FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF MARKET REGULATION, Complainant, v. BHARMINDER SINGH (CRD No. 5428974), Respondent.	Disciplinary Proceeding No. 20100226911-02 Hearing Officer — LOM **EXTENDED HEARING PANEL DECISION** August 24, 2016

Respondent violated NASD Rule 2440 and its related guidance on markups and markdowns, for which violation Respondent is suspended for 30 business days and fined $50,000. The charge that he committed fraud is dismissed.

Appearances

For the Complainant: Kevin McGee, Esq., and James J. Nixon, Esq., Department of Market Regulation, Michael J. Gross, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondent: Julian W. Friedman, Esq., and Erik M. Zissu, Esq., Ballard Spahr, LLP, New York, New York.

DECISION

I. INTRODUCTION

FINRA's Department of Market Regulation ("Market Regulation") alleges that Respondent, Bharminder (Ricky) Singh ("Respondent" or "Singh") committed fraud in connection with certain note purchases from retail customers by setting prices for the notes far below the prevailing market price. According to Market Regulation, Singh's pricing resulted in unfair and excessive markdowns of 10% or more in 384 transactions. Although we find that Market Regulation proved that Singh violated NASD Rule 2440 and its related guidance on markups and markdowns in retail customer transactions, in the circumstances of this case we conclude that Market Regulation failed to prove that Singh had fraudulent intent. We therefore dismiss the fraud charge.[1]

[1] In the First Cause of Action, Market Regulation charges Singh with fraud in willful violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and FINRA Rules 2020 and 2010. In the Second Cause of Action, it alleges that

At the time of the events at issue, between August 2009 and December 2010, Singh was a trader on a fixed income debt securities trading desk of Banc of America Securities LLC ("BAS" or the "Firm"). He was three years out of college and had just been promoted during a period of great turmoil on the debt trading desk from a support position to trader. With limited exceptions, the desk almost exclusively facilitated trades with institutional customers and did not deal with retail customers. One of the limited exceptions gives rise to this case.

The exception to the desk's typical institutional trading occurred in the context of the merger of the parent company of BAS and Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill"), and had to do with notes that were created in connection with a voluntary bankruptcy filing by General Motors Corporation ("GM"). The GM bankruptcy notes replaced other notes that GM had previously issued and were called the Motors Liquidation Company Notes ("MLC Notes"). The MLC Notes had an uncertain value that depended on the outcome of the bankruptcy proceeding, and they traded at a steep discount from the original notes they replaced. They were distressed debt. Merrill had been one of the firms that sold the original issue notes, and it offered to purchase the MLC Notes when its retail customers wanted to sell them.

Singh's senior manager at BAS directed him to facilitate purchases of MLC Notes from Merrill's retail customers. Singh was given the task because he was the junior trader on the BAS debt trading desk. He had no prior experience with retail customer transactions, and he received no training or guidance when he was given the assignment—all of which contributed to his failure to comply with NASD Rule 2440 and related guidance. In particular, Singh failed to comply with IM-2440-2, which requires that specific steps be taken in determining the prevailing market price for a debt security.

As directed, Singh facilitated purchases of the Notes. Whenever a Merrill retail customer wanted to sell MLC Notes, the customer would ask the financial advisor for a price, the financial advisor would pass along the inquiry to a Merrill liaison desk, and the liaison desk would contact Singh for a price. Singh would give a bid price to the liaison desk, which would relay it back through the chain. A transaction might or might not result. Singh did not enter the customer orders to purchase in Merrill's books and was not involved in disclosures to customers. He did not add any markup or markdown to the execution price. However, he was responsible for the data entry to transfer the MLC Notes from Merrill, which had no proprietary account in which to keep the Notes, to BAS.

Singh would not have traded MLC Notes if his manager had not instructed him to do so. He was not familiar with distressed debt like the MLC Notes, and the investment grade securities he usually traded were generally more liquid and traded in larger blocks of at least $1 million notional value. Singh bought MLC Notes in retail size "odd lots" as they were offered, typically in amounts ranging from 300 to 4,000 Notes, which were valued at less than $75,000. He then

he charged excessive markdowns in violation of NASD Rule 2440, IM-2440-1, IM-2440-2, and FINRA Rule 2010. After the events at issue, NASD Rule 2440 (along with its related guidance) was superseded by FINRA Rule 2121.

accumulated the Notes in his BAS account and only sold them when he thought that he had an amount sufficiently large to sell as a "round lot" into the inter-dealer market. Singh viewed the accumulation of MLC Notes as a risk to capital because he had no clear exit strategy, and he viewed the paperwork to transfer MLC Notes from Merrill to BAS as tedious and burdensome. Singh was not especially rewarded for taking on this unfamiliar risk and extra paperwork. The MLC Note transactions constituted less than 1% of his business and were not a significant factor in his evaluations or compensation.

An important factor in our analysis is that Singh thought that the Merrill liaison desk was comparing the bid prices he gave the liaison desk to prices offered by competitors and determining whether his prices were the best available. Thus, he thought that the purchase transactions occurred because his price had been determined by the liaison desk to be the best price available at the time. In all his other trading, the liaison desk performed that comparative function, and in connection with the MLC Note transactions there were occasions when the liaison desk informed him that there was a better price. Colleagues and others corroborated Singh's testimony on the customary role of a liaison desk. What Singh did not know was that Merrill's liaison desk that handled most of the MLC Note transactions at issue did *not* check for competitive prices.

Singh was unaware of the specifics of NASD Rule 2440 and related guidance on setting fair prices in securities transactions with retail customers. Consequently, he did not attempt to determine the prevailing market price—as required by IM-2440-2 for retail customer transactions in non-investment grade debt securities like the MLC Notes—when he provided a price for the Notes to the liaison desk. Rather, he followed the same process that he used in setting prices for trades with institutional customers and focused on risk to capital. He priced the MLC Notes to take into account the risk he perceived in holding them for relatively lengthy and uncertain periods of time.

As a result, in numerous transactions Singh purchased MLC Notes from Merrill retail customers for much less than the prevailing market price, as defined in IM-2440-2. Singh thereby violated NASD Rule 2440 and the related guidance on pricing securities in retail customer transactions, for which we impose sanctions.

Although his lack of awareness of the applicable requirements under Rule 2440 and IM-2440-2 is not a defense to the allegation that he charged unfair markdowns, it does contribute to our conclusion that Singh did not have the fraudulent intent that is required for securities fraud under Section 10(b) of the Exchange Act, SEC Rule 10b-5, and FINRA Rules 2020 and 2010. Thus, we dismiss the fraud charge.

II. FACTS

A. Procedural History

Market Regulation filed its Complaint against Respondent on August 3, 2015. After an extension of time, Respondent filed an Answer on September 17, 2015. The hearing ran six days, beginning on March 9, 2016, and concluding on March 16, 2016. Ten witnesses testified at the hearing.[2] By agreement of the Parties, in lieu of live testimony at the hearing, excerpts from the testimony of two additional witnesses in on-the-record interviews ("OTRs") were admitted as exhibits, along with other exhibits submitted by the Parties either separately or jointly.[3] The Parties also filed simultaneous opening post-hearing briefs on April 29, 2016, and reply briefs on May 13, 2016.[4]

The case arose from a quarterly sweep for the fourth quarter of 2009 in which FINRA staff identified a number of Merrill transactions that were executed at prices that appeared to be below the prices of other firms at the time. In subsequent quarterly sweeps, Merrill's transactions in MLC Notes became a particular focus. Following an investigation, Merrill settled charges of fair pricing and supervision violations related to Merrill's purchases of MLC Notes from its

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[2] In addition to Singh, the following persons testified at the hearing: Marcus Bell ("Bell"), a manager in the fixed income investigations group at FINRA; Christopher Sinkus ("Sinkus"), who worked at a Merrill trading support desk during the relevant period, which desk facilitated retail orders and is sometimes referred to here as the "Hopewell desk"; William Kubeck ("Kubeck"), who managed the fixed income specialists desk at Merrill, which acted as a Merrill liaison desk for institutional accounts; Stanley Fortgang ("Fortgang"), an expert on trading and pricing of corporate bonds called by Market Regulation; Edward LaVelle ("LaVelle"), an employee of an inter-dealer broker with whom Singh did business during the relevant period; Zygment Stubelek ("Stubelek"), an employee of BAS's liaison desk for fixed income securities; Charles Clyde Estes ("Estes"), another person who worked on BAS's liaison desk for fixed income securities; Tsvetan Beloreshki ("Beloreshki"), a financial economist and statistician who testified on behalf of Respondent regarding the marketplace generally for MLC Notes; Robert MacLaverty ("MacLaverty"), a consultant and former trader who testified on behalf of Respondent as an expert on the trading of fixed income securities.

[3] Complainant's exhibits are referred to here with the prefix "CX" and an identifying number. Respondent's exhibits are referred to with the prefix "RX" and an identifying number. Joint exhibits are referred to with the prefix "JX" and an identifying number.

Respondent presented the OTR testimony of two witnesses: Charles Cho ("Cho"), the new Head of Global Credit who promoted Singh to the position of trader (RX-61); and David John Ulrich ("Ulrich"), the senior trader on the BAS fixed income trading desk when Singh was promoted to trader (RX-62).

[4] The Parties' opening briefs were titled as follows: Department of Market Regulation's Post-Hearing Brief ("MR PH Br."); Respondent's Post-Hearing Brief ("Resp. PH Br."). The reply briefs were titled as follows: Department of Market Regulation's Post-Hearing Reply Brief ("MR Reply"); Respondent's Post-Hearing Reply Brief ("Resp. Reply").

customers.[5] The staff instituted this disciplinary proceeding against Singh because they concluded he was primarily responsible for the MLC Note transactions.[6]

B. Charges

Between August 2009 and December 2010, Singh provided bid prices for MLC Notes that resulted in more than 700 executed transactions with Merrill retail customers. The charges against Singh relate to roughly half of those transactions.[7] Market Regulation alleges that Singh's bids to the Merrill liaison desk in 384 executed transactions were so far below the prevailing market price that they were fraudulent. Market Regulation labels a transaction as fraudulent if, by its calculations, Singh's bid prices were 10% or more below the lowest inter-dealer price for the same CUSIP identification number on the same day and the profit was more than $200. Market Regulation contends that Singh knew that his prices were far below the prevailing market price, in part because Singh consistently sold the MLC Notes in aggregated "round lots" at higher prices than Merrill paid the customers for "odd lots" in the smaller retail transactions.[8]

C. Jurisdiction

FINRA has jurisdiction to bring this proceeding against Singh because he is currently registered, and the Complaint charges him with misconduct committed while he was registered.[9]

D. Respondent

(1) Employment

After graduating from college in 2006, Singh started his first full-time job in the financial industry. He worked as an operations analyst for the parent company of BAS. In that position he prepared profit and loss and risk spreadsheets.[10]

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[5] The Firm consented to a censure, a fine of $1.4 million for fair pricing violations, a fine of $500,000 for supervision violations, and restitution in the amount of $541,629.19 plus interest. It also consented to an undertaking to provide three reports at six-month intervals on the effectiveness of the firm's supervisory system with respect to pricing in retail customer transactions. JX-3.

[6] Hearing Tr. (Bell) 73-76, 193.

[7] Hearing Tr. (Singh) 1055-56. Singh provided prices for additional purchases of MLC Notes from Merrill customers that were outside the relevant period. All told, including all purchases of MLC Notes based on Singh's bids, there were approximately 1,200 consummated purchases from Merrill customers. Hearing Tr. (MacLaverty) 1454-55.

[8] Hearing Tr. (Bell) 266-68.

[9] CX-1; Hearing Tr. (Singh) 855-56; FINRA By-Laws, Art. V, Section 4.

[10] Hearing Tr. (Singh) 343-45, 850-51, 854.

