

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 05-112
NOMURA SECURITIES INTERNATIONAL, INC.
MEMBER ORGANIZATION

October 17, 2005

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Violated Exchange Rule 342.17 by failing to ensure that supervisory employees were adhering to Respondent Firm's written policies and procedures on communications to customers and the public; violated Exchange Rule 472(a)(1) by failing to supervise employees' electronic communications to customers or public; violated Exchange Rule 345(a) by permitting unregistered employee to perform duties customarily performed by registered representative; violated section 5(b)(1) of Securities Act of 1933 by failing to prevent employee from disseminating electronic communications regarding new offering during pre-effective period of secondary offering; violated Exchange Rule 440 and Rule 17a-4 under Securities Exchange Act of 1934 by failing to retain attachments to certain e-mails sent or received via Bloomberg's proprietary e-mail system. – Consent to censure and \$400,000 fine.

Appearances:

For the Division of Enforcement
Susan Merrill, Esq.
Virginia Harnisch, Esq.
Radhika Bhargava, Esq.

For the Respondent
John F. Pritchard, Esq.

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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 Exchange Rule 342.17 in that Respondent Firm failed to provide for surveillance and follow-up to ensure that its written policies and procedures on electronic communications with the public were implemented and adhered to by its supervisory employees;
- II. Violated Exchange Rule 472(a)(1) in that, on one or more occasions, Respondent Firm failed to ensure that one or more employees' electronic communications to customers or the public constituting sales literature and/or market letters were properly reviewed and approved;

- III. Violated Exchange Rule 345(a) in that Respondent Firm permitted an unregistered individual to perform duties customarily performed by a registered representative;
- IV. Engaged in conduct inconsistent with just and equitable principles of trade in that Respondent Firm, on one or more occasions, through one or more employees, improperly distributed to the public a prospectus, as defined in Section 2a(10) of the Securities Act of 1933 (the “1933 Act”), prior to the effective date of registration of a secondary offering in violation of Section 5(b)(1) of the 1933 Act;
- V. Violated Exchange Rule 342 in that Respondent Firm failed to supervise reasonably one or more employees to prevent violations of the 1933 Act; and
- VI. Violated Exchange Rule 440 and Rule 17a-4 under the Securities Exchange Act of 1934 (the “1934 Act”) in that the Firm failed to retain certain electronic mail message attachments transmitted via Bloomberg “inet” service to and from its employees.

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, a New York corporation, is a member organization of the Exchange. Respondent Firm engages in businesses including sales of domestic and foreign equities, equity finance, and investment banking.
- 2. In October, 2002 Respondent Firm reported to the Exchange the circumstances surrounding its termination of two employees as set forth in more detail in paragraphs 31 to 44 below. By a letter dated December 11, 2003, Enforcement notified Respondent Firm that Enforcement’s pending investigation of the termination included an investigation of Respondent Firm’s supervision.

Summary of Violative Conduct

- 3. From September 2001 through September 2002, in violation of Exchange Rule 342.17, Respondent Firm failed to provide for reasonable surveillance and follow-up to ensure that its supervisory employees were implementing and adhering to Respondent Firm’s written policies and procedures on communications to customers and the public. Respondent Firm further failed, in violation of Exchange Rule 472(a)(1), to ensure that certain employees’ electronic communications to customers or the public constituting sales literature and/or market letters received proper supervisory review and approval. One such employee was unregistered, yet the Firm permitted him to perform duties customarily performed by a registered representative, in violation of Exchange Rule 345(a).

4. In September 2002, during the pre-effective period of a secondary offering of XYZ Corp. equity securities, several Respondent Firm employees sent to Respondent Firm customers several electronic communications concerning the offering that were in violation of Section 5(b)(1) of the 1933 Act. Respondent Firm, which served as the co-lead underwriter of the XYZ Corp. secondary offering, failed to supervise reasonably its employees to prevent violations of the 1933 Act.
5. In addition, Respondent Firm permitted its employees to use Bloomberg LP (“Bloomberg”)’s proprietary e-mail system for business purposes. Although Respondent Firm attempted to retain all attachments to Bloomberg messages sent or received by its employees, it failed to retain attachments to certain e-mails sent or received by its employees via Bloomberg’s proprietary e-mail system in violation of Exchange Rule 440 and Rule 17a-4 under the 1934 Act.

