

# CHAPTER THREE

A comprehensive network of safeguards, from individual broker-dealers all the way up to the U.S. government, serves to protect investors, the health of the financial system and the integrity of the capital-formation process. The federal government is at the top of the regulatory pyramid: The SEC, which the U.S. Congress established in 1934, monitors the securities industry and enforces penalties against those that violate the industry's regulations. This federal agency oversees every securities firm participating in the financial markets as well as the U.S. markets themselves. Congress adopts laws governing the securities industry and is responsible for ensuring that the SEC functions effectively.

The NYSE is a self-regulatory organization, as are various other U.S. stock exchanges. As such, the NYSE, through its independent, not-for-profit subsidiary NYSE Regulation Inc., regulates member organizations through the enforcement of marketplace rules and federal securities laws. More than 300 of the largest securities firms in America are NYSE member organizations. These firms service 98 million customer accounts, or 84 percent of the total public customer accounts handled by broker-dealers, with total assets of \$4 trillion. They operate from 20,000 branch offices around the world and employ 195,000 registered personnel.

These NYSE member organizations must meet rigorous regulatory standards. Firms are obliged to monitor their own compliance with applicable rules and regulations for possible violations. Each year, NYSE Regulation examines every member organization that does business with the public to determine whether these requirements are met. NYSE Regulation also works with other government and law-enforcement agencies, including the SEC and U.S. Attorney's office, and belongs to a group of domestic and non-U.S. markets and agencies that share regulatory and financial information.

In addition to regulating member organizations through the enforcement of marketplace rules and federal securities laws, NYSE Regulation also ensures that companies listed on the NYSE meet their financial and corporate governance listing standards. NYSE Regulation, which has more than 700

## **SAFEGUARDING THE SYSTEM: NYSE REGULATION**



employees, includes the divisions of Listed Company Compliance, Member Firm Regulation, Market Surveillance, Enforcement, and Dispute Resolution/Arbitration:

- **Listed Company Compliance.** The NYSE requires listed companies to meet original listing criteria and thereafter maintain continued compliance with these standards. This division, which monitors and enforces compliance with these standards, is split into two parts: 1) the financial compliance group, which reviews a company's reported financial results both at the time of listing and thereafter to ensure that it meets original listing and continued-listing requirements; and 2) the corporate compliance group, which ensures that listed companies adhere to the highest standards of accountability and transparency, including governance requirements for configuration of corporate boards, director independence and financial competence of audit committee members.
- **Member Firm Regulation.** This division conducts examinations of the more than 380 member organizations of the NYSE (representing 90% of the total public customer accounts handled by broker-dealers in the United States) for financial, operations and sales-practice compliance. In addition, the division interprets and develops NYSE rules, develops and administers various industry qualifications and examinations, and administers the NYSE's continuing education programs for registered persons in the securities industry.
- **Market Surveillance.** This division is responsible for, among other things, monitoring equity insider trading activities on the facilities of the NYSE. Such monitoring of trading activities involves both real-time and post-trade review. The Market Surveillance division reviews transactions to determine whether auction-market rules and principles are being complied with and fairly maintained, and whether such transactions involve abusive or manipulative trading practices. The Market Surveillance division uses sophisticated computer technology to detect unusual trading patterns, and the staff of the Market Surveillance division also maintains a presence on the trading floor of the NYSE. Market Surveillance makes referrals to the NYSE Enforcement division and the SEC Division of Enforcement, as appropriate.

- Enforcement.** This division investigates and prosecutes violations of NYSE rules and U.S. federal securities laws and regulations. Enforcement cases include customer-related sales practice violations, breaches of financial and operational requirements, books and records deficiencies, reporting and supervisory violations, misconduct on the trading floor, insider trading, market manipulation and other abusive trading practices. Sources of cases for the Enforcement division include examination findings referred by the Member Firm Regulation division, surveillance reviews referred by the Market Surveillance division, arbitration referrals from the Dispute Resolution/Arbitration division, reviews of customer complaints by the Enforcement division, settlements and reporting by member organizations, referrals from the SEC and complaints by members of the investing public and securities professionals.
- Dispute Resolution/Arbitration.** This division provides a neutral forum for the resolution of securities industries disputes in more than 46 cities throughout the United States. For more than 125 years, the NYSE has made available an arbitration forum to resolve disputes between investors and member organizations/brokers and between member organizations and their employees. Arbitration enables a dispute to be resolved quickly and fairly by impartial arbitrators, who are knowledgeable and trained in the art of resolving controversy.



2.79 101.99 22.73 35.86 15.96

## The Securities Investor Protection Corporation

What happens if your cash and securities are on deposit with a brokerage firm that encounters financial difficulties and goes out of business? Could you lose your entire investment? In 1970 Congress established the Securities Investor Protection Corporation (SIPC) as a private customer protection program to protect investors' money. In the event that a brokerage company fails, SIPC will cover losses up to \$500,000 per customer. This amount includes a maximum of \$100,000 for cash. Although infrequently used, SIPC is another example of the protective measures designed to instill investor confidence in today's stock markets.

### KEY TERMS

**Arbitration:** A low-cost alternative to the court system in settling disputes over securities transactions.

**Regulatory Pyramid:** A network of safeguards that surrounds the securities industry from individual brokerages all the way up to the U.S. Congress.

**Securities and Exchange Commission (SEC):** A watchdog agency created by the U.S. Congress to monitor the securities industry and enforce punishments of those who violate the industry's regulations.

**Securities Investor Protection Corporation (SIPC):** A safeguard for investors' capital created by Congress to ensure that cash and securities on deposit with a brokerage company are insured up to \$500,000 per customer, in the event that the brokerage company goes out of business.

**Self-Regulation:** The way in which the securities industry monitors itself to create a fair and orderly trading environment.

**Stock Watch:** The NYSE's state-of-the-art computer surveillance unit, which monitors the market in NYSE listed stocks for aberrant price and volume activity, which may indicate illegal transactions.

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