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FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. Respondent.	Disciplinary Proceeding No. 2007010580702 Hearing Officer – RSH **HEARING PANEL DECISION** November 18, 2011

The Hearing Panel dismissed the Amended Complaint following a hearing. The Department of Enforcement failed to prove by a preponderance of the evidence that Respondent violated Rules 8210 and 2110 by giving false information to his firm and FINRA.

Appearances

David Sonnenberg and Christopher Perrin, in Washington, DC, for the Department of Enforcement

Benjamin Rosenberg and Sarah Mendola, of Dechert, in New York, NY, for the Respondent.

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DECISION

I. PROCEDURAL HISTORY[1]

Enforcement filed the Complaint with the Office of Hearing Officers on December 1, 2010, and Respondent filed his Answer on December 17, 2010. On May 17, 2011, Enforcement filed an Amended Complaint, and Respondent filed his Answer to the Amended Complaint on May 23, 2011.

In three Causes of Action, Enforcement alleged that Respondent, while registered with FINRA-registered firm, [] ("the Firm"), knowingly made a false and misleading statement to the Firm's' chief compliance officer ("CCO") during a FINRA investigation into the use of stock finders by the firm. According to Enforcement, Respondent, then the co-head of the Firm's stock lending desk, falsely told the CCO that the Firm had never used a stock finder, when it had in fact used the services of Respondent's father, who was a stock finder. The CCO repeated the allegedly false information in the Firm's response to a FINRA request for information made pursuant to Rule 8210. Respondent reviewed the response letter, but did not correct the false information. Enforcement alleged that by knowingly providing false information that he knew would be included in an 8210 response, Respondent violated Rule 8210. Further, Enforcement alleged that Respondent continued to make false statements about the Firm's use of stock finders to the firm's compliance and legal personnel, thereby acting unethically and violating Rule 2110. Finally, Enforcement alleged that Respondent gave false on-the-record ("OTR") testimony to FINRA when he stated that the Firm had never paid a stock finder, thereby violating Rule 8210.

[1] As of July 30, 2007, NASD began operating under a new corporate name, the Financial Industry Regulatory Authority ("FINRA"). References in this decision to FINRA include, where appropriate, NASD. On December 15, 2008, certain consolidated FINRA rules became effective, replacing parallel NASD rules, and in some cases the prior rules were re-numbered and/or revised. *See* Regulatory Notice No. 08-57, FINRA Notices to Members, 2008 FINRA LEXIS 50 (Oct. 2008). This Decision refers to and relies on the NASD rules that were in effect at the time of the Respondent's alleged misconduct and cited in the Complaint as the basis for the charges against him.

The hearing was held in New York City on June 28 and 29, 2011, before a hearing panel composed of the Hearing Officer and two former members of the District 10 Committee. Enforcement called as witnesses JF (former Firm CCO), Kristen Conway (a FINRA case manager), MO (former Firm general counsel), and Respondent. Respondent called JA (former Firm stock loan desk employee) and RL (former Firm stock loan desk employee). Nine of Enforcement's exhibits, four of Respondent's exhibits, and 11 joint exhibits were admitted into evidence.[2]

After a thorough review of the record, the Hearing Panel finds that Enforcement failed to prove by a preponderance of the evidence that Respondent violated Conduct Rules 8210 and 2110 by providing false information to his firm and to FINRA. Accordingly, the Hearing Panel dismisses the Amended Complaint.

II. FINDINGS OF FACT

A. Origin of the Proceeding

This proceeding originated in early 2007, when Enforcement began an investigation into the use of finders by the Firm in its securities lending business. The investigation with respect to the Firm was resolved by a Letter of Acceptance, Waiver and Consent ("AWC") that became effective February 22, 2010.[3]

B. The Respondent

Respondent first became registered as a General Securities Representative in March 1996 through [a] FINRA-registered firm []. Respondent worked on the securities lending desk at [that

[2] In this decision, "Tr." refers to the transcript of the hearing; "CX" to Enforcement's exhibits; "RX" to Respondents' exhibits; and "JX" to the parties' joint exhibits. See Tr. at 296, 565.

