UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9467 / October 18, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3696 / October 18, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30746 / October 18, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15574

In the Matter of **HARDING ADVISORY LLC and** **WING F. CHAU,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Harding Advisory LLC ("Harding Advisory" and together with its predecessor, "Harding") and Wing F. Chau ("Chau" and together with Harding Advisory, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. Summary

1. This matter involves violations of the federal securities laws by Harding and its principal Wing F. Chau in their role as investment managers for certain collateralized debt obligation transactions ("CDOs"). As the Collateral Manager of these CDOs, Harding was responsible for the selection, acquisition, and monitoring of portfolios of assets – the collateral – backing tranches of securities issued to investors by special-purpose vehicles (the "Issuers"), including one named Octans I CDO Ltd. ("Octans I").

2. Unbeknownst to investors and in conflict with the marketing materials and offering circular for Octans I, a third party named Magnetar Capital LLC (together with affiliates, "Magnetar") – a hedge fund firm whose interests were not aligned with those of the debt investors in Octans I – had undisclosed rights over the selection of collateral for Octans I. Magnetar's influence led Harding to select assets for Octans I that Harding's own personnel disfavored.

3. The Octans I transaction was a $1.5 billion CDO that closed on September 26, 2006. The collateral for the transaction consisted mostly of credit default swaps ("CDS") referencing subprime residential mortgage-backed securities ("RMBS"),[1] as well as securities of other CDOs backed by RMBS. Octans I was structured and marketed by subsidiaries of Merrill Lynch & Co., Inc. (collectively "Merrill"), which also lent their balance sheet to store, or "warehouse," collateral acquired for Octans I in the months leading up to the closing of the transaction. By April 3, 2008, Octans I had failed, costing the transaction's outside investors approximately $1.1 billion. Harding received approximately $4.5 million in fees for its role in the transaction.

4. The warehouse agreement governing the process of accumulating collateral prior to the closing of the Octans I transaction was actually a three-way agreement among Harding, Merrill, and Magnetar. The agreement gave Magnetar important rights, chief of which was the right to veto Harding's selection of collateral for the Octans I portfolio. Consistent with the agreement, Magnetar exercised significant control over the composition of the portfolio, but this right, among the others granted to Magnetar, was not disclosed to the debt investors in Octans I.

5. The so-called "pitchbook" and offering circular used to market Octans I, the relevant portions of which were drafted or reviewed by Harding, described Harding's credit-selection processes and represented that the collateral would be selected by Harding and housed at Merrill in accordance with a warehouse agreement between Merrill and Harding. These representations were materially misleading because they did not disclose Magnetar's rights in and influence over the collateral selection process.

6. The offering circular and a Collateral Management Agreement with the Octans I Issuer executed by Chau also represented that Harding, in selecting collateral for the CDO, would perform its obligations as collateral manager:

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[1] RMBS are bonds backed by pools of residential mortgage loans, in this case subprime loans. CDS are explained below.

> with reasonable care (i) using a degree of skill and attention no less than that which [Harding] would exercise with respect to comparable assets that it manages for itself and (ii) without limiting the foregoing, in a manner consistent with the customary standards, policies and procedures followed by institutional managers of national standing relating to assets of the nature and character of the [Octans I collateral].

This was a material misrepresentation in that Harding and Chau, as they knew or at least recklessly disregarded, compromised their standards to accommodate trades requested by Magnetar.

7. Harding and Chau also later breached their obligations by purchasing, for inclusion in several other CDOs managed by Harding, tens of millions of dollars' worth of notes from a troubled Magnetar-related CDO underwritten by Merrill known as Norma. Harding and Chau bought the Norma securities despite their basically unfavorable view of them, adding lower-rated notes to their prior Norma commitment only after receiving pressure from Merrill and a direct request from Magnetar. Chau was apparently trying to return a favor and show that he was a "team player" who "never forget[s] my true friends." For each of the CDOs into which Harding placed the Norma notes, the collateral management agreement contained standard of care representations similar to that in the collateral management agreement for Octans I.

8. Harding and Chau committed the breaches described in this Order because they wanted fees that could be earned only if Magnetar agreed to close the Octans I transaction, and because they were seeking to please Merrill and Magnetar. Merrill had arranged the Octans I transaction at the impetus and behest of Magnetar, which, together with Merrill, had selected Harding as the collateral manager. Merrill and Magnetar had sent, and were in a position to continue sending, significant CDO business to Harding. As such, Harding's interests were in keeping Merrill and Magnetar happy, and Harding put those interests ahead of its obligations to the Issuers and their investors.

