FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. MICHAEL JENNINGS (CRD No. 702719), BRIAN MULVEY (CRD No. 2286524), and RESPONDENT 3, Respondents.	Disciplinary Proceeding No. 2008013864401 Hearing Officer—Andrew H. Perkins **AMENDED HEARING PANEL DECISION**[1] March 4, 2013

Respondents Jennings and Mulvey violated NASD Conduct Rule 2110 by shadowing trades in a customer's accounts. Jennings is suspended from associating with any FINRA registered firm for ten business days and fined $20,000, and Mulvey is fined $5,000. They are also ordered to pay the costs of this proceeding.

The charge that Respondent 3 failed to supervise Jennings and Mulvey is dismissed.

Appearances

For the DEPARTMENT OF ENFORCEMENT, Complainant, Frank Mazzarelli, Esq., and Lane Thurgood, Esq., Rockville, Maryland.

For Michael Jennings, Respondent, Joseph A. Sack, Esq., THE SACK LAW FIRM PLLC, Purchase, New York.

For Brian Mulvey, Respondent, Andrew W. Sidman, Esq., and David G. Buffa, Esq., BRESSLER, AMERY & ROSS, P.C., New York, New York.

For Respondent 3, Theodore A. Krebsbach, Esq., MURPHY & MCGONIGLE, P.C., New York, New York.

[1] This amended decision modifies the commencement date for Respondent Michael Jennings' suspension. No other changes have been made to the original decision.

DECISION

I. INTRODUCTION

Respondents Michael Jennings, Brian Mulvey, and Respondent 3 were formerly associated with Deutsche Bank Securities, Inc. Jennings and Mulvey were financial advisers employed in Deutsche Bank's Boston branch office. Respondent 3 was their supervisor and the managing director of the Boston branch office.

While at Deutsche Bank, Jennings and Mulvey "shadowed" trades of third-party managers in accounts Jennings and Mulvey established for that purpose and managed on a discretionary basis for their joint customer, the H family. As used in this disciplinary proceeding, "shadowing" refers to the practice of replicating the confidential strategies and trading activities of third-party managers who had contractual agreements with Deutsche Bank to provide services to its customers without the third-party managers' knowledge or consent.[2] By shadowing investment managers' trades in this manner, Jennings and Mulvey were able to misappropriate the third-party managers' trading strategies without incurring the fees that otherwise would have been due the third-party managers if Jennings had left the accounts with the third-party managers who were enrolled in Deutsche Bank's "Adviser Select" program, which was one of several investment advisory services Deutsche Bank offered customers under its "Charter Select" program.

[2] Deutsche Bank prohibited shadowing, which it defined as "the act of using the complete portfolio of a third party manager as a substitute to determining and evaluating suitable investments for managed accounts handled by [the firm's financial advisers]." CX-4, at 14.

Enforcement's are identified with the prefix "CX"; Jennings' exhibits with the prefix "J"; and Respondent 3's exhibits with the prefix "D." Mulvey's exhibits are identified as "Mulvey Ex." followed by the exhibit letter and number (*e.g.*, "Mulvey Ex. D-4").

Deutsche Bank customers who enrolled in the Charter Select program elected to have their accounts managed either by Deutsche Bank financial advisers under the "Managed Select" program or by third-party managers under one of several other programs, one of which was the Adviser Select program. Under the Managed Select program, customers grant discretionary trading authority to their Deutsche Bank financial advisers. Under the Adviser Select program, the customers' financial advisers recommend third-party managers who are then appointed and granted discretionary trading authority over the customers' accounts. Each of the third-party managers Jennings and Mulvey shadowed had contracts with Deutsche Bank under the Adviser Select program.

When Jennings and Mulvey left Deutsche Bank in May 2008 for another brokerage firm, Deutsche Bank reassigned the H family accounts to another team of financial advisers. Immediately, a member of the new team discovered evidence of shadowing in 13 H family Managed Select accounts and alerted Respondent 3. In turn, Respondent 3 immediately notified Deutsche Bank's compliance and legal departments. Deutsche Bank then conducted an investigation to determine the extent of shadowing nationwide. Deutsche Bank confirmed that Jennings and Mulvey had engaged in shadowing in accounts they managed on a discretionary basis as Managed Select accounts. Deutsche Bank reported its findings to FINRA, which then initiated an investigation that led to this disciplinary proceeding.

The Department of Enforcement charged Jennings and Mulvey with violating their duty to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business, and Respondent 3 with failing to supervise Jennings and Mulvey.

Jennings and Mulvey admit that they shadowed trades made by four third-party managers in the 13 H family accounts Jennings established for that purpose, but argue that the Hearing Panel must dismiss the charges against them because (1) there is no FINRA rule specifically prohibiting shadowing, (2) Deutsche Bank managers approved their activity, and (3) shadowing was an open and common practice in Deutsche Bank's Boston branch office. In direct contradiction to Jennings and Mulvey's contentions, Respondent 3 denied that he knew of the practice and that he had approved shadowing for the H family.

The Hearing Panel rejects Jennings' and Mulvey's defenses and concludes that they violated just and equitable principles of trade by shadowing Deutsche Bank's third-party managers. Jennings is suspended from associating with any FINRA member firm in any capacity for ten business days and fined $20,000. Mulvey is fined $5,000.

Respondent 3 reasonably supervised Jennings and Mulvey. Accordingly, the Hearing Panel dismisses the charge against him.

II. PROCEDURAL HISTORY AND JURISDICTION

Enforcement initiated this disciplinary proceeding on June 28, 2011, by filing a complaint with the Office of Hearing Officers. Respondents filed their answers to the complaint on August 9, 2011, denying the charges and requesting a hearing.[3] The complaint contains two causes of action. The first charges Jennings and Mulvey with violating NASD Conduct Rule 2110 by shadowing the trades of four third-party

[3] Jennings filed an amended answer a month later.

managers. Rule 2110 (now FINRA Rule 2010) requires members, "in the conduct of [their] business, [to] observe high standards of commercial honor and just and equitable principles of trade." Rule 2110 applies to Jennings and Mulvey through NASD General Rule 115 (now FINRA Rule 140), which provides that persons associated with a member have the same duties and obligations as a member. The second cause of action charges Respondent 3 with violating NASD Conduct Rules 3010 and 2110 by failing to supervise Jennings and Mulvey. NASD Rule 3010(a) requires members to establish and maintain a system to supervise the activities of each registered representative and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and FINRA's rules.

In November 2011, Jennings and Mulvey filed motions for summary disposition, which the Hearing Panel denied because the motions failed to establish that there were no genuine issues of material fact in dispute.

The hearing was held in May and August 2012.[4]

III. FINDINGS OF FACT

A. Respondents' Backgrounds In The Securities Industry

Jennings, Mulvey, and Respondent 3 are experienced securities professionals. Jennings started his career in 1979. He spent approximately 19 years at his first firm before joining DB Alex. Brown LLC, which later merged into Deutsche Bank.[5] While he was associated with Deutsche Bank, Jennings was registered with FINRA as a General

[4] The Hearing Panel is composed of a Hearing Officer, a member of FINRA's District 11 Committee, and a member of FINRA's District 9 Committee.

[5] For convenience, in this decision Deutsche Bank also refers to DB Alex. Brown.

Securities Representative. Jennings left Deutsche Bank in May 2008 to join his present firm where he is registered with FINRA as a General Securities Representative.[6]

Mulvey started his securities career in 1992, shortly after graduating from college.[7] In 1996, he joined Deutsche Bank, where he was registered as a General Securities Representative.[8] Apart from a short period when he left to start his own business, Mulvey was a financial adviser with Deutsche Bank until May 2008, when he left with Jennings to join their current firm where he is registered with FINRA as a General Securities Representative.[9]

Respondent 3 went to law school after college and then practiced law for seven years before he returned to college to pursue a business degree. Following graduation from business school at Dartmouth, he entered the securities industry in 1998 as a financial adviser. In 2004, his firm asked him to manage its Boston branch office, which he agreed to do. Between late 2004 and 2006, Respondent 3 ran that office, with responsibility for between 17 and 30 financial advisers. In October 2006, he left to manage Deutsche Bank's Boston branch office.[10]

While at Deutsche Bank, Respondent 3 was registered with FINRA as a General Securities Representative and a General Securities Sales Supervisor.[11] He left Deutsche Bank in September 2009 and currently works for a private wealth management firm

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[6] Tr. 423; CX-28, at 2-5.

[7] Tr. 791.

[8] CX-29, at 2-7.

