FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. ANTHONY A. GREY (CRD 709788), Respondent.	Disciplinary Proceeding No. 2009016034101 Hearing Officer—LOM **HEARING PANEL DECISION** June 20, 2013

Respondent secretly interposed his own personal accounts between his customers and the prevailing market for municipal bonds, which allowed him to charge his customers unfair, unreasonable, and excessive markups. Respondent did not disclose to his customers either his personal involvement in the transactions or the excessive markups that resulted. These acts were willful.

Respondent's conduct violated MSRB Rule G-17 concerning fair dealing, because the interpositioning itself constituted an unfair practice and, moreover, the failure to disclose constituted a deceptive and dishonest practice. Respondent's conduct also violated MSRB Rule G-30, which concerns, in particular, fair pricing. None of the prices Respondent charged bore a reasonable relationship to the prevailing market price of the securities at the time of the customer transactions. Finally, as to those transactions where Grey charged his customers particularly high markups (ranging from 8.62% to 19.12%), Respondent committed fraud in violation of Section 10(b) of the Securities Exchange Act of 1934. In those transactions, Grey's failure to disclose his personal involvement and the resulting excessive markups was intentional deception.

Because the same misconduct was the basis for all three causes of action, Respondent is sanctioned for all violations on a unitary basis. Respondent is suspended from associating with any FINRA member firm in any capacity for two years, fined $30,000, ordered to pay disgorgement in the amount of $16,000, and ordered to pay costs. Because the violations were willful, Respondent is statutorily disqualified.

Appearances

Michael A. Gross, Boca Raton, Florida, and Bradley L. Mirkin, Rockville, Maryland, represent the Department of Enforcement.

Peter J. Aldrich, Palm Beach Gardens, represents Respondent, Anthony A. Grey.

I. INTRODUCTION

The Financial Industry Regulatory Authority, Inc. ("FINRA") Department of Enforcement ("Enforcement") filed a Complaint against Anthony A. Grey ("Grey" or "Respondent"),[1] who was, at the time of the events in issue, a registered securities representative with Gardnyr Michael Capital, Inc. ("GMCI" or the "Firm"). Enforcement alleges that Grey secretly interposed himself between his customers and the prevailing market for municipal bonds. Grey accomplished this interpositioning by routing municipal bonds in and out of his own personal accounts before having his Firm sell the bonds to his retail customers. This enabled Grey to charge unfair, unreasonable, and excessive markups on the bonds without revealing that he had done so, in violation of Rules of the Municipal Securities Rulemaking Board ("MSRB") regarding fair dealing (MSRB G-17) and fair pricing (MSRB G-30).[2] Enforcement further alleges as to some of the transactions, where the markups were especially large, that Grey's failure to disclose his personal involvement in the transactions or the excessive markups was fraud, in violation of Section 10(b) of the Securities Exchange Act of 1934

[1] FINRA is a self-regulatory organization ("SRO") that is responsible for regulatory oversight of securities firms and associated persons who do business with the public. It was formed in July 2007 by the consolidation of NASD and the regulatory arm of the New York Stock Exchange ("NYSE"). FINRA is developing a new "Consolidated Rulebook" of FINRA Rules that includes NASD Rules. The first phase of the new Consolidated Rulebook became effective on December 15, 2008. *See* FINRA Regulatory Notice 08-57 (Oct. 2008). Because the Complaint in this case was filed after December 15, 2008, FINRA's Procedural Rules apply to the proceeding. FINRA's Rules (including NASD Rules) are available at www.finra.org/Rules.

[2] MSRB Rules apply because this case involves municipal securities subject to MSRB regulation. FINRA's By-Laws provide that its members and persons registered with members agree to comply with MSRB Rules, and FINRA is authorized to impose sanctions for violations of MSRB Rules. Article IV, § 1(a)(1) (agreement by firms); Article V, § 2(a)(1) (agreement by registered persons); Article XIII, § 1(b) (authorization to impose sanctions for violation of MSRB Rules). The Rules of the MSRB are found at www.msrb.org.

("Exchange Act"). Enforcement alleges that all the conduct was willful.

The Hearing Panel finds that Grey interposed his own personal accounts between his customers and the market, causing his customers to pay unfair, unreasonable, and excessive markups over the prevailing market price. Respondent did not disclose to his customers that they paid more than they would have paid in the prevailing market at the time that he offered them the bonds, and he did not disclose to them that he was personally involved in the transactions and profited from the excessive markups they were charged. Grey's willful conduct violated MSRB Rules G-17 and G-30 and Section 10(b) of the Exchange Act.

In light of Respondent's testimony and demeanor at the hearing, significant sanctions are required to deter him from future violations. Respondent is suspended for two years, fined, ordered to pay disgorgement, and ordered to pay costs. Because the violations were willful, Respondent is subject to statutory disqualification.[3]

II. PROCEDURAL MATTERS

A. Jurisdiction

Although Grey is no longer registered, FINRA has jurisdiction over this disciplinary proceeding pursuant to Article V, Section 4 of FINRA's By-Laws. That provision of the By-Laws specifies that FINRA retains jurisdiction for two years after a person's registration is terminated. The Complaint alleges misconduct that occurred while Respondent was registered with GMCI, and Respondent was still registered with GMCI when the Complaint was filed on December 2, 2011.[4]

[3] Securities and Exchange Act ("Exchange Act") 15 U.S.C. 78c(a)(39); Article III, § 4 of FINRA's By-Laws.

[4] CX-1 (Grey CRD as of 12/14/2012) at 1 of 4. Grey's registration was terminated in November 2012.

B. The Charges And The Hearing

The Complaint alleges violations not only by Grey but also by GMCI and two other general securities representatives at the Firm. GMCI and those two other individuals settled the claims against them, leaving Grey as the only Respondent at the hearing.

As to Grey, the charges all have to do with six municipal bonds that he sold in ten transactions to three of his retail customers. The most serious charges relate to six transactions. As to those six transactions, Enforcement charges that Grey willfully committed fraud in violation of the Exchange Act, along with engaging in unfair dealing and unfair pricing in willful violation of MSRB Rules G-17 and G-30 (First Cause of Action). As to the other four transactions, Enforcement charges Grey with willful unfair dealing and unfair pricing in violation of MSRB Rules G-17 and G-30 (Second Cause of Action). Enforcement charges all ten transactions as unfair dealing in violation of MSRB Rule G-17 (Third Cause of Action).

The two-day hearing took place February 5-6, 2013, in Boca Raton, Florida, before a three-person panel composed of the Hearing Officer assigned to the matter, a member of the District 6 Committee, and a member of the District 7 Committee. Enforcement presented the testimony of three witnesses: a FINRA examiner, Barbara Walley ("Walley"); Respondent Grey; and an expert, James D. McKinney ("McKinney"). Respondent presented the testimony of two additional witnesses: an expert on ethics of broker-dealers, David Paulakaitis ("Paulakaitis"); and an expert on municipal bond pricing, John Bagley ("Bagley"). Each side submitted exhibits, with Enforcement's identified here as CX-1 et seq. and Respondent's identified as RX-1 et seq.

III. FINDINGS OF FACT

A. Respondent's Background

Respondent Anthony A. Grey became registered with a FINRA (then NASD) firm in 1986. In 1994 he moved to GMCI, where he was registered until November 2012. He is no longer registered with any FINRA member firm.[5]

B. Respondent's Conduct

A routine examination by FINRA staff revealed that Grey regularly engaged in a pattern of routing municipal bonds through his own personal accounts before having his Firm sell the bonds to his customers. The Complaint focuses on ten transactions in six particular municipal bonds that followed the pattern revealed by the examination. In each instance, Grey acquired the bond for GCMI or his own account. If he acquired the bond for GCMI, he simultaneously placed it in his personal account. No more than a few trading days later (one to four days), Grey moved the bonds back to GCMI and simultaneously sold the bonds to his retail customers at a much higher price than he had paid. He did not disclose to the customers either that his personal accounts were involved or that the customers were paying a much higher price than Grey had paid only a few trading days before. No interdealer transactions occurred during the interim between Grey's acquisition and the sale to the retail customer that could indicate a shift in the prevailing market price from the time that Grey first acquired the bonds.

(1) Respondent's Pattern Of Interpositioning

The FINRA examiner, Walley, testified that she was conducting a routine examination of the Firm when she discovered a pattern of trades going through Grey's personal account and then out to retail customers. This caused her concern because of an apparent conflict of interest.

[5] CX-1 (Grey CRD as of 12/14/2012).

