

NEW YORK STOCK EXCHANGE LLC

NYSE HEARING BOARD DECISION 07-28

March 8, 2007

FIRST CLEARING, LLC

MEMBER ORGANIZATION

* * *

Violated NYSE Rule 452 by submitting votes for more shares than it was entitled to vote in proxy matters; failed to implement adequate policies and procedures to accurately adjust its record of stock ownership to ensure that it did not vote more shares than it was entitled to vote in proxy matters, submitted votes for more shares than it was entitled to vote in proxy matters; violated NYSE Rule 401 by failing to reconcile record of stock ownership to ensure that it did not vote more shares than it was entitled to vote in proxy matters; violated Exchange Act Section 15(c) and Rule 15c3-3 thereunder by improperly computing Customer Reserve Formula and PAIB Reserve Formula requirements; violated Exchange Act Section 15(c) and Rule 15c3-1(c)(2) thereunder in that it incorrectly calculated required Net Capital Computation; violated Exchange Act Section 17(a) and Rule 17a-5 thereunder by filing an inaccurate FOCUS Report with NYSE; violated Exchange Act Section 17(a) and Exchange Act Rules 17a-3 and 17a-4 and NYSE Rule 440 by failing to maintain books and records regarding accounts necessary for computation of net capital, Customer Reserve Formula, and PAIB Reserve Formula requirements; violated NYSE Rule 440.20 by failing to maintain proper records identifying suspense accounts and not having procedures in place for supervisory review of suspense accounts; violated NYSE Rule 132.30 by failing to submit to NYSE accurate account type indicators with respect to certain transactions; violated NYSE Rule 342 (a) by failing to supervise proxy operations to prevent over-voting, (b) failing to provide for and implement adequate written procedures for proxy operations and supervision of the proxy function, (c) failing to provide for and implement written procedures for supervision of its proxy service provider and, (d) failing to provide for appropriate procedures of supervision and control and to establish a system of follow-up and review to prevent the foregoing customer reserve, PAIB, net capital, and audit trail violations – Consent to censure and \$325,000 fine.

Appearances:

For the Division of Enforcement
 Susan Light, Esq.
 Steven Korostoff, Esq.
 Suzanne Elovic, Esq.
 Jacqueline Davis, Esq.
 Jeremy Bloom, Esq.
 Steven Tanner, Esq.

For Respondent
 Howard Elisofon, Esq.

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A Hearing Officer on behalf of the New York Stock Exchange LLC (“NYSE”) considered a Stipulation of Facts and Consent to Penalty entered into between NYSE Regulation, Inc.’s Division of Enforcement (“Enforcement”) and First Clearing, LLC (“Respondent” or the “Firm”), an NYSE member organization. Without admitting or denying guilt, Respondent consented to a finding by a Hearing Officer that it:

I. Proxy violations:

1. Violated NYSE Rule 452 by, on one or more occasions, submitting votes for more shares than it was entitled to vote in proxy matters.
2. Engaged in conduct inconsistent with just and equitable principles of trade by:
 - a. failing to implement adequate policies and procedures to accurately adjust its record of stock ownership to ensure that it did not vote more shares than it was entitled to vote in proxy matters; and,
 - b. submitting votes for more shares than it was entitled to vote in proxy matters
3. Violated NYSE Rule 401 by failing to adhere to the principles of good business practices by failing to reconcile its record of stock ownership to ensure that it did not vote more shares than it was entitled to vote in proxy matters.

II. Customer Reserve, PAIB, Net Capital, and Audit Trail Violations:

4. Violated Exchange Act Section 15(c) and Rule 15c3-3 thereunder by improperly computing its Customer Reserve Formula and PAIB Reserve Formula requirements.
5. Violated Exchange Act Section 15(c) and Rule 15c3-1(c)(2) thereunder in that it incorrectly calculated its required Net Capital Computation.