[9] Tr. 792.

[10] Tr. 1050-53.

[11] CX-30, at 2.

where he holds the positions of chief executive officer and general counsel.[12] He is currently registered with FINRA as a General Securities Representative.[13]

None of the Respondents has a prior disciplinary history.

B. Jennings and Mulvey's Partnership At Deutsche Bank

1. Background

In early 1999, Jennings formed a partnership with Doug Sanders, another broker in Deutsche Bank's Boston branch office. Originally they joined forces because they had some clients in common.[14] As partners, they shared clients, assistants, and income.

Over the years, Jennings and Sanders expanded their partnership. They added Mulvey in 2002 and Robin Monleon in January 2006.[15] The partnership operated as "Team 107."[16] All of the team members' activity was reported under the Team 107 production number although each member had primary responsibility for servicing the clients he introduced to Deutsche Bank.[17]

The Team 107 members split revenue among themselves based upon a trailing three-year average of their individual production. After deducting Deutsche Bank's share, they would determine each member's average production over the previous three years and then calculate a percentage split. By 2007, Jennings, Mulvey, and Sanders had equal percentages, and Monleon received a much smaller share.[18] Monleon received less

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[12] Tr. 1054-55.

[13] Tr. 1054.

[14] Tr. 424.

[15] D-15, at 7.

[16] Tr. 975.

[17] Tr. 800-01.

[18] Tr. 801-03. Mulvey testified that he recalled the split in 2007 was 30% each for Jennings, Sanders, and himself, and 10% for Monleon.

because he was new to the business and therefore did not have a large client base. Monleon had been an executive in the technology industry and one of Team 107's clients before joining Deutsche Bank.[19] Jennings and Mulvey asked him to join Team 107 because of his management and operational background. Monleon spent most of his first few months with Deutsche Bank studying for the securities licensing exams. Jennings and Monleon remain partners at their present firm.[20]

For the most part, Jennings and Mulvey (as well as the other Team 107 members) did not recommend individual stocks to their clients. Rather, their basic business model was asset allocation and manager selection for their clients. The equity allocations were in either separately managed accounts or mutual funds.[21] By the time the team left Deutsche Bank in May 2008, they were managing approximately $1 billion in assets, of which approximately $140 million was invested in either Adviser Select or Managed Select accounts, and were producing approximately $8.4 million in fees annually.[22] Team 107's production equaled 20 to 25% of the total production of Deutsche Bank's Boston branch office, and the team was one of the top two producing teams in the office. The other was the team of John Lechner, Clay Yungst, and Terrence McMahon.[23]

2. The H Family Account

The H family was Team 107's largest client and one of the largest in Deutsche Bank's Boston branch office.[24] In total, the H family had roughly $100 million spread

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[19] Tr. 280-81.

[20] Tr. 352.

[21] Tr. 794-95, 964, 977, 1034-35.

[22] Tr. 426-27.

[23] Tr. 239, 427-28.

[24] Tr. 517-18.

across separate trust accounts for the benefit of the H family's children.[25] Team 107 earned between $1 million and $1.5 million per year from the H family accounts.[26] During the time in question, MR and HH were the trustees for each trust. HH is a certified public accountant who works full time managing the family's business affairs. MR is a corporate attorney in private practice at a large Boston law firm. Of the two trustees, HH was far more involved in the trusts' day-to-day management and was Jennings' primary contact.[27]

Jennings first began work with the H family in 1992 while he was at his first firm. Originally, the H family had their accounts spread across a number of managers. However, Jennings ultimately persuaded the family to consolidate their investment accounts with him at Deutsche Bank.[28] Once the accounts were consolidated, Jennings allocated the assets to a broad number of asset classes, including private equities, equities, fixed income, commodities, international, and hedge funds. The accounts had a heavy weighting in private equities, and a relatively small percentage in separately managed accounts with third-party managers through the Adviser Select program.[29]

Financial advisers at Deutsche Bank had discretion to set the rate they charged their clients up to a ceiling set by the firm. In the H family accounts, Jennings charged 1.5%.[30] However, HH constantly pressured Jennings to charge lower fees or he would move some or all of the accounts to a firm that had done work for the H family in the past

[25] Tr. 585-86, 943.

[26] Tr. 545-46.

[27] Tr. 440.

[28] Tr. 583-85.

[29] Tr. 586.

[30] Tr. 444.

and which was offering to charge no more than 1.1% on the managed accounts.[31] To keep the H family business, Jennings proposed lowering fees on the managed accounts by taking the "thinking" of the third-party managers on one beneficiary's account and spreading it among the other beneficiaries with the same investment profile.[32] Jennings reasoned that his plan would give the H family the benefit of the third-party managers' expertise without paying them for it while keeping his fees constant. In Jennings' words, he designed the plan to be revenue neutral to Team 107.[33]

Jennings explained to HH that the plan would work because the children had identical assets and investment policy statements.[34] Jennings further justified his proposal by pointing out to HH that the third-party managers for the three younger children's accounts were being paid "to do the same job in identical situations three times over."[35] At the hearing, Jennings acknowledged that his reasoning "[didn't] sound like a great justification right now."[36]

To facilitate the shadowing, Jennings had to open new accounts for that purpose and create "dispersion reports" so that HH could monitor the performance of the new Managed Select accounts against the performance of the shadowed Adviser Select accounts that remained with the third-party managers.[37] To prepare the dispersion reports, Jennings went "through every single account and put together a spreadsheet that basically

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[31] Tr. 444-45, 940.

[32] Tr. 445, 572.

[33] Tr. 457.

[34] Tr. 445.

[35] Tr. 478.

[36] Tr. 478.

[37] Tr. 462-63.

noted the amount of dispersion in the returns between the accounts that were run by the [third-party managers]" and the Managed Select accounts he established.[38] The dispersion reports showed that Jennings kept the shadow accounts identical to the accounts they shadowed.[39] Jennings sent the dispersion reports to HH each quarter.[40] Jennings never showed the reports to Respondent 3 or to anybody in Deutsche Bank's compliance department.[41]

Jennings opened 13 Managed Select accounts to shadow the third-party managers. Because they were Managed Select accounts, Jennings and his team had discretionary authority over the accounts. The sole purpose of these new accounts was to create a cost-free vehicle to copy the trading strategies of four third-party managers. Jennings learned about shadowing from Mulvey, who had used the technique for a number of years in approximately 12 other accounts, albeit for different reasons.[42] Mulvey, however, did not participate directly in formulating the shadowing scheme for the H family or in setting up the accounts.

Jennings did not consider lowering the fees he charged the H family to keep the family's accounts because he felt entitled to the full amount. As he explained in response to being asked why he had not cut his fee rather than the amount the third-party managers received, it had "everything to do with this sense of entitlement that I had … We did a really good job. We felt we were entitled to pay and we didn't feel there was any reason

[38] Tr. 462.

[39] Tr. 463.

[40] Tr. 462.

[41] Tr. 544, 752.

[42] Tr. 522-23, 804-07.

that our pay should be discounted particularly."[43] He also did not approach any of the third-party managers to explore cost-cutting strategies or to seek their permission to shadow their investment strategies.[44] Jennings acknowledged that his shadowing harmed the third-party managers, but he justified his actions by the fact that he provided the managers with a lot of business.[45]

Jennings set up his shadowing plan by dividing the H children into two groups. One group was composed of the three younger children whose trust accounts were identical in size and style. The second group was composed of the three older children. The principal difference between the two groups was that the younger children had significantly more assets in their trust accounts and therefore their accounts were placed with four separate third-party managers whereas the older children's accounts were with one third-party manager.

Jennings set up a total of eight shadow accounts for two of the younger children, one account each for each of the four Adviser Select accounts.[46] To duplicate the investment strategies and transactions of the four third-party managers, Jennings and Mulvey copied the transactions the managers entered the day before in one child's accounts into the corresponding new Managed Select accounts for the other two.[47] Jennings and Mulvey could see the holdings and activity in shadowed accounts because the third-party managers in the Adviser Select program used Deutsche Bank's trading platform. Thus, Jennings and Mulvey could monitor all activity in the shadowed Adviser

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[43] Tr. 556.

[44] Tr. 515-16.

[45] Tr. 509.

[46] Tr. 454.

[47] Tr. 456.

Select accounts on a real-time basis and duplicate that activity in the eight Managed Select accounts Jennings established for shadowing.

