FINRA
Financial Industry Regulatory Authority

**Lisa Jones Toms**
Assistant General Counsel

Direct: (202) 728-8044

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**VIA MESSENGER**

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Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

**RE: In the Matter of the Application of Anthony Grey**
**Administrative Proceeding No. 3-16230**

Dear Mr. Fields:

Enclosed please find the original and three copies of the Brief of FINRA In Opposition To Application For Review in the above-captioned matter.

Please contact me at (202) 728-8044 if you have any questions.

Very truly yours,

Lisa Jones Toms, Esq.

cc: Peter Aldrich, Esq.
Brennan Love

Enclosures

**BEFORE THE**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C.**



In the Matter of the Application of

Anthony A. Grey

For Review of

Disciplinary Action Taken by FINRA

File No. 3-16230

# FINRA'S BRIEF IN OPPOSITION TO APPLICATION FOR REVIEW

Alan Lawhead
Vice President and
Director – Appellate Group

Lisa Jones Toms
Assistant General Counsel

FINRA
1735 K Street, NW
Washington, DC 20006
(202) 728-8044

Dated: February 9, 2015

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**BEFORE THE**

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**FINRA'S BRIEF IN OPPOSITION TO APPLICATION FOR REVIEW**

## I. INTRODUCTION

Anthony A. Grey ("Grey") was a seasoned securities professional working in the securities industry for over 30 years. For more than half of those years, Grey was a bond trader for Gardner Michael Capital Inc. ("GMCI" or the "firm") and conducted 99% of the firm's bond trades. Toward the end of 2008 through 2009, he had anywhere from 10 to 15 retail customers that relied on his advice and expertise to determine which municipal bonds to buy. For some customers, Grey had discretionary authority over their account(s).

In late 2008, Grey purchased six bonds at what he considered to be "distressed prices." Within a few days he sold the bonds in ten transactions to his customers at prices that were 5% to 19% higher than his purchase price. What Grey did with the bonds in between GMCI purchasing and selling them was highly unusual. After buying the bonds from the street, he used his personal account to buy the bonds from GMCI and later sell them back to GMCI. In doing so, Grey set the prices for the transactions, and he increased the price on each leg of the trades.

Trading the bonds in this manner allowed Grey to reap profits he would not have otherwise gained.

The National Adjudicatory Council ("NAC") found that Grey's routing of the bonds through his personal accounts was interpositioning and that he charged excessive mark-ups in violation of the federal securities laws, and Municipal Securities Rulemaking Board ("MSRB") rules. The NAC also found that Grey violated the anti-fraud provisions of the federal securities laws, when he charged mark-ups in excess of 8% in seven of the transactions. For the reasons set forth in this brief, the Commission should affirm the NAC's decision in all respects.

## II. STATEMENT OF FACTS

### A. Factual Background

Grey entered the securities industry in May 1980 and joined GMCI as a general securities representative in 1994. In 2009, GMCI was a small brokerage firm that underwrote small municipality deals and had a limited retail business. RP 570. As GMCI's primary municipal bond trader, Grey conducted nearly 100% of the firm's municipal bond business. RP 573.[1]

In 2009, FINRA's Department of Member Regulation conducted a routine cycle examination that reviewed the firm's municipal business from August 2008 through September 2009. RP 570-571. Grey had two personal accounts—a personal prime brokerage account with Triad Securities Corporation and an IRA account with GMCI—that he used for his bond trading. RP 2130.

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[1] Grey voluntarily ended his employment with GMCI on October 25, 2012 and, since then, has not been associated with a FINRA member firm. RP 2128. "RP" refers to the record page number.

FINRA's examiner, Barbara Walley, testified that her review revealed that a significant number of trades were executed through Grey's personal accounts. RP 572. Most notably, in 10 municipal bond transactions involving six bonds, Grey followed the same four-legged pattern.[2] In the first leg, he purchased through GMCI a specific quantity of municipal bonds from the "street" at a designated price. In the second leg, he sold the same quantity of bonds to his own personal account at a higher price that he determined. In the third leg, Grey sold the bonds from his personal account to GMCI at an even higher price. In the fourth leg, he sold the bonds through GMCI to his customer at a final price determined by him and based on what he testified that he believed the fair market value of the bonds was at the time of sale.[3]

The customers purchased the bonds at prices higher than—and in some cases *significantly* higher than—what Grey originally paid. The following chart represents the notable increases in prices of the bonds between the date of Grey's (GMCI's) purchase and the date of sales to GMCI's customers:

| Issuer | Transaction | Price | Purchase/ Sale Date |
|---|---|---|---|
| Osceola | GMCI purchased at | \$71.2500 | 10/22/08 |
| | Customer purchased at | \$84.1700 | 10/27/08 |
| Ocala | Grey purchased at | \$84.2500 | 10/29/08 |
| | Customers 1 and 2 purchased at | \$88.7700 | 10/30/08 |

2 The six different municipal bonds include: Osceola, Ocala, Collier, Florida State, Highlands (Health), and Highlands (School).

3 *See* RP 1844 n. 58 (referring to Enforcement expert witness testimony before the Hearing Panel and suggesting that Grey knew he was engaged in wrongdoing because the bulk of his profit or mark-ups were charged on the third leg of the transaction (i.e., the sales from his personal account to GMCI); *see also* RP 851 (noting that Grey's dealing from his own personal account is highly unethical, and "obvious conflict of interest" that needs to be disclosed).

| | | | |
|---|---|---|---|
| Collier | GMCI purchased at | $76.8800 | 11/06/08 |
| | Customers 1 and 2 purchased at | $92.1740 | 11/11/08 |
| Florida State | GMCI purchased at | $59.0000 | 12/16/08 |
| | Customer purchased at | $72.5250 | 12/22/08 |
| Highlands (Health) | Grey purchased at | $69.1940 | 12/18/08 |
| | Customers 1, 2, and 3 purchased at | $76.0300 | 12/22/08 |
| Highlands (School) | GMCI purchased at | $85.5690 | 07/23/09 |
| | Customer purchased at | $91.2500 | 07/27/09 |

On average, the sales to customers occurred one to four trading days after Grey's acquisition. There were no inter-dealer trades or intervening market events that occurred between Grey's acquisition and his retail sales to GMCI's customers.[4] For each transaction, Grey alone determined the mark-up. In some cases, Grey had discretionary authority to buy bonds from, and sell bonds to, the customer's account without speaking with them first.[5] GMCI had written supervisory procedures ("WSPs") that limited the amount of mark-ups on municipal bond transactions to 3% without the approval of a firm designated principal.[6] The firm's WSPs also prohibited interpositioning when dealing with customers.[7]

4 RP 552, 829; *see also* RP 1181, as an example, which contains trade report data from the MSRB's Electronic Municipal Market Access (EMMA) system for the Florida State municipal bond and shows that no inter-dealer trades occurred between the inter-dealer trade that occurred on 12/16/08 in the amount of $59.000 (representing Grey's acquisition of the bonds) and the sale to GMCI's customer on 12/22/08 in the amount of $72.5250.

5 RP 609-610.

6 RP 1704.

7 RP 1588 ("In any transaction for or with a customer, the [firm] will not interject a third party between the [firm] and the best available market, except in cases which the [firm] can show that the total cost or proceeds of the transaction were better than the prevailing inter-dealer market for the security.").

Grey's aggregate mark-up for each bond—the difference between the firm's initial price and the customer's price—ranged between 5.36% and 19.12%. The mark-up on each bond trade was as follows:

| | |
|---|---|
| Osceola | 14.38% |
| Oscala | 5.36% |
| Collier | 19.12% |
| Florida State | 16.88% |
| Highlands (Health) | 8.62% |
| Highlands (School) | 6.64% |

The customer account statements for these transactions provided only the price that the customers paid for the bonds and did not disclose the mark-ups that Grey charged on legs two, three and four of the transactions.[8] Grey did not disclose to customers his interpositioning or the resulting excessive mark-up that he charged.

