

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

CMG INSTITUTIONAL TRADING, LLC
(CRD No. 47264),

and

SHAWN D. BALDWIN
(CRD No. 4281564),

Respondents.

Disciplinary Proceeding
No. E8A20050252

Hearing Officer – SNB

Hearing Panel Decision

December 12, 2006

Respondent CMG is expelled and Respondent Baldwin is barred for failing to respond to written requests for information in violation of Rules 8210 and 2110.

Appearances

Pamela Shu, Esq., Richard S. Schultz, Esq., Chicago, IL, (Rory C. Flynn, Esq., Washington, DC, of Counsel), for the Department of Enforcement.

Nichole C. Patton, Esq., Ted Word, Esq., Chicago, IL, for Respondents.

I. Procedural History

On April 18, 2006, the Department of Enforcement filed a Complaint charging that Shawn D. Baldwin (“Baldwin”) and CMG Institutional Trading, LLC, (“CMG”) (sometimes collectively referred to as “Respondents”) failed to respond to written requests for information, in violation of Rules 8210 and 2110. Respondents filed an Answer denying the charges and

requesting a hearing. The Hearing was held in Chicago, IL on July 27 and August 24, 2006, before a Hearing Panel that included a Hearing Officer and two Panelists.¹

II. Jurisdiction

Respondent CMG became registered with NASD on December 12, 2001, and its registration was suspended, but still in effect, at the time of the hearing.² Baldwin first became registered with NASD as a General Securities Representative in 2000. Since November 2001, Respondent Baldwin has served as CMG's president, and has been registered as a General Securities Representative and General Securities Principal. CX-1. Respondents are therefore subject to NASD's jurisdiction.

III. Discussion

Enforcement's one-count complaint charges that Respondents failed to respond to two distinct Rule 8210 requests for information. The first occurred in July 2005, when Staff requested a written response and documentation with respect to its Exit Conference Report findings. The second occurred in November 2005, when Staff requested information regarding purported capital infusions to CMG to address a net capital deficiency, following an SEC inquiry on this subject.

Rule 8210 authorizes NASD to require any person subject to its jurisdiction to provide information and testimony related to any matter under investigation. The Rule serves as a key element in NASD's oversight function and allows NASD to carry out its regulatory functions

¹ The Panelists are current members of the District 8 Committee. Enforcement offered Complainant's Exhibits ("CX") 1-33, which were admitted without objection. By Order of July 21, 2006, Respondents' exhibits were administratively rejected as untimely. References to the Hearing transcript are cited as "Tr. at p."

² CMG was suspended in April of 2006 for failure to file its annual audit pursuant to SEC Rule 17a-5. Tr. 205, 206.

without subpoena power.³ When NASD does not timely receive responses to its requests, NASD's ability to perform its regulatory responsibilities is subverted.⁴ Moreover, it is well settled that a respondent cannot dictate the terms and conditions under which information will be furnished, nor can NASD members "take it upon themselves to determine whether information requested is material to an NASD investigation of their conduct."⁵

As the Complainant, Enforcement had the burden of proving, by a preponderance of the evidence that Respondents failed to respond.⁶

As discussed in greater detail below, Enforcement failed to prove, by a preponderance of evidence, that Respondents failed to respond to the NASD's first 8210 request concerning the Exit Conference Report. As to that allegation, Enforcement's evidence was incomplete and inconsistent and, therefore, the Panel was unable to determine that there were any specific deficiencies in the responses that Respondents submitted. Enforcement did establish, however, that Respondents failed to fully respond to NASD's separate Rule 8210 request regarding capital contributions to Respondent CMG.

³ See, e.g., *Dep't of Enforcement v. Valentino*, No. FPI010004, 2003 NASD Discip. LEXIS 15, at *12 (NAC May 21, 2003), *aff'd*, 2004 SEC LEXIS 330 (Feb. 13, 2004) ("It is well established that because NASD lacks subpoena power over its members, a failure to provide information fully and promptly undermines NASD's ability to carry out its regulatory mandate.") (citation omitted); *Joseph G. Chiulli*, Exch. Act Rel. No. 42,359, 2000 SEC LEXIS 112, at *16 (Jan. 28, 2000) (noting that Rule 8210 provides a means for the NASD effectively to conduct its investigations, and emphasizing that NASD members and associated persons must fully cooperate with requests for information).

⁴ *Joseph P. Hannan*, Exch. Act Rel. No. 40,438, 1998 SEC LEXIS 1955, at *9 (Sept. 14, 1998).

