

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 63724 / January 14, 2011**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-14191**

**In the Matter of**

**BNY MELLON SECURITIES  
LLC,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO SECTION  
15(b) OF THE SECURITIES EXCHANGE  
ACT OF 1934, MAKING FINDINGS, AND  
IMPOSING REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”), against BNY Mellon Securities LLC (“Respondent” or “Mellon Securities”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. These proceedings arise out of Respondent's failure reasonably to supervise the order desk manager on its institutional order desk and traders under his supervision from November 1999 through March 2008. The institutional order desk executed orders to purchase and sell securities on behalf of Mellon Securities' affiliate, Mellon Investor Services LLC ("MIS"), an administrator for various employee stock purchase plans, employee stock option plans, direct stock purchase and sale plans, and similar plans (collectively, the "Plan Customers"). Throughout the relevant period, Mellon Securities' order desk manager failed to meet his duty of best execution to certain Plan Customers by executing many of their orders at stale or inferior prices, which in many instances were outside of the National Best Bid and Offer ("NBBO")<sup>2</sup> at the time of execution, in cross trades with a favored handful of accounts held by hedge funds and individuals (together, the "hedge fund(s)"). The order desk manager directed traders under his supervision to do the same.

2. The cross trades were all executed on a regional stock exchange that permitted Member Firms to capture and freeze the NBBO market data for a security for up to three minutes. Generally, a Mellon Securities trader would call a Member Firm to capture the NBBO for a particular security while simultaneously viewing quotations for the security to determine whether and, if so, at what price to execute the cross trade. For Plan Customer sales, Mellon Securities' traders in many instances sought and obtained lower prices to benefit the hedge funds and, conversely, for Plan Customer purchases, they sought and obtained higher prices, again to benefit the hedge funds. In this way, the order desk in many instances advantaged the hedge fund customers and deprived the Plan Customers of best execution of their orders.

3. MIS paid Respondent two cents per share for Plan Customer orders. The hedge funds paid Respondent, generally, between two and six cents per share. When the order desk crossed an order, Respondent received full commissions from both sides of the transaction. The hedge funds' commission rates varied with each trade and, customarily, were set by the hedge funds at the end of each day's trading. The order desk's annual bonus pool depended in part upon the commissions it generated, and the order desk manager determined how he and the traders under his supervision shared in the bonus pool.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> National best bid and national best offer means, with respect to quotations for an NMS Security, the best bid and best offer for such security that are calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan. 17 C.F.R. § 600(b)(42).

## **Respondent**

4. Mellon Securities, a Delaware corporation with its principal place of business in Jersey City, New Jersey, is a broker-dealer registered with the Commission. Mellon Securities is a legacy entity of Mellon Financial Corporation of Pittsburgh (“Mellon Financial”).

5. In 2009, Bank of New York Mellon Corporation (“BNY Mellon”), the ultimate parent of Mellon Securities, sold the assets of Mellon Securities to a separate (but affiliated) broker-dealer. In August 2009, BNY Mellon withdrew Mellon Securities’ broker-dealer registrations from all states except New Jersey. Today, Mellon Securities exists only as a shell entity; it has no employees and no business operations.

## **Other Relevant Entities**

6. MIS, a New Jersey corporation with its principal place of business in Jersey City, New Jersey, is a registered transfer agent and administrator for the Plan Customers. It, too, is a legacy entity of Mellon Financial and subsidiary of BNY Mellon.

7. BNY Mellon, a Delaware corporation with principal executive offices in New York, New York, was created in July 2007, when the Bank of New York Company acquired Mellon Financial.

## **Background**

8. From November 1999 through March 31, 2008, Respondent provided trade execution services to the more than seven hundred issuers whose stock plans were administered by MIS. Consistent with Respondent’s best execution obligations to the Plan Customers, the order desk had authorization to handle all Plan Customer orders as market not-held orders, meaning it had discretion as to the time of execution but was required to execute Plan Customer orders within prevailing market prices. Generally, Plan Customer orders for the purchase or sale of 2,000 or more shares of a security were routed to the order desk for special handling. As Plan Customer orders arrived at the order desk, the order desk manager and traders solicited orders from the hedge funds for the purpose of crossing the orders. The order desk manager directed his traders to cross as much of the Plan Customer orders routed to the order desk as possible, and that is what they did.