**B. Procedural Background**

Enforcement filed the complaint on December 2, 2011. RP 1-30. After presiding over a hearing, a Hearing Panel found that, in 10 municipal bond transactions, Grey engaged in interpositioning and charged unfair prices and excessive mark-ups that he willfully and

8 *See* RP 1235, as an example of a GMCI customer account statement that reflects the 10/27/08 purchase of the Osceola County Florida municipal bond at Grey's determined price of $84.1700 (representing a significant increase from his acquired price of $71.2500 just three trading days prior). *See also* RP 1131, which provides a breakdown of the prices that Grey charged in each leg of the transaction from his acquisition date until the date he sold the bonds to GMCI customers.

fraudulently failed to disclose to retail customers. RP 1825-1864. The Hearing Panel fined Grey $30,000, suspended him from associating with any FINRA member firm in any capacity for two years, and ordered him to pay $16,000 in disgorgement, plus prejudgment interest, paid to FINRA. The Hearing Panel's finding of Grey's willful misconduct caused him to be statutorily disqualified. *Id.*

Both Grey and Enforcement presented expert witness testimony before the Hearing Panel on Grey's pricing of the bonds when he sold them to his customers. Grey's expert, James Bagley, testified that the customers paid a fair and reasonable price for the bonds. RP 1849. He compared the price and yield of the bonds to the Municipal Market Data or "MMD" yield curve. RP 964-965. He also reviewed bonds that Grey selected for him to compare, RP 1000, including the trading in those bonds, and historical trading in the subject bonds. He did not review inter-dealer trades because he felt they were not applicable. RP 990. Bagley determined that the yield for the bonds at the time of sale were "very attractive" and did an analysis on whether he *felt* the bonds were sold at a fair and reasonable price. RP 1005.

Enforcement's expert, James McKinney, opined that the customers paid substantially more than the prevailing market price for the bonds. RP 1839. McKinney used EMMA, along with the MMD scale, to review the ratings and other characteristics of the bonds at issue. RP 827. He noted that there were no intervening trades that occurred in the market or other trade data for the bonds, and determined that the prevailing market price for each of the subject bonds was the last inter-dealer trade (i.e., the price at which Grey acquired the bonds).[9] Notwithstanding this, McKinney credited any market movements based on the MMD scale that

[9] *See* RP 831 ("[T]he process is always to look at what the trade was between two professionals, when two people agree.").

increased the bonds' fair market value during the time Grey held the bonds. RP 828. He then calculated the maximum allowable mark-up for each bond and concluded that Grey had charged mark-ups on the bonds well in excess of 3%.

The Hearing Panel accepted McKinney's testimony. The Panel found his methodology in determining the fair market price "reliable," and the estimates of the prevailing market prices for the six bonds "accurate." RP 1844. Accepting McKinney's maximum mark-up of 3% as the industry standard, the Panel agreed with McKinney's assessment that Grey's mark-ups were in fact, excessive. RP 1844-1845.

On appeal, the NAC affirmed the Hearing Panel's findings, but modified the sanctions. RP 2127-2142. In affirming the Hearings Panel's findings, the NAC found that McKinney's testimony was reliable and his mark-up analysis was supported by applicable case law. The NAC rejected Bagley's expert testimony because he used a methodology that has several flaws. RP 2134-2135. The NAC thus concluded that the prevailing market price for the subject bonds was Grey's contemporaneous cost. Based on this, the NAC found that, in 10 bond transactions, Grey engaged in interpositioning that resulting in unfair prices and excessive mark-ups in violation of MSRB Rules G-17 and G-30. The NAC also found that Grey violated Section 10(b) of the Securities Exchange Act ("Exchange Act") and Exchange Act Rule 10b-5 in seven of the 10 bond transactions when he charged excessive mark-ups that ranged between 8.62% and 19.12% and failed to disclose the excessive mark-ups and his interpositioning to customers. RP 2127-2138.

The NAC reduced Grey's sanction of a two-year suspension from association with any FINRA member firm in any capacity to an 18-month suspension. RP 2127-2144. The NAC ordered Grey to pay a $30,000 fine, and to disgorge $15,750 plus prejudgment interest from the date of the last transaction. *Id.* This appeal followed.

## III. ARGUMENT

Grey's multi-legged mark-ups of the bond were excessive, unfair and fraudulently omitted as material information. The NAC's findings of violations against Grey are well-supported by the record. There is no question that Grey had complete dominion over the 10 municipal bond transactions at issue. He solicited all of the bond transactions, and, for some GMCI customers, he had discretionary authority over their accounts. RP 609-610, 693. He used two personal accounts where the acquired bonds were held as his own inventory. RP 72. He deliberately interposed himself between his customer and the prevailing market price, and set the bond prices himself in each leg of the four-legged transaction. RP 687, 692-693. Ultimately, Grey sold the bonds to GMCI customers at prices that he also determined. His interpositioning went undisclosed and caused GMCI customers to pay excessive mark-ups ranging from 5.36% to 19.12%, while he garnered $15,750 in ill-gotten gains. RP 694-695,1131. Grey's actions were deliberate and harmful. These facts are uncontested. He placed his own interest in making trading profits ahead of his customers' interest and thereby violated MSRB and SEC rules.

It is uncontested that the firm's WSPs prohibited interpositioning and the charging of mark-ups in excess of 3% without the approval of a firm designated principal. RP 1588, 1704. In each transaction, Grey failed to comply with the firm's internal policies, MSRB rules, and the federal securities laws when he unlawfully and willfully engaged in undisclosed interpositioning, charged excessive mark-ups, and sold bonds to GMCI customers at prices that bore no reasonable relation to the prevailing market price. The NAC's sanctions reflect the egregiousness of Grey's misconduct and were carefully tailored to deter future misconduct and ensure investor protection. The Commission should sustain the NAC's decision in all respects.

### A. The NAC Correctly Found that Grey Engaged in Undisclosed Interpositioning, Charged Customers Unfair Prices and Excessive Mark-Ups, and Engaged in Fraud.

#### 1. Grey's Interpositioning Resulted in Unfair Prices in Violation of MSRB Rule G-17.

The NAC correctly found that Grey, through his personal accounts, purchased and sold the municipal bonds at prices he determined, which resulted in GMCI customers paying excessive mark-ups. Grey's mark-ups constituted unfair dealing in violation of MSRB Rule G-17.

Pursuant to MSRB Rule G-17, Grey was obligated to deal fairly with GMCI's customers in the course of executing municipal bond transactions. MSRB Rule G-17 specifically requires that, "[i]n the conduct of its municipal securities . . . activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."[10] Fundamental to MSRB Rules is the duty to deal fairly with customers and to ensure that a broker-dealer charges prices that are reasonably related to the market value of the security.[11]

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10 *See* MSRB Rule G-17, available at www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17. "MSRB Rule G-17 sets forth the basic customer protection obligation of dealers when executing municipal securities transactions with or on behalf of customers. . . . The rule contains an anti-fraud provision, and a general duty to deal fairly, even in the absence of fraud." MSRB Answers to Frequently Asked Questions Regarding Dealer Disclosure Obligations under MSRB Rule G-17 (November 30, 2011), available at www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-67.

11 *See* MSRB Notice 2010-10 (April 21, 2010), available at www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010-10 ("Two fundamental principles of fair pricing are embodied in the requirement for a 'fair and reasonable' price. The first principle is that the

(Footnote continued on next page)

Grey engaged in undisclosed interpositioning in violation of MSRB Rule G-17. It is undisputed that Grey, through his personal accounts, purchased and sold municipal bonds. RP 72. He admitted that he had been trading in this manner so for many years and that it generated profits for him. RP 66. In each of the 10 bond trades at issue, Grey interposed an account controlled and maintained by him between the customer and the fair or prevailing market value of the bonds. In each leg of the four-legged transactions, he determined the prices of the bonds which incrementally increased as the bonds were executed to and from his personal accounts, and ultimately sold them to the customers. Finally, Grey admitted that he did not disclose to GMCI customers that he sold the bonds through his personal accounts or the prices at which he had acquired the bonds. RP 66, 694-95.

