

# NEW YORK STOCK EXCHANGE, INC.

In the Matter of )  
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Deutsche Bank Securities Inc. )

Request for Review of  
Exchange Hearing Panel  
Decision 05-45

In accordance with Exchange Rule 476(g), after a consideration of the record in this matter, written submissions and oral argument by the parties, the Board affirms the facts and findings set forth in Hearing Panel Decision 05-45. With respect to penalty, the Board reverses the decision of the Hearing Panel, which reduced the penalty to which the parties consented in the subject *Stipulation of Facts and Consent to Penalty*. In doing so, the Board fixes and imposes the penalty agreed to by the parties in the *Stipulation of Facts and Consent to Penalty*.

The Board believes that the penalty to which the parties consented is reasonable and appropriate under the facts and circumstances of this case, is consistent with relevant precedent and is the product of voluntary and good faith negotiations by the parties intended to settle this disciplinary proceeding.

Accordingly, the Board accepts the facts stipulated to by the Division of Enforcement and Deutsche Bank Securities Inc. (the “Firm” or “Respondent”) for the sole purpose of settling this disciplinary proceeding, the substance of which are:

## **Background and Jurisdiction**

1. Respondent commenced business as a member organization of the Exchange in 1987, as C.J. Lawrence, Morgan Grenfell, Inc. Since that time it has undergone a series of mergers, acquisitions, and name changes.
2. In or about January 2001, Respondent merged into another member organization, DB Alex. Brown LLC (“Alex. Brown”), which it had operated as a subsidiary since June 1999. This enterprise, under the names of Alex. Brown & Sons Incorporated and BT Alex. Brown Inc., had been a member organization of the Exchange since 1933.
3. Prior to the acquisition of Alex. Brown, Respondent was headquartered in New York City. Respondent had an institutional customer base and approximately 1,500 employees, including approximately 700 registered employees. Prior to its acquisition by Respondent, Alex. Brown was headquartered in Baltimore, and engaged primarily in a retail securities and investment banking business.
4. In or about October 2003, examiners from the Exchange’s Division of Member Firm Regulation (“MFR”) conducted a special Financial, Operational, and Supervision examination (“the MFR examination”). In a

Report dated April 22, 2004, the MFR examiners noted certain deficiencies related to the operations and supervision of the proxy function at Respondent. In or about May 2004, this matter was referred to Enforcement for investigation.

5. By letter dated May 18, 2004, Enforcement notified Respondent of its investigation.

### Overview

6. As set forth more particularly below, during the period from about March 1998 to November 2003 (“the relevant period”), Respondent (a) failed to timely reconcile stock records on beneficial ownership in connection with proxy voting; (b) issued duplicate requests for proxy voting instructions for securities held in certain omnibus accounts, which resulted in duplicate votes in some instances; (c) failed to transmit accurate information to its proxy services provider on numerous occasions; (d) voted more shares than it was entitled to vote (“over-voting”) in proxy matters in numerous instances;<sup>1</sup> and (e) did not adequately retain certain proxy solicitation records. Respondent also failed to reasonably supervise and control its business activity, and failed to establish a separate system of follow-up and review, to comply with the Exchange Rules and the federal securities laws, in that Respondent: (a) failed to reasonably supervise its proxy operations to prevent over-voting; (b) failed to provide for and implement written operations and supervisory procedures for its Proxy Department; and (c) failed to provide for and implement written procedures for the oversight of its proxy service provider.

### Summary of the Proxy Process

7. Pursuant to Exchange Rule 451, a member organization is required to transmit proxy materials to the beneficial owners of stocks which it holds in street name, when a person soliciting proxies supplies such material and provides assurance for reimbursement of expenses.
8. Pursuant to Exchange Rule 452, a member organization is required to give or authorize the giving of a proxy for stock registered in its name, at the direction of the beneficial owner. Routine matters in which a firm may vote without customer instructions and non-routine matters in which it may not are defined by Exchange Rules 452.10 and 452.11.
9. When securities are held by a member organization in street name on behalf of itself or a customer (collectively referred to as “Shareholders”), the member organization is required under Exchange Rule 451 to transmit proxy materials

