

This Order has been published by NASD's Office of Hearing Officers and should be cited as OHO Order 05-35 (CAF040058).

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondents.

Disciplinary Proceeding
No. CAF040058

Hearing Officer – DRP

**ORDER GRANTING THE PARTIES' MOTIONS FOR LEAVE
TO INTRODUCE EXPERT TESTIMONY**

Enforcement charges Respondents with fraudulently interpositioning a hedge fund between their firm and retail customers in convertible bond transactions and charging excessive and fraudulent markups that were not disclosed. Respondents deny wrongdoing and assert that the trades at issue were effectuated at prices determined by the firm's trading desk and that the markups or markdowns charged were not excessive. The parties agree that pricing and valuation of the convertible bond transactions, including calculation of markups and markdowns, are central issues in this proceeding and that expert testimony on these topics will assist the Hearing Panel in determining whether the retail customers paid prices that were fair and reasonable.

Enforcement seeks leave to present expert testimony by Dr. _____, who once worked in the securities industry and held Series 7 and 63 licenses. He is the former head of Risk Management Research at J.P. Morgan Securities, where he managed Commodity Derivatives Research for the firm's trading desk. He holds a Ph.D. in Managerial Economics and Finance from Northwestern University, has taught courses in corporate finance, derivatives

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theory and debt instruments at several business schools, and has published more than 50 academic and trade articles on the quantitative analysis of securities and derivatives, strategic issues, and the practice of risk management. He is founder and president of Risk Capital Management Partners, a risk management and transaction advisory firm.

Respondents seek leave to present expert testimony by _____, who has approximately 34 years' experience in the securities industry, having started and managed the trading department at several firms, including Gruntal & Co. and Fidelity, before forming his own firm in 1998. He is familiar with the methodology by which convertible bonds are priced and how they tend to trade through his experience as a market maker for several firms and as a supervisor at a New York Stock Exchange specialist firm as well as at Fidelity, where he advised the firm regarding hedges for its proprietary convertible bond positions and was involved in pricing particular convertible bond transactions. For the last three years, he has provided consulting services to the financial services sector and to securities attorneys. He currently holds Series 7, 9, 10, 24, 55 and 63 licenses. He earned an MBA from Baruch College and has recently lectured at several graduate schools.

Expert testimony is generally unnecessary in NASD disciplinary proceedings, because the hearing panel includes associated persons with substantial experience in the securities industry. While at least one of the industry members of this Hearing Panel has considerable experience with trading debt securities, the proper pricing of convertible bonds is a fairly specialized area. The Hearing Officer thus concurs that expert testimony on this subject would be both relevant and helpful to the Panel and finds that the parties' proffers are sufficient to allow the proposed witnesses to testify regarding the pricing of the convertible bond transactions at issue in this proceeding.

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Thus, the Hearing Officer grants Enforcement's motion for leave to offer testimony by Dr. _____ and Respondents' motion for leave to offer testimony by _____.¹

SO ORDERED.

Dana R. Pisanelli
Hearing Officer

Dated: October 19, 2005
 Washington, DC

¹ Under the Federal Rules of Evidence, a district court performs a "gatekeeping" function in deciding the admissibility of expert testimony to ensure it is relevant and rests on a reliable foundation. *See Kumho Tire Co. v. Carmichael*, 526 US 137 (1999); *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 US 579 (1993). Unlike a jury, however, there is no danger that the industry hearing panelists in this proceeding will give undue weight to the proffered expert testimony. Accordingly, the Hearing Officer will permit the parties to offer evidence at the hearing that supports or refutes the reliability of the expert testimony, rather than make a reliability determination on the basis of the pending motions.