

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 98-69

July 16, 1998

BARING SECURITIES INC.
MEMBER ORGANIZATION

* * *

Violated Exchange Rule 342 in that the Firm failed to reasonably supervise or control certain activities, provide for appropriate procedures of supervision and control and establish a separate system of follow-up and review; violated Exchange Rule 440.20 in that the Firm did not properly create and reconcile suspense accounts; violated SEC Regulations 240.17a-3 and 240.17a-4 and Exchange Rule 440 in that the Firm failed to keep current and preserve required records; and violated Exchange Rule 472(a) in that the Firm issued or made available a research-related communication prior to approval -- Consent to censure and \$65,000 fine.

Appearances:

For the Division of Enforcement
Robert A. Marchman, Esq.
Nancy Reich Jenkins, Esq.
Clarence E. Sanders, Jr., Esq.

For the Respondent
Charles M. Carberry, Esq.

* * *

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 Baring Securities Inc. (the "Firm"), a member organization. Without admitting or denying guilt, the Firm consented to a finding by the Hearing Panel that it:

- I. Violated Exchange Rule 342 in that the Firm failed to (a) reasonably supervise or control certain of its business activities; (b) provide for appropriate procedures of supervision and control; and (c) establish a separate system of follow-up and review to determine that delegated authority and responsibility was being properly exercised, in that:
 - A. the Firm permitted employees to trade with the Firm's proprietary accounts without proper procedures to ensure propriety of trades;
 - B. the Firm's policies and procedures for employee trading were deficient and the Firm inadequately monitored employee trading in accounts maintained outside the Firm; and
 - C. the Firm's policies and procedures relating to restricted lists and research were deficient.

- II. Violated Exchange Rule 440.20 in that the Firm did not properly create and reconcile suspense accounts for aged items on a net basis.
- III. Violated SEC Regulations 240.17a-3 and 240.17a-4 and Exchange Rule 440 in that the Firm failed to keep current and preserve required records relating to employee trading and financial operations.
- IV. Violated Exchange Rule 472(a) in that the Firm issued or made available to customers or the public, a research-related communication prior to its approval by a supervisory analyst.

For the sole purpose of settling this disciplinary proceeding, and without admitting or denying any facts, the Division of Enforcement and the Firm stipulate to certain facts, the substance of which follows:

Background and Jurisdiction

1. During the first quarter of 1994 (“the relevant period”) and at all times relevant to this matter, the Firm was an Exchange member organization. In or about March 1995, subsequent to the conduct described herein, the Firm was taken over by ING, a Dutch company and later renamed ING Barings.
2. On or about August 9, 1994, the Exchange’s Division of Member Firm Regulation issued a Report of Examination (“the Report”) to the Firm containing findings alleging various violations of Exchange rules and federal securities laws. The Firm received the Report and responded to it by letter dated September 14, 1994.
3. By letter dated May 10, 1995, which the Firm received, the Exchange notified the Firm of its investigation into matters raised in the Report.

Overview

4. During the relevant period, the Firm violated various Exchange Rules and Securities and Exchange Commission (“SEC”) regulations when it: failed to reasonably supervise or control its business activities and provide for appropriate procedures of supervision and control with respect to the monitoring of employee trading; failed to preserve and keep current required records relating to employee trading; did not properly create and reconcile a suspense account; and made available to customers a research-related communication prior to its approval by a supervisory analyst.

Failure to Supervise

5. Exchange Rule 342, in pertinent part, requires that a member organization: (a) reasonably supervise or control its business activities; (b) provide for appropriate procedures of supervision and control; and (c) establish a separate system of follow-

up and review to determine that delegated authority and responsibility was being exercised.

