

**Disciplinary Panel  
American Stock Exchange, LLC**

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IN THE MATTER  
OF  
CHARLES SCHWAB & CO., INC.

Case No. 02-28

**Disciplinary Panel Decision**

Hearing Officer – JN

May 15, 2003

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**In accordance with a Stipulation of Facts and Consent to Penalty, the Disciplinary Panel determined that Respondent violated Exchange Rules 208 and 320(b), as stipulated, and as a penalty imposed a censure and a \$20,000 fine.**

**DECISION**

**I. Introduction**

The American Stock Exchange, LLC (the “Exchange”) instituted a formal disciplinary proceeding against Charles Schwab & Co., Inc., a Regular Member organization of the Exchange. A Disciplinary Panel held a hearing on April 21, 2003, pursuant to Article V, Section 2 of the Exchange Constitution, to review a Stipulation of Facts and Consent to Penalty (attached) that the Exchange and Charles Schwab & Co., Inc. entered into for the purposes of settling this proceeding and concluding all disciplinary actions by the Exchange against the firm based upon or arising out of the facts set forth in the Stipulation.

**II. Facts**

Charles Schwab & Co., Inc., without admitting or denying liability, stipulated to the facts set forth in the attached Stipulation. The Disciplinary Panel 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 concludes that:

- 1.) Schwab violated Exchange Rule 208 in that the firm accepted multiple odd-lot orders for execution through its Layoff System, when such orders should have been consolidated into round lots, as described in paragraphs 2.4 through 2.8 of the Stipulation.
- 2.) Schwab violated Exchange Rule 320(b) in that the firm failed to have reasonable policies or procedures in place designed to detect or prevent an account or related accounts from entering multiple odd-lot orders rather than one round lot order, into the firm's Layoff System so as to reasonably detect or prevent the entry of multiple odd-lot orders in an abusive manner and allowing the same customer to circumvent the round lot auction market, as described in paragraphs 2.4 through 3.0 of the Stipulation.

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

The Stipulation proposes that the Disciplinary Panel impose a censure and a \$20,000 fine for the above misconduct. At the hearing, the Parties urged the Disciplinary Panel to accept the proposed penalty as being appropriate to the facts and circumstances of this case. After consideration of the Stipulation and the agreed-upon penalty, the Disciplinary Panel finds that the proposed penalty is at the appropriate level to be imposed in this proceeding and therefore accepts the penalty proposed in the Stipulation.

The Disciplinary Panel 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**

Based on the foregoing, the Disciplinary Panel, by unanimous vote, accepts the Stipulation of Facts and Consent to Penalty and hereby imposes a censure and a fine of \$20,000 upon Charles Schwab & Co., Inc.

**FOR THE DISCIPLINARY PANEL**

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Jerome Nelson, Chair

Dated: May 15, 2003

Copies to: David C. Whitcomb, Jr., Esq. (via overnight delivery and first class mail)  
David Piscitelli, Esq. (via overnight delivery and first class mail)  
Zandra M. Cheung, Esq. (via electronic mail and first class mail)

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<sup>1</sup> Rule 12 exempts from publicity those cases where 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	
OF	X	STIPULATION OF FACTS
CHARLES SCHWAB & CO., INC.	X	AND
	X	CONSENT TO PENALTY
	X	Case No. 02-28
.....	X	

This proceeding was instituted by the American Stock Exchange LLC (the “Exchange” or “AMEX”) against CHARLES SCHWAB & CO., INC. (“Schwab” or the “Firm”) (CRD # 5393), a Regular Member organization of the Exchange. This Stipulation of Facts and Consent to Penalty is entered into pursuant to Article V, Section 2 of the Exchange Constitution, in order to settle and conclude all disciplinary actions by the Exchange against Schwab based upon or arising out of the facts hereinafter stipulated. Schwab, without admitting or denying the facts, allegations and conclusions contained in this Stipulation of Facts and Consent to Penalty, hereby consents to the finding of violations of the Exchange Rules and to the imposition of the penalties hereinafter provided. Schwab understands that this settlement is subject to approval by an Exchange Disciplinary Panel and the Amex Adjudicatory Council and that, if so approved, shall constitute a final decision which may not be appealed by the parties. Schwab understands and acknowledges that the Disciplinary Panel’s decision in this matter will become part of Schwab’s disciplinary record, and may be considered in any future proceeding brought by the Exchange.

**STIPULATED FACTS:**

- 1.1 At all times relevant herein, Schwab was a Regular Member Organization of the Exchange.
- 1.2 During all relevant periods herein, Chicago Securities Group (“CSG”)<sup>1</sup> was a member organization and specialists of the Chicago Stock Exchange and customer of Schwab.
- 1.3 During all relevant periods herein, CSG contracted with Schwab to use Schwab’s Specialist Execution Services Layoff System (“Layoff System”). Schwab’s Layoff System provides Specialists on regional exchanges access to the primary markets and allows Specialists to execute listed security transactions on their own behalf. Access to Schwab’s Layoff System is limited to the Specialists on regional exchanges and not provided to other retail or institutional clients of Schwab.
- 2.0 During all relevant periods herein, Schwab was subject to Exchange Rule 208, which provided that:

“A member or member organization may not combine the orders given by several customers to buy or sell odd-lots<sup>2</sup> of the same stock into a round lot order without the prior approval of all of the customers interested. When a person gives, either for his own account, for various accounts in which he has an actual monetary interest, or for accounts over which such person is exercising investment discretion, buy or sell odd-lot orders which aggregate one or more round lots, a member or member organization shall not accept such orders for execution unless they are, as far as possible, consolidated into round lots, except that selling orders

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<sup>1</sup> Chicago Securities Group is not a member of the American Stock Exchange.

