

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 05-111
NOMURA SECURITIES INTERNATIONAL, INC.
MEMBER ORGANIZATION

October 17, 2005

* * *

Violated Section 220.12 of Regulation T of Board of Governors of Federal Reserve System and Exchange Rule 431(b) and (c) by improperly extending credit to customer; violated Rule 15c3-1 under Securities and Exchange Act of 1934 by failing to deduct certain margin maintenance from net capital calculation; violated Rules 17a-3(a)(4)(viii) and 17a-4(b)(1) under Securities and Exchange Act of 1934 and Exchange Rule 440 by failing to preserve and maintain records of equity reverse repurchase transactions for required retention periods; violated Exchange Rules 342(a) and (b) by failing to supervise reasonably a business activity and failing to establish and maintain appropriate procedures for supervision and control with respect to equity reverse repurchase transactions. – Consent to censure and \$400,000 fine.

Appearances:

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

For the Respondent
Wayne M. Carlin, Esq.
Nancy Prahofner, Esq.

* * *

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

- I. Violated Section 220.12 of Regulation T of the Board of Governors of the Federal Reserve System (“Regulation T”) and Exchange Rule 431(b), by improperly extending credit to a customer;
- II. Violated Rule 15c3-1 adopted under the Securities Exchange Act of 1934 (the “1934 Act”), by failing to deduct certain margin maintenance from its net capital calculation;

- III. Violated Rules 17a-3(a)(4)(viii) and 17a-4(b)(1) adopted under the 1934 Act and Exchange Rule 440, by failing to preserve and maintain records of certain equity reverse repurchase transactions for the required retention periods; and
- IV. Violated Exchange Rules 342(a) and (b), in that Respondent Firm failed to supervise reasonably a business activity and failed to establish and maintain appropriate procedures for supervision and control, including a separate system of follow-up and review, with respect to certain business activities relating to certain equity reverse repurchase transactions.

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 has been a member organization of the Exchange since 1981. Respondent Firm is a wholly owned subsidiary of Nomura Holding America, Inc., which is indirectly owned by Nomura Holdings Inc. of Japan. Respondent Firm employs approximately 800 individuals, has approximately four branch offices, has its home office in New York City, and engages in various businesses, including institutional securities brokerage and investment banking.
2. By letter dated November 12, 2003, Enforcement notified Respondent Firm that it was investigating matters that were referred to Enforcement by the Exchange's Division of Member Firm Regulation, following Respondent Firm's report to the Exchange and restatement of its net capital for the months of March and April 2003.
3. Thereafter, Respondent Firm appeared, represented by counsel, and provided documents, information and testimony in connection with the Exchange's investigation.

Summary of Violative Conduct

4. In 2003, Respondent Firm entered into equity reverse repurchase transactions ("equity reverse repos") with a non-broker/dealer that, at the end of a three-month period, increased from approximately \$50 million to \$350 million. As a result of extending 100% financing on the equity reverse repos and recording the transactions on Respondent Firm's books and records as stock borrows, rather than equity reverse repos, Respondent Firm violated: Rule 15c3-1 under the 1934 Act by failing to deduct certain margin maintenance from its net capital calculation; Section 220.19 of Regulation T and Exchange Rule 431(b) and (c), by improperly extending credit to a customer; Rules 17a-3(a)(4)(viii) and 17a-4(b)(1) under the 1934 Act and Exchange Rule 440, by failing to preserve and maintain records of certain equity reverse repurchase transactions for the required retention periods; and Exchange Rules 342(a) and (b), in that Respondent Firm failed to supervise reasonably a business activity and failed to establish and maintain appropriate procedures for supervision and control,

including a separate system of follow-up and review, with respect to certain business activities relating to certain equity reverse repurchase transactions.

Respondent Firm Overextended Margin to a Counterparty, Failed to Report Net Capital Properly, Erroneously Entered Equity Reverse Repurchase Transactions in Its Books and Records, and Failed to Supervise the Activities of a Trading Desk

5. Respondent Firm engaged in equity reverse repos with a pension fund (“PF”) from on or about February 12, 2003 until May 28, 2003.
6. An equity reverse repo is an agreement whereby, as here, PF agreed to sell a portfolio of hundreds of equity securities in exchange for Respondent Firm’s agreement to loan cash equal to the market value of the portfolio, and PF agreed to repurchase the portfolio and return the cash plus interest to Respondent Firm at an unspecified date in the future.
7. On or about February 12, 2003, the first equity reverse repo transaction occurred between Respondent Firm and PF, with a market value on the day of such transaction of approximately \$50 million.
8. The equity securities in PF’ portfolio were marked to market daily over the approximately three-month period of these transactions, and the loan amount was readjusted daily to correspond to the value of the equity securities.
9. PF gradually increased the number and value of the equity securities in the reverse repo’ed portfolio in \$50 million increments, over the course of the period from February 12 to May 28, 2003, to a total of approximately \$350 million.
10. Respondent Firm’s equity reverse repo transactions with PF were financing transactions, not stock lending transactions. The PF equity reverse repos were inaccurately entered as stock borrows on Respondent Firm’s books and records.