⁵ *General Bond & Share Co. v. SEC*, 39 F.3d 1451, 1461 (10th Cir. 1994); See also, *Paul Joseph Benz*, Exch. Act Rel. No. 51046, 2005 SEC LEXIS 116 (Jan. 14, 2005); *Robert Fitzpatrick*, Exch. Act Rel. No. 44956, 2001 SEC LEXIS 2185 (Oct. 19, 2001); *Joseph Patrick Hannan*, Exch. Act Rel. No. 40438, 1998 SEC LEXIS 1955 at *11 (Sept. 14, 1998) ("an NASD member may not second guess or impose conditions on the NASD's request for information") (internal quotes omitted).

⁶ See, *Dep't. of Enforcement v. Respondent*, No. C07010037, 2003 NASD Discip. LEXIS 16 (NAC May 13, 2003).

A. The Exit Conference Request

Beginning in early July 2005, the NASD Staff conducted a routine, on-site examination of CMG.⁷ On July 22, 2005, NASD Staff had an exit conference with Respondent Baldwin, and gave him an Exit Conference Report. CX-2; Tr. 25-31, 298. As is typical, the Exit Conference Report was intended to outline preliminary findings of deficiencies and violations noted during the examination, based on the information that NASD Staff had at the time the report was prepared. Tr. 27, 28, 149, 196. As part of their standard process, NASD Staff required a written response from Respondents to address apparent violations, so that Staff could timely conclude the examination and charge violations, if found. CX-2; Tr. 30, 31, 195, 196.

At the end of the Exit Conference Report, Staff noted, in bolded, underlined, capitalized, text:

THE FIRM NEEDS TO RESPOND TO THIS EXIT CONFERENCE IN WRITING AND PROVIDE THE REQUESTED DOCUMENTS, AMENDED WRITTEN PROCEDURES, ETC TO THE STAFF ON OR BEFORE THE CLOSE OF BUSINESS FRIDAY, AUGUST 5, 2005. (emphasis in the original)

CX-2 p. 17. Respondent Baldwin received the report, signed it, and noted this bolded text. Tr. 31, 301. On August 11, 2005, NASD Staff sent Respondents a letter by facsimile, First Class, and Certified Mail, reminding them of NASD Staff's request. The letter stated that the request was made pursuant to Rule 8210, and noted that failure to timely respond "may subject the Firm to regulatory sanctions including, but not limited to censures and fines." The letter also extended Respondents' deadline to August 25, 2005. CX-3; Tr. 32. In the same manner, on August 30 and September 14, 2005, NASD Staff sent Respondents two more reminders saying the same thing, and again extending the deadline for a response. CX-5, CX-8; Tr. 32, 33, 146, 147.

⁷ Enforcement asserted at the hearing and in its post hearing brief that Respondents did not fully respond to oral and other requests during the routine examination of Respondent CMG; an account that Respondents dispute. However, this alleged conduct was not charged in the Complaint.

NASD received confirmation of the delivery of these three requests, and Respondents stipulate that they received them. CX-4, 6, 7, and 9; Tr. 160, 161.

There is evidence that Respondents provided responses relating to at least some of the items referenced in the Exit Conference Report; however, the extent and timing of these responses is unclear. During testimony, NASD Staff conceded that, prior to the filing of the Complaint, Respondents provided some information related to some of the items covered in the Exit Conference Report. Tr. 54, 56-64. NASD Staff testified “some of...the information...we did receive.” Tr. 64. However, NASD Staff was unable to specify what NASD had and had not received, testifying “I would have to itemize it. I don’t know” and “I’m talking about maybe four to five items.” Tr. 64, 68, 76–78. While NASD Staff thought that Respondents may have been responding to earlier, July 12 and 14, 2005, inquiries, apparently the same information was also requested in the Exit Conference Report, so it could have been responsive. Tr. 64. Neither the July 12 and 14 requests nor Respondents’ responses were included in Enforcement’s exhibits.

Because NASD Staff admitted to receiving some responses, but failed to offer them into evidence, Enforcement’s case rested on generalized NASD Staff testimony that Respondents failed to provide complete responses. However, the Panel did not find this testimony sufficient to sustain Enforcement’s burden of proof, particularly given that NASD Staff was unable to identify any specific information that they did not receive.⁸ Moreover, the Panel was disturbed that two NASD Staff members testified that Respondents did not respond to the final disposition letter that Staff sent to Respondents following the Exit Conference Report – testimony that

⁸ Enforcement did introduce a Staff analysis of the integrated response to the Exit Conference Report that Respondents provided after the filing of the complaint. CX-32, see, CX-31; Tr. 33, 147, 148, 304-306, 310-312. However, the fact that items were omitted from this integrated response does not negate the possibility that responsive information and documents may have been provided earlier.