Accordingly, she looked at the trades more closely to see whether he was taking advantage of the customer. She found some 40-50 trades that were going through Grey's personal accounts that appeared to her to be "off market."[6]

Grey used his personal accounts extensively to trade bonds. He attributed approximately half his income during the 2008-2009 time period to his personal bond trading.[7] He engaged in thousands of bond transactions in the course of a year.[8]

During the financial crisis that arose in late 2008, Grey looked for ways to increase his buying power and liquidity to take advantage of disruptions in the market.[9] He leveraged his capital and increased his trading capacity in 2009 by rolling over money from his IRA to a profit-sharing plan of a company that he wholly owned because he could buy on margin with the profit-sharing plan and he could not with the IRA.[10]

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[6] Hearing Tr. (Walley) at 86-97. Respondent's counsel cross-examined Walley in a way to suggest that it was significant that Enforcement had charged only a few of the transactions Walley suspected to be improper. Perhaps counsel meant to cast doubt on Walley's judgment and to suggest that none of the transactions was problematic. Perhaps he meant to suggest that most of Grey's suspect transactions had been determined to be proper and that whatever infractions might be found were minor.

The Hearing Panel finds that neither of these implications is warranted. Walley acknowledged that only six bonds are covered by the Complaint and that only three of those were discussed at Grey's on-the-record interview ("OTR"). Hearing Tr. (Walley) at 91-97. She explained, however, that "[W]e just wanted to find out exactly how he priced the bonds and once we established that general practice, we determined that we didn't need to go any further." *Id.* at 96-97.

[7] Hearing Tr. (Grey) at 241 (Grey's income was in excess of $1.5 million in the aggregate for the two years).

[8] Hearing Tr. (Grey) at 247.

[9] Hearing Tr. (Grey) at 142-45. He testified that from the fourth quarter 2008 through the first half of 2009 it "was an unprecedented chaotic time in the market." *Id.* at 141-42. Liquidity had dried up and it was a "very scary time." Hearing Tr. (Grey) at 143-45. The municipal bond market was volatile and there was some "seller distress." Hearing Tr. (Grey) at 178. Grey believed that there were "deals" to be had on municipal bonds and that his thirty years of experience gave him an advantage in buying such bonds. Hearing Tr. (Grey) at 178-79. When asked whether he got what he perceived to be extraordinary prices on some of the municipal bonds he acquired, he responded, "Yes." Hearing Tr. (Grey) at 180.

[10] Hearing Tr. (Grey) at 141-42.

Grey explained his use of his personal accounts by saying that until July 2009 the Firm did not have a proprietary trading account. He said that if "[w]e wanted to take risk on our bonds – if we wanted to buy bonds, it was at our own risk, not the [F]irm's risk."[11] He said, "The bottom line was at the end of the day, whatever I purchased had to be out of that [Firm] account, so either I would sell it to the street or sell it to a customer or sell it to my IRA account. But at the end of the day, the company went [l]ong nothing."[12]

(2) Grey's Pattern Of Interpositioning Caused Grey's Customers To Pay Higher Prices

As to all the bonds at issue, Grey's customers paid higher prices than they would have without the intermediate transactions routing the bonds through his personal accounts, because Grey marked up each transaction from the initial acquisition to the ultimate sale to his retail customer. Grey first acquired the bond from another dealer in an arms-length transaction between sophisticated parties at one price, and, instead of marking up the bond and selling it directly to his retail customer, he moved the bond in and out of his own account, marking it up on each leg, both in and out of his account. By the time Grey sold the bond to the retail customer, he was charging the customer a substantially higher price than the price at which he had acquired the bond from the "street."

Walley prepared a summary chart showing the pattern of Grey's interpositioning in connection with six different municipal bonds: Osceoloa, Ocala, Collier, Florida State, Highlands (Health), and Highlands (School). To create the summary chart, she used the Firm's order tickets, customer account statements, and blotter, along with Grey's account statements.

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[11] Hearing Tr. (Grey) at 145.

[12] Hearing Tr. (Grey) at 154. The term "street" is commonly used when referring to transactions with or quotations from other broker-dealers. *See Dep't of Enforcement v. SFI Investments, Inc.*, No. C10970176, 2000 NASD Discip. LEXIS 52, at *7 n.11 (OHO Mar. 28, 2000).

The chart showed that Grey engaged in ten transactions in which the Firm sold these bonds to retail customers after Grey or his Firm first bought the bonds from another dealer and Grey held the bonds in one of his personal accounts. If the Firm bought the bonds, it then sold them at a markup to Grey either the same day or the next. Grey held the bonds for one to four trading days. Then he sold them back to the Firm at a markup and the Firm sold them to a retail customer immediately at an additional markup.[13] In each instance, the cost to buy the bonds increased.[14]

In simplified form, the chart showed the following increases in the prices of the bonds between the time that Grey or GMCI purchased the bonds and the time that Grey's customers purchased the bonds from GMCI:

Osceola	GMCI purchased at	$71.250
	Customer purchased at	$84.170
Ocala	Grey purchased at	$84.250
	Customer 1 purchased at	$88.770
	Customer 2 purchased at	$88.770
Collier	GMCI purchased at	$76.880
	Customer 1 purchased at	$92.174
	Customer 2 purchased at	$92.174
Florida State	GMCI purchased at	$59.000
	Customer purchased at	$72.525
Highlands (Health)	Grey purchased at	$69.194
	Customer 1 purchased at	$76.030
	Customer 2 purchased at	$76.030
	Customer 3 purchased at	$76.030

[13] Hearing Tr. (Walley) at 48-63; CX-2. When the Firm bought the bonds, the order tickets sometimes indicated a simultaneous sale to Grey. Hearing Tr. (Walley) at 40- 44 (Osceola bond, CX-6; Ocala bond, CX-10).

[14] Hearing Tr. (Walley) at 63; CX-2.

Highlands (School)	GMCI purchased at	$85.569
	Customer purchased at	$91.250

During the period between the acquisition by Grey or GMCI and the sale to the retail customer, there were no interdealer trades. Such trades might have suggested a change in the prevailing market price from the price at which Grey or GMCI acquired the bonds, but there were none.[15] Walley identified print-outs from a public website sponsored by the MSRB. The website provides information regarding municipal bonds, including a trading history of all the trades that have been executed on a given bond through the life of the bond. That website is commonly referred to as EMMA (electronic municipal market access).[16] Walley testified on the basis of EMMA that during the relevant time period no interdealer trades occurred between the initial purchases by Grey or GMCI and the sales to the retail customer.[17] Grey did not dispute the absence of interdealer trades during the interim between his acquisition and the ultimate sale to customers.

Walley testified that she thought Grey had cheated his customers, even before she received the report of Enforcement's expert.[18] Her conclusion was based on the absence of market trading around the time that he sold the bonds to his customers, except for Grey's acquisitions from the "street." She explained, "The interdealer trade on the 22nd [the date of Grey's initial acquisition of the Osceola bond] is considered the prevailing market price. If there's no other intervening interdealing trades between those two. You look back five days and

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[15] Hearing Tr. (Walley) at 48-62.

[16] Hearing Tr. (Walley) at 38-39.

[17] Hearing Tr. (Walley) at 50-63. *See* CX-7 (EMMA on Osceola), CX-11 (EMMA on Ocala), CX-15 (EMMA on Collier), CX-19 (EMMA on Florida State), CX-23 (EMMA on Highland (Health)), CX-27 (EMMA on Highland (School)).

[18] Hearing Tr. (Walley) at 93-94, 108-113.

look forward five days and see if there's any other trades and based on our policy or our procedures indicate that if there are no other interdealer trades, then the cost of the firm should be considered the fair market value."[19]

(3) Grey Admits He Did Not Disclose The Involvement Of His Personal Accounts Or The Higher Prices That Resulted

Grey admitted that he solicited his customers without disclosing to them that he was involved in the transactions or that his customers were paying much higher prices than he had paid for the bonds a few days before. He testified that he had around 50 retail customers during the 2008-2009 time period, of whom 10-15 were active customers who bought municipal bonds from him through GMCI.[20] He acknowledged that his customers looked to him for advice on which bonds to buy and sell.[21] He said that they were wealthy families who were interested in the favorable tax treatment of municipal bonds, and that they turned to him for advice because he was the expert on municipal bonds.[22] He testified that he solicited the sales of the six municipal bonds charged in the Complaint.[23] He also acknowledged that he set all the prices on all the legs of the transactions – the price at which he or the Firm bought the bonds from the "street," the price at which he purchased the bonds from GMCI, the price at which he sold the bonds to GMCI, and the price at which GMCI sold the bonds to Grey's retail customers.[24] He admitted that he did not disclose to the customers that he was selling them bonds from his personal

[19] Hearing Tr. (Walley) at 113.