## **The Validated Cross Window**

9. In December 2006, the regional exchange through which Mellon Securities’ cross trades were executed and reported added a functionality to its order management system called the validated cross window. The intended purpose of the validated cross window was to support timely reporting of cross trades while simultaneously ensuring the transaction did not trade through the NBBO for compliance with Rule 611 of Regulation NMS, the Order Protection Rule, and certain regional exchange rules. (A trade through occurs when a security is traded at a price outside of the NBBO prevailing at the time of execution.) The validated cross window remained in use until the end of the relevant period.

10. The validated cross window validated a market, meaning the NBBO, by capturing and freezing a snapshot of the NBBO market data for a security (“Snapshot NBBO”) at the moment a Member Firm broker typed the security’s symbol into the system. At the same moment, a window expiration timer was initiated. The timer gave the broker up to three minutes to fill in required fields, including quantity and price, and to submit the trade for execution and reporting.

11. Once submitted for execution and reporting, the system would ensure that the proposed cross trade did not trade through the Snapshot NBBO.<sup>3</sup> If the cross trade satisfied all requirements, the trade was accepted by the system and reported to the consolidated tape; if not, the trade was rejected.

12. Instead of submitting a trade for execution and reporting, a Member Firm broker could refresh the window, meaning he could capture another subsequent Snapshot NBBO, and initiate a new window expiration timer. (The system did not limit the number of times a window could be refreshed.) The Member Firm broker also could allow a window to expire at the end of the timer.

### **Using Trade Tickets to Validate Markets**

13. Prior to the introduction of the validated cross window, the regional exchange used trade tickets to validate markets. This system, although manual, was in many instances used in the same way by the order desk traders to cross orders at prices favorable to the hedge funds, and unfavorable to the Plan Customers. Once a Member Firm broker stamped a trade ticket, the broker had up to one minute to clear the post, that is, to make sure the cross trade would not trade through any outstanding orders held by the specialist on the exchange. If the cross trade would clear the post, the broker could execute it at the NBBO prevailing at the time of the stamp, or any other price that prevailed before the minute expired.

14. The regional exchange time stamp showed only the hour and minute, not seconds. Thus, the “minute” a broker had to clear the post could, in actuality, be up to nearly two minutes. If in these two minutes, a broker preferred a subsequent price in the market, he could execute at that price or, by stamping a new ticket, capture the new price. If he stamped a new ticket to capture the new price, he would have another two minutes in which to decide whether to execute a trade.

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<sup>3</sup> To ensure compliance with the Order Protection Rule, the system should have ensured that the proposed cross trade did not trade through the NBBO prevailing in the market at the moment of execution, not the Snapshot NBBO. In practice, however, that is not how the regional exchange’s system functioned.

## **The Order Desk's Conduct**

15. The order desk manager and, at his direction, traders under his supervision in many instances used the validated cross window to work the Plan Customers' not-held orders in a manner designed to benefit the hedge funds and deprive the Plan Customers of best execution, generally, in one of two ways. In the first scenario, they used the ability to capture and freeze prices to chase better prices for the hedge funds. In the second scenario, they executed trades at stale prices, more favorable to the hedge funds than prices prevailing in the market at the time the trade was executed.

16. For example, when the order desk crossed a Plan Customer order to sell securities with a hedge fund order to buy those same securities, if the security *fell in price* after a Member Firm broker first captured a Snapshot NBBO for the order desk, the broker would in many instances refresh the validated cross window to capture the new, lower price, *i.e.*, a new Snapshot NBBO, and reset the window expiration timer. If the price of the security continued to fall, the Member Firm broker, working at the behest of the order desk, would in many instances lock in new, lower prices to advantage the hedge fund, until the order desk decided to execute the trade. This could be done within a second of capturing the previous Snapshot NBBO or at any point prior to the end of the window expiration timer. The Snapshot NBBO for a security could be captured anywhere from a few times to a few dozen times before the order desk directed the Member Firm broker to execute and report the trade. On the other hand, if the security *rose in price* after a Member Firm broker captured a Snapshot NBBO for the order desk, the order desk would in many instances direct the broker to execute and report the trade at the stale, lower price, to advantage the hedge fund.