6. Violated Exchange Act Section 17(a) and Rule 17a-5 thereunder by filing an inaccurate FOCUS Report with the NYSE.
7. Violated Exchange Act Section 17(a) and Exchange Act Rules 17a-3 and 17a-4 and NYSE Rule 440 by failing to maintain books and records regarding its accounts necessary for computation of its net capital, Customer Reserve Formula, and PAIB Reserve Formula requirements;
8. Violated NYSE Rule 440.20 by failing to maintain proper records identifying suspense accounts and not having procedures in place for supervisory review of suspense accounts.
9. Violated NYSE Rule 132.30 by failing to submit to the NYSE accurate account type indicators with respect to certain transactions.

III. Failure to Supervise:

10. Violated NYSE Rule 342 by:
 - a. failing to supervise proxy operations to prevent over-voting;
 - b. failing to provide for and implement adequate written procedures for proxy operations and supervision of the proxy function,
 - c. failing to provide for and implement written procedures for supervision of its proxy service provider; and,
 - d. failing to provide for appropriate procedures of supervision and control and to establish a system of follow-up and review to prevent the foregoing customer reserve, PAIB, net capital, and audit trail violations.

For the sole purpose of settling this disciplinary proceeding, without adjudication of any issues of law or fact, and without admitting or denying any allegations or findings referred to in the Stipulation of Facts and Consent to Penalty, Respondent stipulates to certain facts, the substance of which follows:*

* Hearing Officer Note: The facts, allegations, and conclusions contained in paragraphs 1 to 56 are taken from the executed Stipulation of Facts and Consent to Penalty between Enforcement and Respondent. No changes have been made to the stipulated paragraphs by the Hearing Officer.

Background and Jurisdiction

1. First Clearing, LLC, a member organization of the NYSE, is the successor to First Clearing Corporation, and is a wholly owned subsidiary of Wachovia Securities Financial Holdings LLC. The Firm carries approximately 8 million retail and institutional customer accounts for approximately 115 correspondents.
2. In or around July 2005, the NYSE Regulation Division of Member Firm Regulation (“MFR”) referred to Enforcement its findings contained in a special proxy examination of the Firm. The results, contained in the “Report on the Special Examination of First Clearing LLC,” dated September 24, 2004 (the “Special Report”), noted certain deficiencies related to the operations and supervision of the proxy function at the Firm.
3. By letter dated February 10, 2005, which the Firm received, Enforcement notified the Firm that it was investigating the matters set forth in MFR’s report.
4. On or about February 1, 2006, Enforcement issued a Charge Memorandum in connection with the proxy matters contained in the Special Report, and on or about March 17, 2006, the Firm filed an Answer.
5. Additionally, in September and October 2004, MFR conducted an examination of the Firm’s compliance with financial and operational requirements (the “2004 FinOp Exam”). The conclusions of the 2004 FinOp Exam were set forth in a report issued to the Firm by MFR dated December 21, 2004, which was referred to Enforcement.
6. By letter dated September 15, 2005, which the Firm received Enforcement notified the Firm of its investigation of the matters set forth in the 2004 FinOp Exam.

Overview

7. This matter involves violations by the Firm of matters pertaining to proxy voting. Beginning prior to January 2003, and through June 2004, the Firm submitted more votes than it was entitled to vote in proxy matters (“over-voting”). The over-voting was caused by the Firm’s failure to exclude from the vote long shares that, because they had been loaned out, were not in the Firm’s possession or control. Also contributing to the over-voting was the failure of the Firm to timely reconcile stock records of beneficial ownership in connection with proxy voting.
8. This matter also involves various violations of the Firm’s financial and operational requirements. In connection with its customer reserve account, the Firm overstated its Excess Customer Debits Over Credits by approximately \$30,000,000 in its Customer Reserve Formula Computation in its August 31, 2004 Financial and