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<sup>1</sup> As used herein, “over-voting” by a broker-dealer means that the broker-dealer’s services provider submitted proxies for more shares than the broker-dealer was entitled to vote on a specific proxy matter and does not mean that the transfer agent tabulating the votes (“the Tabulator”) necessarily counted these over-voted shares in determining the outcome of the proxy matter. See NYSE Information Memo 04-58, “Supervision of Proxy Activities and Overvoting” (Nov. 5, 2004).

to Shareholders in a timely manner. A member organization is also required to collect and properly transmit to a Tabulator, an agent of the issuer, any votes cast by Shareholders of the security for which proxies are solicited. This is normally done through a member organization utilizing a proxy service provider.

10. For each proxy solicitation, the Tabulator compares the proxy votes submitted on behalf of the member organization and/or its customers with the number of shares reflected on the records of the Depository Trust and Clearing Corporation (“DTCC”) for the member organization on the applicable record date. The number of shares showing on the records of DTCC for the member organization, with certain adjustments, is the maximum number of shares (votes) that will be tallied by the Tabulator in determining the outcome of the proxy vote. If a member organization submits to the Tabulator more shares than are shown for the member organization on the records of DTCC, then an “over-vote” results.
11. There are no standard industry procedures which govern Tabulators’ approach to dealing with over-voting. Tabulators may respond to over-votes with a variety of vote-counting procedures, including counting votes on a first in-first voted or last in-first voted basis, or disregarding altogether a vote submitted by a broker-dealer.
12. For certain routine matters included on corporate ballots, proxies may be voted by a member organization on a discretionary basis absent the receipt of votes cast by Shareholders. Votes cast by a member organization on these specified proposals are known as “discretionary” votes. Discretionary votes, if cast, are generally cast in favor of management’s recommendations. Unless otherwise instructed, the proxy service provider casts these votes according to standard instructions to vote these street-name positions. In non-routine matters on corporate ballots, as specified in Exchange Rule 452, a member organization may not vote its customer shares without instructions.
13. Member organizations use timely reconciliation of their records to provide accurate proxy instructions to their proxy service providers. Failure to timely reconcile stock records on beneficial ownership may result in inaccurate instructions being given to the proxy service provider. If there is no reconciliation of stock records of beneficial ownership, customer votes may be allocated inaccurately, because customers with both long and short positions will receive requests for proxy voting instructions for too many shares.

#### **History of Respondent’s Operations and The Proxy Department**

14. From March 1998 through about December 2000, Respondent’s proxy activities were assigned to personnel in New York. Between about January 2001 and May 2003, the proxy function was handled in Baltimore, Maryland. In February 2003, Respondent outsourced its retail clearing operations and the proxy functions relating to those accounts to another broker-dealer. In June

2003, the proxy function for Respondent's institutional business was transferred back to New York, where it has since remained.

15. Beginning in March 1998 and continuing to the present, Respondent has used a proxy service provider ("the Agent"). The Agent receives notice of pending proxy actions on behalf of Respondent, accesses Respondent's stock record (maintained at the Agent) to identify Respondent's accounts that hold an issuer's securities on record date, and determines the number of shares that are eligible to vote in the proxy action. It then arranges with the issuer or its agent, the Tabulator, to obtain the appropriate number of copies of the proxy-related material, which it then forwards to the beneficial owners (including Respondent, if applicable) of the issuer's security. Proxy votes cast are generally returned directly to the Agent, which then reports the votes to the Tabulator.
16. The Agent also has offered a service relating to the monitoring of potential over-votes. This service compares a broker-dealer's DTCC position with the voting instructions submitted by that broker-dealer through the Agent and notifies the broker-dealer if instructions to vote shares exceed that position. This notification permits broker-dealers to examine their records and to adjust (when appropriate) their records with the position reflected on DTCC's records.
17. The outsourcing of its proxy function to the Agent, as set forth above, did not relieve Respondent of the regulatory responsibility for compliance with the Exchange Rules relating to operation and supervision of the proxy function.<sup>2</sup>

#### **Over-Voting by Respondent**

18. As set forth below, over-voting at Respondent was caused by Respondent's failure to reconcile its records of beneficial ownership and by Respondent's erroneous issuance of duplicate requests for voting instructions to certain omnibus accounts.

