

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

**SECURITIES ACT OF 1933**  
**Release No. 9544 / February 4, 2014**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 71472 / February 4, 2014**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3771 / February 4, 2014**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 30904 / February 4, 2014**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15737**

**In the Matter of**

**THOMAS C. GONNELLA,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO SECTION 8A OF THE  
SECURITIES ACT OF 1933, SECTIONS  
15(b) AND 21C OF THE SECURITIES  
EXCHANGE ACT OF 1934, SECTION 203(f)  
OF THE INVESTMENT ADVISERS ACT OF  
1940, AND SECTION 9(b) OF THE  
INVESTMENT COMPANY ACT OF 1940  
AND NOTICE OF HEARING**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), Section 203(f) of the Investment Advisers Act of 1940 (“Advisers Act”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against Thomas C. Gonnella (“Gonnella”).

**II.**

After an investigation, the Division of Enforcement alleges that:

**Summary**

1. Between May and November 2011, Gonnella, at the time a trader at Firm A, agreed with Ryan King, another trader who worked at Firm B, to defraud Gonnella’s firm by temporarily

placing securities from Gonnella's trading book at Firm A in King's trading book at Firm B and later repurchasing them. The purpose of this arrangement was to allow Gonnella to avoid charges by Firm A to his trading profits, and ultimately his year-end bonus, that would result from holding the securities for too long. Instead of incurring those charges or selling the securities in bona fide market transactions, and in violation of Firm A's policies, Gonnella placed the securities with King, who purchased them on behalf of Firm B, with the understanding that he would repurchase them thereafter and that Firm B would not be exposed to market risk because Gonnella would repurchase them at a profit to Firm B at the expense of Gonnella's employer, Firm A.

2. Gonnella placed ten securities with King. With respect to nine securities, Gonnella, on behalf of Firm A, repurchased them before the securities had even settled in Firm B's account. With respect to the tenth security, Gonnella did not immediately repurchase it. He later did so at a loss to Firm B, but made Firm B whole by selling it two other bonds from Gonnella's trading book at Firm A at prices favorable to Firm B and unfavorable to Firm A. King then used the resulting profit on the two bonds to offset the loss incurred on the tenth security. With respect to each of the foregoing transactions, Gonnella did not disclose to Firm A that he sold the securities to King on the understanding that he would thereafter repurchase them from King at a profit to Firm B.

3. In total, Gonnella and King's trades caused Firm A to lose approximately \$174,000. Gonnella and King never told their firms the truth about their trades, which was that they were not bona fide market transactions but were done solely to reset the holding period on securities in Gonnella's trading book and allowed Firm B to earn improper profits at Firm A's expense.

4. After Gonnella's supervisor began inquiring about the trades, Gonnella and King interposed interdealer brokers in subsequent transactions and spoke on their cell phones to evade detection. They continued to conduct round-trip trades until Firm A detected Gonnella's conduct and summarily fired him. Firm B later fired King for the same misconduct.

### **Respondent**

5. Gonnella, age 29, was employed as a registered representative with Firm A from September 2008 through December 2011. Firm A was then, and is today, registered with the Commission as a broker-dealer and investment adviser. As an employee of Firm A, Gonnella owed that firm fiduciary duties of care, candor, and loyalty with respect to matters within the scope of his employment, which included the management of a trading portfolio. In 2011 this trading portfolio contained asset-backed securities and had a total market value that was between \$200 million and \$250 million. Since February 2012, Gonnella has been a registered representative associated with another registered broker-dealer. Gonnella holds Series 7 and 63 licenses. He resides in New York, NY.

### **Other Relevant Person**

6. King, age 35, was a registered representative with Firm B from February 2009 through December 2011. Firm B was then, and is today, a broker-dealer registered with the Commission. King held Series 7 and 63 licenses. He resides in New York, NY.

### **Firm A's Policies on Aged Inventory and Prearranged Trades**

7. In early 2011, Thomas Gonnella was employed at Firm A as a trader of esoteric asset-backed securities. Gonnella was allowed to commit, on behalf of Firm A, up to \$300 million of Firm A's capital for his trades. The bulk of Gonnella's expected compensation for 2011 was a bonus, to be based in part on the profitability of his trading book.

8. In 2011 Firm A had an "aged inventory" policy expressly designed to encourage turnover of trading positions by penalizing traders for holding securities in their inventory for too long. Under the policy, after Gonnella held a position for three months, his book's profits began to accrue a monthly charge equivalent to 0.5% of the security's market value. Charges accrued until Gonnella held a position for seven months or more, when they generally became irreversible.