Operational Combined Uniform Single Report (“FOCUS Report”), and overstated its Excess Customer Debits Over Credits by \$43,430,341 in its weekly Reserve Formula Computation as of September 17, 2004. The Firm also understated Excess Credits Over Debits in its Proprietary Account for Introducing Brokers (“PAIB”) Reserve Formula Computation in the August 31, 2004 FOCUS Report, and overstated Excess Credits Over Debits in its weekly PAIB Reserve Formula Computation for September 17, 2004. Also in its Customer Reserve and PAIB computations, the Firm failed to include overdraft balances in two accounts, overstated outstanding checks, misclassified accounts, calculated certain balances as of the wrong date, failed to determine the aggregate value of stock included in margin securities, improperly included accrued commissions payable, and failed to include certain securities positions. The Firm also committed violations pertaining to its net capital requirements by incorrectly calculating net capital charges for aged unfavorable differences in two bank accounts and by failing to take the proper net capital charges on all aged unresolved suspense items, resulting in the Firm overstating its excess net capital by \$14,676,565. Additionally, the Firm committed violations with regard to the audit trail requirements by failing to submit to the NYSE accurate account type indicators.

9. The Firm also failed to reasonably supervise and control its business activities relating both to the proxy processing function and its financial and operational requirements. In connection with proxy processing, the Firm failed to reasonably supervise proxy operations to prevent the submission of more votes than it was entitled to, implement adequate written procedures for proxy operations and supervision of the proxy processing function, or to implement written procedures for supervision of its proxy process provider. In connection with its financial and operational requirements, the Firm failed to establish, and maintain adequate procedures and controls, including a system of follow-up and review of certain of its business activities in order to prevent net capital and customer reserve violations.

PROXY MATTERS

Summary of The Proxy Process

10. When securities are held by a member organization in street name on behalf of a customer, the member organization is required, pursuant to NYSE Rule 451, to transmit proxy solicitation materials to the customer.
11. Pursuant to NYSE Rule 452, a member organization is required to “give or authorize the giving of a proxy to vote stock registered in its name, or the name of its nominee, at the direction of the beneficial owner.”
12. To accomplish the obligations embodied in NYSE Rule 452, member organizations must collect and transmit to the issuer any voting instructions furnished by its customer shareholders of the security for which proxies are solicited. Member

organizations typically contract with a proxy service provider to distribute the proxy materials, collect the voting instructions from shareholders, and transmit those instructions to the transfer agent engaged by the issuer to tabulate the votes (the “Tabulator”).

13. Matters in which a firm may vote without customer instructions and matters which it may not are set forth in NYSE Rules 452.10 and 452.11. For certain routine matters included on corporate ballots, proxies may be voted by a member organization, on a discretionary basis, absent the receipt of votes cast by shareholders.
14. For each proxy solicitation, the Tabulator compares the proxy votes submitted on behalf of the member organization and/or its customers with the number of shares reflected on the records of the Depository Trust Clearing Corporation (“DTC”) for the member organization on the applicable record date. The number of shares showing on the records of DTC for the member organization, with certain adjustments, is the maximum number of shares (votes) that will be tallied by the Tabulator in determining the outcome of the proxy vote. If a member organization submits to the Tabulator more shares than are shown for the member organization on the records of DTC, and they are not held at another depository or in physical form at the Firm, then it may have over-voted.¹
15. There are no standard industry procedures that govern the Tabulator’s approach to dealing with over-voting. Tabulators may respond to over-votes with a variety of vote-counting procedures, including counting votes on a “first in-first voted” or “last in-first voted” basis, or disregarding altogether a vote submitted by a broker-dealer. Depending on the procedure implemented by the Tabulator, certain customers’ voting instructions may not be represented as originally given.
16. Failure to timely reconcile stock records on beneficial ownership may result in inaccurate instructions being given to the proxy service provider. Failure to perform proper reconciliations may result in the allocation of more votes to customers than is proper.

Over-Voting by the Firm

17. During the period from at least January 2003 through June 2004 (the “Relevant Period”), the Firm employed a proxy service provider (the “Agent”) to perform its proxy obligations.
18. The Agent received notice of pending proxy actions on behalf of the Firm, accessed the Firm’s stock record to identify Firm accounts that held an issuer’s securities on

¹ As used herein, “over-voting” by a broker-dealer means that the broker-dealer’s services provider submitted proxies for more shares than the broker-dealer was entitled to vote on a specific proxy matter and does not mean that the Tabulator necessarily counted these over-voted shares in determining the outcome of the proxy matter.

the record date, and determined the number of shares that were eligible to vote in the proxy vote. It then arranged with the issuer or its agent, the Tabulator, to obtain the appropriate number of copies of the proxy-related material, which it then forwarded to the beneficial owners of the issuer's security. Proxy instructions were generally returned directly to the Agent, which then reported the votes to the Tabulator.