#### **Respondent Failure to Reconcile Records of Beneficial Ownership in Connection with Proxy Voting**

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<sup>2</sup> NYSE Information Memo 04-58, "Supervision of Proxy Activities and Over-voting" (Nov. 5, 2004), issued after the matters addressed in this Stipulation, provides that, with regard to member organizations' use of service providers in the proxy process, although member organizations may outsource the gathering and voting of proxies, this "does not relieve the member organization of the regulatory responsibility for complying with the relevant regulations, supervising this process, maintaining adequate and accurate books and records, and ensuring that the rights of beneficial shareholders are protected. This responsibility would entail initial and continuing due diligence to assure that the service provider is capable of collecting and reporting the customer votes, and that the source of share information is accurate." Id., pp. 1-2.

19. During the relevant period, Respondent generally failed to reconcile its records of beneficial ownership so that beneficial owners' votes would be accurately tallied by the Tabulator for proxy voting purposes. Respondent lacked written procedures relating to proxy reconciliations and customarily voted shares as per its unadjusted DTCC level.
20. Between March 1998 and about December 2000, Respondent subscribed to the Agent's over-vote service. Pursuant to that service, the Agent notified Respondent when a potential over-vote was pending. Such notification could be used by Respondent to assist it in performing reconciliations. Nonetheless, even though this service was in effect, Respondent generally failed to reconcile its records of beneficial ownership and did not use such notifications to support its reconciliation work. Upon notification of a pending over-vote, Respondent's practice was generally to instruct the Agent to limit Respondent's discretionary votes to the number of shares held at DTCC, instead of performing a reconciliation and making appropriate adjustments to its records of beneficial ownership. In this period, the accounts for which Respondent failed to reconcile beneficial ownership records were primarily Respondent's proprietary accounts and proprietary accounts of Respondent's affiliates.
21. In or about January 2001, when Respondent transferred the proxy function from New York to Baltimore, Respondent's subscription to the Agent's over-vote service lapsed through lack of due care by Respondent. Respondent failed to notice or correct this error until in or about November 2003. From January 2001 through February 2003, when the over-vote service subscription was not in effect, Respondent's failure to reconcile records of beneficial ownership also related to prime brokerage and retail customer accounts.
22. In the period beginning in 1999, and continuing through the summer of 2004, Respondent failed to net securities positions held in Respondent's proprietary accounts, institutional accounts, prime brokerage accounts, and proprietary accounts of Respondent's affiliates. At various times in that period, Respondent did not net long and short positions within a single account, and did not net across all the accounts owned by a single legal entity to sum up that entity's position in a stock to a single net long (or short) position.

**Duplicate Mailing of Proxy Materials to Shareholder  
and Omnibus Accounts for Respondent Prime Brokerage Clients**

23. Respondent, in conjunction with its affiliates, offers enhanced prime broker services. The prime broker customers' long positions are carried in individual accounts at Deutsche Bank A.G., New York Branch ("DBNY"). However, DBNY custodies these long positions in an omnibus account at Respondent.
24. In identifying account owners to whom proxy materials were to be sent, Respondent erroneously issued requests for proxy voting instructions for certain prime brokerage accounts. Prior to June 2002, for prime brokerage clients who had accounts at DBNY, all proxy cards were sent to Respondent,

in an amount equal to the total shown in Respondent's omnibus account. The prime brokerage staff then sought instructions from the appropriate customers on how to vote the shares. In June 2002, at the request of the prime brokerage desk, the Agent reset DBNY's platform so that proxy cards for positions in individual accounts would also be sent to the account owners. Nevertheless, proxy cards for the overall positions in Respondent's omnibus accounts continued to be sent to the prime brokerage desk at Respondent.