The NAC's finding of a MSRB Rule G-17 violation is fully supported by applicable precedent. In *Protective Group Sec. Corp.*, 51 S.E.C. 1233, 1239-40 (1994), for example, the respondents similarly were found to have violated a broker-dealer's fundamental duty to treat its customers fairly when they had typically arranged a pattern of purchasing securities in the market, selling the stock to the firm's inventory account at an increased price, and almost immediately thereafter, selling the stock to two discretionary accountholders at an even higher price. Just as the respondent in *Protective Group* violated NASD's just and equitable principles of trade rule by successively marking up the price of the stocks, Grey's interpositioning in similar fashion violated MSRB Rule G-17.

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(cont'd)

customer's price must be reasonably related to the market value of the municipal securities in the transaction. The second principle is that the mark-up or mark-down on a transaction must not exceed a fair and reasonable amount.") (footnotes omitted).

In his appeal to the Commission, Grey argues that his routing of the bonds through his personal accounts was the firm's decision, and cites to his testimony that the firm did not "have a proprietary trading account and thus required him to trade the bonds at his own risk." Appellant Brief at 17-18. But his contention does not absolve Grey. Although GMCI may not have engaged in proprietary trading until shortly after the review period, Grey never produced any evidence demonstrating the firm's request for him to trade the bonds at issue through his personal accounts. To the contrary, the record reflects that the firm's WSPs explicitly prohibited interpositioning. RP 1588. And the NAC correctly found Grey's assertion immaterial to his practice of unjustifiably *increasing* the bond prices that he determined in each leg of the transactions. RP 2140. Put another way, Grey's use of his personal accounts did not compel him to charge unfair prices; he alone decided what price to charge his customers.

In re-arguing a point he raised before the Hearing Panel, Grey opines that he would have had the same "conflict" (i.e., level of profitability) if the bonds were sold from the firm's account. Applicant Brief at 18.[12] On one hand, if Grey had sold the bonds at the same prices from the firm's account, the mark-ups would have been equally excessive. On the other hand, bonds traded without being routed through Grey's personal accounts would have made Grey's unfair pricing easier to detect by regulators or his firm because there would have been no second and third legs of each transaction. *See Andrew P. Gonchar*, Exchange Act Release No. 60506, 2009 SEC LEXIS 2797, at *27 (Aug. 14, 2009) (citing *Milton M. Star*, 47 S.E.C. 58, 59 (1979)

[12] Grey's brief argues that the Hearing Panel below incorrectly applied MSRB Rule G-30. Applicant Brief at 16. This and other references to the Hearing Panel's decision are irrelevant. The application before the Commission is to review the NAC's findings of violation and order of sanctions against Grey. 15 U.S.C. 78s(d); *see Harry Friedman*, Exchange Act Release No. 64486, 2011 SEC LEXIS 1699, at *25 (May 13, 2011) (holding that, in disciplinary cases, NAC decisions, not Hearing Panel decisions, are subject to Commission review).

("[W]here interpositioning has occurred, the burden is on the member to demonstrate that his action resulted in the customer being charged a lower price than that prevailing in the inter-dealer market.")), *aff'd*, 409 F. App'x 396 (Dec. 17, 2010). In any event, MSRB Rule G-17 requires fair and non-excessive prices regardless of how circuitous a route a municipal bond takes. The prices Grey charged his customers were unfair and violated MSRB Rule G-17.

### 2. Grey Charged Excessive Mark-ups in Violation of MSRB Rules G-17 and G-30.

The record further proves that Grey's undisclosed interpositioning and excessive mark-ups violated MSRB Rules G-17 and G-30.[13] MSRB Rule G-30 "generally requires brokers, dealers and municipal securities dealers . . . to trade with customers at fair and reasonable prices and to exercise diligence in establishing the market value of municipal securities and the reasonableness of their compensation."[14] Pursuant to Rule G-30, dealers, such as Grey, are prohibited from selling municipal securities to a customer "except at an aggregate price (including any mark-up or mark-down) that is fair and reasonable."[15]

The NAC found excessive mark-ups by following the traditional analysis of determining the prevailing market price, calculating the mark-up, and then considering the evidence that

13 *See Inv. Planning Inc.*, 51 S.E.C. 592, 599 (1993) (finding respondents violated MSRB Rules G-17 and G-30 with respect to charging excessive mark-ups in municipal bond sales and holding that "[o]vercharging customers is a serious breach of a firm's obligation to deal fairly with investors . . .").

14 Exchange Act Release No. 72956, 2014 SEC LEXIS 3131, at *3-4 (Sept. 2, 2014) (proposing SR-MSRB-2014-07) ("MSRB Best Execution Proposal").

15 *See* MSRB Rule G-30, available at www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30.

would rebut the prevailing market price finding. The NAC found that Grey's inter-dealer purchase price was the prevailing market price.

While the MSRB has provided no benchmark or specific guideline for a reasonable mark-up, it has interpreted the "fair and reasonable" pricing requirement for municipal securities in MSRB Rule G-30.[16] According to the MSRB, the price in a municipal securities transaction must be reasonably related to the security's market value, and the mark-up or mark-down for a transaction must not exceed a fair and reasonable amount. *See* MSRB Notice 2010-10, *supra* note 11. "A markup is excessive when it bears no reasonable relation to the prevailing market price." *Grandon*, 147 F.3d at 190 (internal quotations omitted). Prevailing market price is defined as "the price at which dealers trade with one another, i.e., the current inter-dealer market." *Id.* at 189.

The excessive mark-ups, that Grey alone determined, ranged from 5.36% to 19.12%. RP 72, 687. These mark-ups are well above industry standards for municipal securities. *See* RP 839-840 (McKinney testifying that firms' internal procedures generally reflect a maximum mark-up of three percent); *see also Dep't of Enforcement v. David Lerner Associates, Inc.*, Complaint No. 20050007427, 2012 FINRA Discip. LEXIS 44, at *17 (FINRA Hearing Panel Apr. 4, 2012) (noting that market participants understand that municipal bond mark-ups should be substantially less than 5% and holding that mark-ups above 3% were subject to regulatory scrutiny); *Grandon*, 147 F.3d at 191 (noting that "[i]t also seems to be accepted that proper markups for municipal bonds are 'significantly lower than those for equity securities.'"). Based

16 *See* MSRB Notice 2010-10, *supra* note 11; *Grandon v. Merrill Lynch & Co.*, 147 F.3d 184, 190 (2d Cir. 1998) (noting that the MSRB has provided no benchmark or specific percentage guideline for a reasonable mark-up in view of the heterogeneous nature of municipal securities transactions and dealers).

on this, the NAC correctly found that Grey charged excessive mark-ups in violation of MSRB Rules G-17 and G-30.

### 3. Grey Failed to Overcome His Presumptive Burden of Determining the Prevailing Market Price.

As noted in the NAC decision, the main dispute on appeal was determining the prevailing market price for the subject bonds. Courts have widely held that in excessive mark-up cases the best measure of a prevailing market price is the dealer's contemporaneous cost for the securities, i.e., "the price at which dealers trade with one another, i.e., the current inter-dealer market." *Grandon*, 147 F.3d at 189; *First Honolulu Sec., Inc.*, 51 S.E.C. 695, 697 (1993) (holding that the best evidence of market prices, absent countervailing evidence, is the dealer's contemporaneous cost); *Gonchar*, 2009 SEC LEXIS 2797, at *26 (holding that a dealer that is not a market maker must base its prices on its own contemporaneous cost); *Dep't of Market Regulation v. Lane*, Complaint No. 20070082049, 2013 FINRA Discip. LEXIS 34, at *23 n.20 (FINRA NAC Dec. 26, 2013) (noting the best indication of prevailing market price is a member's own contemporaneous cost), *appeal docketed*, SEC Admin. Proceeding No. 3-15701 (Jan. 22, 2014).