B. Respondents

9. **Harding Advisory LLC** is a registered investment adviser located in Morristown, New Jersey. Harding's principal and near-100% owner is Wing Chau. Harding was founded in or around July 2006 as the successor to an affiliate of Maxim Group LLC. Harding has been the adviser or sub-adviser to 21 CDOs, including Octans I. At its peak in 2007, Harding had approximately $20 billion in assets under management. Harding remains collateral manager for nine CDOs with total assets of approximately $1 billion.

10. **Wing F. Chau**, age 46 and a resident of Basking Ridge, New Jersey, has served since 2006 as Harding's CEO, Managing Member, and Chief Compliance Officer.

C. Other Relevant Entities

11. **Merrill Lynch, Pierce, Fenner & Smith Incorporated** ("MLPFS"), a registered broker-dealer and investment adviser based in New York, at all relevant times was the principal

U.S. broker-dealer subsidiary of Merrill Lynch & Co., Inc. MLPFS structured and marketed the Octans I transaction, and was one of the leading arrangers of CDOs between 2005 and 2008. Merrill was formerly one of the world's leading investment banks. Merrill was acquired by Bank of America Corporation on January 1, 2009.

12. **Merrill Lynch International**, a Merrill affiliate incorporated under the laws of England, was the warehouse provider for Octans I.

13. **Magnetar Capital LLC** is a hedge fund manager headquartered in Evanston, Illinois. During 2006-07 Magnetar was involved in creating a series of CDOs with Merrill and other arranging banks. These CDOs were typically named after astronomical constellations, and so are sometimes known as "Constellation CDOs."

14. **Octans I CDO Ltd.** was a special-purpose vehicle incorporated in the Cayman Islands.

D. Facts

Background on CDOs and CDS

15. A CDO is a special-purpose vehicle that issues debt to investors and uses the proceeds to invest in fixed income securities or loans. The CDO's debt is issued in different tranches that feature varying levels of risks and returns. The senior tranche is the highest rated, is first in the priority of repayment through what is called the CDO's waterfall and has the lowest risk of default. Because of the lower risk of default and the priority of repayment in the CDO's waterfall, the holders of the senior tranche have lower rates of return. The inverse is true for the lowest-rated tranche in the CDO. Typically, that tranche (usually referred to as "equity") is unrated, has the highest rate of return, is last in terms of the priority of repayment through the CDO's waterfall and has the highest risk of default.

16. A CDS is a type of derivative through which two parties transfer the risk of ownership of a particular reference obligation. The protection buyer ("short") of a CDS pays to purchase protection upon the occurrence of certain events, such as an event of default, failure to pay interest, writedowns or substantial credit ratings downgrade of the reference obligation (collectively, "Credit Events"). The protection seller ("long") sells that protection and assumes the risk of a Credit Event on the reference obligation. In 2006, the protection buyer normally paid the protection seller a premium or spread as part of the CDS.[2] Reference obligations can take many forms but in this case took the form of RMBS or CDOs comprised of them. In essence, a CDS mimics the performance of the referenced asset. Thus, an investor can gain exposure to an asset by entering into a CDS that references the asset, instead of by purchasing the asset itself.

[2] For example, a protection buyer may agree to pay a protection seller 150 basis points to purchase protection against default on a $10 million of a designated reference obligation, or $150,000 per annum, paid periodically.

17. A CDO can be backed by bonds (a "cash CDO") or by CDS (a "synthetic CDO"). A CDO backed by both bonds and CDS is called a "hybrid CDO." Octans I was a hybrid CDO with approximately 90 percent synthetic assets. Typically, a collateral manager would acquire synthetic collateral by, among other things, sending out BWICs (bids wanted in competition) or responding to OWICs (offers wanted in competition). Generally speaking, BWICs were sent out by a "long" party seeking quotes from potential "short" counterparties on the assets referenced in the BWIC. The winner of a BWIC would be the party that offered to pay the highest premium amount. OWICs were sent out by a "short" party seeking quotes from a potential "long" counterparties on the assets referenced in the OWIC. The winner of an OWIC would be the party willing to accept the lowest premium amount.