[20] Hearing Tr. (Grey) at 139-40.

[21] Hearing Tr. (Grey) at 147.

[22] Hearing Tr. (Grey) at 147-48.

[23] Hearing Tr. (Grey) at 157.

[24] Hearing Tr. (Grey) at 154-57.

account,[25] and that he never disclosed the prices at which he had acquired the bonds.[26] As a result, Grey's customers never knew the amount of the markups on the bonds.

C. Respondent's Counter Assertions Of Fact

Although Grey did not dispute that he routed the bonds in issue through his personal accounts without disclosing his personal involvement in the transactions, he made certain counter assertions of fact in his defense that are relevant to the violations alleged and the sanctions. He asserted that, despite the interpositioning of his personal accounts in a chain of transactions, he charged no markups at all on the sales to his customers. He also asserted that he had no conflict of interest, and that his Firm's policies and procedures did not set a maximum of three percent on the markup for any municipal bond. The Hearing Panel specifically rejects these assertions.

Markups. Grey claimed that he charged no markups because he sold the bonds at issue at the same price he would have charged another dealer. He called that price a "wholesale" price. He said: "They [the bonds at issue] weren't marked up at all. The price that the customers paid was what I determined was the fair market value, not the fair market value plus the markup."[27]

He explained his assertion by reference to the Osceola bond as an example. He bought the bond at 71.25, but he believed that the "fair market value" of the bond when he bought it was 81. Eventually, after GCMI sold the bond to Grey's personal account and Grey sold the bond back to GCMI, the retail customer bought the bond at 84.17. However, Grey testified that he did not charge a markup to the customer because he had determined that the fair market value

[25] Hearing Tr. (Grey) at 158-59.

[26] Hearing Tr. (Grey) at 159.

[27] Hearing Tr. (Grey) at 188.

without any markup was 84.17. He said, "I didn't charge a markup. I felt the fair market value of that bond was 84.17 and I worked down from there."[28] He expanded on his answer to say that if he had charged a markup he would have charged the customer even more than the 84.17 he charged. He said, "I would have charged 84.17 plus a commission. I didn't. I felt that 84.17 was the fair market value for that bond without any kind of markup."[29]

The Hearing Panel finds that Grey charged markups. The prices his customers paid were not "wholesale" prices. There was no evidence that Grey had another dealer ready to pay the price at which Grey offered and sold the bonds to his customers, although Grey testified that he might have put out an "ask" for bids on some of the bonds. Nor was there any evidence that other dealers were trading in the market at the high prices Grey charged his customers. The Hearing Panel finds that Grey sold the bonds to his customers at a price that he could not have obtained at the time in an interdealer trade.[30]

Conflict Of Interest. Grey also denied that he had any conflict of interest. When asked whether the money he made in his personal accounts from the six transactions constituted a conflict of interest, he responded, "No, because I gave my clients good prices on those bonds. My job is to give the client a fair price for their bonds."[31] He was asked again whether selling

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[28] Hearing Tr. (Grey) at 206.

[29] *Id.* Grey testified that his "cost basis" was irrelevant to the issue of the appropriate markups. He said that "fair market value of that bond at the time" of the sale to the retail customer was what mattered in determining whether he charged excessive markups. Hearing Tr. (Grey) at 236. It was somewhat difficult to know what Grey meant by the term "fair market value." There was testimony regarding a number of different terms that were not clearly distinguished from one another, with bid and ask prices sometimes referred to as "prevailing" prices and value sometimes referred to as "prevailing market value." Hearing Tr. (Grey) at 215-16.

[30] The fact that Grey may have sought to sell to the "street" at the price he charged his customers and failed to obtain a buyer only confirms that the prices at which he sold to his retail customers were not "wholesale" prices. Rather, they were Grey's desired prices.

[31] Hearing Tr. (Grey) at 158.

from his accounts was a conflict of interest, and, again, he said "Not at all."[32] For a third time he was asked, "You view none of the activity on CX-2 [the exhibit summarizing the trading] as any type of conflict of interest?" Before responding ,"No,"[33] he justified his view by saying, "I live and breathe the bonds. I'm a trader for 30 years. I can set a price of a bond as good as ten other bond traders out there."[34]

The Hearing Panel finds that Grey's use of his personal accounts in intermediary transactions created a conflict of interest. Grey essentially played two roles at once in the transactions – as a trader with a self-interest and as a broker with a duty to act in the interest of his customers. Those interests were in conflict.

Firm Policies. GMCI's Written Supervisory Procedures Manual ("WSPs") contained a provision that cautioned its representatives against charging more than a three percent markup on fixed income securities. In that provision, section 12.4.1, the Firm warned that regulators would object to any markup on a fixed income security in excess of 3% and might charge fraud. The Firm expressly noted that government securities were included in this policy.[35]

When Grey was questioned about section 12.4.1, and whether it meant that GMCI did not want its registered representatives to charge more than three percent on municipal securities, Grey equivocated and suggested that the provision did not apply to municipal securities. He said, "[I]t only specifies government securities….Do I see municipals in there?"[36] He was asked whether he would agree that a municipal security is a type of fixed income security. He

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[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] CX-41at 68.

[36] Hearing Tr. (Grey) at 182-83.

responded, "But it's not – there's no mention of municipal securities in that p[ara]graph, just government securities."[37] Eventually, Grey admitted that a municipal security is a fixed income security and a debt security, but he returned to his assertion that section 12.4.1 "only says government securities there."[38] He would only concede that "possibly" that provision would apply to municipal securities.[39]

Grey's reading of the Firm's policy regarding a three percent limit on fixed income markups is wrong, and the Hearing Panel flatly rejects it. Section 12.4.1 clearly covers municipal securities and sets three percent as the maximum markup on such securities. The Hearing Panel further finds that Grey's attempt to "cleverly" read the policy to avoid its clear import diminishes his credibility overall.

D. Enforcement's Expert

Enforcement's expert on municipal securities conducted a detailed analysis of the prevailing market price on the six bonds at the time Grey sold them to his retail customers and concluded that Grey had charged excessive markups. The expert further concluded that Grey should have disclosed to his customers his personal involvement in the transactions and the resulting high markups. The Hearing Panel finds the opinion of Enforcement's expert reliable and correct in all regards.

<u>Qualifications.</u> Enforcement's expert was James D. McKinney, the manager of all fixed income securities at William Blair for almost three decades. McKinney recently stepped into an advisory role at his firm, but prior to that he managed all of the firm's fixed income activities,

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[37] *Id.* at 183.

[38] *Id.* at 183-84.

[39] *Id.* at 184.

supervising five trading desks and the activities of more than 70 representatives, traders, and salespeople. He has been with the firm for 39 years, 28 of them as a manager. As a manager, he oversaw bond pricing decisions by traders and made sure that they were fair and appropriate. He reviewed all of the firm's municipal bond trades for appropriateness of markups.[40]

Opinion. In summary, McKinney testified that Grey's customers paid substantially more than the prevailing market price for the six bonds at issue. He characterized the markups as excessive. He also testified that Grey should have disclosed his personal involvement in the transactions and the resulting excessive markups.[41] The expert labeled Grey's trading as "chicanery."[42]

McKinney summarized his conclusions as follows:

> Two things. One, I thought the markups were beyond egregious, they were so high, and then I guess the thing that really glared at me that I've never seen before is the fact that these bonds were moved through someone's personal account as part of this markup.[43]

McKinney explained how he reached the conclusion that GMCI, through Grey, had charged egregiously high markups. He estimated the prevailing market price at the time of the retail customer's purchase. He then added an appropriate markup, in each case three percent or less. When that total was compared to the price the customer actually paid, the difference was the excessive markup.[44]

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[40] Hearing Tr. (McKinney) at 283-90. The Hearing Panel accepted McKinney as an expert on municipal bonds. *Id.* at 290.

[41] Hearing Tr. (McKinney) at 304-17.

[42] Hearing Tr. (McKinney) at 319.

[43] Hearing Tr. (McKinney) at 292.

[44] Hearing Tr. (McKinney) at 292-302.

Prevailing Market Price

In estimating the prevailing market price for each bond, McKinney first took note of the price at which Grey or GCMI acquired a bond, and then he followed the changes in price until Grey's retail customer purchased the bond. He noted the dates of the trades and checked EMMA, the MSRB website with data on the trading history of every bond, to see whether any trades on the bonds occurred in the market between those dates. McKinney explained that "the process [for determining prevailing market price] is always to look at what the trade was between two professionals, when two people agree."[45] He testified that there were no trades in the market on the CUSIP numbers for the bonds at issue during the interim between Grey's acquisition and the ultimate sale to the retail customer. Thus, the best evidence of the prevailing market price for any one of the bonds at issue was the interdealer trade by which Grey acquired each bond.

