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 03-61 **April 28, 2003**
GERARD KLAUER MATTISON & CO., INC.
MEMBER ORGANIZATION

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Violated SEC Rule 15c3-1 and Exchange Rule 325 by conducting its securities business while failing to maintain its net capital at the required level; violated Exchange Rule 342 by failing to adequately supervise its compliance with moment-to-moment net capital requirements; and violated SEC Rules 17a-3 and 17a-4 and Exchange Rule 440 by not accurately recording the terms of an order on its books and records – Consent to censure and $75,000 fine.

Appearances:

For the Division of Enforcement
Steven J. Brostoff, Esq.
Dorian M. Gross, Esq.

For the Respondent
Michelle A. Coffey, Esq.
Ben A. Indek, 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 Gerard Klauer Mattison & Co., Inc. (the "Firm"), a member organization. Without admitting or denying guilt, the Firm consents to findings by the Hearing Panel that it:

I. Violated SEC Rule 15c3-1 promulgated under the SEA, and Exchange Rule 325, by conducting its securities business while failing to maintain its net capital at the required level.

II. Violated Exchange Rule 342 in that it failed to adequately supervise its compliance with moment-to-moment net capital requirements.

III. Violated SEC Rules 17a-3 and 17a-4 and Exchange Rule 440, in that it did not accurately record the terms of an order on its books and records.

For the sole purpose of settling this disciplinary proceeding, the Firm stipulates to the following:

Background and Jurisdiction

1. The Firm is a member organization and began operations in or about 1989. It has offices in several cities, and employs approximately 200 people. The Firm engages in

equity research, institutional equity sales, institutional trading, investment banking (including public offerings and private sales), and asset management (including mutual funds).

2. On October 31, 2000, pursuant to the reporting requirements of Securities and Exchange Commission ("SEC") Rule 17a-11, the Firm notified the SEC and the Exchange of an "intraday hindsight [net capital] violation of [SEC] Rule 15c3-1" that occurred on October 26, 2000.

3. By letter dated January 16, 2001, which it received, the Firm was advised it was the subject of an Exchange investigation.

Overview

4. As set forth more fully below, on October 26, 2000, in anticipation of a large purchase order from another broker-dealer, the Firm accumulated a stock position intra-day without sufficient net capital to do so, resulting in an intra-day net capital deficiency of approximately $19.5 million. In so doing, the Firm did not maintain its net capital at required levels while conducting its securities business, did not reasonably supervise its compliance with moment-to-moment net capital requirements, and did not accurately record the terms of the order from the broker-dealer.

Net Capital Violation

5. Pursuant to SEC Rule 15c3-1, promulgated under the Securities Exchange Act of 1934 (the "SEA"), and pursuant to Exchange Rule 325, broker-dealers must maintain sufficient net capital at all times.

6. On October 26, 2000, before the market opening, the over-the-counter trading desk (the "OTC Desk") at the Firm communicated with another broker-dealer (the "Broker Dealer") about an opportunity to compete for an order from the Broker Dealer in the stock XYZ Inc. The Broker Dealer conveyed to the OTC Desk that it intended to purchase approximately 1.9 million shares of XYZ, and that it wanted to purchase the shares at a "discount from the last sale price" of the trading day.

7. The OTC Desk put in its bid, and thereafter, the Broker Dealer made a commitment to the OTC Desk to enter an order with the Firm later that day to purchase the approximate number of shares of XYZ that had been discussed.

8. After receiving the purchase commitment from the Broker Dealer, the OTC Desk began to accumulate a position in XYZ. By approximately 3:24 p.m., the OTC Desk had purchased a significant amount of shares of XYZ in anticipation of receiving an order from the Broker Dealer.

9. At approximately 3:24 p.m., the Broker Dealer entered an order with the OTC Desk to purchase 1,980,266 shares of XYZ at the close at the agreed upon discount from the last sale price, an eighth of a point. Thereafter, the OTC Desk purchased significant additional shares of XYZ. At the close of the market, the OTC Desk sold 1,980,266 shares of XYZ to the Broker Dealer at a price of 133.125, including the agreed upon discount. A subsequent price adjustment by the OTC Desk increased the discount given to the Broker Dealer by an additional point. The Firm's participation in the XYZ transaction with the Broker Dealer resulted in a significant trading profit to the Firm.

10. On October 26, 2000, after the close of trading, the Firm initiated an inquiry into the intra-day accumulation of the XYZ shares by its OTC Desk. As a result of its inquiry, the Firm concluded that the accumulation should have been treated as a proprietary position and was subject to a required 15% haircut on its market value.

11. During October 26, 2000, the XYZ purchased by the Firm was valued at approximately $250 million, and was subject to a haircut charge of approximately $38 million. The Firm applied this haircut charge against net capital of approximately $18.5 million, resulting in an intra-day net capital deficiency of $19.5 million, which was reported to the SEC and the Exchange on October 31, 2000.

Failure to Supervise

12. The Firm had in place written policies and procedures relating to position limits (the "Firm Position Limits") to monitor on a "real time" basis the Firm's net capital compliance with respect to proprietary trading activity on its OTC Desk and its listed trading desk (the "Listed Desk").

13. The Firm Position Limits provided that without prior approval, the OTC Desk and Listed Desk could take intra-day securities positions that in total did not exceed $10 million. The Firm expected the head of its OTC Desk and the head of its Listed Desk to coordinate their respective intra-day positions, so that the $10 million intra-day position limit was not exceeded.

14. The Firm, however, failed to properly train its personnel regarding the Firm Position Limits, and their relationship to the Firm's net capital requirements. For example, neither the head of the OTC Desk, nor the head of the Listed Desk, understood that the Firm Position Limits applied to a proprietary position taken in anticipation of a large customer order. In addition, more generally, neither was fully familiar with the requirements of the Firm Position Limits. Thus, the Firm failed to reasonably supervise its compliance with moment-to-moment net capital requirements.

Books and Records Violation

15. On October 26, 2000, the OTC desk was utilizing a paperless order entry system. When the XYZ order from the Broker Dealer was received at approximately 3:24

p.m., it was entered by the OTC Desk into this paperless system as a "market not held day" order, instead of as an order to purchase XYZ at the close at a "discount from the last sale price". Thus, the Firm's records did not accurately reflect the true terms of the order, in violation of SEC Rules 17a-3 and 17a-4 and Exchange Rule 440.

Additional Factors Considered

16. The Firm brought the intra-day net capital violation to the attention of the Exchange, and the Firm represented that it subsequently instituted remedial actions to address the issues described above.

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 majority vote, imposed the penalty consented to by the Firm of a censure and a fine of $75,000. One member of the Hearing Panel recommended a greater fine, one related to the "significant trading profit."

For the Hearing Panel

Edward W. Morris, Jr.
Chief Hearing Officer