

N E W Y O R K S T O C K E X C H A N G E , I N C .

SHEARSON LEHMAN BROTHERS INC. (THE "FIRM"), A MEMBER ORGANIZATION, VIOLATED SECTION 220.8 OF REGULATION T OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM ("REGULATION T") BY FAILING TO PROMPTLY CANCEL PURCHASE TRANSACTIONS IN CUSTOMER CASH ACCOUNTS WHICH WERE ON A 90 DAY RESTRICTION; VIOLATED SECTION 220.8(b) OF REGULATION T BY FAILING TO PROMPTLY CANCEL OR OTHERWISE LIQUIDATE CERTAIN PURCHASE TRANSACTIONS IN CUSTOMER CASH ACCOUNTS OR OBTAIN EXTENSIONS OF TIME WHEN PAYMENT WAS NOT RECEIVED WITHIN THE REQUIRED TIME; VIOLATED SECTION 220.8(c) OF REGULATION T BY FAILING TO RESTRICT FOR 90 DAYS CUSTOMER CASH ACCOUNTS THAT HAD PURCHASED AND SOLD SECURITIES WITHOUT FULL PAYMENT BEING MADE FOR SUCH PURCHASES; VIOLATED FORMER EXCHANGE RULE 431(d)(9) BY PERMITTING CUSTOMERS TO MAKE A PRACTICE OF FREE RIDING; VIOLATED REGULATION 240.10b-10, PROMULGATED PURSUANT TO THE SECURITIES EXCHANGE ACT OF 1934 (THE "SEA"), BY FAILING TO DISCLOSE MARK-UPS CHARGED ON CERTAIN PURCHASE TRANSACTIONS ON WRITTEN CONFIRMATIONS TO CUSTOMERS; VIOLATED SEA REGULATIONS 240.15c3-3(m) AND (n) BY FAILING TO PURCHASE SECURITIES OF A LIKE KIND AND QUANTITY THAT WERE SOLD FOR CUSTOMERS IN "RETAIL" AND "RECEIVE VERSUS PAYMENT" ACCOUNTS AND WHICH HAD NOT BEEN RECEIVED WITHIN TEN BUSINESS DAYS AFTER THE SETTLEMENT DATE OF THE TRANSACTION, OR OBTAINING AN EXTENSION OF TIME WITHIN WHICH SUCH SECURITIES HAD TO BE PURCHASED; VIOLATED EXCHANGE RULE 342(a) BY FAILING TO REASONABLY DISCHARGE ITS DUTIES AND OBLIGATIONS IN CONNECTION WITH SUPERVISION AND CONTROL OF CERTAIN OF ITS BUSINESS ACTIVITIES BY: PERMITTING A REGISTERED REPRESENTATIVE TO PLACE SECURITIES, WHICH IT WAS DISTRIBUTING TO THE PUBLIC, IN THREE INACTIVE CUSTOMER ACCOUNTS WITHOUT ANY AUTHORIZATION TO DO SO, WHICH SECURITIES WERE THEREAFTER TRANSFERRED TO THIRTEEN OTHER CUSTOMERS ACCOUNTS; EFFECTING TRADE CORRECTIONS IN CUSTOMER ACCOUNTS WHICH WERE NOT APPROVED BY A BRANCH OFFICE MANAGER; AND PERMITTING SEVERAL REGISTERED REPRESENTATIVES TO TRANSACT BUSINESS WITH CUSTOMERS IN STATES IN WHICH SUCH REGISTERED REPRESENTATIVES WERE NOT REGISTERED; VIOLATED EXCHANGE RULE 342(b)(1) AND (2) BY FAILING TO PROVIDE FOR APPROPRIATE PROCEDURES OF SUPERVISION AND CONTROL, INCLUDING A SEPARATE SYSTEM OF FOLLOW-UP AND REVIEW, WITH RESPECT TO: THE ENFORCEMENT OF 90 DAY RESTRICTIONS PLACED ON CUSTOMER CASH ACCOUNTS PURSUANT TO REGULATION T; THE EXECUTION OF CUSTOMER ORDERS WITH THE ACCOUNT DESIGNATION

INFORMATION REQUIRED BY EXCHANGE RULE 410; AND THE APPROVAL OF TRADE CORRECTIONS INVOLVING THE TRANSFER OF SECURITIES BETWEEN DIFFERENT CUSTOMER ACCOUNTS; VIOLATED EXCHANGE RULE 342(b)(2) BY FAILING TO ESTABLISH A SEPARATE SYSTEM OF FOLLOW-UP AND REVIEW TO DETERMINE THAT DELEGATED AUTHORITY AND RESPONSIBILITY WERE BEING PROPERLY EXERCISED WITH RESPECT TO: LIMITING CUSTOMER ACCOUNTS WHICH TRADED IN VIOLATION OF REGULATION T TO LIQUIDATING TRANSACTIONS; CONFIRMING WITH CUSTOMERS THAT THE TRADING ACTIVITY IN THEIR ACCOUNTS WAS AUTHORIZED AND SUITABLE; MONITORING AND APPROVING SOLICITATIONS BY REGISTERED REPRESENTATIVES OF SECURITIES NOT RECOMMENDED BY THE MEMBER ORGANIZATION; AND CONDUCTING QUARTERLY REVIEWS OF CUSTOMER ACCOUNTS; VIOLATED EXCHANGE RULE 410 BY EXECUTING CUSTOMER ORDERS FOR EXCHANGE LISTED SECURITIES, WITHOUT THE REQUIRED ACCOUNT DESIGNATION INFORMATION ON THE ORDER TICKETS; ENGAGED IN CONDUCT INCONSISTENT WITH JUST AND EQUITABLE PRINCIPLES OF TRADE BY EXECUTING CUSTOMER ORDERS FOR OVER-THE-COUNTER SECURITIES WITHOUT THE ACCOUNT DESIGNATION INFORMATION REQUIRED BY EXCHANGE RULE 410 ON THE ORDER TICKETS; VIOLATED EXCHANGE RULE 440 AND SEA REGULATION 240.17a-3 BY FAILING TO MAKE, AND KEEP CURRENT, CERTAIN BOOKS AND RECORDS; AND VIOLATED EXCHANGE RULE 440 AND SEA REGULATION 240.17a-4 BY FAILING TO PRESERVE CERTAIN BOOKS AND RECORDS FOR THE REQUIRED PERIOD OF TIME -- CONSENT TO A CENSURE, A FINE OF \$750,000, AND AN UNDERTAKING BY THE FIRM OF A REVIEW OF, AND THE IMPLEMENTATION OF THE RECOMMENDED CHANGES TO, THE POLICIES, PROCEDURES AND SYSTEMS FOR COMPLIANCE WITH REGULATION T.

