

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 04-148

September 21, 2004

RBC DAIN RAUSCHER INC.
MEMBER ORGANIZATION

* * *

Violated SEC Rule 15c3-3 by failing to fund its proprietary account for introducing brokers, thereby causing a hindsight deficiency; violated Exchange Rule 92(b) by entering proprietary orders while representing customer orders that could be executed at the same price, without using separate proprietary facilitation accounts; violated SEC Rules 17a-3(a)(6) and 17a-4(b)(1) and Exchange Rule 440 by failing to maintain certain required records of customer orders; violated Exchange Rules 342(a) and (b) by failing to prevent the aforementioned violations – Consent to censure and \$80,000 fine.

Appearances:

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

For the Respondent
Jay W. Freiberg, Esq.

* * *

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 RBC Dain Rauscher Inc. (the "Firm"), a member organization of the Exchange. Without admitting or denying guilt, the Firm consents to findings by the Hearing Panel that it:

- I. Violated SEC Rule 15c3-3 by failing to fund its proprietary account for introducing brokers, thereby, on one or more occasions, causing a hindsight deficiency.
- II. Violated Exchange Rule 92(b) by, on one or more occasions, entering proprietary orders while representing customer orders that could be executed at the same price, without using separate proprietary facilitation accounts for such trades.
- III. Violated SEC Rules 17a-3(a)(6) and 17a-4(b)(1) and Exchange Rule 440 by failing to make, maintain and preserve certain required records of customer orders.
- IV. Violated Exchange Rules 342(a) and (b) by failing to provide for appropriate procedures of supervision and control and to establish a system of follow-up and review to prevent the aforementioned violations.

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, a member organization of the Exchange since 1993, was acquired by Royal Bank of Canada in 2001. The Firm has 186 branch offices in thirty-nine states and currently employs a total of approximately 5,000 individuals. The Firm engages in numerous businesses, including retail securities brokerage. (In February 2004, the Firm transferred a portion of its business to an affiliate with a common parent, RBC Capital Markets Corporation, which is also a member firm. The transferred business was involved in two of the violations herein).
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 December 13, 2002, 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, information and testimony in connection with the Exchange's investigation.

Summary of Violative Conduct

5. The Firm violated Securities and Exchange Commission ("SEC") Rule 15c3-3 by failing to fund its proprietary account for introducing brokers, thereby, on one or more occasions, causing a hindsight deficiency; violated Exchange Rule 92(b) by, on one or more occasions, entering proprietary orders while representing customer orders that could be executed at the same price, without using separate proprietary facilitation accounts for such trades; violated SEC Rules 17a-3(a)(6) and 17a-4(b)(1) and Exchange Rule 440 by failing to make, maintain and preserve certain required records of customer orders; and violated Exchange Rules 342(a) and (b) by failing to provide for appropriate procedures of supervision and control and to establish a separate system of follow-up and review to prevent the aforementioned violations.

The Firm Failed to Fund its Reserve Account for the Benefit of Proprietary Accounts of Introducing Brokers, Resulting in Hindsight Deficiencies

6. SEC Rule 15c3-3(e) requires that a broker or dealer make weekly computations, using a specific formula, to determine the amount to be deposited into its proprietary account for introducing brokers ("PAIB Reserve Account"), and to timely make such deposits as are necessary to maintain that account at a minimum required level. Under SEC Rule 15c3-3(e), the clearing broker must maintain a separate account, the

PAIB Reserve Account, for the protection of the assets of introducing brokers held by the clearing broker. "Proprietary Accounts of Introducing Brokers and Dealers," SEC No Action Letter (November 3, 1998).

7. 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.
8. During the 2002 examination, MFR discovered that on one or more occasions the Firm had used excess deposits in its special reserve account for the exclusive benefit of customers to fund its PAIB Reserve Account, which is not permitted under SEC Rule 15c3-3. Accordingly, the Firm had not funded its PAIB Reserve Account and thus the Firm had hindsight deficiencies on or about the following dates in the following approximate amounts:

<u>Date</u>	<u>Amount of Deficiency</u>
February 15, 2002	\$3,317,000
March 15, 2002	\$5,737,000
March 22, 2002	\$9,697,000
July 12, 2002	\$6,514,000

9. By letter dated July 23, 2002, the Firm notified the SEC of the hindsight deficiencies described above.

The Firm Entered Proprietary Orders While Representing Customer Orders That Could Be Executed At the Same Price Without Using Separate Proprietary Facilitation Accounts

10. Exchange Rule 92 limits member organizations from trading on the same side of the market in the same stock as an unexecuted customer order. Exchange Rule 92(b) was amended on November 1, 2001 to provide that a "member organization may enter a proprietary order while representing a customer order which could be executed at the same price . . ." under certain limited circumstances, including that the "member organization is liquidating a position held in a proprietary facilitation account."
11. Exchange Rule 92.40 defines a proprietary facilitation account as "an account in which a member organization has a direct interest and which is used to record transactions whereby the member organization acquires positions in the course of facilitating customer orders."

12. During the period November 2001 to July 2002, on one or more occasions, the Firm entered proprietary orders while representing customer orders that could be executed at the same price, without using separate proprietary facilitation accounts for such trades.

The Firm Failed to Create and Maintain Certain Required Books and Records

13. SEC Rule 17a-3(a)(6) and 17a-4(b)(1) require member organizations to create and maintain records of orders, including the time the order was received and the quantity of securities, for a period of three years. Exchange Rule 440 requires member firms to “make and preserve books and records . . . as prescribed by [SEC] Rule 17a-3.”
14. MFR noted during its 2002 examination that the Firm was not documenting the availability of securities to be borrowed for short sale transactions.
15. A sample of four months (February, July, August and October 2002) of order tickets for short sale transactions for customers with prime broker arrangements showed that the Firm was not creating and maintaining the following required records:
 - (a) approximately half of the order tickets did not include a notation as to the method of locating the subject securities of the short sale for borrowing on the settlement date; (b) a number of order tickets did not contain a time stamp for short sale orders that customers added onto their initial order; and (c) a number of order tickets had no notation as to the time of partial cancellation of the order.

Other Factors Considered

16. The Firm has informed Enforcement, and Enforcement has considered, the circumstances described below relating to the matters covered in the Stipulation and Consent.
17. The Firm has changed its method of calculating the amount to be on deposit in its PAIB Reserve Account. In July 2002, the Firm revised its written policy regarding funding the PAIB Reserve Account.
18. As of July 11, 2002, the Firm established proprietary facilitation accounts and sent a memorandum to all traders requiring the use of the proprietary facilitation accounts for executing proprietary transactions to facilitate a customer order or execute a proprietary trade in the same stock on the same side as an unexecuted customer order in compliance with Exchange Rule 92(b).
19. On September 26, 2003, the Firm issued a “New Policy – Documenting Short Sale Affirmative Determination in Fidessa.” This policy implemented a computerized system that requires entry of an affirmative determination (either from the customer or the Firm’s stock loan department) identifying the person providing assurance of delivery of the securities to be borrowed and the present location of the securities to

be delivered. The Firm's computer system blocks entry of the order unless such information is provided.

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 of \$80,000.

For the Hearing Panel

Milton M. Stein
Hearing Officer