[3] RX-10.

firm] until he moved to the Firm.[4] The Firm was a hedge fund that was founded in 1994 by PC and JS.[5] JS supervised the Firm's stock lending, and in early 2001, he hired Respondent as the first member of the Firm's stock lending group. Respondent's job was to monitor the rates that the Firm's traders were receiving when they borrowed securities from prime brokers.[6] In or about the summer of 2002, the Firm set up a stock lending desk, with Respondent as its co-head.[7] Once the desk was set up, the stock lending group was able to supply securities for the hedge fund side of the Firm.[8] In 2003, the stock lending group began to execute "matchbook" transactions. In such transactions, the firm borrowed securities from one firm and immediately lent them to another firm, earning revenues on the difference between the borrowing costs paid and the lending fees earned.[9]

Respondent's father, RD, had worked with JS and PS at [another firm].[10] After leaving [that firm], RD worked as a stock finder through his company, ["RD's firm"].[11] Stock finders typically locate securities for stock lending transactions between registered broker-dealers. Finders themselves are not registered broker-dealers.[12] Through his relationship with JS and PC, RD worked with the Firm both before and after his son became employed there. RD often spoke with traders at the Firm, proposing transactions and providing his services as a finder in

[4] Tr. at 191:17-192:12; CX-1 at 6-7.

[5] Tr. at 280:19-281:4.

[6] Tr. at 192:18-193:3.

[7] Tr. at 193:24-194:6.

[8] Tr. at 277:23-278:2.

[9] RX-10 at 4.

[10] Tr. at 280:14-281:12; 428:3-23.

[11] Tr. at 199:5-9.

[12] Tr. at 196, 252-53.

connection with lending transactions.[13] Respondent's co-workers on the stock lending desk (JA and RL), the Firm's general counsel (MO), and the chief compliance officer (JF) knew that RD worked as a stock finder.[14] On March 20, 2002, the Firm paid RD's firm approximately $4,913.[15]

C. The Firm's Stock Lending Desk and Policy

When the Firm created its stock lending desk, it implemented a new policy with respect to finders. The new policy was never written down, however, and neither the compliance department nor the general counsel provided any oral guidance on the subject. Therefore, there was confusion between the stock loan desk employees and their supervisor, on the one hand, and the compliance department and general counsel, on the other hand, about the existence and substance of the Firm's policy.[16]

The three people from the stock loan desk who testified at the hearing -- JA, RL, and Respondent – all testified that the new rule was that one could not *pay* finders, but it was acceptable to receive assistance from them in locating securities so long as the finders were paid by someone else.[17] JS, who supervised the desk, had the same understanding.[18] JA further testified that she dealt with another finder who would show her stocks, and if the Firm was interested, the finder would then show the stock to one of the Firm's counterparties. The counterparties would deal directly with the Firm and then (JA assumed) compensate the finder.[19]

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[13] Tr. at 428:24-430:11, 280:6-9.

[14] Tr. at 487:11-488:4 (JA), 499:7-21 (RL), 425:25-426:9 (MO), 41:2-14 (JF).

[15] CX-7 at 7-10.

[16] Tr. at 103:6-107:21 (JF).

[17] Tr. at 483:18-484:20 (JA), 501:2-10 (RL), 277:3-5 (Respondent).

[18] RX-10; Tr. at 422:9-426:22 (MO), 346:4-15 (Conway).

[19] Tr. at 484:24-485:22.