A year later, Singh was promoted to trading assistant, a support function for the BAS fixed income debt securities trading desk. As a trading assistant, Singh booked trades, followed up on failed trades, ran errands such as getting breakfast for the traders, and answered telephones.[11]

After serving as a trading assistant for two years, Singh was promoted to be a trader on the same fixed income debt securities trading desk. His employment switched from the parent company to BAS, the broker-dealer.[12] On June 30, 2009, he became dual-registered with both BAS and Merrill. He remained dual-registered until November 1, 2010, when he became registered solely with Merrill, which was the surviving broker-dealer after the merger of the parent company of BAS and Merrill.[13] He was employed by Merrill until December 2014. He currently holds securities industry licenses (Series 7, 63, and 55) and is employed as a registered representative by another FINRA member firm.[14]

(2) Training

When Singh first joined the parent company of BAS, he received five weeks of training generally in the basics of working at an investment bank. He and the other first-year analysts learned basic finance, accounting, the different functions of the bank, and how broker-dealers and investment banks operate.[15] None of that training included FINRA rules.[16]

Singh received no additional formal training. He considered his training to be on-the-job. When he was a trading assistant, he watched the traders and how they worked, how they priced securities, and how they interacted with clients and internal personnel. He said that he acted as a "shadow" to get a sense of the traders' normal operations.[17]

E. BAS Fixed Income Debt Securities Trading Desk

The BAS debt trading desk on which Singh worked traded almost exclusively with institutional clients and in the inter-dealer market. It specialized in fixed income debt instruments

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[11] Hearing Tr. (Singh) 345-47, 855, 861-64.

[12] Hearing Tr. (Singh) 347-48.

[13] Hearing Tr. (Singh) 348-51, 356, 873; CX-1. BAS paid Singh during the relevant period until he became registered solely with Merrill. Hearing Tr. (Singh) 875.

[14] Hearing Tr. (Singh) 851-52; CX-1.

[15] Hearing Tr. (Singh) 855-56.

[16] Hearing Tr. (Singh) 856.

[17] Hearing Tr. (Singh) 857. *See also* Hearing Tr. (Singh) 447.

and hybrid securities that had aspects of both debt and equity. The desk traded senior, unsecured corporate bonds and junior, subordinated bonds, and credit default swaps.[18]

The purpose of the debt trading desk was to facilitate trading in securities for institutional clients, not to establish proprietary positions or to speculate. Residual positions in securities were entered into what the traders referred to as their balance sheet.[19] Although there were no specific time limits for holding residual positions in 2009-2010, traders were expected to move inventory off the balance sheet and not to retain positions for long periods. This expectation was formalized in a 2010 written policy, which imposed a financing fee on traders for retaining a position longer than 90 days.[20] This policy reflects that the longer a security is held, the greater is the bank's risk exposure to that security.[21]

F. BAS-Merrill Merger And Turmoil On The BAS Debt Trading Desk

The events at issue took place at a time of great uncertainty, both in the markets generally and at BAS in particular. The 2009 merger of BAS and Merrill precipitated staff turnover and confusion over responsibilities.

Confusion regarding the liaison desk's responsibilities, in particular, was one of the root causes of the fair pricing violation in this case. Singh testified that he understood it to be the responsibility of a liaison desk to compare his price against other prices in the marketplace, and for that reason he thought his bid prices for MLC Notes had been checked against the competition. Other BAS and Merrill employees testified that they had the same understanding of the responsibility of a liaison desk, demonstrating that Singh's testimony was credible. However, the Merrill liaison desk that handled most of the trades involved in this case did not understand that it had any responsibility to conduct such a price comparison and did *not* compare Singh's prices to other prices in the marketplace. A second Merrill liaison desk did price comparisons on some of the MLC Note purchases but was inconsistent about comparing Singh's prices to the competition, apparently because someone thought that the MLC Note transactions were too small to warrant the effort.

(1) Staff Turnover

In late 2008, while Singh was still a trading assistant, the BAS fixed income debt securities trading desk was in turmoil. Singh testified that there was general uncertainty because of the financial crisis, the Lehman bankruptcy, and the impending acquisition of Merrill by the

[18] Hearing Tr. (Singh) 859-61. The desk was sometimes described as the hybrid preferred securities desk. Hearing Tr. (Singh) 345.

[19] Hearing Tr. (Singh) 357-58 (discussing purpose of trading desk from Singh's perspective when he was a trader).

[20] RX-61, at 39-41; RX-62, at 51-53.

[21] Hearing Tr. (Fortgang) 723, 801.

parent company of BAS. Some senior management for corporate bond trading had left prior to the official acquisition of Merrill by the parent company of BAS on January 1, 2009.[22] Singh testified that when he was a trading assistant, the desk consisted of as many as six traders (along with two sales people and the trading assistant, Singh).[23] By mid-2009, however, there was only one experienced trader left on the desk, David Ulrich.[24]

Consistent with Singh's testimony, Ulrich testified that in the nine months leading up to July 2009 there were many defections from the BAS fixed income debt trading desk. Three BAS traders left by the end of 2008, and in the first few months of 2009 a couple of traders from Merrill who had been assigned to the desk to engage in retail trading departed. That left Ulrich as the only experienced trader on the desk and Singh as the trading assistant.[25] Ulrich described the turmoil, saying that it was a "crazy time period" with a lot of uncertainty and volatility.[26] At the same time when the trading desk was reduced in staff, trading volume in the market greatly increased.[27]

Charles Cho, the senior manager who became responsible for the desk in mid-2009, testified similarly. In June 2009, he had just returned to the United States from abroad to become the new Head of Global Credit. In that position he was in charge of the BAS fixed income debt securities trading desk, as well as other traders and staff totaling approximately 140 people. He was responsible for a balance sheet of $36-38 billion, with thousands of positions and thousands of trades per day. He testified that the turmoil, particularly the huge amount of turnover, made it difficult for him to take over. He said that he did not have all the facts necessary to understand the situation, and most of the people who could have informed him were no longer at the firm. In particular, he noted that the Merrill traders who had been assigned to the BAS fixed income debt trading desk to do retail trading had left within a five-month period at the beginning of 2009.[28] He testified that he was unfamiliar with the operations of the debt trading desk prior to his arrival as Head of Global Credit.[29]

Cho testified that the debt trading desk did not have a direct supervisor from the summer of 2009 through the first half of 2010,[30] and Singh noted that Cho was not a licensed Series 24

[22] Hearing Tr. (Singh) 347, 867-69. The parent company of BAS officially acquired Merrill on January 1, 2009, but the merger was not effective until November 1, 2010. CX-12, at 5.

[23] Hearing Tr. (Singh) 864-65.

[24] Hearing Tr. (Singh) 866-67, 972-73.

[25] RX-62, at 9-10, 19-21.

[26] RX-62, at 12-13.

[27] RX-62, at 23, 43-47.

[28] RX-61, at 2-3, 7, 43, 45.

[29] RX-61, at 43.

[30] RX-61, at 3.

supervisor for most of the relevant period.[31] Thus, although Cho provided oversight during the relevant period, his lack of background and experience, coupled with the chaotic conditions he inherited and the large scope of his responsibility, necessarily limited the effectiveness of his oversight.

(2) Confusion Regarding Responsibilities

During the transition period, when BAS and Merrill were attempting to integrate their businesses, the lines of connection between employees were not clear and the employees' understanding of their differing responsibilities was confused. People within the two companies were being shifted around. However, even when Merrill personnel were assigned to BAS units, they did not necessarily physically join their colleagues. For example, the two Merrill traders who were assigned to the BAS fixed income debt trading desk to conduct retail trading at the beginning of 2009 continued to sit in their World Financial Center downtown offices, while the BAS trading desk and its staff continued to sit in their Bryant Park offices, in mid-town.[32] As a result, there was little opportunity for Ulrich or Singh to observe how the Merrill traders conducted their retail trading or to discuss it with them in the few months before the Merrill traders departed. Ulrich, the senior trader on the BAS debt trading desk, testified that he did not know how the Merrill retail traders who handled retail order flow in early 2009 bought and sold retail-sized transactions.[33]

Similarly, there were two Merrill liaison desks in separate locations, one in Hopewell, New Jersey, and the other in New York. The Hopewell desk took the overflow and smaller trades from the New York desk. However, any distinction between the two was not visible to Singh. No one informed Singh that there were two separate liaison desks or that they followed different procedures.[34] His contact with the staff on the Merrill liaison desks was largely in the form of Bloomberg chats, an instant message service, in which Merrill's employees were simply identified as Merrill staff, without distinguishing their location, position, or desk.[35]

The physical separation and general confusion at the time contributed to Singh's misunderstanding of the various desks' respective responsibilities. Singh thought that it was the liaison desk's responsibility to check competitors' prices and determine whether the internal bid offer provided a customer the best execution price.[36] Singh understood that when the trading desk gave the liaison desk a price, the liaison desk would compare it to the price of other dealers. And then, if the trading desk offered the best price, there would be a transaction. But if the

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[31] Hearing Tr. (Singh) 1141-42.

[32] Hearing Tr. (Singh) 347.

[33] RX-62, at 19-21.

[34] Hearing Tr. (Bell) 104-10; Hearing Tr. (Singh) 951-52; Hearing Tr. (Sinkus) 588-89, 592-93; Hearing Tr. (Kubek) 608-09, 620-21, 624.

[35] Hearing Tr. (Singh) 917-19, 926-30.

[36] Hearing Tr. (Singh) 536, 883-85.

liaison desk found a better price elsewhere, it might offer the trading desk an opportunity to match it.[37]

Singh's experience in connection with the MLC Notes was consistent with his general understanding of the role of a liaison desk. On occasion, after Singh provided a bid on MLC Notes, he was told that another dealer had a better price and he was given an opportunity to match it. Sometimes when no MLC Note transaction occurred at his bid price, he was told that the transaction went to another dealer at a higher bid.[38] Also, in mid-2010, a woman who had worked at the New York liaison desk joined Singh and Ulrich on the debt trading desk. She told them that when she worked on the liaison desk internal bids were "always put in competition with other broker-dealers."[39]

Singh's view of the role of the liaison desk also was consistent with views expressed by others. Cho, the senior manager for the BAS trading desk, understood that the liaison desk would typically go outside of the Firm to speak to other dealers, and, if the internal bid was not the best price, the liaison desk would ask the debt trading desk to match the better outside price. If the debt trading desk decided not to match the outside price, the transaction would take place away from the Firm.[40]

Cho did not think that markups and markdowns were the trader's responsibility. He testified that traders provide a bid but financial advisors add the markup or markdown.[41] He further testified that the markup or markdown "wasn't as big of a factor for the traders because the best execution job was actually from the liaison desk."[42] He said: "In terms of interpreting fair, that was—that was the liaison's job, to determine what was the best fair price for the customer. We [the debt trading desk] were not always the best bid."[43] He repeated, "I think with regards to markup versus prevailing price, that was—the responsibility of determining that was the liaison desk. Our traders provided prices … that they deemed the best possible price they could provide at the time."[44] He summarized: "In a principal transaction with a customer, the

[37] Hearing Tr. (Singh) 883-85.

[38] Hearing Tr. (Singh) 948-49, 1065-66, 1108-10, 1111-12, 1114-16; CX-41; RX-22; RX-31; RX-34–RX-36; RX-40–RX-41; RX-43–RX-46.

[39] Hearing Tr. (Singh) 1131-35.

[40] RX-61, at 4.

[41] RX-61, at 16.

[42] RX-61, at 22.

[43] RX-61, at 24.