19. At all times, the Agent acted pursuant to instructions from the Firm.
20. The outsourcing of its proxy function to the Agent, as set forth above, did not relieve the Firm of the regulatory responsibility for compliance with the NYSE rules relating to the operation and supervision of the proxy function.
21. For 2003 and 2004, the Special Report and subsequent Enforcement investigation identified seven instances out of fifteen sampled in which the Firm had over-voted, *i.e.*, the Firm submitted more proxy votes than it was entitled to cast in connection with the proxy solicitation. In March 2003, for example, the Firm submitted voting instructions for a total of 9,446,917 shares in a proxy matter involving Wells Fargo & Company ("Wells Fargo") (record date March 4, 2003). As of the record date, according to the information maintained at the DTC, the Firm was in fact eligible to vote only 9,428,636 shares. Thus, the over-vote was approximately 18,281 shares.
22. The above-mentioned over-voting was caused by the Firm's failure to exclude from the vote long shares that, because they had been loaned out, were not in the Firm's possession or control.
23. During the Relevant Period, the Firm did not subscribe to an over-vote service offered by the Agent. This service compares a broker-dealer's DTC position with the voting instructions submitted by that broker-dealer through the Agent and notifies the broker-dealer if instructions to vote shares exceed that position. This notification permits broker-dealers to examine their records and to adjust (when appropriate) their records with the position reflected on DTC's records.
24. Enforcement's investigation did not disclose any instance in which an over-vote affected the outcome of a proxy vote or any instance in which a shareholder who attempted to vote his or her shares was disenfranchised.
25. However, by submitting an over-vote, the Firm subjected its customers to the risk that their proxy votes would not be accepted by the Tabulator.

Failure to Supervise

26. Pursuant to NYSE Rule 342(a), "each office, department, or business activity of a member or member organization...shall be under the supervision and control of the member or member organization establishing it..." Pursuant to NYSE Rule 342(b), each member organization, through its designees, is required to "provide for appropriate procedures of supervision and control" and to "establish a separate

- system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.”
27. During the Relevant Period, the Firm did not implement adequate written operational or supervisory procedures relating to its proxy activities, and did not maintain written procedures relating to proxy reconciliations.
 28. During the Relevant Period, the Firm’s failure to reconcile the stock record resulted in the Firm submitting to the Tabulator more votes than it was entitled to vote.
 29. During the Relevant Period, the Firm did not provide for and did not implement written procedures for the supervision of the Agent responsible for handling certain proxy functions.
 30. The Firm did not reasonably supervise its proxy operations to prevent over-voting. Specifically, the Firm (a) failed to implement adequate procedures to reconcile and adjust its records of beneficial ownership; (b) did not transmit to the Agent accurate information in connection with proxy matters; (c) did not assure that its systems and procedures provided for the accurate submission of proxy data to proxy tabulators; and (d) submitted voting instructions for more shares than it was entitled to vote in proxy matters.

FINANCIAL AND OPERATIONAL MATTERS

Customer Reserve Computations

31. The Firm’s FOCUS Reserve Formula Computation as of August 31, 2004 overstated the Firm’s Excess Customer Debits Over Credits by approximately \$30,000,000. The Firm’s weekly Reserve Formula Computation as of September 17, 2004 overstated the Firm’s Excess Customer Debits Over Credits by \$43,430,341.
32. Exchange Act Rule 15c3-3 requires, in part, that a broker-dealer maintain a special reserve bank account for the exclusive benefit of customers. The account must be funded through deposits of cash and/or qualified securities in amounts computed weekly in accordance with the formula set forth in the rule.
33. The Firm understated its Debits for partly secured and unsecured accounts by \$2,509,760 because it calculated these amounts as of August 30, 2004 instead of as of August 31, 2004.
34. The Firm overstated its Debits for its control and restricted securities by \$58,476 because it used the value of the securities as of July 31, 2004 rather than August 31, 2004. The charge to Debits for July 31, 2004 was \$1,339,993 whereas the charge for August 31, 2004 was \$1,398,469.

