

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 78571 / August 15, 2016**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4484 / August 15, 2016**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 32213 / August 15, 2016**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17386**

**In the Matter of**

**Tianyu Zhou,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE AND  
CEASE-AND-DESIST PROCEEDINGS, PURSUANT  
TO 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, MAKING FINDINGS,  
AND IMPOSING REMEDIAL SANCTIONS AND  
A CEASE-AND-DESIST ORDER**

**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 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 Tianyu “Arnie” Zhou (“Respondent”).

**II.**

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

### **III.**

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

#### **Summary**

1. Tianyu “Arnie” Zhou securitized and traded commercial mortgage-backed securities (“CMBS”) at a broker-dealer from 2012 to 2015. For most of that time, Zhou inaccurately marked certain loans that were held on his employer’s books, and he provided inaccurate information to his employer’s internal control function concerning those loans.

2. Zhou’s actions prevented his employer’s internal control function from learning the accurate value of those loans. He claimed that the largest loan in question featured a “step-up” coupon – i.e., that the loan would ratchet up to a higher interest rate – but it did not. When asked for supporting documentation, Zhou fabricated a loan document that featured such a “step-up coupon.” In late 2015, consistent with an instruction to reduce the risk held in his employer’s books, Zhou decided to securitize the loan in question, leading to the discovery of the fabricated document. Upon discovery, Zhou acknowledged responsibility and resigned.

#### **Respondent**

3. Zhou, aged 40, was a registered representative with the Broker-Dealer beginning in July 2012 through his resignation in November 2015 (followed by his formal termination effective Jan. 1, 2016). Zhou, who worked in New York City, holds Series 7 and 63 licenses. He resides in Short Hills, NJ.

#### **Other Relevant Entities**

4. The “Broker-Dealer” was, at all relevant times, registered with the Commission as a broker-dealer and investment adviser. It has its principal place of business in New York, NY. It is a wholly-owned indirect subsidiary of the Bank.

5. The “Bank” is an international financial services firm and a foreign issuer whose stock is registered under Section 12(b) of the Exchange Act and trades on the New York Stock Exchange.

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

## **Background**

6. During the relevant period Zhou traded a portfolio or “book” of agency-backed multifamily CMBS. These are asset-backed securities that offer exposure to a variety of housing and other developments where repayment is guaranteed by the U.S. government or a Government Sponsored Enterprise. Part of Zhou’s book was a “warehouse” of whole loans awaiting CMBS securitizations, and this is where the mismarking took place.

7. One of Zhou’s responsibilities was to value, or “mark,” his warehouse each month, i.e., to provide the Broker-Dealer with his best assessment of the aggregate market value of the whole loans in the warehouse. The types of loans in the warehouse were not traded on a regular basis, and the Broker-Dealer therefore did not have ready access to market-pricing to value Zhou’s warehouse. The Broker-Dealer’s financial statements stated that they were prepared in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”), while the Bank’s financial statements stated that they were prepared in accordance with International Financial Reporting Standards (“IFRS”). To enable these entities to properly prepare their financial statements, it was important that Zhou give his honest view of the fair value of his warehouse, which for purposes of both GAAP and IFRS, as a general matter, is the price that the Broker-Dealer would receive in an orderly sale of the assets in the warehouse. Zhou’s warehouse mark was incorporated into the books and records that the Broker-Dealer used to account for its assets and income. The mark also affected the profitability of Zhou’s book.

8. As part of its internal accounting controls, the Broker-Dealer had a price verification function (the “Valuation Group”) that independently tested the valuation of Zhou’s warehouse on a regular basis. Zhou was responsible for providing the Valuation Group with certain information concerning his warehouse, which he typically did by providing the Valuation Group with a “loan tape” around the end of every month. The loan tapes listed the “coupons” (interest rates) payable on Zhou’s warehouse loans. Using this information, the Valuation Group independently valued the loans in the warehouse and compared its aggregate mark to Zhou’s. When the difference between these marks exceeded a threshold, the Valuation Group would confer with Zhou to determine the reason. If the Valuation Group was not satisfied with Zhou’s explanation for a discrepancy that exceeded a threshold, it would make a downward adjustment to bring Zhou’s mark in line with its mark.

### **Zhou Begins Submitting Inaccurate Coupon Data**

9. In September 2013, to hide losses in his warehouse, Zhou submitted an inflated mark for the warehouse to the Broker-Dealer. At the same time, Zhou provided the Valuation Group with a loan tape containing inaccurate coupon information that supported this inflated mark. Zhou submitted a coupon of 3.03 percent for the largest loan in the tape (“Warehouse Loan 1”), whereas the correct coupon was 2.03 percent.

10. Over the next six months, as losses in his warehouse mounted, Zhou submitted increasingly higher coupons for Warehouse Loan 1, so that by March 2014, the loan tape showed a coupon of 4.63 percent.