Enforcement Counsel was later required to correct.⁹ Tr. 152, 197, 221- 224. This response was relevant, because apparently the final disposition letter covered some of the items the Staff had requested in the earlier Report. Tr. 150, 151, 198. However, again, Enforcement did not include the final disposition letter and Baldwin's response in its exhibits.¹⁰

Based upon the record before it, therefore, the Panel was unable to find that Respondents failed to respond to NASD Staff requests for information and documentation relating to the Exit Conference Report.

B. Requests for Information as to Respondent CMG's Capitalization

On September 26, 2005, the U.S. Securities and Exchange Commission Staff ("SEC Staff") called Respondent Baldwin and advised him that CMG's net capital was below the minimum amount required by SEC Rule 15c3-1.¹¹ CX-10; Tr. 84. SEC Staff calculated that CMG was under capitalized by at least \$44,000. Tr. 84, 85. In response, Baldwin stated that he would contribute \$75,000 to the firm's capital to correct this deficiency. *Id.*; Tr. 86, 87.

On October 13, 2005, SEC Staff sent a letter confirming its September 26, 2005, communication with Baldwin, and noting that the \$75,000 had not been contributed as promised. CX-10; Tr. 86, 87. SEC Staff requested that Baldwin provide "a deposit ticket or bank statement evidencing the deposit of funds, and a written resolution stating that any funds so contributed are

⁹ One Staff member correctly testified that NASD received a response to the final disposition letter relating to some of the same issues raised in the Exit Conference Report. Tr. 66, 68.

¹⁰ Respondent Baldwin asserted that he substantively responded to the Exit Conference Report prior to the filing of the Complaint, asserting that he "answered all of these questions, multiple times." Tr. 302 - 304. Baldwin claimed that he could establish this based upon facsimile and Fed Ex receipts. See, May 9, 2006, Initial Pre-Hearing Conference Transcript, p. 7 - 10; Tr. 303-305. Again, at the hearing, Baldwin claimed that he had "a copy of all these letters that I forwarded to the district." Tr. 315. However, he never produced them. While the Panel found Baldwin's testimony unpersuasive, because Enforcement failed to meet its burden of showing that Respondents did not respond to NASD Staff requests relating to the Exit Conference Report, it was not incumbent upon Respondents to show that they did comply.

¹¹ CMG is a "\$5,000 Broker," meaning that it is permitted to operate with just \$5,000 in net capital under SEC Rule 15c3-1(a)(2)(vi), and was not permitted to engage in proprietary trading. Tr. 83, 181, 182.

in fact permanent capital of the firm and do not represent a loan.” Consistent with its practice, SEC Staff sent NASD a copy of this letter, and through this letter NASD Staff became aware of the SEC’s inquiry. CX-10; Tr. 82 – 85, 88.

On October 20, 2005, Baldwin met with SEC Staff and provided a deposit slip showing that he had deposited \$100,000 into a bank account in the name of CMG on October 19, 2005. He also provided a record indicating that the funds came from an entity called FX Trading. With this deposit, SEC Staff told Baldwin, NASD, and CMG’s clearing broker that CMG appeared to be net capital compliant.¹² Tr. 105 -109.

On or about October 20, 2005, Baldwin also provided SEC Staff with CMG financial statements, including a balance sheet for October 12, 2005, showing a receivable from FX Trading of \$3 million, and a document entitled “trader transactions” purporting to show \$3 million held in a CMG account. CX-11, CX-26 p. 7, CX-28 p. 3; Tr. 89. SEC Staff viewed this documentation as suspicious, for several reasons. The account statement showing the \$3 million was noted as reflecting a “Day” value, rather than a typical one month period; Chicago was misspelled on the customer’s address; the \$3 million equity included an additional digit and did not line up with the numbers above it, suggesting the document might have been altered; and the document referred to “Acct ID: 140,” but there was no indication that the account was with FX Trading. Finally, the document referred to a website address that did not match the FX Trading website. CX-28; Tr. 105-112.

As a result, the SEC Staff told Baldwin that CMG could not count the \$3 million as capital until its existence could be confirmed. Tr. 106. The SEC Staff attempted to verify the

¹² The SEC Staff’s conclusion changed however, on December 15, 2005, when Baldwin stated that the \$100,000 had been returned, and therefore, could not be counted as permanent capital. Tr. 109, 110, 119-121.

source of the funds by contacting FX Trading, but FX Trading failed to respond.¹³ Tr. 100, 101, 111.