A dealer's cost is considered "contemporaneous" if the inter-dealer transaction occurs close enough in time to the transaction at issue that it reasonably is expected to reflect the current market price of the security. *See* MSRB Notice 2010-10, *supra* note 11. This standard reflects that the prices broker-dealers paid for securities in transactions closely related in time to retail sales to customers are a highly reliable indication of the prevailing market price. *Grandon*, 147 F.3d at 189.[17]

[17] In his brief, Grey argues that Enforcement's expert, James McKinney, used a "flawed" best execution standard in pricing the municipal bonds. In support of his argument, Grey cites a number of occasions in McKinney's testimony where he stated "best execution" in describing

(Footnote continued on next page)

The record supports the NAC's finding that Grey failed to overcome his presumptive burden in proving that the prevailing market price of the subject bonds was different than the price at which he acquired the bonds. Grey, through the firm's account, made contemporaneous purchases in the subject bonds. For each transaction, Grey's acquisition of the bonds was the last inter-dealer trade. No intervening dealer trades occurred between Grey's acquisition of the bonds and his sales to the customers. RP 711. Grey's final sales of the bonds to customers occurred one to four days after Grey's acquisition, which constituted a reasonable timeframe in estimating the bonds' current market price.[18] The NAC therefore correctly used Grey's contemporaneous cost as the prevailing market price.

Because Grey contended that his purchase price did not reflect the prevailing market price, the burden shifted to him to provide substantial evidence overcoming the presumption that his contemporaneous cost was the best measure in determining the prevailing price. *Gonchar*, 2009 SEC LEXIS 2797, at *28 ("once NASD presents evidence of contemporaneous cost, the burden shifts to [a]pplicants to refute that evidence."); *First Honolulu*, 51 S.E.C. at 697 ("We

(cont'd)

what he believed GMCI customers should have received. Applicant Brief at 6-8. While "best-execution obligations and fair-pricing obligations are closely related," MSRB Best Execution Proposal, *supra* note 14, at *3-4, the NAC independently applied existing fair pricing standards under MSRB Rule G-30 in determining whether Grey sold the subject bonds at prices that were fair and reasonable. In doing so, the NAC found credible McKinney's use of the last inter-dealer trade in the bonds as the appropriate in establishing the prevailing market price. RP 2133.

18 Grey sold the Oscala bond within one trading day; the Highlands (Health) and (School) bonds within two trading days; the Collier and Osceola bonds within three trading days; and the Florida State bond within four trading days of his acquisition. *See LSCO Sec., Inc.*, 50 S.E.C. 518, 520 (1991) (holding that absent some showing of changes in the prevailing market, a dealer's inter-dealer cost may be used to established the prevailing market price up to five business days from the date of the dealer's purchase).

have consistently held that, where a dealer is not a market maker, the best evidence of that market price, absent countervailing evidence, is the dealer's contemporaneous cost."); *Lerner*, 2012 FINRA Discip. LEXIS 44, at *61 ("[a] broker's contemporaneous cost is presumptively the fair market value, and [r]espondents have the burden to show otherwise.").

Grey, however, failed to overcome this burden. He asserts that the prevailing market price of the bonds when he sold them to his customers was based on the yield curve.[19] On this issue, the NAC independently evaluated his assertion and found that it lacked merit for the following reasons. First, the record did not support Grey's claim that he relied on the MMD yield curve. In fact, Grey's testimony before the Hearing Panel regarding his participation in answering FINRA's questions during FINRA's investigation showed otherwise. When asked at the hearing whether Grey referenced the MMD or the MMD yield curve as a factor in determining the bond prices at issue, Grey agreed that the firm's written responses, which he assisted in preparing, did not mention the MMD:

> Q: Do you recall that Ms. Walley had sent letters to the firm asking how you priced specific bonds? . . . And do you recall assisting the firm in preparing written responses to how some of th[e subject] bonds were priced?
>
> A: Yes.
>
> ---
>
> Q: Would you agree there's no reference to the municipal market data in that letter?

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19 In his brief, Grey states: "any reliable determination in this case of the prevailing market value of the subject bonds must be based on and compared to the yield curve." Applicant Brief at 12. He also states: "Stated simply, if the yield to the customer exceeded the municipal yield curve on that date, then the customer must have paid market price or less for the disputed securities." Applicant Brief at 11.

A: There does not seem to be.

---

Q: Both of the letters, the October 8th, 2009 and the November 24th, 2009 discuss the pricing of bonds that you sold to your customers, right?

A: Yes.

Q; You will agree that both of those letters, there's no reference to municipal market data, isn't that correct?

A: Yes.[20]

Accordingly, the Hearing Panel and the NAC did not credit Grey's testimony at the hearing that he based his prices on the MMD yield curve.

Second, Grey's claim is further undermined because the record contains no supporting documentation evidencing Grey's reliance on the MMD yield curve in determining his prices in each leg of the transactions at issue, or the prices that GMCI customers ultimately paid. While Grey contends that the yield of the bonds at issue were "attractive," he did not provide any supporting evidence that, on the day of the transactions, he relied on yield to determine the price of the subject bonds. *See Dep't of Enforcement v. SFI Investments, Inc.*, Complaint No. C10970176, 2000 NASD Discip. LEXIS 52, at *16 (NASD Hearing Panel Mar. 28, 2000) (finding that the price respondents paid in acquiring the bonds was the prevailing market price on the date of sale to the firm's customers). The NAC correctly rejected Grey's claim as unsupported.

Grey's expert witness, John Bagley, also failed to prove that Grey's contemporaneous cost was not the prevailing market price. In fact, Grey's expert focused on the yield curve of

20 RP 700-704.

unrelated bonds and used those yields as comparables. RP 1010-1016. He then strained to bolster his theory of yield being the best measure of the prevailing price by reviewing historical trading data of the unrelated bonds that in some cases went back to two years. Knowing that "[t]he yield to the customer should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size *then available in the market* . . .," the NAC found notable flaws in Bagley's expert testimony. *Grandon*, 147 F.3d at 190-191 (emphasis added and internal quotes omitted). His comparables were of bonds selected by Grey and opposite in character of the bonds at issue. RP 1010-1016. Even Bagley admitted that historical trading data from two years prior to the transactions was irrelevant to his analysis of the prevailing market price of the subject bonds. *See* RP 988 ("Q: Will you agree that trades all the way back in September of 2005 are less germane to the fair market value of a bond than trades that were within five business days? –A: Yes, especially in an absolute price . . .").

And although Bagley concluded that the customer prices had attractive yields, he admitted that his analysis was based on whether he *felt* they were sold at a fair and reasonable price.[21] The NAC appropriately gave weight to this testimony in rejecting Grey's argument that he relied on yield-curve data. Indeed, Grey's obligation was to ensure that his prices to customers bore a reasonable relation to the prevailing market price, which they did not. *Grandon*, 147 F.3d at 189 ("There exists an implied representation that broker-dealers charge their customers securities prices that are reasonably related to the prices charged in an open and competitive market.").

21 *See* RP 1005; *see also* RP 742 (Grey testifying: " . . . I felt the fair market value of that bond was 84.17 and I worked down from there."); RP 1067 (Paulukaitis testifying: "[Grey] determined the price to the customer ultimately based upon what he felt was the appropriate price and then determined the amount of the markup . . . out of that.").

Grey argues in his brief that because the bonds were purchased as odd-lots in bid-wanted auctions, he obtained the bonds in exceptional circumstances *below* the market price of the bonds. Applicant Brief at 9-10 ("The very nature of the bid-wanted process precludes conclusive reliance on the auction pricing as equaling market value."). Grey's reasoning lacks merit.

Although "bid-wanted" or "offer-wanted" indications are permissible for informational purposes, this does not negate the obligation of municipal dealers—at all times—to provide bona fide quotations in municipal securities that represent the "best judgment of fair market value" price. *See* MSRB Rule G-13, available at www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-13 (stating "If a . . . municipal securities dealer is distributing or publishing a quotation . . . such . . . dealer shall have no reason to believe that the price stated in the quotation is not based on the best judgment of the fair market value of the securities . . ."); *see also* McKinney testimony, RP 863-865 ("Q: Must all bids on municipal bonds be reasonably related to the market price for the bond?—A: Yes").