EXCHANGE HEARING PANEL DECISION 91-69

May 14, 1991

An Exchange Hearing Panel met to consider a Stipulation of Facts and Consent to Penalty entered into between the Exchange's Division of Enforcement and the Firm. Without admitting or denying guilt, the Firm consents to findings by the Hearing Panel that it:

- I. violated Section 220.8 of Regulation T by failing to promptly cancel purchase transactions in customer cash accounts which were on a 90 day restriction;
- II. violated Section 220.8(b) of Regulation T by failing to promptly cancel or otherwise liquidate certain purchase transactions in customer cash

accounts or obtain extensions of time when payment was not received within the required time;

- III. violated Section 220.8(c) of Regulation T by failing to restrict for 90 days customer cash accounts that had purchased and sold securities without full payment being made for such purchases;
- IV. violated former Exchange Rule 431(d)(9) by permitting customers to make a practice of free riding;
- V. violated SEA Regulation 240.10b-10, by failing to disclose mark-ups charged on certain purchase transactions on written confirmations to customers;
- VI. violated SEA Regulations 240.15c3-3(m) and (n) by failing to purchase securities of a like kind and quantity that were sold for customers in "retail" and "receive versus payment" transactions in cash accounts and which had not been received within ten business days after the settlement date of the transaction, or obtaining an extension of time within which such securities had to be purchased;
- VII. violated Exchange Rule 342(a) by failing to reasonably discharge its duties and obligations in connection with supervision and control of certain of its business activities by:
 - A. permitting a registered representative to place securities, which it was distributing to the public, in three inactive customer accounts without any authorization to do so, which securities were thereafter transferred to thirteen other customers' accounts;
 - B. effecting trade corrections in customer accounts which were not approved by a branch office manager; and
 - C. permitting several registered representatives to transact business with customers in states in which such registered representatives were not registered;
- VIII. violated Exchange Rule 342(b)(1) and (2) by failing to provide for appropriate procedures of supervision and control, including a separate system of follow-up and review, with respect to:
 - A. the enforcement of 90 day restrictions placed on customer cash accounts pursuant to Regulation T;
 - B. the execution of customer orders with the account designation information required by

Exchange Rule 410; and

- C. the approval of trade corrections involving the transfer of securities between different customer accounts;
- IX. violated Exchange Rule 342(b)(2) by failing to establish a separate system of follow-up and review to determine that delegated authority and responsibility were being properly exercised with respect to:
- A. limiting customer accounts which traded in violation of Regulation T to liquidating transactions;
 - B. confirming with customers that the trading activity in their accounts was authorized and suitable;
 - C. monitoring and approving solicitations by registered representatives of securities not recommended by the member organization; and
 - D. conducting quarterly reviews of customer accounts;
- X. violated Exchange Rule 410 by executing customer orders for Exchange listed securities, without the required account designation information on the order tickets;
- XI. engaged in conduct inconsistent with just and equitable principles of trade by executing customer orders for over-the-counter securities without the account designation information required by Exchange Rule 410 on the order tickets;
- XII. violated Exchange Rule 440 and SEA Regulation 240.17a-3 by failing to make, and keep current, certain books and records; and
- XIII. violated Exchange Rule 440 and SEA Regulation 240.17a-4 by failing to preserve certain books and records for the required period of time.

For the sole purpose of settling this disciplinary proceeding, the Division of Enforcement and the Firm stipulate to the following facts:

1. The Firm is, and was at all times relevant herein, a member organization of the Exchange. At all times relevant herein, the Firm maintained branch offices nationwide, including a branch located at 55 Water Street, New York, New York (the "Water Street Branch").

2. During 1986, 1987 and 1988, Exchange examiners conducted examinations regarding financial and operational matters at the Firm and set forth their findings in three reports: a report dated November 19, 1986 ("1986 FINOP Report"), a report dated February 12, 1988 ("1987 FINOP Report") and a report dated September 29, 1988 ("1988 FINOP Report"). In addition, during 1986, Exchange sales practice examiners conducted an examination of the Firm's supervisory standards and sales practice procedures established and maintained at the Water Street Branch, as well as other branch offices of the Firm, and set forth their findings in a report dated November 19, 1986 (the "1986 SPRU Report").
3. In June 1984, a predecessor firm merged with the Firm (the "Merger"). Prior to the Merger, A served as the Branch Office Manager (the "BOM") for the predecessor's Water Street Branch, and, at all times relevant herein, he continued to serve as BOM in the Water Street Branch. On or about February 1, 1991, A retired as BOM of the Water Street Branch and is currently employed as a registered representative with the Firm.
4. At all relevant times, within the Water Street Branch, B and C served as Assistant BOMs, D served as Administrative Manager, E served as Operations Manager and, beginning in June 1986, F served as Compliance Manager.
5. At all relevant times, A delegated certain supervisory duties and functions to the other managers in the Water Street Branch (who are hereinafter referred to as "Delegates"). However, at all times relevant herein, A retained overall supervisory responsibility for the activities in the Water Street Branch. At all times relevant herein, approximately 130 registered representatives were employed in the Water Street Branch, servicing approximately 50,000 customer accounts.
6. During 1986, the Water Street Branch utilized a verbal order entry system (the "Verbal Order Entry System") for customer orders entered by registered representatives. The Water Street Branch was the only branch utilizing such a system.
7. Under the Verbal Order Entry System, registered representatives generally did not prepare order tickets. Instead, registered representatives telephoned orders directly into a "desk" (OTC or Listed), if such orders exceeded certain volume limits. Order tickets were then prepared at such desks. For transactions where customer orders did

not exceed certain volume limits, the registered representative telephoned in such orders to the Water Street Branch "mini-order" room, where an order clerk prepared the order ticket.

