

NEW YORK STOCK EXCHANGE LLC

NYSE HEARING BOARD DECISION 08-45

October 23, 2008

GOLDMAN, SACHS & CO.  
MEMBER ORGANIZATION

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**Violated NYSE Rule 342 by failing to reasonably supervise or control business activities of Equity Finance Group, provide for appropriate procedures of supervision and control, and establish separate system of follow-up and review to determine that delegated authority and responsibility were being properly exercised, in that it failed to establish procedures reasonably designed to (a) detect and prevent certain improper trades between affiliates from being executed by New York EFG trading desk; (b) monitor certain trading activities of New York EFG trading desk; (c) make and preserve certain books and records; (d) ensure compliance with uptick rule; and (e) ensure compliance with certain NYSE reporting requirements; violated Section 17(a) of Securities Exchange Act of 1934 and Rules 17a-3 and 17a-4 thereunder and NYSE Rule 440 by failing to make and preserve current books and records relating to order tickets for transactions; violated Section 10(a) of Exchange Act by (a) failing to mark tickets for sale orders as either long or short as required by Rule 10a-1(c); (b) erroneously executing sell orders on minus tick for securities in which the Firm held short position in violation of Rule 10a-1(a); violated NYSE Rule 410B by failing to report to NYSE certain transactions in NYSE listed securities executed off Floor of NYSE – Consent to censure and \$600,000 fine to be paid in equal shares to NYSE and FINRA.**

**Appearances:**

For the Division of Enforcement  
Susan Light, Esq.  
Richard Chin, Esq.

For Respondent  
David Brodsky, 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 Goldman, Sachs & Co. LLC (“Respondent” or “GS&Co.”), an NYSE member organization. Without admitting or denying guilt, Respondent consented to a finding by a Hearing Officer that it violated:

- I. NYSE Rule 342 in that it failed to reasonably supervise or control certain business activities of its Equity Finance Group (“EFG”), provide for appropriate procedures of supervision and control, and establish a separate system of follow-up and review to determine that delegated authority and responsibility were being properly exercised, in that it failed to establish procedures reasonably designed to:
  - a. detect and prevent certain improper trades between affiliates from being executed by the New York EFG trading desk;
  - b. monitor certain trading activities of the New York EFG trading desk;
  - c. make and preserve certain books and records;
  - d. ensure compliance with the uptick rule; and
  - e. ensure compliance with certain NYSE reporting requirements.
- II. Section 17(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rules 17a-3 and 17a-4 thereunder, and NYSE Rule 440 by failing to make and preserve current books and records relating to order tickets for transactions.
- III. Section 10(a) of the Exchange Act by:
  - a. failing to mark tickets for sale orders as either long or short as required by Rule 10a-1(c);
  - b. erroneously executing sell orders on a minus tick for securities in which the Firm held a short position in violation of Rule 10a-1(a).
- IV. NYSE Rule 410B by failing to report to the NYSE certain transactions in NYSE-listed securities executed off the Floor of the NYSE.

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:\*

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\* Hearing Officer Note: The facts, allegations, and conclusions contained in paragraphs 1 to 49 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 except that a pseudonym has been provided to protect the privacy of a non-party.