Roles of Harding and Merrill

18. As Collateral Manager, Harding's role was to act as investment adviser for Octans I, selecting and managing a portfolio pursuant to a Warehouse Agreement and a Collateral Management Agreement.

19. In general, the collateral manager for a CDO must determine whether a potential asset is appropriate for inclusion in the CDO's portfolio. A CDO transaction may or may not have a collateral manager. However, when a CDO was managed, the manager's independent selection of assets was an important selling point to potential investors, and information on the collateral manager's selection process was included in the marketing materials and offering circular by which the CDO's debt was sold.

20. Octans I was structured and marketed by Merrill, which also acted as the warehouse provider and as the initial counterparty on the CDS collateral that went into the transaction. A warehouse is essentially a segregated account through which the arranging bank finances the acquisition of collateral before the transaction closes. During the warehouse phase, Harding's role was to select collateral that would be held in the warehouse until closing, at which point the collateral would be placed into the Issuer's portfolio.

Origin of Octans I CDO

21. Octans I was a "reverse-inquiry" transaction, meaning that Magnetar approached Merrill to create the deal, as opposed to Merrill having been engaged by an asset manager to create the deal and then seeking out investors to purchase the securities issued in the transaction.

22. In the spring of 2006, Magnetar approached Merrill to arrange a series of CDO transactions. At a meeting in May 2006, a Magnetar representative ("Magnetar Representative") discussed with officials at Merrill, as the Merrill salesperson covering Magnetar ("Merrill Salesperson") later put it in an email, an arrangement whereby Merrill and Magnetar would "pick mutually agreeable [collateral] managers to work with, Magnetar plays a significant role in the structure and composition of the portfolio . . . and in return [Magnetar] retain[s] the equity class and [Merrill] distribute[s] the debt."

23. The equity piece of a CDO transaction was typically the hardest to sell and therefore the greatest impediment to closing a CDO. Magnetar's willingness to buy the equity in a series of CDOs, including Octans I, therefore gave it substantial leverage in the assembly of these transactions.

24. Magnetar and Merrill jointly agreed on Harding as the collateral manager for Octans I. On or about May 26, 2006, Merrill, Harding, and Magnetar entered into an Engagement Letter that assigned the parties roles in the transaction. The agreement contemplated that Magnetar would purchase the equity piece of the transaction. Chau executed the Engagement Letter on behalf of Harding.

25. Chau understood that Magnetar was interested in investing as the equity buyer in a series of potential CDO transactions. Chau also understood that Magnetar's strategy included "hedging" its equity positions in CDOs, potentially by taking short positions on RMBS or certain tranches of CDOs, including the CDOs it was investing in. Chau therefore understood that, because Magnetar stood to profit if the CDOs failed to perform, Magnetar's interests were not aligned with those of potential investors in the debt tranches of Octans I, whose investment depended solely on the CDO performing well.

26. Octans I was the seventh CDO arranged by Merrill for which Harding became collateral manager. Over the course of the year following this Engagement Letter, Harding was selected as collateral manager for four more CDOs arranged by Merrill, as well as three other Constellation CDOs.

<u>The Three-Way Warehouse Agreement</u>

27. On or about May 26, 2006, Merrill, Harding, and Magnetar also entered into a Warehouse Agreement to govern the acquisition of collateral for the Octans I portfolio. Chau executed the Warehouse Agreement on behalf of Harding. The agreement gave Magnetar the right to receive 85% of the "carry" (essentially, the returns on the assets during the time they were warehoused) in exchange for taking 85% of the risk on the warehouse. Harding had never managed, nor had Merrill ever arranged, a CDO with a tri-party warehouse agreement prior to Octans I.

28. The Warehouse Agreement also gave Magnetar a series of rights over the collateral selection process, including:

- the right to veto collateral selected by Harding prior to purchase for the warehouse;
- the right to mutually agree with Merrill and Harding on the price to be paid for collateral selected for the warehouse; and
- the right to veto a designation by Merrill of any warehoused collateral as "Ineligible" for the Issuer's portfolio because Harding or Merrill has determined that the collateral no longer satisfies certain criteria.

29. Chau understood that granting a veto right relating to collateral selection to a third party like Magnetar would cede some of the collateral manager's authority and impair its independence.

