"), a provider of local and long distance telephone service, publicly traded on NASDAQ. On August 19, 2002, after reviewing a proxy statement filed by TALK after market close on that day, Forkin drafted a research report, recommending selling TALK. On the afternoon of August 20, 2002, Forkin sent his completed report to six of his institutional clients, knowing that the sell recommendation and the research report were not yet disseminated to the public. That day, TALK stock closed down over 14% compared to the prior day; Wunderlich was responsible for 3% of the trading activity on that day.

Forkin did not release his TALK research report publicly until about noon of August 21, 2002. He sent the report to Bloomberg and shortly thereafter Bloomberg broadcast to the public the information that Wunderlich had initiated coverage of TALK with a "sell" recommendation. That day, the stock closed down over 1% compared to the prior day and over 11 % of trading activity in TALK was through Wunderlich.

Forkin's selective disclosure of his TALK report and sell recommendation to his own institutional clients before the sell recommendation and the report were disseminated to the public provided an unfair advantage to his institutional clients-i.e., they could avoid losses by selling their positions before the market reacted to the report, or sell short the company's stock, profiting on the subsequent market reaction. Further, because his compensation, in part, was commission-based, Forkin himself potentially stood to profit personally from increased trading activity in TALK by the Firm's clients. Although he made no such commissions from TALK trades, by providing the report early to his institutional clients, he improperly gave these clients incentive to trade through Wunderlich prior to public dissemination of the sell rating.

Thus, Forkin's selective disclosure of the pending rating and selective early release of the research report to his institutional clients potentially undermined the fair and efficient operation of the market place. Although his clients did not trade through the Firm, such selective sharing of unpublished research and ratings, which disadvantages the investing public, does not comport with

high standards of commercial honor and just and equitable principles of trade. Accordingly, Forkin, and Wunderlich because of Forkin's actions, violated NASD Rule 2110.

d. Wunderlich, through Rolla, Traded Ahead of a Research Report by Purposely Establishing a Short Position in TALK in a Wunderlich Inventory Account in Anticipation of the Issuance of the TALK Research Report in Violation of NASD Conduct Rule 2110 and IM-2110-4.

By the morning of August 20, 2002, Rolla knew that Forkin was preparing a negative research report on TALK because early that morning Forkin forwarded a copy of the draft report by e-mail to Rolla among others. Later that afternoon, Forkin e-mailed a copy of his final version of the TALK report to Rolla at about the same time Forkin selectively disclosed the report to some of his institutional customers. Forkin sent yet another copy of the report to Rolla before market opening on August 21, 2002.

Although Rolla knew that release of the TALK report to the public was imminent, he neither checked with Forkin nor with any financial news source immediately available to him to determine whether the report had, in fact, been publicly released. Instead, on August 21, 2002 and prior to release of the report to the general public through Bloomberg, Rolla sold short 2,395 shares of TALK through the Firm's inventory account. In shorting TALK, Rolla borrowed the shares from a broker and then immediately sold them; later, after the value had dropped, he bought the equivalent number of shares and repaid the cheaper shares to the broker, pocketing the difference in price as profit. Thus, by shorting TALK, Wunderlich, through Rolla, was anticipating that the price of TALK's common stock would drop once the public became aware of Forkin's sell recommendation. When Rolla later covered the short position, the Firm made a profit of approximately $400.

NASD IM-2110-4, in relevant part, states that "trading activity purposely establishing, increasing, decreasing or liquidating a position in a NASDAQ security ... in anticipation of the issuance of a research report in that security is inconsistent with just and equitable principles of trade and is a violation of NASD Rule 2110." The principal intent of the interpretation is to prevent a firm from taking unfair advantage of the effect that its research report might have on the market.

Here, Wunderlich, through Rolla, established a position in TALK in anticipation of public release of the negative report on TALK; this allowed Wunderlich to profit once the sell recommendation became widely known. Accordingly, Wunderlich and Rolla violated NASD Rule 2110 and IM-2110-4.

e. Wunderlich, through Forkin, Failed to Disclose Market Making in Research Reports-Violations of NASD Conduct Rules 2711(h)(8) and 2110 NASD Rule 2711(h)(8) has, since July 9, 2002, required a member to disclose explicitly in a research report that it makes a market in the securities covered by the report. Wunderlich violated this requirement in publishing four research reports. Wunderlich was a market maker in Itron, Inc. ("ITRI") on July 17, 2002, but Forkin's July 17, 2002 research report on ITRI did not disclose that fact. Similarly, Wunderlich's July 24, 2002 Headwaters, Inc. ("HDWR") research report did not disclose that Wunderlich was a market maker at that time. Forkin's August 21, 2002 TALK research report did not disclose that, at the time, Wunderlich was a market maker in TALK. Likewise, a research report on Hoover, Inc. ("HOOV") on August 29, 2002 did not disclose that Wunderlich was a market maker in HOOV.

