N E W   Y O R K   S T O C K   E X C H A N G E, I N C.

<u>EXCHANGE HEARING PANEL DECISION 99-132</u> **September 22, 1999**
DAVID A NOYES & COMPANY
MEMBER ORGANIZATION

> **Violated Rule 342 by failing to provide appropriate supervisory procedures relating to annuity products and hand delivery of checks, by failing to conduct supervisory inspections and by failing to designate an individual to direct compliance activity – Consent to censure, $60,000 fine and an undertaking.**

Appearances:

For the Division of Enforcement
Mary L. Brienza, Esq.
Susan E. Light, Esq.
Anthony J. Cavallaro, Esq.
Joseph Gibney, Esq.
Julie Han, Esq.

For the Respondent
Robert L. Cram, Esq.

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An Exchange Hearing Panel met to consider a Stipulation of Facts and Consent to Penalty entered into between the Exchange's Division of Enforcement and David A. Noyes & Company (the "Firm"), a member organization. Without admitting or denying guilt, the Firm consents to a finding by the Hearing Panel that it violated Exchange Rule 342 in that the Firm:

A. Failed to provide for and maintain appropriate supervisory procedures pertaining to the purchase, sale and transfer of annuity products by its registered representatives.

B. Failed to provide for and maintain appropriate supervisory control over the hand delivery of checks to customers.

C. Failed to conduct supervisory inspections of certain branch offices at least annually.

D. Failed to designate an individual to direct compliance activity who had passed the requisite Compliance Official Qualification Examination.

For the sole purpose of settling this disciplinary proceeding, the Division of Enforcement and the Firm stipulate to the following:

Background and Jurisdiction

1. The Firm was established in 1908 and became a member of the Exchange in 1978. The Firm is a full service brokerage firm that also sells insurance products. It is headquartered in Chicago, Illinois and has seven branch offices located in Indiana, Illinois and Wisconsin.

2. During 1998, the Exchange's Division of Member Firm Regulation ("MFR") conducted a Sales Practice Examination. Following the examination, MFR issued a report which identified certain deficiencies in the Firm's sales practice procedures.

3. The Exchange received a Form RE-3 from the Firm dated September 15, 1998, which indicated that AB, a registered representative at the Firm, had been terminated from employment for causing checks to be issued from three customer accounts, forging the signatures of the customers on the checks and misappropriating the proceeds of the checks.

4. By letters dated May 15, 1998 and October 12, 1998, which it received, Enforcement notified the Firm of its investigation into the above matters.

5. During the period of October 1997 through August 1998, the Firm failed to provide for and maintain appropriate supervisory procedures pertaining to the purchase, sale and transfer of annuity products and in the delivering of checks by its registered representatives, as set forth below.

6. Exchange Rule 342 requires, among other things, that the Firm provide for appropriate supervision and control for each of its business activities.

Supervision of Annuity Products

7. During the period of October 1, 1997 through December 31, 1997, the Firm, through its registered representatives, wrote approximately 66 annuity contracts of which 23 represented transfers from other annuity contracts. The total value of the annuity contracts written by the Firm during the relevant period was approximately $1,753,180.

8. During the period of October 1, 1997 through December 31, 1997, the Firm failed to supervise its annuity products business in that it:

   a. did not maintain written procedures for its registered representatives relating to annuity products providing clear guidance with respect to their compliance responsibilities;

   b. did not maintain written procedures with respect to the supervision of its annuity products business;

c. did not maintain written procedures pertaining to the review of its annuity products business for use during branch office inspections;

d. did not have procedures in place to monitor the number of annuity transfers effected by the Firm's registered representatives or the number or frequency of annuity transfers completed by its customers;

e. permitted its registered representatives to submit annuity contracts and transfer applications to issuing annuity companies without first having been reviewed by a supervisor for completeness, accuracy and suitability; and

f. maintained no master listing of annuity transfers and, therefore, generated no exception reports, including reports to capture multiple purchases or sales to one customer or reports indicating excessive transfers by customers or registered representatives.

Supervision of Check Disbursements

9. During the period of January 1998 through August 1998 (the "relevant period"), the Firm failed to provide for and maintain appropriate supervisory control over the hand delivery of checks to customers.

10. It was the policy of the Firm to permit registered representatives to personally deliver checks issued in the Indianapolis branch office to customers.

11. During the relevant period, AB misappropriated funds totaling approximately $40,000 from the accounts of three customers. Without any authorization from the customers, AB caused the Firm to issue checks from the customers' accounts. He obtained the checks under the pretense that he was personally delivering them to the customers. He then forged endorsements and the signatures of the customers, and deposited the funds into his personal bank account.

12. The Firm had no procedure to independently verify that the customers actually received the checks and had no system to monitor the frequency of hand delivery of checks by individual registered representatives. The Firm relied on its cashier to make certain that checks were drawn in the correct amount, and it would rely on the registered representatives and the cashier to make certain that there were sufficient funds in an account to cover the withdrawal. However, the Firm had no procedure in place to ensure that hand delivered checks were, in fact, delivered to customers. Customers were expected to telephone the Firm if they did not receive a check they had requested. Moreover, customers were expected to note the check withdrawals on their monthly statements and complain if such withdrawals were unauthorized.

13. As of the year ending December 31, 1997, the Firm failed to conduct annual branch office examinations of its branch offices, as set forth below:

14. Exchange Rules 342(a) and (b), and Exchange Interpretation Rule 342(a) and (b)(03), require, in relevant part, that branch office inspections by member organizations be conducted at least annually.

15. As of December 31, 1997, five of the Firm's seven branch offices had not been examined within a 12 month period including one that had not been inspected within a 22 month period.

16. Between the period of on or about May 2, 1997 through January 12, 1998, the Firm failed to designate an individual to direct compliance activity who had passed the requisite Compliance Official Qualification Examination, as set forth below:

17. Exchange Rule 342.13(b) requires, in relevant part, that member organizations designate individuals to direct day-to-day compliance activity who have passed the Series 14 examination (Compliance Official Qualification Examination).

18. The Firm's compliance director resigned on May 2, 1997. After the resignation, the Firm did not have a Series 14 qualified individual designated to direct day-to-day compliance activity, yet failed to notify the Exchange or request an extension.

19. On January 12, 1998, the Firm submitted to the Exchange a request for a 30-day extension to operate without a Series 14 qualified individual. The extension was granted and an individual at the Firm passed the Series 8 Examination on January 5, 1998 and the Series 14 Examination on February 6, 1998. The individual was thereafter appointed the Firm's compliance director.

DECISION

The Hearing Panel, in accepting the Stipulation of Facts and Consent to Penalty, found the Firm guilty as set forth above by unanimous vote.

PENALTY

In view of the above findings, the Hearing Panel, by unanimous vote, imposed the penalty consented to by the Firm of a censure and a fine of $60,000. The Firm also agrees to an undertaking to create written procedures reasonably designed to ensure the proper hand delivery of checks to customers and the supervision thereof, and submit a copy of the procedures to the Exchange within three months from the date that this decision becomes final.

For the Hearing Panel

Edward W. Morris, Jr.
Chief Hearing Officer