30. Harding, Merrill, and Magnetar were in close contact as Harding accumulated collateral for the Octans I portfolio. On the morning of May 30, 2006, a Harding vice president ("Harding VP") emailed the Magnetar Representative, copying Chau and a senior manager at Harding ("Senior Manager"):

> Now that we have the documents signed up, we just wanted to touch base with you regarding process. It sounds like you want us to send you a copy of our bid lists for your review prior to sending it to the street. If so, should we send the lists to you or to someone else at Magnetar?
>
> Please let me know how you would like this to work.

The Magnetar Representative responded, copying Chau and the Senior Manager: "Yes . . . . Please send the lists to me. Also, would like to talk frequently so I'm up to date on your plan of action, how things are going, etc."

31. Harding complied, typically sending bid lists to Magnetar before circulating them to the market, and, at times with Merrill, seeking Magnetar's approval before collateral was added to the Octans I warehouse.

<u>The ABX Trade</u>

Harding Agrees to Magnetar's Request

32. Magnetar was seeking, for reasons related to its own CDO investment strategy, to have the Constellation CDOs, including Octans I, acquire exposure to the RMBS bonds referenced in an investment product known as the ABX Index.

33. Launched in January 2006, the ABX Index was a standardized CDS referencing a benchmark basket of 20 RMBS. The ABX Index was available at various levels of credit rating. The relevant levels in this case were BBB and BBB-. New ABX Indices became available twice per year, and in each case referenced RMBS issued in the preceding six months. Thus, for example, ABX 2006-1 referenced a basket of 20 RMBS issued in the second half of 2005.

34. In late May 2006, Magnetar had discussions, first with Merrill and then with Chau and others at Harding, about acquiring exposure to the ABX Index at the BBB (Baa2) or BBB- (Baa3) levels for the Octans I warehouse. However, the Collateral Manager might not regard all of the bonds in the ABX index as acceptable. The parties therefore discussed having the Octans I warehouse first buy the index in a block and then exclude (via offsetting "short" positions on individual RMBS bonds) those bonds that Harding disfavored.

35. Harding agreed to the concepts of acquiring exposure to the ABX Index and of excluding from that exposure selected bonds. In a three-way telephone conversation on the

afternoon of May 30, 2006, Magnetar and Merrill asked the Harding Senior Manager which RMBS bonds Harding wanted to exclude from the index. The Senior Manager said Harding would report back. After the call, the Merrill Salesperson promised the Magnetar Representative in an email: “We’ll push to get names [i.e. RMBS bonds] they [i.e. Harding] have issue with [i.e. want excluded from the index exposure] tomorrow am.”

36. Shortly after the telephone call, the Harding VP, apparently unaware of the agreement on the ABX trade, sent the Magnetar Representative, with a copy to a distribution list of Harding’s CDO professionals, including Chau (“Group List”), “a list of names we’d like to circulate [i.e. to collect bids on in the marketplace for ultimate inclusion in the CDO] first thing tomorrow morning. We have not shown these to Merrill yet. Please let us know what you think.” The Magnetar Representative replied to the Harding VP: “Great, these look fine,” and then later that evening sent the Harding VP another email, copying Chau and the Harding Senior Manager: “Noticed some index bonds in the list . . . . We’re going to do a big block trade of the index names, so please leave them off of any other lists you do.”

37. In other words, the Magnetar Representative asked Harding not to acquire exposure to any constituent bonds of the index via the usual BWIC process because a separate block index trade was planned. The Harding VP agreed to comply in an email to the Magnetar Representative copied to the Harding Senior Manager and Chau. And Harding in fact complied with Magnetar’s directions as to how to acquire collateral for the CDO, stripping the index bonds from a bid list that Harding sent to Merrill on May 31.

Harding’s Selections

38. Shortly after the three-way telephone call on the afternoon of May 30, the Senior Manager sent a list of the ABX Index bonds to a credit analyst at Harding (“Analyst 1”), apparently so Harding’s credit team could identify constituents of the ABX Index to which Octans I should not be exposed. The Harding Senior Manager was aware that Magnetar would have preferred that Harding exclude as few bonds as possible.