Overextending Margin

11. Section 220.12(a) of Regulation T provides that borrowing and lending equity securities transactions with entities that are not broker-dealers are subject to a margin requirement of 50% of the value of the securities in the initial transaction. See Credit by Brokers and Dealers (Regulation T), 12 C.F.R. § 220.12 (2005). Exchange Rule 431(b) provides that, “[f]or the purpose of effecting new securities transactions and commitments, the customer shall be required to deposit margin in cash and/or securities in the account which shall be at least . . . the amount specified in Regulation T”
12. Pursuant to Regulation T and Exchange Rule 431(b), in the initial transaction with PF, Respondent Firm was prohibited from extending more than 50% of the value of the PF

portfolio in financing, and on each day that PF added equity securities in \$50 million increments thereafter.¹

13. Exchange Rule 431(c) provides in relevant part that “[t]he margin which must be maintained in all accounts of customers . . . shall be as follows: (1) 25% of the current market value of all securities”
14. Pursuant to Exchange Rule 431(c), Respondent Firm was prohibited from extending more than 75% of the value of the PF portfolio in financing for each day after the initial \$50 million equity reverse repo and each day after the transaction was increased.
15. The cash loaned by Respondent Firm to PF daily equaled 100% of the value of the equity securities repo’ed to Respondent Firm, exceeding the 50% initial maintenance required by Regulation T and Exchange Rule 431(b) and the 25% maintenance margin required by Exchange Rule 431(c) thereafter. For example, when the reverse repo reached \$350 million, Respondent Firm loaned PF \$350 million.

Reporting Net Capital

16. Rule 15c3-1(c)(2)(iv)(F)(2)(ii)(A) under the 1934 Act requires that “[a]ny margin or other deposits held by the broker or dealer on account of [a] reverse repurchase agreement” be deducted from Respondent Firm’s net capital.
17. Respondent Firm failed to make the deductions associated with the equity reverse repos with PF when reporting its net capital. As a result of overextending credit to PF, Respondent Firm overstated its excess net capital by approximately \$24 million as of February 28, 2003, approximately \$83 million as of March 31, 2003 and approximately \$56 million as of April 30, 2003.

Books and Records

18. Rule 17a-3(a)(4)(vii) under the 1934 Act requires firms to “make and keep current . . . books and records . . . ,” including “[l]edgers (or other records) reflecting . . . [r]epurchase and reverse repurchase agreements” Rule 17a-4(b)(1) under the 1934 Act requires preservation of such records for a certain time period. Exchange Rule 440 requires firms to “make and preserve books and records as the Exchange may prescribe and as prescribed by Rule 17a-3,” for the time periods prescribed by Rule 17a-4.
19. Respondent Firm inaccurately booked the equity reverse repos with PF as stock borrowing transactions.

¹ To clarify, the Hearing Panel notes that Respondent Firm was prohibited from extending more than 50% of the value of each of the \$50 million dollar increments on the respective day on which each such \$50 million increment was added.

Supervisory Failures

20. Exchange Rule 342 requires each member or member organization to supervise each of its offices, departments and business activities, to provide for appropriate procedures of supervision and control and to establish a separate system of follow-up and review.
21. Respondent Firm had inadequate written policies and procedures for the equity repo desk, no written policies or procedures for equity reverse repos, and an inadequate system of control or follow-up with respect to the entry of an equity reverse repo into Respondent Firm's books and records.
22. Respondent Firm's failure to supervise included the following: Respondent Firm entered into an agreement to conduct repos, not stock borrowing and lending transactions; there was no follow-up to compare the repo agreement to how the transactions were entered on Respondent Firm's books and records as stock borrows; the transactions were marked to market and rolled over every day for approximately three months without detection of the trader's inaccurate booking or Respondent Firm's improper extension of credit.
23. Accordingly, Respondent Firm violated Exchange Rules 342(a) and (b), in that Respondent Firm failed to supervise a business activity reasonably and failed to establish and maintain appropriate procedures for supervision and control, including a separate system of follow-up and review, with respect to the equity reverse repos.

Corrective Action Taken By Respondent Firm

24. In May 2003, during a regular internal audit of the equity repo desk, Respondent Firm's internal auditors discovered the erroneous entries of the equity reverse repos as stock borrows.
25. In a telephone call on May 23, 2003, and communications thereafter, Respondent Firm reported to the Exchange the equity reverse repo transactions and its restatement of net capital.
26. Respondent Firm has since closed the equity repo desk.

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.

PENALTY

Respondent Firm has consented to a fine of \$400,000. This amount is in line with the penalties imposed on firms in other cases involving a similar failure to report trading data accurately or to supervise traders appropriately. See In re Spear, Leeds & Kellogg, L.P., Decision 03-108 (N.Y.S.E. Hearing Panel June 9, 2003) (consent to \$450,000 fine and undertaking in case

involving failure to supervise employees who aided and abetted a non-member firm direct-access customer that manipulated price of listed security); In re CS First Boston Corp., Decision 95-98 (N.Y.S.E. Hearing Panel July 18, 1995) (consent to \$450,000 fine and undertaking in case involving failure to supervise program trading desk activities and misreporting of orders). No undertaking is required in this case because the division of Respondent Firm responsible for the wrongful conduct in this case—the so-called “equity repo desk”—has been closed.

In view of the above findings, the Hearing Panel, by unanimous vote, imposed the penalty consented to by Respondent of a censure and a fine of \$400,000.

For the Hearing Panel

Peggy Kuo – Chief Hearing Officer

Panelists:

Richard M. Jablonski

John P. O'Brien