1. Hereinafter, all figures are approximate.

REGULATION T VIOLATIONS IN THE WATER STREET BRANCH

Trading Through 90 Day Restrictions

1. At all relevant times, the Firm had procedures in its national credit department ("National Credit") to review trading activity in customer accounts on a daily basis, and to notify the branch office when a customer account was subject to a 90 day restriction, pursuant to Section 220.8(c) of Regulation T. Upon receipt of such notification in the Water Street Branch, clerks in the branch were required to inform the registered representatives of the 90 day restriction.
2. At all relevant times, National Credit also had procedures to review trading activity on a daily basis in customer accounts subject to a 90 day restriction ("Restricted Accounts") to detect purchases effected in customer accounts on a cash basis without sufficient funds in the cash account on the trade date of the purchase to pay for the security in full ("Trade Through Restriction"), in violation of Regulation T. In those instances where such a purchase was detected, the margin clerk was required to inform his/her supervisor and notify the branch by wire. The branch was required to report to the margin clerk on the status of the trade within forty-eight hours.
3. Prior to April 1986, the Water Street Branch did not have procedures of supervision and control to effectively monitor and enforce 90 day restrictions in Restricted Accounts.
4. In or about April 1986, a new procedure was implemented in the Water Street Branch whereby A was added as an "interested party" to Restricted Accounts (the "Interested Party Procedure"), so that A received a duplicate copy of the confirmation slips for all transactions effected in Restricted Accounts which were properly coded. However, from the inception of the Interested Party Procedure, in or about April 1986, until the beginning of June 1986, such duplicate confirmations were not being reviewed by A or his

Delegates.

5. On sixty-five occasions during the period from February through June 1986, sixteen customer accounts, serviced by eight registered representatives in the Water Street Branch, were permitted to effect Trade Through Restriction purchases, in violation of Regulation T. The total cost of securities purchased on the sixty-five occasions was in excess of \$3.8 million.
 6. At all relevant times, customer G maintained a securities account at the Water Street Branch (the "G Account") serviced by H, a registered representative employed in the Water Street Branch until his departure from the Firm in January 1988.
 7. During February 1986 and March 1986, National Credit personnel spoke with D and the Divisional Operations Manager, regarding the trading activity in the G Account, and the failure of the Water Street Branch to cancel certain transactions in the G Account which National Credit had identified as being in violation of Regulation T. During this period of time, D and the Divisional Operations Manager notified A of National Credit's inquiry regarding the G Account.
 8. Because certain trades in the G Account were not cancelled by the Water Street Branch, the Firm's Margin Manager was informed of the Regulation T violations in the G Account. On March 20, 1986, the Margin Manager prepared and sent a memorandum and an analysis of the trading activity in the G Account to the Firm's Director of Compliance. The memorandum reported that the G Account had "excessively" traded through a 90 day restriction, and that the Water Street Branch would be notified to close the G Account upon the occurrence of any future violations.
 9. During the period between March 20, 1986 and June 27, 1986, H effected an additional thirteen Trade Through Restriction purchases in the G Account, in violation of Regulation T.2 In addition, on or about September 4, 1986, the G Account was again placed on a 90 day restriction due to "excessive liquidations in cash account". However, the G Account was not closed.
2. All dates referred to hereinafter are trade dates, unless otherwise specified.

Practice of Free Riding in Customer Accounts

10. During the period from February through June 1986, the Firm permitted four customers of H to engage in a practice of "free riding", as those terms are defined in Exchange Rule 431(d)(9),³ by allowing such customers to make payment for the purchase of securities with the proceeds of sales of the same securities on thirty-six occasions, in violation of Exchange Rule 431(d)(9). The total cost of securities purchased on the thirty-six occasions was \$2.5 million.

Failing to Restrict Accounts

11. On thirty-seven occasions during the period from February through June 1986, the Firm violated Section 220.8(c) of Regulation T in that it failed to restrict for 90 days eleven customer accounts in the Water Street Branch which had purchased and sold securities on a cash basis, without full payment being made for such purchases.
 12. In addition, during at least the first six months of 1986 in the Water Street Branch, purchases of securities for which no payment had been received from customers ("reneges") were generally cancelled and transferred into a branch error account (the "Error Account"), rather than liquidated in the customer accounts. In certain instances, National Credit was not notified of the reneges and was, therefore, unable to detect that these "cancellations" were actually liquidations for non-payment.⁴
 13. For example, Exchange examiners noted that, during May 1986, the Firm failed to restrict for 90 days fourteen customer accounts in the Water Street Branch because "first trade reneges" of securities purchased in such customer cash accounts were
3. Effective September 1, 1987, Exchange Rule 431(d)(9) became Exchange Rule 431(f)(9).
 4. Under Section 220.8(c) of Regulation T, a cancellation, other than to correct an error, is treated as a sale of such security.

cancelled in the Error Account, rather than liquidated in the customer accounts.

Class U Accounts

14. At all relevant times, the Firm had procedures that required certain customer accounts which were determined to be conducting business in a manner unacceptable to the Firm to be classified as "Class U Accounts", thereby limiting such accounts to liquidating transactions. Customer accounts which were placed on a 90 day restriction two or more times during a twelve month period were to be classified as Class U Accounts. The authority to classify a customer account as a Class U Account was delegated to various individuals in Compliance and National Credit, and to the BOM.
15. During the period from January through June 1986, at least twenty customer accounts in the Water Street Branch were placed on a 90 day restriction two or more times within twelve months, but such accounts were not thereafter limited to liquidating transactions, contrary to the Firm's procedures.

FAILURE TO DISCLOSE MARK-UPS (REGULATION 240.10b-10)

1. The Firm participated in the initial public offering ("IPO") of XYZ common stock as lead underwriter. The XYZ IPO consisted of 8,625,000 shares at an offering price of 9 3/4 per share.
 2. At all relevant times, XYZ was listed with NASDAQ as a National Market System ("NMS") security. The Firm was a NASDAQ market maker in XYZ. At all relevant times, with respect to securities for which the Firm acted as a market maker, the Firm's policy required that the maximum price a stock would be offered to a customer was the best price publicly quoted by any market maker, plus a mark-up charged to the customer.⁵
5. A mark-up, as referred to hereinafter, is the difference between the net amount the Firm customer pays for the security sold to the customer by the Firm on a principal basis and the inside ask price at the time of execution.
3. In addition, pursuant to the requirements of SEA Regulation 240.10b-10, the Firm was required to provide to its customers written disclosure of the amount of any mark-up charged on an NMS security.
 4. On one day in May 1986, as a market maker in XYZ, the Firm sold 1,677,000 shares of XYZ to 530 customer accounts in various branch offices. Of these 1,677,000 XYZ shares, 1,003,000 XYZ shares were sold to 360 customer accounts in the Water Street Branch.

5. Of the 360 customer accounts in the Water Street Branch which purchased XYZ shares on the aforementioned day, 330 of those customer accounts purchased a total of 900,000 shares at a net price of 10 1/2, without any written mark-up being disclosed to the customers. However, on that same day, no other customer in any other branch office paid a price for XYZ shares higher than 10 3/8, unless a written mark-up was disclosed to the customer.
6. On that same day, the opening inside ask price for XYZ was 10 1/4. At no time thereafter on that day, did the inside ask price for XYZ exceed 10 3/8, the price at which XYZ closed on that day.
7. As described above, registered representatives in the Water Street Branch effected numerous purchases of XYZ for customer accounts, the confirmations for which purchases did not disclose a mark-up paid by these customers, in violation of SEA Regulation 240.10b-10.

EXCESSIVELY TRADED ACCOUNTS

1. At all relevant times, Firm procedures required all BOMs to conduct a daily review of all transactions effected in customer accounts, and to conduct a quarterly review of customer accounts of every registered representative in the branch to detect and prevent, among other things, excessive and unsuitable trading. A conducted the daily review of transactions with his Assistant BOMs, and delegated the performance of most of the quarterly reviews to his Assistant BOMs.
2. At all relevant times, on a monthly basis, the Firm's compliance department ("Compliance") provided all BOMs with a computerized report identifying customer accounts which, due to the number of trades and/or the commissions generated in such accounts, required additional review by the BOM (the "Monthly Account Evaluation"). Upon receipt of the Monthly Account Evaluation, the BOM was required to confirm in writing to Compliance that the activity in such accounts was suitable and in accord with the customer's investment objectives.
3. The procedure at the Water Street Branch, regarding the review of the Monthly Account Evaluation, was for A and his Assistant BOMs to discuss each account on the Monthly Account Evaluation. For any account that was unfamiliar to the managers, A and his Assistant BOMs were to contact the customer to ascertain, among other things, whether the trading activity in the account was suitable.

4. Beginning in March 1986, for certain customer accounts designated on the Monthly Account Evaluation, including those generating over \$20,000 in year-to-date commissions, each BOM was required to contact the customer with a specific letter (the "Activity Letter") requesting the customer's confirmation in writing ("Signed Activity Letter") that all transactions in the account were authorized and consistent with the customer's investment objectives. A arranged for the initial mailing of Activity Letters in April 1986.
5. Although the Firm's procedure did not specifically describe what action should be taken by a BOM if a customer did not return a Signed Activity Letter, A failed to establish an adequate system of follow-up and review in the Water Street Branch for promptly contacting customers who did not return a Signed Activity Letter.

The G Account

6. The G Account was opened on or about May 23, 1985 and, as stated above, was serviced by H. The original new account documentation for the G Account listed G's investment objectives as "Appreciation with Safety" and "Income with Safety," and described G as a partner in a trucking company with an annual income of \$100,000, a liquid net worth of \$300,000 and a total net worth of \$1 million. On June 16, 1986, without G's knowledge or authorization, H caused G's investment objectives to be changed to "Appreciation with Risk" and "Speculative."
7. During the twenty-four months from June 1985 through May 1987, H excessively traded the G Account by effecting 226 purchase and sale transactions in the G Account, generating commissions⁶ of \$206,300 and incurring trading losses (realized and unrealized) and net charges of \$176,577. As calculated by the Division, the turnover ratio was 15.45.
8. G closed his account at the Water Street Branch in June 1987. In December 1987, G's attorney wrote to the Firm alleging that H excessively traded the G Account and that H made misrepresentations to G regarding the status of the account. The Firm settled G's complaint in June 1988 for \$100,000.
9. The G Account appeared on the Monthly Account Evaluation in every month in 1986 and was designated to receive an Activity Letter beginning in March 1986. In April and September 1986, and January 1987, A sent G an Activity Letter.

However, G did not return a Signed Activity Letter to A at any time in 1986 or 1987. Despite the nonreceipt of any Signed Activity Letters from G, A and his Assistant BOMs did not contact G to determine independently whether the trading activity in the G Account was authorized and suitable.

6. Commissions consist of commissions on agency transactions, mark-ups/mark-downs on principal transactions, concessions on public offerings, and/or additional compensation on certain principal transactions in which the Firm was a market maker, and in which the Water Street Branch and registered representatives shared in part or all of the "spread" on OTC securities. The spread on OTC securities represents the difference between the purchase cost of the securities by the Firm's OTC trading department and the inside ask price, which is the price a customer usually pays for a security before a "mark-up". The additional compensation based upon the spread was not disclosed in any written notice to Firm customers.

10. Although B reviewed the customer accounts of H in the first and fourth quarters of 1986, such accounts, including the G Account, were not reviewed by any manager in the Water Street Branch in the second and third quarters of 1986.

The J Account

11. On or about January 24, 1985, customer J opened a securities account at the Water Street Branch which was serviced by K, a registered representative employed in the Water Street Branch until his departure in October 1986. The new account documentation for the J Account listed J's investment objectives as "Appreciation with Safety," "Appreciation with Risk", "Speculative" and "Income with Safety" and described J as president of his own trucking company with an annual income in excess of \$500,000, a liquid net worth in excess of \$2 million, and a total net worth in excess of \$30 million. Prior to opening the J Account, J had limited experience investing in securities.

12. During the twenty-one months from February 1985 through October 1986, K excessively traded the J Account by effecting 208 purchase and sale transactions in the J Account, generating commissions of \$353,400, and incurring trading losses (realized and unrealized) and net charges of \$335,000. As calculated by the Division, the turnover ratio was 12.26.

13. Subsequent to K's leaving the Firm in October 1986,

J spoke with one or more managers in the Water Street Branch alleging that K misrepresented to J the value of the J Account and had effected unauthorized and excessive trades in the J Account. In or about May 1987, the Firm settled J's complaint for \$110,000 and other consideration in the form of discounted commissions for future transactions.

14. In the 1985 annual branch examination report issued by Compliance in January 1986 (the "1985 Audit"), Compliance recommended that A obtain a Signed Activity Letter from seventy-six customers, including J.
15. The J Account appeared on the Monthly Account Evaluation each month during the period from January through September 1986, and was designated to receive an Activity Letter in March 1986. In April and June 1986, and twice in September 1986, A sent J an Activity Letter. However, J did not return a Signed Activity Letter to A. Despite the nonreceipt of any Signed Activity Letters from J, A and his Assistant BOMs did not contact J to determine independently whether the trading activity in the J Account was authorized and suitable.
16. Although B reviewed the customer accounts of K in the first and second quarters of 1986, such accounts, including the J Account, were not reviewed by any manager in the Water Street Branch in the third quarter of 1986.

The L Account

17. On or about March 14, 1985, customer L opened a securities account at the Water Street Branch which was serviced by K. The new account documentation for the L Account listed L's investment objectives as "Appreciation with Safety," and described L as a president of a real estate company with an annual income in excess of \$500,000 and a liquid net worth in excess of \$5 million. Prior to opening the L Account, L had virtually no previous experience investing in securities.
18. During the twenty months from March 1985 through October 1986, K excessively traded the L Account by effecting 102 purchase and sale transactions in the L Account, generating commissions of \$117,500, and incurring trading losses (realized and unrealized) and net charges of \$105,300. As calculated by the Division, the turnover ratio was 19.52.
19. In May 1988, L filed an arbitration claim alleging

that, during the period K serviced the L Account, K effected numerous unauthorized trades in the L Account and made misrepresentations regarding the activity in the L Account. In or about December 1990, the Firm settled L's claim for \$158,000.

20. The L Account appeared on the Monthly Account Evaluation each month during the period from January through September 1986, and was designated to receive an Activity Letter beginning in March 1986. In April, June and September 1986, A sent L an Activity Letter. However, L did not return a Signed Activity Letter to A. Despite the nonreceipt of any Signed Activity Letter from L, A and his Assistant BOMs did not contact L to determine independently whether the trading activity in the L Account was authorized and suitable.
21. Although B reviewed the customer accounts of K in the first and second quarters of 1986, such accounts, including the L Account, were not reviewed by any manager in the Water Street Branch in the third quarter of 1986.

The M Account

22. On or about July 1, 1985, customer M opened a securities account at the Water Street Branch which was serviced by K. The new account documentation for the M Account listed M's investment objectives as "Appreciation with Risk", and described M as a president of a construction company with an annual income in excess of \$300,000 and a liquid net worth and total net worth in excess of \$1 million. The information regarding M's occupation, income and net worth was inaccurate, and K never discussed investment objectives with M. Prior to opening the M Account, M had no previous experience investing in securities.
23. During the twelve months from July 1985 through June 1986, K excessively traded the M Account by effecting twenty-eight purchase and sale transactions in the M Account, generating commissions of \$56,190, and incurring realized trading losses and net charges of \$38,340. As calculated by the Division, the turnover ratio was 19.60.
24. The M Account appeared on the Monthly Account Evaluation each month during the period from January through September 1986, and was designated to receive an activity letter beginning in March 1986. In April, June and September 1986, A sent M an Activity Letter. M did not return a Signed

Activity Letter to A. However, on or about September 19, 1986, M sent a letter to A stating that he did not return a Signed Activity Letter because K had effected one or more unauthorized transactions in the M Account in February 1986, and that K had paid M \$10,000 in early September 1986, to cover M's losses from these unauthorized transactions. Despite the nonreceipt of any Signed Activity Letter from M, A and his Assistant BOMs did not contact M prior to the receipt of M's letter to determine independently whether the trading activity in the M Account was authorized and suitable.

25. Although B reviewed the customer accounts of K in the first and second quarters of 1986, such accounts, including the M Account, were not reviewed by any manager in the Water Street Branch in the third quarter of 1986.

The N Account

26. On or about December 2, 1985, customer N opened a securities account at the Firm which was serviced by K. The new account documentation for the N Account listed N's investment objectives as "Appreciation with Risk," and described N as president of a manufacturing business with an annual income of \$200,000 and a net worth of \$1 million. The information regarding N's occupation, income and net worth was inaccurate. Prior to opening the N Account, N had virtually no previous experience investing in securities.
27. During the eleven months from December 1985 through October 1986, K excessively traded the N Account by effecting twenty-eight purchase and sale transactions in the N Account, generating commissions of \$43,900, and incurring realized trading losses and net charges of \$33,763. As calculated by the Division, the turnover ratio was 30.34.
28. In February 1988, N filed an arbitration claim alleging that, during the period K serviced the N Account, K excessively traded the N Account and effected unauthorized trades in the N Account. In October 1989, the Firm settled N's claim for \$30,000.
29. The N Account appeared on the Monthly Account Evaluations each month during the period from February through September 1986, and was designated to receive an activity letter beginning in August 1986. In August 1986, A sent an Activity Letter to N. N did not return a Signed Activity Letter to

A. Despite the nonreceipt of a Signed Activity Letter from N, A and his Assistant BOMs did not contact N to determine independently whether the trading activity in the N Account was authorized and suitable.

30. Although B reviewed the customer accounts of K in the first and second quarters of 1986, such accounts, including the N Account, were not reviewed by any manager in the Water Street Branch in the third quarter of 1986.

TRADE CORRECTIONS

1. At all relevant times, the Firm's procedures required BOM approval for trade corrections, including transfers of securities positions between different customer accounts ("Trade Corrections"). According to these procedures, before a BOM could approve a Trade Correction, the BOM was required to review certain documents, including a copy of the order ticket and the trade confirmation. In addition, the BOM had to receive a thorough explanation for Trade Corrections which involved two unrelated accounts, or which did not involve an obvious transposition of numbers.
2. At all relevant times, prior to the employment of F in the Water Street Branch in June 1986, A permitted the Delegates to approve Trade Corrections. As a result, except for Trade Corrections involving securities that were being distributed by the Firm as part of an "offering" to the public, the Water Street Branch failed to have one designated manager with responsibility to review and approve Trade Corrections to detect, among other things, "patterns" of transfers of securities between different customer accounts. Contrary to a directive by Compliance in the 1985 Audit, E was permitted to approve numerous Trade Corrections during 1986.
3. Due to the Verbal Order Entry System, most Trade Corrections were not processed with the order ticket attached to the Trade Correction form, as required by the Firm's procedures. Furthermore, despite the fact that the Firm trade correction form contained a space to provide a written explanation of the reasons for the trade correction, most Trade Corrections in the Water Street Branch were processed and approved without a written explanation.
4. Under the Trade Correction procedure in the Water Street Branch discussed above, on fifteen occasions during the period from January through August 1986, certain registered representatives were permitted

to transfer unauthorized trades from a customer's account to one or more unrelated customer accounts. On these fifteen occasions, thirteen Trade Corrections were approved without a written explanation, seven Trade Corrections were approved from five to twenty-eight days after the settlement date of the unauthorized trade, and four Trade Corrections were approved by E.

Placing Syndicate Securities in Inactive Customer Accounts

5. On one day in May 1986, UVW made a public offering of 6,400,000 units of RST common stock and warrants at a price of \$41.50 per unit. H participated in the UVW offering by causing orders to be executed for the purchase of 29,000 units for nineteen customer accounts.
6. Four days after the effective date of the UVW offering and two days prior to the settlement date of the transaction, H effected a purchase of 4,500 units of the UVW offering, for a total cost of \$186,750, for the account of customer O, without the prior knowledge or authorization of O. Prior to this transaction, the only other transaction in the O account was a purchase of 1,000 shares of a public utility company, for a total cost of \$15,900, approximately two and one-half years earlier. These shares were subsequently sold in June 1984.
7. On or before the settlement date of the UVW offering, E approved the transfer by H of the 4,500 units in the O Account to five other customer accounts at the Water Street Branch without providing a written explanation for the transfer on the Trade Correction form.
8. Five days after the effective date of the UVW offering and one day prior to the settlement date of the transaction, H effected a purchase of 4,500 units of the UVW offering, for a total cost of \$186,750, for the account of customer P at the Firm, without the prior knowledge or authorization of P. Prior to this transaction, the only other transactions in the P account were two purchases of two public utility companies' shares for a total cost of \$9,800, approximately two and one-half years earlier, which shares were sold shortly thereafter, and the sale in May 1986 of 273 units of OPQ for \$1,283, which units were received into the P account in April 1986.
9. On or before the settlement date for the UVW offering, D approved the transfer by H of the 4,500 units in the P account to four other customer accounts in the Water Street Branch without

providing a written explanation for the transfer on the Trade Correction form.

10. In May 1986, the Firm participated in an open market sale of 12,000,000 shares of LMN Corporation. H participated in the distribution of these LMN shares by causing orders to be executed for the purchase of 30,000 LMN shares for seven customer accounts in the Water Street Branch.
11. In connection with the LMN distribution described above, on or about May 16, 1986, for settlement May 22, 1986, H effected a purchase of 5,500 shares of LMN, for a total cost of \$125,125 for the account of customers, the Qs, without their prior knowledge or authorization. Prior to this unauthorized purchase, the last transactions in the Q account were the sales of two securities more than two years earlier.
12. On or about May 21, 1986, C approved the transfer by H of the 5,500 shares of LMN in the Q account to five other customer accounts in the Water Street Branch without providing a written explanation for the transfer on the Trade Correction form.

