

NEW YORK STOCK EXCHANGE LLC

NYSE HEARING BOARD DECISION 07-144

September 7, 2007

MESIROW FINANCIAL, INC
MEMBER ORGANIZATION

* * *

Violated Exchange Act Rule 15c3-3(e) by failing to adequately fund its Special Reserve Bank Account for the Exclusive Benefit of Proprietary Accounts Introducing Brokers and its Special Reserve Account for the Exclusive Benefit of Customers; violated Exchange Act Rule 15c3-3a by failing to properly compute Customer Reserve Formula; violated Exchange Act Rules 17a-3 and 17a-4, and NYSE Rule 440, by failing to make or keep and preserve daily position records for Special Reserve Bank Account for the Exclusive Benefit of Proprietary Accounts Introducing Brokers and Special Reserve Account for the Exclusive Benefit of Customers; violated NYSE Rule 409 by sending customer's confirmations, account statements, and other communications to branch office address; violated NYSE Rule 401 by not adhering to own policy regarding changes of address made to customer accounts; violated NYSE Rule 445 by not establishing an adequate anti-money-laundering compliance program, in that it failed to (a) establish and implement policies and procedures that can be reasonably expected to detect and cause reporting of transactions required under 31 U.S.C. 5318(g) and implementing regulations thereunder and (b) provide ongoing training for appropriate persons; violated NYSE Rule 342 by failing to exercise reasonable supervision and control, including separate system of follow-up and review, to prevent foregoing violations and adequately monitor and review proxy-voting results in timely manner – Consent to censure and \$60,000 fine.

Appearances:

For the Division of Enforcement
Anthony J. Cavallaro, Esq.
Scott M. Andersen, Esq.
Robert Moreiro, Esq.

For Respondent
Phillip M. Goldberg, 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 Mesirow Financial, Inc (“Respondent” or the “Firm” or “MFI”), an NYSE member organization. Without admitting or denying guilt, Respondent consented to a finding by a Hearing Officer that it:

- I. Violated Rule 15c3-3(e) under the Securities Exchange Act of 1934 (the “Exchange Act”) by failing to adequately fund its Special Reserve Bank Account for the Exclusive Benefit of Proprietary Accounts Introducing Brokers (the “PAIB Reserve Account”) and its Special Reserve Account for the Exclusive Benefit of Customers (the “Customer Reserve Account”).
- II. Violated Exchange Act Rule 15c3-3a by failing to properly compute its Customer Reserve Formula.
- III. Violated Exchange Act Rules 17a-3 and 17a-4, and NYSE Rule 440, by failing to make or keep and preserve daily position records for the PAIB Reserve Account and Customer Reserve Account.
- IV. Violated NYSE Rule 409 by sending a customer’s confirmations, account statements, and other communications to a branch office address.
- V. Violated NYSE Rule 401 by not adhering to its own policy regarding changes of address made to customer accounts.
- VI. Violated NYSE Rule 445 by not establishing an adequate AML compliance program, in that it failed to:
 - (a) establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder; and
 - (b) provide ongoing training for appropriate persons.
- VII. Violated NYSE Rule 342 by failing to exercise reasonable supervision and control, including a separate system of follow-up and review, to:
 - (a) prevent the foregoing violations, and
 - (b) adequately monitor and review proxy-voting results in a timely manner.

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:*

Background and Jurisdiction

1. MFI has been a member of the New York Stock Exchange, LLC (“NYSE”) since November 1982. The Firm, a Delaware corporation, is headquartered in Chicago, Illinois, and has 10 branch offices.
2. During 2004, NYSE Regulation’s Division of Member Firm Regulation (“MFR”) conducted an examination of the financial, operational and supervisory standards of the Firm and reported its findings in a report dated October 7, 2004 (the “2004 FINOP Exam”).
3. During 2005, MFR conducted an examination of its supervisory standards and sales practices of the Firm and reported its findings in a report dated March 22, 2005 (the “2005 SPRU Exam”).
4. In 2005, MFR referred the 2004 FINOP Exam and also referred the 2005 SPRU Exam to Enforcement.
5. Enforcement opened an investigation relating to both the 2004 FINOP Exam and the 2005 SPRU Exam and, by letter dated July 21, 2005, Enforcement notified the Firm of its investigation.