11. Additionally, starting with the November 2013 loan tape, Zhou submitted inaccurate coupon information for other loans in his warehouse. By the time Zhou submitted the January 2014 loan tape, he was submitting inaccurate coupons for Warehouse Loan 1 and seven other loans. However, given that Warehouse Loan 1 was by far the largest in his warehouse, the inaccurate coupon submitted to the Valuation Group for that loan explained most of the amount by which Zhou inflated his warehouse mark.

12. By March 2014, Zhou stopped acquiring new loans in his warehouse and, consequently, ceased submitting new loan tapes to the Valuation Group. The Valuation Group continued to rely on the last loan tape – which had inaccurate coupons for five loans – for purposes of independent price verification.

#### **Zhou Makes Inaccurate Statements to Conceal His Mismarking**

13. In August 2014, Zhou's warehouse mark came under heightened scrutiny. An employee in the Valuation Group noticed that five coupons in Zhou's loan tape did not match information publicly available from third parties. He asked Zhou why, and Zhou responded: "will take a closer look ... some loans have step cpns ... meaning the cpn changes one or twice from the initial ... for those i will send u loan docs." However, the discrepancies were not due to coupons that stepped up to higher rates.

14. In September 2014, the Valuation Group again asked Zhou for an explanation, after noting that the difference between the group's mark and Zhou's mark had grown. Zhou again pointed to a nonexistent step-up coupon. When an employee from the Valuation Group noted that Bloomberg data terminals showed a coupon of 2.03 percent for Warehouse Loan 1, Zhou responded: "no, bbg [Bloomberg] shows curr[ent] cpn ... only the loan doc has it [the step-up coupon] ... i will send to u." These statements were false.

15. In October 2014, the Valuation Group asked Zhou a third time for the terms of Warehouse Loan 1. Zhou responded: "thot i fwded u ... let me double check, i have it ... need do later today." But Zhou did not have a loan document with such terms.

#### **Zhou Fabricates a Loan Document**

16. After this third request from the Valuation Group, Zhou altered a version of a Warehouse Loan 1 agreement. Zhou inserted language providing that, starting in February 2016, which Zhou defined in the altered agreement as the "Coupon Step-up Date," monthly payments would increase by 50 percent. Zhou sent this document to the Valuation Group in October 2014.

17. Having not received explanations as to the coupon discrepancies for the other four loans with inaccurate coupon information, the Valuation Group decided to rely on third party coupon data for such loans. Accordingly, the Valuation Group learned the accurate coupon data for those loans around the beginning of 2015, but continued to rely on the fabricated document as to Warehouse Loan 1 past that date.

### **Zhou is Questioned Further and Resigns**

18. Near the end of 2015, consistent with an instruction to reduce the risk held in his employer's books, Zhou decided to securitize Warehouse Loan 1 and other loans. When the Valuation Group noticed that the sale price for the resulting CMBS implied a lower market value for Warehouse Loan 1 than what was reflected in Zhou's warehouse mark, it investigated this discrepancy.

19. In early November 2015, the Valuation Group asked Zhou about the circumstances of the step-up coupon. Although Zhou initially claimed that there were different versions of the loan outstanding, some with the step-up coupon and some without, he subsequently acknowledged responsibility for the valuation discrepancy and resigned.

### **Zhou's Mismarks Improved His Profitability**

20. Zhou's mismarking had the effect of improperly inflating his profitability from 2013 to 2015. Zhou took credit for approximately \$38 million of profits in 2013, but his actual profits were approximately 33% lower. In 2014, Zhou reported a modest profit, when he ought to have reported a loss for the year. Finally, Zhou's mismarking continued to materially impact his profitability by millions of dollars in 2015, until he resigned.

### **Violations**

21. As a result of the conduct described above, Zhou willfully<sup>2</sup> 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. The ledgers of the Broker-Dealer did not accurately reflect the assets held in Zhou's warehouse. Zhou aided and abetted, and caused, such violations when he submitted false information to the Broker-Dealer concerning the value of the positions in his warehouse.

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<sup>2</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

22. As a result of the conduct described above, Zhou willfully violated Section 13(b)(5) of the Exchange Act, which prohibits any person from knowingly circumventing or failing to implement a system of internal accounting controls or knowingly falsifying any book, record, or account described in Section 13(b)(2) of the Exchange Act. He also willfully violated Exchange Act Rule 13b2-1, which prohibits a person from directly or indirectly falsifying any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act. By submitting false information to the Broker-Dealer concerning the value of the positions in his warehouse, and by submitting false coupon information and a false loan document to the Valuation Group, Zhou circumvented a system of internal accounting controls described in Section 13(b)(2) and falsified books and records subject to Section 13(b)(2)(A).

#### IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, Section 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 17(a) and 13(b)(5) of the Exchange Act and Rules 17a-3 and 13b2-1 promulgated thereunder.

B. Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock;

with the right to apply for reentry after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$50,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Zhou as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Michael J. Osnato, Jr., Chief, Complex Financial Instruments Unit, U.S. Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281-1022.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To

preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Brent J. Fields  
Secretary