Respondent Firm’s Supervisory Failures With Respect to Electronic Communications to Customers or the Public

6. Exchange Rule 472(a)(1) provides in pertinent part that “[e]ach advertisement, market letter, sales literature or other similar type of communication which is generally distributed or made available by a member or member organization to customers or the public must be approved in advance by a member, allied member, supervisory analyst, or qualified person designated under the provisions of [Exchange] Rule 342(b)(1).” The Exchange’s Board of Directors has held that “[d]istribution to two or more persons satisfies the ‘generally distributed’ or ‘made available...to customers or the public’ standard of [Exchange] Rule 472(a). . . .” In re Jennifer Byron, Decision BPD 01-135, at 2 (N.Y.S.E. Hearing Panel Apr. 4, 2002).
7. Exchange Rule 472.10(4), prior to its amendment in July 2003, provided as follows:

“Market letters” are defined as, but are not limited to, any written comments on market conditions, individual securities, or other investment vehicles. They also include “follow-ups” to research reports and articles prepared by members or member organizations which appear in newspapers and periodicals.
8. Exchange Rule 472.10(5) defines “[s]ales literature” to include:

[W]ritten or electronic communications including, but not limited to, telemarketing scripts, performance reports or summaries, form letters, seminar texts, and press releases discussing or promoting the products, services and facilities offered by a member or member organization, the role of investment in an individual’s overall financial plan, or other material calling attention to any other communication.

9. Although a member or member organization may permit its employees, without pre-use review and approval, to distribute certain communications to customers or the public, Exchange Rule 342.17 provides that such member or member organization must, among other requirements, provide for surveillance and follow-up to ensure that its policies and procedures governing pre-use review and approval of written communications are being implemented and adhered to by its employees.
10. During the period of September 2001 through September 2002, Respondent Firm permitted RR, the registered representative who headed its Japanese Equities Derivative Sales Desk (the "Derivative Sales Desk") to work from late afternoon to early morning (i.e., from approximately 5:30 p.m. to 2:30 a.m. EST) so that he would be able to conduct business when the Japanese securities markets were open.
11. Respondent Firm caused RR to report jointly to ST, then the co-head of Respondent Firm's Equities Sales Division with supervisory responsibility for international equities sales, and AV, then the head of the Firm's Equity Finance Division and the co-head of Respondent Firm's Equities Sales Division with supervisory responsibility for domestic equities sales. Respondent Firm delegated to both ST and AV the supervisory responsibility for RR's written communications to customers and the public.
12. During the period of September 2001 through September 2002, ST generally left the office at 8:00 p.m. EST, and AV generally left the office at 5:30 p.m. EST. Respondent Firm did not make specific provision for a supervisor with authority to review and approve written communications to be available on-site to RR after ST's and AV's departures from the office, although RR did have telephonic and e-mail access to his supervisors.
13. During the period of September 2001 through September 2002, one of RR's job responsibilities was to market arbitrage trading strategies, such as Japanese equities pairs trading strategies, to institutional investor clients of the Derivative Sales Desk. Respondent Firm issued formal research reports, prepared or approved in advance by qualified supervisory analysts, concerning arbitrage trading. RR, however, in addition to disseminating the Firm's research reports, regularly transmitted electronically to customers his own analysis of arbitrage trading strategies and his recommendations as to particular trades. RR had a customized group distribution list, consisting of numerous institutional customers of Respondent Firm and several Respondent Firm employees, including ST, to which he sent such e-mails.
14. Many of RR's arbitrage trading strategy e-mails included his comments on market conditions and individual securities and, therefore, constituted market letters. For example, on April 1, 2002, RR disseminated to his group distribution list an e-mail with the subject line, "BUY 1111 AND SHORT 2222,"¹ which read in pertinent part:

¹ Japanese securities are sometimes referred to by the issuer's company code and not by the issuer's name. [The Hearing Panel has changed the number of any company code herein, as well as any actual company name.]

1111 has been sold off as the economy slowed, and electric rates were cut 7%. 2222 has fallen less as the kansai region is a little stronger and kansai's [sic] investment in AAA a BBB telecom service company may provider [sic] some growth. But any profits from that are far off and a lot of capital investment still needs to happen. Now would be a good time to buy 1111 and sell 2222 at 1.32 or lower and expect the ratio to trade back to it's [sic] normal range of 1.4 to 1.55...