25. This duplication was corrected in November 2003, following the MFR Examination.

### Over-Votes by Respondent

26. For 2003, the MFR Examination identified 12 instances, out of 15 tested, in which Respondent over-voted, that is, Respondent submitted more proxy votes than it was entitled to cast, in connection with proxy matters. For example, in March 2003, Respondent cast a total of 8,537,151 shares in a proxy matter involving "XYZ." (record date March 4, 2003). As of the record date, according to the information maintained at DTCC, Respondent in fact was eligible to vote only 4,232,867 shares. Thus, the over-vote in this matter was 4,304,284 shares. The over-votes submitted by Respondent in the other 11 proxy matters in 2003 ranged from 16,710 shares to 2,152,721 shares.
27. Enforcement's investigation disclosed that, in 2002, Respondent over-voted in 11 instances out of 12 tested. For example, in March 2002, Respondent cast a total of 11,168,338 shares in a proxy matter involving "XYZ" (record date March 5, 2002). As of the record date, according to the information maintained at DTCC, Respondent in fact was eligible to vote only 6,679,676 shares. Thus, the over-vote was 4,488,662 shares. The over-votes submitted by Respondent in the other 10 proxy matters in 2002 ranged from 31 shares to 1,876,283 shares.
28. Respondent's failure to reconcile the stock record in connection with proxy voting instructions was a central cause of the over-votes set forth above. In these uncontested matters, Respondent voted shares up to its unreconciled unadjusted long position, which was generally greater than its DTCC position.
29. Enforcement's investigation has not disclosed any instance in which an over-vote improperly shifted the balance of a proxy matter or any instance in which a shareholder who attempted to vote his or her shares was disenfranchised and lost his or her vote.
30. Despite the absence of actual harm, by submitting an over-vote, Respondent subjected its customers to the risk that their proxy votes would not be accepted. Tabulators have reported that they as a group have no standard approach for dealing with over-voting. The lack of any uniform procedure raises the possibility that Tabulators may employ procedures that cause votes to be lost. In counting the votes received in a proxy solicitation, the Tabulator compares the proxy votes submitted by a broker-dealer on behalf of the

Shareholders with the number of shares reflected on the records of DTCC for the applicable record date. Where a broker-dealer has over-voted, the Tabulator is faced with the problem of which shares to count (in reaching the DTCC level) and which to disregard (as exceeding the DTCC level). In the lack of an established procedure for resolving such situations, if faced by an unduly large number of proxy votes (because the total has been inflated by an over-vote), a Tabulator may count votes on a first in–first voted (FIFO) or last in–first voted (LIFO) basis, or disregard altogether a vote submitted from a street-name nominee holder on the basis that such inaccuracies give it no confidence in the validity of the submission.

### **Failure to Maintain Proxy Records**

31. Pursuant to Securities and Exchange Commission Rule 17a-4(b)(4), a member organization must retain “originals of all communications received and copies of all communications sent” by Respondent, “relating to [its] business as such,” for not less than three years, the first two in an accessible place.” Exchange Rule 440 requires that member firms shall make and preserve books and records as prescribed by SEC Rule 17a-3 and/or SEC Rule 17a-4.
32. Pursuant to Exchange Rule 452.20, firms must retain “all proxy solicitation records, originals of all communications received and copies of all communications sent” for “not less than three years, the first two in an easily accessible place.”
33. Certain records requested during the MFR Examination were not available and had to be reconstructed by Respondent or the Agent. Similarly, to produce certain records requested by Enforcement in connection with its investigation of this matter, Respondent was required to reconstruct the information from materials maintained by the Agent since those records had not been maintained by Respondent. Accordingly, Respondent did not maintain proxy records in accordance with SEC Rule 17a-4(b)(4) and Exchange Rule 452.20.

