BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Robert Conway East Islip, NY, and Kakit Ng Bronx, NY, Respondents.	AMENDED DECISION Complaint No. E102003025201 Dated: October 26, 2010

Respondents executed late trades involving mutual fund shares and used deception to evade mutual fund market-timing restrictions. Held, findings affirmed and sanctions affirmed in part, vacated in part.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Philip J. Berkowitz, Esq., David Jaffe, Esq., Frank M. Weber, Esq., Elissa M. Meth, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Pro Se

Decision

Robert Conway ("Conway") and Kakit Ng ("Ng") appeal an April 23, 2008 Hearing Panel decision.[1] The Hearing Panel found that the respondents failed to observe high standards of commercial honor and just and equitable principles of trade when they executed late trades

[1] This amended decision corrects the date on which the Hearing Panel issued its decision, which was inaccurately stated as October 28, 2008, in the decision issued by FINRA on October 15, 2010.

involving mutual fund shares for hedge funds and used deceptive practices to evade market-timing restrictions imposed by mutual funds. The Hearing Panel, imposing sanctions per cause, fined Conway a total of $100,000, ordered that he disgorge $78,720, and imposed consecutive suspensions restricting his ability to associate with any FINRA member in any capacity for a total of 18 months. The Hearing Panel also fined Ng a total of $20,000 and imposed consecutive suspensions limiting Ng's capacity to associate with any FINRA member in any capacity for a period of nine months.

After an independent review of the entire record, we affirm the Hearing Panel's findings that Conway and Ng each engaged in misconduct that violated FINRA's rules and that this misconduct warrants remedial sanctions.[2] We affirm in part, and vacate in part, the sanctions imposed by the Hearing Panel.

I. Procedural Background

For purposes of this appeal, we are concerned only with the two causes of the Department of Enforcement's ("Enforcement") amended complaint that allege that Conway and Ng engaged in transgressions while each was registered with FINRA through members A.B. Watley, Inc. ("Watley") and A.B. Watley Direct, Inc. ("Watley Direct") (together, the "Watley firms").[3]

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[2] Following the consolidation of NASD and the member regulation, enforcement, and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57* (Oct. 2008). Because the complaint in this case was filed before December 15, 2008, the procedural rules that apply are those that existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

[3] On March 15, 2006, Enforcement filed a five-cause complaint initiating disciplinary proceedings against Conway and Ng and several other respondents, including Watley Direct. On November 27, 2006, Enforcement moved to amend the complaint. The Hearing Officer granted Enforcement's unopposed request to amend the pleading; the complaint was amended on January 26, 2007. The amended complaint did not alter the respondents named or the central theories of wrongdoing set forth in the original complaint's five causes of action.

Each of the respondents, except Conway and Ng, subsequently entered into settlements with FINRA staff to resolve any claims relating to their alleged misconduct. On July 11, 2007, Watley Direct consented to findings that the firm facilitated late and market-timing trades of mutual fund shares, failed to keep certain books and records, and failed to supervise the activities of its registered representatives. Watley Direct was fined $175,000, censured, and agreed to undertake certain reviews and restrictions relating to its ability to transact mutual fund orders on behalf of customers. In a separate proceeding, FINRA expelled Watley on July 2, 2004, for its failure to pay fines and costs resulting from two letters of Acceptance, Waiver & Consent into which the firm entered to resolve disciplinary charges unrelated to this matter.

The first cause of the amended complaint alleged that Conway and Ng, from October 2002 through September 2003, executed "late" trades involving mutual fund shares, in violation of NASD Rule 2110. "Late trading" is the practice of entering an order to buy or sell mutual fund shares after the time at or as of which mutual funds typically value their shares, 4 p.m., and executing the order at the share prices determined for that day as if the order had been received prior to the time of valuation.[4] Enforcement's amended complaint identified 145 instances in which Conway and Ng allegedly processed orders to buy and sell mutual fund shares that were not sent by customers until after 4 p.m. and nevertheless were given that day's share price when executed.

Cause three of Enforcement's amended pleading alleged that Conway and Ng also facilitated transactions that were executed through the Watley firms by certain hedge funds and involved the "market timing" of mutual funds, which is the practice of buying and selling mutual fund shares in short-term trades meant to exploit pricing inefficiencies. In this respect, Enforcement alleged that in 210 instances, from August 2002 through September 2003, Conway and Ng deceptively utilized multiple accounts and branch and representative codes to circumvent systematically the efforts of mutual funds to restrict the market-timing activities of Conway's customers. Enforcement claims that the foregoing conduct also represents a breach of NASD Rule 2110.

Conway and Ng each answered the amended complaint and denied any wrongdoing. After conducting a seven-day hearing, the Hearing Panel issued its decision. In the decision, the panel found that Conway and Ng engaged in the alleged violations of NASD Rule 2110. Conway and Ng each subsequently timely appealed the Hearing Panel's decision to the NAC.[5]

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4 All times noted herein refer to Eastern times.

5 On June 17, 2009, the day prior to scheduled appellate arguments, Enforcement filed a motion seeking to disqualify, under NASD Rule 9332(b), one of the two members of the National Adjudicatory Council ("NAC") subcommittee empanelled to consider this matter (the "Subcommittee") and requested that arguments be postponed. Enforcement asserted that the fairness of the Subcommittee member "might reasonably be questioned" as a result of opinions expressed, both in a law review article and as an expert witness, on certain legal positions being advanced by Enforcement in this case.

The Subcommittee Chair (who was not the subject of Enforcement's motion) issued an oral ruling on June 18, 2009, denying Enforcement's request to postpone arguments scheduled for that day. In his ruling, the Subcommittee Chair stated that Enforcement failed to establish that good cause existed to postpone arguments under NASD Rule 9322, citing in support of his ruling the length of time the proceedings in this matter had been pending, a previous postponement of arguments, and the potential for prejudice to the respondents if arguments were postponed any further. After permitting the respondents an opportunity to respond to Enforcement's motion to disqualify, the NAC Chair (who in this case also served as the Subcommittee Chair) issued a written ruling pursuant to NASD Rule 9332(c). In his July 7, 2009 order, the NAC Chair denied Enforcement's motion to disqualify. The NAC Chair

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II. Facts

A. Conway and Ng Meet

Conway and Ng entered the securities industry in 1993 and 1996, respectively. Over the ensuing years, each was registered to conduct securities business through a number of FINRA member broker-dealers.

Conway began developing customer relationships in 1999 with certain hedge funds that market timed mutual funds. Conway and Ng first met and started working together the next year. Ng later followed Conway to a succession of broker-dealers where they executed mutual fund transactions on behalf of hedge funds that employed market-timing trading strategies.

B. Conway and Ng Join the Watley Firms

The Watley firms hired Conway in July 2002 to establish a business to execute mutual fund orders for hedge funds and institutional customers.[6] The Watley firms expected Conway to bring with him the customers for whom Conway and Ng previously executed mutual fund transactions at other broker-dealers.

From July 3, 2002, until February 3, 2004, Conway was registered through Watley as a general securities representative and as an investment company and variable contracts products - limited representative. From July 23, 2002, until April 16, 2004, Conway was also registered as a general securities representative through Watley Direct.[7] Conway's responsibilities at the Watley firms included communicating with clients, developing new business and customer relationships, and making sure things were "running smoothly."

Soon after Conway joined the Watley firms, Ng was hired to serve as Conway's assistant. Ng was registered as a general securities representative through Watley from October 28, 2002, until February 3, 2004, and as an equity trader – limited representative from November 21, 2003,

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concluded that neither the legal writings nor the expert opinions of the Subcommittee member reasonably called into question his ability to fairly and impartially adjudicate this matter.