Jennings established a similar scheme for the three older children. However, because the accounts were smaller, their accounts were with a single third-party manager. Each of the older children had identical individual trusts, and two had identical additional trusts, which they referred to as the middle name trusts.[48] Thus, for the older children, Jennings opened five new Managed Select accounts to shadow the third-party manager's strategy. The shadowing in these accounts worked the same way as it did in the accounts he established for the younger children. Each morning, Jennings or Mulvey would look at the previous day's activity and duplicate the trades from the Adviser Select accounts in the Managed Select accounts.

In the 14 months between April 2007 and May 2008, Jennings and Mulvey entered 1504 shadowed transactions in the 13 accounts.[49] Jennings entered 905 (or 60%) of the transactions, and Mulvey entered 599 (or 40%) of the transactions.[50] Jennings could not have executed the shadowing scheme without the direct access Deutsche Bank's Advisor Select program gave him to the third-party managers' trading activity.

C. Respondent 3 Learns Of The Shadowing In The H Family Accounts

Respondent 3 first learned of the shadowing in the H family accounts in May 2008 when the Team 107 members left Deutsche Bank to join another broker-dealer. Deutsche Bank discovered their impending departure from e-mail traffic between Team

[48] Tr. 455.

[49] CX-25; Tr. 134.

[50] Tr. 134.

107 members and their prospective firm.[51] Upon discovering their plans, Deutsche Bank asked that they resign and assigned their accounts to other financial advisers in the Boston branch office.[52] Deutsche Bank reassigned the H family accounts to the Lechner team, which included McMahon.[53]

McMahon's primary responsibilities on the Lechner team were risk management and asset allocation.[54] He monitored holdings in the team's accounts and researched the third-party managers Deutsche Bank had under contract in the Adviser Select program. As a result of those responsibilities, he was familiar with the Adviser Select third-party managers and the holdings in their portfolios.[55]

When the Lechner team assumed responsibility for the H family accounts, McMahon immediately began to review the holdings in the Managed Select accounts to understand how they were managed.[56] McMahon noted from his review that there were many individual stocks in the Managed Select accounts that would require active management by one of his team's financial advisers. He also realized that there appeared to be an overlap between the holdings in the accounts and those he knew to be in accounts managed by some of the managers in the Adviser Select program. McMahon then performed a side-by-side comparison of the holdings in the H family Managed

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[51] Mulvey testified that the team wanted to leave because Deutsche Bank was not committed to the wealth management business. Tr. 793. Monleon said he suggested that they leave Deutsche Bank because it lacked the degree of operational support larger firms provided in the team's business sector. Tr. 293-94.

[52] Tr. 1076-77.

[53] Tr. 241, 1077.

[54] Tr. 249-51, 258.

[55] Tr. 258.

[56] Tr. 241-42.

Select accounts with the composite profile of the third-party managers.[57] McMahon confirmed a significant overlap in the holdings, which he reported to Respondent 3.[58] McMahon told Respondent 3 that he estimated that 95% of the holdings in the H family Managed Select accounts were the same as those held by certain third-party managers.[59] Respondent 3 asked McMahon to show him the account documents and explain his findings in greater detail.[60] Respondent 3 expressed surprise at McMahon’s findings.[61]

After looking at the account statements in detail, Respondent 3 concluded that McMahon’s assessment was correct. Team 107 had copied the holdings and activity in similar Adviser Select accounts. Respondent 3 was not very familiar with the practice of shadowing.[62] He therefore sought guidance from Deutsche Bank’s legal and compliance group in New York City.[63] Respondent 3 also notified his immediate supervisor, Michael Burke, who headed private client services for the firm.[64] Respondent 3 was advised that Deutsche Bank had a written policy prohibiting shadowing.[65] The following day, Deutsche Bank’s legal department began a comprehensive firm-wide investigation of shadowing that took months to complete.[66]

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[57] Tr. 242.

[58] Tr. 242.

[59] Tr. 243.

[60] Tr. 1078.

[61] Tr. 248, 263.

[62] Respondent 3 had heard of the concept of shadowing years earlier at another firm, but he did not have an understanding of how it worked. He had never engaged in shadowing or dealt with it in his capacity as a manager. Tr. 1072-73.

[63] Tr. 1078.

[64] Tr. 1078.

[65] Tr. 1079.

[66] Tr. 1079.

In addition to reporting the shadowing to Deutsche Bank, Respondent 3 and McMahon alerted the affected third-party managers,[67] and Respondent 3 directed McMahon to inform HH of their findings. McMahon spoke to HH on May 16, 2008, the day after Jennings, Mulvey, and the other Team 107 members departed Deutsche Bank. McMahon summarized their conversation in an e-mail he sent to HH later the same day.[68] McMahon's e-mail recounts the four topics he discussed with HH. First, McMahon offered to cut the fees on all Adviser Select and Managed Select accounts from 1.2% to 1.0%, which McMahon estimated would save the H family approximately $48,500 per year. Second, McMahon identified the 13 accounts that Team 107 had managed as "mirror" or shadow accounts.[69] Third, McMahon acknowledged HH's request that the Lechner team update the Managed Select accounts to incorporate any trades made in the shadowed Adviser Select accounts since Jennings and his team left to ensure that the Managed Select accounts' performance equaled that of the shadowed accounts. Fourth, McMahon recommended that the H family convert the Managed Select accounts to Adviser Select accounts because his team was not comfortable with the shadowing strategy Team 107 had employed.

Upon receipt of McMahon's e-mail, HH requested a meeting with McMahon and his team "to discuss your approach to managing the assets that we currently have at Deutsche Bank."[70] The requested meeting was held. The following persons attended: Dr. and Mrs. H; the trustees, HH and MR; Lechner team members McMahon and Yungst;

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[67] Tr. 244-45.

[68] J-39.

[69] J-39, at 2.

[70] J-39, at 1.

Respondent 3; and Burke.[71] Although the purpose of the meeting from the client's perspective was to review the accounts and their asset allocations, the Deutsche Bank team also saw the meeting as an opportunity to convince the H family to keep its accounts at Deutsche Bank.

D. The H Family Meeting In May 2008

In their defense, Jennings and Mulvey placed great emphasis on Trustee MR's account of the H family meeting in May 2008. Jennings and Mulvey contended that Respondent 3 made statements at the meeting that supported their claim that Deutsche Bank had approved of shadowing generally and that Respondent 3 specifically had approved shadowing in the H family accounts. We disagree.

MR testified that he was far less involved in the day-to-day management of the trusts than his co-trustee, HH.[72] Pertinent to this case, he testified that he was not aware of the shadowing or the dispersion reports Jennings prepared for HH.[73] MR first heard of shadowing at the meeting with Deutsche Bank in May 2008 after Jennings and Mulvey had left the firm. Thus, when McMahon and Respondent 3 disclosed the shadowing activity at the meeting, it took on greater significance to him than it did to HH and the others at the meeting who knew about it beforehand. His surprise led MR to form the view that the shadowing issue was the "highlight" of the meeting.[74] MR concluded that Deutsche Bank had called the meeting to "pitch" the reasons the H family should leave

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[71] Tr. 245.

[72] Tr. 583.

[73] Tr. 588.

[74] Tr. 591.

their accounts at Deutsche Bank and that it used Jennings and Mulvey's unethical shadowing as the primary reason for not following them to their new firm.[75]

Although MR could not recall the exact words Respondent 3 used at the meeting, his best recollection was that Respondent 3 told them that shadowing was a "very bad thing and that [the H family] should reconsider whether or not to continue our relationship with [Jennings] and his team as a result of this," but shadowing did not violate Deutsche Bank's policies.[76] MR further testified that Respondent 3 told the H family that "he and others at Deutsche Bank were aware that the shadowing practice had been occurring."[77] However, MR admitted that he could not recall Respondent 3 specifying when they first discovered the shadowing.[78]

McMahon, who also attended the meeting, contradicted MR on significant points. McMahon testified that the H family asked Respondent 3 how Deutsche Bank discovered the shadowing, whether it was a common practice, and did Deutsche Bank's management consider it an unethical practice.[79] In response, Respondent 3 said shadowing was uncommon and unethical and that he had not been aware of the shadowing.[80] Importantly, McMahon denied that Respondent 3 made any statements justifying shadowing under any circumstances.[81]

[75] Tr. 590-92.

[76] Tr. 591. MR admitted that he could not recall Respondent 3 explaining how the practice could be unethical and yet be permitted by firm policy. *See* Tr. 618.

[77] Tr. 617-18.

[78] Tr. 618.

[79] Tr. 246.

[80] Tr. 246.

[81] Tr. 246-47.