### **Failure to Supervise**

34. Pursuant to Exchange Rule 342(a), each office, department, or business activity of a member organization is required to be under the supervision and control of the member organization establishing it. Pursuant to Exchange Rule 342(b), each member organization, through its designees, is required to provide for appropriate procedures of supervision and control and to establish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.
35. Between March 1998 and October 2003, Respondent did not provide for or implement adequate written operational or supervisory procedures relating to its Proxy Department. Specifically, when the proxy function resided in New York between March 1998 to about December 2000 and from June 2003 to

November 2003, Respondent did not create or maintain written policies or procedures for the operations and oversight of the Proxy Department. Moreover, when the proxy function was handled by the Baltimore operations area from about January 2001 to May 2003, Respondent lacked adequate written operational and supervisory procedures, notwithstanding a May 2001 internal audit report that had identified this deficiency and the Proxy Department's undertaking to develop and implement such procedures.

36. During the relevant period, Respondent did not provide for and did not implement written procedures for the supervision of the Agent responsible for handling certain proxy functions.
37. During the relevant period, Respondent did not reasonably supervise its proxy operations to prevent over-voting. Specifically, Respondent (a) failed to implement adequate procedures to reconcile and adjust its records of beneficial ownership; (b) did not transmit to the Agent accurate information in connection with proxy matters; (c) did not assure that its systems and procedures provided for the accurate submission of proxy data to proxy tabulators; and (d) voted more shares than it was entitled to vote in proxy matters.

#### **Additional Matters**

38. In or about the summer of 2003, responding to a separate matter which had come to its attention, Respondent implemented a process to appropriately net long and short positions within a single account.
39. Prior to completion of the MFR Examination or shortly thereafter: (a) written operational and supervisory procedures for Respondent's proxy area were prepared with the assistance of a consultant and put into effect by Respondent, (b) Respondent reinstated its subscription to the agent's proxy over-voting reporting service, and (c) the agent's systems platform was reset to prevent further mailing of duplicate proxy material. A subsequent review of Respondent by MFR confirmed that the remedial procedures put in place by Respondent were in effect and functioning.
40. In the summer of 2004, Respondent developed a process to appropriately net across all the accounts owned by a single legal entity. At about the same time, Respondent also devoted additional staff to the proxy function.

Accordingly, the Board also accepts the findings stipulated to by the Firm and the Division of Enforcement, and, without any admission or denial of guilt by the Firm, the substance of which are that, Deutsche Bank Securities Inc.:

- I. Violated Exchange Rule 451 in that Respondent, on numerous occasions, failed to transmit to its customers who were beneficial owners of stock, via its service provider, accurate information in connection with proxy solicitations.

- II. Violated Securities and Exchange Commission Rule 240.17a-4, Exchange Rule 440, and Exchange Rule 452.20, in that Respondent failed to retain all proxy solicitation records for a period of not less than three years, the first two in an easily accessible location.
- III. Engaged in conduct inconsistent with just and equitable principles of trade, in that Respondent:
  - A. failed to implement adequate policies and procedures to adjust its record of stock ownership so that votes of its customers who were beneficial owners of stock were accurately tallied by the Tabulator for proxy voting purposes;
  - B. on numerous occasions, voted more shares than it was entitled to vote in proxy matters;
  - C. failed to assure that its systems and procedures provided for the accurate submission of proxy data to the proxy Tabulators.
- IV. Violated Exchange Rule 401 by failing to adhere to the principles of good business practice in that Respondent, on numerous occasions, failed to reconcile its record of stock ownership so that votes of beneficial owners were accurately tallied by the Tabulator for proxy voting purposes.
- V. Violated Exchange Rule 342 in that Respondent failed to:
  - A. supervise proxy operations to prevent overvoting;
  - B. provide for and implement written procedures for proxy operations and supervision of the proxy function;
  - C. provide for and implement written procedures for supervision of its proxy service provider.

The Board, in affirming the Hearing Panel's acceptance of the facts and findings stipulated to the parties, finds Deutsche Bank Securities Inc. guilty as set forth in the *Stipulation of Facts and Consent to Penalty*.

The Board further imposes the penalty consented to by the parties, that of a censure and a \$1,000,000 fine.

February 2, 2006

By the Board of Directors  
New York Stock Exchange, Inc.