35. Exchange Act Rule 15c3-3 (Exhibit A- Item 1)/20 states that, subject to certain exceptions, checks drawn in excess of a bank balance must be included in the Reserve Formula, whether or not the amount is used for customer payments.
36. Overdraft balances in two accounts in the amounts of \$50,561,481 and \$4,168,234, were not included in the Firm's August 31, 2004 Customer Reserve Formula Computation. This caused the Firm to understate its Credits as of August 31, 2004 by \$54,715,715. The same error caused the firm to understate its Credits in its September 17, 2004 Weekly Reserve Computation by \$98,621,689.
37. Exchange Act Rule 15c3-3(k)(2)(ii)/017 requires, in relevant part, that when a broker-dealer writes checks to its customers drawn on a bank account of its clearing firm, the clearing firm must include outstanding checks payable to the customers of the correspondents as a Credit in its Reserve Formula Computation.
38. The Firm overstated outstanding checks issued by an Introducing Firm in one account, which is a repeat exception from MFR's 2003 examination of the Firm. The Firm incorrectly reduced its outstanding checks by the adjusted outstanding balance, which is the difference between the overdraft amount and the outstanding balance amount of the account. The Firm was required to reduce outstanding checks by the overdraft balance on the account. This resulted in an overstatement of Credits in the Reserve Formula Computation by \$22,144,294 as of August 31, 2004 and \$55,167,801 as of September 17, 2004.
39. Exchange Act Rule 15c3-3(a)(1)/01 defines "Customer" and "Non-Customer" and states that certain accounts shown on the books of a broker-dealer must be classified as either Customer or Non-Customer.
40. The Firm misclassified two accounts as Customer accounts that should have been classified as PAIB accounts and treated 11 customer accounts as non-customer accounts. MFR had also determined that the Firm treated customer accounts as non-customer accounts in the 2003 examination.
41. Exchange Act Rule 15c3-3 (Exhibit A- Item 10)/04 states that debit balances in margin accounts are reduced by the amount by which a specific security which is collateral for margin accounts exceeds in aggregate value 15% of all securities which collateralize all margin accounts receivable.
42. The Firm calculated its undue security concentrations as of August 31, 2004 and September 17, 2004 without determining the aggregate value of stock included in margin securities, but rather only included the market value of the stock available to be loaned by the Firm to determine if an undue concentration existed. As of August 31, 2004, the Firm was unable to determine whether a reduction to the reserve formula debits was necessary. As of September 17, 2004, the proper report indicated that a reduction to the reserve computation was not required.

Proprietary Accounts of Introducing Dealers

43. Exchange Act Rule 15c3-3 requires, in part, that a broker-dealer maintain a special reserve bank account to hold proprietary assets from introducing broker-dealers. The account must be funded through deposits of cash and/or qualified securities in amounts computed weekly in accordance with the formula set forth in the rule. Whenever Credits exceed Debits in the PAIB Reserve Calculation, the Firm is required to maintain at least the amount of the difference in a reserve account.
44. The Firm violated Exchange Act Rule 15c3-3 by improperly calculating its PAIB Reserve Formula Computation on the Firm's August 31, 2004 FOCUS Report and its weekly PAIB Reserve Formula Computation for September 17, 2004.
45. The Firm's PAIB Reserve Formula Computation in its August 31, 2004 FOCUS Report understated Excess Credits Over Debits.
46. Specifically PAIB Credits were understated by \$28,850,000 and PAIB Debits were understated by \$7,982,000 because the Firm included PAIB balances, commissions, and other payables and receivables for June 31, 2004 rather than August 31, 2004 and, as described in Paragraph 40, classified two accounts as Customer accounts when they should have been classified as PAIB accounts.
47. In addition, the Firm's weekly PAIB Reserve Formula Computation for September 17, 2004 overstated Excess Credits Over Debits by \$14,261,514. This occurred because the Firm improperly included accrued commissions payable which lowered its Credits by \$14,406,944, failed to include certain securities positions, which totaled \$201,608,547 and increased both Credits and Debits, and classified two accounts as Customer when they should have been classified as PAIB accounts, which decreased Credits by \$145,430.