Grey also fails to demonstrate how market conditions at the time he sold to his customers changed the prevailing market price of the bonds. *LSCO Sec., Inc.*, 50 S.E.C. at 520 ("absent some showing of a change in the prevailing market, a dealer's inter-dealer cost may be used to establish market price . . ."). Indeed, both experts' testified that no extraordinary market events or large movements in the bonds occurred between the time Grey acquired the bonds and when he sold them to the customers.

The Commission should use contemporaneous cost as the basis for determining the prevailing market price, and should sustain the NAC's findings that Grey charged customers unfair prices and excessive mark-ups in violation of MSRB Rules G-17 and G-30. The evidence conclusively demonstrates that, in all instances, the prevailing market price for the bonds at issue was Grey's contemporaneous cost. Grey deliberately charged the firm's customers mark-ups over his contemporaneous cost that ranged between 5.36% and 19.12% in violation of MSRB Rules G-17 and G-30.

**4. Grey's Interpositioning Resulted in Fraudulent Undisclosed Excessive Mark-ups in Violation of Section 10(b) and Rule 10b-5.**

The NAC also correctly found that Grey willfully violated Exchange Act Section 10(b) and Rule 10b-5 when he charged excessive mark-ups that ranged from 8.62% to 19.12% and failed to disclose the excessive mark-ups and his interpositioning to GMCI's customers.

The federal anti-fraud provisions make it unlawful for any person, acting with scienter, to omit material facts in connection with the purchase or sale of a security. *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1466 (2d Cir. 1996); *Grandon*, 147 F.3d at 188. Scienter is a mental state embracing intent to deceive, manipulate, or defraud, *see Tellabs Inc. v. Makor Issues & Rights., Ltd.*, 551 U.S. 308, 318 n.3 (2007), or at least knowing misconduct. Scienter may also be established by showing that a respondent acted recklessly. *Alvin W. Gebhart, Jr.*, Exchange Act Release No. 58951, 2008 SEC LEXIS 3142, at *26 (Nov. 14, 2008), *aff'd*, 595 F.3d 1034 (9th Cir. 2009). Regarding mark-ups, "[a] broker-dealer commits fraud (in violation of [Section] 10(b) and Rule 10b-5) by charging customers excessive markups without proper disclosure." *Grandon*, 147 F.3d at 190. Based on this premise, the Commission has held that a fraud violation is only avoided by "charging a price which bears a reasonable relation to the prevailing [market] price or disclosing such information . . . ". *Id.* at 192.

Although Grey interpositioned his personal accounts in all 10 bond transactions, the NAC found his excessive mark-ups to be fraudulent in seven bond transactions, in which the excessive mark-ups Grey charged ranged from 8.62% to 19.12%. The NAC's finding is supported by the record and is correct. The seven mark-ups soared well above municipal bond industry standards. *Id.* at 191 (noting that proper mark-ups for municipal bonds are significantly lower than other mark-ups, which were not in excess of five percent of the prevailing market price); *Inv. Planning Inc.*, 51 S.E.C. at 595 (holding that for municipal bond transactions, mark-ups as low as 5.1% were unfair); *Donald T. Sheldon*, 51 S.E.C. 59, 77 (1992) (finding fraud when respondent's undisclosed mark-ups for municipal bonds exceeded 8%), *aff'd* 45 F.3d 1515 (11th Cir. 1995).

The NAC also found Grey's conduct to be fraudulent when he failed to disclose his interpositioning and excessive mark-ups to the customers. As noted in the NAC decision, the SEC has long held that interpositioning can result in fraud where it is done with scienter and results in the charging of excessive and undisclosed mark-ups. RP 2137. The NAC correctly found that Grey acted with scienter when he knowingly routed the bonds through his personal accounts before he sold them to the customers. Grey himself testified that he set the prices for each leg of the transactions and therefore controlled the amount of the mark-ups. The evidence also clearly establishes that Grey's interpositioning enabled him to charge successive mark-ups on each leg of the transactions. Grey testified himself that executing the bond trades through his personal accounts in this manner generated profits for him. RP 66. His failure to disclose those mark-ups demonstrated his intention to conceal his excessive profits from GMCI and its customers to their detriment, which is fraudulent. *Inv. Placement Grp.*, Exchange Act Release No. 66055, 2011 SEC LEXIS 4547, at *3 (Dec. 23, 2011) (holding that respondent's undisclosed, excessive mark-ups were part of a fraudulent interpositioning scheme and resulted in ill-gotten gains).

Similarly, the courts have long recognized that undisclosed and excessive mark-ups are fraudulent. The Second Circuit in *Grandon* held that it "long ago accepted the SEC's position that 'a dealer cannot charge prices not reasonably related to the prevailing market price without disclosing that fact.'" *Grandon*, 147 F.3d at 190; *see also First Jersey*, 101 F.3d at 1467 (noting that respondents acted with scienter when they intentionally charged excessive mark-ups).

The evidence also convincingly shows that Grey knowingly or recklessly charged the customers excessive mark-ups at prices that were not reasonably related to the prevailing market price. Grey admitted that he determined the mark-ups charged on each leg of the bond transactions, but provided no reasonable justification for his deviance or utter disregard of the prevailing market price.[22] Although Grey characterizes his purchase price for the bonds as remarkably low and due to the 2008 financial crisis, nether Grey nor the experts indicated any significant market event or large movements in the pricing of the subject bonds within the few days he held the bonds to warrant disregarding Grey's purchase price.

Grey argues in his brief that the NAC decision concluded he acted with scienter *because* he charged excessive mark-ups, noting that it is "incongruous to think that [he] would simultaneously cheat the customers on one bond for insignificant compensation, while selling them numerous bonds at the same time at prices which have not been challenged as fraudulent." Applicant Brief at 19. Grey's argument is logically faulty. FINRA need not explain why Grey did not commit additional fraud. Rather, Grey must explain why—when he set the price on each leg of the transactions at issue—his undisclosed and excessive mark-ups were not fraudulent. He

22 *See First Jersey*, 101 F.3d at 1459 (affirming that district court's conclusion that, in light of the respondent's dominion and control of the prices for the securities in question, the excessive mark-ups constituted securities fraud).

failed to do so and the facts of this case cogently demonstrate Grey's intention to deliberately charge excessive mark-ups for his pecuniary gain without disclosing the mark-ups and his interpositioning to GMCI customers.

In fact, the NAC found further support for the intentional or reckless nature of Grey's misconduct because he violated his firm's policies. The firm's internal policies and procedures outright prohibited Grey from interpositioning and charging mark-ups in excess of 3% without approval from a designated principal. RP 1588, 1704. As noted in the NAC decision, a trader is obligated to know the standards for determining fair prices. *John Montelbano*, 56 S.E.C. 76, 96 (2003). With over 30 years of securities industry experience, Grey must have understood his obligation to comply with his firm's policies and procedures; yet, he charged the excessive mark-ups anyway without disclosing this material information to GMCI's customers.

Grey argues that there is no consistency to his excessive mark-ups or pattern to the timing of the disputed trades. A linkage or pattern of trading, however, is not a pre-requisite to a finding of fraudulent mark-ups. Further, although Grey argues that his compensation was "insignificant," as the NAC decision noted, there is no *de minimis* exception to fraudulent conduct. RP 2138. Grey cannot dismiss his violations because he impacted "only" a few of GMCI's customers, a random set of trades, or what he considers to be an inconsequential sum of ill-gotten gains. *Tellabs*, 551 U.S. at 325 ("While it is true that motive can be a relevant consideration, and personal financial gain may weigh heavily in favor of a scienter inference, we agree . . . that the absence of a motive allegation is not fatal.").[23]

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[23] In attempts to downplay the significance of his misconduct, Grey dwells on the fact that he had charged the same "fraudulent" mark-ups in "thousands of other transactions during the identical time period" that was somehow overlooked by Enforcement. Applicant Brief at 2-4. According to Grey, because these trades went unchallenged, it somehow proves that he could not

(Footnote continued on next page)

Charging excessive mark-ups is material information.[24] Therefore, the NAC correctly found that in seven of the 10 bond transactions, Grey intentionally or recklessly charged fraudulently excessive mark-ups that he failed to disclose to GMCI's customers. *Meyer Blinder*, 50 S.E.C. 1215, 1230 (1992) (finding scienter "[w]here a dealer knows the circumstances indicating the prevailing interdealer market price for the securities, knows the retail price that it is charging the customer, and knows or recklessly disregards the fact that its markup is excessive, but nonetheless charges the customer the retail price").