[6] The Watley firms operated as subsidiaries of A.B. Watley Group, Inc., and shared common supervisory, compliance, and operations staff, as well as the same office space.

[7] Conway is not currently associated with a FINRA member firm.

until February 3, 2004.[8] From January 16, 2003, until March 17, 2004, Ng was registered through Watley Direct as a general securities representative.[9]

Ng reported directly to Conway and, as Conway's "worker bee," performed much of the everyday work associated with the mutual fund trading conducted by Conway's customers. Ng served as the primary point of contact for customers, processed their account documents, communicated with them daily, accepted and executed their mutual fund orders, and interacted with the Watley firms' clearing broker-dealer, compiled records, and reconciled trades. Although Conway was present at the Watley firms' offices only three or four days a week and generally left the offices at approximately 3:30 p.m., he remained in constant cell-phone contact with Ng concerning any substantial business matters or trading issues that arose during the typical day.

C. Conway Opens Accounts for Hedge Funds

Conway opened accounts through the Watley firms for four hedge funds that traded mutual fund shares. These customers, the entirety of Conway's client base at the Watley firms, were Chronos Asset Management, Inc. ("Chronos"), Nettcorp Group ("Nettcorp"), Simpson Capital Management, Inc. ("Simpson"), and Parametric Capital Management ("Parametric"). Chronos and Simpson were customers that Conway brought with him and for whom the respondents had executed mutual fund trades in the past.[10]

D. Mutual Fund Order Execution Practices

The practice that Conway and Ng used to execute trades involving mutual fund shares was the same at Watley and Watley Direct. The parties stipulated that the process started with a customer sending an email to Conway and Ng that presented an "indication of interest" to engage in certain mutual fund transactions through the Watley firms.[11]

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8 Although Ng did not first register with a Watley firm until October 2002, he in fact began working at the Watley firms' offices in July 2002. Indeed, while still registered through another FINRA member, and prior to registering with either Watley or Watley Direct, Ng helped hedge funds open new accounts through the Watley firms, reviewed and processed correspondence from the Watley firms' clearing broker-dealer concerning mutual fund market-timing restrictions placed upon the trading of these customers, and processed orders to purchase and sell mutual fund shares placed for their Watley firms' accounts.

9 Ng is also not currently associated with a FINRA member firm.

10 Conway started conducting business for Chronos and Simpson in 1999 and 2000, respectively.

11 The customer indicated, either in the text of the email or in an attached spreadsheet, the mutual fund trades that the customer contemplated undertaking in each of the accounts that it maintained through the Watley firms. Customers typically provided the name of the mutual

[Footnote continued on next page]

An indication of interest, however, was a proposed order only. A customer was required later to confirm verbally by telephone the mutual fund transactions that were the subject of the customer's expression of interest. The customer's verbal confirmation typically expressed the customer's desire to "do everything" or "do nothing," meaning that the customer wanted Conway and Ng to execute or cancel, respectively, all of the transactions that were proposed in the customer's earlier indication of interest.[12] The customer's verbal confirmation constituted the customer's order.

After receiving the customer's verbal confirmation, Conway and Ng processed the customer's order, initially by forwarding the customer's indication of interest by facsimile or email to personnel in the mutual fund department at the Watley firms' clearing broker-dealer, Penson Financial Services, Inc. ("Penson").[13] Beginning in October 2002, Conway and Ng utilized an internet-based order-entry system provided by Penson that allowed for the direct submission of mutual fund orders through "Fund/SERV."[14]

E. Mutual Fund Share Prices

The price of a mutual fund share is derived from the value of the fund's assets and liabilities. *See SEC v. Pentagon Capital Mgmt. PLC*, 612 F. Supp. 2d 241, 247 (S.D.N.Y. 2009). A mutual fund generally calculates the "net asset value" or price of its shares once each trading day. *See Joseph John VanCook*, Exchange Act Rel. No. 61039A, 2009 SEC LEXIS 3872, at *4 (Nov. 20, 2009); *see also* 17 C.F.R. § 270.22c-1(b) (requiring that the current net asset value of a mutual fund's securities be determined at least once daily). In practice, a mutual fund typically discloses in its prospectus that the net asset value of its shares is fixed either "at" or "as of" the close of trading upon the American equity markets, which is normally 4 p.m.[15] This proved to be universally true for the mutual funds traded by Conway's customers in this case. The

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fund, the fund's ticker symbol, and the number of shares to be purchased, sold, or exchanged for each proposed trade.

12 Conway and Ng dealt with the same one or two traders for each hedge fund customer's multiple accounts.

13 Penson served as the Watley firms' primary clearing broker-dealer. Chronos, however, maintained two accounts at Watley that cleared through other broker-dealers. The trading that occurred in these accounts is not at issue in this case.

14 Fund/SERV is an order entry platform used by the mutual fund industry for the processing, execution, and settlement of orders involving mutual fund shares.

15 The time at which a mutual fund actually performs the calculation necessary to establish a share's net asset value is not necessarily the same time at which net asset value is fixed.

prospectuses for such mutual funds also commonly stated that mutual fund orders had to be received by 4 p.m. to be executed at that day's net asset value.[16]

Conway and Ng testified that they did not read the prospectuses for the mutual funds traded by Conway's customers. We find, nevertheless, that each was well acquainted with the times that were central to the pricing of mutual fund orders. Conway testified that he knew that customers were required to place mutual fund orders by 4 p.m. Ng's testimony established that he too was attentive to this generally accepted cut-off time for accepting customer orders to trade mutual fund shares.

Penson's order-entry instructional materials further emphasized that correspondent broker-dealers were required to receive a mutual fund order by 4 p.m for pricing at the current day's net asset value.[17] Although it is unclear whether the respondents were familiar with the contents of Penson's instructional materials, on-the-record testimony provided by Stephaney Robinson, the manager of Penson's mutual fund department, established that Conway and Ng were told that they could only process through Penson those mutual fund orders that the respondents received by 4 p.m.[18]

F. Conway and Ng Execute Mutual Fund Trades Late

Enforcement established that three of Conway's customers -- Chronos, Simpson, and Nettcorp -- transmitted 15 indications of interest to the respondents after 4 p.m. Each of the indications of interest, dated between October 15, 2002, and August 7, 2003, identified an even larger number of proposed mutual fund trades. Although each of the indications were presumably also confirmed verbally after 4 p.m., Conway and Ng processed and executed the mutual fund trades outlined within the indications of interest through Penson's order-entry system as if Conway and Ng had received the orders prior to 4 p.m. Conway and Ng executed

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16 In this respect, the prospectuses often disclosed that the time at which an order was received by a mutual fund intermediary, rather than the fund itself, was the time for determining the share price to be assigned for the order's execution.

17 Penson allowed a correspondent to enter and process a mutual fund order through its on-line order-entry system until at least 5 p.m., but only if the order was received from the customer by 4 p.m. Broker-dealers often received customer orders prior to 4 p.m. but did not submit the trades for execution until after 4 p.m. *See Pentagon Capital Mgmt.*, 612 F. Supp. 2d at 248; *NASD Notice to Members 03-50* (Sept. 2003). This fact was reflected in the prospectuses of a number of the mutual funds traded by Conway's customers.

18 Penson's order-entry system did not permit or require a correspondent to indicate the time at which they received a customer's mutual fund order. Penson thus did not know the time at which a customer's mutual fund order was received by the correspondent. Penson instead assumed that any order processed by the correspondent through Penson was received by 4 p.m.