On November 18, 2005, the SEC Staff sent Baldwin a letter confirming this conversation. CX-12. SEC Staff also stated that, because FX Trading had not verified that the funds existed, Baldwin was required to immediately provide proof of the source of the funds in the form of a deposit ticket and bank statement. SEC Staff also noted that it called Baldwin several times, but he did not respond.¹⁴ Again, NASD Staff was copied on this letter. CX-12; Tr. 86-91. NASD Staff also received CMG's October 12, 2005, financial statements showing the \$3 million capital contribution, as well as certain preliminary documentation offered by Respondents to NASD Staff, purporting to document the contribution. Tr. 163-165.

NASD has an independent obligation to ensure that its members comply with the net capital rule. In light of the information and documents received from the SEC and Respondents, NASD Staff was concerned about the validity of the \$3 million capital contribution, as well as the \$100,000 capital contribution, which purportedly had come from FX Trading. Tr. 155, 163-165. Accordingly, on November 29, 2005, NASD Staff made a Rule 8210 request to Respondents for additional documentation as to the source of the \$3 million, including bank statements reflecting the source of the funds, account statements for CMG's account number 140 at FX Trading from July through October 2005, and all documentation characterizing the funds

¹³ The SEC Staff also contacted the National Futures Association ("NFA"), the regulatory agency for FX Trading, and explained its inquiry into the \$3 million capital contribution purportedly made by FX Trading. After this contact, the NFA visited the offices of FX Trading and took action to suspend FX Trading and its principal, Shaheryar Kahn, based upon their failure to demonstrate compliance with NFA requirements. CX-33; Tr. 101-103.

¹⁴ On December 21, 2005, CMG's outside counsel sent a letter to SEC Staff providing further information as to the \$3 million capitalization, and stating it would provide information as to the \$100,000 capitalization at a later time. SEC Staff found the documentation suspicious, and thought certain items may have been altered. CX-26 p. 3-17; Tr. 91-97.

as a loan or contribution to CMG. NASD Staff gave Respondents until December 7, 2005, to respond.¹⁵ CX-13; Tr. 155-157.

When NASD Staff did not receive a response by the deadline, it reiterated its request in a December 8, 2005, letter. NASD Staff delivered the letter to CMG by hand, hoping to examine the requested documents in the CMG offices that day.¹⁶ CX-16; Tr. 157, 158. However, NASD Staff did not call ahead to arrange this, and left without seeing any documents when CMG staff informed them that the documents were locked in Baldwin's office, and that he was in a meeting. Tr. 202-203, 226-228, 244, 245. CMG staff said that the documents would be faxed to NASD Staff later that day. However, they never were. Tr. 163, 165, 229.

On December 13, 2005, Respondents sent a letter to NASD asserting that the \$3 million capital contribution was immaterial to the firm's net capital compliance. CX-22. Respondents had apparently determined that the purported \$3 million capital contribution was not material, so they would not respond to NASD Staff's request for documents relating to that capital contribution. However, NASD Staff continued to press for this information. CX-30; Tr. 178, 179.

At approximately the same time, the SEC Staff was experiencing the same frustration in its efforts to receive information on the purported \$3 million capital contribution. On December 15, 2005, the SEC Staff met with Baldwin, who then contradicted his earlier statement that he was the source of the \$3 million, and claimed that the funds came from a foundation. Tr. 111, 112. He also said that documentation as to the source of the \$3 million contribution was not then

¹⁵ On December 7, 2005, NASD Staff sent Respondents a letter noting that CMG had not demonstrated that it was currently in net capital compliance as required by SEC Rule 15c3-1, and stating that firms out of compliance with net capital requirements were required to cease conducting business. CX-17; Tr. 203.

¹⁶ Respondents stipulate that they received these requests. Tr. 160.

available, but would be provided at a later date. *Id.* During that meeting, Baldwin also said that CMG had returned the prior \$100,000 capital contribution. Because such a temporary infusion of funds is treated as a loan, not as permanent capital, CMG was then out of compliance with the net capital requirement.¹⁷ Tr. 110, 119.

On December 21, 2005, CMG's outside counsel sent a letter to SEC Staff claiming that Baldwin had requested information regarding the transfer of the \$3 million from the transferor, which was identified as Amaranth Holdings, but Baldwin had not received a response. CX-26 p. 3; Tr. 114. The letter also stated that information as to the \$100,000 capitalization would be provided at a later time. CX-26 p. 3-17.