(cont'd)

have possessed the requisite intent to defraud with respect to the bond trades at issue. But Grey cannot prove that he committed no misconduct based on allegations that were not in the complaint. Moreover, FINRA's Examiner, Barbara Walley, testified to reviewing a "sampling" of approximately 50 trades—certainly not the thousands of transactions that Grey mistakenly believes were under review. RP 626-630. The 10 bond transactions at issue were derived from that sampling. From an evidentiary standpoint, the record proves the allegations brought against Grey involving the bond mark-ups. In any event, the record does offer critical distinctions in Grey's trading of the bonds at issue from the other bond transactions he executed at the time. For example, Enforcement noted it did not allege violations in other bond transactions because the sales to customers occurred several weeks, or in some cases months, after Grey acquired the bonds. RP 2004-2005. Indeed, Grey's brief itself accounts for certain bond trades that were not charged when he explained that there were "other contemporaneous trades" conducted in these bonds that likely reflected the prevailing market price. Regardless of Grey's mere speculation, Enforcement's prosecutorial discretion is not an issue in this case, and is immaterial to Grey's misconduct. *See Schellenbach v. SEC*, 989 F.2d 907, 912 (7th Cir. 1993) (holding that NASD disciplinary proceedings are treated as an exercise of prosecutorial discretion).

24 *David Disner*, 52 S.E.C. 1217, 1219-1220 (1997) (noting that basic to the federal securities laws is the notion that an excessive mark-up or mark-down is material to the purchaser of a security, and holding that a dealer violates the anti-fraud provisions of the federal securities laws when, with scienter, he marks up the price of the security and charges his retail customer a price not reasonably related to the prevailing market price and fails to disclose this to his customer).

### 5. Grey's Misconduct was Willful.

The NAC correctly affirmed the Hearing Panel's findings that Grey's actions were willful. Pursuant to Sections 3(a)(39) and 15(b)(4)(D) of the Exchange Act, broker-dealers are subject to disqualification from the securities industry for willful violations of the federal securities laws or MSRB rules. 15 U.S.C. 78c(a)(39), 15 U.S.C. 78o(b)(4)(D). The term "willfully" means in this context intentionally committing the act that constitutes the violation. *Mathis v. SEC*, 671 F.3d 210, 216-18 (2d Cir. 2012). There is no requirement that the actor be aware that he or she is violating a particular rule or regulation. *See id.*; *see also Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). As a result of his actions, Grey willfully violated MSRB Rules G-17, G-30, and Exchange Act Section 10(b) and Rule 10b-5. Grey controlled all aspects of the transactions and he voluntarily marked up the bonds that he sold to his customers. *See Mathis*, 671 F.3d at 216-218 (finding statutorily disqualification of a respondent who voluntarily failed to amend Form U4 to disclose tax liens). Because of his willful actions, Grey is statutorily disqualified.

## B. The Sanctions Are Consistent with the FINRA Sanction Guidelines and Are Neither Excessive Nor Oppressive.

In determining sanctions, the NAC considered FINRA's Sanction Guidelines ("Guidelines"), including the Principal Considerations in Determining Sanctions set forth therein and any other case-specific factors,[25] and suspended Grey from associating with any member

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25 *See FINRA Sanction Guidelines* 6-7 (2013), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter "*Guidelines*"].

firm in any capacity for 18 months, fined him $30,000, and ordered him to pay $15,750 in disgorgement along with prejudgment interest to FINRA. RP 2139-2142.[26]

The sanctions imposed against Grey are appropriately tailored to prevent future misconduct and fall well within the range of the Guidelines. For excessive mark-ups, the Guidelines recommend a fine of $5,000 to $100,000 plus, if restitution is not ordered, the gross amount of the excessive mark-ups (or mark-downs). In addition, the Guidelines recommend suspension in any or all capacities for up to 30 business days. In egregious cases, FINRA should consider imposing a suspension in any or all capacities for up to two years or a bar.[27] For intentional or reckless misrepresentations or material omissions of fact, the Guidelines recommend that adjudicators consider imposing a fine between $10,000 to $100,000, a suspension in any or all capacities of 10 business days to two years, and, in egregious cases, a bar.[28]

Grey's 18-month suspension, $30,000 fine and order of disgorgement remedially address the egregious nature of Grey's misconduct. *Inv. Planning, Inc.*, 51 S.E.C. at 599 ("Overcharging customers is a serious breach of a [broker-dealer's] obligation to deal fairly with investors."); *Nicholas Codispoti*, 48 S.E.C. 842, 845 (1987) (holding that NASD's sanction to requalify as a general securities principal was "fully warranted" and "relatively lenient" considering the

26 The NAC issued a unitary sanction because Grey's violations resulted from the same course of conduct and violated rules that have similar purposes.

27 *Guidelines*, at 90; *see also id.* at n.1 (stating that this Guideline is also appropriate for violations of excessive mark-ups under MSRB Rule G-30).

28 *Id.* at 88.

serious misconduct of charging excessive mark-ups).[29] The NAC appropriately issued sanctions aimed to deter future misconduct and protect the investing public. *See* Guidelines, at 2 (General Principles Applicable to All Sanction Determinations, No. 1) ("Adjudicators should design sanctions that are significant enough to prevent and discourage future misconduct by a respondent, to deter others from engaging in similar misconduct, and to modify and improve business practices.")

As highlighted in the NAC decision, the NAC assessed Grey's claims of mitigation, but found that they lacked merit. The record sufficiently supports the NAC's finding of aggravating factors that contributed to Grey's sanctions. Grey concealed his misconduct by creating a multi-leg transaction, which created the appearance of a reasonable mark-up when the firm sold the bond to the customer. Moreover, Grey attempted to blame GMCI for his fraudulent misconduct by suggesting that the firm required him to use his own personal accounts when in fact Grey never provided evidence of such a request and the firm's WSPs prohibited charging excessive

[29] Despite Grey's assertions, the disgorgement amount of $15,750 constituted a reasonable approximation of Grey's ill-gotten gains and is appropriate for his egregious misconduct. *See Guidelines*, at 5 (General Principles Applicable to All Sanction Determinations, No. 6); *First Jersey,* 101 F.3d at 1474-75 (noting broad discretion given not only in determining whether or not to order disgorgement but also in calculating the amount to be disgorged); *Dep't of Enforcement v. Evans*, Complaint No. 2006005977901, 2011 FINRA Discip. LEXIS 36, at *40 n.42 (FINRA NAC Oct. 3, 2011) ("We may order disgorgement after a reasonable approximation of a respondent's unlawful profits."); *Laurie Jones Canady*, 54 S.E.C. 65, 84 (1999) (noting that "courts have held that the amount of disgorgement ordered need only be a reasonable approximation of profits causally connected to the violation") (internal quotation marks omitted), *aff'd*, 230 F.3d 362 (D.C. Cir. 2000). The NAC's order that Grey disgorge his pecuniary gain from the bond transactions serves as an effective enforcement of the federal securities laws, and its deterrent effect ensures that violators, such as Grey, do not unduly profit. "[D]isgorgement is intended to force wrongdoers to give up the amount by which they were unjustly enriched." *Michael David Sweeney*, 50 S.E.C. 761, 768 (1991). The Commission should affirm the NAC's order of disgorgement against Grey.

mark-ups and interpositioning.[30] Finally, Grey has yet to acknowledge that his misconduct constituted a violation of the securities laws.[31]

In support of his claim that his sanctions are punitive, Grey asserts "[d]ue to the finding on the 10b-5 charge, in effect Grey has been banned from the industry for life." Applicant Brief at 20. Grey's assertions lack merit for a number of reasons.

