

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 05-83

August 5, 2005

MOORS & CABOT, INC.  
MEMBER ORGANIZATION

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**Violated Exchange Rule 342 (a) and (b) by failing to ensure reasonable systems for supervision, review, and follow-up of error account transactions and failing to provide for appropriate supervisory control of electronic communications with the public and compliance with Exchange requirements for independent contractors; failed to comply with an Exchange sanction involving an undertaking; permitted persons who had not been approved by the Exchange to perform services as independent contractors; failed to give proper notice that certain individuals no longer maintained an independent contractor relationship with it; violated Exchange Rule 440 and SEA Rule 17a-4 in that it failed to properly preserve electronic communications; violated Exchange Rule 342.17 in that it failed to establish adequate procedures for its review of electronic communications with the public; violated Exchange Rule 351(d) in that it misreported seven customer complaints; and violated Exchange Rule 304(h) in that it failed to register two affiliated entities as approved persons. – Consent to censure and a fine of \$250,000.**

**Appearances:**

For the Division of Enforcement  
Myles L. Orosco, Esq.  
Michael Krevor, Esq.  
Danielle Schanz, Esq.

For Respondent  
Nader Salehi, Esq.

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A Hearing Panel of the New York Stock Exchange, Inc. (“Exchange”) met to consider a Stipulation of Facts and Consent to Penalty entered into between the Exchange’s Division of Enforcement (“Enforcement”) and Moors & Cabot, Inc. (“Respondent Firm”), a member firm. Without admitting or denying guilt, Respondent Firm consented to a finding by the Hearing Panel that it:

- I. Violated Exchange Rule 342(a) and (b), in that it failed to adequately ensure reasonable systems for supervision, review, and follow-up of error account transactions by one of Respondent Firm’s employees who was Respondent Firm’s designated Senior Supervising Floor broker and failed to provide for appropriate supervisory control of electronic communications with the public and compliance with Exchange requirements for independent contractors.

- II. Engaged in conduct inconsistent with just and equitable principles of trade in that it failed to comply with an Exchange sanction involving an undertaking.
- III. Violated Exchange Rule 345(a)/02 in that it permitted approximately 41 persons who had not been approved by the Exchange to perform services for Respondent Firm as independent contractors; and failed to give the Exchange proper notice that approximately 41 individuals no longer maintained an independent contractor relationship with Respondent Firm.
- IV. Violated Exchange Rule 440 and Securities Exchange Act (“SEA”) Rule 17a-4 in that it failed to preserve electronic communications in a non-rewriteable, non-eraseable format, in violation of SEA Rule 17a-4(f)(2)(ii)(A), and copies of outgoing electronic communications in a readily retrievable manner, in violation of SEA Rule 17a-4(b)(4).
- V. Violated Exchange Rule 342.17 in that it failed to establish adequate procedures for its review of electronic communications with the public.
- VI. Violated Exchange Rule 351(d) in that during the period July 2001 to June 2002 it misreported seven customer complaints.
- VII. Violated Exchange Rule 304(h) in that it failed to register two affiliated entities as approved persons.

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

### **Background and Jurisdiction**

1. Respondent Firm and a predecessor partnership have been member organizations of the Exchange since January 28, 1932. The Exchange is Respondent Firm’s designated examining authority. Respondent Firm is primarily engaged in the business of operating a retail brokerage business in U.S. securities and has 22 branch offices located in various cities throughout the United States.
2. By letter dated September 16, 2003, which Respondent Firm received, Enforcement notified Respondent Firm that it had opened an investigation to review Respondent Firm’s financial and operational procedures. In addition, Enforcement notified Respondent Firm that the investigation also related to Respondent Firm’s Floor broker activities and supervision and focused on allegations of on-Floor trading with respect to Respondent Firm’s senior supervisory Floor broker.
3. In addition, by letter dated December 10, 2002, which Respondent Firm received, Enforcement notified Respondent Firm that it had opened an investigation with respect to the findings made by the Exchange’s Division of Member Firm Regulation (“MFR”) during an examination in 2002 of supervisory standards and sales practice procedures at Respondent Firm.