The Hearing Panel finds that the evidence as a whole does not support Jennings and Mulvey's contentions that Respondent 3 admitted that he had known about shadowing for years before McMahon discovered it in the H family accounts and that Respondent 3 had approved shadowing in those accounts. McMahon testified unequivocally that Respondent 3 did not say he knew about Jennings' and Mulvey's shadowing or that Deutsche Bank's policies did not prohibit shadowing. The Hearing Panel found McMahon's testimony more reliable than MR's. McMahon had no reason to color his version of events to protect Respondent 3 or anyone else at Deutsche Bank.

McMahon's version of the meeting was corroborated by circumstantial evidence. The Hearing Panel places particular reliance on Respondent 3's actions in response to McMahon's report of shadowing. Respondent 3 immediately notified Deutsche Bank's legal and compliance group, directed McMahon to call HH, and notified the affected third-party managers. Nothing Respondent 3 did or said after McMahon reported his findings of shadowing supports Jennings and Mulvey's arguments that shadowing was an approved practice. In addition, the uncontested evidence shows that Deutsche Bank's legal and compliance group advised Respondent 3 before the May 2008 meeting that the firm had a written policy against shadowing in its Registered Investment Adviser Policy and Procedure Manual.[82] As such, there is no basis to conclude that Respondent 3 would have taken a different position at the meeting with the H family. To the contrary, Respondent 3's effort to persuade the H family to leave the accounts at Deutsche Bank would have been strengthened by showing that Jennings and Mulvey had violated firm policies.

[82] CX-4, at 14. The manual is dated October 5, 2004. The excerpt in evidence shows that it was updated on October 19, 2006. *Id*. at 1.

E. Jennings And Mulvey Did Not Have Management's Approval To Shadow Third-Party Managers

Another cornerstone of Jennings and Mulvey's defense was their argument that they had a good-faith belief that Deutsche Bank supervisors were aware of and explicitly approved shadowing in discretionary accounts, including the H family Managed Select accounts. Jennings and Mulvey point to three circumstances to support this argument. First, they contend that Mulvey had secured approval from Stuart Williams to shadow accounts for other clients. Williams managed the Boston branch office from approximately 1998 to 2006. Second, they contend that Deutsche Bank supervisors approved shadowing in the H family accounts through the account opening process. Third, they contend that Monleon questioned Respondent 3 about the practice in the H family accounts, and Respondent 3 told him it was permissible. The evidence does not support their contentions.

1. Mulvey Did Not Get Permission From Williams To Shadow Accounts

In 2001, Mulvey confronted a situation where a third-party manager, Systematic Financial, closed to new investors before Mulvey could complete an asset allocation plan he had devised for a new client. Mulvey had devised the plan assuming that he would be able to use Systematic. When Systematic closed, Mulvey went to Williams to ask if he could open a discretionary account in which he would replicate the trades Systematic made in his other clients' accounts.[83] Mulvey testified that he explained the situation to Williams and noted that he had heard of the practice from another financial adviser. Although the conversation took place more than ten years earlier, Mulvey testified that he

[83] Tr. 810-11.

recalled Williams exact reply—"[I]t's okay, you can do that."[84] Mulvey further claimed that he spoke to Williams in 2001 to 2002 about three other clients who had similar situations.[85] However, Mulvey could not provide details about those alleged conversations.

The Hearing Panel did not find Mulvey's testimony credible. First, there was nothing about the situation in 2001 that would make the conversation with Williams stand out. Mulvey testified that he did not see anything troubling about the request because he had observed another financial adviser doing something similar. Mulvey also did not point to any other reason to explain why he could recall the conversation so clearly. Second, Williams' testimony directly contradicted Mulvey's. Williams testified credibly that he recalled that Mulvey approached him sometime in the early 2000s about replicating trades made by one of Deutsche Bank's third-party managers.[86] Williams testified that it was hard to recall details because of the passage of time and the fact that he had not considered it a significant conversation at the time, but to the best of his recollection, Mulvey had asked him about replicating trades for accounts that did not meet the minimum account size for a particular manager.[87] Williams told Mulvey that it was not in his "jurisdiction" and that he would have to speak to the group in Baltimore that managed Deutsche Bank's relationship with the third-party managers.[88] Williams did confirm that he was aware that Mulvey engaged in the practice sometime after their conversation in a limited number of accounts. Williams assumed at the time that the

[84] Tr. 811-12.

[85] Tr. 812.

[86] Tr. 1025.

[87] Tr. 1025.

[88] Tr. 1025.

manager research group in Deutsche Bank's Baltimore office had approved Mulvey's request.[89] Therefore, he saw no need to follow up with Mulvey.

Williams' account and credibility is supported by a number of factors. First, Williams had no apparent bias or stake in the outcome of this proceeding. At the time of the hearing, he no longer worked with Deutsche Bank or any of the financial advisers associated with the H family. In addition, he had not been accused of any deficiency in his supervision of Deutsche Bank's Boston branch office. Second, Williams had unique knowledge of the Adviser Select program because he had managed it shortly after joining Deutsche Bank.[90] This experience gave him insight into the relationship between Deutsche Bank and the managers in the Adviser Select program and gives added credibility to his testimony that he believed at the time of Mulvey's request that the manager research group would need Systematic's consent before Mulvey could copy Systematic's transactions for one client account to a Managed Select account for another client.

Based on the foregoing, the Hearing Panel concluded that Mulvey had engaged in shadowing in as many as 12 accounts between 2001 and 2007, but Williams had not approved the activity. In addition, the Hearing Panel finds that Mulvey never asked Williams to approve copying trades to avoid paying fees to third-party managers. Accordingly, there is no factual basis for Jennings and Mulvey's assertion that they believed in good faith that the shadowing scheme Jennings devised for the H family accounts would meet with Deutsche Bank's approval.

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[89] Tr. 1047.

[90] Tr. 1024.

2. Deutsche Bank Did Not Approve Shadowing In The H Family Accounts By The Account Opening And Review Process

Jennings and Mulvey contend that Deutsche Bank supervisors Adrienne Tubridy and Nancy Meharg implicitly approved shadowing in the H family Managed Select accounts by permitting Jennings to open the accounts and by approving from time to time trades of low-priced stock in the Managed Select accounts. The Hearing Panel rejects both arguments.

Tubridy and Meharg[91] reported to Respondent 3. For the relevant period, Tubridy was the Administrative Manager and Meharg was the Operations Manager for Deutsche Bank's Boston branch office.[92] Between them, they were responsible for the day-to-day compliance and supervisory functions of the Boston branch office.[93] They approved new accounts and reviewed the daily trade blotter and exception reports, among other duties.[94] Each was an exemplary professional with more than 20 years' experience.

Tubridy outlined the standard account opening process they used at the time. The financial adviser would fill out the new account form and drop it in Tubridy's office. She would then review the form for completeness. If the form was complete, she would assign an account number and then forward the form to the wire room, which would process the form and open the account.[95] Tubridy testified that this was not a lengthy

[91] Leanne Drayton replaced when Meharg when she retired in approximately June 2007. Tr. 632, 747.

[92] Tubridy filled in as acting Branch Manager for the Boston branch office between May and October 2006. Tr. 631-32.

[93] Tr. 633.

[94] Tr. 635.

[95] Tr. 657.

process.[96] As a matter of standard practice, Tubridy did not question the financial adviser about the nature of the new account.[97] Importantly, Tubridy did not require financial advisers opening Managed Select accounts to explain how they intended to manage the accounts.[98] She also did not review the Charter Select agreement that was required for Adviser Select and Managed Select accounts. She sent the Charter Select form agreement to the managers of that program in Baltimore.[99]

When Jennings opened the H family Managed Select accounts between 2003 and 2005, HH wanted the ability to track the Managed Select accounts.[100] To give HH that ability, Jennings noted the name of the third-party manager he intended to shadow on the new account forms. For example, Jennings designated a new account for the RH Trust as the "'K' Account."[101] By doing so, the account statements for this account were identified as the RH Trust "'K' Account."

The Hearing Panel rejects Jennings and Mulvey's argument that such notations on the new account forms were sufficient to inform Tubridy (or any other supervisor) that Jennings intended to manage the H family Managed Select accounts by copying 100% of the transactions from the noted third-party manager into the H family Managed Select accounts, or that the purpose of this arrangement was to avoid paying fees to the identified third-party managers. The forms provided no information about Jennings'

[96] Tr. 659-60.

[97] Tr. 663.

[98] Tr. 663.

[99] Tr. 786.