First, Grey was not barred by FINRA. FINRA's sanctions against Grey included an 18-month suspension, $30,000 fine, and an order to disgorge $15,750 with prejudgment interest to FINRA for his misconduct.[32] Second, Grey's statutory disqualification is not a FINRA-imposed penalty or remedial sanction. Grey's status of being statutorily disqualified follows because he

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30 While Grey was aware of the firm's policies and procedures prohibiting interpositioning and excessive mark-ups. Applicant Brief at 21 ("Grey has never disagreed, that markups exceeding 3% are suspect and probably excessive"); RP 725 (Grey testifying that bond trades with retail customers should be marked up no more than 3-5% from the fair market value), and RP 468 (stating "[w]e agree that markups well under 5% are the norm . . ."), he fails to understand that those policies applied to him. Grey chose on his own to ignore firm procedures and charged mark-ups in most cases well beyond 5%, which was ultimately borne by his unsuspecting customers.

31 With respect to admission of wrongdoing, Grey incorrectly believes that FINRA punished him for defending himself in a disciplinary action. FINRA did not. More precisely, the acceptance or acknowledgment of misconduct is a principal consideration in tailoring appropriate sanctions to ensure they are significant enough to deter future violations. *See Guidelines,* at 2. When a respondent acknowledges misconduct and accepts responsibility for the violation, an adjudicator can assess whether assurances of not repeating the misconduct are believable. Here, Grey continues to believe that he can buy from other dealers below the market price and is entitled to excessive mark-ups. *See Kevin Lee Otto*, 54 S.E.C. 847, 856 (2000) (noting that respondent's refusal to acknowledge his misconduct and actions demonstrate a serious misunderstanding of his obligations and commitment to the high standards demanded by the securities industry), *aff'd* 253 F.3d 960 (7th Cir. 2001).

32 In response to Grey's claim in his brief that the NAC decision has lengthened his order of suspension "for nearly a year," Applicant Brief at 24, we note that the NAC's sanction of an 18-month suspension is stayed pending his application for review with the SEC. *See* FINRA Rule 9730(a).

meets the definition in Exchange Act 3(a)(39), not because the NAC imposed a discretionary sanction. Grey's actions were a "willful" violation of MSRB Rules and the federal securities laws because he intentionally interpositioned himself between his customer and the best available market and charged undisclosed excessive mark-ups. Indeed, Grey's statutory disqualification event is not a "life sentence" and FINRA has not expelled Grey "from the securities industry, nor has FINRA imposed a penalty or remedial sanction" by virtue of his disqualification. *See Timothy Emerson*, Exchange Act Release No. 60328, 2009 SEC LEXIS 2417, at *26 (July 17, 2009).

Third, although Grey argues that substantive due process requires his sanctions to be proportional to the wrong and not excessive, the standard for review of FINRA's sanctions is set forth in the Exchange Act, not the Constitution's due process clause.[33] As an initial matter, "self-regulatory organizations [such as FINRA] . . . are not state actors and thus are not subject to the Constitution's due process requirements." *Emerson*, 2009 SEC LEXIS 2417, at *25 ("We have held that NASD proceedings are not state actions and thus not subject to constitutional requirements.") (citation omitted). Nevertheless, Grey's sanctions fell within the applicable Guidelines for his misconduct. For example, with the Guidelines' recommendation of a fine between $10,000 to $100,000 for intentional or reckless misrepresentations or material omissions of fact, and a suspension in any or all capacities up to two years (or, in egregious cases, a bar), Grey's 18-month suspension and $30,000 fine is well within that range.

In support of his claim that the sanctions are improperly punitive, Grey cites to a number of excessive mark-up cases with lesser sanctions as a comparison. In assessing whether the

[33] *See* 15 U.S.C. 78s(e) (noting that the standard for the Commission's review of the sanctions is whether a sanction is excessive or oppressive).

sanctions are excessive or oppressive, the Commission should disregard the cases Grey cites for two reasons. First, most of his references are to settled cases that add minimal to no probative value to the case at hand. *See Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) ("The employment of a sanction within the authority of an administrative agency is thus not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases."); *see also* Guidelines, at 1 (acknowledging the broadly recognized principle that settled FINRA cases generally result in lower sanctions than fully litigated cases to provide incentives to settle.). Second, in all of the cases Grey referenced, none of the cases were fraud cases, which can include sanctions up to, and including, a bar.[34] Thus, the appropriate remedial action that FINRA takes in each case depends on the facts and circumstances.

In sum, the NAC imposed balanced sanctions that are within the Guidelines' recommended ranges for Grey's misconduct.

34 For example, Grey cites to *Lerner* and *SFI Investments, Inc.*, to highlight lesser sanctions. Applicant Brief at 23. Exchange Act Section 10(b) and Rule 10b-5 were not, however, charged in either of these cases. *Compare Gonchar*, 2009 SEC LEXIS 2797, at *57 (sustaining the sanction of a bar in all capacities against respondents for fraudulently interpositioning and charging customers undisclosed excessive mark-ups), with *Lerner* and *SFI Investments, Inc.*

## IV. CONCLUSION

The NAC's findings that Grey engaged in violations are fully supported by the record, and the sanctions imposed for the violations are appropriate to deter Grey from engaging in future misconduct. The Commission should sustain the NAC's decision in all respects.

Respectfully submitted,

Lisa Jones Toms
Assistant General Counsel
FINRA
1735 K Street, NW
Washington, DC 20006
Tel.: (202) 728-8044

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<u>**APPENDIX OF APPLICABLE FINRA SANCTION GUIDELINES**</u>

This appendix sets forth the relevant text of FINRA's Sanction Guidelines, as they existed during the relevant time period. The sources of the reproduced rule text are indicated.

(Source: *See FINRA Sanction Guidelines* (2013), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf)

FINRA

Financial Industry Regulatory Authority

# Sanction Guidelines

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6. **To remediate misconduct, Adjudicators should consider a respondent's ill-gotten gain when determining an appropriate remedy.** In cases in which the record demonstrates that the respondent obtained a financial benefit[4] from his or her misconduct, where appropriate to remediate misconduct, Adjudicators may require the disgorgement of such ill-gotten gain by ordering disgorgement of some or all of the financial benefit derived, directly or indirectly.[5] In appropriate cases, Adjudicators may order that the respondent's ill-gotten gain be disgorged and that the financial benefit, directly and indirectly, derived by the respondent be used to redress harms suffered by customers. In cases in which the respondent's ill-gotten gain is ordered to be disgorged to FINRA, and FINRA collects the full amount of the disgorgement order, FINRA's routine practice is to contribute the amount collected to the FINRA Investor Education Foundation.

7. **Where appropriate, Adjudicators should require a respondent to requalify in any or all capacities.** The remedial purpose of disciplinary sanctions may be served by requiring an individual respondent to requalify by examination as a condition of continued employment in the securities industry. Such a sanction may be imposed when Adjudicators find that a respondent's actions have demonstrated a lack of knowledge or familiarity with the rules and laws governing the securities industry.

8. **When raised by a respondent, Adjudicators are required to consider ability to pay in connection with the imposition, reduction or waiver of a fine or restitution.** Adjudicators are required to consider a respondent's *bona fide* inability to pay when imposing a fine or ordering restitution. The burden is on the respondent to raise the issue of inability to pay and to provide evidence thereof.[6] If a respondent does not raise the issue of inability to pay during the initial consideration of a matter before "trial-level" Adjudicators, Adjudicators considering the matter on appeal generally will presume the issue of inability to pay to have been waived (unless the inability to pay is alleged to have resulted from a subsequent change in circumstances). Adjudicators should require respondents who raise the issue of inability to pay to document their financial status through the use of standard documents that FINRA staff can provided. Proof of inability to pay need not result in a reduction or waiver of a fine, restitution or disgorgement order, but could instead result in the imposition of an installment payment plan or another alternate payment option. In cases in which Adjudicators modify a monetary sanction based on a *bona fide* inability to pay, the written decision should so indicate. Although Adjudicators must consider a respondent's *bona fide* inability to pay when the issue is raised by a respondent, monetary sanctions imposed on member firms need not be related to or limited by the firm's required minimum net capital.