Summary of Violative Conduct

6. As set forth below, during the period January 9, 2004 through March 5, 2004 (the “Review Period”), the Firm violated NYSE Rules and the federal securities laws in that it did not exercise reasonable supervision and control over the Firm’s Special Reserve Bank Account for the Exclusive Benefit of Proprietary Accounts Introducing Brokers (“PAIB Reserve Account”) and Special Reserve Account for the Exclusive Benefit of Customers (“Customer Reserve Account”), and failed to both adequately fund its PAIB and Customer Reserve Accounts and to properly compute its weekly Customer Reserve Account Formula. Moreover, during other time periods discussed below, the Firm violated NYSE Rules when it did not exercise reasonable supervision and control over proxy voting, communications to customers, customer changes of address, and aspects of the Firm’s Anti-Money Laundering (“AML”) program.

* Hearing Officer Note: The facts, allegations, and conclusions contained in paragraphs 1 to 31 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.

Violative Conduct

PAIB and Customer Reserve Accounts

7. Exchange Act Rule 15c3-3(e) requires that every broker or dealer must maintain with a bank a separate account entitled "Special Reserve Bank Account for the Exclusive Benefit of Customers" (the "Reserve Account(s)") into which it must deposit cash and/or qualified securities in amounts computed in accordance with Exchange Act Rule 15c3-3a (the "Reserve Formula"). Computations are to be made weekly and the broker or dealer is required to make requisite deposits on a timely basis.
8. During the Review Period, the amounts on deposit in the Firm's PAIB Reserve Account in several instances reviewed were not sufficiently funded. For those several instances, despite the fact that the Firm provided its bank with the appropriate funds and accurate deposit instructions, the PAIB Reserve Account did not have the required cash or qualified securities on deposit, resulting in deficiencies ranging from approximately \$1 million to \$1.7 million.
9. The Firm's PAIB Reserve Account was not properly funded during the Review Period due to deposit errors made by the Firm's bank. Regardless, the Firm was responsible for actively monitoring its Reserve Account to ensure the requisite deposits required by the Reserve Formula were properly made.
10. During the Review Period, the Firm also computed the Reserve Formula incorrectly, and did not sufficiently fund, its Customer Reserve Account on several instances reviewed. For those several instances, required adjustments ranged from approximately \$7.9 million to \$10.6 million on each computation and resulted in deficiencies ranging from approximately \$4.5 million to \$7.5 million.
11. The Firm's Customer Reserve Account was not properly computed or funded as a result of overdrawn bank balances that were incorrectly excluded by the Firm from its Reserve Formula computations. The Firm excluded these payables based upon reliance on a netting agreement with its bank that would have permitted the Firm to offset these payables against positive balances in other accounts the Firm maintained at its bank. The Firm's treatment of the computations was incorrect, however, because although the Firm did properly have a legal opinion applicable to its netting agreement with its bank, as required by NYSE Interpretation Memo 92-1, the legal opinion was not properly updated to reflect the Firm's most current netting arrangement.
12. Since learning of these deficiencies, the Firm has implemented new supervisory review procedures relative to monitoring its PAIB and Customer Reserve Accounts, including procedures reconciling its accounts and the timely verification of required deposits. The Firm also had subsequently obtained an updated legal opinion from outside counsel reflecting its then current netting arrangement with its bank prior to the completion of the FINOP Exam.