145 mutual fund trades late because of the 15 indications of interest.[19] Each trade received the share price determined for that day.[20]

G. Mutual Fund Market Timing

Market timing commonly refers to the frequent buying and selling of mutual fund shares to exploit inefficiencies in pricing.[21] *Gregory O. Trautman*, Exchange Act Rel. No. 61167, 2009 SEC LEXIS 4173, at *10 & n.13 (Dec. 15, 2009) (collecting cases). Market timing is a highly discouraged practice because the frequent buying and selling of a mutual fund's shares increases the fund's costs and harms the fund's long-term shareholders. *See SEC v. Gann*, 565 F.3d 932, 935 (5th Cir. 2009); *Druffner*, 517 F. Supp. 2d at 506. Many mutual funds and mutual fund companies therefore prohibit market timing or impose stringent restrictions on the frequency of trades in order to limit market-timing activities. *See Gann,* 565 F.3d at 934-35; *Mut. Funds Inv. Lit.*, 529 F.3d at 211; *Druffner*, 517 F. Supp. 2d at 506.

Certain mutual fund companies track market timers and attempt to restrict their practices by monitoring various potential identifiers, including customer account numbers and branch and representative codes. Brokers that frequently buy and sell shares within a mutual fund family for their customers are often sent "stop" notices. A stop or "restriction" notice typically includes a statement of the relevant mutual fund company's objection to market timing and places restrictions upon future trading in the company's family of funds, including the prohibition of purchases or exchanges of shares by certain customer accounts or by a particular broker or his branch office.

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[19] Most, but not all, of the proposed mutual fund trades identified in the relevant indications of interest were executed. The number of late trades identified by Enforcement does not include any proposed mutual fund transactions that Conway's customers ultimately instructed Conway or Ng to cancel.

[20] In its amended complaint, and throughout these proceedings, Enforcement has alluded to the potential of a number of additional instances where Conway and Ng executed mutual fund orders that they received after 4 p.m. Enforcement couched its allegations in these terms because the Watley firms did not keep records of when Conway and Ng received confirming telephone calls from customers and did not require that the respondents time-stamp the receipt or execution of a customer's order. We note, however, that neither Conway nor Ng were charged with any recordkeeping failures in this case and there is insufficient evidence to conclude that the respondents executed additional mutual fund trades late. We thus draw no adverse inferences against Conway and Ng and make no findings concerning any transactions other than the 145 late trades that Enforcement specifically identified in the amended complaint.

[21] Market timers rapidly buy and sell mutual fund shares to exploit momentary discrepancies between the stock prices used to determine the value of a mutual fund's shares, which funds generally calculate only once each day, and the prices at which those stocks are actually trading. *See Mut. Funds Inv. Lit.*, 529 F.3d 207, 210-11 (4th Cir. 2008); *SEC v. Druffner*, 517 F. Supp. 2d 502, 506 (D. Mass. 2007); *SEC v. Pimco Advisors Fund Mgmt. LLC*, 341 F. Supp. 2d 454, 458 (S.D.N.Y. 2004).

H. Conway and Ng Execute Market-Timing Trades that Circumvent Stop Notices

The mutual fund companies whose funds were traded by Conway's customers generally discussed in their fund prospectuses the harmful effects of market timing, disclaimed the frequent trading of mutual fund shares, and reserved the right to restrict or prohibit an investor's trading within their funds when the investor exhibited a pattern of abusive trades made for short-term considerations. From August 2002 through September 2003, Penson received approximately 150 stop notices from mutual fund companies that detected market-timing trading by Conway's customers. The stop notices generally stated that Conway's customers were engaged in market-timing transactions, discussed the detrimental effects that the customers' trading had upon the investment objectives of the relevant mutual funds, and restricted future purchases and exchanges of shares within the respective mutual fund families by customers and certain representative and branch codes.[22]

Conway and Ng received copies of these stop notices from Penson's mutual fund operations department.[23] The respondents also received from Penson lists and spreadsheets that summarized the customer accounts, representative and branch codes, and branch identification numbers "stopped" by various mutual fund companies whose funds had been traded by Conway's customers.

Conway knew well that each of his customers at the Watley firms used market-timing strategies to purchase and sell mutual fund shares.[24] Indeed, Ng also compiled a spreadsheet of mutual fund stop notices and kept copies of the notices in a file.[25] Despite this, Conway and Ng systematically disregarded market-timing restrictions and used various means to execute purchases and exchanges of mutual fund shares within fund families that had restricted their trading.

As the Hearing Panel found, "[t]here is no credible dispute that in at least 210 instances, despite having received stop letters from mutual fund companies, Respondents Ng and Conway

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22 On several occasions, mutual fund companies, invoking rights reserved within their fund prospectuses, rejected and reversed certain trades executed on behalf of Conway's customers that were inconsistent with the mutual fund companies' market-timing policies.

23 Penson personnel also notified Conway and Ng by telephone when it received mutual fund stop notices. Conway or Ng then contacted the appropriate customer to inform it of the restrictions imposed by the particular mutual fund.

24 Conway used the phrase "mutual fund market timing" in emails to the Watley firms' chief compliance officer on more than one occasion to describe the transactions that he and Ng executed for hedge funds.

25 Ng was the primary point of contact between Penson and the Watley firms for market-timing notices. Ng alerted Conway whenever he received stop notices and Conway read them.

processed trades in restricted mutual fund companies" and that they did so "via deceit."[26] The record amply supports the Hearing Panel's findings. The record contains numerous notices from mutual fund companies attempting to stop the market-timing activities of Conway's customers or the trading conducted by representative and branch codes assigned to Conway and Ng. Rather than heed these notices, Conway and Ng used multiple accounts and representative and branch code combinations to make it appear as if different customers and brokers were making trades in the restricted mutual funds.

Conway, with Ng's assistance, opened multiple accounts for Chronos, Nettcorp, and Parametric.[27] Although the multiple accounts opened for each hedge fund customer had dissimilar names and account numbers, they typically shared identical mailing addresses, officers and directors, authorized agents, traders, and were under common control and ownership.[28] Zachary Apoian ("Apoian"), a senior trader for Chronos in 2002 and 2003, testified that Chronos maintained multiple accounts with the Watley firms for the special purpose of evading the efforts of mutual funds to restrict market-timing trades. Trading through multiple accounts with different names and account numbers disguised the customer's identity and enabled trading to continue in mutual fund families that had restricted or prohibited the customer's ability to purchase or exchange shares. By using different accounts, Conway and Ng were thus able to disguise the frequency and magnitude of Conway's customers' trading in restricted funds.

For example, on March 3, 2002, the Alger Fund sent a stop notice to Penson, which Penson in turn forwarded to Conway and Ng, prohibiting a number of Conway's customers from executing further exchanges in any equity fund operated by the Alger Fund. One account that

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[26] Enforcement also used the terms "at least" in its amended complaint to hedge its allegations that Conway and Ng facilitated improper, market-timing transactions. We likewise draw no inferences against the respondents and make no findings concerning any transactions other than the 210 evasive market-timing trades specifically identified by Enforcement in the amended complaint.

[27] Chronos opened six accounts in total, four accounts through Watley and two through Watley Direct. Four of the Chronos accounts were opened in the name of Standard Atlantic, Ltd. ("Standard Atlantic"), and two were opened in the name of Hutchkins, LLC ("Hutchkins"). Standard Atlantic and Hutchkins were both owned by Chronos Offshore, Inc. Nettcorp opened two accounts through Watley Direct, one in the name of Boston Pipes, LLC ("Boston Pipes"), and the other in the name of NettFund, Inc. (Portfolio 7). Finally, Parametric opened six accounts through Watley, one each in the name of Allencord Investments, LLC ("Allencord"), Bluecrab, LLC ("Bluecrab"), Doublecut Capital, LLC ("Doublecut"), Green Brook Investors, LLC ("Green Brook"), Pine Brook Investors ("Pine Brook"), LLC, and Troybilt, LLC ("Troybilt"). Each of these entities were owned by Vinshop, LLC. Parametric also opened two accounts through Watley Direct. These two accounts, however, were never funded.