[44] RX-61, at 27.

liaison desk has the responsibility to give the best execution for the customer, which would imply that it's a fair price."[45]

Ulrich, the other trader on the BAS trading desk, testified to the same understanding of the role of a liaison desk. He said: "Liaisons have existing relationships with other dealers. It's a competitive process. Normally if we're not the best bid or offer they give us an opportunity to match the best bid or offer. If it suits us we'll do that."[46] Ulrich expanded on his understanding of the different roles of the trading desk and the liaison desk:

> We were asked as an accommodation to provide a bid on securities or an offer, with the understanding that it was in competition with other dealers.
> So we bid according to where we felt comfortable taking in the risk in a principal capacity, and when we weren't the best market we were normally made aware we were not the best market and given the option to match the best market.[47]

William Kubek, head of Merrill's New York liaison desk from August 2009 to the end of 2010, which handled some of the trades at issue, confirmed that it was his desk's best practice to check other sources of information for competitive prices to compare them to internal bid offers. Typically, the New York liaison desk checked for competitive pricing when it got a bid from a trader inside the Firm. A specialist on that desk would instant message the inside trader on Bloomberg asking for a bid on a particular security at a given size. The specialist then would often look at information on the Trade Reporting and Compliance Engine ("TRACE") to compare the prices bid by competitors. The specialist also would look at trade runs showing other dealer prices when available and might even reach out to other broker-dealers directly. As a general rule, the New York liaison desk would try to generate two or three competitive bids in addition to the internal bid.[48]

Kubek believed that his staff handled MLC Notes the same way. He believed that they searched for a better competitive price and would only have executed the transaction at Singh's bid price if they could not find a better price.[49]

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[45] RX-61, at 70. Cho's beliefs regarding the role of the liaison desk were the same as Singh's (see RX-61, at 5-6, 57-62, 66, 70, 72, 74, 79-80), which bolstered Singh's credibility regarding his understanding of the liaison desk's function.

[46] RX-62, at 15.

[47] RX-62, at 46.

[48] Hearing Tr. (Kubek) 607-15, 617, 633-37.

[49] Hearing Tr. (Kubek) 616-17, 633-37.

The BAS liaison desk for fixed income securities followed a similar practice of getting competitive prices. Zygment Stubelek, who worked on that desk from May 2005 to May 2010 confirmed that the "rule of thumb" was to get two or three external prices to compare with an internal bid.[50] Charles Clyde Estes, who also worked on the BAS liaison desk, confirmed that the desk obtained outside bids to compare with internal bids when possible.[51] In May or June of 2010, the Merrill and BAS liaison desks merged under Kubek's leadership, but there were no changes in the procedures.[52]

Robert MacLaverty, one of Respondent's expert witnesses, testified that it was the normal practice of a liaison desk, once the liaison desk got a price from an internal trader, to contact other dealers to obtain competitive prices. In his experience a liaison desk would "get runs" from other dealers' desks, and, if a customer was not satisfied with an internal bid, might work to find a better price than the internal bid on a security.[53]

However, it was a different story at the liaison desk that handled the majority of the transactions at issue. Christopher Sinkus, who headed the Merrill liaison desk in Hopewell, New Jersey, which handled overflow from the New York desk, believed that fair pricing was the responsibility of the trader and that fair pricing and best execution were one and the same.[54] Sinkus testified that the Hopewell desk did *not* check for competitive prices. In his testimony, he described the work of the Hopewell liaison desk largely as a manual process of executing transactions that financial advisors were unable to execute for themselves on the Firm's electronic system. Unknown to Singh, the Hopewell desk did not have access to other prices in the marketplace. The Hopewell desk performed an operations function, not the kind of evaluative process that Singh thought the liaison desk was performing.[55]

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[50] Hearing Tr. (Stubelek) 1199-1207, 1215.

[51] Hearing Tr. (Estes) 1224-28.

[52] Hearing Tr. (Stubelek) 1206-07.

[53] Hearing Tr. (MacLaverty) 1445-49, 1591-93, 1599-1600.

[54] Hearing Tr. (Sinkus) 594-96.

[55] Hearing Tr. (Sinkus) 575-81. Kubek, the head of Merrill's New York liaison desk, similarly described the Hopewell desk as helping with functions like order entry, not with facilitating trading or gathering competitive prices. Hearing Tr. (Kubek) 621.

The FINRA examiner's testimony was consistent with the conclusion that the Hopewell desk mainly provided Merrill's financial advisors with operational assistance. He described the Hopewell desk as a "call center for the financial advisors at Merrill Lynch." He said: "Mostly their responsibilities revolved around helping out with user-related issues of the electronic platform, helping out the financial advisors with really facilitating their platform itself." He recognized that the work to facilitate smaller retail transactions was "a small portion of their responsibilities." Hearing Tr. (Bell) 104-05. The examiner testified that the biggest difference between the two Merrill liaison desks was that the New York liaison desk had access to bids being made by competitors and the Hopewell desk did not. Hearing Tr. (Bell) 109-10.

Not only did the Hopewell desk fail to compare Singh's bids on MLC Notes to the competition, but Singh testified that he learned in the course of the investigation that the New York desk also failed to research competitive bids on a consistent basis. Singh learned during the investigation that the New York desk had been told to accept his bids on MLC Notes without checking the competition because of the small size of the transactions.[56] Because some people on the New York liaison desk were still checking Singh's bids against the competition, and he had interactions with them, Singh believed that that was standard practice. But, unknown to Singh, some people on the New York liaison desk were *not* checking his bid offers against the competition.[57]

G. Singh's Promotion To Trader

In the summer of 2009, during the turnover and turmoil on the debt trading desk, Cho promoted Singh to trader, making Singh the junior trader on the BAS debt trading desk, with Ulrich as the senior trader.[58] Cho told Singh that he was qualified for the job because he had been observing the traders on the desk and had a "basic understanding of how the traders are coming up with their prices and how the market works."[59] Singh received no additional training or guidance upon his promotion.[60] He had never priced securities before he was promoted to trader.[61]

H. Singh's Customary Trading

(1) Trading With Institutional Clients

The purpose of the BAS debt trading desk was to facilitate client trading and provide liquidity. As a trader, Singh's principal function was to make markets in fixed income debt securities for BAS institutional clients. Although at the end of a trading day he would be left with residual positions on his balance sheet, Singh was not trading as a proprietary trader and was not speculating with the bank's capital.[62]

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[56] Hearing Tr. (Singh) 1129-30.

[57] Hearing Tr. (Singh) 1131-35.

[58] Hearing Tr. (Singh) 867-69.

[59] Hearing Tr. (Singh) 868. Ulrich, the senior trader on the BAS debt trading desk when Singh was promoted, testified that he never talked with Singh about how to price fixed income securities, either when Singh was a trading assistant or after he was promoted to trader. Ulrich was unaware of what anyone else on the trading desk might have told Singh about pricing. RX-62, at 11-12.

[60] Hearing Tr. (Singh) 856-57, 971-72.

[61] Hearing Tr. (Singh) 863.

[62] Hearing Tr. (Singh) 908-09.

Singh did not deal directly with customers. He responded to inquiries from intermediary liaison desks, primarily by Bloomberg chat, and sometimes by telephone. In his regular trading, liaison desks regularly responded to his bids with feedback on prices offered by other broker-dealers. He might match a competing price or he might decline to do so.[63] If he did not hear back from a liaison desk after he made a bid offer, he assumed that the customer either found a better price away or decided to hold.[64]

Traders on the BAS debt trading desk specialized in different industries. Singh's priority was trading in insurance hybrids.[65] He dealt in corporate bonds, junior subordinated bonds, subordinated bonds, non-convertible preferred securities, and some credit default swaps.[66]

Singh mainly traded with institutional accounts and with other dealers via the inter-dealer market in institutional sized "round lots" with a notional value of $1 million and above.[67] In fall 2009, Singh traded on a daily basis between $50-$60 million notional value of securities. He would average 10-12 different securities transactions in a day, with the average ticket size around $5 million.[68] At that time, there were more than 150 unique line items in his trading inventory, and he could have been watching another 100 items.[69] Singh's balance sheet ranged in size from $300 million to $1 billion,[70] with his aggregate total balance sheet generally around $500 million.[71] He never received inquiries from inter-dealer brokers about "odd lot" trades, and he never initiated a trade about an "odd lot."[72]

Singh's typical day as a trader was long and hectic. It would begin at 6:00-6:30 a.m. with a review of news relating to items he was trading and developments in the European market. He would review his profit and loss spreadsheets that were disseminated on the evening of the prior trading day. From 7:30 a.m. to 5:30 p.m., he was engaged in email and Bloomberg messaging and watching information as it crossed his screen. He averaged 1000-2000 Bloomberg messages

[63] Hearing Tr. (Singh) 920-21, 926-28, 932-42; RX-34; RX-36; RX-43; RX-44; RX-51; RX-52; RX-56.

[64] Hearing Tr. (Singh) 924-25.

[65] RX-62, at 25. Ulrich had a priority on trading bank hybrids. RX-62, at 25.

[66] Hearing Tr. (Singh) 871. Respondent's expert, MacLaverty, described the role Singh performed as "provid[ing] liquidity through competitive bids and offers for [the firm's] customers using the firm's own capital." RX-59, at 4 ¶ 10. He explained that trading to facility transactions for customers is separate and distinct from proprietary trading activity that speculates on the market for a broker-dealer's own account without regard to facilitating customers. RX-59, at 7 ¶ 23.

[67] Hearing Tr. (Singh), 887-89, 908-09.

[68] Hearing Tr. (Singh) 893, 1054-55.

[69] Hearing Tr. (Singh) 894, 901.

[70] Hearing Tr. (Singh) 360.

[71] Hearing Tr. (Singh) 894-95.

[72] Hearing Tr. (Singh) 890.

per day and upwards of 50 telephone calls. At the end of the trading day, because he was the junior person on the desk, he was responsible for following up on trade fails or any unconfirmed trades that were still outstanding. He continued to handle some operational issues along with his trading responsibilities.[73]

The process of receiving inquiries and responding was fast-paced. Sometimes Singh responded to an inquiry in less than a minute. Sometimes an inquiry, bid, and response occurred within a matter of a couple of minutes. The process also required close attention to multiple lines of inquiry. Much of the work took place in the form of Bloomberg chats in which multiple parties were exchanging bids and offers on different securities within the same chat.[74]

Singh enjoyed the hectic activity and the fact that every day was different. He said: "[W]hat I like most about trading every trading day is different. You are not going to come in and expect what happened yesterday to happen today. It is exciting because you don't know."[75] He noted, however, the risk of missing critical information in the busy environment. He said: "There was a lot of activity and if you were not paying attention to the things that are being flashed on the screen, you know, you could make or lose a lot of [the] firm's capital at any given time."[76]

(2) Focus On Risk

Singh's primary concern when he took a security into inventory was the risk he was creating. He wanted to protect the bank's capital position. Accordingly, Singh set his price based on the kind of risk he was willing to undertake.[77] He generally based his price on credit risk, volatility, and liquidity.[78] He provided a bid price at which he would be comfortable owning the securities. He did not think he was setting markups or markdowns.[79]

Singh described his general methodology for pricing securities. He looked at whether he already owned the security and whether he owned a lot of it. He would consider general market conditions, news developments for the particular credit, whether there had been recent comparable trades, the size of the transaction, liquidity, and risk.[80] In particular, he would

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[73] Hearing Tr. (Singh) 895-902.

[74] Hearing Tr. (Singh) 926-33, 941-42; RX-34; RX-36: RX-56.

[75] Hearing Tr. (Singh) 897.

[76] Hearing Tr. (Singh) 897-98.

[77] Hearing Tr. (Singh) 467-70.

[78] Hearing Tr. (Singh) 470-71.

[79] Hearing Tr. (Singh) 424-25, 513.

