

MEMO# 21680

September 28, 2007

SEC Institutes Settled Charges Against Two Broker-Dealers for Fraud in Municipal Bond Market

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TO: MUNICIPAL SECURITIES ADVISORY COMMITTEE

FIXED-INCOME ADVISORY COMMITTEE No. 29-07 RE: SEC INSTITUTES SETTLED CHARGES AGAINST TWO BROKER-DEALERS FOR FRAUD IN MUNICIPAL BOND MARKET

The Securities and Exchange Commission settled administrative proceedings against two broker-dealers and their CEOs for fraudulent auction practices in the municipal bond market that violated the antifraud and books and records provisions of the federal securities laws and various Municipal Securities Rulemaking Board (“MSRB”) rules. [\[1\]](#) A supervisor at one of the firms also was charged with supervisory failures. The Respondents consented to the issuance of the SEC Orders, without admitting or denying the Commission’s findings.

The first Order found that the broker-dealer engaged in deceptive practices to obtain future business by creating the illusion of additional and greater interest in the bond being sold than the broker-dealer was actually able to collect. Specifically, the broker-dealer placed “cover bids” after the high bid had been made and immediately before the close of the auction. Under this scheme, the Order found that the broker-dealer knew it would not win the auction but it was able to narrow the spread between the winning bid and the legitimate next highest bid, creating the perception of an active and successful auction. The Order also found that the broker-dealer accepted late bids in “Sharp Time” auctions with knowledge that the bidding broker-dealer’s late bid was the highest bid in the auction. The Order states that this conduct favored the late bidder and disadvantaged other auction participants who timely submitted their bids. The Order found that the broker-dealer and the CEO failed to supervise the firm’s traders and failed to establish policies and procedures to prevent and detect the violative conduct. Further, the broker-dealer did not maintain emails and facsimiles related to its municipal securities business.

Based on the alleged conduct, the SEC found that the broker-dealer violated Sections

15(c)(1)(A), 15B(c)(1), 17(a), and 15(b)(4)(E) of the Securities Exchange Act of 1934 and Rule 17a-4 thereunder as well as MSRB Rules G-17, G-13, G-8, G-9 and G-27. The SEC found that the CEO violated Section 15(b)(4)(E) of the Exchange Act and aided and abetted the broker-dealer's violations of Sections 15(c)(1)(A), 15B(c)(1) and 17(a) of the Exchange Act, Rule 17a-4(b)(4) thereunder, and MSRB Rules G-17, G-13, G-8 and G-9.

The broker-dealer was censured and ordered to cease and desist from violating the securities laws, pay \$100,000 in civil penalties, and certify to the Commission within six months that it has implemented new procedures to prevent and detect similar conduct in the future. The CEO was ordered to cease and desist from violating the securities laws and pay a \$50,000 civil penalty. In addition, the CEO received a permanent supervisory bar and a one-year associational bar.

The second Order found that the broker-dealer also engaged in deceptive practices to obtain future business by creating the illusion of additional and greater interest in the bond being sold than the broker-dealer was actually able to collect. In this instance, the Order found not only that the broker-dealer engaged in the practice of entering fake "cover bids" but also that the broker-dealer used the fake bids to meet the requirement of certain selling broker-dealers that a minimum number of bids be solicited before executing a sale to the high bidder. Further, the Order found that the broker-dealer engaged in an "adjusted trading" scheme for the benefit of a municipal securities trader at another broker-dealer, and reported these fictitious prices to the market. In particular, the settling broker-dealer paid the other broker-dealer proceeds from sales that were sometimes greater than and sometimes less than the actual prices paid by the purchasers. These inaccurate prices were then transmitted to the market as actual prices paid on the transactions. Lastly, the Order found that the broker-dealer, CEO and a supervisor failed to supervise the firm's traders and failed to establish policies and procedures to prevent and detect the violative conduct, and the broker-dealer failed to maintain facsimiles related to its municipal securities business.

In addition to the same violations found in the administrative proceeding against the first broker-dealer, the SEC found that the second broker-dealer violated Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and MSRB Rule G-14 because of its participation in the adjusted trading scheme in which it reported deceptive prices to the market. The Commission also found that the CEO and a supervisor at the firm violated the securities laws and aided and abetted the broker-dealer's violations.

The Commission revoked the broker-dealer's registration and ordered the CEO to cease and desist from violating the securities laws and to pay a \$15,000 civil penalty. In addition, the CEO received a five-year supervisory bar and a one-year associational bar. The supervisor also received a five-year supervisory bar.

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endnotes

[\[1\]](#) See In the Matter of Regional Brokers, Inc., and Patrick Lubin, SEC Release No. 56542, Admin. Proc. File No. 3-12838 (September 27, 2007) ("first Order") and In the Matter of D.M. Keck & Company, Inc., d/b/a Discount Munibrokers, Donald Michael Keck and Patricia

Ann Seelaus, SEC Release No. 56543, Admin. Proc. File No. 3-12839 (September 27, 2007) (“second Order”). The Orders are available at <http://www.sec.gov/litigation/admin/2007/34-56542.pdf> and <http://www.sec.gov/litigation/admin/2007/34-56543.pdf>, respectively.

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