[28] Mutual fund prospectuses often cautioned that trading conducted in multiple accounts under common ownership or control would be considered when imposing limitations upon excessive, short-term mutual fund trading. Mutual fund stop letters also often highlighted this policy.

the Alger Fund identified was Chronos's Standard Atlantic account. Undeterred by the stop notice, within days Conway and Ng executed several short-term, exchanges of shares in Alger Fund equity funds through Chronos's Standard Atlantic account at Watley Direct.[29]

Similarly, in January 2003, Conway and Ng executed several short-term trades in three ARK Funds portfolios for Nettcorp's Boston Pipes account. On January 29, 2003, Penson forwarded to Ng a letter from ARK Funds noting that its funds "clearly prohibit market timing activity along with other forms of excessive trading." ARK Funds therefore stated it was stopping future purchases of shares of its funds by the Boston Pipes account. Disregarding the prohibition, Conway and Ng started executing Nettcorp's trades in mutual funds operated by ARK Funds in an account bearing the name NettFund (Portfolio 7), another Watley Direct account maintained by Nettcorp. The trading continued until ARK Funds discovered what Conway and NG were doing and sent a second stop letter to Penson. In the second letter, which Penson forwarded to Conway and Ng, ARK Fund's chief compliance officer observed that the representative whose trading had precipitated the first stop notice had evidently "continued to market time by opening new accounts under new account numbers." ARK Funds stated that it was therefore "going to shut down all trading" from the branch code from which the trades originated.

Conway and Ng also used multiple branch and representative codes to help Conway's customers evade market-timing stops. Each customer account that cleared through Penson was coded with a two-letter branch office code and a two-digit broker or representative code that identified the branch and representative who handled the account. During the relevant period, Conway and Ng used six different code combinations for the 13 Conway customer accounts that cleared through Penson.[30]

For example, Conway and Ng received several stop and restriction notices from mutual funds concerning trading through Parametric accounts that bore the branch and representative code combination WD50. Ng thereafter asked Watley personnel about the process, in effect, to change branch and representative codes. Ng then requested through Watley that both he and

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[29] As this example shows, Conway sometimes opened different accounts for particular customers at both Watley and Watley Direct. Conway testified that he did this because of accounting problems that were preventing him from being fairly paid by Watley. Based upon a review of the manner in which customers funded these accounts, however, the Hearing Panel did not find Conway's testimony credible and concluded that the opening of accounts at both Watley firms for the same customers furthered the evasion of market-timing restrictions. We defer to the Hearing Panel's credibility decision. *See Daniel D. Manoff*, Exchange Act Rel. No. 46708, 2002 SEC LEXIS 2684, at *11 n.6 (Oct. 23, 2002) (holding that, absent substantial evidence to the contrary, the Hearing Panel's credibility determinations are entitled to deference).

[30] Parametric's Allencord, Green Brook, and Pine Brook accounts were alternately coded WD50, WB50, and WB99, and its Doublecut and Troybilt accounts were first coded WD50 and then WB50. Chronos's two Penson-cleared Watley accounts had different branch and representative code combinations; its two Watley Direct accounts had yet a third code combination. The coding on Simpson's account was changed from IQ00 to IQ01.

Conway be granted the branch and representative code combination WZ50 for a new Parametric account. When this account was funded and started trading it carried the new code combination WZ50.

By masking themselves and the hedge funds for which they executed trades, the respondents helped circumvent stop notices and continued to execute market-timing trades in mutual funds that had previously restricted such trading.[31] Conway and Ng thus enabled customers to execute mutual fund transactions that the mutual funds would have otherwise rejected. After news reports of an investigation conducted by the New York Attorney General concerning the market timing of mutual funds arose in September 2003, the respondents' business executing mutual fund trades for hedge funds substantially declined and effectively ended.

I. The Respondents' Compensation

Conway earned compensation equal to 82 percent of the net revenues that the mutual fund trading processed by Conway and Ng generated for the Watley firms.[32] For his efforts, Ng was paid a salary of approximately $4,000 to $5,000 per month from the gross revenues produced by Conway's hedge fund customers.

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31 Penson sent numerous notices to Conway and Ng complaining about the respondents' disregard for mutual fund market-timing restrictions and the effect this was having upon Penson's relationships with mutual funds. For example, on June 20, 2003, Penson complained:

> As you know once the fund flags you they will stop all subsequent accounts. To allow subsequent exchanges only increases our rejects, alienates the fund and puts Penson at risk of having our dealer agreements revoked by the fund. We cannot and will not allow activity that jeopardizes our ability to transact business with fund companies.

On July 23, 2002, someone from Penson wrote to the respondents:

> I need you to stop all trading in the Blackrock Funds due to market timing. It is very important that this happens today -- our dealer agreement is in jeopardy. The exchanges you put through yesterday are in question.

Ultimately, the Blackrock Funds terminated its dealer's agreement with Penson because of the market-timing trades that the respondents executed for Conway's customers.

32 These revenues consisted of monthly "wrap" fees that represented an assessment of 1.2 percent of the value of assets held by hedge fund customers in their Watley firms' accounts, transaction-based "ticket" charges or fees, and "12b-1" fees paid out by mutual funds to cover distribution expenses. During the 18-month period of July 2002 to December 2003, Conway's gross earnings at the Watley firms totaled approximately $887,000.

III. Discussion

This case concerns claims relating to two abusive practices -- late trading and market timing -- which this body has not before examined. Consistent with the allegations in Enforcement's amended complaint, the Hearing Panel found that Conway and Ng failed to observe high standards of commercial honor and just and equitable principles of trade, in violation of NASD Rule 2110, when they executed late trades and used deceptive practices to evade mutual fund market-timing restrictions for hedge fund customers. We affirm the Hearing Panel's findings.

A. Just and Equitable Principles of Trade

The "special focus" of FINRA's rules is upon "the professionalization of the securities industry." *Gustafson v. Strangis*, 572 F. Supp. 1154, 1158 (D. Minn. 1983). Section 15A(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act") requires FINRA, as a registered securities association, to have and enforce rules that "promote just and equitable principles of trade." When Congress enacted the Exchange Act, it recognized that the law "must be supplemented by regulation on an ethical plane in order 'to protect the investor and the honest dealer alike from dishonest and unfair practices by the submarginal element in the industry' and 'to cope with those methods of doing business which, while technically outside the area of definite illegality, are nevertheless unfair both to customer and to decent competitor, and are seriously damaging to the mechanism of the free and open market.'" *See Heath v. SEC*, 586 F.3d 122, 132 (2d Cir. 2009) (quoting VI Louis Loss & Joel Seligman, *Securities Regulation* 2796 (3d ed. 2002)), *cert. denied*, No. 09-959, 2010 U.S. LEXIS 3029 (Apr. 5, 2010).

NASD Rule 2110 provides that "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."[33] The rule underscores a "broad ethical principle that implements the requirements of [Exchange Act] Section 15A." *Timothy L. Burkes*, 51 S.E.C. 356, 360 n.21 (1993), *aff'd*, 29 F.3d 630 (9th Cir. 1994). Disciplinary actions brought to enforce compliance with standards of commercial honor and just and equitable principles of trade are "ethical proceedings" and are concerned with the "ethical implications" of the respondent's conduct. *Id.* at 360.