### **Background and Jurisdiction**

1. GS&Co. is a global investment banking and multi-service brokerage firm that, among other things, trades securities for institutional and individual customers as well as for proprietary accounts. GS&Co.'s principal place of business is in New York City. GS&Co. is registered with the SEC and has been a member organization of the NYSE since November 1982.
2. On or about July 21, 2004, the Division of Member Firm Regulation ("MFR") of NYSE Regulation directed GS&Co. to confirm its short interest position in American Depository Receipts of XYZ.
3. On or about September 21, 2004, the Firm advised MFR that it had identified trade reporting deficiencies with respect to transactions effected by the Firm's Equity Finance Group ("EFG") and commenced a review of its trading in XYZ and certain other securities, and would provide additional information based on their findings.
4. In or about September 2004, the Division of Market Surveillance ("MKS") of NYSE Regulation initiated an investigation of GS&Co.'s trades of XYZ. In particular, MKS investigated three proprietary sell orders that drove the price of XYZ down from \$17.32 to \$17.30 and were followed immediately by a proprietary buy order at \$17.30. The sell-side of the Firm's buy order was GS & Co.'s London-based affiliate, Goldman Sachs International ("GSI"). The MKS investigation resulted in a referral to Enforcement dated January 2006 (the "Referral").
5. MKS' review included certain over-the-counter trades of NYSE-listed securities, conducted by EFG between December 2003 and July 2004 (the "Relevant Period") pursuant to a trading strategy by which GS&Co. and GSI, coordinated with each other to provide GSI with certain tax benefits. One such transaction involved XYZ.
6. On or about November 9, 2004, GS&Co. met with senior management of NYSE Regulation's Divisions of Enforcement and MFR and advised that certain over-the-counter trades of NYSE-listed securities, conducted by the EFG pursuant to a proprietary yield enhancement strategy had been carried out without the Firm's supervisory approval and had not been reported to the NYSE as required by NYSE Rule 410B. Pursuant to the above-referenced transactions, GS&Co. and GSI had established corresponding positions in certain securities that they were unable to practicably unwind in the open market, including via algorithmic trading. The November 9, 2004 meeting also served to advise the NYSE that GS&Co. and GSI would have to cross transactions in the OTC market in order to unwind these positions.

### **OVERVIEW**

7. During the Relevant Period, the Firm's EFG trading desk violated Firm guidelines and certain NYSE Rules in connection with implementing a trading strategy, and the Firm also failed to reasonably supervise certain activities of its New York EFG trading desk. Specifically, the Firm's EFG trading desk failed to maintain its

independence in the conduct of certain over-the-counter stock transactions involving American Depositary Receipts in which its affiliate, GSI, was the counterparty. In certain of these contemporaneous transactions, GSI directed GS&Co. with respect to, among other things, the number of shares to trade, the GS&Co. account in which the transactions should be booked and the interdealer broker to use in their execution. In some instances, the Firm also failed to maintain adequate order tickets of the transactions and to report the trades to the NYSE as required by NYSE rules. In connection with that conduct and these activities, the Firm failed reasonably to supervise or control certain activities of its EFG by failing to establish procedures reasonably designed to: detect and prevent improper trades between affiliates, monitor certain trading activities conducted by the New York EFG trading desk, make and preserve certain books and records, and ensure compliance with the uptick rule and certain NYSE reporting requirements.

### **HISTORY OF THE FIRM'S EQUITY FINANCE GROUP**

8. The EFG's typical business involves the execution of equity swaps, stock loans, and stock purchases and sales, in a multitude of jurisdictions, for both clients and its own account.
9. From its inception, the EFG has pursued numerous trading strategies including proprietary yield enhancement transactions, which are the types of transactions at issue in this case. The EFG's proprietary yield enhancement transactions are generally designed to enhance yields received by GSI on the securities of certain non-U.S. issuers without incurring market price exposure on those securities.
10. Over the years, the EFG has maintained operations in New York, the United Kingdom and Hong Kong. In 2003 and 2004, the EFG's business units in New York ("NY") and the United Kingdom were each comprised of, among other things, a trading desk, a sales and marketing team and support staff. The EFG business unit maintained in the United Kingdom is affiliated with GSI and the EFG business unit maintained in NY is affiliated with GS&Co.