However, McKinney did more. In an effort to estimate the prevailing market price for each bond at the time the retail customer purchased from GCMI through Grey, McKinney studied the particular characteristics of each bond, along with the rating and the overall market. If there was general market motion for similar types of bonds during the period between Grey's acquisition and his sale to his customer, McKinney gave Grey the benefit of that motion, saying that roughly the market had moved so many basis points and adding those basis points to the prevailing market price when the market moved up. He did not, however, lower his estimate of the prevailing market price for Grey's bonds when the market moved downward.[46]

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[45] Hearing Tr. (McKinney) at 295.

[46] Hearing Tr. (McKinney) at 291-93.

McKinney also examined with respect to each bond whether there was a material event that would explain an increase in the prevailing market price from the time that Grey acquired the bond, either for himself or for GMCI, and the time that the retail customer purchased the bond at a much higher price. He said, "I can tell you that none of these bonds had a material event notice, I checked all that. There was no material event on any of these bonds during this period of time…."[47]

Excessive Markups

McKinney testified that for at least a dozen years the industry has understood that a three percent markup is the maximum markup permitted on municipal bonds. He said that any markup over three percent is going to be a "flag" to regulators, who will then say "you've got some explaining to do."[48] According to McKinney, "It's in almost everyone's manual now reflecting that the maximum markups are going to be at three percent."[49] He emphasized that three percent is the maximum permitted but that most traders would impose a smaller markup in most transactions. Regarding the 2008-2009 timeframe, he said, "Just to be clear, I think when we say three percent, that's certainly the maximum. I think if you were to go any one day and go look at 150 pages of EMMA, you are going to see almost no trades at three percent. Most trades are being done for a quarter of a point, a half a point. That's the kind of range you would generally see and that's in 90-percent plus of traders."[50]

[47] Hearing Tr. (McKinney) at 375.

[48] Hearing Tr. (McKinney) at 303.

[49] Hearing Tr. (McKinney) at 303. Indeed, GMCI's compliance manual specified that the maximum markup permitted on municipal bond sales was three percent. CX-41 at 68.

[50] Hearing Tr. (McKinney) at 304-05.

McKinney's analysis showed that the markups on the transactions on the six municipal bonds in issue were well in excess of three percent. He testified that all of the markups were excessive. That testimony on the amount of Grey's markups is summarized as follows:[51]

Osceola	14.38%
Ocala	5.36%
Collier	19.12%
Florida State	16.88%
Highlands (Health)	8.26%
Highlands (School)	6.64%

Failure To Disclose

McKinney testified that Grey should have disclosed his involvement in the transactions to his customers, along with the fact that they were paying him and his Firm excessive markups. He explained that Grey's customers would not know from public sources that he was involved in the transactions. They would only know if Grey himself told them. McKinney testified that EMMA, which shows the trading history of each municipal bond, would only show the transactions by which Grey put the bonds in his own accounts as "customer" purchases of the bonds. EMMA does not identify who the customer is, so a person checking on the trading

[51] Hearing Tr. (McKinney) at 305-14; CX-3, CX-31. As discussed above, McKinney's calculations took into account a variety of factors in addition to the price at which Grey purchased the bonds and sometimes gave Grey the benefit of the doubt. For that reason, McKinney's estimates of the excessive markups are smaller than the estimates that Enforcement pleaded in the Complaint. The estimates in the Complaint appeared to be based solely on the difference between Grey's acquisition price and the eventual retail sale price. In particular, as to the transactions alleged in paragraph 58 of the Complaint to be fraudulent, the excessive markups pleaded and proved were the following: Collier (pleaded 19.89%; proved 19.12%); Florida State (pleaded 22.92%; proved 16.88%); Highland Health (pleaded 9.88%; proved 8.62%); and Osceola (pleaded 18.13%; proved 14.38%).

history of a bond would never know that Grey, the broker recommending that the customer buy the bond, was actually on the other side of the transaction.[52]

McKinney was critical of Grey's pattern of secret self-dealing when he had a conflict of interest. He said, "[Grey] was dealing from his own personal account, which I think is highly unethical because it's a practice that I don't know anyone who allows. But the point is that the customer needed to know that because there is an obvious conflict of interest when he's dealing from his own account."[53] He returned to the unusual nature of Grey's practice, saying, "I mean, in 41 years, I've never seen anybody sell bonds from an individual account directly to a client, especially not in this sort of a scheme…."[54] McKinney firmly concluded that the Grey should have disclosed that he had bought the bonds more cheaply only shortly before selling them to the customers, "[Grey] is conflicted. He is taking all the profit and giving it to himself. That's the point I'm making; his conflict got him in trouble. And he should have told his customer, hey, guess what, I bought these bonds ten points cheaper and I ran them through another account, I hope you are happy with that….He was conflicted beyond anything I've seen in my career what he did."[55]

[52] Hearing Tr. (McKinney) at 314-15.

[53] *Id.* at 315.

[54] Hearing Tr. (McKinney) at 317.

[55] Hearing Tr. (McKinney) at 389-90.

McKinney expanded on his criticism:

> And bonds like these, these little odd lots that were around with these high yields, they were all over the place. They were like grains of sand on the beach. So a customer who comes in who is sitting in his office who doesn't watch the market all day doesn't know about all the values that are in there, but he is supposed to be able to call his broker and know that he is going to go out and find him the best value he can in the market at the time; not, well, you are not entitled to the real price, you are entitled to whatever goes through my IRA account because I'm going to take the bulk of this profit out of the trade and give you a so-so yield that is okay, but it's not the best execution.[56]

McKinney described Grey as wearing the hat of a proprietary trader when he acquired the bonds and then putting on a different hat purporting to protect his customers when he sold the bonds, except that he always made sure that the largest part of the markup or profit accrued to him alone and not to his Firm.[57] As noted above, McKinney concluded that Grey's pattern and practice amounted to "chicanery."[58]

Hearing Panel Findings. In all respects, the Hearing Panel finds McKinney's methodology for determining the prevailing market price of the six bonds reliable. McKinney also was more favorable to Grey than if he had strictly applied his methodology to all the transactions. Accordingly, the Panel finds McKinney's estimates of the prevailing market price of the six bonds at issue at the time of Grey's sales to customers to be accurate. The Hearing Panel also finds McKinney's testimony concerning the industry standard and the customary three percent maximum markup on municipal bonds reliable. Accordingly, the Panel accepts the

[56] Hearing Tr. (McKinney) at 319.

[57] Hearing Tr. (McKinney) at 315-16.

[58] Hearing Tr. (McKinney) at 319. McKinney pointed out a fact that strongly suggests that Grey knew that he was engaged in wrongdoing. The bulk of the profit or markup on the subject transactions was taken by Grey in his sale back to his Firm. When the Firm sold the bonds to the customers, its ostensible markup was in the three percent range. The perception from the publicly available information would have been that the customer had purchased the bonds and paid a standard three percent markup. Grey's personal involvement would have been concealed, making it impossible for Grey's customers to uncover his scheme on their own.

expert's assessment of Grey's markups – they were excessive. Finally, the Hearing Panel agrees with the expert's analysis of the deception Grey practiced on his customers. The Hearing Panel concludes that Grey purposely, knowingly, and willfully concealed his self-interest in the transactions and that his customers were paying excessive markups far beyond the industry standard of a maximum of three percent, which also was all the Firm allowed.

E. Respondent's Experts

Respondent presented the testimony of two experts. One qualified as an expert on ethics, the other as an expert on municipal bonds. Neither of them provides any basis for doubting, much less rejecting, McKinney's opinions. The Hearing Panel finds that their opinions should be disregarded.

(1) Respondent's Ethics Expert

Qualifications. Respondent's ethics expert was David Paulakaitis, who had been in increasingly senior positions with NASD for 23 years before joining Mainstay Capital Markets Consultants, which provides consulting services on compliance regulatory issues.[59]

Opinion. Paulakaitis testified that the concept of conflict of interest is "integral" to the securities industry. He said that there are inherent conflicts of interest whenever a broker sells a security to a customer because the broker expects to generate a commission. He noted that there is a conflict of interest whenever a broker-dealer sells a security out of a proprietary account because the firm expects to generate a markup or profit on the transaction.[60]

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[59] Hearing Tr. (Paulakaitis) at 483-87, 528-29. The Hearing Panel accepted Paulakaitis as an expert on the subject of ethics but rejected Paulakaitis as a municipal securities expert. Hearing Tr. at 508. Paulakaitis has no expertise in the municipal securities business except for teaching a basic course more than a dozen years ago to examiners that included municipal securities as one of its subjects. Hearing Tr. (*voir dire* by Enforcement and ruling by Hearing Officer) at 493-508.

[60] Hearing Tr. (Paulakaitis) at 488-89.

Paulakaitis testified that Grey's conflict of interest was no different than that of a proprietary account at a broker-dealer.[61] Although Paulakaitis acknowledged that Grey's pattern of running municipal bond trades in and out of his personal accounts was highly unusual, he said that it was not of itself a violation of any industry rule or practice.[62] Because he viewed Grey's trading as the same as an inventory account at a brokerage firm, Paulakiaitis testified that Grey did not need to disclose the markups to his customers.[63]

Hearing Panel Findings. The Hearing Panel disagrees with Paulakaitis's conclusion that Grey's personal accounts were the same as a brokerage firm inventory account. Grey's trading was significantly different from trading in a firm's proprietary account. After running the bonds through his personal accounts, Grey marked them up when he sold them back to the Firm, sometimes substantially more than three percent. Then the Firm marked them up again before selling the bonds to the customers. The Firm had a policy of limiting markups on municipal bonds to a maximum of three percent.[64] If the bonds at issue had been sold to the customers directly by GMCI without intermediary transactions, the sales to the customers would have been subject to the Firm's policy limiting markups to no more than three percent and there would have been no intermediate markups.

The transactions looked normal and customary, but were not. The extra steps by which the bonds moved to Grey's personal account and then back to the Firm gave Grey the incentive

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[61] Hearing Tr. (Paulakaitis) at 510-18, 528. The expert's words were, "Him engaging in the capacity as a proprietary trader – it happens to be his personal account in this context under the supervision of [GMCI] – in my view is no different than him trading those same securities in a proprietary account of [GMCI]." *Id.* at 528.

[62] Hearing Tr. (Paulakaitis) at 508-10, 512.

[63] Hearing Tr. (Paulakaitis) at 531-32.

[64] CX-41 at 68. As discussed above, Grey denied that his Firm had a three percent limit on municipal bond markups, but in fact the Firm did have such a policy.

to impose the higher markups, since he was the primary beneficiary; and it was those extra steps that also allowed Grey to mark up the bonds even more than the industry standard maximum. He knew that he could impose excessive markups with impunity because his involvement in the transactions was concealed and GCMI's own markup by itself was within the industry standard.

The extra steps that allowed the increase in the markups had no purpose other than to benefit Grey. Grey suggested that the extra steps were necessary because the Firm had no proprietary account,[65] but there was no evidence that the Firm could not have operated a proprietary account if it had elected to do so; and, in any event, if Grey's accounts were only serving the Firm's need for a place to hold the bonds, the markups should have been in line with what the Firm would have charged. Instead, the arrangement was for the Firm to serve Grey's personal needs as a municipal bond trader. He could count on reselling his bonds to his customers, through the Firm, if he was unable to sell them to the "street."[66]

The Hearing Panel therefore disagrees also with Paulakaitis's conclusion that disclosure was not required. Disclosure was required to eliminate the advantage Grey enjoyed over his customers by virtue of his concealed conflict of interest. Only if there were disclosure could a customer make an informed decision whether to go ahead with the purchase despite the high price.

(2) Respondent's Expert On Municipal Bonds

<u>Qualifications.</u> Respondent's municipal bond expert was John Bagley. He is currently the president of the Bond Desk Trading Group, which is partly a technology business that sells "front ends" for financial advisors, and is partly an ATS or alternative trading system that

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[65] Hearing Tr. (Grey) at 145.

[66] Indeed, Grey's testimony made plain that the arrangement was for his purposes, not the Firm's. He said that if "we" wanted to take the risk (apparently referring to the traders at the Firm) we could, but the Firm would not. Hearing Tr. (Grey) at 145.

provides a platform for showing offers, bids, and other information relating to bonds. Prior to joining that enterprise, Bagley oversaw the entire trading desk for bonds of all sorts at UBS. Earlier in his career, he was a trader and ran municipal bond trading desks.[67]

Opinion. Bagley's opinion on all six of the bonds was that Grey's customers had paid a fair price. After Bagley went through his analysis separately for each of the six bonds,[68] he was asked a summary question: "[I]s it your opinion based upon your expertise and your knowledge of this market that the prices that Tony Grey offered these bonds to his clients at and which they paid for these bonds were all fair, reasonable prices and reflected the prevailing market value of these bonds?" He responded, "Yes, I think at a minimum, they are fair and reasonable, and a lot of them were attractive for his clients at the time."[69]

Bagley described his approach to the analysis as follows. He looked at the price and yield on each bond at the time that Grey sold the bond to his retail customer.[70] He referred to the "MMD" (Thomson Reuters Market, Municipal Market Data), a survey of 20 or so major banks and dealers conducted on a daily basis as to prevalent municipal yields.[71] Then he used that information to consider how that type of bond had traded historically.[72] He testified on that basis that Grey's prices to his customers were "the right price in the scheme of things."[73]

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[67] Hearing Tr. (Bagley) at 412-16. The Hearing Panel accepted Bagley as an expert on municipal bonds. Hearing Tr. at 416.

[68] Hearing Tr. (Bagley) at 436-42.

[69] Hearing r. (Bagley) at 443.

[70] Hearing Tr. (Bagley) at 427-28.

[71] *Id.*; Hearing Tr. (Walley) at 47.

[72] Hearing Tr. (Bagley) at 427-28.

[73] Hearing Tr. (Bagley) at 437 (testifying in particular with regard to the Collier bond).

Bagley summarized the process of finding "comparables": "I've gone through all the securities and my focus has been on what price and yield the client that [Grey] sold them to got on the bonds and I compared that to an MMD scale. On some of them, I was able to find a comparable security and I compared it to that to see where I was, and I looked at where that bond would trade historically. So if the bonds traded 150 over the triple-A scale, I believe that is attractive for a client. I think that is a very good purchase for the client."[74] He continued, "[L]ike I said, I used MMD, or if I could find some comparable trades, I looked at comparable trades. And I thought all of these credits were very attractive on a yield basis to their client, not because the yields are generally high, but because they were attractive relative to whether he would have traded historically or bonds like that were traded historically."[75] Bagley reached back as much as two years for historical trading data.[76]

Hearing Panel Findings. Bagley's opinion is not useful for two reasons. First, he did not address the right question; second, his methodology was flawed.

The first reason his opinion must be rejected is because Bagley did not actually focus on the prevailing market price and whether the prices paid by Grey's retail customers were impermissibly higher than the prevailing market price. Rather, he focused on showing that Grey's customers had received a good deal in light of other information relating to the bonds, such as how high the yield on the bonds was. He opined that the prices paid by Grey's clients were "fair and reasonable" and "attractive."[77]

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[74] Hearing Tr. (Bagley) at 427-28.

[75] Hearing Tr. (Bagley) at 429.

[76] Hearing Tr. (Bagley) at 458.

[77] Hearing Tr. (Bagley) at 443.

Bagley failed to distinguish between two different concepts – his subjective estimate of the underlying value and "right" price of the bonds, and the objective estimate of the prevailing market price at a particular moment in time. He opined as to his estimate of underlying value; he did not focus on the prevailing market price of the bonds at issue at the time Grey's customers purchased them. While prevailing market price might also be viewed as the market's perception of the value of the bonds at a particular point in time, when Bagley discussed value he did not focus his analysis in this way. Nothing he said had any bearing on the question of market perception of the value of the particular bonds at the particular time Grey's customers purchased the bonds. In fact, to the extent that he discussed market perception of the value of the bonds, he condemned it as less accurate than his own estimate of value.[78]

Even assuming that Bagley's opinion on the value of the bonds were relevant to the issues here, it must be rejected for a second reason. The methodology on which Bagley based his opinion was flawed. Bagley used "comparables" that were not comparable because they

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[78] Bagley testified that interdealer trades did not establish the prevailing market price. On cross-examination, Bagley was asked whether he would agree that "when two firms trade a bond, … that sets the fair market value for that bond at that given point in time?" He responded: "No, I don't agree with that. I think it's possible that it does….So I think that though the interdealer firms can often be that, I don't think it necessarily means all the time because I don't know circumstances behind why somebody had to sell and why somebody bought." Hearing Tr. (Bagley) at 449-50. Bagley said he focused mainly on customer trades. Hearing Tr. (Bagley) at 452.

