

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 03-100

June 4, 2003

FAHNESTOCK & CO., INC.  
MEMBER ORGANIZATION

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**Violated and/or caused or permitted a violation of: Exchange Rule 401 by failing to notify the Exchange immediately upon discovery of a condition which it reasonably should have believed could lead to operational problems and/or impairment of specified functions; SEC Regulation §240.17a-3, SEC Regulation §240.17a-4, and Exchange Rule 440, in that it failed to make and/or keep current certain books and records, and did not preserve or could not locate required records; SEC Regulation §240.17a-11(d), in that it failed to timely give required notice to the SEC and the Exchange that it did not make or keep current certain required books and records; Exchange Rule 440.10(1), in that it failed to reconcile mutual fund positions in a timely manner and it failed to timely resolve position differences; Exchange Rule 440.10(3), SEC Regulation §240.15c3-1(c)(2)(iv), and SEC Regulation §240.17a-13(b)(5), in that it failed to: (i) enter aged unresolved security position differences into a difference account, and (ii) value short security position differences as of the date of a required computation of net capital; SEC Regulation §240.15c3-1, in that it did not accurately prepare computations of net capital; by failing to take a deduction for the value of aged unresolved short securities differences, and by taking deductions for such differences using information that was not current as of the date of the computations; SEC Regulation §240.17a-5 and Exchange Rule 476(a)(10), in that it filed inaccurate FOCUS Reports with the Exchange; SEC Regulation §240.15c3-3(b)(1), (e) and (h), in that it failed to: (i) obtain and/or maintain the physical possession or control of fully-paid securities or excess margin securities carried by it for accounts of customers; (ii) accurately compute the amount of cash or qualified securities required to be on deposit in its Special Reserve Bank Account for the Exclusive Benefit of Customers; and (iii) buy in unresolved short security differences within the required time period; Exchange Rule 412, in that it did not obtain an exemption from the Exchange concerning the delivery of mutual fund assets outside the established system; Exchange Rule 342, in that it failed to supervise and control and provide for appropriate procedures of supervision and control over its business activities, including its mutual fund clearance activities, its financial regulatory reporting activities, and its compliance with regulatory notification requirements – Consent to censure, \$500,000 fine and a requirement to comply with two undertakings.**

**EXCHANGE HEARING PANEL DECISION 03-101**

ALBERT G. LOWENTHAL  
 ALLIED MEMBER

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**Permitted a violation of Exchange Rules 401 and 412, and SEC Regulation §240.17a-11(d), in that he permitted his member organization to fail to immediately notify the Exchange and other appropriate regulators of a condition which he reasonably should have believed could lead to operational problems and/or impairment of recordkeeping functions; and to seek from the Exchange an exemption from Exchange Rule 412 concerning the delivery of mutual fund assets outside the established system – Consent to censure and a requirement to comply with an undertaking.**

**Appearances:**

For the Division of Enforcement  
 Joy A. Weber, Esq.  
 Michael Krevor, Esq.  
 Dorian M. Gross, Esq.  
 Margaret M. Tolan, Esq.

For the Respondents  
 George Brunelle, Esq.  
 Eric J. Shames, Esq.  
 (for Fahnstock & Co., Inc.)  
 Robert M. Romano, Esq.  
 (for Albert G. Lowenthal)

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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 Fahnstock & Co., Inc. (the "Firm") and Albert G. Lowenthal ("Lowenthal"), Chief Executive Officer and Chairman of the Board of the Firm. Without admitting or denying guilt, the Firm consented to a finding by the Hearing Panel that it violated and/or caused or permitted a violation of:

- I. Exchange Rule 401, in that it did not adhere at all times to the principles of good business practice, by failing to notify the Exchange immediately upon discovery of any existing or impending condition which it reasonably should have believed could lead to operational problems and/or impairment of recordkeeping, clearance or control functions.
- II. SEC Regulation §240.17a-3, SEC Regulation §240.17a-4, and Exchange Rule 440, in that it failed to make and/or keep current certain books and records, and it did not preserve or could not locate one or more required records.
- III. SEC Regulation §240.17a-11(d), in that it failed to timely give required notice to the SEC and the Exchange that it did not make or keep current certain required books and records.