### **Overview**

4. Between February 2002 and April 2002, Respondent's Firm senior supervisory Floor broker "HR" engaged in improper on-Floor trading in that he initiated and executed numerous trades in Respondent Firm's error account, exercised discretion with respect to the error account transactions, and committed a number of books and records violations with respect to the error account transactions. Accordingly, with respect to HR's conduct, Respondent Firm violated Exchange Rules 342 (a) and (b) by failing to adequately ensure reasonable systems for supervision, review, and follow-up of error account transactions executed by HR, and failing to have adequate controls to prevent HR from creating and approving his own error account entries and transactions. Respondent Firm also failed to ensure that its written procedures provided for adequate supervisory oversight of HR's activities regarding the designation and recording of erroneous trades for Respondent Firm's error account.

Additionally, in 2003 and for a period of several years previously, Respondent Firm permitted independent contractors who had not been approved by the Exchange, as required, to perform the duties of registered representatives. Moreover, in 2003 and for a period of several years previously, Respondent Firm terminated numerous independent contractor relationships without giving the required notice of such terminations to the Exchange. Separately, in 2002, Respondent Firm failed to review and retain electronic communications with the public in accordance with applicable Exchange Rules and the rules of the Securities and Exchange Commission ("SEC").

### **The Firm's Failure To Supervise Its Supervisory Floor Broker**

5. In January or February 2002, HR began trading in Respondent Firm's error account for his own benefit. HR attempted to generate profitable trades in Respondent Firm's error account to compensate Respondent Firm for the prior losses relating to transactions placed in the error account. In addition, HR wrote vague and inadequate descriptions of the transactions in Respondent Firm's error account logs to hide the fact that he had initiated certain orders on the Floor of the Exchange.
6. For example, on February 22, 2002, HR prepared an error account log on which he wrote his initials, "HR," to identify himself as both broker and clerk for the transaction. According to the error log, HR had initiated a profitable trade for a customer in a particular stock. HR placed the trade in Respondent Firm's error account and wrote the following description on the error log: "Customer owed us money and instead of check gave us trade to cover previous error loss."
7. During the period from January 2002 to April 2002, without first having received a customer order, HR initiated approximately 40 to 50 trades on the Floor in various stocks and placed them in Respondent Firm's error account.

8. During the same period, HR intentionally delayed the executions of actual orders from a customer in order to guarantee that customer a profitable trade. In addition, most of the error logs that HR generated were deficient in that they lacked proper supporting documentation, such as detailed descriptions of the transactions and copies of order tickets and execution reports.
9. In March 2002, Respondent Firm's Executive Vice President of Capital Markets in Respondent Firm's main office in Boston, Massachusetts, initiated an internal investigation into HR's trading activities with respect to the error account. Pursuant to that investigation, the Executive Vice President determined that HR was engaging in on-Floor trading and instructed him to cease using Respondent Firm's error account to initiate trades on the Floor.
10. HR failed to comply with that instruction and, as a result, Respondent Firm terminated HR's employment in May 2002.
11. Exchange Rule 342 requires, in relevant part, that (i) a member organization provide reasonable controls to assure compliance with the rules and regulations of the Exchange and the SEC; (ii) qualified persons acceptable to the Exchange shall be in charge of, among other things, any sales department or activity; and (iii) each office, department or business activity of a member or member organization be under the supervision and control of the member or member organization establishing it.
12. In addition, Exchange Rule 342 requires member firms and organizations to provide for appropriate procedures for supervision and control over their business activities and to establish a system for follow-up and review with respect to their compliance with Exchange Rules and federal securities laws.
13. In this matter, Respondent Firm violated the provisions of Exchange Rule 342 in that HR had considerable autonomy to supervise himself on the Exchange Floor. As a result, Respondent Firm failed to have adequate procedures in place to supervise and monitor HR's activities and the performance of his supervisory duties.
14. Respondent Firm also failed to have adequate controls to prevent HR from creating his own error account entries and approving his own error transactions.
15. For example, with respect to error trades, Respondent Firm's written policies and procedures in effect in 2002 specified that the Floor Supervisor, in this case HR, was solely responsible for identifying error trades and completing error account forms detailing the erroneous trades.
16. As a result, Respondent Firm's written procedures failed to provide for supervisory oversight of HR's activities regarding the designation and recording of erroneous trades for Respondent Firm's error account.

