

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 05-37

March 24, 2005

PRUDENTIAL EQUITY GROUP, LLC
f/k/a PRUDENTIAL SECURITIES INCORPORATED
MEMBER ORGANIZATION

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Violated Exchange Rule 421 in that, on a monthly basis during the period May 1995 through April 2003, the Firm submitted to the Exchange inaccurate reports of short positions in securities listed on the Exchange; and violated Exchange Rule 342 in that the Firm failed to establish and maintain appropriate policies, systems and procedures for the supervision and control of areas responsible for complying with Exchange short interest reporting requirements, and failed to establish a separate system of follow-up and review to ensure compliance with Exchange short interest reporting requirements and to detect and prevent the foregoing violations – Consent to censure and fine of \$350,000.

Appearances:

For the Division of Enforcement
Susan E. Light, Esq.
Dorian M. Gross, Esq.

For the Respondent
Harry J. Weiss, Esq.
Renee Kwait Rettig, Esq.
Stephen Shine, 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 Prudential Equity Group, LLC f/k/a Prudential Securities Incorporated, a member organization (the "Firm"). Without admitting or denying guilt, the Firm consented to a finding by the Hearing Panel that it violated:

- I. Exchange Rule 421 in that, on a monthly basis during the period May 1995 through April 2003, the Firm submitted to the Exchange inaccurate reports of short positions in securities listed on the Exchange.
- II. Exchange Rule 342 in that the Firm failed to establish and maintain appropriate policies, systems and procedures for the supervision and control of areas responsible for complying with Exchange short interest reporting requirements, and failed to establish a separate system of follow-up and review to ensure compliance with Exchange short interest reporting requirements and to detect and prevent the foregoing 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 is a member organization of the Exchange, which is the Firm's designated examining authority ("DEA") and principal regulator. The Firm is also a member of the NASD and the American Stock Exchange (the "AMEX"). The Exchange, the NASD and the AMEX are herein collectively referred to as the "SROs." The Firm maintains its headquarters in New York. Its primary activities relate to its Equity Division, and include with respect to equity securities: research, trading, sales to institutional customers, and OTC market making activities. The Firm is not self-clearing.
2. The violations set forth in this Stipulation and Consent solely occurred during the period of time when the Firm was known as Prudential Securities Incorporated ("PSI"). During all relevant times, PSI was a member organization of the SROs, with the Exchange being PSI's DEA and principal regulator. During all relevant times, PSI provided a full range of investment services to both individual and institutional investors, and was self-clearing with respect to its customer accounts and proprietary accounts, and provided clearing services on an omnibus basis to a correspondent clearing subsidiary. (The Firm assumed its current name and structure on July 1, 2003, as a result of a business combination entered into between the Firm's parent, Prudential Financial, Inc. and Wachovia Corporation. As part of the business combination, PSI contributed its U.S. and Latin American retail brokerage business, and its securities clearing and settlement business [including the business and activities of PSI's correspondent clearing subsidiary] towards the formation of Wachovia Securities LLC. As part of the above-mentioned business combination, PSI also changed its name to the Firm, which continues to operate the business lines referred to in paragraph 1 above. In or about February 2004, the Firm converted from a corporation to a Limited Liability Company.)
3. During 2003, the Exchange, together with the NASD and the AMEX, initiated a joint investigation into PSI's activities with regard to its short interest reporting to the SROs.

Overview

4. During an approximately eight-year period between May 1995 and April 2003 (the "Relevant Period"), PSI inaccurately reported or failed to report its short interest positions to the Exchange on approximately 1,225 occasions, in violation of Exchange Rule 421. During the same period, PSI also submitted inaccurate short interest reports to the NASD and the AMEX. PSI also failed to provide for appropriate procedures of supervision and control, and to implement a separate system of follow-up and review, over its business activities relating to its regulatory obligation to accurately report short interest.

Inaccurate Reports of Short Interest

5. Exchange Rule 421 requires, in part, that member organizations and individual direct clearing members, for which the Exchange is the DEA, shall submit to the Exchange monthly reports of short positions (or short interest reports) in securities which are

listed on the Exchange. Such reports must include customer and proprietary accounts. The Exchange relies on the accuracy of the short interest reports submitted by member organizations in compiling its own calculation of overall short interest in Exchange-listed securities, which is made available to the marketplace.

6. Pursuant to NASD Rule 3360 and AMEX Rule 30, member organizations of the NASD and the AMEX, must also report to those organizations short positions for applicable listed securities.
7. During the Relevant Period, in computing short interest in a particular security for purposes of making a required filing to the Exchange of a short interest report, member organizations were required to report short positions in the member organization's proprietary accounts on a "gross" basis. See Securities Exchange Act Release No. 35450 (60 FR 13744) (March 1995) (the "1995 SEC Release"). This means that short positions in proprietary accounts were not to be netted against long positions in the same security in other proprietary accounts, in determining the proprietary short interest position amount. The gross short position for a security in each proprietary account, along with short positions in the security in customer accounts, were to be aggregated, and the total short interest amount was to be reported to the Exchange in the member organization's short interest report.
8. During the approximate eight-year Relevant Period, PSI did not follow the regulatory requirement to report its short interest positions on a gross basis, as set forth by the 1995 SEC Release. Instead, PSI continued to follow its prior practice of netting positions in its proprietary accounts.
9. During the Relevant Period, as a result of PSI's inaccurate treatment of proprietary accounts in the short interest reports that it submitted to the Exchange, certain short interest positions in Exchange-listed securities were underreported or not reported at all.
10. Based upon a review of a 13-month sample chosen from the Relevant Period, PSI inaccurately reported or failed to report a short interest position to the Exchange on approximately 1,225 occasions. During the period sampled, the average monthly total number of shares reported by PSI to the Exchange on its short interest report was approximately 13.8 million shares. Based upon the same sample, on average, approximately 24,856 short interest shares were not accurately reported to the Exchange each month.

Supervisory Deficiencies

11. Pursuant to Exchange Rule 342, member organizations are required to provide for appropriate supervision and control of every area of business activity which must include a separate system of follow-up and review, to ensure, among other things, compliance with Exchange rules and federal securities laws. PSI failed to provide appropriate systems and procedures effective to ensure accurate reporting of short interest to the Exchange.

12. During the Relevant Period, PSI relied on an automated system to comply with its short interest reporting requirements. The automated system utilized a program that calculated short interest for a particular security by directly accessing PSI's stock record. As described above, the program netted short and long positions in proprietary accounts.
13. The responsibility for the actual short interest filing to the SROs was assigned by PSI to its Operations Regulatory Compliance area ("Operations"). Written supervisory procedures of Operations (the "Procedures") codified PSI's incorrect practice of netting positions in proprietary accounts.
14. As set forth in the Procedures, supervisory personnel were required to review all submissions to the SROs to ensure that PSI's short interest report accurately matched the stock record, and that proprietary accounts were being reported on a net basis.
15. No modifications were made to the short interest reporting process at PSI during the Relevant Period, nor was an internal audit conducted by PSI to determine whether the reporting process was in compliance with the regulatory requirements in effect throughout the Relevant Period.
16. PSI failed to adequately supervise its process for reporting short interest to the Exchange because it failed to implement the correct method for calculating its short interest positions and failed to have an adequate system of follow-up and review to ensure its compliance with Exchange rules in the area of short interest reporting.

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 \$350,000 to be paid jointly to the Exchange, the NASD and the AMEX.

For the Hearing Panel

Vincent F. Murphy – Hearing Officer
Panelists:
Laurence A. Shadek
Thomas A. Tranfaglia