Respondent testified that he had a similar relationship with RD's firm.[20] Respondent and JA believed that they were behaving consistently with the Firm's policy.[21]

MO testified, "Looking back at everything, it's very clear that there was some confusion somewhere, and that we probably didn't do a good job, which is what the AWC found, of communicating and enforcing the policy."[22] The AWC stated, "[The Firm] had no written procedures or guidelines addressing the Firm's use of finders. Additionally, no clear oral guidance regarding the use of finders was provided. These failures caused employees to have conflicting understandings as to what was and was not permitted regarding the use of finders."[23]

D. Alleged Violations

1. Participating in a False Response to a Rule 8210 Request

Rule 8210 requires member firms and persons subject to FINRA's jurisdiction to provide information requested by FINRA. The failure to respond truthfully to FINRA requests for information, whether in writing or in oral testimony, constitutes a violation of Rule 8210.[24] Providing false information to NASD is an independent violation of NASD Rule 2110.[25]

The First Cause of Action alleges that Respondent caused the Firm's April 13 response to FINRA's March 30 request for information to be false by telling JF that the Firm did not use finders, knowing that JF would include that representation in the response. The Hearing Panel

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[20] Tr. at 196:22-198:5.

[21] Tr. at 486:15-17 (JA), Tr. 277:3-5 (Respondent).

[22] Tr. at 477:11-15.

[23] RX-10.

[24] *Dist. Bus. Conduct Comm. v. Doshi,* No. C10960047, 1999 NASD Discip. LEXIS 6 (N.A.C. Jan. 20, 1999) (imposing a bar for lying during investigative testimony).

[25] *See Geoffrey Ortiz*, 2008 SEC LEXIS 2401, at *23–24 (Aug. 22, 2008) (citing *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) (determining that respondent engaged in conduct contrary to just and equitable principles of trade by providing false information to NASD).

found that Enforcement failed to prove by a preponderance of the evidence that Respondent violated Rules 8210 and 2110 as charged.

On March 30, 2007, Enforcement sent a letter to the Firm, addressed to JF, asking for copies of its "written policies and procedures, instructions, memoranda and other documents…concerning the hiring, retention, or use of, and/or payment to, a stock finder (the "March 30 Inquiry").[26] JF consulted with Respondent before submitting the Firm's response, and Respondent reviewed a draft of the response.[27] The response, written and signed by JF, was submitted on April 13, 2007 (the "April 13 Response").[28]

The April 13 Response stated that the Firm had no documents responsive to the March 30 Inquiry. It further stated that the Firm had never "used the services of finders for its securities lending activities."[29] The latter phrase forms the basis for the First Cause of Action: The Complaint alleges that the Firm used finders, and that Respondent falsely represented to JF that it did not, thus causing the April 13 Response to be false.

The key question in this case is whether the Firm "used" stock finders. Respondent, JA and RL all testified that they always believed that "using" a stock finder meant paying a stock finder.[30] When MO was asked what she meant by "use" in this context, she testified, "Well, this seems to be the $60,000 question. What I mean by "use" is that we, meaning the firm, would not interact from a business perspective directly with finders." She admitted that the Firm had never put this understanding into written procedures and policies. [31] MO also testified that JS, who

[26] JX-3.

[27] Tr. at 137:23-138:12 (JF).

[28] JX-4

[29] JX-4 ¶ 1.

[30] Tr. at 513:7-11, 514:13-14 (Respondent), 483-4 (JA), 501 (RL).

[31] Tr. at 393:4-9, 394:15-19.

supervised the stock lending desk, believed that the Firm's policy allowed employees to use the services of finders, as long as the firm did not pay the finders. She further testified that JS had explained the policy to the employees on the stock lending desk.[32] Finally, MO testified that when she spoke to Respondent about responding to FINRA's requests for information about stock finders, there may have been a misunderstanding between the two of them about the meaning of the word "use."[33]

The evidence established that many people understood that interacting with finders the way the Firm did was *not* "using" them, because the Firm did not pay them.[34] Other employees at the Firm expressed confusion and uncertainty about the word "use" in their OTR testimony, which led Kristen Conway ("Conway"), the FINRA investigator in this matter, to conclude that *her* definition of the word "use" may not be fully understood and accepted by everyone at the Firm.[35]

Enforcement failed to produce any drafts of the April 13 Response, or any e-mails or any other physical evidence reflecting how the letter came to be written as it was. There was no evidence that the draft that Respondent saw contained the allegedly false language. JF and MO also reviewed the letter, and may have added language.[36] There was no credible evidence that Respondent provided any false information to JF or that he approved the allegedly inaccurate language in the Response.