[80] Hearing Tr. (Singh) 903-08.

consider "how quickly am I going to get out of those bonds if I buy them."[81] He was always concerned about the risk to his Firm if he was unable to sell a security for a week or two or three. Having a clear exit strategy was an important factor in pricing a security.[82]

Singh's focus on risk was consistent with the testimony of Ulrich, the senior trader on the BAS trading desk. Ulrich likewise emphasized that the debt trading desk's role was to manage the bank's capital, "first and foremost."[83] Ulrich testified that the traders on the desk were to provide liquidity to accounts looking to buy and sell, but that he always thought about credit risk when he priced a security. He always asked himself, "[I]s it a price that I [am] comfortable I [am] not going to compromise the capital position of the bank."[84]

Ulrich stressed that traders are concerned with the risks involved with their trading. He testified that when he first started as a trader, his manager taught him that in pricing fixed income transactions "the number one thing" to keep in mind was that "if I'm ever going to own something and something adverse happens and the situation blows up, that I should be prepared to explain to him why I owned it in the first place. So first and foremost, the number one factor you think about when you're pricing a security is the credit risk, the risk of owning the security."[85] Ulrich repeatedly linked pricing with an effort not to compromise the bank's capital position.[86] He testified that credit risk, liquidity, and interest rate risk were all considerations when pricing a bond.[87]

Oversight of the trading desk also focused on risk, not fair pricing. When Cho, the manager for the BAS trading desk, returned from abroad he evaluated the traders on their ability to price, monitor, and manage risk. In particular, he spoke to the traders about how they priced large transactions and how that could affect risk on the desk. He did not talk with them about smaller retail transactions coming from the liaison desk.[88]

Ulrich spoke to Cho almost daily, and Ulrich provided Cho with a weekly report. Ulrich and Cho focused on whether they wanted to increase or decrease the risk on the desk's balance sheet. Ulrich could not recall that anyone ever reviewed the desk's transactions for fair price or best execution.[89] Cho testified: "The trader's responsibility was to provide the best price that

[81] Hearing Tr. (Singh) 906.

[82] Hearing Tr. (Singh) 910-14.

[83] RX-62, at 32.

[84] RX-62, at 32-33.

[85] RX-62, at 3.

[86] RX-62, at 4-5.

[87] RX-62, at 6.

[88] RX-61, at 7-8.

[89] RX-62, at 7-8.

they could with regards to responding to the inquiry based on … credit risk, liquid risk, market risk."[90]

I. MLC Notes

At approximately the same time that Singh was promoted to trader, in June 2009, GM filed for bankruptcy and changed its name to Motors Liquidation Company. GM created the MLC Notes as part of a "pre-packaged" bankruptcy plan pursuant to which GM bondholders agreed to exchange their portion of old GM for a 10% share in the new GM when it came out of bankruptcy, along with warrants to purchase an additional 15%. The MLC Notes replaced other notes that GM had originally issued in six different offerings, and the MLC Notes were identified by six different CUSIPs. Merrill was one of the firms that had sold the original offerings. The original notes had carried an interest coupon and were listed on the New York Stock Exchange. When they were replaced by the MLC Notes, however, the interest payments stopped and the MLC Notes were de-listed.[91]

After the de-listing, the MLC Notes had an uncertain value that depended upon the resolution of the bankruptcy proceeding. They were highly distressed debt instruments and highly volatile.[92] The original notes had a par value of $25,[93] but, during the period at issue, the lowest daily price for the Notes in the inter-dealer market varied within a range of $2.25 to $8.20.[94]

GM's bankruptcy plan received final approval by the bankruptcy court on March 29, 2011, and, on April 21, 2011, holders received notice of the exchange of the MLC Notes for new GM securities.[95]

J. Singh's Assignment To Facilitate Purchases Of MLC Notes From Merrill Retail Customers

Because the BAS debt trading desk primarily traded with institutional accounts and in inter-dealer transactions, the departure of the Merrill retail traders early in 2009 left no one on

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[90] RX-61, at 22. Cho understood that the traders "would look at the creditworthiness, so the rating. They would look at the spread it traded at. They would look at our existing position, our credit view and also how some of the correlative markets were trading." RX-61, at 10.

[91] Hearing Tr. (Bell) 76-87; Hearing Tr. (Singh) 953; JX-1; JX-3, at 4; CX-33; CX-34. The MLC Notes bore the following symbols: MTLQ.GU, MTLQ.GM, MTLQ.GT, MTLQ.GQ, MTLQ.GS, and MTLQ.GV. Hearing Tr. (Singh) 506; CX-67.

[92] Hearing Tr. (Beloreshki) 1278-80; Hearing Tr. (MacLaverty) 1474-78.

[93] Hearing Tr. (Bell) 76-81; Hearing Tr. (MacLaverty) 1474, 1476-77; CX-27–CX-32; RX-60, at 14 ¶¶ 46-47.

[94] Hearing Tr. (Singh) 960-61; CX-41; CX-42; RX-63.

[95] CX-8, at 4; CX-37, at 1-5.

the desk who was familiar with retail trading.[96] Cho directed Singh, the junior trader on the desk, to respond to inquiries about prices for MLC Notes in transactions with Merrill's retail customers. Cho told Singh he would need to be dual-registered with BAS and Merrill so that he could go into Merrill's system and book trades out of Merrill's system at the end of the day, thereby "flattening" Merrill's risk.[97] Singh understood that he had to be dual-registered with Merrill as well as BAS in order to access Merrill's system and book a "sell" from Merrill to BAS.[98] Thus, Singh's dual registration was to facilitate the paperwork necessary to transfer securities from one broker-dealer to another. It did not involve him in contact with the customers or in the disclosures to them.

Singh was new to trading in general and new to trading with retail customers in particular.[99] He had never traded distressed debt,[100] and, because he had never traded a security issued by an automotive company,[101] he had no familiarity with GM or the MLC Notes. However, he received no training in connection with this assignment. He was not told that he had any additional legal responsibilities in connection with dealing with Merrill's liaison desk or Merrill's retail customers. He never had any conversations with management or compliance about pricing and how it should be done.[102] Singh acknowledged at the hearing that once he became dual-registered he had obligations to Merrill's customers, just as he did to the customers of BAS, but he had no understanding of the new and different responsibilities associated with trading with retail customers.[103]

Singh did not believe he had a choice with regard to trading MLC Notes. He testified: "[B]eing a junior, being, you know, this is my first shot at trading and there is a mandate coming from my manager … I didn't want to disagree with the directions that were coming from my direct manager."[104] Singh felt the weight of this new responsibility. He said, "You don't want to screw up when it is such a big role."[105]

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[96] RX-62, at 19-21.

[97] Hearing Tr. (Singh) 880-83. Ulrich testified that Singh was assigned to do the retail trading in part because it was simpler than trading with institutional accounts and Singh was new to trading. RX-62, at 21-23. We note that Singh had been in operations and support positions until his recent promotion, which would have made him a logical choice to do the paperwork connected with the MLC Note transactions.

[98] Hearing Tr. (Singh) 378.

[99] Hearing Tr. (Singh) 368-69.

[100] Hearing Tr. (Singh) 971.

[101] Hearing Tr. (Singh) 956.

[102] Hearing Tr. (Singh) 886, 973.

[103] Hearing Tr. (Singh) 885-87, 972-73.

[104] Hearing Tr. (Singh) 917.

[105] Hearing Tr. (Singh) 958.

K. Singh's Trading In MLC Notes

(1) General Process Of Trading

Singh did not solicit MLC Note purchases and did not deal with Merrill's retail customers directly. He received inquiries for prices on MLC Notes through a chain of people and provided prices in response back down the chain. A Merrill retail customer seeking to sell MLC Notes would contact a Merrill financial advisor and request to know how much Merrill would pay for them. The Merrill financial advisor would then contact a Merrill liaison desk to facilitate the order. The Merrill liaison desk would call or instant message Singh asking him to provide a bid. Singh would determine the price at which he would be willing to take the Notes into his inventory at BAS and would inform the liaison desk of his bid. The Merrill liaison desk would relay a price to the financial advisor. If the customer accepted Singh's bid, the transaction would be executed.[106]

Once the MLC Notes were de-listed, transactions in them had to be executed manually.[107] Purchases of MLC Notes were initially booked at Merrill by someone other than Singh. He had nothing to do with the disclosures made to customers and did not know what they were told about markups or markdowns.[108]

After Merrill acquired the MLC Notes, Singh would "flatten" the Merrill book at the end of the day by manually documenting what were referred to as "back-to-back" trades. At the end of the day, Singh would document a "sell" from Merrill to BAS and a corresponding "buy" from Merrill by BAS, because the firms were still operating as two separate broker-dealers. Both of these entries were recorded at the same price.[109]

Essentially, one transaction was booked as though it were three, the original Merrill purchase from the customer, the "sale" on Merrill's books to BAS, and the "purchase" from Merrill on the books of BAS. But Singh's role was limited to the back-office operation of transferring the Notes from Merrill to BAS.

Most of the purchases of MLC Notes from Merrill customers were in "odd lot" sizes of less than 1,000, but they ranged from as few as 200 Notes to, occasionally, as many as 4,000-

[106] Hearing Tr. (Singh) 369-71; Hearing Tr. (Bell) 104-06. Respondent's expert, MacLaverty, provided a chart that laid out the chain from the retail customer through the financial advisor and liaison desk to Singh and compared it to the simpler way in which a trade occurs with an institutional counterparty. RX-59, at 6 ¶ 20.

[107] Hearing Tr. (Singh) 948-49; JX-3, at 4.

[108] Hearing Tr. (Singh) 377, 382, 519, 922-23.

[109] Hearing Tr. (Singh) 371-80; Hearing Tr. (Bell) 202-05; CX-12, at 5-6.

5,000.[110] The largest volume purchase was for 9,000 Notes at an approximate total value of $60,000.[111]

(2) Singh's Pricing Methodology

Singh priced the MLC Notes in the same way that he priced securities in his institutional trading. He did not think about markdowns.[112] He testified: "I provided them with a price which I thought was a bid price, which I would be comfortable owning the risk of owning the securities."[113] He further explained: "Again, I wasn't providing markups or markdowns. My understanding was I provided a price that I believed was fair."[114] As with his institutional trading, if his bid offer on MLC Notes was accepted, he believed that the liaison desk had determined that it was the best bid at the time.[115]

When Singh first started pricing the MLC Notes, he noted the very wide spread in the trading range. The Notes traded between $1.50 and $4.50, a more than 100% difference. That told him that the Notes were volatile, which he factored into formulating his bid offer. The volatility or price fluctuation in the Notes was a risk that concerned him particularly because he did not have the ability to exit from the securities quickly.[116]

Singh did not look at TRACE every time he was asked to bid on MLC Notes, or even every day. But he did consider it among other factors in his pricing.[117] Singh did not see an active bid-ask market in the Notes.[118]

(3) Ulrich Employed The Same Methodology

From time to time, Ulrich filled in for Singh on MLC Note transactions. When he did, he, like Singh, used the same process for pricing as he used in institutional trading. He looked at the spread from "high prints" to "low prints" and tried to bid the lower end of the range, because he did not feel comfortable owning the risk. He wanted to make sure that he bid conservatively on the MLC Notes.[119] Ulrich explained that with institutional trading, TRACE would be a

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[110] Hearing Tr. (MacLaverty) 1443; RX-68.

[111] CX-41, at 5 (trade no. 199).

[112] Hearing Tr. (Singh) 424-25, 917-22.

[113] Hearing Tr. (Singh) 425.

[114] Hearing Tr. (Singh) 425.

[115] Hearing Tr. (Singh) 958-59.

[116] Hearing Tr. (Singh) 960-61, 999-1003.

[117] Hearing Tr. (Singh) 986-89.

[118] Hearing Tr. (Singh) 559-61, 1156.