15. Numerous other arbitrage trading strategy e-mails of RR, if not market letters, at a minimum, constituted sales literature because they included performance reports or summaries promoting arbitrage trades. For example, on May 7, 2002, RR disseminated to his group distribution list an e-mail with the subject line, "Buy 3333 and Sell 4444," which read:

Attached please find a chart of the ratio of 3333 to 4444 for the past 14 months. We have a BUY rating on 3333 and a REDUCE on 4444. 3333 has come under pressure recently after the President of 3333 indicated they would not enter the private mail deliver [sic] business that is currently run by the government. This deflated profit hopes. We think 3333 has great profit opportunities in it's current business and expansion into China and the rest of Asia. The relative performance of 3333 stock vs. 4444 is at a year and a half low, and other then a brief period in the final quarter of 2000 we'd have to go back 3 years to see these levels. BUY 3333 and SHORT 4444 at a ratio of 3.9 or lower.

16. RR never submitted his arbitrage trading strategy e-mails to ST or AV for approval in advance of disseminating such communications to customers.
17. ST, as a member of RR's group distribution list, received RR's arbitrage trading strategy e-mails upon their dissemination to customers.
18. AV, although not a recipient of RR's arbitrage trading strategy e-mails, knew that RR, when electronically disseminating Respondent Firm research reports to customers, commonly would include his own discussion of arbitrage trading strategies.
19. ST and AV failed to direct RR to cease disseminating his arbitrage trading strategy e-mails to customers without supervisory pre-approval.
20. Respondent Firm's Compliance Department did not provide any advice or instruction to ST, AV, or RR concerning RR's performance of his job responsibilities at night in the absence of an on-site supervisor qualified to review and approve his written communications to customers. Respondent Firm did not provide any modified or enhanced supervision to RR.

21. In 2001, RR began to work with an unregistered employee of Respondent Firm's Equity Finance Department, NR, who worked during regular business hours EST.
22. Exchange Rule 345(a) provides, in relevant part, that a member or member organization shall not "permit any natural person to perform regularly the duties customarily performed by (i) a registered representative . . . unless such person shall have been registered with, qualified by and is acceptable to the Exchange." The duties customarily performed by a registered representative include engaging "in the solicitation or handling of accounts or orders for the purchase or sale of securities...." Exch. R. 10.
23. AV, as well as Respondent Firm's Compliance Department, understood that NR was forwarding RR's arbitrage trading strategy e-mails of the previous night to additional Firm customers with operations during regular business hours, and that NR was assisting RR with respect to such customers by performing duties customarily performed by a registered representative, such as by soliciting orders for the purchase or sale of securities.
24. Respondent Firm did not provide NR with any training concerning the business that he conducted for the Derivative Sales Desk. Respondent Firm did not cause NR to become a registered representative until July 2002.
25. Respondent Firm delegated to AV the supervisory responsibility for NR's written communications to customers.
26. NR never submitted e-mails containing RR's arbitrage trading strategy to AV for approval in advance of forwarding such communications to additional customers of the Firm.
27. AV never instructed NR not to disseminate the arbitrage trading strategy e-mails to customers without supervisory pre-approval.
28. Respondent Firm had an e-mail surveillance system that filtered employees' e-mails and automatically selected for supervisory, post-transmission review any e-mail containing certain terms. ST and AV had responsibility for conducting a post-transmission review of RR's e-mails selected by the surveillance system. AV had responsibility for conducting a post-transmission review of NR's e-mails selected by the surveillance system. The surveillance system captured for review, among other e-mails, some of the arbitrage trading strategy e-mails.
29. Respondent Firm failed to detect that ST and AV permitted RR to disseminate regularly to multiple Respondent Firm customers, and that AV permitted NR to disseminate regularly to multiple Respondent Firm customers, e-mails constituting market letters and sales literature that had not received any pre-use review and approval by a qualified supervisor. Although Respondent Firm monitored whether its supervisors performed timely post-transmission reviews of e-mails captured by Respondent Firm's e-mail surveillance system, Respondent Firm did not employ any system to review and monitor whether its designated supervisors, such as ST and AV, were performing pre-use reviews of written communications where required.

30. Respondent Firm failed to ensure that ST and AV understood what kinds of communications were subject to pre-use review and approval pursuant to the Exchange’s rules and Respondent Firm’s written policies and procedures concerning communications to customers or the public.