During December 2005, there were a number of telephone messages between NASD Staff and Baldwin. In one of these messages, Baldwin starkly expressed his unwillingness to respond to NASD Staff's inquiry:

I'm telling you this so you clearly get it; the \$3 million came from an account from me. That's at FX. Prior to where it came to from that is, quite frankly, none of your business. It came from another account from me, but I'm not going to share that with you because I don't think you've been the most scrupulous of people.

CX-30 p. 8. The voicemail went on to say that Baldwin would send NASD the information regarding CMG's account at FX Trading. However, he never did. Tr. 163, 165.

At the hearing, Baldwin surprisingly testified that he did not have CMG's account records with FX Trading, and this is why he could not produce them. Tr. 333-337. He then provided, for the first time, a detailed explanation of the transaction resulting in the \$3 million capital contribution, including people and entities involved in the transaction. Tr. 338-355. To

¹⁷ *Dep't. of Enforcement v. Investment Management Corp.*, No. C3A010045, 2003 NASD Discip. LEXIS 47 (NAC Dec. 15, 2003). On January 4, 2006, the SEC received information from Respondents' outside counsel documenting a \$200,000 capital contribution to CMG, which put CMG back into capital compliance. CX-26 p. 8; Tr. 118.

say the least, Baldwin's explanation, which the Panel found to be inconsistent and unconvincing, would have prompted further inquiry, had it timely been provided to the NASD Staff prior to the filing of the Complaint.

In finding that Respondents failed to respond to NASD Staff requests for information to support the \$3 million capital contribution to CMG, the Panel gave particular weight to Baldwin's express refusal to provide information as to the source of the capital contribution when he commented that this was "frankly, none of your business." CX-30, p. 8. The Panel also considered Respondents December 13, 2005, letter response, which dismissed the Staff's inquiry into the \$3 million capital contribution as immaterial, rather than responding to it. CX-22. In addition, the Panel considered that while Respondents claimed that they were unable to provide information in response to NASD Staff requests, Baldwin was able to offer detailed information as to the transaction in the form of testimony at the hearing – testimony that raised more questions than it answered.

For these reasons, the Panel found that Respondents failed to respond to NASD's requests for information and documents concerning Respondents' capital contributions, in violation of Rules 8210 and 2110.¹⁸

IV. Sanctions

The NASD Sanction Guidelines ("Guidelines") provide that for a failure to respond to Rule 8210 requests, a bar is the standard sanction for the responsible individual, and in egregious cases, the firm should be expelled.¹⁹ Enforcement requests that CMG be expelled and Baldwin barred for their violations, and Respondents request that no sanction be imposed.

¹⁸ A violation of Rule 8210 is also a violation of Rule 2110, contravening "high standards of commercial honor." *Dep't of Enforcement v. Baxter*, No. C07990016, 2000 NASD Discip. LEXIS 3, at *25 (NAC, Apr. 19, 2000).

¹⁹ *Guidelines* at 35 (2006 ed).

In assessing sanctions, the Guidelines suggest consideration of the nature of the information requested, whether it was provided, the number of requests made, the time respondent took to respond, and the degree of regulatory pressure required to obtain a response.²⁰

Here, NASD's inquiry was serious, involving a large, suspicious, capital contribution intended to bring CMG into compliance with the net capital rule. While the requests spanned a fairly brief period of time, they were repeated, and involved NASD's in-person visit to Respondents' office. Nonetheless, Respondents' refusal was knowing and unequivocal – as was vividly illustrated by Baldwin's hostile voicemail refusing to provide information – an act that the Panel found to be an aggravating factor in assessing sanctions.

The Hearing Panel finds that Respondents' conduct was egregious, and, therefore, finds it is appropriate to expel CMG from NASD membership and to bar Baldwin from associating with any NASD member in any capacity for failing to respond to NASD Staff requests for information pursuant to Rule 8210. In light of the expulsion and bar, no fines will be imposed.

V. Conclusion

Respondent CMG Institutional Trading, LLC is expelled from NASD membership and Respondent Shawn D. Baldwin is barred from associating with any NASD member in any capacity for failing to respond to requests for information, in violation of Rules 8210 and 2110. If this decision becomes NASD's final disciplinary action in this matter, the expulsion and the bar shall become effective immediately.

HEARING PANEL

By: Sara Nelson Bloom
Hearing Officer

²⁰ *Id.*

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