- IV. Exchange Rule 440.10(1), in that it failed to reconcile mutual fund positions in a timely manner by comparison of its books and records with position statements required to be received from other organizations, and failed to timely resolve position differences.
- V. Exchange Rule 440.10(3), SEC Regulation §240.15c3-1(c)(2)(iv), and SEC Regulation §240.17a-13(b)(5), in that:
  - A. It failed to enter aged unresolved security position differences into a difference account.
  - B. It failed to value short security position differences as of the date of a required computation of net capital.
- VI. SEC Regulation §240.15c3-1, in that it did not accurately prepare computations of net capital, by failing to take a deduction for the value of aged unresolved short securities differences, and by taking deductions for such differences using information that was not current as of the date of the computations.
- VII. SEC Regulation §240.17a-5 and Exchange Rule 476(a)(10), in that it filed inaccurate FOCUS Reports with the Exchange.
- VIII. SEC Regulation §240.15c3-3 (b)(1), (e), and (h), in that it failed to:
  - A. Obtain and/or maintain the physical possession or control of fully-paid securities or excess margin securities carried by it for accounts of customers.
  - B. Accurately compute the amount of cash or qualified securities required to be on deposit in its Special Reserve Bank Account for the Exclusive Benefit of Customers.
  - C. Buy in unresolved short security differences within the required time period.
- IX. Exchange Rule 412, in that it did not obtain an exemption from the Exchange concerning the delivery of mutual fund assets outside the established system.
- X. Exchange Rule 342, in that it failed to supervise and control and provide for appropriate procedures of supervision and control over its business activities, including its mutual fund clearance activities, its financial regulatory reporting activities, and its compliance with regulatory notification requirements.

Mr. Lowenthal consented to a finding by the Hearing Panel that he permitted a violation of Exchange Rules 401 and 412, and SEC Regulation §240.17a-11(d), in that he permitted his member organization to fail to immediately notify the Exchange and other appropriate regulators of a condition which he reasonably should have believed could lead to operational problems and/or impairment of recordkeeping functions; and to seek from the Exchange an exemption from Exchange Rule 412 concerning the delivery of mutual fund assets outside the established system.

For the sole purpose of settling this disciplinary proceeding, the Division of Enforcement, the Firm, and Mr. Lowenthal stipulate to certain facts, the substance of which follows:

### **Background and Jurisdiction**

1. The Firm is a member organization and is a subsidiary of Fahnstock Viner Holdings Inc. (the "Holding Company"), which is a Canadian public corporation listed on the Exchange. During 1997 and at other relevant times, the Firm's business included retail securities brokerage, clearing services, trading, research, investment banking and market-making. During 1997, the Firm employed approximately 500 or more full-time registered representatives in approximately 47 branch offices in the United States, with its main office located in New York City. The Firm has grown to approximately 102 branch offices and 1,100 full-time registered representatives. The Firm also maintains associated offices outside the United States.
2. In or about July 1997, the Firm, via a subsidiary, acquired XYZ ("XYZ"), a member organization of the Exchange, by way of a tender offer made to shareholders of XYZ's parent. At the time of the tender offer, XYZ operated approximately 34 branch offices in the United States and maintained its main office in Detroit. During all relevant times, XYZ was engaged in retail securities brokerage and trading and investment banking services.
3. After the tender offer, the Firm acquired XYZ as its wholly-owned operating subsidiary and the Firm became a successor to any and all of XYZ's liabilities. XYZ continued to do business under its own name, but the Firm became the clearing broker for XYZ, to which XYZ introduced accounts on a fully disclosed basis.
4. After the tender offer, the Firm assumed various responsibilities relating to the servicing of accounts of customers of XYZ. Among them, the Firm became responsible for: the safekeeping of customers' cash and securities; the receipt and payment of dividends; the maintenance of certain books and records relating to transactions for which the Firm performed clearance services for XYZ; and the preparation and transmittal of monthly statements and confirmations to XYZ customers.
5. In or about December 1998, as a result of a corporate reorganization, XYZ ceased to be a member organization of the Exchange.
6. Lowenthal was born on April 11, 1945. Lowenthal entered the securities industry in or about 1967 when he joined Firm A, where he eventually became a managing partner. Lowenthal holds various securities registrations including the Series 27 (Financial and Operations Principal). In or about 1985, Lowenthal left Firm A and opened his own broker-dealer, Firm B. In or about 1985, Lowenthal also obtained a controlling interest in, and became Chief Executive Officer ("CEO") and Chairman of the Board ("Chairman") of Edward A. Viner & Co., Inc., n/k/a the Firm. During all relevant times, Lowenthal has been CEO and Chairman of the Firm. In approximately

July 1997, Lowenthal became CEO and Chairman of XYZ. Lowenthal is also Chairman and CEO of the Holding Company.