By failing to disclose market making in four research reports when NASD mandates such disclosure, Wunderlich violated NASD Rules 2711 and 2110. By authoring two reports that failed to include required disclosures with respect to market making and, as head of research, permitting two other reports to be published without the required disclosures, Forkin violated NASD Rules 2711 and 2110.

f. Wunderlich Failed to Disclose Market Making on Confirms-Violations of NASD Conduct Rules 2230, 3110, 2110 and Sections 17(a) and 10(b) of the Exchange Act and SEC Rules 17a-3 and 10b-10 thereunder From June 11, 2002 to August 31, 2002, Wunderlich failed to provide, at or before the completion of the transaction, written disclosure to customers that Wunderlich was, at that time, a market maker in nine securities traded by its customers (Act Teleconferencing, Amcor Financial Inc., Casey's General Store Inc., Itron Inc., MarketWatch.com, Penigio Co., Quaker City Banccorp, Standard Management Corp. and TALK).

By failing to provide written disclosure of Wunderlich's market making on transaction confirmations, Wunderlich violated Section 10(b) of the Exchange Act of 1934 (the "Exchange Act") and SEC Rule l0b-10 there under and NASD Rule 2230 (confirmations) which require such disclosure. Further, the failure to disclose Wunderlich's market making on trade confirmations caused Wunderlich's books and records to be inaccurate, and, thus, Wunderlich violated the record keeping requirements of Section 17(a) of the Exchange Act, SEC Rule 17a-3 (Books and Records) and NASD Rule 3110 (Books and Records). By this conduct, Wunderlich also violated NASD Rule 2110.

g. Wunderlich Failed to Retain St. Louis E-mails and E-mails From 11 Bloomberg E-mail Accounts Used in St. Louis -Violations of § 17(a) of the Exchange Act and Rule 17a-4 there under and Conduct Rules 3110 and 2110

After Wunderlich acquired the assets of JMP, Wunderlich continued to use in St. Louis the e-mail system that had previously been used by JMP (the "legacy system"), rather than converting JMP e-mail users to Wunderlich's e-mail system. A third party that provided the legacy system also retained and archived that system's e-mails. Generally, the third-party provider forwarded a copy of the archived e-mails monthly on a CD-ROM disk to Wunderlich.

From May 20, 2002 through August 21, 2002, the third-party provider failed to retain and archive e-mails on the legacy system. During that period, no one from Wunderlich reviewed legacy system CD-ROM disks or detected that disks were not being forwarded to Wunderlich. Consequently, Wunderlich did not retain any legacy system e-mails during that period. As a result, when NASD requested e-mails for that period as part of its investigation, Wunderlich could not provide them.

Further, from at least June 1, 2002 through at least June 5, 2003, ten persons associated with Wunderlich in St. Louis had access to and used 1 1 e-mail accounts provided through a terminal leased from Bloomberg. The Firm failed to address the use and retention of outside e-mail accounts such as the e-mail accounts through Bloomberg. During this period, Wunderlich did not retain and archive those e-mails in a readily accessible place. Indeed, Wunderlich's compliance office was

unaware of those e-mails until it was discovered during the course of NASD's investigation that employees in St. Louis were using Bloomberg's e-mail service. It took over six months for the Firm to provide these a-mails to NASD.

Section 17(a)(1) of the Exchange Act requires broker dealers to "make and keep for proscribed periods" certain records, and SEC Rule 17a-4(b)(4) there under requires broker dealers to "preserve for a period of not less than 3 years, the final two years in an accessible place.... [o]riginals of all communications received and copies of all communications sent ... relating to [the broker dealer's] business as such." Further, NASD Rule 3110 requires members to comply with SEC rule 17a-4.

Despite the SEC and NASD requirements to maintain copies of e-mails (and keep such copies readily accessible for two years), Wunderlich failed to retain e-mails in the legacy system for a three-month period and failed to retain over a year's worth of Bloomberg e-mails in St. Louis in a readily accessible place.