Bagley was asked whether the interdealer trade between Edward Jones and GMCI by which Grey first acquired the Osceola bonds at issue in this case established the fair market value of the bonds at that time. He responded, "I didn't look at what the fair price was between two interdealer brokers. I looked at the price Tony's client paid. That's what I looked at being relevant. Hearing Tr. (Bagley) at 450.

Bagley considered but rejected some interdealer trades in his analysis based on his subjective judgment whether the price was "right." He said: "When I did my analysis, there were many times I threw out interdealer trades because I didn't think they were relevant or the price was wrong. So just because they are interdealer trades doesn't mean they are right." Hearing Tr. (Bagley) at 453. He repeatedly said that interdealer trades in the particular bonds at issue were "cheap" and that other trading was more relevant. Hearing Tr. (Bagley) at 453-58.

involved transactions in different bonds and those transactions occurred as much as two years earlier.[79] The "comparables" were not relevant to the particular bonds at issue and were not relevant to the particular time of the transactions at issue. Not only that – the "comparables" were actually chosen by Grey for Bagley's consideration, apparently based on Grey's judgment regarding comparability, not Bagley's.[80] This fact came out in cross-examination of Bagley, after Grey's testimony had concluded. There was no meaningful evidence as to why the selected "comparables" should be accepted as comparable or as to why various other transactions were, for whatever reason, not offered as "comparables."

F. Summary Of Fact Findings

The facts are clear. Grey traded in municipal bonds for his own account and his own benefit, interposing his personal accounts between his acquisition of municipal bonds and any ultimate sales by his Firm to his customers. He did not disclose to his customers either his personal involvement in the transactions or that the intermediary transactions resulted in higher prices to the customers. The markups to Grey's customers were excessive when compared to the prevailing market price at the time of the customer transactions. Grey structured the multi-legged transactions and set the prices in such a way that the Hearing Panel can only conclude that he acted knowingly and intentionally. The bulk of the markups were hidden in the transactions routed through his personal accounts. By this means, he was able to make it appear that the Firm only charged a markup within the industry standard of a three percent maximum, when, in fact, his customers were paying a price far higher than the prevailing market price.

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[79] Hearing Tr. (Bagley) at 458-59.

[80] Hearing Tr. (Bagley) at 463-64.

IV. CONCLUSIONS OF LAW

As to all ten customer transactions in the six bonds, Grey willfully violated MSRB Rules regarding fair dealing (MSRB Rule G-17) and fair pricing (MSRB Rule G-30). As to the transactions in which the markups ranged from 8.62% to 19.12%, the misconduct also amounted to fraud in violation of Section 10 of the Exchange Act.

A. Grey Willfully Violated MSRB Rules G-17 and G-30

(1) MSRB G-17

The fair dealing Rule, MSRB Rule G-17, is broad. It requires any broker or dealer to "deal fairly with all persons" and prohibits brokers from engaging in "any deceptive, dishonest, or unfair practice."[81] It encompasses both a general requirement of fair dealing, regardless of scienter,[82] and a prohibition against fraud and deceit.[83]

MSRB Rule G-17 is the MSRB counterpart of NASD Rule 2110 (now FINRA Rule 2010), and the case law under NASD Rule 2110 is viewed as applicable to MSRB G-17.[84] It is well-established that NASD Rule 2110 serves "as an industry backstop for the representation, inherent in the relationship between a securities professional and a customer, that the customer

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[81] MSRB Rules are found on the MSRB website at www.msrb.org/Rules-and-Interpretations.

[82] *See Dep't of Enforcement v. SFI Investments, Inc.*, No. C10970176, 2000 NASD Discip. LEXIS 52, at *33 (OHO Mar. 28, 2000) ("G-17, like Conduct Rule 2110, 'seek[s] to discourage not only fraudulent conduct, but also conduct that is unfair or unethical….'").

[83] *See* Reminder of Customer Protection Obligations in Connection with Sales of Municipal Securities – March 30, 2007 ("Customer Protection Obligations – Mar. 30, 2007"); MSRB Answers Frequently Asked Questions Regarding Dealer Disclosure Obligations Under MSRB Rule G-17 – November 30, 2011 ("MSRB FAQs – Nov. 30, 2011"), both of which are found on the MSRB website under Interpretations of Rule G-17 (www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17). *See also SFI Investments*, at *32-33.

[84] *SFI Investments*, at *32 and n.78.

will be dealt with fairly and in accordance with the standards of the profession."[85] NASD Rule 2110 preserves power to discipline members for a wide variety of misconduct, including merely "unethical behavior."[86] It is unfair and unethical, and a violation of NASD Rule 2110, for a broker to interpose his own accounts between the customer and the prevailing market.[87]

Under NASD Rule 2110, brokers have the same duty to determine the prevailing market price when setting markups on debt securities as they do under MSRB G-17. Where there is no contemporaneous trading at the time of the sale to the customer, the best evidence of the current or prevailing market price is considered to be the dealer's contemporaneous cost of acquiring the security, if it occurs sufficiently close in time to the customer transaction as to make the presumption reasonable. If the dealer believes that circumstances justify a different basis of calculating the prevailing market price, then the burden is on the dealer to come forward with evidence showing that the dealer's cost should not be deemed the prevailing market price. [88]

(2) <u>MSRB G-30</u>

The fair pricing Rule, MSRB G-30, focuses specifically on the pricing of municipal bonds. In principal transactions, where a dealer sells municipal securities for its own account to a customer, the seller is required to charge a "fair and reasonable" price or markup, taking into consideration all relevant factors, including, among other factors, the "fair market value of the securities at the time of the transaction."

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[85] *Dep't of Enforcement v. Golonka*, No. 2009017439601, 2013 FINRA Discip. LEXIS 5, at *22 (NAC Mar. 4, 2013).

[86] *Heath v. SEC*, 586 F.3d 122, 134 (2d Cir. 2009), *cert. denied*, 130 S. Ct. 2351 (2010).

[87] *Dep't of Market Regulation v. Lane*, No. 20070082049, 2012 FINRA Discip. LEXIS 49, at *27-28 (OHO July 2, 2012), *appeal docketed* (NAC July 26, 2012).

[88] *Dep't of Enforcement v. David Lerner Assoc., Inc.* ("Lerner"), No. 20050007427, 2012 FINRA Discip. LEXIS 44, at*60-61 (OHO Apr. 4, 2012), appeal docketed (NAC Apr. 27, 2012).

*(3) **MSRB Interpretations Of Its Rules***

The MSRB has issued interpretations putting industry members on notice of their duties of fair dealing and fair pricing under the two MSRB Rules. In those interpretations, the MSRB has expressly stated two duties that are derived from the Rules and that apply here.

One is a general duty under MSRB Rule G-17 to disclose all material information that is not generally available from industry sources but is known to the dealer, along with material information about the security that is reasonably accessible to the market.[89] Information is material "if there is a substantial likelihood that its disclosure would have been considered important or significant by a reasonable investor."[90] The required disclosure must be made before or at the time of the transaction with the customer.[91]

The other duty described in the MSRB interpretations is a specific duty under MSRB Rule G-30 in pricing municipal bonds. In the process of determining what is a "fair and reasonable" markup (as required by MSRB Rule G-30), a broker has a duty to ascertain the prevailing market price of the security by reference to the interdealer price at the time of the customer sale.[92] It is well-established that a determination of the prevailing market price is the

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[89] *See* Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities – July 14, 2009, which is found on the MSRB website under Interpretations of Rule G-17 (www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17) ("Disclosure and Sales Practice Obligations – July 14, 2009").

[90] *Id.* The MSRB's articulation of the definition of materiality is derived from *Basic v. Levinson*, 485 U.S. 224 (1988). Disclosure and Sales Practice Obligations – July 14, 2009 at note 8. The MSRB also looks to an SEC description of material facts as those "facts which a prudent investor should know in order to evaluate the offering before reaching an investment decision." *Id.*

[91] Disclosure and Sales Practice Obligations – July 14, 2009.

[92] *See* Review of Dealer Pricing Responsibilities – January 26, 2004, which is found on the MSRB website under Interpretations of Rule G-30 (www.msrb.org/Rules-and-Interpretations/MSRB-Rules/Rule-G-30) ("Dealer Pricing Responsibilities – Jan. 26, 2004").

first, and most crucial step, in analyzing the appropriate markup on a municipal bond.[93] The MSRB has explained, "Dealer compensation on a principal transaction is considered to be a mark-up or mark-down that is computed from the inter-dealer market price prevailing at the time of the customer transaction."[94] The MSRB has also expressly stated that a customer is entitled to rely on the dealer to ascertain the prevailing market price from interdealer trading and to impose reasonable markups on the basis of that information: "The rules contemplate that the customer may legitimately rely on the dealer to use its market expertise to ensure that the customer's price is reasonably related to market value."[95]

(4) __Grey's Willful Conduct Violated The MSRB Rules__

The evidence showed that the markups on the ten retail customer transactions were excessive in comparison to the prevailing market price at the time Grey sold the bonds to his customers. Grey did not actually attempt to determine the fair market price as reflected in interdealer trading in order to set the markups on the bonds. Rather, he determined whether the yield was attractive and if he thought the underlying credit of the borrower was strong. Based on his subjective judgment, and not on the prevailing market view, he then set the markups on all the transactions to and from his personal accounts and to his customers.

Grey provided no evidence to show that his cost of acquisition should not be deemed the prevailing market price at the time he sold the bonds to his customers only one to four trading days later. In fact, it was McKinney, Enforcement's expert, who provided evidence of a prevailing market price slightly higher than Grey's acquisition cost. McKinney gave Grey some

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[93] *Lerner*, No. 2012 FINRA Discip. LEXIS 44, at *60 ("The 'key issue' in a markup case is determining the 'prevailing market price' for the securities at issue. It is with reference to this price that the dealer must determine the appropriate markup.").

[94] Dealer Pricing Responsibilities – Jan. 26, 2004.

[95] *Id.*

credit for upward market movements during the brief period between his acquisition of the bonds and his sales to his customers. Grey is entitled to no more than that.

Grey was in control of all aspects of the transactions in issue, and he purposely structured the transactions to benefit himself and not his customers. He also structured the trades so as to conceal his involvement in the transactions and the amount of the excessive markups.

The information Grey concealed from his customers was material. It would have been important to the customers that Grey interposed his own accounts between them and the prevailing market and that they were paying substantially higher prices as a result.[96] In fact, it has been long held that interpositioning without disclosure to the customer is a material omission that violates the antifraud provisions of the federal securities laws.[97]

Grey's practice of secretly enriching himself at the expense of his retail customers was certainly not "fair dealing." His practice of charging excessive markups also was not "fair pricing." In addition, his conduct was willful within the meaning of the securities laws and regulations because he did the acts intentionally, not accidentally or inadvertently.[98] The

[96] *See* Disclosure and Sales Practice Obligations – July 14, 2009, *supra*, at nn. 86-87. *See also In re William Jackson Blalock*, Exchange Act Rel. No. 35002, 1994 SEC LEXIS 3677, at *9-10 (Nov. 23, 1994) (a reasonable investor would want to know that the person recommending a thinly-traded security was selling the security from his own account at a substantially higher price than he had paid); *Dep't of Enforcement v. Monroe Parker Sec., Inc.*, No. CAF970011, 1999 NASD Discip. LEXIS 54, at *60-65 (OHO June 18, 1999) (same), *aff'd in part and modified in part on other grounds, Dep't of Enforcement v. Levitov*, 2000 NASD Discip. LEXIS 12 (June 28, 2000).

[97] *See, e.g., Dep't of Enforcement v. Gonchar*, No. CAF040058, 2008 NASD Discip. LEXIS 31, at *27-35 (NAC Aug.. 26, 2008)), *aff'd*, Exchange Act Rel. No. 60506, 2009 SEC LEXIS 2797 (Aug. 14, 2009), *pet. for review denied*, 2010 U.S. App. LEXIS 25763 (2d Cir. 2010); *Robert L. Ridenour*, Initial Decision Release No. 18, 1991 SEC LEXIS 691 (Apr. 9, 1991), *notice of final decision*, Exchange Act Rel. No. 29184, 1991 SEC LEXIS 881 (May 9, 1991); *W.K. Archer & Co.*, Exchange Act Rel. No. 3253, 11 SEC 635, 642 (June 13, 1942), *aff'd*, 133 F.2d 795 (8th Cir. 1943).

[98] In the context of violations of the securities laws and regulations, willfulness is defined as intentionally committing the act that constitutes the violation. *See, e.g., Mathis v. SEC*,, 671 F.3d 210, 216-18 (2d Cir. 2012) (discussing willfulness and collecting cases); *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (willfulness requires only that the person violating his duty knows what he is doing, not that he know he is breaking the law).

Hearing Panel finds in connection with all ten customer transactions at issue that Grey willfully violated MSRB Rules G-17 and G-19.

B. Grey's Willful Conduct Constituted Fraud In Violation Of Section 10(b)

(1) __Section 10(b)__

Section 10(b) of the Exchange Act broadly proscribes securities fraud. The statute provides, "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails … [t]o use or employ, in connection with the purchase of sale of any security … any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."[99]

In an enforcement action such as this, the substantive elements of a violation are the following: (i) a misrepresentation or omission (ii) of a material fact (such that, with respect to an omission, the omission made what was said misleading) (iii) in connection with a purchase or sale of a security, and (iv) that is done with scienter.[100]

(2) __Grey Committed Securities Fraud In Violation Of Section 10(b)__

As to the transactions at markups exceeding 8%, which range from 8.62% to 19.12%, Grey's willful conduct amounted to fraud in violation of Section 10(b) of the Securities Exchange Act. Enforcement proved all four substantive elements of the fraud.

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[99] 15 U.S.C. § 78j.

[100] *SEC v. PIMCO Advisors Fund Management LLC*, 341 F. Supp. 2d 454, 463-64 (S.D.N.Y. 2004). Civil enforcement actions for fraud do not require proof that someone relied on the misrepresentation or misleading omission or that someone was harmed. Those are additional elements of a private action under Section 10(b) for damages.

A Section 10(b) violation also requires that the conduct be accomplished by the jurisdictional means, such as the telephone or U.S. mail, to establish that interstate commerce is involved. This requirement was met. Grey called customers by telephone to offer the bonds and sent customer confirmations through the U.S. mail. Hearing Tr. (Grey) 149-51, 160-62.

First, Grey omitted to inform his customers of facts relating to the transactions. He freely conceded that he did not disclose to his customers that his personal accounts were involved in intermediary transactions prior to the sales to the customers. He also conceded that he did not disclose to his customers that they were paying higher prices as a result of those intermediary transactions, or the amount of the excessive markups.

Second, the omitted facts were material, and their omission misleading. As noted above, it would be important to investors in making their investment decision that their broker was interposing his own accounts between them and the market and causing them to pay higher prices than they would otherwise pay.[101] The importance of the information would be particularly acute in connection with the transactions where the markups ranged from 8.62% to 19.12%. The lowest of those markups was almost triple the industry standard maximum of three percent, and the highest was more than six times as high as the industry standard. Without a doubt, the amount of the excessive markups on these transactions was also material.

The omission of information about these excessively high markups was misleading because a broker has a fundamental and inherent duty to act in the interest of his customers. Without disclosure of the interpositioning and the high markups that resulted, Grey's customers were misled into thinking that Grey was acting in their interest and selling the bonds to them at a price consistent with that duty. It is abundantly clear that he was doing neither – he was not acting in the interest of his customers and his high markups were many times more than the industry standard.

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[101] Materiality is an objective question that turns on the significance of an omitted fact to a reasonable investor. *Amgen, Inc. v. Conn. Ret. Plans & Tr. Funds*, 133 S. Ct. 1184, 1195-96 (Feb. 27, 2013) (citing *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976). *See also Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1318 (2011).

Third, municipal bonds are securities, and the omissions at issue occurred in connection with sales of those securities to retail customers.

Fourth, Grey had scienter. Scienter is "a mental state embracing intent to deceive, manipulate or defraud."[102] A confession is not necessary. Scienter may be proven by circumstantial evidence.[103] The evidence here showed that Grey intentionally routed the bonds through his personal accounts for no purpose other than to enrich himself. It also showed that he arranged the transactions so as to make it appear that the Firm charged only the industry standard markup of three percent, knowing that the customers could not discover the hidden markups created by the intermediary trades. This evidence compels the Hearing Panel to conclude that Grey intentionally deceived his customers.[104]

Interpositioning is widely recognized as a form of securities fraud in violation of Section 10(b).[105] Grey's willful misconduct is a prime example of why. His interpositioning of his personal accounts enabled him to profit excessively at his customers' expense without their knowledge.

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[102] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976) (quoted in *Dep't of Enforcement v. Gonchar*, No. CAF040058, 2006 NASD Discip. LEXIS 46, at *39 n.35 (OHO Oct. 26, 2006)).

[103] *United States v. Mylett*, 97 F.3d 663 (2d Cir. 1996) (quoted in *Dep't of Enforcement v. Gonchar*, 2006 NASD Discip. LEXIS 46, at *39 n.35 (OHO Oct. 26, 2006)).