7. As Chairman and CEO, Lowenthal was the individual at both the Firm and XYZ (after its acquisition by the Firm) designated with overall authority and responsibility for internal supervision and control and compliance with securities laws and regulations.
8. In or about March 1998, the Firm requested from the Exchange an extension of time for the Firm's outside auditor, (the "Auditor"), to complete its audit of the financial statements and supplemental schedules of the Firm for the year ended December 31, 1997. One reason given by the Firm for this extension request was to allow the Auditor time to complete its review of "out-of-balance networked mutual funds." The Exchange granted the extension.
9. On or about March 4, 1998, as part of the audit, the Auditor issued a report to the Firm on the internal control structure of the Firm which disclosed a "material weakness." The Auditor reported that the Firm "had significant differences with [respect to] mutual funds as of December 31, 1997 for which it did not (1) include regulatory charges in its periodic computations of aggregate debits and net capital under Rule 17a-3(a)(11) and the reserve required by Rule 15c3-3, or (2) obtain and maintain physical possession or control of fully paid and excess margin securities as required by 15c3-3 as of December 31, 1997 or during the year."
10. The disclosure in or about March 1998 to the Exchange of differences relating to mutual funds led to an inquiry by the Exchange's Division of Member Firm Regulation ("MFR").
11. At the request of MFR, the Firm corresponded with the Securities and Exchange Commission ("SEC") in May 1998, and the Firm disclosed problems relating to mutual fund positions on its records which the Firm attributed to a conversion of the customer accounts of XYZ, which the Firm had attempted in or about August 1997.
12. In a letter from the Exchange to the Firm dated November 5, 1998, the Firm was advised that it was the subject of an Exchange investigation relating to the problems at the Firm which were discussed in correspondence from the Firm sent in and after March 1998 to the Exchange and/or the SEC. The Firm was further advised that Lowenthal could become the subject of a disciplinary action.
13. On March 26, 2001, Enforcement issued a Charge Memorandum against the Respondents, and on June 1, 2001, the Respondents submitted an Answer.

### **Overview**

14. As set forth more fully below, after the acquisition of XYZ in July 1997, the Respondents became aware that numerous mutual fund reconciliation position differences were being reflected on the Firm's internal reports. The problem of the position differences continued into 1998, by which time the Firm and Lowenthal had

also learned of other mutual fund related operational problems and complaints, and by which time certain books and records at the Firm related to mutual funds were not being kept current, as required. Although required to do so, during relevant times the Firm did not adequately complete reconciliations of mutual fund positions, nor did it timely resolve, or value, age, and suspense mutual fund related reconciliation differences, or, when required, comprehend such position differences in the Firm's net capital and reserve computations. In addition, during relevant times, the Firm did not timely notify the Exchange and/or the SEC of certain problems and conditions at the Firm, nor did Lowenthal cause the Firm to do so.

### **Untimely Reconciliation of Mutual Fund Positions**

15. Mutual fund "networking" is a system offered through the National Securities Clearing Corporation. Networking allows mutual funds and a brokerage firm to exchange account information about customers of the brokerage firm who own mutual fund shares, including information relating to mutual fund account positions and dividends. Networking allows customer mutual fund account positions that appear long on the records of the mutual funds or their agents to also appear as long positions on the records of the brokerage firm. Networking enables a brokerage firm to issue consolidated customer account statements showing all customer holdings, including mutual fund shares held at a mutual fund or its agent.
16. In the networking environment, a mutual fund or its agent sends electronic position updates or files to the brokerage firm, which contain information about customer mutual fund share balances on the books and records maintained by the mutual fund or its agent. The position updates or files are sent to the brokerage firm to enable the brokerage firm to reconcile its customer accounts to the records of the mutual fund.
17. Beginning in or about August 1997, the Firm initiated a conversion of the customer accounts at XYZ to the books and records of the Firm (the "Conversion"). The Conversion was intended to cause long customer positions on the books and records of XYZ to be transferred to the Firm, where they would become long on the Firm's books and records. Included in the Conversion were approximately 100,000 "networked" customer mutual fund positions maintained on XYZ's books and records.
18. During the period from approximately August 1997 to approximately December 1998 (the "Period") the Firm maintained on its books and records, on a networked basis, customer mutual fund positions, including those transferred to the Firm from XYZ.
19. Pursuant to Exchange Rule 440.10(1), the Firm was required to conduct a reconciliation of its books and records of networked mutual fund positions with records of the positions obtained from the mutual funds or their agents and to resolve any reconciliation differences in a timely manner.
20. During the Period, the Firm compiled information, in more than one format, which was relevant to the requirement on the Firm to conduct a reconciliation of networked mutual fund positions. (As used hereafter, the term "Reconciliation Report" refers to