Much of Enforcement's case against Respondent on the First Cause of Action rested on JF's testimony. The Hearing Panel concluded that JF had a strong motive to blame Respondent

[32] Tr. at 424:14-426:25.

[33] Tr. at 448.

[34] Tr. at 422:9-24, 432:14-433:12 (MO), 514:9-14 (Respondent).

[35] Tr. at 343:16-349:5.

for any inaccuracies in the April 13 Response, and his testimony was largely discredited. JF could not recall any specific conversations he had with Respondent relating to the March 30 Inquiry or the April 13 Response. JF admitted that he had "no direct recollection of anyone saying anything about question one"; that he did not "recall any discussion particularly about the word use" as related to finders; and that in fact "[t]here was no careful discussion about what it meant to use and what it didn't mean to use."[37] JF had no notes of any conversation he might have had with Respondent, or any documents whatsoever relating to the March 30 Inquiry or the April 13 Response. He admitted, however, that he may have had notes and later destroyed them.[38] The record does not even establish that Respondent saw a final draft of the response letter, or whether Respondent gave any comments to any draft.[39]

As became clear at the hearing, the meaning of the word "use" is central to this case. Yet, each time JF testified in this matter, he changed his testimony regarding what it means to "use" a finder:

- In his April 17, 2009, OTR, JF testified that he became aware that Respondent was using finders in December 2007, after Respondent provided him with a list of transactions involving finders.[40]
- In his October 14, 2009, OTR, JF testified that he came to the conclusion that Respondent "had not been using finders." [41]

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[36] Tr. at 143:20-144:7.

[37] Tr. at 142: 2-21.

[38] Tr. at 136:2-22.

[39] Tr. at 143:13-19.

[40] Tr. at 167:9-13; 168:18-169:9.

[41] Tr. at 170:9-13.

- At the hearing, JF testified that he thought Respondent "had been using finders," but that he "had different understandings of what the word 'use' meant at different times."[42]
- At the Hearing, JF explained that he had understood that "FINRA had been tying the word "use" to payment, and I believe that's where the confusion came up, and I never meant to imply that [Respondent] or the firm had paid directly the finders by utilizing that term."[43]

In addition, JF's veracity was called into question at the hearing. When Enforcement sent the Firm an 8210 request on August 28, 2009, asking how the April 13 Response came to be prepared, the Firm's outside legal counsel, based on information provided by the Firm, prepared a response. This response letter, dated September 23, 2009, stated that JF shared a copy of the March 30 Inquiry with all four of the Firm's stock loan employees (including Respondent, RL, and JA[44]), and interviewed each of them separately. The letter further stated that each person "separately told [JF] that he or she did not hire, retain, use or pay a finder and that they were not aware that any other member of the department had done so."[45] At the hearing, JF acknowledged that he had reviewed the letter before it was sent to Enforcement, that he saw these representations, that they were accurate, and that he recalled asking each of the employees the questions.[46]

But the witnesses at the hearing contradicted JF. JA testified that she was out of the country on her honeymoon from before the Firm received the inquiry until after the Firm

[42] Tr. at 170:14-20.

[43] Tr. at 166:20-24.

[44] The letter refers to [JA's] maiden name.

[45] JX-11.

[46] Tr. at 135:3-25.

submitted its response, and that she never saw the letter or spoke to JF about it.[47] RL also testified unequivocally that JF did not show him the March 30 inquiry and did not interview him about the use of finders.[48]

Enforcement acknowledged at the conclusion of its case that JF was sometimes "sloppy," did not "know the business all that well," and "wasn't quite on top of things."[49] These acknowledgements, about the key witness against Respondent, are significant understatements. The Hearing Panel found JF's testimony to be incredible and unreliable.