9. Every month Gonnella received a document informing him how long he had held each of his positions, and it was Gonnella's practice to review that document to see if there were any upcoming irreversible charges. When this document was sent to Gonnella, it came with a copy of Firm A's aged inventory policy.

10. Firm A also had a policy in place prohibiting traders, including Gonnella, from circumventing the aged inventory policy by arranging round-trip transactions with third parties aimed at resetting the clock on the holding period for securities in their book. Firm A's policy prohibited "parking or pre-arranged trades," and stated that traders "shall not pre-arrange the availability of bonds or the specific repurchase price of a security in order to re-establish a position . . . ."

### **Prearranged Transactions in May 2011**

11. At the end of May 2011, Gonnella was about to incur irreversible aged inventory charges on several asset-backed bonds issued by Bayview Commercial Asset Trust ("BAYC"). On May 31, 2011, Gonnella wrote to King, "i have 4 small bonds that i'm looking to turnover today for good ol' month end/aging purposes . . . i like these bonds . . . and would more than likely have a higher bid for these later this wk when the calendar turns . . . ."

12. Gonnella's offer to King was prompted by his desire to evade the penalties under Firm A's aged inventory policy, *i.e.*, the charge to Gonnella's trading profits and the resulting negative impact on his year-end bonus.

13. Shortly after being contacted by Gonnella, King agreed to buy on behalf of Firm B two of the BAYC bonds Gonnella had offered at prices of \$56 and \$54 per bond, with settlement scheduled for June 3, 2011.

14. The next day, June 1, 2011, before the BAYC bonds had settled in Firm B's account, Gonnella repurchased them from King at prices of \$57 and \$55 per bond, thereby providing an immediate profit of approximately \$23,000 to Firm B at the expense of Firm A and resetting the clock on the holding period for these bonds in Gonnella's book. Had these prearranged transactions not occurred, Firm A would have continued to own the two BAYC bonds, just as it had before the transactions, only without paying Firm B approximately \$23,000. There was no negotiation over the repurchase prices.

### **Prearranged Transactions in August 2011**

15. At the end of August and the beginning of September 2011, Gonnella's supervisor took a mandatory two-week vacation during which he was not allowed to be in contact with Gonnella or others on Gonnella's trading desk at Firm A. Before he left, the supervisor instructed Gonnella to reduce his book's exposure to small-loan asset-backed securities, which included BAYC bonds. Instead, Gonnella took advantage of his supervisor being away by resetting the aged-inventory clock on multiple bonds in his trading book.

16. On August 29, 2011 Gonnella wrote to King, "let's talk tmrw. Have some aged bonds that I might offer you, if you're game . . . maybe do what we did a few months ago w/ some of those bayc's . . ." The next day, Gonnella offered three BAYC bonds to King at prices of \$72, \$73, and \$40 per bond. King asked, "when would you be looking to purchase something similar? end of the week?" Gonnella replied, "yes. Most likely."

17. King then agreed to buy on Firm B's behalf the three BAYC bonds that Gonnella had offered at the prices Gonnella proposed, with settlement scheduled for September 2, 2011. On one of those three bonds, Gonnella was about to incur almost \$85,000 in aged inventory charges, which he avoided through his sale to King.

18. The next day, August 31, 2011, before the BAYC bonds had even settled in Firm B's account, Gonnella repurchased two of the three bonds at prices of \$73.75 and \$40.75 per bond, thereby providing an immediate profit of approximately \$49,000 to Firm B at the expense of Firm A. As for the third bond — a BAYC 07-4A A1 bond — on September 7, 2011, Gonnella repurchased \$12 million of the \$19.65 million he had sold to King at a price of \$72.125 per bond, thereby providing an immediate profit of approximately \$14,000 to Firm B at the expense of Firm A. Had these prearranged transactions on August 31 and September 7 not occurred, Firm A would have continued to own these BAYC bonds, just as it had before the transactions, only without paying Firm B approximately \$14,000. As in May 2011, there was no negotiation over the repurchase prices.

19. Also on August 31, 2011, Gonnella sold King five additional bonds on which he faced aged inventory charges. Two days later, on September 2, Gonnella repurchased these five bonds, each at a slight markup, and again before Firm B had taken delivery of them. As a result of these trades, Firm B earned a profit on each of the bonds, for a total profit of approximately \$84,000, at Firm A's expense. Had these prearranged transactions not occurred, Firm A would have continued to own the five bonds, just as it had before the transactions, only without paying \$84,000 to Firm B.