[119] RX-62, at 16, 47-48.

consideration but "it's not going to guide ultimately where you price a security if you're making a bid to an institutional customer, and that's how we were taught how to make markets."[120] TRACE was a variable, but it was not Ulrich's regular practice to check it in his institutional trading.[121] Moreover, with respect to the MLC Notes, he testified that TRACE did not guide his pricing because it did not reflect the liquidity available to him. Some days there was no volume and other days there was some.[122] He said of the MLC Notes, "There was no exchange where I could sell the securities."[123]

(4) Singh's Sales Of MLC Notes

Singh was concerned about his exit strategy for the MLC Notes. He was always asked by Merrill customers to buy MLC Notes, never to sell them. This meant to him that he had no clear exit strategy. Consequently, Singh developed a strategy for trading in the inter-dealer market with which he was familiar. He would keep accumulating the MLC Notes until he had, in the aggregate for all six CUSIPs, what he considered a "round lot" position that was large enough to offer for sale in the interdealer market.[124] Singh developed this strategy after noticing that often in the inter-dealer market all six CUSIPS for MLC Notes were grouped for sale in "round lots" of around $1 million in notional value. He did not think that there was a market for exiting out of the MLC Notes at 200 to 300 at a time. The cost of doing a transaction like that would be disproportionate, and, given that the vast majority of his trading was with institutional traders in institutional sized transactions, he thought it was not the best use of his time to trade "odd lots" of MLC Notes.[125]

Singh initiated a sale when he became uncomfortable with the amount of MLC Notes he owned and he thought the amount was large enough to sell in the interdealer market.[126] Singh never sold less than all the MLC Notes he owned at the time. His goal was to "flatten" or get to zero once he had a position large enough to sell.[127]

After Singh accumulated a "round lot" of MLC Notes, he offered the Notes through the same inter-dealer broker with whom he dealt in his institutional trading, Edward LaVelle. Singh's offers did not immediately result in a transaction. LaVelle testified that it would take

[120] RX-62, at 33-34.

[121] RX-62, at 33.

[122] RX-62, at 39-43.

[123] RX-62, at 41.

[124] Hearing Tr. (Singh) 970-73, 977-80.

[125] Hearing Tr. (Singh) 977-80.

[126] Hearing Tr. (Singh) 556-58.

[127] Hearing Tr. (Singh) 981-83.

work to get the transaction done.[128] When there was an expression of interest, Singh would negotiate with the potential buyer and agree on a price.[129] He was unaware during the relevant period that LaVelle's firm had available a separate "odd lot" desk through which he could have sold small amounts of the Notes.[130] LaVelle testified that he did not tell Singh about the desk for "odd lot" transactions because he thought of Singh as a "round lot" trader. LaVelle thought that "odd lots" would be a waste of Singh's time and that telling him about the desk for smaller trades might irritate Singh.[131]

Singh did not receive messages about other bids and offers on MLC Notes. He was unaware at the time of the transactions whether he was close or far from the TRACE prints.[132] Indeed, there was little information in the market about bids and offers for the MLC Notes. The head of the New York liaison desk testified that sometimes it was difficult to get competitive bids on the Notes.[133] Singh only bought MLC Notes when asked to provide a bid to Merrill customers and did not bid on Notes held by other broker-dealers.[134]

Despite the BAS policy against holding residual positions for very long, Singh held the MLC Notes an average of approximately 27 days.[135] The longest he held any MLC Notes identified by a single CUSIP was 105 days,[136] but he held many MLC Notes for more than a month and sometimes more than two months.[137] There was an average of 30 days between his sales of MLC Notes, but once there was a gap of 67 days between his sales of MLC Notes.[138] These holding periods affected his view of the reasonable and fair price to bid for the Notes

[128] Hearing Tr. (LaVelle) 1049.

[129] Hearing Tr. (Singh) 556-59.

[130] Hearing Tr. (Singh) 1006-07.

[131] Hearing Tr. (LaVelle) 1028-33. One of Singh's experts, Tsvetan Beloreshki, similarly testified that traders tended to specialize in "round lots" and "odd lots," and a trader who specialized in "round lots" would not want to be bothered with a small transaction such as 300 notes. Hearing Tr. (Beloreshki) 1302-03.

[132] Hearing Tr. (Singh) 461-63, 558-61.

[133] Hearing Tr. (Kubek) 618.

[134] Hearing Tr. (Singh) 545-46.

[135] Hearing Tr. (Singh) 564; RX-13. For example, between September 14, 2009, and October 16, 2009, Singh accumulated 8,700 MLC Notes bearing the CUSIP number 37044121 and the symbol MTLQ.GM. His purchases of MLC Notes bearing that CUSIP ranged from 800 to 4,000 in volume. On October 20, 2009, he sold those Notes, aggregated with MLC Notes bearing other CUSIPS. The amount of the total sale of all Singh's MLC Notes on October 20, 2009, was 89,165 MLC Notes. By the time of the sale, he had held some of the MTLQ.GM Notes for 36 days and others for only 4 days. RX-13, at 1.

[136] RX-13, at 9-10.

[137] RX-13.

[138] RX-59, Exhibit 10.

because in his view each purchase carried with it the risk of acquiring and holding the Notes.[139] During the relevant period, Singh sold aggregates of MLC Notes in the inter-dealer market 14 times.[140]

(5) Singh Was Unaware Of NASD Rule 2440 And Related Guidance For Transactions With Retail Customers

Singh's only experience with markups and markdowns was in working with senior traders. He was generally familiar with the 5% guideline memorialized in IM-2440-1 as a benchmark for evaluating the fairness of markups and markdowns because he had heard about it when he shadowed senior traders on the desk. But, at the time Singh traded MLC Notes, he was unaware that a markup or markdown of 10% or more was presumed to be fraudulent.[141]

Singh received no training on NASD Rule 2440 and its related guidance.[142] Although BAS had him certify annually that he was aware of the location of policies applicable to him and his responsibility to read and abide by them, Singh did not review the BAS policy on markups and markdowns in retail transactions. BAS policies and procedures were more than 1000 pages, and there was no evidence that anyone ever told Singh that his work on MLC Note transactions required him to review additional policies and procedures different from the ones that applied to his other trading. Thus, he was unaware of the BAS policy for pricing securities in retail customer transactions, which mirrored IM-2440-2.[143]

At the time of his trading in MLC Notes, Singh was unfamiliar with the text of NASD Rule 2440 and its related guidance, IM-2440-1 and IM-2440-2. He maintained at the hearing that he had a general awareness of the "principles" and of the requirement to provide a fair price; but he conceded that he may have been unaware of some of the "substance" and that, in particular,

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[139] Hearing Tr. (Singh) 910-14. Beloreshki corroborated Singh's testimony about the connection between the risk of holding a security and the price one is willing to pay in acquiring it. Beloreshki testified that a trader would charge more for the service of providing a customer with liquidity if the trader thought that he would have to hold the security in inventory. He explained that when a trader holds a security in inventory he is making a bet that nothing bad will happen until he is able to sell it. He testified that as a trader he would be concerned with "protecting my book," and he noted that a trader was always conscious that the capital he was using was not his own but was his employer's. Hearing Tr. (Beloreshki) 1307-16.

Another of Singh's experts, MacLaverty, echoed the same view. He said that there was no way for Singh to be able to hedge his holdings of MLC Notes, and, even if the purchases were small, the risk was real that Singh would be unable to exit the position successfully. Hearing Tr. (MacLaverty) 1469-70, 1474.

[140] CX-53.

[141] Hearing Tr. (Singh) 418, 446-47, 449.

[142] Hearing Tr. (Singh) 414-15.

[143] Hearing Tr. (Singh) 438-44, 449-54; JX-2; CX-5; CX-6. Ulrich, the more experienced trader on the desk, similarly testified that he knew that 5% was a guideline. However, he, like Singh, did not read the BAS procedures on markups and markdowns. He did not even know that such written procedures existed prior to his preparation for his OTR. RX-62, at 30-31.

he was unfamiliar with the requirement to calculate the prevailing market price as part of the process of providing a fair price in retail customer transactions.[144]

(6) Singh Did Not Consider The Prevailing Market Price For MLC Notes

There is no genuine dispute that Singh failed to follow the methodology set forth in IM-2440-2. In connection with the MLC Notes, he never thought about the prevailing market price and never followed the series of specific steps set forth in the guidance for pricing debt securities in transactions with retail customers.[145]

[144] Hearing Tr. (Singh) 405-416, 430-34.

[145] Hearing Tr. (Singh) 405-07, 410, 417-21, 433, 441-51.

(7) Analysis Of Markdowns

For the 384 transactions at issue, Market Regulation compared the price that Singh provided to the lowest inter-dealer price on the same trade date, treating the lowest inter-dealer price as the prevailing market price.[146] On that basis, by Market Regulation's calculations, all 384 transactions involved markdowns of 10% or more. In approximately two-thirds of the charged transactions, the markdowns were 15% or more. Forty-one of the markdowns were 40% or more.[147]

When he gave his bid offers, Singh did not focus on the amount by which his prices deviated from the lowest price in a contemporaneous inter-dealer trade because he was unaware of the requirement in IM-2440-2 to treat that inter-dealer trade price as the prevailing market price. As he testified, he did not always check TRACE for inter-dealer trades when he provided bid offers on MLC Notes, and when he did check TRACE he focused on the wide spread and volatility of the Notes.[148]

Singh was unaware of the precise amount by which the price he received when he sold the Notes exceeded the price he had given in any individual MLC Note transaction with a customer, because he did not track the individual MLC Note transactions in that way.[149] However, Singh consistently obtained a better price when he sold MLC Notes than the price he bid to purchase the Notes from Merrill retail customers.[150] All of Singh's MLC Note sales transactions into the inter-dealer market took place at or near the prevailing market price.[151] From those sales transactions and from his periodic review of trading on TRACE, Singh had a general sense of the prevailing market price for MLC Notes.

Furthermore, in connection with 39 customer transactions executed either the same day or the next day as one of his sales in the inter-dealer market, he knew that the price he received was substantially higher than the price he gave the customer in a contemporaneous

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[146] CX-41.

[147] CX-45. There was evidence that Singh bought and sold some MLC Notes in larger amounts at close to the same price, taking a very small profit, but the record does not indicate how many times overall that occurred. Hearing Tr. (Fortgang) 778-86.

[148] Hearing Tr. (Singh) 462-63, 470-75, 492-94, 958, 987-89. Singh described how he prepared his first bid on MLC Notes. He observed at the time that the difference between high and low prices was 100% and said, "[W]ow, these are pretty volatile." Hearing Tr. (Singh) 958.

[149] Hearing Tr. (Singh) 1189-94.

[150] Hearing Tr. (Bell) 185; CX-52, CX-53. For example, between August 24, 2009, and October 20, 2009, Singh bought "odd lots" of MLC Notes bearing the CUSIP MLQ at prices ranging from $1.75 to $2.00. He sold those Notes on October 20, 2009, aggregated with MLC Notes bearing other CUSIPS, in a "round lot" for $2.90. CX-52, at 1-2.