### **THE EQUITY FINANCE GROUP TRADING STRATEGY**

11. GSI and GS&Co. developed a strategy to enhance yields received by GSI on the securities of certain non-U.S. issuers without incurring market price exposure on those securities (the "Strategy"). The Strategy was comprised of a series of transactions by GSI and attendant transactions by GS&Co., in certain instances with or through unrelated stock lending counterparties and interdealer brokers. In large part, the transactions were designed to provide GSI with tax benefits that were not available to GS&Co. by holding stock over a dividend period. The Strategy was carried out as described below.
12. GSI was to identify expected dividend payments by companies in jurisdictions that had favorable tax treaties with the United Kingdom, and then determine the market

- prices for total-rate-of-return swaps and stock loans on those companies' shares over the dividend record date.
13. If GSI identified a disparity between the market prices and values it ascribed to those swaps and stock loans, it was to purchase shares of the relevant issuer through an interdealer broker and then effect its own hedge to avoid market exposure on the underlying long position by entering into a total-rate-of-return swap with a third party.
  14. GS&Co. was to locate suitably priced shares available for loan and, then, at a different time and in transactions independent from GSI, sell shares of the relevant issuer through an interdealer broker and then effect its own hedge to avoid market exposure on the underlying short position by entering into a total-rate-of-return swap with a third party.
  15. GSI was to hold its position for a period of approximately one month (thereby qualifying for favorable treatment under the United Kingdom's tax laws), after which it was to terminate its swap and contact an interdealer broker to sell its long position. The interdealer broker was generally expected to be different from the one through which the initial purchase had been made.
  16. GS&Co. was to terminate its swap and close out its short position by purchasing the same amount of securities in an independent transaction with another interdealer broker. After repurchasing the securities, GS&Co. was to close out any outstanding stock loans if it had no further purpose for borrowing the securities.
  17. If the Strategy were successful, the EFG, as a global business unit, would make a profit because the benefits of GSI's long position, which included any tax benefit, would be greater than the costs associated with acquiring the position and the attendant costs of the hedging.

#### The Guidelines

18. In conjunction with the Goldman Sachs Tax Department, the EFG developed guidelines to ensure that the transactions between GS&Co. and GSI would be viewed as independent market transactions for tax purposes and ensure that the tax benefits associated with the Strategy could be realized. The first set of written guidelines relating to the Strategy was created by the Firm in early 2000 (the "2000 Guidelines").
19. The 2000 Guidelines provided, among other things, that (i) the number of shares be reasonable when compared to the securities' average daily trading volume (for the period of one year prior to trade date); (ii) GSI and GS&Co. execute their transactions at different times, with different interdealer brokers and without coordination; and (iii) there be no pre-arrangement with swap counterparties and that those counterparties be unrelated third parties.

## **THE POST DECEMBER 2003 TRANSACTIONS**

### **Improper Trades Between Affiliates**

20. From December 2003 through July 2004, EFG personnel conducted a series of improper transactions that deviated from the aforementioned guidelines (the “Post December 2003 Transactions”) which, among other things, helped to ensure certain treatment under applicable tax laws and compliance with NYSE Rules. The principal differences between the Strategy as executed via the 2000 Guidelines and the Post December 2003 Transactions relate to the size of the trades, the level of coordination between GSI and GS&Co., and the counterparties to the swap transactions.
21. In conducting the Post December 2003 Transactions, GS&Co. coordinated with GSI, in the planning and execution of the Post December 2003 Transactions, with GSI giving and GS&Co. accepting direction in varying degrees regarding when to trade, the number of shares to trade, the account in which the trade was to be booked and/or the interdealer broker to use in a given transaction. Consequently, GS&Co. and GSI purchased and sold shares through interdealer brokers in contemporaneous after-hours transactions executed at the prior day’s closing price.
22. The Post December 2003 transactions involved share volumes that ranged from a significant percentage to multiples of the average daily trading volume for those American Depository Receipts during the previous year.
23. The Post December 2003 Transactions were also the subject of direct swaps between GSI and GS&Co., rather than each entity executing a swap with an independent third party. Although no specific price was identified for the unwind portion of the Post December 2003 Transactions, it was understood that the price would be dictated by the market close on the date the unwind transaction occurred.
24. In total, GS&Co. executed approximately 48 improper OTC stock trades in NYSE listed securities with several interdealer brokers involving 12 U.S. American Depository Receipts (22 purchases and 26 sales) for the purpose of facilitating the Post December 2003 Transactions. GS&Co.’s side of the purchases and sales had a notional value exceeding \$4 billion.
25. In connection with these transactions, as described herein, (i) the New York EFG trading desk violated its own guidelines and certain NYSE Rules, (ii) the Firm failed to detect and prevent the level of direction provided by GSI, the degree of coordination between GSI and GS&Co. and the large share volume of the transactions as compared to the average daily trading volume, and (iii) the Firm failed to reasonably supervise the business activities of its New York EFG trading desk.