## **Violations Disclosed by the 2002 and 2003 MFR Examinations**

### **Deficiencies Related to Independent Contractors**

17. Exchange Rule 345(a) obligates member organizations, among other things, to comply with certain requirements before permitting any natural person to perform regularly the duties customarily performed by a registered representative.
18. To provide member organizations with some flexibility in personnel matters, Exchange Rule 345(a)/02 permits an “independent contractor” to act as a registered representative of a member organization provided that the conditions set forth in that Rule are satisfied.
19. One of the requirements of Rule 345(a)/02 is that the Exchange’s Qualifications and Registrations Department in MFR (“Q&R”) must be given written notification of the cessation of “independent contractor” status.
20. As disclosed by MFR’s 2002 examination of Respondent Firm, Respondent Firm had not notified Q&R in writing, as required, that 34 individuals who had previously had an independent contractor relationship with Respondent Firm no longer maintained that independent contractor relationship.
21. As disclosed by MFR’s 2003 examination of Respondent Firm, 41 individuals who had independent contractor status with Respondent Firm had not been approved as such by the Exchange.
22. As further disclosed by MFR’s 2003 examination, Respondent Firm had not notified Q&R in writing, as required, that seven individuals who had previously had an independent contractor relationship with Respondent Firm no longer maintained that independent contractor relationship.

### **Deficiencies Related to the Firm’s Treatment of Electronic Communications**

23. As further disclosed by the 2002 examination, Respondent Firm did not adequately retain and review electronic communications.
24. Respondent Firm’s ability to retrieve such communications was limited and inadequate. Although Respondent Firm retained all incoming (external) e-mail communications on its server, the retention by the server was not in a non-rewriteable, non-erasable format, as required.
25. Moreover, Respondent Firm’s procedures required that outgoing (external) electronic communications be printed by the individual senders and forwarded to their respective supervisors for retention because these communications were not retained on the server. This procedure for the retention of outgoing e-mail was inadequate in that Respondent Firm relied on individual senders for retention and could not guarantee the retention of all required communications.

26. Furthermore, Respondent Firm's review of outgoing e-mails did not guarantee that a sample of electronic communications for each employee was reviewed. Respondent Firm's system of supervision was inadequate in that it relied on the sender of communications for completion of the procedure and did not guarantee that Respondent Firm obtained and sufficiently reviewed each employee's e-mail communications.
27. Also, all Respondent Firm employees, through Respondent Firm's computer systems, could access on-line Internet e-mail services such as Yahoo!, AOL, etc., which provided the opportunity for circumvention of Respondent Firm's supervisory and retention systems pertaining to electronic communications.

#### **Deficiencies Related to Reporting by the Firm**

28. In its 2002 examination, MFR reviewed 23 Poor Performance complaints reported by Respondent Firm to the Exchange for the period July 2001 to June 2002.
29. Seven of the 23 complaints had been misreported. Specifically, four of the seven complaints were misreported by using the social security number of a registered representative, when the complaint should have been reported against Respondent Firm. The other three complaints were misreported as Poor Performance when they should have been reported under the more egregious allegation made in the complaint, namely "misrepresentation."

#### **Other Registration Deficiencies**

30. As of the commencement of the 2002 examination, M&C, Inc. was a control entity with 49% ownership of Respondent Firm, and M&C Insurance Agency was an affiliated entity of Respondent Firm that engaged in a kindred business, including the sale of variable annuities. Neither of these two entities was registered with the Exchange as an "Approved Person," as was required, although each entity had been in existence and had possessed the stated attribute for many years.

#### **Prior Discipline**

31. In Exchange Hearing Panel Decision ("HPD") 00-8, Respondent Firm consented to findings that it violated Exchange Rules 345(a) and 345(a)/02 by permitting independent contractors to perform the duties of registered representatives without filing the required documentation; violated Exchange Rules 345(a), 345(a)/02 and 342(b)(1) by permitting independent contractors to perform duties customarily performed by direct supervisors of registered representatives; violated Rule 17a-3 under the Securities Exchange Act of 1934 ("SEA") and Exchange Rule 440 by failing to maintain its books and records; violated Exchange Rule 351(a)(1) by failing to report promptly that an employee had engaged in misconduct related to his floor brokerage activities; and violated Exchange Rule 342 by failing to maintain provisions for supervision and control.