6. As set forth below, the Firm failed to comply with these requirements.

**Permitting Employees to Trade with Proprietary Accounts
Without Proper Procedures to Ensure Propriety of Trades**

7. On or about trade date March 2, 1994, A, head of the Firm's Equity Trading Desk, authorized the purchase of 252,679 shares of XYZ, an Argentinean stock for the Firm's proprietary account.
8. At or about 6:30 p.m. on March 7, 1994, ABC Bank and Trust Company placed an order with the Firm to purchase 138,100 shares of XYZ.
9. In March 1994, the Firm did not make a market in XYZ stock and the stock was not traded in ADR form. Accordingly, the Firm forwarded ABC's order to its Argentinean affiliate to be filled locally.
10. ABC Bank's order was executed on trade date March 8, 1994 at approximately 3:30 p.m. ABC paid \$1.8956 per share for its XYZ stock.
11. On trade date March 8, 1994, at or about 8:15 a.m., A placed an order to buy 100,000 shares of XYZ stock for his personal account.
12. A's order was executed approximately one minute later, at or about 8:16 a.m. Pursuant to this execution, A purchased his XYZ shares from the Firm's proprietary account at a price of \$1.80 per share.
13. At the time of A's XYZ purchase, ABC's order, which had been entered approximately fourteen hours earlier, was still pending. However, ABC's order was executed after A's and ABC paid a higher price for its XYZ shares than A did for his.
14. On trade date March 15, 1994, A sold his XYZ shares to the Firm's proprietary account for \$1.90 per share.
15. On or about May 9, 1994, when it became aware of the timing of the executions discussed above, the Firm reversed the prices of A's and ABC's XYZ purchases.
16. At the time of A's XYZ trading, the Firm did not have clear policies and procedures regarding employee trading with the Firm's proprietary account. This permitted A to effect what appeared to be preferential trades for his own account at the expense of a customer order.
17. On or about March 25, 1994, the Firm's policies and procedures were changed to prohibit employee trading with the Firm's proprietary account. This change was

reflected in a memorandum (“the March 25 Memo”) to staff issued by the Firm’s Compliance Department. The March 25 Memo also reminded employees that customer orders took precedence over Firm and employee orders.

Deficient Approval Process for Employee Trading

18. During the relevant period, the Firm relied essentially on its trading floor supervisors to detect and prevent improprieties in employee personal trading.
19. During this period, prior to placing an order, employees who wanted to effect trades for their own accounts were required to complete a written form, the “Employee Transaction Request,” which listed: the date; account name and broker/dealer; security; number of shares; and whether the trade was a “buy” or a “sell.”
20. The employee then gave the completed form to their choice of one of several trading floor supervisors for authorization.
21. Before approving the employees’ trade, the supervisor was supposed to inquire about a number of matters, including the existence of pending customer orders in the security; whether the security was on the Firm’s restricted list; and other potential conflict of interest situations.
22. Upon approving the transaction, the supervisor signed the form and returned it to the employee, who was then supposed to forward it to the Firm’s Compliance Department for review.
23. However, employees were permitted to proceed with their trading as soon as they received the supervisor’s approval. This meant trades were sometimes completed before the Firm’s Compliance Department had a chance to review and confirm their propriety.
24. An example of the potential problems inherent in this system is evident in A’s XYZ trading, discussed above. In that situation, A, who was one of the individuals authorized to approve employee trading, obtained the required supervisory approval for his XYZ purchase, only to have the transaction reversed upon Compliance Department review.
25. On or about March 25, 1994, the procedures noted above were changed to require both supervisory and Compliance Department approval before employees were permitted to place orders for their personal accounts. This change was also reflected in the March 25 Memo.

ITSFEA Related Deficiencies

26. Section 21A(b)(1) of the Insider Trading and Securities Fraud Enforcement Act of 1988 (“ITSFEA”) requires that firms establish and maintain adequate policies and procedures reasonably designed to limit or contain the flow of non-public information

to employees. According to Exchange Information Memo 91-22, a copy of which was distributed to all Exchange members and member organizations, adequate procedures include the use of accurate “restricted” and “watch” lists.