17. An analysis of more than 8,500 cross trades indicates that the order desk manager and, at his direction, traders under his supervision used the validated cross window to chase better prices for the hedge funds and/or to execute trades at stale prices more favorable to the hedge funds more than eighty percent of the time.

18. The order desk's practices were the same prior to the introduction of the validated cross window, only the mechanics differed. Prior to the introduction of the validated cross window, the order desk routinely asked its Member Firm brokers to capture more than one NBBO for a trade, and used the ability to capture and freeze prices to achieve better prices for the hedge funds.

19. As a result of the conduct described above, from November 1999 through March 31, 2008, the order desk manager and traders violated Section 17(a) of the Securities Act of 1933 ("Securities Act").

## **Respondent's Failure to Supervise**

20. Mellon Securities' written supervisory procedures ("WSP") created a best execution committee and required it to meet quarterly to assess the quality of execution being obtained by the order desk. Mellon Securities also had established procedures relating to the best execution of market not-held orders that required the order desk manager to conduct a daily best execution review of executions on regional exchanges. However, Mellon Securities' supervisory

procedures were unreasonable in two important respects. First, Mellon Securities failed to establish reasonable procedures for the best execution committee concerning how to follow up on red flags raised in best execution exception reports. Second, Mellon Securities did not have procedures in order to determine whether the order desk manager was fulfilling his responsibility to conduct a daily best execution review of executions on regional exchanges.

21. Quarterly reports prepared for Mellon Securities' best execution committee compared Mellon Securities' execution statistics with industry averages. One of the statistics tracked by the reports was the frequency with which Mellon Securities executed trades in listed securities outside of the prevailing NBBO, or "outside the quote." According to the reports, Mellon Securities executed orders outside the quote at a rate greater than industry averages for repeated quarters, beginning at least as early as the third quarter of 2003, and at a rate two to three times of the industry averages for every quarter beginning with the fourth quarter of 2006.

22. The order desk manager and traders in many instances caused trades to be executed outside of the prevailing NBBO, resulting in Mellon Securities' anomalous "outside the quote" statistics; however, Mellon Securities failed to establish reasonable procedures for the best execution committee concerning how to follow up on the best execution exception reports. If Mellon Securities had had reasonable procedures concerning how to follow-up on the red flags raised in the exception reports, it likely would have prevented and detected the violations by the order desk manager and traders.

23. The order desk manager and traders used the ability to capture and freeze prices in many instances to benefit the hedge funds at the expense of the Plan Customers and, thus, failed to meet their duty of best execution with respect to the Plan Customers' market not-held orders. Mellon Securities' WSP required the order desk traders to use their professional judgment, consistent with their best execution obligations to customers, to determine the time and manner of execution of market not-held orders based on current market conditions and, at a minimum, to provide the best price a customer likely could obtain on the open market. However, the only ongoing monitoring and review of the effectiveness of these procedures in detecting or preventing violations was a daily best execution review by the order desk manager of executions on regional exchanges. The order desk manager never conducted such a review and Mellon Securities did not have procedures to determine whether he was fulfilling his responsibility to do so. If Mellon Securities had had such procedures in place, it would have learned the order desk manager never conducted such a review, and likely would have prevented and detected the order desk manager's and traders' violations.

24. As a result of the conduct described above, from November 1999 through March 31, 2008, Respondent failed reasonably to supervise the order desk manager and traders on its institutional order desk within the meaning of Section 15(b)(4)(E) of the Exchange Act with a view to preventing and detecting violations of Section 17(a) of the Securities Act.

### **Cooperation and Remedial Efforts**

25. In determining to accept the Offer, the Commission considered remedial acts undertaken by Respondent and cooperation afforded the Commission staff.

26. On March 31, 2008, within three days of discovering that the Commission had charged one of the hedge funds in an unrelated matter, Respondent suspended cross-trading activity. BNY Mellon immediately commenced an internal investigation of the order desk's activities.

