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

EXCHANGE HEARING PANEL DECISION 02-150 **July 19, 2002**
PRENTICE SECURITIES, INC.
MEMBER ORGANZATION

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Recommended securities to customers which were unsuitable and violated Rule 342 by failing to reasonably supervise and control its business activities – Consent to censure, $25,000 fine and an undertaking.

Appearances:

For the Division of Enforcement
Steven F. Korostoff, Esq.
Neil T. O'Donnell, Esq.

For the Respondent
David J. Hase, Esq.

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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 Prentice Securities, Inc., a member organization. Without admitting or denying guilt, the Firm consents to a finding by the Hearing Panel that it:

I. Engaged in conduct inconsistent with just and equitable principles of trade in that on various occasions it recommended securities to certain customers which were unsuitable in view of the investment objectives, investment experience and financial resources of the customers.

II. Violated Exchange Rule 342 in that it failed to reasonably supervise and control its business activities to detect and/or prevent the recommendation and sale of unsuitable securities.

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

Background and Jurisdiction

1. The Firm, a privately held corporation formed in or about September 1988, became a member organization of the Exchange in September 1991. The Firm's principal place of business is in New York City, and it has five branch offices located in Wisconsin, Florida, Kentucky, Arizona and New Jersey.

2. The Firm's business activities include securities brokerage business from retail customers. The Firm clears through National Financial Services Corporation.

3. The Sales Practice Review Unit of the Exchange's Division of Member Firm Regulation conducted an examination during 1999 of the supervisory standards and sales practices of the Firm's branch office in Milwaukee, Wisconsin, and set forth various exceptions in a written report to the Firm. The report was referred to Enforcement for review.

4. Thereafter, Enforcement notified the Firm of its investigation in this matter, and the Firm, represented by counsel, appeared and provided information and testimony.

Summary of Violative Conduct

5. The Firm engaged in conduct inconsistent with just and equitable principles of trade in that, during 1997-1999, it recommended securities to certain of its customers which were unsuitable in view of the investment objectives, investment experience and financial resources of the customers. The Firm also violated Exchange Rule 342 in that it failed to reasonably supervise and control its business activities to detect and prevent the recommendation and sale of unsuitable securities.

Recommendation of Unsuitable Securities

6. During the period 1997-1999, the Firm's Milwaukee branch office solicited transactions in speculative, high-yield corporate bonds, also known as junk bonds, in the accounts of approximately 30 customers for whom such high yield bonds were unsuitable based on the customer's investment objectives, investment experience, and financial resources. The accounts in question were handled by AB, the producing branch office manager of the Firm's branch office in Milwaukee, Wisconsin, and CD and DF, two registered representatives employed at the branch.

7. The high yield bonds recommended by the Firm (which were not priced on the customer account statements) made up a substantial portion (and in some cases all) of the assets in the accounts, and exposed the accounts to a substantial level of market risk. Such bonds were unsuitable for the customers, who had conservative investment objectives and low levels of risk tolerance, investment experience, and net worth.

8. High yield corporate bonds that were recommended included, among others XYZ 11.875% Senior Notes, due 2006 (the "XYZ Senior Notes"), RST 12.75% Senior Subordinated Notes due 2003 (the "RST Notes"), UVW 11.125% Notes due 2001 (the "UVW Notes"), OPQ 12.50% Senior Subordinated Notes due 2004 ("the "OPQ Notes"), and LMN 11.00% Senior Subordinated Notes due 2005 (the "LMN Notes"). All of the above-cited bonds defaulted.

9. Approximately 25 customers have filed complaints against the Firm. The damages claimed by the complaining customers generally ranged from $20,000 to $75,000, with some claims of higher amounts. To date, the Firm has settled 11 of the complaints for a total of approximately $460,000.

10. The following are examples of customer accounts in which unsuitable trading in high yield bonds occurred. Each of the purchases discussed below was made pursuant to a recommendation by the Firm.

The Account of EF

11. In July 1995, EF a bank secretary born in 1953, who had maintained a joint account at the Firm with her husband prior to his death, opened an individual account with the Firm.

12. According to the new account documents completed for EF's individual account, her investment objective was income, and she had one year of investment experience. Her annual income was $25,000, and her net worth was $50,000.

13. In October 1997, based on the Firm's recommendation, EF purchased approximately $31,000 of XYZ Senior Notes. The XYZ Senior Notes represented 100% of the assets in her account from October 1997 through December 1998. The size of the bond position exceeded her annual income and represented approximately 60% of her net worth.

14. The value of EF's approximately $31,000 investment in the XYZ Senior Notes has become worthless.

15. The EF account was concentrated in a speculative corporate bond which was unsuitable in view of the customer's investment objectives, investment experience and financial resources.

The Account of GH

16. In August 1992, GH, a homemaker born in 1938, opened an account with the Firm. According to the new account documents completed for her account, GH had investment objectives of capital appreciation and income, an annual income between $25,000 and $50,000, and a net worth of $50,000 to $100,000.

17. In September 1997, based upon the Firm's recommendation, GH purchased approximately $45,000 of XYZ Senior Notes. All of the assets in her account consisted of speculative high yield bonds, the XYZ Senior Notes and $29,000 of the RST Notes, which she purchased, pursuant to the Firm's recommendation, in June 1997.

18. In January 1998, GH sold her XYZ Senior Notes for approximately $19,000 resulting in a loss to GH of approximately $26,000. RST filed for Chapter 11 Bankruptcy, and holders of the RST Notes received a partial repayment of $671.72 per $1,000. On the RST, GH lost approximately $9,500.

19. The GH account was concentrated in speculative corporate bonds that were unsuitable in view of the customer's investment objectives, investment experience and financial resources.

The Account of I and JK

20. In January 1995, IK, a self-employed farmer born in 1931 and his wife JK, born in 1940, opened a joint account with the Firm.

21. According to the new account form completed for the Ks' account, their investment objectives were preservation of capital, income, capital appreciation and speculation. According to the Ks, their net income was approximately $20,000 and their estimated liquid net worth was between $50,000 and $100,000.

22. In September 1997, as a result of securities purchases made pursuant to the Firm's recommendation, the Ks' account consisted of approximately $3,000 in equities and approximately $50,000 invested in eight positions of high yield bonds. Five of the high yield bond positions were purchased between January and September 1997. The $50,000 position in high-yield bonds in September 1997 was greater than twice the Ks' net income and represented approximately 94% of the net equity in their account.

23. Four of these positions, XYZ Senior Notes, RST Notes, UVW Notes, and OPQ Notes involved issuers that subsequently filed for bankruptcy and defaulted on the investments. Only RST and OPQ made partial payments to bondholders.

24. The Ks' account was concentrated in speculative corporate bonds which were unsuitable in view of the customers' investment objectives, investment experience and financial resources.

The Account of L and MN

25. In June 1993, LN, a mechanic born in 1933 and his wife MN, born in 1932, opened a joint account with the Firm.

26. According to the new account form completed for the N's account, their investment objectives were preservation of capital and income. According to the Ns, their net income was approximately $25,000 - $50,000 and their estimated liquid net worth was between $100,000 and $500,000.

27. In September 1997, as a result of securities purchases made pursuant to the Firm's recommendations, the Ns' account consisted of approximately $47,000 in cash and equities and approximately $105,000 invested in thirteen positions of high yield bonds. Six of these high yield bond positions were purchased between January and September 1997. The $105,000 position in high-yield bonds was greater than twice the Ks' net income and represented approximately 70% of the net equity in their account.

28. The Ns' account was concentrated in speculative corporate bonds which were unsuitable in view of their investment objectives, investment experience and financial resources.

Failure to Supervise

29. During the period 1997-1999, the Firm failed to reasonably supervise and control its business activities to detect and/or prevent the recommendation and sale of unsuitable securities, as described above.

30. During the period 1997-1999, the Firm failed to implement and maintain procedures adequate to supervise the Milwaukee branch office and its producing branch office manager with respect to the recommendation of the high yield corporate bonds described above.

31. During the period 1997-1999, the Firm did not review the suitability of corporate bonds recommended to customers by the branch office manager and registered representatives in the Milwaukee branch office.

32. For example, the Firm allowed the producing branch office manager in the Milwaukee branch office to determine whether high yield bonds he recommended to his own customers were suitable. Thus, the branch office manager was supervising his own sales activities.

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 in the amount of $25,000 and a requirement to comply with an undertaking to retain an outside consultant, not unacceptable to the Exchange, to conduct a review of the Firm's policies, procedures, practices and supervisory systems relating to the matters described herein, including a review of the Firm's policies, procedures, practices, and supervisory systems for ensuring that recommendations of securities are suitable for the customers involved and for supervising the sales activities of producing branch office managers, and prepare a report of the results of such review, including recommendations for additional systems and procedures, if necessary, reasonably designed to ensure compliance with federal securities laws and Exchange Rules and to prevent recurrence of the violations described herein, and submit such report and recommendations, if necessary, to the Exchange within 120 days from the date that this decision becomes final.

For the Hearing Panel

Edward W. Morris, Jr.
Chief Hearing Officer