[151] Hearing Tr. (Bell) 185.

transaction.[152] For example, on October 20, 2009, before noon, Singh sold 89,165 Notes into the inter-dealer market at a price of $2.90. At 3:00 p.m. that same day, a Merrill customer sold 640 MLC Notes to the firm for $1.75. The following day, Merrill customers sold MLC Notes to the firm in eight individual transactions of 500 or less also at a price of $1.75. Market Regulation calculates the markdown in these customer transactions as 39.65%.[153]

According to Market Regulation, there were six separate trading days during the relevant period when Singh had same-day customer purchases and inter-dealer sales. There were 16 separate customer transactions on those days, and the percentage difference between the price he received and the price he gave the customers ranged from 14.89% to 42.31%.[154]

With respect to these six trading days, Singh's knowledge of the disparity between the price he received for the Notes and the price he gave the customers in contemporaneous trades is undeniably troubling. Market Regulation's expert, Stanley Fortgang, testified that it would be inconsistent with industry custom and practice to exceed a 10% markup or markdown except in unusual circumstances.[155]

To put Singh's knowledge in perspective, however, we believe it is important to consider the nature of the market for MLC Notes. Throughout their existence, from June 2009 to April 2011, the MLC Notes were highly volatile and the spread between the high and the low price was substantial. Particularly when the Notes were first issued, the spread between high and low on the same day in inter-dealer trading could reach 100%. In August 2009, when Singh began trading, the spread was often over 50%. Through 2010, the spread was generally around 20%, but it spiked often above that to as much as 40%.[156] Beloreshki calculated that the average daily high-low range for the MLC Notes was 25.9% and that it exceeded the volatility of virtually every other key equity and debt asset class.[157] According to Market Regulation, during the relevant period, on the days of Singh's Note purchase transactions, the lowest price on an inter-dealer trade of MLC Notes ranged from $2.25 to $8.20.[158] The prevailing market price thus changed in the span of a year and half by more than 300%. Beloreshki characterized the market for MLC Notes as "atypical" and as marked by "volatility of a very high magnitude."[159]

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[152] CX-52; CX-54.

[153] CX-52, at 2. Same day and next day transactions have been considered contemporaneous for purposes of Rule 2440. *Dist. Bus. Conduct Comm. v. Escalator Sec., Inc.*, No. C07950049, 1997 NASD Discip. LEXIS 78, at *20 (NBCC Dec. 31, 1997).

[154] MR PH Br. at 12; CX-54.

[155] Hearing Tr. (Fortgang) 680-83.

[156] Hearing Tr. (Beloreshki) 1278; RX-60, at 43, Exhibit 8.

[157] RX-60, at 14-15 and 43, Exhibit 8.

[158] MR PH Br. at 1; CX-41.

[159] Hearing Tr. (Beloreshki) 1263.

The extreme volatility of the security contributed to Singh's belief that holding the Notes involved risk and uncertainty. In his regular trading, risk and uncertainty were factors in his pricing and he had the flexibility to consider such concerns. Indeed, he and other traders testified that risk is of utmost importance to them. Singh treated the MLC Notes no differently. Although he was aware that his prices in purchases of the MLC Notes were lower than the prices that he received when he aggregated and sold the Notes later, he believed that it was appropriate for him to take into account the risk and uncertainty of holding them. Beloreshki testified that a trader faced with a hugely volatile marketplace would be "naturally … extra defensive in trading [his] book."[160]

L. Singh's Credibility

We find Singh's testimony credible in some regards, but not in others.

In considering whether Singh had fraudulent intent, we have reviewed the record for a motive to commit fraud and find none. We find Singh credible when he says that he would not have traded MLC Notes if he had felt he had a choice. The MLC Notes were an insignificant component of Singh's business and were not important to his evaluation or compensation. They represented less than one-half of 1% of his trading activity.[161] At the same time, the manual documentation of the back-to-back trades was tedious and time consuming, and took a disproportionate amount of time for the size of the transactions.[162] The Notes were volatile, and Singh had no clear, reliable exit strategy.[163] However, when his new manager gave him the assignment, Singh simply did not feel in a position to refuse or question it.[164]

We also find Singh's testimony regarding his exit strategy credible. Essentially, he says that he thought the exit strategy of holding and accumulating a block of MLC Notes before selling them in a "round lot" was the only feasible strategy. He also says that he was unaware of any ability to trade small amounts of MLC Notes through his inter-dealer broker. Given the small size of the Note transactions and that they represented less than 1% of Singh's trading, his conclusion was logical. Moreover, Singh's inter-dealer broker corroborated Singh's testimony, saying that he would not have suggested to Singh that he trade small amounts of Notes because Singh was an institutional trader.

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[160] Hearing Tr. (Beloreshki) 1266.

[161] Hearing Tr. (Singh) 1054-55. The MLC Notes also represented less than one-half of 1% of the overall profit he generated for his employer. Hearing Tr. (Singh) 1062-63; CX-41. One of Singh's experts estimated that the 384 transactions at issue represent one-half of 1% of Singh's total consummated purchases in all the securities that he traded during the relevant period. Hearing Tr. (MacLaverty) 1450-54.

[162] Hearing Tr. (Singh) 376, 402-03; RX-62, at 23.

[163] Hearing Tr. (Beloreshki) 1263; Hearing Tr. (Singh) 534-41, 976-80.

[164] Hearing Tr. (Singh) 977.

We credit Singh's testimony that he believed that the Merrill liaison desk was comparing his bids with the prices of competitors and determining whether his bids were the best price available at the time. As discussed above, his belief was consistent with the understanding of his colleagues and others as to the typical role of a liaison desk. It also was consistent with what happened in connection with the MLC Note transactions. On occasion, the liaison desk told him that a better price on MLC Notes was available and asked if he wanted to meet it, or told him that the transaction had occurred at a better price away from the Firm. That indicated to Singh that the liaison desk was checking the competition. Singh was unaware that the Merrill liaison desk that handled most of the transactions at issue did not check competitors' prices, and he only learned during the investigation that the other liaison desk was inconsistent about checking competitors' prices because someone had determined that the transactions were too small to warrant the effort.

We acknowledge, however, that Singh had information that could have caused him to question whether the Merrill liaison desk was actually checking for competitors' prices—if he had paused to analyze the information. The same-day purchases and sales at different prices are significant. In those transactions, Singh knew that he had obtained a better price in inter-dealer trading than he was providing to the Merrill customer on the same day. The fact that his bid prices to Merrill customers were usually at the bottom of the market also is significant. Although Singh did not check every day for MLC Note transactions on TRACE, he did check several times a week, and, when he did, he had to have seen that MLC Notes consistently traded in the inter-dealer market at prices above his bid prices to Merrill customers.

We conclude, however, that Singh did not pause to analyze the information. He operated in a rapid-fire environment in which he was responding to multiple bid inquiries on a moment-by-moment basis, and his institutional trading was far more significant to him than the MLC Note transactions. In his institutional trading, TRACE did not have the same significance that it has in connection with retail customer transactions, and TRACE was only one of many factors he might consider. Because Singh had no training or guidance regarding the specific requirements applicable to trading in non-investment grade debt instruments with retail customers, he did not have a proper understanding of his responsibilities or the necessity of analyzing the information he had about pricing in inter-dealer transactions.

We credit Singh's testimony that he would have done things differently if he had known that the Merrill liaison desk was not checking for competitive bids. He said that he would have "called for help" and would have gone to his manager or to compliance for guidance.[165] Singh depended upon the comparison of his internal bids to competitors' prices in his institutional trading. If he had been informed that that comparison was not being performed in connection with the MLC Notes, he would have considered it a fundamental difference and would have sought guidance.

[165] Hearing Tr. (Singh) 551, 1130.

On the other hand, Singh's credibility was undercut by his refusal to acknowledge that his bid prices for MLC Notes could be considered excessive and unfair. He maintained that his $3 bid price was fair even after being shown about 20 inter-dealer trades on the same day where the lowest price was $4.80. Similarly, he maintained that his bid price of $4.50 was fair even though the lowest inter-dealer price the same day was $5.70.[166] In the face of the evidence and the plain meaning of the guidance on NASD Rule 2440, Singh's position is not tenable.

III. CONCLUSIONS

A. Singh Violated NASD Rule 2440 And Related Guidance

(1) Applicable Rule And Guidance

When a member buys or sells from a retail customer for the member's own account, NASD Rule 2440 requires that the member buy or sell at a "fair" price, "taking into consideration all relevant circumstances."[167] The Rule specifies some of the relevant circumstances: market conditions in the security at the time of the transaction, the expense involved, and the fact that the member is entitled to a profit. It acknowledges that what is a fair price will depend on the circumstances. The Rule does not, however, define the term fair price or prescribe any particular methodology for determining a fair price.[168] Two related guidelines provide more detail on how to determine a fair price.

The first guideline is IM-2440-1. It confirms that a fair price depends on the circumstances, stating, "No definitive answer can be given and no interpretation can be all-inclusive for the obvious reason that what might be considered fair in one transaction could be unfair in another transaction because of different circumstances." This guideline emphasizes that whether a price is fair will depend on analysis of all relevant factors, including identified factors such as the type of security, its availability in the market, and the price. Generally, the percentage of markup increases as price decreases, and where the security requires more handling a wider spread may be warranted. The guideline notes that, where the transaction involves a small amount of money, it may require a larger percentage markup to cover expenses.

IM-2440-1 refers to a long-standing 5% policy as a guide on fair pricing. It notes, however, that a markup either over or under 5% could be considered unfair or unreasonable depending on the relevant factors.

[166] Hearing Tr. (Singh) 385-90, 396, 436-38, 444-45, 478-79, 485-88.

[167] This Rule, like other FINRA and NASD Rules, is made applicable to associated persons by FINRA Rule 140.

[168] Regulatory Notice 08-36 likewise does not define the term fair price or dictate a methodology for determining a fair price. It merely reiterates that NASD Rule 2440 requires member firms "to buy or sell securities only at fair prices" FINRA Regulatory Notice 08-36 (June 2008), http://www.finra.org/industry/notices/08-36.

Finally, IM-2440-1 introduces the concepts of "current market price" and "prevailing market price." It provides that it shall be deemed a violation of NASD Rule 2440 to enter into any transaction with a customer in any security at any price "not reasonably related to the current market price of the security." It further provides that in the context of a purchase from a customer the price "must be reasonably related to the prevailing market price of the security."

The second guideline is IM-2440-2. That guideline specifically applies to transactions in debt securities. Unlike Rule 2440 or IM-2440-1, it prescribes a methodology to be followed in determining a fair price. It also defines who is a customer for purposes of NASD Rule 2440 and related guidance, making plain that for purposes of NASD Rule 2440 and related guidance, in the context of a transaction in a non-investment grade debt security (such as the MLC Notes in this case), the term customer applies to retail customers, not institutional clients or Qualified Institutional Buyers who have the capacity to evaluate the investment risk independently and are exercising their independent judgment.

The method established by the second guideline begins with the dealer's own contemporaneous transactions. Under IM-2440-2, a markup or markdown "must" be based on the prevailing market price, and the prevailing market price, in turn, is presumptively established by reference to the dealer's contemporaneous cost or contemporaneous proceeds. Other evidence of the prevailing market price may be considered only where the dealer's own transactions are not sufficiently contemporaneous with the customer transaction or where, for other reasons, the dealer can show that its contemporaneous cost or proceeds are not indicative of the prevailing market price. Generally, the presumption may be overturned if there has been a change in relevant circumstances, such as a change in interest rate or credit quality, or news affecting perceived value of the security. Once the dealer has overcome the presumption, then it <u>must</u> "consider" in the order listed certain specified information, starting with the prices of any contemporaneous inter-dealer transactions in the security. It is only in the absence of any such transactions that other information may be consulted. If there are no contemporaneous inter-dealer transactions, then prices in dealer transactions with institutional accounts may be considered. IM-2440-2 creates a kind of "waterfall" of considerations that must be followed in order.

In summary, NASD Rule 2440 requires that the price to a customer be fair. IM-2440-1 establishes that the price must be reasonably related to the prevailing market price, and IM-2440-2 establishes a presumption in a transaction with a retail customer involving a non-investment grade debt instrument that the dealer's cost or proceeds in a contemporaneous transaction is the prevailing market price. Absent such a contemporaneous transaction, IM-2440-2 requires an analysis that proceeds in specific steps, starting with consideration of prices in any contemporaneous inter-dealer transactions.