20. In total, by selling these eight bonds to King in August 2011, Gonnella avoided approximately \$600,000 in aged inventory charges that would have become irreversible on August 31, 2011, and any additional charges incurred monthly after that. As with the earlier trades in May, Gonnella's intention in carrying out the trades was to evade charges under Firm A's aged inventory policy.

### **Gonnella Lies to Firm A When Asked to Explain His Trades.**

21. Gonnella's repurchases of the five bonds from King on September 2 triggered a compliance review by Firm A, whose systems flagged the trades as possible "parking" transactions.

22. A compliance officer interviewed Gonnella, who falsely explained that he had sold the bonds to King because he had been "hoping to get more individuals involved in the bonds" but subsequently decided to repurchase the bonds because he was "confident that they could package some of them together and make them attractive to investors." Gonnella did not disclose to the compliance officer that in fact he had an understanding with King, before selling him the bonds, that he would repurchase them thereafter at a profit to Firm B.

23. After Gonnella's supervisor returned from his vacation, he noticed that while he was away Gonnella had sold a small-loan asset-backed bond but shortly thereafter repurchased it at a higher price. This repurchase was inconsistent with the supervisor's directive to Gonnella to reduce exposure to such bonds. The supervisor asked Gonnella about the trade, and Gonnella again gave a misleading explanation, stating that he had decided to repurchase the bond because he could restructure it and sell it to another investor. Gonnella never told anyone at Firm A the truth about these trades, namely, that he did them to avoid aged inventory charges and on the understanding that he would repurchase the bonds from King and at a profit to Firm B.

### **Gonnella Sells Bonds to Compensate King for a Loss.**

24. As noted, on September 7, 2011, Gonnella repurchased \$12 million of the BAYC 07-4A A1 bond he had sold to King on August 30, which left King still holding \$7.65 million of the bond.

25. On multiple occasions in September 2011, King urged Gonnella to repurchase the remaining portion of the BAYC 07-4A A1 bond and Gonnella assured him that he would do so. On September 22, 2011, Gonnella wrote, "have patience, if you can. Still like them, and eventually want them . . . but not in September." Gonnella assured King that he would buy the remainder of the bond in October.

26. During the time that King held the BAYC 07-4A A1 bond, Gonnella and King were aware that its market value was declining. Although King was supposed to mark the positions in his trading book to fair value each day, he delayed marking down the BAYC 07-4A A1 bond.

27. On October 11, 2011, King and Gonnella agreed to do additional trades that would result in a profit to King's book at Firm B so that King could use that profit to offset the mark-to-market loss on the BAYC 07-4A A1 bond. Gonnella offered to sell King two bonds known as PALS and LBSBC on which Gonnella was set to incur aged inventory charges at the end of October. Gonnella wrote to King, "when you sell these later this month, mark down the [BAYC 07-4A A1 bond] accordingly . . . ."

28. The same day, King agreed to buy the PALS and LBSBC bonds on Firm B's behalf at prices of \$39.50 and \$30.

29. The next day, October 12, Gonnella wrote to King that he was interested in buying back all three of the bonds in question — the PALS and LBSBC bonds, as well as the remaining portion of the BAYC 07-4A A1 bond — in the last week of October, in what Gonnella called a “package bid.”

**Gonnella’s Supervisor Identifies an Improper Transaction and Instructs Him to Stop.**

30. On October 26, 2011, consistent with the earlier arrangement between them, Gonnella repurchased the LBSBC bond from King at a markup of more than 18% over its sale price two weeks earlier. This repurchase resulted in a profit of approximately \$215,000 to Firm B. Had the prearranged transactions in the LBSBC bond not occurred, Firm A would have continued to own that bond, just as it had before the transactions, only without paying \$215,000 to Firm B and without missing out on periodic principal and interest payments of \$1,500 between October 11 and 26.

31. Also on October 26, 2011, Gonnella’s supervisor noticed the repurchase of the LBSBC bond at a mark-up from Firm B. He then looked at Gonnella’s trading history and noticed several similar trades with Firm B. Gonnella’s supervisor discussed these trades with Gonnella on October 26 and the morning of October 27. In these discussions, Gonnella’s supervisor instructed Gonnella not to do such a trade again.

**Gonnella Uses Interdealer Brokers to Conceal Prearranged Trades.**

32. On October 27, 2011, King called Gonnella about the BAYC 07-4A A1 and PALS bonds. King informed Gonnella that he had spoken with his supervisor and that his supervisor had an ultimatum for Gonnella: repurchase the two bonds or King’s supervisor would call Gonnella’s supervisor to discuss the trades that resulted in Firm B holding these bonds.