<sup>2</sup> Exchange Rule 204 defines an odd-lot order as any order less than the unit of trading. Exchange Rule 204 further states that an odd-lot order “shall be executed . . . at a price based on the price of a transaction in the round-lot market on the Floor of the Exchange, plus or minus, if any differential is charged the amount of such differential.” Odd-lot orders are not printed to the tape, i.e. such orders are not displayed to the market.

marked “long” need not be so consolidated with selling orders marked “short.”

2.1 Pursuant to Exchange Rule 205, Specialists on the Exchange are required to execute an odd-lot market order at the prevailing offer (in the case of an order to buy) or bid (in the case of an order to sell).

2.2 During all relevant periods herein, Schwab was subject to Exchange Rule 320(b), which provided 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 obligation 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.”

2.3 During all relevant periods herein, stock ABC was listed for trading on the Exchange.

2.4 On November 15, 2001, a trader for CSG entered multiple odd-lot buy orders in ABC stock using Schwab’s Layoff System. The trader entered twelve 99 share orders for ABC stock (1188 shares in total) and one 1212 share order for ABC stock rather than one round lot order for 2400 shares. The twelve 99 share orders were entered between 9:52:47 a.m. and 9:54:02 a.m. The 1212 share order was entered at 9:59:27 a.m.

2.5 By entering multiple odd-lot buy orders for ABC stock, the CSG trader circumvented the execution of a round lot order which would have appeared on

- the Exchange tape, thereby failing to publicly reflect actual market interest by the CSG trader in ABC stock. Additionally, by entering multiple odd-lot orders rather than a round lot order, an order(s) was not represented to the trading crowd, thereby depriving public customers the opportunity for price improvement in the auction market for ABC stock.
- 2.6 By entering multiple odd-lot buy orders for ABC stock, the CSG trader limited participation on the execution of the odd-lot orders to the Specialist in ABC stock, since only the Specialist is the contra party to odd-lot trades.
- 2.7 By entering multiple odd-lot buy orders for ABC stock, the CSG trader compelled the Specialist to execute the multiple odd-lot buy orders at the prevailing offer in ABC stock. The prevailing offer in ABC stock at the time of entry of the odd-lot buy orders was \$27.65.
- 2.8 During the relevant time period, Schwab did not systematically survey for or prevent the entry of multiple odd-lot orders through the Layoff System in the manner described above in paragraph 2.4. Schwab advised the Exchange that it principally relied on the fact that the users of the Layoff System were regional specialists themselves to effect compliance with Exchange odd-lot trading rules. In April 2002, however, Schwab issued an information memorandum reminding users of its Layoff System of the Exchange rules concerning the multiple entries of odd-lot orders.
- 2.9 On October 7, 2002, following a second inquiry from the Exchange concerning the implementation by the firm of procedures designed to detect or prevent the multiple entry of odd-lot orders, Schwab implemented procedures for its Layoff

- System designed to detect odd-lot orders entered in a short period of time. Shortly after implementation of these procedures, Schwab detected instances of further potentially violative odd-lot trading activity in New York Stock Exchange (“NYSE”) stocks; Schwab alerted the NYSE of its findings.
- 3.0 On October 22, 2002, Schwab revised its procedures and technology with respect to its Layoff System, by completely restricting the direct entry by its customers of odd-lot orders through the firm’s Layoff System.

**CONCLUSION:**

- By reason of the foregoing Stipulated Facts, an Exchange Disciplinary Panel may conclude that:
- 4.0 Schwab violated Exchange Rule 208 in that the firm accepted multiple odd-lot orders for execution through its Layoff System, when such orders should have been consolidated into round lots, as described in above paragraphs 2.4 through 2.8.
- 4.1 Schwab violated Exchange Rule 320(b) in that the firm failed to have reasonable policies or procedures in place designed to detect or prevent an account or related accounts from entering multiple odd-lot orders rather than one round lot order, into the firm’s Layoff System so as to reasonably detect or prevent the entry of multiple odd-lot orders in an abusive manner and allowing the same customer to circumvent the round lot auction market, as described in above paragraphs 2.4 through 3.0.

DISCIPLINARY ACTION:

A Disciplinary Panel may impose the following penalties upon Schwab:

- a) a censure, and
- b) a \$20,000 fine.

AMERICAN STOCK EXCHANGE

By: \_\_\_\_\_  
Glen Barrentine  
Senior Vice President

Agreed to this \_\_\_\_ day of \_\_\_\_\_, 2003.

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David C. Whitcomb, Jr.  
Vice President  
Compliance Department  
Charles Schwab & Co., Inc.