NASD Rule 2110 reaches beyond legal requirements and, among other things, depends upon general rules of fair dealing, the reasonable expectations of parties, and marketplace practices.[34] *See Dep't of Enforcement v. Shvarts*, Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6, at *12 (NASD NAC June 2, 2000). Accordingly, in disciplinary proceedings,

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[33] NASD Rule 2110 applies with equal force to FINRA members and their associated persons. *See* NASD Rule 0115(a).

[34] That a violation of other FINRA rules or securities laws or regulations constitutes a violation of NASD Rule 2110 is well established. *See Stephen G. Gluckman*, 54 S.E.C. 175, 185 (1999).

"[t]he analysis that is employed is a flexible evaluation of the surrounding circumstances with attention to the ethical nature of the conduct."[35] *Id.* at *15.

B. Respondents' Late Trades Violated NASD Rule 2110

Late trading is unlawful and refers to the practice of executing an order to buy or redeem mutual fund shares at today's price even though the order was not received until after the time at or as of which the shares were valued.[36] *Trautman*, 2009 SEC LEXIS 4173, at *7 & n.9 (collecting cases). By engaging in late trading, a customer can profit from market events, such as earnings announcements and futures trading, which occur after 4 p.m. but are not reflected in the current day's net asset values. *Id.* at *7. Late trading harms innocent mutual fund shareholders by diluting the value of their shares. *Id.* & n.12 (collecting cases).

The evidence of late trading violations in this case is obvious. The respondents' mutual fund order submissions were contrary to provisions in mutual fund prospectuses that stated that orders would be priced at or as of the close of the market and required that broker-dealers receive mutual fund orders by 4 p.m. in order to have them executed at that day's net asset value.

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[35] NASD Rule 2110 focuses upon the conduct of the securities professional rather than a subjective inquiry into the professional's intent or state of mind. *Thomas W. Heath*, Exchange Act Rel. No. 59223, 2009 SEC LEXIS 14, at *15 (Jan. 9, 2009), *aff'd*, 586 F.3d 122 (2d Cir. 2009). "Proof of scienter is therefore not required to establish a violation of NASD Conduct Rule 2110." *Eliezer Gurfel*, 54 S.E.C. 56, 63 (1999), *aff'd*, 205 F.3d 400 (D.C. Cir. 2000). *But see NASD Notice to Members 03-50* (stating that those who "knowingly or recklessly" effect late trades or facilitate market-timing activities may violate NASD Rule 2110).

[36] Late trading also violates the "forward pricing rule" stated in Investment Company Act Rule 22c-1, 17 C.F.R. § 270.22c-1(a), which generally requires, with exceptions not applicable here, that mutual fund shares be priced at the net asset value "next computed" by the mutual fund after the receipt of an order for the mutual fund's shares. The forward pricing rule serves to place those who trade mutual fund shares on equal footing as to price and information on any given day. *NASD Notice to Members 03-50*. Decisions that have interpreted this rule have read it to prohibit mutual fund investors from trading a mutual fund's shares after the time at or as of which the shares are valued while still receiving the current day's net asset value. *Trautman*, 2009 SEC LEXIS 4173, at *7 n.10 (collecting cases).

The Hearing Panel found that Conway and Ng, in addition to acting unethically in this case, also violated NASD Rule 2110 because they violated Investment Company Act Rule 22c-1. Conway and Ng, however, could not directly violate the forward pricing rule because they are not within the class of persons or entities subject to the rule's provisions. *See* 17 C.F.R. § 270.22c-1(a) (limiting the rule's application to registered investment company issuers, persons designated in issuer prospectuses to consummate transactions in their securities, principal underwriters, and dealers of mutual fund shares); *see also Trautman*, 2009 SEC LEXIS 4173, at *4 n.5. We also make no findings concerning the respondents' secondary liability for violations of Investment Company Act Rule 22c-1. We discuss the rule here because it governs the pricing of mutual fund shares and gives context to the ethical implications of the respondents' conduct.

Although Penson provided an administrative grace period that permitted orders to be processed until at least 5 p.m., neither the relevant mutual fund prospectuses nor Penson provided additional time after the close of the market for broker-dealers to accept new mutual fund orders, or to confirm, modify, or cancel orders received prior to 4 p.m.

Conway and Ng permitted customers to submit indications of interest and make their trading decisions after 4 p.m. Between October 2002 and September 2003, Conway and Ng executed 145 late trades involving mutual fund shares that revealed this imprint. By processing and executing these trades late, Conway and Ng left the false impression that the trade orders were placed before 4 p.m. and were entitled to that day's net asset value, when in fact they were not. As a result, Conway's customers obtained an inherent advantage, at the expense of other shareholders of the relevant mutual funds, by being given the opportunity to buy or redeem mutual fund shares at net asset values set before the release of market-moving information. There can be no dispute that the respondents, by virtue of their conduct, breached just and equitable principles of trade. Their actions on behalf of hedge funds were patently unethical and reflect badly upon their ability to comply with regulatory and business standards necessary to the proper functioning of the securities industry and the protection of the public. We therefore affirm the Hearing Panel's findings that Conway and Ng violated NASD Rule 2110 by executing late trades involving mutual fund shares.[37]

Conway and Ng each denied accepting mutual fund orders after 4 p.m. They instead suggested that customers sometimes verbally confirmed mutual fund orders prior to 4 p.m. without Conway and Ng having received an indication of interest. In this respect, the respondents each alluded to "technology" issues that perhaps delayed their receipt of the emailed expressions of interest that are the basis for Enforcement's late trading claim.[38]

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[37] Conway and Ng argue that a violation of NASD Rule 2110 in this case requires "a purposeful effort to benefit (or have a client benefit) from late trading." In this respect, Conway and Ng point to calculations prepared by FINRA staff that attempted to detail the hypothetical profits enjoyed by Conway's customers one day after the late trades that are at issue in this case. These calculations showed that customers did not always profit under staff's analysis. We conclude, however, that the ethical prohibition on late trading is not contingent on either proving a recognizable gain to the late trader or a tangible harm to the mutual funds involved, or proving that the respondent acted with a motive to reap a benefit for himself or his client. *See Heath*, 2009 SEC LEXIS 14, at *37 ("We are not persuaded . . . that any of the circumstances cited by Heath absolve his conduct."); *id.* at *40 & n.63 ("The ethical prohibition on the disclosure of confidential information is not contingent upon future harm."); *Ronald Justiss*, 52 S.E.C. 746, 750 (1996) ("While the misconduct did not involve direct harm to customers, it flouts the ethical standards to which members of the industry must adhere."); *see also Jason A. Craig*, Exchange Act Rel. No. 59137, 2008 SEC LEXIS 2844, at *12 n.19 (Dec. 22, 2008) (finding that motive is not necessary to find that misconduct occurred under NASD Rule 2110); *Anthony Tricario*, 51 S.E.C. 457, 459 n.3 (1993) (finding that motive is not necessary to prove that misconduct violated just and equitable principles of trade).

[38] Conway and Ng claimed that they sometimes spoke with customers calling to verbally confirm trades for which the respondents had not yet received an indication of interest. In these

[Footnote continued on next page]

The Hearing Panel did not credit this testimony, and neither do we. First, the Hearing Panel did not find the respondents credible. Absent substantial evidence to the contrary, the Hearing Panel's credibility determinations are entitled to our deference. *See Manoff*, 2002 SEC LEXIS 2684, at *11 n.6.