33. Notwithstanding his own supervisor’s instruction from that very morning, Gonnella on October 27, 2011 repurchased the PALS bond at a markup of almost 9% above the price at which he had sold it to King two weeks before. However, whereas prior prearranged trades between Gonnella and King had been conducted without intermediaries, Gonnella’s repurchase of the PALS bond was routed through an interdealer broker. Gonnella’s repurchase of the PALS bond resulted in a profit of approximately \$227,000 to Firm B and approximately \$5,600 to the interdealer broker. Had the prearranged transactions in the PALS bond not occurred, Firm A would have continued to own that bond, just as it had before the transactions, only without paying \$227,000 to Firm B and approximately \$5,600 to an interdealer broker.

34. In keeping with the plan discussed earlier with Gonnella, King marked down to fair value the remaining \$7.65 million of the BAYC 07-4A A1 bond. Then, on November 3, 2011, he sold it back to Gonnella at a price of \$64.53 per bond, which resulted in a loss to Firm B of approximately \$444,000. Like the repurchase of the PALS bond, Gonnella and King routed the repurchase of the remaining portion of the BAYC 07-4A A1 bond through an interdealer broker. Although Firm B incurred a loss on the trade, this loss was recouped through the “package bid” in which Gonnella repurchased the LBSBC and PALS bonds at a markup and also through periodic principal and interest payments that Firm B had received while holding the remainder of the BAYC 07-4A A1 bond and the LBSBC bond. Had these transactions not occurred, Firm A would

have continued to own the remainder of the BAYC bond, just as it had before, only without paying approximately \$1,900 to an interdealer broker and without missing out on periodic principal and interest payments.

35. In each of his round-trip transactions with King, Gonnella recorded the first leg as a straightforward “sale” in his firm’s books and records, without any reference to his understandings with King that Gonnella would thereafter repurchase the bond and that Firm B therefore was not exposed to the true risk of owning such bonds.

#### **Gonnella Uses Cell Phones and Text Messages to Avoid Detection.**

36. As their scheme began to unravel, Gonnella and King on several occasions arranged to communicate about their trading plans via cell phone and text messaging to avoid having their conversations overheard or recorded by their firms. For example, their arrangement to trade the BAYC 07-4A A1, PALS, and LBSBC bonds in October was done via text message. After discussing the subject in Bloomberg chats, Gonnella told King, “Check your text [messages] in like 3 minutes.” King responded, “haha, ok . . . sneaky sneaky.”

37. Cell phone records for Gonnella and King confirm that, over a period of more than four years, Gonnella and King almost never called each other’s cell phone, except during the period in which they did the trades discussed above.

38. These cell phone communications and text messages were in violation of Firm A’s policy, which prohibited Gonnella from using personal phones to conduct firm business.

#### **Gonnella is Terminated.**

39. As a result of the trades described above, Firm A terminated Gonnella’s employment in late 2011.

#### **Violations**

40. As a result of the conduct described above, Gonnella willfully violated Sections 17(a)(1) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

41. As a result of the conduct described above, Gonnella willfully aided and abetted and caused violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, which require that each broker-dealer registered with the Commission make and keep current ledgers (or other records) reflecting all assets and liabilities, income, and expense and capital accounts relating to the broker-dealer’s business. Firm A’s ledgers did not accurately reflect the understandings reached between Gonnella and King. Gonnella aided, abetted, and caused such violations when he failed to report accurate information about such understandings to Firm A.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

- A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Gonnella an opportunity to establish any defenses to such allegations;
- B. What, if any, remedial action is appropriate in the public interest against Gonnella pursuant to Section 8A of the Securities Act including, but not limited to, civil penalties pursuant to Section 8A(g) of the Securities Act;
- C. What, if any, remedial action is appropriate in the public interest against Gonnella pursuant to Section 15(b) of the Exchange Act including, but not limited to, civil penalties pursuant to Section 21B of the Exchange Act;
- D. What, if any, remedial action is appropriate in the public interest against Gonnella pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;
- E. What, if any, remedial action is appropriate in the public interest against Gonnella pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and
- F. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Gonnella should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act and Sections 10(b) and 17(a) of the Exchange Act and Rules 10b-5 and 17a-3 thereunder.

### IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Gonnella shall file an answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Gonnella fails to file the directed answer, or fails to appear at a hearing after being duly notified, Gonnella may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served forthwith upon Gonnella personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy  
Secretary