39. On the morning of May 31, 2006, even as the credit team was beginning its analysis of the ABX Index bonds, the Magnetar Representative continued to press Harding for the list of ABX Index bonds that Harding would exclude from the block index exposure. At or about 9:40 a.m., he emailed the Senior Manager, copying Chau: “you have abx names that you want out [i.e. excluded from the index], ready to trade?” In emails later that morning to the Harding Senior Manager, VP, and Chau, the Magnetar Representative followed up: “For our block index trade, u guys were going to let us know if there were any of the 20 index names you wanted to exclude, we had a call w [the Senior Manager] and [a Merrill trader] last nite.” The Senior Manager replied, copying Chau and the Harding VP: “Yes, we should have these names to you and [the Merrill trader] soon. Wing and I just got back from a meeting away from the office this morning.”

40. At or about 4:22 p.m. on May 31, Analyst 1 sent the Senior Manager an email titled “ABX Index Rejections.” Attached to the email was a list of 12 bonds in the ABX Index. Four were at the BBB (Baa2) level; eight were at the BBB- (Baa3) level. This was the list for

which Magnetar had been pressing Harding. Over the next week, Merrill, Magnetar, and Harding worked together to acquire, for the Octans I portfolio, $300 million worth of block exposure to the ABX Index at the combined BBB (Baa2) and BBB- (Baa3) levels. The twelve bonds identified as "Index Rejections" were then excluded from the index exposure (which included 40 bonds – 20 at each of the two rating levels), such that the Octans I portfolio was left with approximately $220 million worth of long exposure to 28 bonds. In selecting twelve bonds to *ex*clude from the index, therefore, Harding also effectively selected 28 index bonds for *in*clusion in Octans I (the "Accepted Index Bonds").

Harding's Negative Analysis of the Selected Credits

41. Harding's internal communications indicate that many of the 28 Accepted Index Bonds were disfavored within Harding and would likely not have been included in the Octans I portfolio but for Magnetar's desire to have the portfolio exposed to the ABX Index, and Harding's desire to please Magnetar.

42. At approximately 2 p.m. on May 31, a Harding trader sent an email to Harding's Group List: "Here is an OWIC due at 4PM today. Maybe we can see if there are any names we've done the work on already to see if there is a fit for us." The list of bonds attached to this email happened to be the same 40 bonds in the ABX Index at the BBB (Baa2) and BBB- (Baa3) levels. At or about 2:17 p.m., a Harding credit analyst ("Analyst 2") asked a junior colleague to update Harding's credit files on some of the 40 bonds. The junior colleague sent his results at 2:28 p.m. to Analysts 1 and 2.

43. At or about 2:49 p.m., Analyst 1 wrote to the trader and the Group List (emphasis added): "Out of the 40 bonds in this list, we have already looked at 29 bonds. Out of those, 10 have been approved, and *19 have been rejected*. These are the approved deals: [listing bonds]."

44. At or about 3:04 p.m., Analyst 2 wrote to the trader and the Group List: "here's the results for the 4 pm owic. Attached are the 40 bonds. [T]here is a correction. We are not okay on the MABS deal [i.e. an RMBS named MABS]. Some we have already seen as [Analyst 1] mentioned below." The attached spreadsheet had a "Y" (signifying that Harding's credit team approved the bond) next to 15 of the bonds, and a "N" (signifying that Harding's credit team rejected the bond) next to the other 25 bonds, including the "MABS" RMBS at both rating levels.

45. As noted above, however, the email from Analyst 1 at 4:22 p.m. reflected the selection of the 28 Accepted Index Bonds to which the Octans I portfolio ultimately became exposed. Those 28 accepted bonds included all of the 15 bonds marked "Y" at 3:04 p.m., and another 13 bonds that had been marked "N" in that email (including the "MABS" bonds). The 28 acceptances and 12 exclusions, moreover, changed from the 2:49 p.m. email in which Analyst 1 noted that previously "10 have been approved, and 19 have been rejected."

46. There is no contemporaneous record of Harding's reasons for accepting many of these bonds. The only relevant credit work on May 31 of which there is any record (apart from

what is reviewed above) was circulated to Analyst 1 at or about 1:12 p.m., and it was largely negative. For most of the bonds analyzed (which included ten of the 13 bonds that Analyst 2 had marked "N"), the credit analysis indicated substantial write-downs.

47. Subsequent communications confirm that Harding compromised, allowing into the Octans I portfolio bonds that it would have been unlikely to select but for Magnetar's desire for ABX Index bonds.