27. On May 2, 2008, the order desk manager was terminated for cause.

28. On July 22, 2008, BNY Mellon reported the matter to Commission staff.

### **Undertakings**

29. Mellon Securities has undertaken to retain, within 30 days of the entry of this Order, at its own expense, an Independent Distribution Consultant, not unacceptable to the Division of Enforcement, to devise a Distribution Plan to distribute the Fair Fund established in Section IV, below. Mellon Securities shall require the Independent Distribution Consultant to develop a Distribution Plan to administer and distribute the monetary sums ordered to be paid pursuant to Section IV(C) below (and any other monetary sums ordered by the Commission or any federal court related to the conduct described in this Order) in a manner that compensates fairly and proportionately the Plan Customers for losses attributable to cross trades conducted on their behalf by the Respondent from November 1999 through March 2008. Mellon Securities (which for the limited purpose of the undertakings set forth herein, paragraphs 31 through 35, shall include, where appropriate, BNY Mellon) shall cooperate fully with the Independent Distribution Consultant and shall provide the Independent Distribution Consultant with access to its files, books, records, and personnel as reasonably required to develop the Distribution Plan.

30. Mellon Securities shall require the Independent Distribution Consultant to submit to Mellon Securities and the staff of the Commission the Distribution Plan within 120 days of the entry of this Order.

31. With respect to any determination or calculation of the Independent Distribution Consultant with which Mellon Securities or the staff of the Commission does not agree, such parties shall attempt in good faith to reach an agreement within 150 days of the entry of this Order. In the event that Mellon Securities and the staff of the Commission are unable to agree on an alternative determination or calculation, within 180 days of the entry of this Order, they shall each advise, in writing, the Independent Distribution Consultant of any determination or calculation from the Distribution Plan that it considers to be inappropriate and state in writing the reasons for considering such determination or calculation inappropriate. After consideration of any written submissions made by Mellon Securities or the staff of the Commission, final determinations or calculations rest with the Independent Distribution Consultant.

32. Within 195 days of the entry of this Order, Mellon Securities shall require the Independent Distribution Consultant to submit the Distribution Plan for the administration and distribution of disgorgement and penalty funds pursuant to the Commission's Rules on Fair Fund and Disgorgement Plans. Following a Commission order approving a final plan of disgorgement, as provided in the Rules on Fair Fund and Disgorgement Plans, Mellon Securities shall require the Independent Distribution Consultant to take all necessary and appropriate steps to administer the final plan for distribution of the fair fund.

33. Mellon Securities shall require the Independent Distribution Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Distribution Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Mellon Securities, or any of its present or former affiliates, directors, officers, employees or agents acting in their capacity as such. The agreement will also provide that the Independent Distribution Consultant will require that any firm with which he or she is affiliated or of which he or she is a member, and any person engaged to assist the Independent Distribution Consultant in the performance of his or her duties under this Order shall not, without prior written consent of Andrew M. Calamari, Associate Regional Director, Division of Enforcement, New York Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Mellon Securities, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

34. In determining whether to accept the Offer, the Commission has considered these undertakings.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 15(b)(4) of the Exchange Act, it is hereby ORDERED that:

A. Respondent is censured.

B. Respondent shall, within 14 days of the entry of this Order, pay disgorgement of \$19,297,016 and prejudgment interest of \$3,748,431, and a civil money penalty in the amount of \$1,000,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to Commission Rule of Practice 600 and/or 31 U.S.C. § 3717. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, VA 22312-0003; and (D) submitted under cover letter that identifies BNY Mellon Securities LLC as a



Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and wire transfer, money order, or check shall be sent to Andrew M. Calamari, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281-1022.

C. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement, interest and penalties referenced in paragraph B, above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that it shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that it is entitled to, nor shall it further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in this Order instituted by the Commission in this proceeding.

D. Respondent acknowledges that the Commission is not imposing a civil penalty in excess of \$1,000,000 based upon its cooperation in a Commission investigation and/or related enforcement action. If at any time following the entry of this Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and without prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay an additional civil penalty. Respondent may not, by way of defense to any resulting administrative proceeding: (1) contest the findings in this Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

E. Respondent shall comply with the undertakings enumerated in Section III, above.

By the Commission.

Elizabeth M. Murphy  
Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions as to BNY Mellon Securities LLC ("Order"), on the Respondent and its legal agent.

The attached Order has been sent to the following parties and other persons entitled to notice:

The Honorable Brenda P. Murray  
Chief Administrative Law Judge  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

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