[104] Certainly, if not intentional, Grey's conduct was reckless, and recklessness satisfies the scienter element of Section 10(b). *See, e.g., SEC v. McNulty*, 137 F.3d 732, 741 (2d Cir. 1998), *cert. denied sub nom. Shanklin v. SEC*, 525 U.S. 931 (1998); *SEC v. U.S. Envtl. Inc.*, 155 F.3d 107, 111 (2d Cir. 1998) (eleven circuits have held that recklessness satisfies scienter).

[105] *See, e.g., Gonchar*, 2006 NASD Discip. LEXIS 46, at *39.

V. **Sanctions**

FINRA's Sanction Guidelines provide the guideposts for sanctions in FINRA disciplinary proceedings.[106] The Sanction Guidelines set forth recommendations regarding sanctions for violations of specific rules. The Sanction Guidelines also instruct adjudicators to consult the Principal Considerations applicable to all determinations of sanctions,[107] and the General Principles for all sanction determinations.[108]

Two types of specific recommendations apply to this case. One set applies to violations involving misleading omissions of material fact. The other set applies to excessive markups.

The recommended sanctions for an individual who intentionally or recklessly makes misleading omissions of material fact range from a suspension for ten business days to a suspension for up to two years. In addition, a respondent may be fined from $10,000 to $100,000. In egregious cases, a person may be barred in any or all capacities.[109] These recommendations specifically apply violations of MSRB Rule G-17 and securities fraud under Section 10(b).[110]

There is a similar broad range of sanctions for excessive markups. In an egregious case, an individual may be suspended for as much as two years or barred. In addition, a fine may be imposed of $5,000 to $100,000, and payment of the excessive markups may be ordered. These

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[106] FINRA Sanction Guidelines (2011) ("Sanction Guidelines"), available at www.finra.org/oho (then follow "Enforcement" hyperlink to "Sanction Guidelines").

[107] Sanction Guidelines at 1, 88, 90.

[108] Sanction Guidelines at 2-5.

[109] Sanction Guidelines at 88.

[110] Sanction Guidelines at 90.

recommendations specifically apply to violations of MSRB Rule G-30, as well as its NASD and FINRA counterparts.[111]

Because the same misconduct underlies all the violations, the Panel imposes sanctions in the aggregate. The Panel concludes that a division of the sanctions among the different violations would not be logical and could be viewed as arbitrary. The aggregation or "batching" of violations is authorized in appropriate circumstances.[112]

The Hearing Panel has determined the sanctions here with close attention to the specific recommendations and relevant Principal Considerations and General Principles. In particular, the Panel is concerned to impose sanctions that will impress upon Grey the nature and significance of his misconduct.[113] He has demonstrated no understanding of how he breached a duty owed to his customers to act in their interest, not his.[114]

The Hearing Panel finds that Respondent lacks any recognition of his wrongdoing, an aggravating factor for purposes of sanctions.[115] At the hearing, Respondent not only displayed no remorse, but in some instances he denied the plain truth. For example, he maintained that he had benefited his customers by giving them a "wholesale" price without any markup. This assertion is not true. Grey also denied that he had any conflict of interest, which also is not true, and

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[111] *Id.*

[112] General Principle 4 gives some examples of when it may be appropriate to aggregate violations for purposes of sanctions. It does not limit the aggregation of violations for purposes of sanctions to just those examples. Sanction Guidelines at 4.

[113] General Principle 1 instructs that disciplinary sanctions are remedial and should be designed to deter future misconduct and improve overall business standards in the securities industry. The sanctions should be significant enough to prevent and discourage future misconduct by a respondent or by others in the industry. Sanction Guidelines at 2.

[114] Principal Consideration 2 requires consideration of whether an individual accepted responsibility for and acknowledged the misconduct to his employer or a regulator prior to detection and intervention. *Id.*

[115] *Id.*

which betrays Grey's profound lack of regard for his duties to his customers. In yet another example of his refusal to acknowledge the facts, Grey espoused a tortured reading of his firm's procedures and policies so as to permit his conduct, when, in fact, the firm's policies and procedures clearly prohibited it.

Grey's whole pattern of doing business was to treat his customers as a resource for his own profit and liquidity in connection with his personal bond trading.[116] He purposefully put his self-interest ahead of his duty to his customers to look out for their interest,[117] and he designed a method of trading for his own benefit that concealed from his customers that he was charging them far more than industry standard markups.[118] He engaged in the misconduct to enrich himself.[119] Grey also injured his customers when he charged them more than they should have been charged. While the absolute amounts of the overcharge in dollar terms are small, the percentages are large.[120] These are all aggravating factors.

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[116] General Principle 6 authorizes adjudicators to consider the respondent's ill-gotten gain when determining the appropriate remedy. Sanction Guidelines at 5.

[117] Principal Consideration 13 requires an adjudicator to take into account whether the respondent acted intentionally or recklessly, rather than merely negligently. Grey acted intentionally, or, at a minimum, recklessly. Sanction Guidelines at 7.

[118] Under Principal Consideration 10, it is an aggravating factor that a respondent attempted to conceal his misconduct or to deceive or mislead a customer. Sanction Guidelines at 6.

[119] Principal Consideration 17 requires consideration of whether the misconduct had the potential of financial reward to the respondent. In this case, the misconduct had no other purpose but to create financial gain for Grey. Sanction Guidelines at 7.

[120] Principal Consideration 11 directs adjudicators to consider whether the respondent's misconduct injured another person, particularly an investor, and to analyze the nature and extent of the injury. Sanction Guidelines at 6.

The Hearing Panel finds that Grey's violations were egregious. Accordingly, the Panel concludes that Grey should be suspended for two years;[121] fined $30,000;[122] and ordered to pay disgorgement in the amount of $16,000.[123]

VI. **Order**

The Hearing Panel finds that Respondent, Anthony A. Grey, willfully violated MSRB Rules G-17 and G-30 and Section 10(b) of the Exchange Act.

For all of these violations in the aggregate, Respondent is suspended from association with any FINRA member firm in any capacity for two years, fined a total of $30,000, ordered to pay disgorgement in the amount of $16,000, and Respondent is also ordered to pay the costs of the hearing in the amount of $5,267.32 which includes a $750 administrative fee and the cost of the transcript.[124] If this decision becomes FINRA's final disciplinary action, Grey's suspension shall commence on August 19, 2013, and end

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[121] The two-year suspension is at the top of the range of suspensions for this type of conduct. This is appropriate in recognition of the egregious nature of the violations and Grey's steadfast refusal to recognize the true nature of his conduct. The Hearing Panel viewed Enforcement's request for only a one-year suspension as too low in light of the evidence adduced at the hearing.

[122] Enforcement folded its request for disgorgement together with its requested fine for a total fine of $36,000. Dep't of Enforcement's Pre-Hearing Brief at 15. The Hearing Panel separates the fine and disgorgement and increases the total amount of fine plus disgorgement to $46,000.

The amount of the fine here, $30,000, approaches the mid-range of the amount recommended by the Sanction Guidelines for making misleading omissions and for excessive markups. As noted above, the absolute dollar amounts at issue here may have been small but the percentages of the excessive markups were high and the pattern of intentional deception was well-established.

[123] The Sanction Guidelines authorize an adjudicator to consider a respondent's ill-gotten gain when determining an appropriate remedy. The purpose of such a sanction is to deprive a wrongdoer of the benefit of his misconduct, irrespective of the losses suffered by the victims of the misconduct. *See* FINRA Regulatory Notice 11-13 at 2, discussing General Principle 6 (available at http://www.finra.org/industry/regulation/notices). It is often difficult to calculate the amount of a respondent's ill-gotten gain because it is difficult to separate lawful from unlawful gains. Accordingly, disgorgement can be a "reasonable approximation" of the respondent's ill-gotten gains. *Dep't of Enforcement v. Midlothian*, No. 2005003610701, 2011 FINRA Discip. LEXIS 42, at *117 (NAC Oct. 20, 2011). Disgorgement is an appropriate sanction in all sales practice cases, even where a respondent is barred, if a respondent has retained substantial ill-gotten gains. *Id.* at *116. Enforcement estimated the amount of Grey's ill-gotten gain at slightly less than $16,000. Dep't of Enforcement's Pre-Hearing Brief at 15.

[124] The Hearing Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this decision.

at the close of business on August 18, 2015. The fine and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding. Because the violations were willful, Respondent is statutorily disqualified.

Lucinda O. McConathy
Hearing Officer
For the Hearing Panel