[100] Neither Mulvey nor Respondent 3 was involved in opening the accounts at issue. Mulvey did not fill out any of the new account paperwork, and Respondent 3 did not review the account documents because he did not assume responsibility for the office until October 2006. Williams was the branch manager when Jennings opened the accounts.

[101] J-18.

planned use of the accounts, and there was no other documentation that set out Jennings' shadowing plan. What Tubridy did know was that the accounts were set up and managed to "model" third-party managers' portfolios. Tubridy testified that she understood that "Team 107 was putting together their own portfolios modeling third-party managers in some form or fashion.… [T]hey were reviewing or doing their own due diligence and putting together portfolios for their clients and that they would look at third-party managers or … other tools that were available."[102] Tubridy specifically testified that she did not understand that they were copying 100% of any particular manager.[103] Although Tubridy could not recall exactly how she reached this conclusion, she testified clearly and consistently that she never understood that Jennings and Mulvey were "shadowing" third-party managers, as she later learned they were. She also had no recollection of Jennings or any other Team 107 member telling her that they were "replicating" third-party managers' trades.[104]

Tubridy's testimony is corroborated by the notes she entered on the Monthly Active Account Summary Reports,[105] which she reviewed before she sent them to Respondent 3, and in the online SunGuard Trade Detail system that was a relatively new application Tubridy used in addition to hard-copy exception reports.[106]

When Tubridy reviewed and approved activity in the H family managed accounts, she entered handwritten notations on the Monthly Active Account Summary Reports to

[102] Tr. 681-82.

[103] Tr. 682.

[104] Tr. 672.

[105] CX-21.

[106] Mulvey Ex. D-4; Tr. 690. Deutsche Bank rolled out the SunGuard application in the summer of 2007, and Tubridy entered data in the new system as she learned the application. Tr. 686, 690. As a result, Tubridy often entered information long after she completed her reviews.

indicate whether the account was a Managed Select account or an Adviser Select account. By doing so for the Managed Select accounts over which Team 107 had discretion, Tubridy indicated that her approval was based upon her understanding that Team 107 "had their own modeled portfolios" and that the activity was generated by their rebalancing the accounts.[107] For the most part, she completed these monthly reviews by looking at other account information she had available online without speaking to the financial advisers.[108]

Tubridy made more specific notes in the SunGuard application. She repeatedly noted that the activity in the H family Managed Select accounts was "modeled" on particular third-party managers.[109] Tubridy testified that she reviewed the SunGuard Trade Detail summary on her own for the most part, and that the notes therefore were based on her previously formed understanding of Team 107's methodology for managing the accounts. Thus, for example, she entered notes such as, "Portfolio modeled with the Lateef all cap growth portfolio."[110] These notes are consistent with her understanding of how Team 107 managed the accounts—they had developed their own strategies to duplicate the style and results of the identified managers. None of the documentation supports Jennings and Mulvey's contentions that Tubridy knew they were engaged in shadowing (i.e., a wholesale copying of trades made by the third-party managers).[111]

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[107] Tr. 708; CX-21.

[108] Tr. 705.

[109] Tr. 728; Mulvey Ex. D-4.

[110] Mulvey Ex. D-4, at 1.

[111] In addition, Tubridy never discussed shadowing with Williams. Tr. 760.

Tubridy believed Jennings and Mulvey had their own portfolios, not that they were copying 100% of the trades made by individual third-party managers.[112]

3. Respondent 3 Did Not Tell Monleon That Shadowing Was An Approved Activity

Jennings and Mulvey also contended that Respondent 3 expressly approved their shadowing in the H family Managed Select accounts in response to a question Monleon raised about the practice. However, the evidence does not establish that Respondent 3 had been given specific enough information to understand Jennings' shadowing scheme. Thus, Respondent 3 could not have approved the actual scheme.

The Hearing Panel carefully reviewed the vague and conflicting accounts of the concerns Monleon raised first with Jennings and later with Respondent 3. Monleon testified that he questioned Jennings about the amount of time Jennings, Mulvey, and Sanders spent entering trade tickets each morning. Monleon's concern centered on the operational inefficiency of the process. He did not understand what Jennings and Mulvey were doing or what separately managed accounts were.[113] Monleon was new to the business and spending most of his time in a separate office preparing for his licensing examinations.[114] Jennings explained that this was part of the team's longstanding practice. Monleon accepted Jennings' explanation without further questioning.

Thereafter, sometime in the middle of 2007, Monleon raised the same issue with Respondent 3 during one of his routine periodic visits to Team 107's office. Although he could not recall the exact words he used, to his best recollection he asked Respondent 3 if replicating or copying trades on separately managed accounts on a daily basis was an

[112] Tr. 708.

[113] Tr. 284-85.

[114] Tr. 281.

allowed practice.[115] He was certain that he did not refer to the activity as "shadowing" or "mirroring" because he was not familiar with those terms.[116] Monleon was uncertain what other information he might have given, but he was certain that he did not tell Respondent 3 that the activity concerned the H family accounts.[117] And Monleon could not have provided an accurate detailed description of the questioned activity because he did not fully understand the nature of the Adviser Select program.[118] In any event, regardless of the words Monleon used, Respondent 3 expressed no concern.[119] He told Monleon that he would raise Monleon's question at an upcoming managers' meeting.[120]

Jennings and Mulvey gave generally similar accounts of the meeting with Respondent 3.[121] Although none had a reliable recollection of the conversation, each described it as a casual inquiry that ended with Respondent 3 telling Monleon that he would raise the issue at an upcoming managers' meeting and get back to Monleon. No one spoke up to defend the practice or expressed astonishment when Respondent 3 stated that he was unsure of the answer, which would have been expected if they truly believed Respondent 3 had approved their shadowing.

Some weeks later, at the conclusion of another one of Respondent 3's routine visits to Team 107's office, Monleon remembered that he had forgotten to ask Respondent 3 if he had learned anything at the managers' meeting. Monleon chased

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[115] Tr. 286, 350.

[116] Tr. 337.

[117] Tr. 287.

[118] Tr. 350.

[119] Tr. 286-87.

[120] Tr. 286.

[121] Sanders also gave an account of the meeting, but he was not present. He got all of his information indirectly from Monleon. Tr. 1005.

Respondent 3 down the hall and asked him for an update. Respondent 3 said he had not gotten to it, but he would look into it and get back to Monleon.[122] A week or so later, Respondent 3 again visited Team 107's office at which time Monleon asked him if he had an answer.[123] According to Monleon, Respondent 3 reported that he had checked and there was no problem with the practice. However, none of the witnesses who testified about the meeting could specify what "practice" Respondent 3 was referring to. After this, the topic was not raised again. For his part, Respondent 3 denied that there was any conversation close to what Monleon described.[124]

The Hearing Panel finds that the evidence fails to establish that Respondent 3 approved shadowing in the H family Managed Select accounts. Monleon never mentioned those accounts, and he lacked a complete understanding of Jennings' and Mulvey's activities. Monleon's main concern was Team 107's operational efficiency, not Jennings' and Mulvey's ethics. The casual manner with which everyone dealt with Monleon's questions supports this conclusion. First, Monleon did not consider the issue urgent. He waited quite a long time before mentioning it to Respondent 3 during a routine visit to Team 107's office. Nor did Monleon consider it so pressing that he needed to alert the compliance department. Second, Jennings and Mulvey did not react to Monleon's question as a challenge to the propriety of their conduct. Jennings and Mulvey felt no need to defend themselves or the practice. Third, Respondent 3 did not treat the questions as addressing a possible violation of firm policy or Jennings' and Mulvey's ethics. The Hearing Panel finds it significant that Respondent 3 was reported to have said

[122] Tr. 288.

[123] Tr. 289.

[124] Tr. 1103.

he would take Monleon's concern to a managers' meeting rather than the firm's compliance and legal department. Logically, if Monleon had accused Jennings and Mulvey of improper conduct and Respondent 3 was unsure of the answer, he would have said he was going to consult with the legal and compliance department. Also, Respondent 3 asked no follow-up questions of Monleon or the other Team 107 members, which would have been expected if he had considered the question to be an accusation that Jennings and Mulvey were acting unethically.

F. Respondent 3's Supervision Of Deutsche Bank's Boston Branch Office

Respondent 3 joined Deutsche Bank in October 2006 as an experienced branch manager. He had managed Credit Suisse's Boston office between the fall of 2004 and late 2006.[125] He joined Deutsche Bank as a Managing Director and Regional Executive in charge of the Boston Private Client branch office.[126] His duties at Deutsche Bank were for the most part quite similar to those he had at his former firm.[127] He ran Deutsche Bank's Boston branch office and had compliance and business responsibilities. On the business side, he had profit and loss responsibility, and he was responsible for recruiting, training, and mentoring qualified professionals.[128] On the compliance side, he was ultimately responsible for supervising Deutsche Bank's Boston branch office, which had approximately 50 employees, 30 of whom were financial advisers.[129]

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[125] Tr. 1052.

[126] Tr. 1092; CX-30, at 12.

[127] Tr. 1053.

[128] Tr. 1053.

[129] Tr. 1053, 1057-58.

When Respondent 3 joined the firm, Deutsche Bank had in place a veteran and well-qualified management team. After he joined, Respondent 3 annually delegated most of his supervisory functions to those managers.[130] Pursuant to the organizational and supervisory structure of Deutsche Bank's Boston branch office, the compliance department monitored trading for potential sales practice violations. Respondent 3 expressly delegated day-to-day responsibility for reviewing trade tickets and trading activities to Tubridy, Meharg, and Drayton. Tubridy and others in her office also were responsible for review of new account documents.[131] The Hearing Panel finds that Respondent 3's delegation of supervisory functions was reasonable.

IV. CONCLUSIONS OF LAW

A. Jennings And Mulvey Engaged In Unjust And Inequitable Conduct, In Violation Of NASD Rule 2110

The Hearing Panel concludes that Jennings and Mulvey's shadowing of accounts constituted unethical conduct in violation of NASD Rule 2110. In copying the trades made by the third-party managers—thereby misusing their proprietary and confidential trading strategies—Jennings and Mulvey violated the fundamental ethical standard to deal honestly and fairly with others in the securities industry.[132] The third-party managers in Deutsche Bank's Charter Select program reasonably expected that Jennings and Mulvey would not exploit their access to the managers' trading strategies.

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[130] Tr. 1020-21, 1064-65; *see, e.g.*, CX-22.

[131] Tr. 978-79, 1063-64.

[132] *Geoffrey Ortiz*, Exchange Act Rel. No. 58416, 2008 SEC LEXIS 2401, at *29 (Aug. 22, 2008) ("The public interest demands honesty from associated persons of NASD members; anything less is unacceptable.").

We conclude that Jennings and Mulvey's shadowing was ultimately self-interested and for their, not the H family's, benefit. Jennings testified that he devised the shadowing scheme because the H family had threatened to move their considerable business to another broker-dealer unless Jennings lowered the fees on the accounts.[133] Jennings considered the threat unfair because he had done a really good job for the family. In Jennings' words, when he was asked at the hearing why he had not cut his fee rather than the amount the third-party managers received, he said it had "everything to do with this sense of entitlement that I had … We did a really good job. We felt we were entitled to pay and we didn't feel there was any reason that our pay should be discounted particularly."[134] Accordingly, he was unwilling to cut the fees he and the other members of Team 107 earned. Instead, to keep the H family accounts, Jennings decided to cut the fees being earned by the four third-party managers without their knowledge or consent, thereby misappropriating the third-party managers' intangible property rights.

As very experienced brokers with many years' experience working with third-party managers, Jennings and Mulvey knew that the managers considered their investment strategies to constitute proprietary, confidential business information. In essence, their investment strategies constituted their stock-in-trade, and Jennings and Mulvey knew that they had no right to utilize those strategies except pursuant to the terms of Deutsche Bank's Charter Select program. As a former executive at one of the third-party managers testified, his firm was in the business of delivering investment advice and recommendations to investors through intermediaries such as Deutsche Bank, and his firm got paid based on the assets that were in its confidential investment

[133] Tr. 445, 572.

[134] Tr. 556.

strategy.[135] Accordingly, it was important to his firm that the information only be used for the express purposes set forth in its contract with Deutsche Bank.[136]

Jennings and Mulvey did not deny that they engaged in shadowing in the accounts Jennings established for that purpose. Instead, they contend that they did not violate Rule 2110 for three reasons. First, they contend that they cannot be found to have violated Rule 2110 because they did not act in bad faith and there is no rule or precedent prohibiting shadowing. Second, they contend that they were entitled to rely on Deutsche Bank's explicit and implicit approval of shadowing in the Boston branch office over many years. Third, they contend that they cannot be found to have violated Rule 2110 in the absence of customer harm. They argue that the H family knew of the shadowing and that Jennings implemented it at the family's insistence that Jennings lower the fees charged on the managed accounts. We reject these defenses.

1. Standard For Rule 2110 Violation

NASD Rule 2110, which requires the observance of "high standards of commercial honor and just and equitable principles of trade," imposes a broad ethical standard of conduct that reaches beyond legal requirements.[137] The rule's "special focus" is on "the professionalization of the securities industry"[138] "[A]mong other things, [the rule] depends upon general rules of fair dealing, the reasonable expectations of parties,

[135] Tr. 227.

[136] Tr. 227. *See also* CX-9, at 10 (contract confidentiality requirement).

[137] *See, e.g., Dep't of Enforcement v. Evans*, No. 2006005977901, 2011 FINRA Discip. LEXIS 36, at *30 (NAC Oct. 3, 2011). Rule 2110 applies to Respondents through NASD General Rule 115 (now FINRA Rule 140), which provides that persons associated with a member have the same duties and obligations as a member.

[138] *Heath v. SEC*, 586 F.3d 122, 134 (2d Cir. 2009) (quoting *Gustafson v. Strangis*, 572 F. Supp. 1154, 1158 (D. Minn. 1983)), *cert. denied*, 2010 U.S. LEXIS 3029 (Apr. 5, 2010).

and marketplace practices."[139] The rule was enacted to discipline "a wide variety of conduct that may operate as an injustice to investors or other participants in the marketplace."[140] Thus, in FINRA disciplinary proceedings, "[t]he analysis that is employed [under the rule] is a flexible evaluation of the surrounding circumstances with attention to the ethical nature of the conduct."[141] Rule 2110 "focuses on the securities professional's conduct rather than on a subjective inquiry into the professional's intent or state of mind. Accordingly, a violation of the rule need not be premised on a motive or scienter finding."[142]

2. Jennings' And Mulvey's Lack Of Bad Faith Defense Lacks Merit

Jennings and Mulvey contend that in the absence of a specific rule prohibiting shadowing, liability must be premised on a finding of bad faith. However, the SEC has repeatedly rejected this argument, applying a disjunctive bad faith or unethical conduct standard to disciplinary actions under Rule 2110.[143]

Jennings and Mulvey acted unethically by using the confidential, proprietary trading strategies developed and owned by the four third-party managers. Jennings and

[139] *Dep't of Enforcement v. Conway*, No. E102003025201, 2010 FINRA Discip. LEXIS 27, at *29 (NAC Oct. 26, 2010) (citing *Dep't of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *12-15 (NAC June 2, 2000).

[140] *Thomas W. Heath, III*, Exchange Act Rel. No. 59223, 2009 SEC LEXIS 14, at *15 (Jan. 9, 2009) (quoting *Daniel Joseph Alderman*, 52 S.E.C. 366, 369 (1995)), *pet. denied*, *Heath v. SEC*, 586 F.3d 122 (2d Cir. 2009). *See also Timothy L. Burkes*, 51 S.E.C. 356, 360 n.21 (1993), *pet. denied*, 29 F.3d 630 (9th Cir. 1994) (table) (Rule 2110 states a broad ethical principle that implements the requirements of Section 15A(b) of the Securities Exchange Act of 1934).

[141] *Dep't of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *15 (NAC June 2, 2000).

[142] *Heath*, 2009 SEC LEXIS 14, at *15 (discussing NYSE Rule 476, counterpart to NASD Conduct Rule 2110) (citations omitted).

[143] *See, e.g.*, *Robert E. Kauffman*, Exchange Act Rel. No. 33219, 1993 SEC LEXIS 3163, at *3 n.5 (Nov. 18, 1993) ("The most that is required [for a violation of Rule 2110] is a finding of bad faith or unethical conduct."), *pet. denied*, 40 F.3d 1240 (3d Cir. 1994) (table).

Mulvey knew as experienced securities professionals that the information they copied was not publicly available and that their direct access to the trading activity was governed by the contractual arrangements governing the Charter Select program. Under these circumstances, Jennings and Mulvey had a clear ethical responsibility not to abuse their access to the third-party managers' trading strategies.[144] By doing so, they placed their self-interest above their duties to Deutsche Bank and the third-party managers, thereby violating NASD Rule 2110.

In a related argument, Jennings and Mulvey contend that they were not parties to the contracts between Deutsche Bank and the managers participating in the Charter Select program and therefore they were not bound by the confidentiality provisions in those contracts. Thus, they contend that Enforcement had to prove that they acted in bad faith. Their argument is meritless. Liability under Rule 2110 is not dependent upon a breach of contract.[145] Jennings' and Mulvey's ethical responsibilities to deal fairly with their firm and the third-party managers stems from the fundamental ethical requirement of fair dealing inherent in the relationships they had with their customer, Deutsche Bank, and the third-party managers. Their misuse of their positions and the confidential information they obtained "implicates the quintessential ethical considerations not necessarily implicated in a breach of contract case."[146]

Jennings and Mulvey had adequate notice that FINRA could discipline them under Rule 2110 for unethical conduct despite their lack of familiarity with the

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[144] *Cf.*, *Dante J. DiFrancesco*, Exchange Act Rel. No. 66113, 2012 SEC LEXIS 54, at *19 (Jan. 6, 2012) ("In analyzing a securities professional's conduct under [Rule 2110], [the SEC] frequently [has] focused on whether the conduct implicates a generally recognized duty owed to clients or the firm.").

[145] *See, e.g.*, *Heath v. SEC*, 586 F.3d 122, 139.

[146] *DiFrancesco*, 2012 SEC LEXIS 54, at *21.

confidentiality provisions in the contracts between Deutsche Bank and the third-party managers. As the SEC has noted, "courts have expressly recognized that 'an experienced registered representative … may be fairly charged with knowledge of the ethical standards of his profession.'"[147] It can come as no surprise to Jennings and Mulvey that their conduct in this case would subject them to sanctions by FINRA. Any reasonably prudent securities professional would recognize that the unauthorized use of a firm's proprietary trading strategy violates the ethical norms of the industry. Moreover, in October 2006, Deutsche Bank put Jennings and Mulvey on notice through its revised written procedures that shadowing was prohibited. Jennings and Mulvey are fairly charged with that notice despite their claim that they failed to read the policy.[148]

The Hearing Panel finds Jennings' testimony that he was not aware of his obligation to abide by his firm's written policies extremely troubling and lacking credibility. When asked whether, during the time frame of January 2005 through May 2008, he knew he had a duty to comply with the firm's policies and procedures, Jennings responded, "I didn't – I don't recall. I don't recall having that duty."[149] It is incomprehensible that a Series 7 licensed registered representative with not less than 25 years' experience, who has been subject to completing annual FINRA Firm Element continuing education requirements since 1995, and Regulatory Element continuing education requirements since 2005, would not know that he has a duty to comply with his firm's policies and procedures.

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[147] *Heath,* 2009 SEC LEXIS 14, at *28 (quoting *Crimmins v. Am. Stock Exch.*, 368 F. Supp. 270, 277 (S.D.N.Y. 1973), *aff'd*, 503 F.2d 560 (2d Cir. 1974)).

[148] *Cf., Kirlin Sec., Inc.*, Exchange Act Rel. No. 61135, 2009 SEC LEXIS 4168, at *66 (Dec. 10, 2009) (Internal firm compliance policies can inform FINRA's determination of whether a respondent's conduct violated the professional standards of ethics covered by Rule 2110.).

[149] Tr. 526.

3. Reliance On Deutsche Bank's Alleged Supervisory Deficiencies Is Not A Defense To Liability

Jennings and Mulvey argue that they cannot be found to have violated Rule 2110 because they had and were entitled to rely upon their managers' approval of shadowing. As discussed above, the Hearing Panel finds that Deutsche Bank did not approve their activities. Accordingly, the Hearing Panel finds no merit to this argument.

In the alternative, Jennings and Mulvey blame their misconduct on Deutsche Bank's failure to detect and stop shadowing in the Boston branch office. However, "a registered representative cannot shift to others his or her responsibility to refrain from violating the federal securities laws or FINRA's rules."[150] Jennings and Mulvey cannot excuse their misconduct by claiming that they relied on others to ensure their compliance with recognized professional norms.[151]

4. Lack Of Customer Harm Is Not A Defense To Liability

Jennings and Mulvey also argue that they cannot be found to have acted unethically or in bad faith because the shadowing did not result in demonstrable harm to the H family. Customer harm, however, is not a necessary element of a Rule 2110 violation. This is an ethical proceeding, not an action to recover damages. "Hence our concern is with the ethical implications of [Jennings' and Mulvey's] conduct. Those implications can be serious even where … no legally cognizable wrong was inflicted."[152]

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[150] *See, e.g.*, *Conway*, 2010 FINRA Discip. LEXIS 27, at *43 (citing *Dep't of Enforcement v. Epstein*, No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *82 (NAC Dec. 20, 2007), *pet. denied*, *Epstein v. SEC*, 2010 U.S. App. LEXIS 24119 (3d Cir. 2010)).

[151] It is also not a defense that others in Deutsche Bank's Boston branch office may have engaged in the same misconduct. *See, e.g.*, *Patricia H. Smith*, 52 S.E.C. 346, 348 n.8 (1995).

[152] *Ben B. Reuben*, Exchange Act Rel. No. 12944, 1976 SEC LEXIS 494, at *7 n.7 (Nov. 2, 1976). *See also Kirlin Sec.*, 2009 SEC LEXIS 4168, at *69 n.93 (rejecting argument that argue that no rule violation can be found in the absence of customer harm).

It is likewise of no consequence that the H family consented to the shadowing. "FINRA's authority to enforce its rules 'is independent of a customer's decision not to complain.'"[153]

B. Respondent 3 Reasonably Supervised Jennings And Mulvey

Enforcement charged Respondent 3 with failing to prevent shadowing, failing to follow up on numerous red flags of shadowing, and failing to ensure that Deutsche Bank's written procedures were followed. Because we find that Respondent 3 acted reasonably, we dismiss the charges against him.

1. Standard For NASD Rule 3010 Violation

NASD Conduct Rule 3010(a) requires that FINRA members "establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of [FINRA]."[154] "Under NASD Rule 3010, a supervisor is responsible for 'reasonable supervision,' a standard that 'is determined based on the particular circumstances of each case.'"[155] "The burden is on [Enforcement] to show that the respondent's procedures and conduct were not reasonable. It is not enough to demonstrate that an individual is less than a model supervisor or that the supervision could have been better."[156]

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[153] *Kirlin Sec.*, 2009 SEC LEXIS 4168, at *69 n.93 (quoting *Maximo Justo Guevara*, 54 S.E.C. 655, 664 & n.18 (2000) (citing *Bernard D. Gorniak*, 52 S.E.C. 371 (1995)); *Ronald J. Gogul*, 52 S.E.C. 307 (1995)), *pet. denied*, 47 Fed. App'x 198 (3d Cir. 2002) (table)).

[154] NASD Conduct Rule 3010(a).

[155] *Dep't of Enforcement v. Midas Sec., LLC*, No. 2005000075703, 2011 FINRA Discip. LEXIS 62, at *22 (NAC Mar. 3, 2011) (citing *Christopher J. Benz*, 1997 SEC LEXIS 672, at *12 (Mar. 26, 1997), *pet. denied*, 168 F.3d 478 (3d Cir. 1998) (table).

[156] *District Bus. Conduct Comm. v. Lobb*, No. C07960105, 2000 NASD Discip. LEXIS 11, at *16-17 (NAC Apr. 6, 2000) (citations omitted).

2. Respondent 3's Conduct Was Reasonable

Respondent 3 effectively and reasonably delegated many of his day-to-day supervisory responsibilities to Tubridy and other managers. When he arrived at Deutsche Bank the compliance and management team in the Boston branch office had been in place for years. The team was composed of highly experienced and capable personnel. There is no evidence that Respondent 3 had any reason to doubt their diligence or competence in reviewing trades and new accounts. Accordingly, Enforcement's supervision charge against Respondent 3 wholly rests upon its allegations that he failed to follow up on several "red flags" of improper conduct. Specifically, Enforcement contends that Respondent 3 failed to take decisive action in response to two pieces of information. First, Enforcement contends that Monleon's inquiries in 2007 should have alerted Respondent 3 to the fact that Jennings and Mulvey were engaged in shadowing. Second, Enforcement contends that notations Tubridy made upon review of activity in the H family Managed Select accounts should have alerted Respondent 3 to the fact that Jennings and Mulvey were engaged in shadowing in those accounts. We disagree.