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4 "Financial benefit" includes any commissions, concessions, revenues, profits, gains, compensation, income, fees, other remuneration, or other benefits the respondent received, directly or indirectly, as a result of the misconduct

5 Certain guidelines specifically recommend that Adjudicators consider ordering disgorgement in addition to a fine. These guidelines are singled out because they involve violations in which financial benefit occurs most frequently. These specific references should not be read to imply that it is less important or desirable to order disgorgement of ill-gotten gain in other instances. The concept of ordering disgorgement of ill-gotten gain is important and, if appropriate to remediate misconduct, may be considered in all cases whether or not the concept is specifically referenced in the applicable guideline.

6 *See In re Toney L. Reed*, Exchange Act Rel. No. 37572 (August 14, 1996), wherein the Securities and Exchange Commission directed FINRA to consider financial ability to pay when ordering restitution. In these guidelines, the NAC has explained its understanding of the Commission's directives to FINRA based on the *Reed* decision and other Commission decisions.

## Principal Considerations in Determining Sanctions

The following list of factors should be considered in conjunction with the imposition of sanctions with respect to all violations. Individual guidelines may list additional violation-specific factors.

Although many of the general and violation-specific considerations, when they apply in the case at hand, have the potential to be either aggravating or mitigating, some considerations have the potential to be only aggravating or only mitigating. For instance, the presence of certain factors may be aggravating, but their absence does not draw an inference of mitigation.[1] The relevancy and characterization of a factor depends on the facts and circumstances of a case and the type of violation. This list is illustrative, not exhaustive; as appropriate, Adjudicators should consider case-specific factors in addition to those listed here and in the individual guidelines.

1. The respondent's relevant disciplinary history (see General Principle No. 2).
2. Whether an individual or member firm respondent accepted responsibility for and acknowledged the misconduct to his or her employer (in the case of an individual) or a regulator prior to detection and intervention by the firm (in the case of an individual) or a regulator.
3. Whether an individual or member firm respondent voluntarily employed subsequent corrective measures, prior to detection or intervention by the firm (in the case of an individual) or by a regulator, to revise general and/or specific procedures to avoid recurrence of misconduct.
4. Whether the respondent voluntarily and reasonably attempted, prior to detection and intervention, to pay restitution or otherwise remedy the misconduct.
5. Whether, at the time of the violation, the respondent member firm had developed reasonable supervisory, operational and/or technical procedures or controls that were properly implemented.
6. Whether, at the time of the violation, the respondent member firm had developed adequate training and educational initiatives.
7. Whether the respondent demonstrated reasonable reliance on competent legal or accounting advice.
8. Whether the respondent engaged in numerous acts and/or a pattern of misconduct.
9. Whether the respondent engaged in the misconduct over an extended period of time.
10. Whether the respondent attempted to conceal his or her misconduct or to lull into inactivity, mislead, deceive or intimidate a customer, regulatory authorities or, in the case of an individual respondent, the member firm with which he or she is/was associated.
11. With respect to other parties, including the investing public, the member firm with which an individual respondent is associated, and/or other market participants, (a) whether the respondent's misconduct resulted directly or indirectly in injury to such other parties, and (b) the nature and extent of the injury.

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1 *See, e.g., Rooms v. SEC*, 444 F.3d 1208, 1214-15 (10th Cir. 2006) (explaining that while the existence of a disciplinary history is an aggravating factor when determining the appropriate sanction, its absence is not mitigating).

12. Whether the respondent provided substantial assistance to FINRA in its examination and/or investigation of the underlying misconduct, or whether the respondent attempted to delay FINRA's investigation, to conceal information from FINRA, or to provide inaccurate or misleading testimony or documentary information to FINRA.

13. Whether the respondent's misconduct was the result of an intentional act, recklessness or negligence.

14. Whether the member firm with which an individual respondent is/was associated disciplined the respondent for the same misconduct at issue prior to regulatory detection. Adjudicators may also consider whether another regulator sanctioned a respondent for the same misconduct at issue and whether that sanction provided substantial remediation.

15. Whether the respondent engaged in the misconduct at issue notwithstanding prior warnings from FINRA, another regulator or a supervisor (in the case of an individual respondent) that the conduct violated FINRA rules or applicable securities laws or regulations.

16. Whether the respondent member firm can demonstrate that the misconduct at issue was aberrant or not otherwise reflective of the firm's historical compliance record.

17. Whether the respondent's misconduct resulted in the potential for the respondent's monetary or other gain.

18. The number, size and character of the transactions at issue.

19. The level of sophistication of the injured or affected customer.

# X. Sales Practices

- Churning or Excessive Trading
- Communications With the Public—Late Filing; Failing to File; Failing to Comply With Rule Standards or Use of Misleading Communications
- Customer Account Transfer Contracts—Failure to Comply With Rule Requirements
- Day-Trading Accounts—Failure to Comply With Risk Disclosure Requirements; Failure Appropriatelyto Approve an Account for Day Trading; Failure to Preserve Required Day-Trading Records
- Discretion—Exercise of Discretion Without Customer's Written Authority
- Guaranteeing a Customer Against Loss
- Institutional Sales Material—Failing to Establish and Maintain Written Procedures in Compliance With Rule Standards; Failing to Comply With Rule Standards Regarding Recordkeeping
- Misrepresentations or Material Omissions of Fact
- Penny Stock Rules—Failure to Comply With Rule Requirements
- Pricing—Excessive Markups/Markdowns and Excessive Commissions
- Research Analysts and Research Reports—Failing to Comply With Rule Requirements Regarding (1) Relationships Between Research Department and Investment Banking Department; (2) Compensation for Research Analysts; and (3) Relationships Between Research Analysts and Subject Companies
- Suitability—Unsuitable Recommendations
- Telemarketing—Failing to Comply With Time-of-Day Restrictions and Do-Not-Call Lists; Failing to Establish and Maintain Procedures to Comply With Rule 2212(a)
- Trading Ahead of Research Reports
- Unauthorized Transactions and Failures to Execute Buy and/or Sell Orders

# Misrepresentations or Material Omissions of Fact

FINRA Rules 2010 and 2020[1]

| Principal Considerations in Determining Sanctions | Monetary Sanction[2] | Suspension, Bar or Other Sanctions |
|---|---|---|
| *See Principal Considerations in Introductory Section* | ***Negligent Misconduct***<br><br>Fine of $2,500 to $50,000.<br><br>***Intentional or Reckless Misconduct***<br><br>Fine of $10,000 to $100,000. | ***Negligent Misconduct***<br><br>Suspend individual in any or all capacities and/or suspend firm with respect to any or all activities or functions for up to 30 business days.<br><br>***Intentional or Reckless Misconduct***<br><br>Suspend individual in any or all capacities and/or suspend firm with respect to any or all activities or functions for a period of 10 business days to two years.<br><br>In egregious cases, consider barring the individual and/or expelling the firm. |

1 This guideline also is appropriate for violations of MSRB Rule G-17

2 In cases involving misrepresentations and/or omissions as to two or more customers, the Adjudicator may impose a set fine amount per investor rather than in the aggregate. As set forth in General Principle No. 6, Adjudicators may also order disgorgement.

# Pricing—Excessive Markups/Markdowns and Excessive Commissions

**FINRA Rule 2010, NASD Rule 2440 and NASD IM-2440**[1]

| Principal Considerations in Determining Sanctions | Monetary Sanction | Suspension, Bar or Other Sanctions |
| --- | --- | --- |
| ***See Principal Considerations in Introductory Section***<br>1. Whether respondent dominated and controlled the market in the subject security or securities.<br>2. Whether respondent (registered representative) had discretion as to the amount of markups, markdowns or commissions on each trade. | Fine of \$5,000 to \$100,000 plus (if restitution is not ordered) the gross amount of the excessive markups, markdowns, or excessive commissions. Consider suspending individual respondent in any or all capacities for up to 30 business days and requiring demonstrated corrective action with respect to the firm's markup/markdown policy or commission policy. | In egregious cases, consider suspending individual respondent in any or all capacities for up to two years or barring individual. For the firm, consider suspending with respect to any or all activities or functions for up to two years or expelling the firm. |

1 This guideline also is appropriate for violations of MSRB Rule G-30