(2) Singh's Violation

Singh failed to comply with NASD Rule 2440 and its guidance. There is no genuine dispute as to the material facts. Singh admitted that he did not consider the prevailing market price, as required by IM-2440-1, when he priced MLC Notes. Nor did he follow the analytical steps specified in IM-2440-2 for determining the prevailing market price, because he was unfamiliar with the Rule and its guidance and was unaware of the step-by-step analysis required. As a result, in the 384 transactions charged in the Complaint, Singh's prices for MLC Notes were substantially in excess of the 5% policy memorialized in IM-2440-1.

Singh's ignorance of the Rule and its guidance does not excuse his failure to comply with the applicable requirements. A violation of NASD Rule 2440 and its related guidance does not require a finding of scienter.[169] Ignorance of the applicable rules is no excuse for their violation.[170] A participant in the industry is responsible for understanding the applicable regulatory obligations.[171] This principle is necessary for the regulatory system to function effectively and for FINRA to fulfill its regulatory mission. Otherwise, ignorance, if permitted to excuse misconduct, could render the rules inconsequential.

We find that Market Regulation proved that Singh set unfair prices in retail customer transactions in violation of NASD Rule 2440 and related guidance. [172]

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[169] *Dep't of Enforcement v. Levitov*, No. CAF970011, 2000 NASD Discip. LEXIS 12, at *17 n.14 (NAC June 28, 2000).

[170] *Dep't of Enforcement v. Elgart*, No. 2013035211801, 2016 FINRA Discip. LEXIS 30, at *20 & n.67 (OHO June 3, 2016), *appeal docketed* (June 14, 2016). *See also Jason A. Craig*, Exchange Act Release No. 59137, 2008 SEC LEXIS 2844, at *16 (Dec. 22, 2008), quoting *Richard J. Lanigan*, 52 S.E.C. 375, 378 n.13 (1995), citing *David A. Gingras*, 50 S.E.C. 1286, 1291 n.12 (1992); *Kirk A. Knapp*, 51 S.E.C. 115, 129 (1992).

[171] *Harry Friedman*, Exchange Act Release No. 64486, 2011 SEC LEXIS 1699, at *33 & n.32 (May 13, 2011). *See also Wind Energy America Inc.*, Exchange Act Release No. 62894, 2010 SEC LEXIS 2975, at *19 & n.27 (Sept. 13, 2010).

[172] Market Regulation also charges Singh with violating the ethical conduct Rule that requires member firms and their associated persons to observe "high standards of commercial honor and just and equitable principles of trade," formerly NASD Rule 2110 and now FINRA Rule 2010. IM-2440-1 states that it shall be deemed a violation of the ethical conduct Rule to enter into any transaction with a customer at a price not reasonably related to the current market price. It is well established that violation of a FINRA Rule is also a violation of Rule 2010. *In re Wedbush Securities, Inc.*, 2016 SEC LEXIS 2794, at *15 n.12 (Aug. 12, 2016). Accordingly, we also find that Respondent violated FINRA Rule 2010.

B. Market Regulation Failed To Prove That Singh Had Scienter, As Required For A Securities Fraud Violation

(1) Applicable Law

Market Regulation charges Singh with violating Section 10(b) of the Securities Exchange Act of 1934 and all three subsections of Rule 10b-5.

Section 10(b) of Exchange Act makes it "unlawful for any person … [t]o use or employ, in connection with the purchase or sale of any security …., any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe."[173]

Rule 10b-5, promulgated by the SEC pursuant to Section 10(b), makes it unlawful to do any of the following:

> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[174]

Market Regulation also charges Singh with violating FINRA Rule 2020. It provides that "[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance."[175]

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[173] 15 U.S.C. § 78j(b).

[174] 17 C.F.R. § 240.10b-5.

[175] The elements of a FINRA Rule 2020 violation are the same as for a securities fraud violation, except that a Rule 2020 violation, unlike a federal securities violation, does not require interstate commerce to establish jurisdiction. A violation of Rule 2020, like a violation of Section 10(b), requires proof of scienter. *Dep't of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *31 & n.31 (NAC Apr. 26, 2013) ("NASD Rule 2120 [now FINRA Rule 2020] requires a showing of scienter, similar to Exchange Act Rule 10b-5."). In light of our conclusion that Market Regulation failed to prove scienter, we do not discuss Rule 2020 separately from the alleged securities fraud violation.

Market Regulation charges that Singh violated the ethical conduct Rule, FINRA Rule 2010, by committing fraud under Section 10(b). Again, because the alleged Rule violation depends on proof of the securities fraud violation, we do not discuss Rule 2010 separately.

(2) Securities Fraud Requires Scienter

To establish liability under any of these provisions, Market Regulation must prove by a preponderance of the evidence[176] that Singh acted with fraudulent intent—scienter.[177] "Scienter is defined as 'a mental state embracing intent to deceive, manipulate, or defraud.'"[178] It is established if the person charged acted either intentionally or recklessly.[179]

Although recklessness will suffice for scienter, recklessness is much more than mere carelessness or thoughtlessness. For purposes of a securities fraud claim, conduct is reckless if it is an extreme departure from the standard of ordinary care such that the person knew or must have been aware of the danger of misleading investors.[180] Reckless conduct is conduct that involves "not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care."[181] That extreme departure from the standard of care must present such "a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."[182] It is that awareness of an obvious danger

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[176] *Dep't of Enforcement v. Claggett*, No. 2005000631501, 2007 FINRA Discip. LEXIS 2, at *25 (NAC Sept. 28, 2007) (Enforcement had burden of proof, which it had to satisfy by a preponderance of the evidence). *See also Luis Miguel Cespedes*, Exchange Act Release No. 59404, 2009 SEC LEXIS 368, at *18 & n.11 (Feb. 13, 2009) (citing *David M. Levine*, 57 S.E.C. 50, 73 n.42 (2003) (holding that preponderance of the evidence is the standard of proof in self-regulatory organization ("SRO") disciplinary proceedings)); *Kirk A. Knapp*, 51 S.E.C. 115, 130 n.65 (1992) (stating the "the correct standard is preponderance of the evidence" in an SRO proceeding). *See also Gonchar v. SEC*, 2010 U.S. App. LEXIS 25763, at *3-4 (Dec. 17, 2010) (SEC disciplinary proceedings governed by the preponderance of the evidence standard, even where discipline is initially imposed by an SRO and then sustained by the SEC).

[177] *Mitchell H. Fillet*, Exchange Act Release No. 75054, 2015 SEC LEXIS 2142, at *40 (May 27, 2015); *Dep't of Enforcement v. Akindemowo*, No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at *29 (NAC Dec. 29, 2015), *appeal docketed*, No. 3-17076 (SEC Jan. 29, 2015).

[178] *Akindemowo*, 2015 FINRA Discip. LEXIS 58, at *33 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)). *Levitov*, 2000 NASD Discip. LEXIS 12, at *19.

[179] *Akindemowo*, 2015 FINRA Discip. LEXIS 58, at *33 (citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007)). *See also Dep't of Enforcement v. Ahmed*, 2015 FINRA Discip. LEXIS 45, at *77 n.78 (NAC Sept. 25, 2015) ("Scienter also is established through a heightened showing of recklessness.") (citing *Tellabs*, 551 U.S. at 319 n.3).

[180] *Hollinger v. Titan Capital Corp*., 914 F.2d 1564, 1569 (9th Cir. 1990).

[181] *Williams Sec. Litig.*, 496 F. Supp. 2d 1195, 1289 (N.D. Okla. 2007). Even gross negligence does not rise to the level of recklessness. *See, e.g., Dep't of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *46 (NAC June 25, 2001); *Dep't of Enforcement v. Kunz*, No. C3A960029, 1999 NASD Discip. LEXIS 20, at *45 & n.21 (NAC July 7, 1999), *aff'd*, 55 S.E.C.551 (Jan. 16, 2002), *aff'd*, 2003 U.S. App. LEXIS 6011 (10th Cir. Mar. 28, 2003).

[182] *Id*. *See also Dep't of Enforcement v. Fillet*, No. 2008011762801, 2013 FINRA Discip. LEXIS 26, at *35 (NAC Oct. 2, 2013) (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (internal quotation omitted)).

of misleading or deceiving investors that distinguishes recklessness—which is a culpable state of mind—from negligence, which is not.

Securities fraud thus requires a state of mind closely approaching knowing misconduct. In distinguishing recklessness from negligence, courts have said, "We perceive it to be not just a difference in degree, but also in kind…."[183] Recklessness has been described as the "functional equivalent of intent."[184]

(3) Scienter In A Markup/Markdown Case Requires Analysis Of All The Facts And Circumstances

Market Regulation asserts that "[a]s a matter of law" Singh's markdowns in the 384 identified transactions were fraudulent. In support, Market Regulation notes that the SEC has consistently held that markups of more than 10% in equity transactions are fraudulent.[185]

To the extent that Market Regulation is arguing that the size of the markdowns alone is sufficient to establish fraud, we reject that proposition. A case concerning alleged fraudulent markups or markdowns is no different with regard to scienter from any other securities fraud case. Undisclosed excessive markups or markdowns are a fraud violation *only* if they are accomplished with scienter.[186]

While the amount of the markups or markdowns is a factor in analyzing scienter, scienter is not demonstrated simply by showing that the markups or markdowns were excessive.[187] The cases in which fraud is found do not rest solely on that one factor. Rather, where fraud is found, the facts and circumstances as a whole strongly support a finding of knowing or consciously reckless wrongdoing. The evidence must be analyzed as a whole to determine whether the person alleged to have committed fraud intentionally engaged in the misconduct or was consciously reckless.[188]

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[183] *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 199 (1st Cir. 1999). *See also In re Imergent Sec. Litig.*, 2009 U.S. Dist. LEXIS 103018, at *22 (D. Utah Nov. 2, 2009).

[184] *SEC v. Ferrone*, 2016 U.S. Dist. LEXIS 21529, at *43 (Feb. 22, 2016) (quoting *Sundstrand*, 553 F.2d at 1045).

[185] MR PH Br. at 26.

[186] *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *45 and nn.51, 53-54 (Feb. 13, 2015) (excessive markups may be found fraudulent *if* done with scienter). *See also Andrew P. Gonchar*, Exchange Act Release No. 60506, 2009 SEC LEXIS 2797, at *22, 25 n.23 (Aug. 14, 2009) (interpositioning can be fraud *if* it is done with scienter and results in excessive undisclosed markups).

[187] Markups of more than 10% over the prevailing market price are evidence of scienter. *Lane*, 2015 SEC LEXIS 558, at *45 & n.56. However, a person commits fraud only where he "knows the circumstances indicating the prevailing inter-dealer market price for the securities, knows the retail price that it is charging … and knows or recklessly disregards the fact that its markup is excessive…. [Then] the scienter requirement is satisfied." *Id*. at *46.

[188] *See Gebhart v. SEC*, 595 F.3d 1034, 1042 n.11 (9th Cir. 2010).

