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July 29, 2004

SEC AND NYSE REACH SETTLEMENTS WITH NYSE SPECIALIST FIRMS FOR VIOLATING FEDERAL SECURITIES LAWS AND NYSE REGULATIONS

[17813] July 29, 2004 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 34-04 RE: SEC AND NYSE REACH SETTLEMENTS WITH NYSE SPECIALIST FIRMS FOR VIOLATING FEDERAL SECURITIES LAWS AND NYSE REGULATIONS The Securities and Exchange Commission and the New York Stock Exchange have announced the initiation and settlement of enforcement actions against two NYSE specialist firms for violating federal securities laws and NYSE regulations.1 Specifically, the SEC's press release announcing the settlements states that in a joint investigation, the SEC and NYSE found that, between 1999 and 2003, the specialist firms, through particular transactions by certain of their registered specialists, violated federal securities laws and Exchange rules by executing orders for their dealer accounts ahead of executable public customer or "agency" orders. Through this conduct, the firms improperly profited from trading opportunities; disadvantaged customer orders; and breached their duty to serve as agents to public customer orders. The SEC and NYSE found that the improper proprietary trading took various forms. For example, the press release states that certain of the firms' specialists "interpositioned" the firms' dealer accounts between customer orders by trading into both of them in succession, e.g., by buying into a customer market sell order first, and then selling, at a higher price, into the opposite market buy order, thus allowing the firms' dealer accounts to profit from the spread. In addition, the specialists traded for their dealer accounts ahead of executable agency orders on the same side of the market. Finally, at other times, the specialists traded ahead of marketable limit orders, which then went unexecuted and ultimately were cancelled by the customers entering the orders. 1 See In the Matter of SIG Specialists, Inc., Securities Exchange Act Release No. 50076, Admin Proc. File No. 3-11559 (July 26, 2004); In the Matter of Performance Specialist Group LLC, Securities Exchange Act Release No. 50075, Admin Proc. File No. 3-11558 (July 26, 2004) (together, "SEC Orders"). Copies of the SEC Orders and accompanying press release are available at http://www.sec.gov/litigation/admin/34-50076.htm, http://www.sec.gov/litigation/admin/34-50075.htm, and http://www.sec.gov/news/press/2004-99.htm, respectively. Previously, the SEC and the NYSE had announced the initiation and settlement of enforcement actions with the other five NYSE specialists firms. For a summary of these prior enforcement actions, see Institute Memorandum to Equity Markets Advisory Committee No. 12-04, dated March 30, 2004 [17320]. 2 The specialist firms will pay a total of $5.2 million in penalties and disgorgement. The settlement provides that this payment will go to a distribution fund for the benefit of

injured customers. The firms also must implement steps to improve their compliance procedures and systems. Jane G. Heinrichs Assistant Counsel

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