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S.E.C. Lays Down the Law After Abuses In Philadelphia

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The Securities and Exchange Commission has come down hard on the Philadelphia Stock Exchange, which has been tarnished by two recent scandals involving members of its board.

Arthur Levitt Jr., the chairman of the commission, paid a highly unusual visit to the exchange last Friday to deliver a report that was sharply critical of the way the exchange does business. He criticized board members for being so preoccupied with political infighting that they neglected their regulatory responsibilities, according to several people who attended the meeting and spoke on the condition that they not be identified.

Mr. Levitt recommended, among other things, that the exchange appoint people who represent the investing public to half of the slots on its board and strengthen its conflict-of-interest rules, according to people familiar with the report. Several of them described Mr. Levitt as "reading the riot act."

Philadelphia has the fewest independent directors of the five regional exchanges, "so we kind of stuck out," said Nicholas A. Giordano, chief executive of the Philadelphia exchange. Only three of the exchange's 29 members represent the public, as opposed to securities firms and members of the exchange, he said.

The exchange is likely to shrink its board and add more independent members after a special committee reports on governance issues later this spring, Mr. Giordano said, adding, "I would say chairman Levitt was firm and uncompromising about what we should be doing."

Lori Richards, the commission's director of compliance, said she would have no comment on the Philadelphia report. But she said the commission had been a strong supporter of increased public membership on the boards of self-regulatory organizations like the exchange.

Philadelphia is the second smallest of the regional exchanges, which generally trade shares of companies that are listed on the New York Stock Exchange. Last year, Philadelphia handled 2 percent of such trades; the Boston Stock Exchange accounted for 1.8 percent.

The exchanges, which call themselves the National Market Exchanges, say brokers send trades to them because their markets have lower costs and better service than the Big Board; critics contend that brokerage firms send orders to the regional exchanges because they have opportunities to make extra profits there.

Mr. Levitt's meeting with the board was in some ways similar to one he held with the directors of the National Association of Securities Dealers while that organization was negotiating with the commission over accusations that it had treated investors poorly. It settled that complaint last year and reorganized itself to add independent directors and strengthen its regulatory staff.

But in Philadelphia's case, the commission's investigation was prompted by a specific problem: the failure to act promptly when officials discovered that the chairman of its board may have had a conflict of interest because of his ownership stake in a small company doing business with the exchange.

The former chairman, Vincent J. Casella, has said he did nothing improper by investing in Ashton Technology Group, a start-up that had received a contract to develop a new trading system for the exchange. The S.E.C. is still looking into that matter.

Mr. Casella invested in the company in April 1995, before he became chairman but while he headed a committee of the exchange that recommended entering into the deal with Ashton. In September, the company contracted with the exchange to develop a special trading system for institutional investors.

When Ashton went public in May, that contract was its greatest selling point. The shares, which began trading at $4.50, soared to $15.50, but have since fallen to $5.25, because of both the S.E.C. inquiry and disagreements among its shareholders that caused a management change.

Although some people at the exchange were apparently aware of Mr. Casella's stake in Ashton, the information did not reach many of the people who should have had it, including the committee that approves new listings, according to people who have read the S.E.C.'s report. Mr. Casella wanted to serve as market-marker, or auctioneer, for Ashton's shares, they said. He resigned as chairman in October.

The exchange has also been embarrassed by a complaint the commission filed last year against Richard Feinberg, a member of the board and former head of the exchange's conduct committee, which supervises the enforcement of rules and standards on exchange members. Mr. Feinberg was accused of cheating customers for whom he was executing trades on the Nasdaq market; he is fighting those complaints.

Regulators generally value regional stock exchanges because they provide competition to the New York Stock Exchange and have been sources of innovation. Federal rules are supposed to prevent investors from doing worse if their trades are executed on a regional exchange, although New York argues that investors would fare even better by trading on the Big Board.

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