Second, the respondents' testimony was speculative. Conway explained that the technology issues about which the respondents testified "could have" or "might have" been an explanation for the late trades identified by Enforcement. Conway and Ng did not recall a specific instance where they accepted a customer's mutual fund order by telephone prior to 4 p.m., only to receive the customer's indication of interest by email later that day.[39]

Third, FINRA staff presented evidence that substantially diluted respondents' assertion that technical problems delayed their receipt of indications of interest. Staff examined the metadata embedded within the emails that formed the expressions of interest that are at issue in this case. Staff's examination confirmed that the respective customers sent each of the expressions of interest *after* 4 p.m. FINRA staff also searched for duplicates of emails sent earlier in the day. FINRA staff found only one instance where the relevant expression of interest was preceded by another email that contained significantly similar information concerning the trades that were ultimately executed by Conway and Ng on behalf of the customer.

Finally, Apoian testified that the respondents knowingly accommodated Chronos's late trading.[40] He stated that Conway and Ng routinely accepted his verbal confirmation of orders after 4 p.m.[41] Indeed, Apoian testified that, based upon accommodations that Conway and Ng provided previously, Chronos developed a new computer-trading model in February 2003.[42] The new model specifically required that Chronos possess the ability to confirm mutual fund orders after 4:15 p.m. Apoian testified that he discussed his needs with Conway and Ng, who acknowledged his ability to place mutual fund orders late and verbally confirm the orders

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[cont'd]

cases, they offered that they would execute the customer's order and require that the customer send a "backup" email containing the transactions that the customer verbally confirmed; this backup or duplicate email would allegedly arrive with the original, delayed indication of interest sometime after 4 p.m.

[39] We place greater trustworthiness in the respondents' testimony, which is consistent with the parties' stipulations, that their regular practice was to require that a customer both submit an indication of interest and verbally confirm their order before the respondents would process and execute any mutual fund trade.

[40] Of the 145 late trades identified in this case, Conway and Ng executed 132 for Chronos.

[41] The Hearing Panel found Apoian credible. We defer to the Hearing Panel's credibility findings. *See Manoff*, 2002 SEC LEXIS 2684, at *11 n.6.

[42] Apoian generally described Chronos's trading strategies as "statistical arbitrage" or mutual fund market timing.

generated by Chronos's new model after the time when mutual funds fixed the price of their shares.[43]

C. Conway and Ng Used Deception to Evade Market-Timing Restrictions in Violation of NASD Rule 2110

Market timing can harm a mutual fund's shareholders by diluting the value of their shares, disrupting the management of the fund's investment portfolio, and causing the fund to incur costs to accommodate frequent purchases, redemptions, or exchanges of fund shares. *Trautman*, 2009 SEC LEXIS 4173, at *10 & n.14 (collecting cases). Although market timing is not per se illegal, it is commonly prohibited by mutual fund companies to protect long-term shareholders from dilution and other adverse effects caused by repeated short-term transactions. *See SEC v. Ficken*, 546 F.3d 45, 48 (1st Cir. 2008); *see also SEC v. Tambone*, 597 F.3d 436, 439 (1st Cir. 2010) ("[M]arket timing . . . is commonly barred (or at least restricted) by those in charge of mutual funds.").

As the evidence demonstrates, during the period of August 2002 to September 2003, numerous mutual funds determined that Conway's customers were market timing and blocked trading under certain account numbers, branch and representative codes, and branch identification numbers that were associated with the trades that Conway and Ng executed on behalf of customers. Although Conway and Ng both testified that they did not read the prospectuses for the mutual funds traded by Conway's customers, Conway and Ng received a large number of stop notices that were unambiguous in their claims that Conway's customers were market timing mutual fund shares and stated that the relevant mutual funds were monitoring and restricting their and their customers' trading activities. Conway and Ng were thus made aware that mutual funds deemed market timing to be improper and unacceptable and sought to prevent future market-timing trades and to freeze known market timers' accounts.

Conway and Ng nevertheless circumvented anti-market-timing policies and took steps to perpetuate the market-timing activities of Conway's customers. Conway, with Ng's assistance, opened multiple accounts in different names for the same customers and permitted hedge funds to use these multiple accounts to evade restrictions placed upon them by mutual fund companies. Conway and Ng also utilized a series of changing combinations of representative and branch codes to hide the trades they were executing for customers. Such practices concealed the identities of Conway's customers and of the respondents, making it difficult for the funds to detect further market-timing activities. As a result, the mutual funds processed transactions that they otherwise would have rejected. Courts, and the Commission, have found that the use of multiple accounts and changing representative and branch codes to evade mutual fund market-timing restrictions are deceptive practices. *Trautman*, 2009 SEC LEXIS 4173, at *25 n.28 (collecting cases). We therefore affirm the hearing Panel's findings that the respondents acted

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[43] Apoian did not recall any problems that caused a delay in the respondents' receipt of an indication of interest or required that Chronos send a duplicate email expressing its interest in conducting certain mutual fund trades.

unethically and that their conduct was inconsistent with the obligations imposed by NASD Rule 2110.

D. The Respondents Received Fair Notice of Enforcement's Market-Timing Claims

Conway and Ng assert on appeal that imposing sanctions upon the respondents for the market-timing transactions that they executed in this case is unfair because the respondents lacked notice that their conduct was wrong under FINRA's rules.[44] In this respect, the respondents assert that market timing is not illegal and FINRA's action serves merely to enforce market-timing standards imposed by self-interested mutual fund companies. We disagree with the respondents' contentions and find that they lack merit.

The fact that market timing is not innately illegal is not germane to our inquiry. *Cf. Gann*, 2006 U.S. Dist. LEXIS 9955, at *21 (denying a motion to dismiss fraud claims where the defendants argued that market timing was not "per se" illegal). Rather, the relevant inquiry is whether, while executing market-timing trades, the respondents engaged in conduct that failed to adhere to the high standards of commercial honor and just and equitable principles of trade embodied in NASD Rule 2110. *Id.* Viewed in this context, we conclude that the respondents cannot credibly complain that they lacked fair notice that their actions violated NASD Rule 2110.[45]

NASD Rule 2110 "sets forth a standard intended to encompass a wide variety of conduct that may operate as an injustice to investors or other participants in the marketplace." *Daniel Joseph Alderman*, 52 S.E.C. 366, 369 (1995), *aff'd*, 104 F.3d 285 (9th Cir. 1997). The Commission and the courts have consistently sustained disciplinary decisions based upon a finding of unethical conduct under just and equitable principles trade, deeming such principles fairly applied to conduct that is not ethical and accepted conduct in the securities industry. *Heath*, 2009 SEC LEXIS 14, at *29 & n. 41 (collecting cases). In reviewing challenges to actions taken under just and equitable principles of trade, courts have recognized that an "experienced registered representative . . . may be fairly charged with knowledge of the ethical standards of his profession." *Crimmins v. Am. Stock Exch.*, 368 F. Supp. 270, 277 (S.D.N.Y. 1973), *aff'd*, 503 F.2d 560 (2d Cir. 1974).

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44 The respondents also argue that FINRA's action is thus "possibly" unconstitutional. FINRA, however, is not a state actor and therefore is not subject to the Constitution's due process requirements. *See Kevin M. Glodek*, Exchange Act Rel. No. 60937, 2009 SEC LEXIS 3936, at *22-23 (Nov. 4, 2009), *appeal filed*, No. 09-5325 (2d Cir. Dec. 28, 2009).

45 "'As long as a party to an administrative proceeding is reasonably apprised of the issues in controversy and is not misled, notice is sufficient.'" *Janet Gurley Katz*, Exchange Act Rel. No. 61449, 2010 SEC LEXIS 994, at *75 (Feb. 1, 2010) (quoting *Steven E. Muth*, Exchange Act Rel. No. 52551, 2005 SEC LEXIS 2488, at *38 n.40 (Oct. 3, 2005)). We find that Conway and Ng were made aware of Enforcement's claims and had plentiful opportunities to defend against them.