SOLICITATION OF IJK

1. At all relevant times, the Firm's procedures generally required a registered representative, through his or her BOM, to obtain the approval of the Firm's research department ("Research") prior to beginning a solicitation of a security that was not recommended by the Firm. In addition, the BOM was required to review transactions on a daily and bi-weekly basis to determine that the volume of shares, and number of accounts solicited, was in accord with the Firm's policy. A delegated to B certain duties with respect to solicitation requests in the Water Street Branch for securities not recommended by the Firm.
2. At all relevant times, IJK was a NASDAQ security. R was a registered representative in the Water Street Branch until his departure from the Firm in October 1986.
3. On or about February 21, 1986, R began his solicitation of IJK (the "Solicitation") when he effected the purchase of 101,000 shares of IJK for ten customer accounts. At the time, IJK was selling at 6 3/4 per share and was not recommended by the Firm. Contrary to the Firm's procedures, R did not obtain approval from Research to solicit his customers to purchase IJK, prior to the purchases of IJK effected for his customer accounts on February 21, 1986.

4. In February 1986, B became aware of the Solicitation, and was told by R that he had received verbal authorization from Research for the Solicitation.
5. In March and April 1986, R continued the Solicitation. By April 30, 1986, twelve of R's customer accounts in the Water Street Branch held a total position of 104,000 shares of IJK. Contrary to the Firm's procedures, at no time during February, March, April or May 1986, did B, or any other manager, attempt to obtain written approval from Research for the Solicitation.
6. On or about June 4, 1986, B approved a written plan of solicitation ("Plan") which was sent to Research requesting approval for R and K to prospectively solicit 100,000 shares of IJK. The Plan did not disclose the fact that R had already positioned 104,000 shares of IJK in his customer accounts. On or about June 5, 1986, Research approved the Plan for future purchases of 100,000 shares of IJK in "Risk Oriented-Speculative Accounts."
7. Between June 5 and June 30, 1986, R continued the Solicitation by effecting purchases of 103,000 shares in his customer accounts thereby exceeding Research's authorization by approximately 3,000 shares. By June 30, 1986, sixteen of R's customer accounts in the Water Street Branch held a total position of 207,000 shares of IJK.
8. Between July 1 and July 15, 1986, R continued the Solicitation by effecting purchases of 138,000 shares in his customer accounts. By July 16, 1986, twenty-eight of R's customer accounts in the Water Street Branch held a total position of 346,000 shares of IJK. Contrary to the Firm's procedures, at no time during July 1986 did B, or any other manager, attempt to obtain written approval from Research for the continued solicitation of purchases of IJK by R.
9. R discontinued the solicitation in August 1986. At the time, the price of IJK shares had fallen below \$2 per share. In or about September 1986, IJK filed for bankruptcy.

ORDER PROCESSING VIOLATIONS

1. Shortly after the the Merger in June 1984, a suspense account (the "Suspense Account") was established by the Firm for the Water Street Branch for the placement of trades that were not timely booked to customer accounts by the end of the

trading day. Under the procedure established when the Suspense Account was created, and at all relevant times, orders that were placed in the Suspense Account due to the absence of account designation information were removed from the Suspense Account after review and approval by A or his Delegates.

2. Although the Suspense Account was established as a "transitional" account by the Firm shortly after the Merger in June 1984, the Suspense Account remained active until October 1986. In addition, in the annual branch examination of the Water Street Branch by Compliance in 1984, and again in the 1985 Audit, the Suspense Account was cited as:
a) a source of potential misuse involving, employee and employee-related accounts and the placement of block trades for customer accounts; and b) a continuing problem with respect to registered representatives failing to provide timely account designation information.
3. In May 1986, A prepared and circulated a memorandum to all registered representatives indicating that, due to the "growing problem" of stock being placed in the Suspense Account instead of being properly booked, and because "things have gotten out of hand in this area", beginning on or about May 9, 1986, the registered representatives' commissions would be taken away on those trades placed in the Suspense Account, unless such trade was caused by operational error or received specific approval from a manager.
4. During the month of May 1986, Exchange examiners noted ninety-two instances where orders were executed without the necessary account designation information required by Exchange Rule 410(a) and were placed in the Suspense Account, despite A's newly instituted policy.
5. The execution of trades by the Firm without account designation information on the order tickets for such transactions resulted in violations of Exchange Rule 410 with respect to those transactions in Exchange listed securities, and constitutes conduct inconsistent with just and equitable principles of trade with respect to transactions in OTC securities.

FAILURE TO CONDUCT QUARTERLY REVIEWS OF CUSTOMER ACCOUNTS

1. At all relevant times, the Firm's procedures required that, on a quarterly basis, BOMs had to review certain records of all registered representatives, including monthly account statements of every customer. As part of the

"Monthly Supervision Report" prepared by A and his Delegates, the Water Street Branch indicated which registered representative customer accounts were reviewed. Copies of the Monthly Supervision Reports were forwarded to Compliance.

2. During the second quarter of 1986, A and his Assistant BOMs failed to conduct a quarterly review of thirty-two registered representatives in the Water Street Branch.
3. During the third quarter of 1986, A and his Assistant BOMs failed to conduct a quarterly review of fifty-nine registered representatives in the Water Street Branch.
4. A and his Assistant BOMs also failed to conduct quarterly reviews in both the second and third quarters of 1986 of twenty seven registered representatives in the Water Street Branch.

