

**Disciplinary Panel  
American Stock Exchange LLC**

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IN THE MATTER  
OF  
PRUDENTIAL EQUITY GROUP, LLC.  
formally known as  
PRUDENTIAL SECURITIES  
INCORPORATED

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Case No. 03-99  
Hearing Officer – DMF  
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**DECISION**  
April 19, 2005  
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**In accordance with a Stipulation of Facts and Consent to Penalty, the Disciplinary Panel Chair determined that Respondent violated Exchange Rules 30 and 320, as stipulated, and as a penalty imposed a censure, and a \$350,000 fine, to be paid jointly to the Exchange, the NYSE and NASD.**

**I. Introduction**

The American Stock Exchange, LLC (Exchange) instituted a formal disciplinary proceeding against Prudential Equity Group, LLC (Prudential), a regular member of the Exchange. The Disciplinary Panel Chair, presiding without convening a full Disciplinary Panel, pursuant to Article V, Section 1(b) of the Exchange Constitution, held a hearing on March 28, 2005, pursuant to Article V, Section 2 of the Exchange Constitution, to review a Stipulation of Facts and Consent to Penalty (Stipulation), which is attached as Exhibit A. The Exchange and Prudential entered into that Stipulation for the purposes of settling this proceeding and concluding all disciplinary actions by the Exchange against Prudential based upon or arising out of the facts set forth in the Stipulation.

**II. Facts**

Prudential, without admitting or denying liability, stipulated to the facts set forth in the attached Stipulation. The Disciplinary Panel Chair has determined to accept those facts for purposes of this Decision, and they are incorporated herein.

### **III. Violation**

Based upon the stipulated facts, the Disciplinary Panel Chair concludes that Prudential violated Exchange Rule 30 by submitting to the Exchange inaccurate reports of short interest positions in securities listed on the Exchange on a monthly basis from May 1995 to April 2003. In addition, Prudential violated Exchange Rule 320 by failing to establish and maintain appropriate policies, systems and procedures of supervision and control, including written supervisory procedures and a separate system of follow up and review to ensure compliance with short interest reporting requirements of the Exchange.

### **IV. Penalties and Publicity**

The Stipulation proposes that the Disciplinary Panel Chair impose on Prudential a censure, and a \$350,000 fine to be paid jointly to the Exchange, the NYSE and NASD. At the hearing, the Parties urged the Disciplinary Panel Chair to approve the proposed penalty. After considering the Stipulation and the statements of the parties, as well as the decisions cited in the Exchange's precedent memorandum and the fact that this is a joint settlement with the NYSE and NASD, the Chair finds that the proposed penalties are appropriate under the facts and circumstances of this case, and therefore, the Chair approves the Stipulation of Facts and Consent to Penalty. The Chair notes that the parties represented that Prudential has entered into parallel settlements with the NYSE and NASD. An NYSE Hearing Panel approved the NYSE settlement on March 24, 2005, and on April 7, 2005, NASD accepted Prudential's Letter of Acceptance Waiver and Consent ("AWC"). The Chair further finds that the results of this

disciplinary proceeding should be publicly disclosed, as provided in Rule 12 of the Exchange Rules on Disciplinary Proceedings.<sup>1</sup>

**V. Conclusion**

The Disciplinary Panel Chair accepts the Stipulation of Facts and Consent to Penalty, subject to NYSE and NASD approval of Prudential's parallel settlements with those entities, and hereby imposes upon Prudential Equity Group, LLC, a censure, and a \$350,000 fine to be paid jointly to the Exchange, the NYSE and NASD.

**FOR THE DISCIPLINARY PANEL**

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David M. FitzGerald, Chair

Copies to: Beth Stekler, Esq. (*via facsimile and first class mail*)  
Prudential Equity Group, LLC (*via overnight and via first class mail*)  
Jennifer D. Kim, Esq. (*electronically and via first class mail*)  
Arlene Collins-Day (*via facsimile and first class mail*)

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<sup>1</sup> Rule 12 exempts from publicity those cases in which the Panel finds that the offense "related solely to minor administrative requirements of the Exchange and does not materially affect the public interest or the interest of investors." Those exemptions do not apply to the facts of this case.