Respondent Firm’s Written Communications to Customers Were in Contravention of the Securities Act of 1933

31. Section 5(b)(1) of the 1933 Act regulates written offers to sell a security during the pre-effective period of a public offering (i.e., the period between the filing of an offering registration statement with the Securities and Exchange Commission (“SEC”) and the SEC’s declaration of the registration statement’s effectiveness). Section 5(b)(1) prohibits any “person”² from directly or indirectly:

[M]ak[ing] use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 10 [of the 1933 Act]

15 U.S.C. § 77e(b)(1). Section 2(a)(10) of the 1933 Act broadly defines “prospectus” to mean, in relevant part, “any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security” 15 U.S.C. § 77b(a)(10).

32. Rule 134 promulgated under the 1933 Act provides that the term “prospectus” as defined in Section 2(a)(10) of the 1933 Act shall not include any written communication transmitted during the pre-effective period if it includes “only the statements required or permitted to be included therein by the following provisions of this section” 17 C.F.R. § 230.134. Such permissible statements, which are commonly referred to as “tombstone information,” include: the issuer’s name; the number of shares subject to the offering; a brief description of the issuer’s business; the price of the security, the method of price determination, or the probable price range; the names of the managing underwriters; and the anticipated offering date. See 17 C.F.R. § 230.134.
33. Rule 134 promulgated under the 1933 Act further excepts from the definition of “prospectus” a written communication requesting the recipient’s indication of interest in the offering provided that, inter alia, it is “accompanied or preceded” by the offering’s formal preliminary prospectus (i.e., “red herring” prospectus) authorized by Section 10(b) of the 1933 Act. See 17 C.F.R. § 230.134(d).

² Pursuant to Section 2(a)(2) of the 1933 Act, “[t]he term ‘person’ means an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organization, or a government or political subdivision thereof.” 15 U.S.C. § 77b(a)(2).

34. XYZ is a Japanese corporation whose common stock is listed on the Tokyo Stock Exchange (code: 5555), and whose American Depository Shares (“ADSs”) are listed on the Exchange.
35. On July 22, 2002, XYZ filed a registration statement with the SEC for a secondary offering of 2.7 million ADSs. Respondent Firm was appointed a joint lead underwriter and the bookrunner (i.e., had principal allocation responsibilities) for the XYZ secondary offering. The registration statement for the XYZ secondary offering was not declared effective by the SEC until September 30, 2002.
36. During the pre-effective period of the XYZ secondary offering, several employees of Respondent Firm, including RR and NR, sent e-mails to Respondent Firm customers soliciting indications of interest in the offering that were not accompanied or preceded by the offering’s formal preliminary prospectus. Some of their e-mails explicitly acknowledged the absence of any preliminary prospectus with language such as, “I will send you the prospectus as soon as it will be available” and “I will send you a prospectus by mail.”
37. Also during the pre-effective period of the XYZ secondary offering, on September 25, 2002, RR sent to his group distribution list, including ST and NR, an e-mail recommending a pairs trading strategy involving equity securities of XYZ and ABC. In addition to containing tombstone information about the XYZ secondary offering, the e-mail solicited customers’ participation in the offering as part of the pairs trade recommendation:

The book for XYZ will be open until 9/30 at least maybe a day or so more. The stock have [sic] fallen 28% in the past 4 weeks and is now looking very cheap. (See chart attached). The book has had a flurry of orders in the past 24 hours and now is covered approx. 1.5 times with several days still go to.

we are bullish on the company (go figure, as we are the lead on their offering). The stock is now cheap to it’s [sic] competitor 6666³ (HOLD). The ratio of 5555/6666 is at the very bottom of it’s [sic] range. It’s 1.7 sdev’s off it’s [sic] 6 month mean, and correlation in this time frame is 77%. As 5555 places it’s [sic] secondary offering the over hang on the stock will disappear, bouncing the stock back. The pricing of the 5555 deal is expected Oct. 1st - 3rd. It would be a good time to buy 5555 and short 6666. Buy 5555 through the secondary offering for the added benefit [sic] of the discount related to the offering.

(Emphasis added.)

³ 6666 is the company code for ABC.