BOOKS AND RECORDS VIOLATIONS IN THE WATER STREET BRANCH

1. During the period from May 1985 through July 1986, the Firm failed to make, and keep current, certain books and records relating to its business and failed to preserve such books and records as required by SEA Regulations 240.17a-3 and 240.17a-4 as well as Exchange Rule 440. For example, the Firm failed to provide to the Exchange:
 - a) a signed margin agreement for a customer in the Water Street Branch who was permitted to effect approximately \$5,068,000 of purchase and sale transactions on margin from May 1985 through January 1986;
 - b) sixty-nine order tickets requested by the Exchange in connection with certain investigations of registered representatives in the Water Street Branch; of the twelve tickets provided, only ten were time stamped;
 - c) over-the-counter order tickets for 1,172 firm-wide executions of XYZ on three successive days. Of the 178 OTC order tickets which were provided, fifty-seven of the tickets were not time stamped;
 - d) eight hundred six branch order tickets for firm-wide executions in XYZ on three successive days. Five of the tickets provided were for discretionary accounts in the Water Street Branch, none of which indicated whether discretion was or was not exercised and none of them indicated manager approval;

- e) five daily transaction reports for the Water Street Branch for five days in February, June and July 1986. Due to the Verbal Order Entry System, A and his Delegates reviewed the daily transaction report, rather than order tickets; and
 - f) five hundred written notices issued by National Credit for accounts in the Water Street Branch which were on a 90 day restriction in 1986.
2. At all relevant times, the Water Street Branch used syndicate allocation sheets ("Syndicate Sheets") as order tickets for all IPO and secondary offerings. Certain Syndicate Sheets provided to the Exchange were deficient as follows:
- a) transactions for the O account and P account appear on the same Syndicate Sheet which was dated May 13, 1986 and time stamped 4:39 P.M. However, the transaction for the P account was effected on trade date May 14, 1986, not May 13, 1986; and
 - b) The Firm provided 125 Syndicate Sheets for the XYZ offering in May 1986, fifty-nine of which were not dated.

OTHER FINANCIAL, OPERATIONAL AND SALES PRACTICE VIOLATIONS

SEA Regulations 240.15c3-3(m) and (n)

1. In the 1986, 1987 and 1988 FINOP Reports, Exchange examiners cited the following violations by the Firm of SEA Regulations 240.15c3-3(m) and (n):
- a) on sixteen occasions involving "retail" customer accounts, and twelve occasions involving "receive versus payment" customer accounts, the Firm failed to purchase securities of a like kind and quantity that were sold for customers and which had not been received within ten business days after the settlement date of the transaction, or obtain an extension of time within which such securities had to be purchased; and
 - b) on two occasions involving "retail" customer accounts and twenty-two occasions involving "receive versus payment" customer accounts, the Firm failed to take appropriate action upon the expiration of, or denial of, an extension of time, requested by the Firm pursuant to SEA Regulation 240.15c3-3(n).

Regulation T

2. In the 1986, 1987 and 1988 FINOP Reports, Exchange examiners reported the following violations of Regulation T by the Firm:
 - a) on seven occasions, the Firm failed to cancel promptly or otherwise liquidate purchase transactions in customer cash accounts or obtain extensions of time when payment for such purchases was not received within seven business days after the purchase, in violation of Section 220.8(b) of Regulation T; and
 - b) on eighteen occasions, the Firm failed to cancel promptly or otherwise liquidate purchase transactions in customer cash accounts upon the expiration of, or denial of, extensions of time, when payment for such purchases was not received, in violation of Section 220.8(b) of Regulation T.

SEA Regulation 240.17a-3

3. On nineteen occasions cited in the 1986, 1987 and 1988 FINOP Reports, the Firm failed to make, and keep current, certain books and records pursuant to SEA Regulation 240.17a-3 and Exchange Rule 440 in that customers' non-negotiable securities received by branch offices to complete sell transactions were booked to customer accounts from three to seventy-one business days from the receipt date.
4. In the 1986 SPRU Report and the 1986 FINOP Report, Exchange examiners cited the following instances when the Firm failed to make and keep current certain other books and records pursuant to SEC Regulation 240.17a-3 and Exchange Rule 440:
 - a) debit balances in the Reorganization and Redemption accounts, as of March 27, 1986, were not current in that such balances were as of November 30, 1985 and such accounts were not reconciled;
 - b) credit balances in the Reorganization and Redemption accounts, as of March 27, 1986, were not current in that such accounts were not reconciled;
 - c) the Firm's "Master Control List" of discretionary accounts serviced by branch offices did not include approximately 109 discretionary accounts being serviced in approximately ten branch offices;
 - d) eleven order tickets for discretionary account

transactions in a Chicago, Illinois ("Chicago") branch office failed to indicate the time and date of execution; and

- e) twenty order tickets for discretionary account transactions in Chicago and Washington, D.C. branch offices failed to indicate whether discretion was exercised.

Exchange Rule 342

5. In the 1986 SPRU Report, Exchange examiners cited the following instances in which the Firm failed reasonably to supervise and control certain of its business activities, in violation of Exchange Rule 342:

- a) three registered representatives employed in branch offices in Los Angeles, California and Davenport, Iowa were not registered in certain states in which they conducted business; and
- b) on nine occasions, in branch offices in Chicago and Houston, Texas, trade corrections were effected without any BOM approval.

DECISION

The Hearing Panel, in accepting the Stipulation of Facts and Consent to Penalty, found the Firm guilty as set forth above by unanimous vote.

PENALTY

In view of the above findings, the Hearing Panel, by unanimous vote, imposed the penalty consented to by the Firm of a censure, a fine of \$750,000, and an undertaking by the Firm that a review will be performed under the supervision of the Audit Committee of the Board of Directors of the Firm (the "Audit Committee"), of the policies, procedures and systems for compliance with Regulation T in the Firm's margin department, which review will be in addition to any regularly scheduled audit of the margin department, and that a written report of the findings and recommendations of such review will be submitted to the Audit Committee, and the Firm further undertakes to implement all recommendations of the Audit Committee resulting from the aforementioned report, and submit a copy of such report, Audit Committee recommendations, and a written representation to the Division that all recommendations have been implemented, within six months from the date any decision rendered by a Hearing Panel accepting this agreement becomes final.

For the Hearing Panel

Edward W. Morris, Jr.
Chief Hearing Officer