**THE FIRM'S FAILURE TO REPORT THE POST DECEMBER 2003 TRANSACTIONS  
TO THE NYSE**

26. NYSE Rule 410B(a), in pertinent part, requires members and member organizations to report to the NYSE “[t]ransactions in securities listed for trading on the Exchange effected for the account of a member or member organization, or for the account of a customer of a member or member organization, that are not reported to the Consolidated Tape ....”
27. NYSE Rule 410B(b) also provides, “[t]ransactions in listed securities required to be reported by paragraph (a) [of NYSE Rule 410B] shall be reported to the Exchange by the close of the next business day that the [NYSE] is open.” NYSE Rule 410B(d) identifies the transaction details required to be included in the report.
28. Certain of the Firm’s EFG trades were manually input by the Firm into a proprietary program called the Structured Equity Trading System and then automatically transferred into two voluminous reports of potential NYSE Rule 410B reportable trades, which were supposed to be manually reviewed.
29. During the Relevant Period, Firm personnel failed to identify reportable trades in one of the reports and the second report was not properly distributed for review and reporting.
30. The Firm’s EFG failed to establish and maintain written procedures for reporting the NY transactions that were manually input into its Structured Equity Trading System.
31. The Firm failed to report the 48 Post December 2003 Transactions conducted by its New York EFG to the NYSE, effectively preventing detection of the Post December 2003 Transactions and violating NYSE Rule 410B.

**THE FIRM'S FAILURE TO MAINTAIN ACCURATE BOOKS  
AND RECORDS**

32. Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder require broker-dealers to make and preserve certain books and records associated with its business, including, among other things, blotters containing an itemized daily record of all purchases and sales of securities and a memorandum of each brokerage order.
33. Exchange Act Rule 17a-3(a)(6) requires each memorandum of a brokerage order to show the terms and conditions of the order or instructions and of any modification or cancellation thereof, the account for which entered, the time of entry, the price at which executed and, to the extent feasible, the time of execution or cancellation. Exchange Act Rule 17a-4(b)(1) specifies that each broker or dealer keep such records for a period of three years, the first two years in an accessible place.

34. NYSE Rule 440 requires that member organizations maintain a recordkeeping format, medium and retention period that complies with Exchange Act Rule 17a-4.
35. At the time of these transactions, Exchange Act Rule 10a-1(c)<sup>1</sup> provided, in pertinent part, that “[n]o broker or dealer shall, by the use of any facility of a national securities exchange, or any means or instrumentality of interstate commerce, or of the mails, effect any sell order for a security registered on, or admitted to unlisted trading privileges on a national securities exchange unless such order is marked either ‘long’ or ‘short’.”
36. A review of the order tickets for the Post December 2003 Transactions revealed that the Firm failed to maintain order tickets for 17 OTC GS&Co. trades and that many of the order tickets maintained by the Firm were missing required information.
37. Specifically, approximately 14 order tickets for the Post December 2003 Transactions were missing an account number, six order tickets did not identify a trader, and three short sale order tickets did not bear evidence of a locate.
38. A review and comparison of GS&Co.’s Structured Equity Trading System records and order tickets pertaining to the Post December 2003 Transactions disclosed that approximately 15 of the order tickets were incorrectly marked as long sales.
39. The foregoing failures constitute violations of Exchange Act Rules 17a-3 and 17a-4 and NYSE Rule 440.
40. Additionally, two tickets for sale orders for the Post December 2003 Transactions were not marked either long or short in violation of Exchange Act Rule 10a-1(c).

#### **THE FIRM’S VIOLATION OF THE UPTICK RULE**

41. At the time of the transactions, Exchange Act Rule 10a-1(a) stated, in pertinent part, that no person shall, for his own account or for the account of any person, effect a short sale of any security registered on or admitted to unlisted trading privileges on a national securities exchange; (i) below the price at which the last sale thereof, regular way, was reported on the national securities Exchange or (ii) at such price unless such price is above the next preceding different price at which a sale of such security, regular way, was reported on the national securities Exchange<sup>2</sup>.
42. A review of order-tickets and related documentation for the Post December 2003 Transactions was conducted to determine whether the Firm’s short sales complied with Exchange Act Rule 10a-1(a). Two short sales did not comply with Exchange Act Rule 10a-1(a). The Firm was unable to locate order tickets for five other trades.

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<sup>1</sup> On September 7, 2004, Exchange Act Rule 10a-1(c) was superseded by the passage of Regulation SHO.

<sup>2</sup> Effective July 3, 2007, Exchange Act Rule 10a-1(a) was eliminated by the Securities and Exchange Commission.

43. The foregoing failures constitute violations of Exchange Act Rule 10a-1(a).

### **THE FIRM'S SUPERVISORY FAILURES**

44. NYSE Rule 342(a) requires, among other things, that “[e]ach office, department or business activity of a ...member organization ... shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility.”
45. NYSE Rule 342(b) requires, in relevant part, that “each member organization shall provide for appropriate supervisory control and shall designate a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. This person shall (1) delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control [and] (2) establish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.”
46. From the inception of the Equity Finance Group in 1999 until approximately May 2004, the Firm did not have written policies and procedures for the Equity Finance Group regarding the establishment of trading strategies or changes to existing trading strategies, the creation and retention of order tickets, the procedures for required trade reporting, the maintenance of accurate books and records and compliance with the uptick rule.
47. The Firm also failed to establish and maintain appropriate procedures of supervision and control, including a system of follow-up and review, with respect to the conduct of the Post December 2003 Transactions. GS&Co. did not have a system in place to monitor or review proprietary yield enhancement transactions to ensure their compliance with NYSE Rules and the Firm’s guidelines. Specifically, GS&Co. failed to establish procedures reasonably designed to detect the improper Post December 2003 Transactions executed by the NY trading desk for approximately seven months and thereby failed to adequately supervise the business activities of the NY trading desk as required by NYSE Rule 342.
48. As described in paragraphs 24 to 43 above, the Firm also failed to establish and maintain appropriate procedures for supervision and control for its Equity Finance Group, including a system of follow-up and review, with respect to: (a) the reporting of OTC transactions to the NYSE; (b) the maintenance of accurate books and records; and (c) and compliance with the uptick rule.

### **OTHER FACTORS CONSIDERED**

49. In arriving at the agreed upon penalty, Enforcement considered a number of factors including the following: (a) the Firm initiated a review of its EFG based upon an

inquiry by MFR, (b) the Firm met with Enforcement and MFR staff and provided information regarding certain activities of its EFG, including the Post December 2003 Transactions; (c) the Firm hired a law firm to conduct a review of these matters, and has provided staff with relevant documents and information; (d) the Firm was proactive in remedying its violative conduct; and (e) the Firm has established written policies and procedures for its EFG and implemented enhanced procedures and additional training for EFG traders and supervisors.

### **DECISION**

The Hearing Officer, in accepting the Stipulation of Facts and Consent to Penalty, found that Respondent committed the offenses 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 \$600,000 fine, to be paid in equal shares to the NYSE and FINRA.

For the Hearing Board

Peggy Kuo - Chief Hearing Officer