one or more such compilations, irrespective of format.) During the Period, a Reconciliation Report could be viewed in hard copy and/or on a computer screen.

21. A Reconciliation Report, in one or more formats, identified exceptions resulting from the Firm's comparison of its books and records concerning customer networked mutual fund positions with information about the customer positions contained on any position files obtained from the mutual funds or their agents. Differences in information concerning customer mutual fund share balances, depending on the nature of the difference, caused a short or long position difference to appear on a Reconciliation Report. Short differences relating to customer mutual fund positions also appeared on a Reconciliation Report if the Firm did not receive a position file for comparison. As reflected on a Reconciliation Report, a short position difference for a customer position meant that there were more shares for the position on the books and records of the Firm than the number of shares which the comparison of information had identified as being located at the particular fund.
22. At times during the Period, a Reconciliation Report was generated weekly. By at least September 1997, Reconciliation Reports disclosed numerous position differences. By at least September 1997, Lowenthal became aware of the position differences.
23. In or about September 1997, the Firm instructed XYZ personnel to resolve networked mutual fund position differences relating to XYZ customers which appeared on Reconciliation Reports. Some of the position differences existing in September 1997 had arisen at XYZ prior to its acquisition by the Firm. During all or part of the Period, the Firm made Reconciliation Reports available to XYZ for use by XYZ personnel, but the Firm was responsible for the supervision and accuracy of any reconciliation work undertaken at XYZ.
24. At times during the Period, the Firm did not adequately complete a reconciliation pertaining to networked mutual fund positions identified on books and records of the Firm, nor did the Firm timely resolve all position differences.
25. At times during the Period, the Firm did not have a system or procedure in place to value and age the mutual fund differences appearing on its Reconciliation Reports, although it was attempting to establish one. An ability to value and age the short differences was necessary for the Firm to properly perform computations relating to net capital and relating to customer reserve requirements.
26. In or about April 1997, the head of the Firm's mutual fund area recommended, in writing, to the Firm's operations manager that the Firm implement a system to automatically value and age mutual fund reconciliation differences. The Firm did not create such a system before the Conversion. Within several months of the Conversion, the Firm had begun work to implement such a system, but it was not fully implemented until approximately April 1998.
27. In or about April 1998, the Firm implemented a program designed to age short position differences appearing on a Reconciliation Report, automatically. The program incorrectly identified the differences as aged only if the position was on a

Reconciliation Report for 14 calendar days, rather than properly identifying short position differences as aged beginning at seven business days, as required by applicable rules or regulations. The short position differences identified as aged were valued on the Reconciliation Reports.

28. In May 1998, in response to a MFR information request, the Firm responded that aged unreconciled mutual fund related short position differences were valued at approximately \$52 million. At the request of MFR, the Firm then began to submit weekly written reports to MFR on the value of the aged short position differences. Shortly thereafter, MFR received a written submission by the Firm which reported that aged unreconciled mutual fund related short position differences were valued at approximately \$40 million, which represented approximately 5,582 items.
29. In a May 1998 letter to the SEC, the Firm advised the SEC that the Firm anticipated it could resolve the reconciliation problem within approximately six weeks. Approximately five months later, the Firm advised the SEC that the Firm could resolve existing mutual fund reconciliation differences within approximately 30 days. It took the Firm until December 1998 to substantially resolve its networked mutual fund related reconciliation problems.

#### **Journaling of Short Differences Into a Security Difference Account**

30. The Firm was required to record aged unresolved security differences in a security difference account pursuant to Exchange Rule 440.10(3) and SEC Regulation §240.17a-13(b)(5).
31. At times during the Period, the Firm did not record into a security difference account unresolved mutual fund related short security position differences.
32. Pursuant to an extension granted by the SEC in October 1998, the Firm began recording these differences in such an account in approximately November or December 1998.

#### **Inaccurate Computations of Net Capital Relating to Mutual Fund Positions**

33. At all relevant times, the Firm was subject to the requirements of SEC Regulation §240.15c3-1 (commonly known as the “net capital” rule.)
34. The Firm did not comply with the net capital rule, in that it did not accurately compute its net capital, due to the following:
  - a. In its net capital computations prepared for the period September 1997 through January 1998, the Firm did not take a deduction for the value of aged mutual fund related short security differences; and,
  - b. In its net capital computations prepared as of February 28, 1998 and as of March 31, 1998, the Firm took a deduction relating to aged mutual fund related short

security differences using information which was known, or which should have been known, by the Firm not to be current as of the respective dates of the computations.

**Inaccurate Computation of Formula  
for Determination of Reserve Requirement for Brokers and Dealers**

35. The Firm was required by SEC Regulation §240.15c3-3(e) to compute the amount of cash or qualified securities required to be on deposit in the Firm's Special Reserve Bank Account for the Exclusive Benefit of Customers in accordance with the formula for determination of reserve requirement for brokers and dealers (the "Reserve Computation").
36. During the period from approximately August 1997 through approximately February 1998, one or more Reserve Computations prepared by the Firm were inaccurate, in that the Firm did not include as a credit in the computation the market value of aged mutual fund related short security position differences which were reflected on books and records of the Firm.

**Filing Inaccurate FOCUS Reports**

37. FOCUS Reports for the Firm prepared for the periods from August 1997 through March 1998 were filed with the Exchange and were inaccurate, in that the computation of net capital and/or the Reserve Computation omitted amounts relating to aged mutual fund related short security differences; or reflected information relating to aged mutual fund related short security differences which was not current as of the date of the computation.
38. The FOCUS Reports referred to in paragraph 37, above, were filed with the Exchange, and were required to be accurate pursuant to SEC Regulation §240.17a-5 and Exchange Rule 476(a)(10).

**Failure to Obtain and/or Maintain  
Possession or Control of Mutual Fund Positions**

39. During the Period, the Firm did not, as required by SEC Regulation §240.15c3-3(b)(1), obtain and/or maintain the physical possession or control of customer mutual fund positions.
40. During the Period, the Firm was required to buy in short security differences pursuant to SEC Regulation §240.15c3-3(h).
41. During the Period, the Firm did not buy in mutual fund related short security position differences which were not resolved within 45 calendar days from: (i) the annual report of the Firm's financial condition, which specifically disclosed such differences; (ii) the date when one or more of the Firm's quarterly security counts identified, or should have identified, such differences; and (iii) the date of any other examination, count, verification or comparison of mutual fund positions.

42. In or about October 1998, the Exchange requested that the Firm buy in mutual fund related short security reconciliation differences. In response, the Firm sought from the SEC an extension of time to do so. The SEC gave the Firm an extension until December 1, 1998 to buy in differences aged 45 calendar days or more.
43. On or before December 1, 1998, the Firm effected a buy-in of mutual fund related short security differences aged 45 calendar days or more, and so advised the Exchange and the SEC in writing. Such purchases totaled \$2.2 million, but were later reduced to \$400,000.

**Nonadherence to Exchange Requirements  
Concerning Customer Account Transfer Requests**

44. In or about November 1997, numerous XYZ registered representatives left XYZ to become employed at ABC and two other securities firms.
45. Beginning in or about November 1997, the Firm began to receive Automated Customer Account Transfer Service (“ACATS”) requests from the three securities firms referred to in paragraph 44, above, related to the customer accounts of the approximately 75 registered representatives who had left XYZ. In or about March 1998, Lowenthal advised MFR that approximately 12,000 customer accounts had requested transfer.
46. During November 1997 and at other relevant times, pursuant to Exchange Rule 412, the Firm and ABC were required to use the ACATS system to effect customer account transfer requests that included mutual fund positions.
47. In November 1997, the Firm was networked on Levels 1 and 2, and ABC was networked on Level 4. Beginning in or about November 1997, the Firm using the ACATS system, attempted to effect deliveries to ABC of mutual fund positions in accounts serviced by former XYZ registered representatives. Numerous deliveries of mutual fund positions were rejected, which resulted in “fail to deliver” contracts being established that were charged to the Firm which exceeded \$10 million. To avoid the establishment of additional “fail” contracts and associated charges to the Firm relating to attempted mutual fund transfers to ABC using ACATS, the Firm and ABC agreed for a time to switch to a method to effectuate the deliveries of mutual fund assets outside the ACATS system, which procedure thereafter occurred.
48. Lowenthal learned of the agreement with ABC at or about the time it went into effect. The agreement required an exemption from the Exchange from one or more provisions of Exchange Rule 412. Neither Lowenthal nor the Firm sought from the Exchange an exemption from Exchange Rule 412, or otherwise advised the Exchange of the agreement during the period it was in effect.

**Failure to Make or Keep Current or Preserve Books and Records**

49. At various times during 1997 and 1998, the Firm did not comply with SEC Regulation §240.17a-3 and Exchange Rule 440, in that the Firm did not make and/or keep current books and records relating to:
- a. The reconciliation of customer networked mutual fund positions;
  - b. Payments to customers of mutual fund dividends and payments of interest, in that in many instances, customer accounts were not timely credited with dividend payments or interest payments; many dividend payments were duplicated; and customers had dividends reinvested when the dividends were supposed to have been received in cash; and,
  - c. Customer positions, including the Firm's stock record and customer monthly account statements, in that in many instances, customer mutual fund positions were inaccurate, including: illogical positions; duplicated positions; positions which were no longer held at the Firm; and positions that were not recorded although they had been transferred off the books and records of XYZ.
50. The Firm's Reconciliation Reports were required to be preserved for a period of at least three years, pursuant to SEC Regulation §240.17a-4 and Exchange Rule 440. The Firm either did not preserve or, when requested to produce them by the Exchange, was unable to locate certain Reconciliation Reports used at the Firm or at XYZ during the period August 1997 through December 1997.

**Nonadherence to Good Business Practices  
and to Timely Notification to the Exchange and the SEC**

51. After the Conversion, Lowenthal was in frequent communication with operations personnel at both the Firm and at XYZ.
52. During 1997, Lowenthal learned of operational problems and complaints relating to mutual funds from such sources as the Firm and XYZ operations and other personnel.
53. During all or part of the period from at least approximately late 1997 through approximately February 1998, the Respondents reasonably should have known that the Firm was involved in a condition which could lead to operational problems, and/or impairment of recordkeeping, clearance or control functions. Pursuant to Exchange Rule 401, the Firm should have notified the Exchange immediately upon discovery of any such condition. The Firm did not timely give such notification.
54. The Firm was required pursuant to SEC Regulation §240.17a-11(d) to timely notify the Exchange and the SEC if it failed to make or keep current certain books and records. The Firm did not timely notify the Exchange and the SEC of one or more such failures by the Firm.

55. The Exchange first learned of recordkeeping and other problems at the Firm relating to mutual funds at or about the time Lowenthal requested the extension of time to submit the audit report referred to in paragraph 8, above.
56. Lowenthal permitted the Firm not to timely notify the Exchange and the SEC of one or more problems or conditions at the Firm.

#### **Failure to Supervise**

57. During periods in 1997 and 1998, the Firm did not comply with one or more of the provisions of Exchange Rule 342.
58. The Firm did not provide for appropriate procedures of supervision and control and have adequate systems or procedures in place concerning its mutual fund clearance activities, in connection with the following requirements: to adequately reconcile mutual fund positions; to timely resolve mutual fund reconciliation differences; to value and age mutual fund reconciliation differences; to record aged mutual fund reconciliation differences into a security difference account; to prepare accurate net capital computations and Reserve Computations; to obtain and/or maintain the physical possession or control of securities; to file accurate FOCUS Reports with the Exchange; and to timely notify the Exchange and/or the SEC of operational and recordkeeping deficiencies.

#### **Prior Discipline**

59. In 1998, without admitting or denying guilt, the Firm consented to a censure, a \$100,000 fine, and an undertaking, imposed by an Exchange Hearing Panel (HPD 98-48) for various violations of Exchange rules and federal securities regulations involving, among other things, possession or control.

#### **Additional Factors**

60. The Firm maintains that XYZ was undergoing management and operational difficulties at the time XYZ was acquired by the Firm. The Firm maintains that these factors contributed to some of the conduct described herein.
61. The Firm also maintains that the problem of mutual fund reconciliation differences was impacted by the departure in November 1997 of numerous XYZ registered representatives to other firms and the consequent transfer of thousands of customer accounts from XYZ.

#### **DECISION**

The Hearing Panel, in accepting the Stipulation of Facts and Consent to Penalty, found the Firm and Mr. Lowenthal 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 \$500,000, and a requirement that the Firm comply with the undertakings set forth at A and B below.

In view of the above findings, the Hearing Panel, by unanimous vote, imposed the penalty consented to by Mr. Lowenthal of a censure and a requirement that he comply in his capacity as CEO of the Firm with the undertaking set forth at B below.

**UNDERTAKINGS**

- A. The Firm agrees to comply with the following undertaking:
1. Not later than 30 days from the date that an Exchange Hearing Panel Decision accepting the Stipulation and Consent (the “Decision”) becomes final, the Firm shall retain an independent consultant, not unacceptable to the Exchange (the “Consultant”), to conduct a review of the Firm’s supervisory systems (the “Review”) in relation to the Firm’s financial and operational areas in general, and to the violations described in the Stipulation and Consent in particular, and to prepare a report of the Review (the “Report”), which shall include recommendations for additional policies, procedures, staffing and supervisory systems, if necessary, reasonably designed to ensure compliance with federal securities laws and Exchange rules.
  2. Within 90 days from the date the Decision becomes final: (i) the Review shall be completed and (ii) the Report shall be delivered to the Board of Directors of the Firm’s parent company and to the Exchange.
  3. The Firm shall adopt and implement any and all recommendations for additional policies, procedures, staffing and supervisory systems, as set forth in the Report; provided, however, that as to any recommendation of the Report which the Firm determines is, in whole or in part, unduly burdensome, or as to which the Firm may wish to take alternative action designed to achieve the same objective or purpose as that of the recommendation in the Report (“Alternative Action”), the Firm shall provide the Exchange with a written representation that such Alternative Action has been presented to the Consultant with a description of how such Alternative Action achieves the same objective or purpose as the Report’s original recommendations. In any case in which the Consultant is not satisfied that such Alternative Action achieves the same objective or purpose as the Report’s original recommendations, the Consultant shall so advise the Firm in writing, stating the reasons for the Consultant’s views, and the Firm shall file such writing with the Exchange.
  4. The Firm shall, within 120 days of delivery of the Report to the Board of Directors of its parent company, submit to the Exchange a letter signed by the Firm’s CEO describing the Firm’s implementation of any recommendations contained in the Report or of any Alternative Actions.

- B. The Firm and Lowenthal, in his capacity as CEO of the Firm, jointly agree to comply with the following further undertaking:
1. Within 60 days from the date the Decision becomes final, the Firm and Lowenthal, as CEO of the Firm, will assign a person not unacceptable to the Exchange, who will be an officer of the Firm familiar with operations or finance, or other person subject to the Exchange's jurisdiction, and this individual will report directly to the Firm's CEO, and will have the responsibility, specifically described and delegated by the Firm and by Lowenthal, to coordinate the operational, net capital and other regulatory aspects of future corporate acquisitions by the Firm which involve account conversions. This individual will be responsible for: (1) monitoring all such aspects of the acquisition and making reasonable efforts to identify factors which might adversely affect the acquisition; (2) functioning as a clearing point for the identification of acquisition-related regulatory issues; (3) reporting such issues to the CEO; (4) reporting to the Exchange on a continuing basis about acquisition-related regulatory issues, regardless of whether they would otherwise be reportable under applicable regulations and requirements; and (5) formulating and recommending resolutions of these issues to the CEO. Upon completion of each such conversion, this individual will prepare a report for submission to the Audit Committee of the Firm's parent company, with a copy to the Exchange. For purposes of this Undertaking B, the term "corporate acquisition shall mean an acquisition, merger or other business combination by the Firm involving a conversion, which is reportable to the Exchange under applicable Exchange rules and/or federal securities laws and which the Exchange designates as one to be governed by the terms of this undertaking. The responsibility of the above identified individual (or other individual not unacceptable to the Exchange who has been appointed as his successor) shall continue for a minimum of two years from the date of the appointment of the individual. Thereafter, for a minimum of three years, a comparable report shall be submitted by the Firm to the Audit Committee of the Firm's parent company, with a copy to the Exchange, upon the completion of any conversion arising out of a corporate acquisition as defined herein.

For the Hearing Panel

Vincent F. Murphy  
Hearing Officer