48. On the morning of June 1, 2006, the Harding VP wrote to Chau and the Senior Manager: "I don't think we can do [$]15[million] of each name even if we do a 1.5B deal since we are buying 2 classes of each issue" – i.e. each index bond at the Baa2 and Baa3 levels – "and the 1% limit applies to the issue. Most we can do is probably 7.5M." The Senior Manager replied to the Harding VP and Chau (emphasis added): "That's correct and we should push them to short [i.e. cause the Octans I portfolio to go long] the Baa2's since *we are less comfortable with some of these index names at the Baa3 level*."

49. Later that morning the Harding Senior Manager sent the Magnetar Representative an email titled "Index names" in which he wrote: "Sent [Merrill] the list yesterday. Don't know if you've got it, so here it is again" – listing the Accepted Index Bonds. The Senior Manager continued (emphasis added): "We can do $15mm each issuer (Baa2 and Baa3 together) *and prefer the Baa2's*."

50. In other words, Harding disfavored some of the Baa3 assets within the set of Accepted Index Bonds but either was not fully in control of, or was willing to leave to others, how much exposure the portfolio gained to the Approved Index Bonds at the two different rating levels.

"Lesser of Evils"

51. Octans I was not the only Constellation CDO for which Harding accepted index bonds seemingly disfavored by its credit team. Harding later executed ABX Index trades for different Constellation CDOs for which it served as collateral manager. In late August 2006 Analysts 1 and 2 debated whether certain index bonds should be internally marked as a "N" or a "Y" on Harding's central bid lists. The analysts did not approve of the bonds but apparently had been pressured by Harding's portfolio managers to accept them in connection with ABX Index trades for a Constellation CDO. Analyst 2 wrote of one bond (emphasis added): "due to the fact *we had to pick the lesser of evils when we were looking at the index* we said 'Y.' . . . . I would stick to the 'N' and note that we are a 'Y' if it were an index trade. Can we do this? Too complicated?"

52. Analyst 1 agreed with Analyst 2's suggestion, and several days later, Analyst 2 suggested doing the same with a different index bond (emphases added): "We had it on the index for a 'Maybe' because *we knew we had to pick the less worse*. So let's . . . [s]witch it back to a 'N' and make a comment noting that we did *not* short it for the index trade."

53. In September 2006, after receiving information about ABX Index trades done for a third Constellation CDO, Analyst 1 wrote to a Harding trader, copying Analyst 2: “Not as bad as I thought. 2 rejected bonds traded with [the Magnetar Representative] from the index. . . . [T]o the extent that you can control it, please refrain from letting any index trades happen for [the third Constellation CDO and another CDO underwritten by Merrill].”

Misrepresentations and Omissions Regarding Collateral Selection for Octans I

54. Magnetar’s rights regarding, and role in, the selection of collateral for Octans I were not disclosed.

55. The pitchbook used to solicit investors in the transaction, the relevant portions of which were drafted by Harding and had been reviewed by Chau, described Harding’s investment approach and credit processes, but said nothing about Magnetar’s control rights and actual influence over the Octans I portfolio.

56. Similarly, the offering circular, which Harding had reviewed, represented that the collateral acquired by the Issuer from the warehouse on closing was “selected by [Harding] and held by [Merrill] pursuant to warehousing agreements between [Merrill] and [Harding].” This disclosure omitted any mention of Magnetar’s involvement in the warehouse phase. Harding and Chau knew or were reckless in not knowing of this representation and the reasons why it was false or misleading. Harding and Chau failed to ensure the accurate disclosure of Magnetar’s warehouse rights.

57. In the Collateral Management Agreement (CMA), which Chau executed at closing on behalf of Harding, Harding represented to the Issuer that Harding in relevant part would “perform its obligations hereunder (including with respect to any exercise of discretion) with reasonable care (i) using a degree of skill and attention no less than that which [Harding] would exercise with respect to comparable assets that it manages for itself and (ii) without limiting the foregoing, in a manner consistent with customary standards, policies and procedures followed by institutional managers of national standing relating to assets of the nature and character of the Collateral.” In the CMA, Harding further represented as relevant here that all collateral acquired on closing – that is, the warehoused collateral – would satisfy the applicable terms and conditions of the CMA.