Restricted List and Research-Related Problems

27. During the relevant period, the Firm failed to delete companies from its restricted list on a timely basis. (The Firm’s restricted list set forth the companies about which the Firm may have had material, non-public information.)
28. During the relevant period, the Firm failed to include on its restricted list securities which were the subject of Firm-related research.
29. During the relevant period, the Firm did not maintain a watch list. The watch list would have ensured that the Firm’s restricted list did not inappropriately highlight securities about which the Firm may have had material, non-public information. (A “watch list” generally lists companies singled out for special surveillance by the broker/dealer. Companies could be on a watch list for a variety of reasons, such as: unusual trading activity in a company’s securities or the broker/dealer is in possession of material, non-public information about the company resulting from an investment banking relationship with the company.)
30. During the relevant period, the Firm did not adequately review and supervise trader positions in non-market-maker securities that were opposite the Firm’s disseminated recommendations and executions of customer orders against these proprietary positions.

Inadequate Procedures Regarding Employee Trading

31. During the relevant period, the Firm: (a) did not adequately restrict employees from trading in their personal accounts before or after the issuance of a research report containing a change in recommendation; and (b) did not adequately review and supervise employees trading in their personal accounts in securities in which the Firm made a market.
32. During the relevant period, the Firm was deficient in obtaining from employees signed certifications acknowledging their review and understanding of the Firm’s “Chinese Wall” procedures.

Inadequate Monitoring of Employee Accounts Maintained Outside the Firm

33. During the relevant period, the Firm: (a) was deficient in learning of the existence of employee accounts maintained outside the Firm; and (b) was deficient in obtaining relevant statements and/or other records regarding employee trading in accounts maintained outside the Firm.

34. The Firm's lack of adequate procedures and controls in this area impeded the Firm's ability to monitor employee compliance with internal and/or Exchange rules and securities laws.
35. In or about March 1994, the Firm's policies and procedures were modified to address each of the ITSFEA matters noted above.

Untimely Reconciliations of Suspense Accounts

36. Exchange Rule 440.20, Identification of Suspense Accounting and Assessment of Responsibility for General Ledger Accounts, provides in pertinent part:

All receipts and payment of money shall be recorded promptly on each member organization's books of account.... A qualified employee shall be assigned responsibility for each general ledger bookkeeping account ... and such employee shall control and oversee entries into each such account and shall determine at all times that the account is current and accurate. A competent supervisory employee shall, as frequently as is necessary considering the function of the account but, in any event, at least monthly, review each account to determine that it is current and accurate and that any items which become aged and/or uncertain as to resolution are promptly identified for research and possible transfer to suspense accounts.

37. A review of the Firm's cash and security clearance account reconciliations for March 31, 1994 revealed suspense accounts were not being established for aged items on a net basis.
38. The Firm's failure to establish suspense accounts for aged items on a net basis violated Exchange Rule 440.20.

Failure to Maintain Accurate Books and Records

39. Pursuant to SEC Rules 17a-3 and 17a-4 and Exchange Rule 440, the Firm was required to maintain accurate books and records.
40. However, the Firm's books and records were inaccurate, in that:
 - a. the Firm did not maintain complete records regarding employee trading;
 - b. the Firm's restricted lists were, at times, inaccurate; and
 - c. suspense accounts were not established for aged items on a net basis.

Failure to Review and Approve Disseminated Research

41. Exchange Rule 472(a) prohibits Exchange members and member organizations from issuing or making available to the public research-related communications before such communications have been approved by a supervisory analyst.
42. On or about January 20, 1994, the Firm's sales staff obtained a copy of a draft research report concerning UVW.
43. The draft UVW research report had not been approved by the Firm's supervisory analyst.
44. The draft UVW research report contained a change in the Firm's recommendation regarding the stock, from "sell" to "buy."
45. On or about January 20, 1994, the Firm's sales staff used the draft research report, or the information contained therein, to solicit UVW "buy" orders from the Firm's customers.
46. These solicitations resulted in the Firm's customers placing orders to buy a total of approximately 16,000,000 shares of UVW on January 20, 1994. On or about January 21, the Firm's customers placed orders to purchase approximately 1,345,000 shares of UVW.
47. The Firm's supervisory analyst did not approve the UVW research report until February 2, 1994.

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 \$65,000 fine.

For the Hearing Panel

Vincent F. Murphy
Hearing Officer