These failures by Wunderlich constitute violations of Section 17(a) of the Exchange Act and Rule 17a-4 there under and NASD Rule 3110. Such failures are inconsistent with just and equitable principals of trade, and therefore, also violate NASD Rule 2110.

h. Wunderlich, Hester and the Respondent Failed to Establish, Maintain and Enforce Adequate Written Supervisory Procedures and Systems-Violations Of NASD Conduct Rules 3010 and 2110, and, With Respect to Market Making Disclosures in Research Reports, Rule 2711(i)

NASD Rule 3010 requires each member to establish both supervisory systems and written supervisory procedures tailored to the member's business that address the activities of its registered and associated persons. As described below, Wunderlich, through the Respondent and Hester, did not establish reasonable supervisory systems and procedures tailored to Wunderlich's activities in St. Louis. These failures constituted violations of NASD Rules 3010 and 2110.

The Respondent, as president of Wunderlich, is and was responsible for Wunderlich's compliance with all of the regulatory requirements imposed on Wunderlich. By Firm

policy and in practice, he exercised final review and approval authority over Wunderlich's compliance policies, its written supervisory procedures and its supervisory systems. Hester, as Chief Compliance Officer, is and was responsible for developing Wunderlich's compliance policies and written supervisory procedures.

When Wunderlich expanded its business by acquiring JMP's assets and hiring former JMP employees, the Respondent and Hester did not fulfill their responsibilities for integrating the new activities into Wunderlich's compliance and supervisory policies and procedures or systems. Because of Hester's and the Respondent's failures, in connection with the new research and trading activities, Wunderlich did not develop, implement, or enforce policies, procedures, or systems reasonably designed to achieve compliance with securities laws and regulations and NASD rules with respect to:

- Sharing of research and ratings with customers and with Wunderlich's associated persons outside the research department prior to release to the public;
- Trading ahead of the release of research reports to the public;
- Review of research reports;
- Disclosures of the Firm's market maker status in research reports;
- Disclosure of the Firm's market maker status on confirmations; and
- Retention of e-mail correspondence.

In each of these areas, Wunderlich either had no policy, procedure or system or, in some instances, had only a policy setting forth applicable rules and describing prohibited practices. Wunderlich did not for any of these areas: identify a responsible supervisor and the relevant business activity; describe the activities the supervisor must undertake; indicate how often the supervisor must undertake the specified activities; or establish how the supervisor should document the undertaken activities. Each and all of these are required by

NASD to meet the requirements of Rule 3010, and with respect to the disclosure of market making in research reports, also by Rule 2711(i). Accordingly, Wunderlich's written supervisory procedures and its systems were deficient with respect to these areas.

Further, Rule 3010(d) (Review of Transactions and Correspondence) requires that among other things, a registered principal review incoming and outgoing electronic correspondence of a firm's registered representatives. At Wunderlich, Hester was assigned the responsibility to review e-mails, yet e-mails for a three-month period were lost and ten employees used Bloomberg e-mail for over a year without Hester's knowledge. Accordingly, Wunderlich and Hester violated rule 3010(d).

As a result of the conduct described above, Wunderlich, the Respondent, and Hester violated NASD Rules 3010, 2711(i), with respect to market making disclosures in research reports, and 2110.

5. That Section 8.E(1)(j) of the Act provides, inter alia, that the registration of a salesperson may be revoked if the Secretary of State finds that such salesperson has been suspended by any self-regulatory organization registered under the Federal 1934 Act or the Federal 1974 Act arising from any fraudulent or deceptive act or a practice in violation of any rule, regulation or standard duly promulgated by the self-regulatory organization.

6. That NASD is a self-regulatory organization as specified in Section 8.E(l)(j) of the Act.

7. That by virtue of the foregoing, the Respondent's registration as a salesperson in the State of Illinois is subject to revocation pursuant to Section 8.E(1)(j) of the Act.

You are further notified that you are required pursuant to Section 130.1104 of the Rules and Regulations (14 Ill. Adm. Code 130) (the "Rules"), to file an answer to the allegations outlined above within thirty (30) days of the receipt of this notice. A failure to file an answer within the prescribed time shall be construed as an admission of the allegations contained in the Notice of Hearing.

Furthermore, you may be requested by legal counsel; may present evidence; may cross-examine witnesses and otherwise participate. A failure to so appear shall constitute

default, unless any Respondent has upon due notice moved for and obtained a continuance.

A copy of the Rules, promulgated under the Act and pertaining to Hearings held by the Office of the Secretary of State, Securities Department, is included with this Notice.

Delivery of notice to the designated representative of any Respondent constitutes service upon such Respondent.

DATED: This 8th day of March 2005

JESSE WHITE
Secretary of State
State of Illinois

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