Net Capital Computations

48. Exchange Act Rule 15c3-1 requires firms to maintain a minimum amount of net capital and further requires firms to compute its net capital in accordance with a specified formula. Exchange Act Rule 15c3-1(c)(2) defines net capital as the net worth of a broker-dealer, with certain adjustments. Exchange Act Rule 15c3-1(c)(2)(iv) requires that when calculating its net capital a broker-dealer must deduct fixed assets and assets that cannot be converted into cash, including, among other things, net overall unfavorable bank reconciliation differences.
49. Exchange Act Rule 15c3-1(c)(2)(iv)/02 requires a broker-dealer to ignore the value of suspense accounts – security positions and money balances whose ultimate disposition is not known – in computing its net capital.

50. The Firm incorrectly calculated net capital charges for aged unfavorable differences – discrepancies between the Firm’s records and the bank’s records as to account balances – in two bank accounts in its August 31, 2004 bank account reconciliations. These incorrect calculations did not cause net capital deficiencies or an aggregate decrease in excess net capital. In one account, the Firm included unfavorable differences in its net capital computation when it should not have because they were resolved prior to the Firm preparing its August 31, 2004 bank reconciliations. In the other, the Firm failed to include aged unfavorable differences, which were not resolved and, therefore, should have been considered in calculating its net capital. MFR noted that this is a repeat exception from the 2002 and 2003 examinations of the Firm.
51. Exchange Act Rule 15c3-1(c)(2)(v) provides, in relevant part, that one of the deductions to net capital is a percentage of the market value of all unresolved short securities differences. The rule requires that 25% of the value of a short securities difference be deducted seven business days after discovery, with the deduction increasing by an additional 25% every seven business days thereafter.
52. The Firm was not taking the proper net capital charges on all aged unresolved suspense items. When aged suspense items are moved to the “Schedule of Aged Suspense Accounts Report” – seven business days after the date of discovery – the Firm’s system caused its discovery date to be reset such that it was accounted for as being only one day old. This caused the Firm to fail to deduct 25% of the value of such items at any given time. For example, 14 business days after discovery, the Firm was deducting 25% of the value rather than 50% as it should have been. This adjustment decreased excess net capital by \$14,676,565.

Audit Trail Requirements

53. NYSE Rule 132.30 states that each clearing member organization that is a party to the comparison and/or settlement of a round-lot regular way contract for the purchase or sale of a security entered into on the NYSE must submit certain trade data elements, including information about the account for which the order was executed.
54. MFR’s review of 25 transactions selected from the NYSE’s “Audit Trail Clearing Firm Investigative Report” for trade date September 20, 2004 disclosed that eight transactions were miscoded. The Firm miscoded five transactions executed by a competing market maker as Agency (“A”) rather than as Competing Market Maker (“R”). The Firm also miscoded one transaction as Agency rather than as Individual (“I”) and two transactions as Individual rather than as Agency. This was a repeat exception from the 2003 examination of the Firm.

Supervision – Customer Reserve, PAIB, Net Capital, and Audit Trail Issues

55. The Firm failed to provide for, establish, and maintain adequate procedures and controls, including a system of follow-up and review of certain of its business activities in order to prevent the foregoing financial violations.
56. The Firm's internal controls failed to prevent multiple net capital and customer reserve violations, despite recent examinations, which disclosed similar deficiencies. This lack of internal controls caused the violations described above.

DECISION

The Hearing Officer, in accepting the Stipulation of Facts and Consent to Penalty, found Respondent guilty as set forth above.

PENALTY

In view of the above findings, the Hearing Officer, imposed the penalty consented to by Respondent of a censure and a \$325,000 fine.

For the Hearing Board

Vincent F. Murphy - Hearing Officer