32. Specifically, with regard to Respondent Firm's failure to supervise its Floor brokerage activities, Respondent Firm did not have in place procedures or systems adequate for monitoring the activities of a Floor broker employed by Respondent Firm with respect to the following: procedures to identify the Floor broker's customers, the types of compensation arrangements the Floor broker entered into with his customers, the volume of floor brokerage business he handled for his customers, the amount of commission payments he received from his customers, his daily trading activity, his order tickets and execution reports, his correspondence, his commission bills and the commission payments he received for services rendered. Respondent Firm received a penalty of a censure, \$60,000 fine, and included a requirement that Respondent Firm comply with its undertaking to retain an outside consultant to complete a review and prepare a report of the procedures and systems of follow-up and review adopted by Respondent Firm to prevent a recurrence of the violations found in HPD 00-8, including assuring compliance with Exchange requirements before independent contractors are permitted to act as registered representatives at Respondent Firm.

### **DECISION**

The Hearing Panel, in accepting the Stipulation of Facts and Consent to Penalty, found Respondent Firm guilty as set forth above by unanimous vote.

The Hearing Panel notes that with regard to Count II, failure to comply with the undertaking that was part of a prior disciplinary penalty, the literal wording of the undertaking in In the Matter of Moors & Cabot, Inc, HPD 00-08 (Feb. 1, 2000) requires only that the Respondent Firm retain an outside consultant to review and prepare a report of new procedures and systems and make additional recommendations to the Exchange within ninety days. It does not explicitly provide for actual compliance within a given time frame, or for implementation of the consultant's recommendations.<sup>1</sup> It appears that Respondent Firm hired the outside consultant, who did prepare and submit the report. While in this case, the Hearing Panel views compliance with its Rules as an implicit continuing obligation, and, therefore, will not acquit Respondent Firm of Count II, we caution that in future cases, a separate charge for violation of a prior undertaking must be grounded in a clear description of the shortcoming to be remedied within a certain timeframe, a system for the Exchange to accept the measures undertaken or to require further remedial actions and a way of ensuring that the proposed measures are actually implemented.

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<sup>1</sup> "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 \$60,000, and a requirement to comply with its undertaking to retain an outside consultant, not unacceptable to the Exchange, to complete a review and prepare a report of the procedures and systems of follow-up and review adopted by the Firm to prevent recurrence of the foregoing violations, including (1) to assure compliance with Exchange requirements before independent contractors are permitted to act as registered representatives at the Firm, and (2) to provide reasonable supervision of employees acting as Floor brokers on the Exchange's Trading Floor; make recommendations for additional procedures, if necessary; and submit such report and recommendations to the Exchange within ninety (90) days from the date that this decision becomes final." Id. at 7.

**PENALTY**

In view of the above findings, the Hearing Panel, by unanimous vote, imposed the penalty consented to by Respondent Firm of a censure and a \$250,000 fine.

In imposing the penalty, the Hearing Panel considered the following factors: the duration of the supervisory deficiencies, the nature of the violations, the state of mind of the actors, any remedial steps taken, cooperation of Respondent Firm, Respondent Firm's ability to pay and Exchange precedents. In addition, the Hearing Panel gives great weight to the fact that Respondent Firm was subject to disciplinary action five years ago for substantially similar failures.

Enforcement argues that In the Matter of Nikko Securities Co Int'l, Inc., HPD 91-84 (May 30, 1991) and In the Matter of Nikko Securities Co. Int'l, Inc., HPD 93-104 (July 26, 1003), demonstrate that a subsequent violation, after an initial disciplinary action, may warrant a far greater penalty. In the first Nikko matter, the Firm agreed to a censure and a \$5,000 fine; in a subsequent action brought two years later for substantial similar conduct, the Firm consented to a censure, a \$250,000 fine and an undertaking. The Hearing Panel agrees that a significant increase in penalty may be warranted where the respondent is on notice of its violations from a prior disciplinary action and, nevertheless, engages again in similar conduct.

Respondent Firm was the subject of prior disciplinary action and clearly was on notice of its violations. Yet, less than five years later, it repeated those violations. At the Hearing, counsel for Respondent Firm stated that Respondent Firm lacked the resources to staff its positions fully or to train its employees adequately, although he also acknowledged that this is not an excuse for violating Exchange Rules. In establishing an appropriate fine, Enforcement has taken into account Respondent Firm's ability to pay, as well as the fact that this is a second violation. The Hearing Panel views this penalty as appropriate and not excessive or punitive, and, therefore, imposes the agreed upon penalty.

For the Hearing Panel

Peggy Kuo – Chief Hearing Officer  
Panelists:  
John Cirrito  
George H. Howard