In assessing notice claims under just and equitable principles of trade, "courts have evaluated the conduct at issue against the professional 'norms' of the vocation or profession." *Heath*, 2009 SEC LEXIS 14, at *35. The use of multiple accounts and representative and branch codes to evade mutual fund market-timing restrictions constitutes "'an egregious abuse of the trust placed in [the respondents] as . . . securities professional[s].'" *Justin F. Ficken*, Exchange Act Rel. No. 58802, 2008 SEC LEXIS 3047, at *17 (Oct. 17, 2008) (quoting *John S. Brownson*, 55 S.E.C. 1023, 1029 (2002)). We conclude that Conway and Ng, experienced securities professionals, had fair notice that their conduct, which amounted to deceptions that helped circumvent industry norms meant to protect long-term shareholders of mutual funds, was dishonorable and inequitable.[46] *Cf. Heath*, 586 F.3d at 140-141 ("[T]he J&E Rule's standard of unethical conduct does not fail to provide Petitioner with adequate notice that the conduct in question was sanctionable.").

E. The Respondents' Remaining Arguments Lack Merit

The respondents make two additional exculpatory arguments on appeal that we find lack merit.

First, Conway and Ng assert that these disciplinary proceedings merely served to make them "scapegoats" for accepted securities industry abuses for which others have not been prosecuted. "[FINRA] disciplinary proceedings are treated as an exercise of prosecutorial discretion." *Schellenbach v. SEC*, 989 F.2d 907, 912 (7th Cir. 1993). As such, "it is no defense that others in the industry may have been operating in a similarly illegal or improper manner." *Patricia H. Smith*, 52 S.E.C. 346, 348 n.8 (1995).

Second, the respondents blame their misconduct on alleged recordkeeping and supervisory failings that existed at the Watley firms and on Penson's alleged failure to track and comply with market-timing stop notices. Even if true, a registered representative cannot shift to others his or her responsibility to refrain from violating the federal securities laws or FINRA's rules. *See Dep't of Enforcement* v. *Epstein*, Complaint No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *82 (FINRA NAC Dec. 20, 2007), *aff'd*, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217 (Jan. 30, 2009), *appeal pending*, No. 09-1550 (3d Cir. Feb. 24, 2009). Conway and Ng were responsible for complying with applicable regulatory requirements and cannot excuse

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46 The courts and the Commission have dispatched similar arguments asserting a lack of fair notice in cases where the defendants or respondents used deceptive means to evade market-timing restrictions in violation of the antifraud provisions of the federal securities laws. *See Pentagon Capital Mgmt.*, 2009 U.S. Dist. LEXIS 9632, at *59-60 (concluding that the defendants could not credibly claim that they did not possess fair notice that actions taken to conceal their identities for purposes of engaging in market timing constituted regulatory violations); *Druffner*, 353 F. Supp. 2d at 151 ("The defendants were professional (presumably licensed) brokers and cannot claim that they had no notice of the illegality of defrauding mutual funds by making material misstatements and omissions."); *cf. Gann*, 2006 U.S. Dist. LEXIS 9955, at *21 (denying defendants' motion to dismiss claim that the defendants engaged in fraud by using deceptive practices to further market–timing activities).

their misconduct by claiming either they lacked experience or relied upon others to ensure their compliance. *See Gann*, 2009 SEC LEXIS 1163, at *16 & n.17.

IV. Sanctions

The Hearing Panel fined Conway $50,000, ordered that he disgorge $78,720, and suspended him in all capacities for six months for late trading. The Hearing Panel also fined Conway $50,000 and suspended him an additional year for his role in facilitating market-timing transactions. As to Ng, the Hearing Panel fined him $10,000 and suspended him for three months in all capacities for late trading and imposed an additional fine of $10,000 and suspended him an additional six months for his role in executing market-timing transactions.[47] Although we agree in principal with the sanctions imposed by the Hearing Panel, we arrive at sanctions from a different viewpoint. We therefore affirm in part, and vacate in part, the sanctions imposed by the Hearing Panel.

First, in deciding upon appropriate sanctions, we have considered the FINRA Sanction Guidelines ("Guidelines"). There are, however, no Guidelines for late trading and deceptive market-timing practices. We therefore have looked to the Guidelines for analogous violations.[48] We agree with the Hearing Panel that the most closely analogous Guidelines are those for misrepresentations and omissions of fact.[49] These Guidelines suggest, for intentional or reckless misconduct, a fine of $10,000 to $100,000.[50] In addition, the Guidelines recommend a suspension of 10 business days to two years and, in egregious cases, a bar.[51]

Second, we have considered the principal considerations applicable to all sanctions determinations under the Guidelines and have determined that a number of aggravating factors are present. In this respect, we have judged that the number of late trades and evasive market-timing transactions executed by the respondents and the period of time over which the respondents perpetrated these trades indicate that their conduct was not an aberration.[52] We find that Conway and Ng systematically failed to uphold high standards of commercial honor. The

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47 The Hearing Panel ordered that the respondents' suspensions be served consecutively.

48 *FINRA Sanction Guidelines* 1 (2010) (Overview) ("For violations that are not addressed specifically, Adjudicators are encouraged to look to the guidelines for analogous violations."), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter "Guidelines"].

49 *Id.* at 93 (Misrepresentations or Material Omissions of Fact).

50 *Id.*

51 *Id.*

52 *Id.* at 6 (Principal Considerations in Determining Sanctions, Nos. 8, 9, 16).

respondents' conduct was not the result of a momentary lapse of judgment that might establish mitigation.[53]

We have also considered that the respondents acted, at a minimum, recklessly.[54] Recklessness is defined as "'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the [respondent] or so obvious that the [respondent] must have been aware of it.'" *Trautman*, 2009 SEC LEXIS 4173, at *61 (quoting *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 513 F.3d 702, 704 (7th Cir, 2008)). As Apoian testified, the respondents accommodated Chronos's late trading and routinely accepted his verbal confirmation of orders after 4 p.m., even though Stephaney Robinson told the respondents that Penson did not allow the respondents to process trades received after 4 p.m. at the current day's net asset value. Conway and Ng manipulated Penson's order-entry systems to facilitate late trades by Conway's customers, a deceptive practice whose advantage must have been known to the respondents given their years in the securities industry and the extent to which mutual fund companies and Penson went to curb this type of trading. Conway also knew that his customers were market timers. Indeed, the respondents received and tracked a large number of stop notices that deemed that Conway's customers were engaged in market-timing activities. Conway and Ng responded to these notices by executing trades through other accounts or using different representative and branch codes to circumvent the efforts of mutual fund companies to restrict their trading and that of Conway's customers.[55] We therefore conclude that Conway and Ng knew, or were reckless in not knowing, that the late trades and market-timing transactions that they executed for customers were improper.

We have further accounted for the fact that Conway stood to gain monetarily from his actions.[56] As Conway testified, his compensation was tied to the amount of funds that hedge funds placed with him for trading. Conway's apparent willingness to execute trades that benefitted these customers had the potential to lead to their placing larger sums of money in their Watley firms' accounts for trading.[57] *See Janet Gurley Katz*, Exchange Act Rel. No. 61449, 2010 SEC LEXIS 994, at *91-92 (Feb. 1, 2010) ("Katz may not have profited directly from

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[53] We do not accept as a mitigating factor that the respondents lack a disciplinary history. *See Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) ("Lack of a disciplinary history is not mitigating.").

[54] *Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 13).

[55] We therefore have also taken measure of the fact that the respondents' misconduct included elements of deception meant to mislead mutual funds and to lull these funds into accepting trades that they would not have otherwise accepted. *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 10).

[56] *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 17).