For example, in *Grey*, the respondent secretly interposed his own personal account between his customers and the prevailing market for municipal bonds, an action that had no legitimate purpose and had the sole function of enriching the respondent. The interpositioning allowed him to charge additional markups and to conceal them. He purchased the bonds through his firm and routed them in and out of his personal account before having the firm sell the bonds to his retail customers at much higher prices than he had paid to purchase them. He undertook little risk in this process because he bought and sold within a matter of days and he was in control of all the transactions. He solicited the transactions with the customers without telling them of his personal involvement, and he was highly motivated to do so because his personal bond trading activity represented a substantial part of his income. He even leveraged his financial ability to do more of the transactions. The evidence was overwhelming that he acted with scienter. The scheme benefited Grey at the expense of his customers, and he knew it. He planned it that way.[189]

Excessive markups have also been found fraudulent where a firm dominates and controls the market for the securities, and respondents achieve excessive markups by exercising that dominance and control in a manipulation. One of the most well-known examples of excessive markups achieved by this means is *First Jersey*.[190] In that case, the firm dominated and controlled the market for the securities at issue. The firm and its owner used that power to orchestrate a massive, highly controlled scheme by which the firm repurchased unit securities at a low price, unbundled the securities and resold the components at an unreasonably high price. The transactions were virtually riskless to the firm. The trial court found that "the whole point of the scheme," which hid from the sales network what was happening by requiring some branches to purchase and others to resell and forbidding each group from talking to the other, "was to keep customers in the dark."[191]

The case cited by Market Regulation for the proposition that a 10% markup on an equity security is fraudulent *per se* states the proposition but does not actually stand for it. In *Powell*, the SEC held that the respondent had scienter not simply because the markups were over 10%, but because the respondent had conversations with an NASD examiner that put him on notice that his contemplated markups were excessive.[192] Similarly, in *Levitov*, another case that recites the proposition that markups over 10% are fraudulent, the NAC did not rely solely on the size of

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[189] *Anthony A. Grey*, Exchange Act Release No. 75839, 2015 SEC LEXIS 3630 (Sept. 3, 2015). Similarly, *see Lane*, 2015 SEC LEXIS 558, another case in which the respondent designed an interpositioning scheme that benefited him at the expense of his customers, and *Dep't of Enforcement v. Gonchar*, No. CAF040058, 2008 FINRA Discip. LEXIS 31 (NAC Aug. 26, 2008), where respondents secretly used their personal account in cross-trades with customers to derive significant profits. In *Gonchar*, the respondents also induced the person on the retail liaison desk to perform her duties in a way that hid what they were doing and facilitated their scheme.

[190] *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450 (2d. Cir. 1996), *cert. denied*, 522 U.S. 812 (1997).

[191] *First Jersey*, 101 F. 3d at 1471. *See also Dist. Bus. Conduct Comm. v. Stratton Oakmant, Inc.*, C10950081, 1996 NASD Discip. LEXIS 52 (NAC Dec. 5, 1996).

[192] *Powell & Assoc.*, 47 S.E.C. 746, 748 (1982).

the markups. It considered extensive evidence of scienter and found it compelling. Respondents had taken advantage of the fact that their firm dominated and controlled the market for certain warrants to manipulate the price.[193]

In fact, there have been instances where markups over 10% have been found unreasonable and excessive but where the responsible parties have not been found to have acted with scienter. In *Gordon*, for example, the SEC found that although the markups at issue ranged from 12.9% to 54.55% on certain riskless principal trades, the record did not support a finding of fraud. The SEC did not further explain its reasons.[194] However, it plainly stated that undisclosed markups on transactions with retail customers can constitute fraud "if they are not reasonably related to the baseline against which they are measured and *if* the responsible parties acted with scienter."[195] In *Anderson*, the SEC found that respondent charged markups and markdowns in riskless principal transactions that deviated significantly from the industry norms, but the SEC nevertheless held that there was insufficient proof of scienter "because of possible uncertainty regarding the applicable standards during the period at issue."[196]

In sum, to find fraud, we must find that Singh acted with scienter. To find scienter, we require evidence that he acted knowingly or recklessly. As discussed below, the facts and circumstances of this case lead us to conclude that, although Singh may have been careless and indifferent in setting prices on the MLC Notes, he did not do so with fraudulent intent.

(4) The Facts And Circumstances Do Not Support A Finding Of Scienter

As discussed above, the markup cases where fraud has been found have several distinctive elements. Generally, the person held liable for fraud has a high degree of control over the transactions and actively structures them to conceal the true size of the markup or markdown from the customer. The profit gained from the markup or markdown is a significant benefit to that person, and provides a motive for the fraud. Finally, there is little or no risk involved.[197]

The facts and circumstances of this case are far different. Unlike the respondents who had dominance and control over the securities at issue, Singh had no control over the MLC Note transactions. He responded to inquiries when they came to him and waited to see whether a transaction resulted. Unlike those who interpositioned themselves between the customer and the

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[193] *Levitov*, 2000 NASD Discip. LEXIS 12, at *20-21.

[194] *Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 SEC LEXIS 819 (Apr. 11, 2008).

[195] *Id.* at *52 (emphasis supplied).

[196] *Mark David Anderson*, Exchange Act Release No. 48352, 2003 SEC LEXIS 3285, at *39 (Aug. 15, 2003).

[197] In addition to interpositioning and abuse of market dominance and control in a manipulation, Singh identified other categories of separate misconduct that, in combination with excessive markups or markdowns, have been found to support a finding of fraud. These include affirmative misrepresentations (*United States v. Szur*, 289 F.3d 200 (2d Cir. 2002)) and disregard of regulatory warnings (*Powell*, 47 S.E.C. at 748). Resp. PH Br. 29-30, Resp. Reply 8-9.

market, Singh did not actively structure a mechanism for imposing and concealing excessive markups. He simply provided a bid offer that might or might not result in a transaction. Furthermore, he thought his bid was being compared to the competition and that a purchase transaction would only happen if his bid favorably compared. Unlike those who obtained excessive markups or markdowns with fraudulent intent, the MLC Note transactions provided Singh no significant benefit and no motive to commit fraud. To the contrary, they were a nuisance to him. Finally, unlike the virtually riskless transactions where fraud has been found, Singh retained the highly volatile MLC Notes for long and uncertain periods, creating risk.

Indeed, the contrast between this case and the markup cases where fraudulent intent has been found is stark. Where fraud is found, the persons responsible for the excessive markups or markdowns purposely created the circumstances that enabled them to charge the unfair markups or markdowns. Singh did nothing of the kind here.

We acknowledge, as discussed above, that Singh could have been more alert to certain facts and more skeptical of whether the liaison desk was checking his prices against the competition. However, his failure to comprehend the significance of the information or to investigate it further does not equate to knowing misconduct or conscious recklessness. In the circumstances of this case, Singh did not have scienter. He was given an assignment that was unfamiliar, burdensome, and not particularly important to Singh or his trading desk, because he was the junior trader. He was required to price the MLC Notes in retail customer transactions, but he had no training or experience in such transactions and was unaware of the applicable requirements.[198] As a result, he priced the MLC Notes in the same way that he priced other securities, based on the risk he was willing to carry. He operated on the understanding—albeit an incorrect understanding—that his prices were being compared to the competition and that they would not be accepted if they were not the best available.

Because we find that Market Regulation failed to prove that Singh acted with scienter, we dismiss the fraud charge.[199]

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[198] We do not treat Singh's lack of appropriate training and guidance as an excuse for misconduct. Rather, we view it as relevant to his state of mind and whether he had the awareness that he was engaged in wrongdoing that is required for scienter—knowing misconduct or conscious recklessness. *See Reynolds*, 2001 NASD Discip. LEXIS 17, at *46, where the NAC found that the respondent did not have scienter in part because he had limited experience in the securities industry and he received little guidance or direction from his supervisor.

[199] Given our conclusion that Market Regulation failed to prove that Singh acted with scienter, it is unnecessary to address the other elements of securities fraud under Section 10(b) and Rule 10b-5. We nevertheless note, for the sake of completeness, that the record establishes the other elements of a federal securities law violation. First, Singh and others involved in the transactions at issue communicated by means of the telephone and other electronic means that constituted the instrumentalities of interstate commerce required for jurisdiction. Second, there is no dispute that the transactions involving the MLC Notes were purchases and sales of securities. Third, the large percentages by which Singh's prices deviated from the lowest inter-dealer prices would have been material to Merrill customers. If Merrill customers had known that they were selling their MLC Notes at a price substantially lower than the lowest price in the inter-dealer market, they quite likely would have sought another bid. Information is material if it "significantly alter[s] the 'total mix' of information made available," such that there is a "substantial likelihood that a reasonable investor would consider it important" in making an investment decision. *Basic v. Levinson*, 485 U.S. 224, 230-31 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

IV. SANCTIONS

FINRA's Sanction Guidelines ("Guidelines") provide the guideposts for sanctions in FINRA disciplinary proceedings.[200] They set forth recommendations regarding sanctions for violations of specific violations, and also instruct adjudicators to consult the Principal Considerations[201] and the General Principles[202] applicable to all sanction determinations.

The specific sanctions for excessive markups and markdowns cover a broad range. A fine of $5,000 to $146,000 may be ordered, along with restitution. If restitution is not ordered, then the gross amount of the excessive markups or markdowns may be ordered in addition to the fine.[203] The Guidelines instruct that adjudicators consider suspending an individual respondent in any or all capacities for up to 30 business days. In an egregious case, an individual may be suspended for as much as two years or barred.[204]

Although we reject the claim that Singh engaged in fraud, we find that Singh's non-scienter based fair pricing violation is serious. There are a number of aggravating factors. The misconduct occurred over the course of 17 months, an extended period.[205] It involved close to 400 transactions, a large number of transactions.[206] The transactions were with retail customers, not sophisticated institutions that might have sought competitive bids.[207] Singh's pricing violation injured the customers who accepted his low prices instead of a price reasonably related to the prevailing market price.[208] Singh had discretion as to the amount of the markdowns.[209]

Finally, we find it aggravating that Singh maintained at the hearing that his prices were fair in the face of strong evidence that they were unfair. Singh developed his prices without knowing that IM-2440-2 required a specific methodology, and without knowing that the liaison desk was not checking the competition. Now he knows both that IM-2440-2 applies and that the liaison desk was not checking the competition. He could have acknowledged that his prices

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[200] FINRA Sanction Guidelines (2015), http://www.finra.org/industry/sanction-guidelines.

[201] Guidelines at 1-5.

[202] Guidelines at 1, 6-7.

[203] Guidelines at 90. As noted with regard to the Firm's settlement of the fair pricing and supervisory charges against it, the Firm agreed to pay restitution in connection with purchases of MLC Notes from its retail customers.

[204] Guidelines at 90.

[205] Guidelines at 6, Principal Consideration 9.

[206] Guidelines at 6-7, Principal Consideration 8, Principal Consideration 18..

[207] Guidelines at 7, Principal Consideration 19.

[208] Guidelines at 6, Principal Consideration 11.

[209] Specific Principal Considerations to be considered in connection with a violation of the fair pricing Rule and guidance. Guidelines at 90.

might have been different if he had had that knowledge during the relevant period without admitting that his prices were unfair. Instead, Singh disputed the applicability and good sense of Rule 2440 and related guidance, and he continued to maintain that his prices were fair.

In light of the aggravating factors, and with the goal of deterring Respondent and others from such misconduct in the future, we believe that the sanctions here must be significant.[210] We believe it is appropriately remedial to suspend Singh for 30 business days, the top of the range recommended in the Guidelines for a violation not labeled egregious. We also believe a fine of $50,000 appropriate, which is substantially more than the $5,000 minimum. We do not impose a larger fine at the upper end of the range recommended in the Guidelines because Singh did not seek a personal monetary benefit from his misconduct, and there is no evidence in the record that he realized any in the form of a bonus or other compensation.[211]

V. ORDER

The Hearing Panel dismisses the First Cause of Action alleging fraud.

With respect to the Second Cause of Action, the Hearing Panel finds that Respondent, Bharminder Singh, violated NASD Rule 2440 and related guidance, IM-2440-1 and IM-2440-2, as well as FINRA Rule 2010. For these violations, Respondent is suspended from association with any FINRA member firm in any capacity for 30 business days, fined $50,000, and ordered to pay the costs of the hearing in the amount of $13284.05, which includes a $750 administrative fee and the cost of the transcript. If this decision becomes FINRA's final disciplinary action, Singh's suspension shall commence on October 17, 2016, and end at the close of business on November 28, 2016. The fine and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.

Lucinda O. McConathy
Hearing Officer
For the Extended Hearing Panel

[210] Guidelines at 2, General Principle 1.

[211] The Extended Hearing Panel has considered and rejects without discussion any other argument made by the Parties that is inconsistent with this decision.