13. Based upon the foregoing, the Firm violated Exchange Act Rule 15c3-3a by failing to properly compute its Customer Reserve Formula for its Customer Reserve Account, and violated Exchange Act Rule 15c3-3(e) by failing to adequately fund its PAIB and Customer Reserve Accounts.
14. Moreover, Section 17(a) of the Securities Exchange Act and Rules 17a-3 and 17a-4 thereunder, and NYSE Rule 440, require that every member organization make or keep, and preserve books and records as prescribed by law or rule, including books and records of its financial and operational activities.
15. During the Review Period, the Firm did not make or keep, or preserve position records for its PAIB and Customer Reserve Accounts, thereby violating Exchange Act Rules 17a-3 and 17a-4, and NYSE Rule 440.
16. NYSE Rule 342 requires member firm organizations to exercise appropriate supervisory control over each business activity, including a system of follow-up and review, for compliance with NYSE Rules and the federal securities laws.
17. The Firm violated NYSE Rule 342 because it did not have adequate supervisory review procedures to monitor its account activity (cash and/or qualified securities), including ending positions and cash balances, in its PAIB and Customer Reserve Accounts. Moreover, the Firm failed to properly reconcile its PAIB and Customer Reserve Accounts, and to verify that required deposits necessary to satisfy the Reserve Formula were being made timely. The Firm remedied its supervisory review procedures before the completion of the FINOP Exam.

Other Violations

Monitoring of Proxy Voting

18. Under NYSE Rule 342, a member firm is required to properly supervise and review proxy voting results in order to, among other items, prevent inaccurate proxy solicitation and voting, and to assure the accuracy of books and records upon which voting is based.
19. The Firm did not conduct on a timely basis, a supervisory review of proxy voting results for three proxies, relative to the annual shareholder meetings in 2003, in violation of NYSE Rule 342.

The Mailing Of Customer Communications

20. NYSE Rule 409 prohibits member organizations from sending confirmations, statements or other communications to a customer at the address of any member organization or its employees.

21. From April 2002 through March 2004, the Firm had sent customer communications, including confirmations and statements for eleven accounts of a Firm customer directly to a Firm branch office in Chicago. The mail was then opened by a registered supervisor and delivered to the customer. This activity was done at the customer's request and no customer harm resulted. The Firm's conduct violated NYSE Rule 409.
22. Upon notification of this violation, the Firm remedied the situation and created an exception report that compares customer addresses with Firm and Firm employee addresses, thereby enhancing Firm monitoring and review.

AML Program

23. NYSE Rule 445 requires each member organization to develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*).
24. NYSE Rule 445(5) requires each member organization to provide ongoing AML training for appropriate persons.
25. From January 2004 through March 2005, the Firm's AML program failed to address the investigative process that would result once a transaction was identified as "suspicious." Moreover, the Firm did not require the reporting of Suspicious Activity Report-Securities and Futures Industry ("SAR-SF") for any transactions deemed to be suspicious that involved \$5,000 or more in funds or other assets, or the reporting within 30-days after the initial detection of the subject suspicious transaction.
26. During 2004, the Firm failed to provide its employees with AML training as required pursuant to NYSE Rule 445(5).
27. Based upon the foregoing, the Firm violated NYSE Rules 342 and 445.
28. Upon being alerted to the NYSE's findings and during the SPRU Exam, the Firm updated its AML procedures to remedy these violations.

Customer Changes of Address

29. NYSE Rule 401 provides in pertinent part that every member organization, allied member and member organization shall at all times adhere to the principles of good business practice in the conduct of his or its business affairs.
30. The Firm violated NYSE Rules 401 and 342 by not adhering to its own policies requiring written, signed authorizations for customer change of address requests during January 2004 through February 2005. During this time period, the Firm, at its main office and branch offices, accepted verbal instructions from customers to change their addresses. Furthermore, the Firm was unable to provide written, signed authorizations from customers to substantiate the address changes that were made.

Other Factors

31. The Firm has informed Enforcement, and Enforcement has considered, certain mitigating circumstances and facts relating to the violations discussed in this Stipulation and Consent, as well as remedial efforts made by the Firm to enhance its supervisory procedures and controls.

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 \$60,000 fine.

For the Hearing Board

Peggy Kuo - Chief Hearing Officer