58. The offering circular described the CMA, and repeated the standard of care representation quoted above. These representations to the Issuer and investors were materially false or misleading in that Chau and Harding, in order to accommodate Magnetar’s preferences, caused Octans I to acquire collateral that Harding’s personnel disfavored. Harding and Chau knew the standard of care representation in the CMA and knew or were reckless in not knowing that it was repeated in the offering circular and was false or misleading.

59. These misrepresentations and omissions were material. Investors in the securities of Octans I would have considered it important that an undisclosed party with interests not aligned with those of the other investors had influence over or rights regarding collateral selection.

The Norma Purchases

60. In January 2007, Merrill was in the process of marketing a Constellation CDO known as Norma. On January 9, Chau, after reviewing information about Norma, wrote to a Merrill salesperson: "Turbo structure is very weak."[3] On January 16, 2007, Merrill's head of CDO syndication ("Syndicate Head") asked Chau in an electronic conversation: "ready to talk about your participation [in the Norma offering]?" Harding then requested from Merrill certain information about the loan pools backing the RMBS referenced in the Norma portfolio.

61. On January 19, 2007, after further conversation with Merrill's sales staff, Chau and Harding agreed to purchase $40 million worth of Norma's A-rated tranche for several CDOs managed by Harding.

62. Chau at first did not agree to buy Norma's lower-rated tranches. But on January 23, the Magnetar Representative emailed Chau with the subject heading "Pls buy some norma bbb." The email continued: "Stop complaining about turbo. :) Remember who was there for u when u were a little guy." Shortly afterwards, Chau wrote: "Did ML tell u I am in for 40mm single-As in Norma – team player!!!"

63. Also on January 23, the Syndicate Head wrote to Chau: "what's your level" – i.e. what coupon rate would make the bond acceptable – "on BBB or BBB- if we can't change the turbo?" Chau responded: "ah-so . . . let me sharpen the pencil," to which the Syndicate Head replied: "sweet."

64. The next day, the Syndicate Head asked Chau if he had "'sharpened your pencil' on norma BBBs yet?" Chau replied: "I never forget my true friends," and subsequently agreed to acquire, at an improved coupon rate, $20 million worth of the Norma BBB notes.

65. When a Merrill sales representative later asked Chau if he had heard the news that Merrill had decreased Harding's allocation of the Norma BBBs from $20 million to $15 million, Chau replied: "Now that's what I'm talking about, the love is in the air" – further suggesting that he had not wanted to purchase those notes in the first place.

66. Although Harding's orders for Norma were placed in January 2007, Norma itself did not close, and its securities were not available for purchase, until March 1. Shortly before Norma's close, an analyst circulated within Harding, including to Chau, a highly critical credit report. The commentary noted that "[t]here's quite a large percentage of deals [i.e. RMBS to which the Norma portfolio was exposed] failing surveillance tests, on the watchlist and on the do not buy list. Also, there is almost 15% exposure to [two RMBS sponsors generally disfavored within Harding.]"

[3] "Turbo" is a feature in a CDO structure that, when triggered, diverts excess cash flow to pay down principal on the notes of certain debt tranches.

67. Harding nevertheless proceeded with the Norma purchases, placing the notes into the portfolios of several CDOs it managed.

68. For each of those CDOs, Chau, on behalf of Harding, executed Collateral Management Agreements containing standard of care provisions similar to the one in the Octans I CMA. In each case, the offering circular for the transaction described the CMA and the standard of care set forth within it.

69. Harding and Chau breached their advisory obligations to those Issuers. Without disclosure, they put their desire to please Merrill and Magnetar – which by January 2007 were together responsible for tens of millions of dollars of revenue for Harding – ahead of the best interests of the portfolio, which they knew were not served by the Norma bonds.

E. **Violations**

70. As a result of the conduct described above, Respondents willfully violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer and sale of securities.

71. As a result of the conduct described above, Chau willfully aided and abetted and caused Harding Advisory's violations of Section 17(a) of the Securities Act.

72. As a result of the conduct described above, Respondents willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

73. As a result of the conduct described above, Chau willfully aided and abetted and caused Harding Advisory's violations of Sections 206(1) and 206(2) of the Advisers Act.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Sections 203(e) and 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 203(i) and 203(j) of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 9(d) and 9(e) of the Investment Company Act; and

D. Whether, pursuant to Section 8A of the Securities Act and Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 206(1) and (2) of the Advisers Act and Section 17(a) of the Securities Act; and whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act and Section 203(k)(5) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary