

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 04-136
THE SEIDLER COMPANIES INCORPORATED
MEMBER ORGANIZATION

August 11, 2004

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Violated Exchange Rules 342(a) and (b) in that the Firm failed to establish and maintain appropriate procedures for supervision and control with respect to the business activities of its research analysts, the activities of producing branch office managers and review of internal and external e-mail communications; Violated Exchange Rules 472(a)(1) and (2) by issuing research reports and newsletters without supervisory analyst approval; and Rule 472(b)(4) by providing subject companies draft research reports containing the research summary, rating and price target; Violated SEC Rules 17a-4(b)(4) and 17a-4(f) and Exchange Rule 440 by failing to properly preserve and maintain e-mail communications; and Violated Exchange Rules 345(a), 342.16 and 342.17 by failing to designate a qualified, registered and approved person to review e-mail – Consent to censure and \$150,000 fine.

Appearances:

For the Division of Enforcement
Steven F. Korostoff, Esq.
Laura A. Cooper, Esq.

For the Respondent
Sean G. Blackman, 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 The Seidler Companies Incorporated (the "Firm"), a member organization. Without admitting or denying guilt the Firm consented to a finding by the Hearing Panel that it:

- I. Violated Exchange Rules 342(a) and (b) in that the Firm failed to establish and maintain appropriate procedures for supervision and control, including a separate system of follow-up and review, with respect to:
 - A. The business activities of its research analysts, including the review and approval of research reports and newsletters by a supervisory analyst;
 - B. The activities of producing branch office managers who handled their own customer accounts; and
 - C. Review of internal and external e-mail communications.
- II. Violated Exchange Rules 472(a)(1) and (2) by issuing research reports and newsletters without supervisory analyst approval; and Rule 472(b)(4) by providing

subject companies draft research reports containing the research summary, rating and price target.

- III. Violated Securities and Exchange Commission (“SEC”) Rules 17a-4(b)(4) and 17a-4(f) and Exchange Rule 440 by failing to preserve and maintain e-mail communications in the required format and for the required retention period.
- IV. Violated Exchange Rules 345(a), 342.16 and 342.17 by failing to designate a qualified, registered and approved person to review e-mail.

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

Background and Jurisdiction

1. The Firm became a member organization of the Exchange on August 29, 1969. The Firm has six branch offices and currently employs a total of approximately 118 individuals. The Firm’s activities include a retail securities brokerage business.
2. In 2002, the Exchange’s Division of Member Firm Regulation (“MFR”) conducted an examination of the Firm’s financial and operational procedures. During the 2002 examination, MFR noted certain deficiencies that were referred to Enforcement for further review.
3. By letter dated March 24, 2003, Enforcement notified the Firm that it was investigating matters that were referred to Enforcement by MFR following the 2002 examination and referral.
4. Thereafter, the Firm appeared, represented by counsel, and provided documents and information in connection with the Exchange’s investigation.

Summary of Violative Conduct

5. The Firm violated Exchange Rules 342(a) and (b) in that the Firm failed to establish and maintain appropriate procedures for supervision and control, including a separate system of follow-up and review, with respect to (a) the business activities of its research analysts including the review and approval of research reports and newsletters by a supervisory analyst; (b) the activities of producing branch office managers who handled their own customer accounts; and (c) review of internal and external e-mail communications. The Firm violated Exchange Rules 472(a)(1) and (2) by issuing research reports and newsletters without supervisory analyst approval; Rule 472(b)(4) by providing subject companies draft research reports containing the research summary, rating and price target; Securities and Exchange Commission (“SEC”) Rules 17a-4(b)(4) and 17a-4(f) and Exchange Rule 440 by failing to preserve and maintain e-mail communications in the required format and for the required retention period; and Exchange Rules 345(a), 342.16 and 342.17 by failing to designate a qualified, registered and approved person to review e-mail.

The Firm's Research Department

6. Exchange Rule 342 requires each member or member organization to supervise each of its offices, departments or business activities, to provide for appropriate procedures of supervision and control and to establish a separate system of follow-up and review.
7. Exchange Rule 472(a)(1) provides that “[e]ach advertisement, market letter, sales literature or other similar type of communication which is generally distributed or made available by a . . . member organization to customers or the public must be approved in advance by a member, allied member, supervisory analyst, or qualified person designed under the provisions of Rule 342(b)(1).” “Communication” is defined as, among other things, electronic communications (Rule 472.10).
8. Exchange Rule 472(a)(2) provides that “research reports must be prepared or approved, in advance, by a supervisory analyst acceptable to the Exchange . . . ”
9. Exchange Rule 472(b)(4) provides that “member organizations may not, under any circumstances, provide the subject company sections of research reports that include the research summary, the research rating or the price target” pre-issuance.
10. In early April 2002, the Firm hired a research group from a non-member firm, and formed the Firm’s Research Department.
11. During the period May 1, 2002 to May 10, 2002, the Firm issued four research reports without supervisory analyst review and approval prior to their issuance.
12. In early April 2002, a managing director of investment banking and a research analyst met with a covered issuer’s management to discuss a secondary offering of stock for the company. The Firm was subsequently retained as co-manager for the secondary offering. The Firm failed to make the required disclosure in a May 1, 2002 research report initiating coverage on the company that the Firm was engaged or about to be engaged in investment banking services for the company.
13. During 2002 and 2003, on numerous occasions, the Firm issued without supervisory analyst approval First Call Notes (which are publicly disseminated summaries of companies covered by the Firm and that contain the analyst’s summary, price target and recommendation) and customer newsletters. In September 2003, a First Call Note was issued even though the supervisory analyst had specifically disapproved of it.
14. During the period April 2002 to June 2002, the Firm did not have any written policies relating to the supervision of research. In June 2002, the Firm issued certain written policies relating to research, which were not adequate for supervisory purposes and not followed by the research analysts on various occasions. In May 2003, the Firm revised its compliance manual to incorporate prohibitions on certain conduct, including prohibiting research analysts from discussing a research report or sending it to the covered issuer without complying with specific rules; prohibiting joint

investment banking and research analyst solicitation of business; and requiring supervisory analyst approval prior to issuance of research.

15. The Firm's May 2003 written policies were not followed with respect to the provision of draft research reports to subject companies. After May 2003, two research analysts on various occasions sent subject companies complete draft research reports prior to issuance, and on one occasion, a research analyst sent an institutional customer a draft research report, without approval.

**Producing Branch Office Managers Who Handled
Their Own Customer Accounts**

16. Exchange Rules 342(a) and (b), 342.16 and 342.17 require that member organizations maintain reasonable procedures for the supervision and review of registered representatives and their communications with the public relating to their business, customer accounts and transactions.
17. In January 2001, the Firm acquired the assets of a non-member firm, which had five branch offices. As a result of this acquisition, the Firm began operating branch offices for the first time.
18. From January 1, 2001 to approximately January 2003, the Firm failed to have procedures adequate for the supervision of branch office managers who performed the duties of registered representatives and handled their own customer accounts.
19. From January 1, 2001 to approximately January 2003, the Firm did not adequately supervise four branch office managers who handled their own customer accounts. Specifically, the Firm did not timely review the producing branch office managers' order tickets (or a substantially equivalent report containing order time), new account forms, outgoing and incoming correspondence, address changes on accounts, letters of authorization to transfer money or securities in and out of accounts.

E-Mail Communications

20. Exchange Rule 342.16 provides that supervision of registered representatives ordinarily includes "reasonable procedures for review of registered representatives' communications with the public relating to their business, and customer accounts and transactions. Such policies and procedures should be in writing and be designed to reasonably supervise each registered representative."
21. Exchange Rule 342.17 provides that "member organizations must develop written policies and procedures that are appropriate for their business, their size, structure and customers in connection with the review of communications with the public relating to their business Where such policies and procedures for the review of public communications do not require pre-use review, they must provide for surveillance and follow-up to ensure that such policies and procedures are implemented and adhered to."

22. Securities and Exchange Commission (“SEC”) Rule 17a-4(b)(4) requires member organizations to maintain “originals of all communications received and copies of all communications sent by such member . . . (including interoffice memoranda and communications) relating to [its] business as such” for a period of three years, the first two years in an accessible place. SEC Rule 17a-4(f) requires that if records are stored electronically, they must be in a non-rewritable, non-erasable format, among other things. Exchange Rule 440 requires that “the record keeping format, medium and retention period shall comply with Rule 17a-4 under the Securities Exchange Act of 1934.”
23. Exchange Rule 345(a) requires registration and approval by the Exchange of employees performing supervisory duties.
24. The Firm’s e-mail system became available to all employees in approximately 1997. During the period from 1997 to the present, Firm employees were permitted to use e-mail for both internal and external correspondence. Prior to September 2002, the Firm preserved external e-mail on erasable and re-writable tapes and did not preserve more than one month of internal e-mail. In mid-September 2002, the Firm began for the first time to maintain e-mail for the required three-year period in the required format.
25. During the period September 2002 to December 2002, Firm employees could send facsimiles directly from their desktop personal computers. The Firm did not have any procedures to review such faxes.
26. Since 1997, Firm employees had access to the Internet and other e-mail services, such as AOL and Yahoo, and to Instant Messenger services when they recently became available. The Firm had no system to monitor Internet based e-mail and Instant Messenger services and did not preserve or review such correspondence.
27. In addition, during the period 1997 to September 2003, review of e-mail was not being conducted by a qualified, registered and approved person and the Firm did not have surveillance and follow-up to monitor communications with the public as required by Exchange Rules 345(a), 342.16 and 342.17.

Other Factors Considered

28. The Firm has informed Enforcement, and Enforcement has considered, the circumstances described below relating to the matters covered in the Stipulation and Consent.
29. In or about December 2003, the Firm revised its policies and procedures with respect to the activities of the research department. In early December 2003, outside counsel for the Firm conducted Firm wide training sessions on compliance with Exchange rules relating to research, investment banking and various other issues.
30. In January 2003, the Firm revised its written policies to require daily review by a senior producing branch office manager of the other producing branch office

managers' handling of customer accounts. In addition, the compliance officer reviews daily the handling of accounts by the branch office manager who reviews the other three branch office managers.

31. The Firm and its counsel revised its policies and procedures for review, storage and maintenance of electronic communications. In addition, the Firm has represented that a person appropriately registered with the Exchange is currently conducting review of e-mail.

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 and a fine in the amount of \$150,000.

For the Hearing Panel

Vincent F. Murphy
Hearing Officer