With respect to Monleon's inquiries, the Hearing Panel finds that Enforcement failed to prove by a preponderance of the evidence that Respondent 3 received sufficient information to assess the true nature of Jennings and Mulvey's activities. The Hearing Panel bases its finding on two factors.

First, Monleon admitted that he did not give Respondent 3 any details about Team 107's trading in the H family Managed Select accounts or even identify that his question concerned those accounts. Nor did he use words such as "shadowing" or "mirroring" when he spoke to Respondent 3. Monleon was certain of this because he had not heard of those terms at the time. In fact, Monleon could not recall any specifics of his conversations with Respondent 3. He thought he might have characterized Jennings' and Mulvey's activity as copying or replicating trades, but he was not sure. Importantly, there was no evidence to show that Monleon understood that Jennings initiated shadowing to retain the H family's business and reduce the fees the family had been paying to the third-party managers. In conclusion, the Hearing Panel finds that Monleon's testimony is insufficient to prove by a preponderance of the evidence that Respondent 3 should have treated Monleon's question as a red flag of improper activity.

Second, the Hearing Panel does not find Monleon's, Mulvey's, and Jennings' accounts of the meetings to be reliable or convincing. Although Monleon was equivocal, he tried to give the impression that he was concerned that the practice was analogous to patent infringement and therefore improper.[157] Based upon this, Enforcement argues that Respondent 3 should have stopped the shadowing. However, when the evidence is viewed in its totality, Monleon's supposition that he challenged the propriety of the trading does not make sense. Everyone that gave an account of the meeting described it as casual. And, as found above, all agreed that no one reacted to Monleon's questioning. If Monleon had suggested that Jennings and Mulvey were acting improperly, one would have expected them to have challenged the statement. After all, Jennings and Mulvey claimed that Respondent 3 and Williams had approved shadowing. It strains credibility that two experienced brokers would sit mute while a junior member of their team accused them of serious misconduct in the nature of patent infringement. The Hearing Panel finds it far more likely that regardless of any underlying concerns he may have had, Monleon did not express those underlying concerns to Respondent 3. Under the circumstances, the

[157] Tr. 284-86.

Hearing Panel concludes that Enforcement failed to prove that Monleon's questions constituted a red flag of possible misconduct that Respondent 3 was obliged to investigate and stop.

Likewise, the notes[158] Tubridy made when she reviewed activity in the 13 H family Managed Select accounts did not constitute red flags of improper conduct. The fact that she noted that an account "followed" an Adviser Select portfolio, or that an account was "modeled" on another account, does not inexorably lead to the conclusion that Jennings and Mulvey were engaged in shadowing—that is, that they were copying the trades of the identified third-party managers on a trade-by-trade basis without making an independent suitability determination. In addition, the Hearing Panel finds it significant that the accounts in question had been opened long before Respondent 3 joined Deutsche Bank. Respondent 3 had no reason to conclude that Jennings and Mulvey were engaged in shadowing to cut the fees the third-party managers had been earning on the H family Managed Select accounts.

In summary, the Hearing Panel concludes that Respondent 3's conduct was reasonable under the facts and circumstances of this case. Immediately upon learning of the shadowing from McMahon in May 2008, Respondent 3 acted swiftly and decisively to put an end to the practice. Respondent 3 cannot be faulted for his supervision. Accordingly, the charges against Respondent 3 are dismissed.

V. SANCTIONS

The FINRA Sanction Guidelines ("Guidelines") do not specifically address shadowing. Instead, we look to the Guidelines' General Principles Applicable to All

[158] *See* CX-21.

Sanction Determinations ("General Principles") and Principal Considerations in Determining Sanctions ("Principal Considerations"). The General Principles provide that "[t]he overall purposes of FINRA's disciplinary process and FINRA's responsibility in imposing sanctions are to remediate misconduct by preventing the recurrence of misconduct, improving overall standards in the industry, and protecting the investing public."[159] To that end, they also provide that "[a]djudicators therefore should impose sanctions tailored to address the misconduct involved in each particular case."[160]

Relevant factors to be considered in determining a sanction that is appropriately remedial include "[t]he seriousness of the offense, the corresponding harm to the trading public, the potential gain to the broker for disobeying the rules, the potential for repetition in light of the current regulatory and enforcement regime, and the deterrent value to the offending broker and others …."[161] Other relevant factors enumerated in the Sanction Guidelines include (1) respondent's disciplinary history, (2) the degree to which respondent accepted responsibility for and acknowledged the misconduct prior to detection, (3) whether respondent engaged in numerous acts of misconduct, (4) whether respondent engaged in the misconduct over an extended period of time, (5) whether respondent attempted to conceal the misconduct, (6) whether others, including other market participants, were directly or indirectly harmed, (7) whether respondent's

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[159] FINRA SANCTION GUIDELINES 2 (2011) (General Principles, No. 1), http://www.finra.org/sanctionguidelines. *See also McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005) (stating that the purpose of a sanction is to remediate misconduct and protect investors).

[160] Guidelines at 3 (General Principles, No. 3).

[161] *McCarthy v. SEC*, 406 F.3d at 190.

misconduct resulted from an intentional act, recklessness, or negligence, and (8) whether respondent's misconduct resulted in the potential for monetary or other gain.[162]

With the foregoing principles in mind, the Hearing Panel first considers the import of the ethical responsibilities at issue. A broker's integrity in dealing with other market participants is critically important to the functioning of the marketplace. Market participants, such as the third-party managers here, rely on securities professionals to deal fairly, respecting the confidentiality of various categories of customer and business information. Even in the absence of direct customer harm—as is true in this case—the risk of harm is real and itself carries a cost for all because of the potential distrust and instability it creates in the marketplace. Accordingly, the Hearing Panel concludes that the nature of the violation in this case is serious. Nevertheless, in fashioning an appropriate remedial sanction, the Hearing Panel must consider not only the seriousness of the misconduct, but also the specific facts of the particular case.[163]

We find three aggravating factors. First, Jennings and Mulvey conducted the shadowing over a considerable period of time and it involved numerous trades. Second, Jennings intentionally set up the shadowing scheme for his and his team's self-interest—to keep the H family from following through on the threat to move all its accounts unless Jennings reduced his fees. Third, the shadowing resulted in the potential for monetary or other gain. Although the evidence establishes that Jennings devised the plan to be

[162] Guidelines at 6-7.

[163] *Id.*

revenue neutral, it was not entirely so. Team 107 did receive a very small increase in fees.[164]

We next consider mitigating factors. First, Jennings and Mulvey demonstrated honesty about their activities throughout this proceeding, starting with the commencement of FINRA's investigation. They also disclosed the activity when they interviewed at their new firm upon leaving Deutsche Bank. At no point did they attempt to conceal the shadowing. Second, we conclude that there is little likelihood that Jennings and Mulvey will repeat their misconduct. Having heard their testimony and having had the opportunity to observe their demeanor and ask them questions, we are convinced that they understand the gravity of their actions and have sincere regret for their errors.[165]

Weighing all of the foregoing factors, the Hearing Panel imposes on Jennings a ten business-day suspension from associating with any FINRA-registered firm in any capacity and a $20,000 fine, and imposes on Mulvey a $5,000 fine.

The Hearing Panel imposes more severe sanctions on Jennings because (1) he had a more significant role in the shadowing, (2) he devised the shadowing scheme, and (3) he demonstrated a fundamental and troubling lack of understanding of his duty to comply with his firm's policies and procedures.

[164] Only one of the four third-party managers requested Deutsche Bank to pay the fees it lost as a result of the shadowing. The other three managers apparently did not consider the amount significant enough to jeopardize their relationship with Deutsche Bank. In addition, there is evidence that at least one of those managers continues to do business with Jennings and Mulvey.

[165] The Hearing Panel further notes that they immediately agreed to cease such activities when in their meeting concerning joining a new firm they were told it was against that firm's policies.

VI. ORDER

Michael Jennings is fined $20,000 and suspended for ten business days from associating with any FINRA-registered firm in any capacity, and Brian Mulvey is fined $5,000, for shadowing third-party managers, in violation of NASD Conduct Rule 2110.[166]

In addition, Jennings and Mulvey are jointly and severally ordered to pay costs of this proceeding in the amount of $10,735.40, which costs include the hearing transcript fees and an administrative fee of $750.

If this decision becomes FINRA's final disciplinary action, Jennings' suspension shall commence at the opening of business on May 6, 2013, and end at the close of business on May 17, 2013. The fines 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.

The charge against Respondent 3 is dismissed.

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Andrew H. Perkins
Hearing Officer
For the Hearing Panel

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