[57] While the injury that the respondents' misconduct caused to mutual funds and their shareholders is not handily established, we likewise cannot ignore it. *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 11).

misappropriating some of her clients' funds, but she did benefit from keeping her clients happy and retaining their business.")

Finally, the respondents' failure to acknowledge the impropriety of their actions is troubling.[58] The respondents' have not accepted responsibility for their misdeeds and they continue to blame others -- including the Watley firms, their supervisors, Penson, and the mutual funds they deceived -- for the circumstances that have occurred. The securities industry "presents a great many opportunities for abuse and overreaching, and depends very heavily upon the integrity of its participants." *Bernard D. Gorniak*, 52 S.E.C. 371, 373 (1995). Neither a claimed ignorance of the securities laws, nor an attempt to shift responsibility for a failure to comply with the securities laws to inadequate training or incompetent supervision, will serve to lessen the sanction imposed. *See Thomas C. Kocherhans*, 52 S.E.C. 528, 531-532, 534 (1995) (concluding that ignorance of NASD rules and absence of supervisory structure do not compel a reduction of sanction); *Smith*, 52 S.E.C. at 348 (finding respondent's claim that her misconduct resulted from the training she received not mitigating); *see also Dep't of Enforcement v. Dieffenbach*, Complaint No. C06020003, 2004 NASD Discip. LEXIS 10, at *43 (NASD NAC July 30, 2004) ("We reject the Hearing Panel's conclusion that the Firm's inadequate training and supervision mitigates the respondents' failures in this regard."), *aff'd on other grounds sub. nom*, *Michael A. Rooms*, Exchange Act Rel. No. 51467, 2005 SEC LEXIS 728 (Apr. 1, 2005), *aff'd*, 444 F.3d 1208 (10th Cir. 2006); *Mkt. Reg. Comm. v Shaughnessy*, Complaint No. CMS950087, 1997 NASD Discip. LEXIS 46, at *30-31 (NASD NBCC June 5, 1997) (rejecting premise that lack of instruction as to the improper nature of conduct is mitigating factor for purposes of sanctions), *aff'd*, 53 S.E.C. 692 (1998).

Based upon the foregoing, we find the respondents' misconduct in this case egregious and warrants significant sanctions. We therefore conclude that a fine of $100,000 and an 18-month suspension in all capacities are appropriate sanctions for Conway's misconduct and serve an appropriate remedial purpose to deter future violations. We also conclude that a $20,000 fine and a nine-month suspension in all capacities are appropriate sanctions for Ng.[59]

Although the sanctions we impose are ostensibly on par with those imposed by the Hearing Panel, we have nevertheless determined to impose unitary sanctions upon each of the respondents rather than sanctions per cause. The Guidelines permit the "batching" of violations for purposes of determining sanctions in disciplinary proceedings where the violations result

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58 *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 2).

59 We agree with the Hearing Panel that Ng played a vital but nonetheless lesser role to Conway and that he did not enjoy the same potential benefits for his improper conduct. We therefore have decided to impose lesser, albeit still significant, sanctions upon Ng. *See Dist. Bus. Conduct Comm. v. Inv. Planning, Inc.*, Complaint No. CHI-1150/1242, 1990 NASD Discip. LEXIS 116, at *21 (NASD Board Aug. 15, 1990) (finding that increased sanctions were in order for a respondent that occupied a "leading role" in misconduct); *see also Wanda P. Sears*, Exchange Act Rel. No. 58705, 2008 SEC LEXIS 1521, at *27 (July 1, 2008) ("[T]he minimal compensation that Sears received . . . indicates that a suspension of less than a year is appropriate.").

from a single systemic problem or cause.[60] We conclude that the respondents late trading and facilitation of market-timing transactions stem from a single systemic problem -- a willingness to mislead and deceive mutual funds to provide benefits to Conway's customers and execute mutual fund orders for these customers no matter the cost to others -- that warrants an aggregation of sanctions in this case. *See Dep't of Enforcement v. Zaragoza*, Complaint No. E8A2002109804, 2008 FINRA Discip. LEXIS 28, at *29 (FINRA NAC Aug. 20, 2008) ("We uphold the Hearing Panel's decision to aggregate these interrelated violations for purposes of assessing sanctions.").

We also vacate the Hearing Panel's order requiring that Conway disgorge $78,720 in ill-gotten gains. In cases in which the record demonstrates that the respondent obtained a financial benefit from his misconduct, the Guidelines permit the NAC and FINRA adjudicators to disgorge such ill-gotten gain by fining away the amount of some or all of the financial benefit derived to remediate misconduct.[61] Disgorgement, however, must represent a reasonable approximation of profits causally connected to the misconduct in question. *SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1474-75 (2d Cir. 1996).

In Enforcement's view, Conway's entire business was "fundamentally corrupt." It therefore requested that the Hearing Panel order disgorgement of $175,000, approximately 20 percent of Conway's total earnings in 2002 and 2003. We agree with the Hearing Panel's decision not to order disgorgement in the amount requested by Enforcement. As we stated above, we draw no inferences against the respondents and make no findings concerning any transactions other than the improper late trades and market-timing transactions specifically identified in Enforcement's complaint. Although we conclude that the respondents' misconduct was systematic, the record does not support the factual premise upon which Enforcement bases its claim for disgorgement and we will not accept some lesser figure of Conway's total earnings as an appropriate amount of disgorgement merely because it appears to represent a palatable amount.[62] *See SEC v. Awe Trading, Inc.*, No. 08-CV-1402, 2009 U.S. Dist. LEXIS 92128, at *17 (E.D.N.Y. Oct. 2, 2009) ("In the absence of any evidence, the court cannot accept plaintiff's approximation.").

We further find the disgorgement figure calculated by the Hearing Panel unreliable. The Hearing Panel based its order of disgorgement upon Chronos's decision to place $8 million in additional funds with Conway for trading, which the Hearing Panel concluded stemmed from Conway's willingness to execute trades late for the hedge fund.[63] The preponderance of the

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[60] *Guidelines*, at 4 (General Principles Applicable to All Sanction Determinations, No. 4).

[61] *Guidelines*, at 4 (General Principles Applicable to All Sanction Determinations, No. 6).

[62] The late and market-timing trades at issue in this case, although numerous and recurrent, represented a small portion of the total number of trades executed by the respondents on behalf of hedge funds during the relevant period of time.

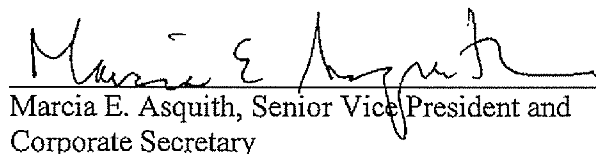
[63] The Hearing Panel calculated that Conway earned an additional $78,720 in wrap fees by having these additional funds to trade.

evidence, however, does not support the conclusion that a decision to place some or all of the additional funds with Conway bore a causal connection to Conway's execution of late trades on behalf of Chronos. We therefore vacate the Hearing Panel's order of disgorgement. *Id.*

V. Conclusion

We affirm the Hearing Panel's findings that Conway and Ng violated NASD Rule 2110 when they executed late trades and deceptively facilitated market-timing transactions for hedge funds. For the forgoing misconduct, we fine Conway $100,000 and suspend him in all capacities for a period of 18 months. We also fine Ng $20,000 and suspend him in all capacities for a nine-month period. We also affirm the Hearing Panel's order that Conway and Ng, jointly and severally, pay hearing costs of $11,519.81.[64]

On Behalf of the National Adjudicatory Council,



Marcia E. Asquith, Senior Vice President and
Corporate Secretary

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[64] We also have considered and reject without discussion all other arguments advanced by the parties.

Pursuant to FINRA Rule 8320, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be revoked for non-payment.