38. ST, despite his receipt of this e-mail, failed to detect that RR had solicited customers in writing to participate in the XYZ secondary offering.
39. On September 26, 2002, NR forwarded RR's arbitrage trading strategy e-mail soliciting customers' participation in the XYZ secondary offering to additional Respondent Firm customers.
40. The foregoing solicitations were made in violation of written Respondent Firm policies and a specific e-mail notification to RR and NR, among others, that XYZ had been placed on Respondent Firm's restricted list.
41. On September 27, 2002, an employee of Respondent Firm's Compliance Department, during the course of a routine review of e-mails captured by Respondent Firm's surveillance system, discovered that an e-mail soliciting customers' participation in the XYZ secondary offering had been disseminated to multiple Firm customers.
42. On the next business day, Respondent Firm instructed RR and NR to attempt to retract all copies of their e-mails soliciting customers' participation in the XYZ secondary offering. Subsequently, Respondent Firm informed customers who had received RR's and NR's e-mails that they would not be eligible to receive an allocation of the XYZ offering.
43. Respondent Firm terminated the employment of RR and NR and reported the matter to both the Exchange and the Securities and Exchange Commission, as it was obligated to do. Respondent Firm has cooperated with the investigation that the staff of the Exchange has conducted with respect to the matter.
44. On October 1, 2002, Respondent Firm held a continuing education session for its salespeople discussing requirements for communications in connection with public offerings. Respondent Firm has also enhanced its e-mail surveillance system to identify communications readily about companies that appear on its restricted list.

Respondent Firm's Failure To Retain Bloomberg E-mail Attachments

45. Exchange Rule 440 provides that "[e]very member not associated with a member organization and every member organization shall make and preserve books and records as the Exchange may prescribe and . . . [t]he recordkeeping format, medium and retention period shall comply with Rule 17a-4 under the [1934 Act]." Rule 17a-4 requires preservation for not less than three years of "[o]riginals of all communications received and copies of all communications sent . . . by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such" 17 C.F.R. § 240.17a-4(b)(4).

46. Members and member organizations must “ensure that all . . . e-mails . . . that relate to the firm’s business as such must be maintained and retained Any records maintained electronically must be in a non-rewriteable, non-erasable format, i.e., WORM (‘Write Once, Read Many’).” Electronic Logs and Record Retention, Exchange Information Mem. 03-7 (Mar. 5, 2003); see also 17 C.F.R. § 240.17a-4(f)(2)(ii)(A) (requiring such records to be preserved “exclusively in a non-rewritable, non-erasable format”).
47. Respondent Firm, at all relevant times, has permitted its employees to use Bloomberg’s proprietary e-mail system to conduct business. Respondent Firm’s employees have sent and received standard Bloomberg messages as well as “inet” messages, which are messages between a Bloomberg e-mail account and an external (i.e., non-Bloomberg) e-mail account, in the course of performing their job responsibilities.
48. Prior to July 2003, Respondent Firm understood Bloomberg to be archiving attachments to e-mails transmitted via Bloomberg’s proprietary e-mail system. Respondent Firm also understood Bloomberg to have the ability to retrieve any such attachments as needed by Respondent Firm. In July 2003, however, Respondent Firm learned that its understandings were incorrect: in fact, Bloomberg was not archiving e-mail attachments.
49. In July 2003, Respondent Firm began downloading and archiving transfer files from Bloomberg that it believed contained every Bloomberg attachment. In May 2004, Respondent Firm learned that the “inet” attachments were not included in the transfer file, but had to be separately downloaded. Thereupon, Respondent Firm began to download “inet” attachment files from Bloomberg for writing to WORM format optical disk storage.

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 falls within a range of penalties imposed by the Exchange and other regulators on large-sized firms, such as Respondent Firm, involving analogous violations. See In re Goldman, Sachs & Co., Exchange Act Release No. 49,953, 83 S.E.C. Docket 442, 2004 WL 1476147 (July 1, 2004) (\$2 million fine where respondent’s sales traders sent e-mails to numerous customers regarding pending stock offerings during so-called “waiting period”); In re Citigroup Global Markets Inc., Decision 05-23 (N.Y.S.E. Hearing Panel Jan. 28, 2005) (\$350,000 fine for failure to supervise institutional sales employees who sent out misleading e-mail to several customers causing misperception that firm analyst had downgraded certain stock). See also In re HSBC Secs. (USA) Inc., Decision 04-190 (N.Y.S.E. Hearing Panel Dec. 15, 2004) (\$500,000 fine for failure to retain electronic communications as required under Exchange Rule 440 and Rule 17a-4 under Securities Exchange Act of 1934 and failure to report violation promptly).

The misconduct with regard to electronic communications in this case involved numerous customers. While Respondent Firm did not discover that “inet” attachments were not included in the transfer files until a year after it began downloading and transferring those files, it thereupon took prompt remedial action. See supra ¶¶ 48-49. In addition, Respondent Firm has taken steps to prevent violations in the future, including employee training and better supervision regarding communications in connection with public offerings. See supra ¶ 44.

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