The Hearing Panel found persuasive the fact that Respondent did not hide his dealings with stock finders, and consequently, many Firm employees, including JF and MO, knew that the Firm interacted with stock finders. For example, in 2006, when Respondent assisted JF in responding to a New York Stock Exchange investigation of the involvement of stock finders in a Firm transaction, Respondent told JF that he spoke with RD's firm about the transaction, and explained RD's firm's role in the transaction.[50] When RD had trading ideas, Respondent openly presented them to Firm traders, JS, and MO on behalf of his father.[51] When the Firm and Respondent received the December 2007 Inquiries from Enforcement that requested transactions in which a finder was "involved," Respondent immediately told JF that there would be some transactions that involved stock finders.[52] Finally, Respondent spoke with RD on the main line into the stock lending desk; he made no effort to conceal his calls.[53]

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[47] Tr. at 489:10-490:22.

[48] Tr. at 505:18-506:20.

[49] Tr. at 523:2-4, 529:19-21.

[50] JX-2 ¶¶ 5(b), 8(g).

[51] Tr. at 428:24-433:7.

[52] Tr. at 67:11-68:11.

[53] Tr. at 499:22-501:13.

The Hearing Panel found that Respondent, JA and RL were direct, honest and straightforward, and that their testimony was credible. To prevail on the first cause of action, Enforcement was required to demonstrate by a preponderance of the evidence that the April 13 Response was false, but it failed to do so. The Response may have been unclear−because of the ambiguity of the word "use" in this context−but it was not plainly false. At the same time, it appears that virtually everyone involved with the Firm's stock lending desk, including JF and MO, knew that the Firm interacted with stock finders. If JF and MO believed that those interactions constituted "using" finders, then they should have drafted the Firm's response to FINRA to reflect that belief. The Hearing Panel found that, under the totality of the circumstances, Respondent reasonably believed that his interactions with stock finders, including those with RD's firm, did not constitute "using" finders. The Hearing Panel concluded that Respondent did not "cause" any falsity in the Firm's April 13 Response. Therefore, the Hearing Panel dismisses the First Cause of Action.

2. Providing False Information to the Firm

The Second Cause of Action alleges that Respondent violated Rule 2110 by providing false information to the Firm. Rule 2110 provides that "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." Conduct punishable under Rule 2110 has been described as "dishonorable and inequitable."[54] Unethical conduct is more than simply confused or mistaken conduct; it is conduct that the actor knows is wrong or is reckless in not knowing.

The Hearing Panel found that Enforcement failed to prove the Second Cause of Action, which alleges that in December 2007 or January 2008, Respondent falsely told AB (another

[54] *Dep't of Enforcement v. Shvarts,* No. CAF980029, 2000 NASD Discip. LEXIS 6, at *28-29 (June 2, 2000).

attorney in the general counsel's office who succeeded MO as general counsel[55]), JF, and MO that the Firm did not "use" finders, and that the alleged misrepresentation hindered FINRA's investigation.

On December 13, 2007, Enforcement sent additional letters to the Firm and to Respondent. The letter [] instructed the [F]irm to identify each stock loan transaction in which it was involved and in which a finder "was paid by any party to the transaction."[56] The letter to Respondent instructed him to provide the same information for transactions in which RD's firm was the finder.[57] Because the trading records did not indicate which transactions involved finders, JF asked Respondent to review the trading records, and to identify, from memory, those transactions that involved finders.[58]

The Firm responded by letter dated January 11, 2008, supplemented by letter dated January 23. Both letters were signed by JF.[59] The letters identified a total of approximately 120 transactions in which RD's firm was involved, and explained that, although the Firm was not involved in conversations regarding finders' compensation, finders "may have been involved" in some of the Firm's stock loan transactions.[60] Respondent's response, dated January 30, was more detailed and informative than the Firm's responses. Respondent's response enclosed a spread sheet of 120 transactions that Respondent believed involved RD's firm, and for each transaction Respondent's response provided the date, security, quantity, value, lending broker,

[55] Tr. at 387:12-22.