Disciplinary Panel  
American Stock Exchange LLC

.....	x	
	x	
IN THE MATTER	x	STIPULATION OF FACTS
OF	x	AND
PRUDENTIAL EQUITY GROUP, LLC	x	CONSENT TO PENALTY
formerly known as	x	
PRUDENTIAL SECURITIES INCORPORATED	x	Case No. 03-99
.....	x	

This proceeding was instituted by the American Stock Exchange LLC (“AMEX” or the “Exchange”), against PRUDENTIAL EQUITY GROUP, LLC (“PEG” or “the Firm”) (CRD #7471), a regular member of the Exchange. This Stipulation of Facts and Consent to Penalty is entered into with PEG pursuant to Article V, Section 2, of the Exchange Constitution in order to settle and conclude all disciplinary actions by the Exchange against PEG based upon or arising out of the facts hereinafter stipulated. PEG, without admitting or denying the facts, allegations and conclusions contained in this Stipulation of Facts and Consent to Penalty, hereby consents to the findings of violations of the Exchange Constitution and Rules and to the imposition of the penalties hereinafter provided. PEG understands that this settlement is subject to approval by an Exchange Disciplinary Panel and by the Amex Adjudicatory Council and that, if so approved, shall constitute a final decision that may not be appealed by the parties. PEG understands and acknowledges that the Disciplinary Panel’s decision in this matter will become part of its disciplinary record and may be considered in any future proceeding brought by the Exchange.

**STIPULATION OF FACTS**

- 1.0 During all relevant periods herein, Prudential Securities Incorporated (“PSI”) was a regular member organization of the Exchange, National Association of Security Dealers, Inc. (“NASD”) and the New York Stock Exchange, Inc. (“the “NYSE”) (collectively referred to as the “SROs”).<sup>1</sup>
- 1.1 During all relevant periods herein, PSI maintained its headquarters in New York with its principal office located at 199 Water Street, 34<sup>th</sup> Floor, New York, NY 10292-2015 and provided a full range of investment services to both individual and institutional investors.<sup>2</sup>
- 1.2 Exchange Information Circular No. 95-136 (“Reporting of Monthly Short Interest Positions”) advised all Members and Member Organizations that it was their responsibility to report to the Exchange, the relevant short positions in Exchange listed securities maintained by them, certain subsidiaries and their customers, pursuant to Exchange Rule 30. The Exchange distributed this circular on May 8, 1995. Short positions in Exchange listed securities were required to be reported on the 15<sup>th</sup> of each month, or where the 15<sup>th</sup> was a non-settlement date, on the preceding settlement date.

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<sup>1</sup> The conduct described in this Stipulation and Consent solely occurred during the period of time when the firm was known as PSI.

<sup>2</sup> PEG assumed its current structure on July 1, 2003, as a result of a business combination entered into between PEG’s parent, Prudential Financial, Inc., and Wachovia Corporation. As part of the business combination, Prudential Financial, Inc. contributed its U.S. and Latin American retail brokerage business, and its securities clearing and settlement business (including the business and activities of its correspondent clearing subsidiary) towards the formation of Wachovia Securities LLC (“Wachovia”). As part of the above-mentioned combination, PSI, also changed its name to PEG.

- 1.3. Exchange Information Circular No. 98-0234 (“Additional Short Position Reporting of Amex Listed Securities”) advised all Members and Member Organizations that it was their responsibility to report to the Exchange, the relevant short positions in Exchange listed Diamonds, SPDRS, MIDCAP SPDRS and the various WEBS series maintained by them, certain subsidiaries, and their customers pursuant to Exchange Rule 30. The Exchange distributed this circular on February 26, 1998. Commencing with the April 30, 1998 settlement date, in addition to the mid-month reporting described in paragraph 1.2 above, short positions in the aforementioned derivative securities were also required to be reported as of the close of the settlement date falling on the last business day of each month.
- 1.4 In computing short interest in a particular security, for purposes of making a required filing to the Exchange of a short interest report, member organizations were required to report short positions in the member organization’s proprietary accounts on a “gross” basis. The basis for reporting on a gross basis arose from an SEC Release in March 1995.<sup>3</sup> The requirement to report on a gross basis was also reiterated in an ISG Memorandum issued in March 1995.<sup>4</sup> Pursuant to these releases, short positions in proprietary accounts were not to be netted against long positions in the same security in other proprietary accounts, in determining the proprietary short interest position amount. The gross short position for a security in each proprietary account, along with short positions in the security in customer

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<sup>3</sup> See Securities Exchange Act Release No. 34-35450 (60 FR 13744) (March 7, 1995).

<sup>4</sup> See Intermarket Surveillance Group (ISG) Regulatory Memorandum 95-01, *Consolidated Reporting of Short Interest, Positions* (March 8, 1995).

accounts, were to be aggregated, and the total short interest amount was to be reported in the Member organization's short interest reports to the Exchange.

- 1.5 During all relevant periods herein, the aggregate short interest positions at the Exchange, NASD and the NYSE were disseminated to the public through various SROs and financial publications, on the basis of the individual short interest reports sent to the SROs by individual firms.

### **Inaccurate Reporting of Short Interest Positions**

- 2.0 In 1995, PSI implemented an automated Short Interest Reporting Program. From approximately May 1995 to April 2003, PSI calculated its short interest position for each security by netting all positions in that security, whether long or short, in its propriety accounts.
- 2.1 In late 2002, NASD initiated a short interest sweep. After reviewing PSI's stock positions for Dell Computer Corp., NASD observed that PSI had "netted" its short position in DELL prior to reporting it to NASD. NASD then contacted the AMEX and the NYSE and collectively, a joint investigation was conducted into PEG's short interest reporting to the Exchange, NASD and the NYSE.
- 2.2 PEG provided the Exchange with corrected short interest data for eleven (11) selected months during the period 2000 through 2003.
- 2.3 A review of the difference between the incorrect and revised numbers for the mid-month short interest reports received from PEG for the eleven (11) selected months during 2000 through 2003 revealed that a total of 31 positions during these selected months were reported incorrectly.

- 2.4 A comparative review of PEG's end of month reports revealed that its originally submitted reported short interest for the firm in AMEX ETFs for January 2003 was 0 shares; for February 2003, 40,000 shares; for March 2003, 290,300 shares; and for April 2003 (the last month of the firm's incorrect reports) was 248,900 shares. In May 2003 (the first month for PEG's "corrected" calculation), PEG reported short interest of 1,493,000 shares and in June 2003 reported short interest positions of 2,907,475 shares (beginning in July 2003, PEG and Wachovia reported their short positions together, reflecting the merger of the firms).
- 2.5 A review of the errors resulting from PSI's erroneous submissions for end of month reporting revealed that PSI's end of the month errors in the AMEX listed derivative securities were material and represented a significant percentage of PSI's total short interest reported to the AMEX.
- 2.6 During the approximate eight-year relevant period, PSI did not follow the regulatory requirement to report its short interest positions on a gross basis, as set forth by the 1995 SEC Release and ISG Memorandum. Instead, PSI continued to follow its prior practice of netting positions in its proprietary accounts.
- 2.7 During the relevant eight (8) year period, as a result of its improper treatment of proprietary accounts in the short interest reports that PSI submitted to the Exchange, certain short interest positions in Exchange-listed securities and derivative securities were underreported or not reported at all by PSI.

### **Supervisory Deficiencies**

- 3.0 During all relevant periods herein, PSI was subject to Exchange Rule 320(b), which provides that:

“Each office, department or business activity of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility. The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer including compliance with securities laws and regulations.”

- 3.1 During the relevant time period, PSI relied on an automated system to comply with its short interest reporting requirements. This system netted short and long positions in proprietary accounts. PSI assigned the responsibility for the actual short interest filings to the SROs to its Operations Regulatory Compliance area (“ORC”). Written supervisory procedures of the ORC (the “Procedures”) codified PSI’s incorrect practice of netting positions in proprietary accounts.
- 3.2 As set forth in the Procedures, supervisory personnel were required to review all submissions to the SROs to ensure that PSI’s short interest report accurately matched the stock record, and that proprietary accounts were being reported on a net basis.
- 3.3 No modifications were made to the short interest reporting process during the relevant period, nor did PSI conduct any internal audits to determine whether the reporting process was in compliance with the regulatory requirements in effect throughout this period.

- 3.4 PSI failed to adequately supervise its process for reporting short interest to the Exchange because it failed to implement the correct method for calculating its short interest positions and failed to have an adequate system of follow-up and review to assure its compliance with Exchange rules in the area of short interest reporting.
- 3.5 PSI's supervisory system did not have adequate procedures in place regarding the calculation and reporting of mid-month and end of month short interest to AMEX and PSI's supervisory system did not include written supervisory procedures providing for: 1) the identification of the person(s) responsible for supervision with respect to the applicable rule; and 2) a statement as to how the completion of the supervisory step(s) included in the written supervisory procedures should be documented.

### **CONCLUSIONS:**

By reasons of the above, a Disciplinary Panel may conclude that:

- 4.0 The Firm violated Exchange Rule 30 in that on a monthly basis during the period May 1995 to April 2003, the firm submitted to the Exchange inaccurate reports of short interest positions in securities listed on the Exchange, as set forth in paragraphs 2.0 through 2.7.
- 4.1 The Firm violated Exchange Rule 320 in that the firm failed to establish and maintain appropriate policies, systems and procedures of supervision and control, including written supervisory procedures and failed to establish a separate system of follow up and review to ensure compliance with short interest reporting requirements of the Exchange, as set forth in above paragraphs 3.0 through 3.5.

**DISCIPLINARY ACTION:.**

By reason of the foregoing Stipulated Facts, a Disciplinary Panel may impose the following penalties upon the Firm:

- (a) a censure; and
- (b) a total fine of \$350,000 to be paid jointly to the Exchange, the NYSE and NASD.

ON BEHALF OF:  
AMERICAN STOCK EXCHANGE LLC

By: \_\_\_\_\_

David Rosenstein  
Vice-President and Chief Counsel  
Enforcement Department  
NASD Amex Regulation Division

Agreed to this \_\_\_\_\_ day of \_\_\_\_\_, 2005.

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