[56] JX-5 ¶ 16.

[57] JX-6 ¶ 1.

[58] Tr. at 158:16-25 (JF), 241:5-11 (Respondent).

[59] JX-7, JX-8.

[60] JX-7 ¶ 16.

lending participants, borrowing/financing broker, borrow participants and the nature of the transaction.[61]

Enforcement alleged that in the course of preparing the response to the December 13 inquiry letters, JF, MO, and AB asked Respondent whether he used finders and he falsely responded that he did not. Even though those statements were not repeated in responses to FINRA, Enforcement alleged that Respondent's false statements to Firm personnel were unethical.

Enforcement alleged that Respondent untruthfully told JF that he had not used a finder; however, for the reasons discussed above, the Hearing Panel did not credit JF's testimony on the issue.

MO testified that she did not know that Respondent was interacting with finders, but admitted that she could not remember the words she used when she spoke with Respondent about finders in December 2007.[62] MO also testified that, looking back, she realized that RD acted as a finder for trades that the firm did, and that Respondent had brought these trades to her attention. MO testified that at that time she did not consider this to be "using" finders in contravention of the Firm policy. MO conceded that there may have been a misunderstanding between MO and Respondent over the use of finders.[63]

Enforcement failed to produce any credible evidence of exactly what Respondent said to either JF or MO, and did not call AB, although he was available. The Hearing Panel found that, because Respondent reasonably believed that he had not "used" finders, even if he had made such statements to JF, MO and AB, that fact would not support FINRA's allegations that he

[61] JX-9.

[62] Tr. at 421:3-5, 446:25-447:19.

provided false information to the For,. Therefore, the Hearing Panel dismissed the Second Cause of Action.

3. Providing False Testimony to FINRA

The Third Cause of Action alleges that Respondent violated Rules 8210 and 2110 by giving false testimony to FINRA. At his OTR on January 27, 2009, Respondent testified that the Firm had never paid a finder.[64] The evidence showed, however, that the Firm had in fact paid RD's firm $4,916.75 in March 2002.[65] At the hearing, Respondent explained that during his OTR he was focused on the period after the stock lending desk was established and had simply forgotten that he had received invoices from RD's firm seven years earlier.[66] Respondent explained that payment to a finder was not prohibited until after the creation of the stock loan desk. And even before the creation of the desk, when payments to finders were permissible, Respondent did not have the authority to authorize any such payments. He testified that he would simply have passed on any invoices he received to the portfolio managers who were responsible for the transactions in question.[67] The Hearing Panel found Respondent's testimony to be credible.

In its closing statement, Enforcement acknowledged that Respondent's conduct might have been merely negligent: "Is the conduct negligent? Maybe. Maybe with respect to the invoices. Maybe. We'd say it's reckless. But maybe."[68] The Hearing Panel found Enforcement's cavalier treatment of this cause of action to be troubling, since it essentially

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[63] Tr. at 432:5-18, 448:9-14.

[64] Tr. at 256:3-260:9.

[65] CX-7 at 5-10.

[66] Tr. at 274:13-25; 275:17-276:6.

[67] Tr. at 277:3-5, 278:11-280:2.

[68] Tr. at 539:23-25.

accused Respondent of lying under oath to FINRA, and the standard sanction for that violation is a bar from the industry. The Hearing Panel found that Enforcement failed to prove by a preponderance of the evidence that Respondent gave false testimony to FINRA, and so dismisses the Third Cause of Action.

III. CONCLUSION

The Hearing Panel finds that Enforcement failed to prove by a preponderance of the evidence that Respondent violated Rules 8210 and 2110 by providing false information to FINRA and his firm. The Amended Complaint is therefore dismissed.

IV. ORDER

For the reasons set forth above, the Hearing Panel dismisses the Amended Complaint.[69]

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Rochelle S. Hall
Hearing Officer
For the Hearing Panel

[69] The Hearing Panel has considered and rejects without discussion all other arguments of the parties.