

STATE OF NEW JERSEY
BUREAU OF SECURITIES
153 Halsey Street
P.O. Box 47029
Newark, New Jersey 07101

IN THE MATTER OF:)

Kai Chong Cheng)
(CRD No. 4987533))

and)

Affinity Capital Management, LLC)
(CRD No. 176531))

RESPONDENTS)

ADMINISTRATIVE
CONSENT ORDER

Pursuant to the authority granted to Amy Kopleton, Deputy Bureau Chief of the New Jersey Bureau of Securities ("Bureau Chief"), under the Uniform Securities Law, (1997), N.J.S.A. 49:3-47 et seq. ("Securities Law"), and after investigation, careful review, and due consideration of the facts and statutory provisions set forth below, the Bureau Chief hereby finds that there is good cause and it is in the public interest, and to preserve resources, to enter into an Administrative Consent Order ("Consent Order") with Kai Chong Cheng ("Cheng") and Affinity Capital Management, LLC ("Affinity") (collectively, "Respondents"), and Respondents hereby agree to resolve any and all issues in controversy regarding the specific conduct described herein on the terms set forth in this Consent Order.

The Bureau Chief makes the following findings of fact and conclusions of law, which Respondents neither admit nor deny:

FINDINGS OF FACT

Respondents

1. Cheng (CRD No. 4987533), residing in Tenaflly, New Jersey, is currently registered with the New Jersey Bureau of Securities (the “Bureau”) as an investment adviser representative of Affinity (CRD No. 176531) and is the President of Affinity.
2. From June 20, 2005 to February 4, 2015, Cheng was registered with the Bureau as an agent of Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill”) (CRD No. 7691).
3. Affinity is a New York limited liability company that maintains a business address at 1180 Avenue of the Americas, 8th Floor, New York, New York 10036. Affinity has been registered with the Bureau as an investment adviser since June 5, 2015.

Background

4. Beginning in January 2010, JO was the principle holder of six accounts (“JO Accounts”) at Merrill. The JO Accounts were a combination of business and personal accounts of JO and XW.
5. From January 2010 through the end of 2013 (the “Relevant Period”), Cheng was the agent of record responsible for any open JO Accounts with Merrill.

Cheng’s Communications with JO via Personal Email

6. The “Merrill Lynch Wealth Management Branch Office Compliance Policy Manual,” was part of Merrill Lynch’s policies and procedures during the Relevant Period, and provided, “All Communications must be...[d]elivered via Firm-approved methods and systems,” and “[t]o comply with industry regulations, Electronic Communications with clients and prospects...may be sent only via Firm-approved resources to facilitate retention and

supervisory monitoring and review.” Throughout the Relevant Period, Cheng acknowledged receipt of these policies and procedures annually in disclosure certifications and attestations encompassed in Merrill’s Global Wealth & Investment Management Annual Certifications.

7. In or around March 2010, Cheng began communicating with JO through his personal Yahoo email account and his personal Gmail account regarding the JO Accounts. Between March 2010 and July 2012, Cheng communicated with JO and/or XW via his personal Yahoo and personal Gmail email accounts on at least 175 occasions. Cheng either copied or forwarded to his Merrill work email address at least 11 of those email communications.
8. In certain of these emails, Cheng provided recommendations regarding transactions in the JO Accounts. For example, in an email dated March 28, 2010, Cheng wrote JO from his personal Yahoo email account:

On the overall portfolio level. I will tell you that, at all time (sic), you will not lose 8% of \$1.7 mil = \$136 K. If I see that is happening, I will definitely let you know...In short, I will explicitly notify you, if the overall portfolio is close to the 8% loss. I will also explicitly notify you, if we need further discussion on whether we should have exception (to the 8% max loss rule) to any individual holdings. If I do not explicitly (sic) notify you, it means we have NOT trigger (sic) this rule.

Similarly, in a March 4, 2011 email with the Subject line “update,” Cheng wrote to JO from his Merrill account, while copying his Yahoo account: “As (sic) close of business day today, the total is no \$2,356,314.23.”

Cheng signed a Note to JO and Named JO and XW as Beneficiaries on His Life Insurance Policy

9. The “Merrill Lynch Wealth Management Branch Office Compliance Policy Manual” provided, “[e]mployees and their family members...are prohibited from: making loans to or

accepting loans from clients...[or]giving or accepting gifts or gratuities in excess of Firm Policies” and that “[a]ny other financial involvement with a client that is not part of an employee’s normal duties is discouraged and exceptions must be approved in advance by the Manager.”

10. N.J.A.C. 13:47A-6.3(a)¹ defines dishonest or unethical practices as including, “(42) Borrowing money or securities from a client...” and “(43) Loaning money to a client...”

11. Financial Industry Regulation Authority (“FINRA”) Rule 3240 states, “no person associated with a member in any registered capacity may borrow money from or lend money to any customer of such person...”²

¹ All references in this Administrative Consent Order to Title 13, Chapter 47A, Bureau of Securities, of the New Jersey Administrative Code are confined to N.J.A.C. 13:47A-1.1 — 14.16 (2008). Chapter 47A was revised effective July 17, 2015 and such revised regulations are not referenced herein.

² FINRA Rule 3240 does permit a lending arrangement between a broker-dealer and a client under the following conditions that follow. No such conditions were met here.

(1) the member has written procedures allowing the borrowing and lending of money between such registered persons and customers of the member;

(2) the borrowing or lending arrangement meets one of the following conditions:

(A) the customer is a member of such person's immediate family;

(B) the customer (i) is a financial institution regularly engaged in the business of providing credit, financing, or loans, or other entity or person that regularly arranges or extends credit in the ordinary course of business, and (ii) is acting in the course of such business;

(C) the customer and the registered person are both registered persons of the same member;

(D) the lending arrangement is based on a personal relationship with the customer, such that the loan would not have been solicited, offered, or given had the customer and the registered person not maintained a relationship outside of the broker-customer relationship; or

(E) the lending arrangement is based on a business relationship outside of the broker-customer relationship; and

(3) the requirements of paragraph (b) [omitted] of this Rule are satisfied.

12. Beginning in mid-2011, the JO Accounts experienced substantial losses from investment activities.
13. Between March 2011 and June 2012, Merrill sent seven separate letters – with a copy to Cheng – to either JO or XW concerning the underperformance of, and significant losses in, five of the JO Accounts. In those letters, Merrill requested that JO or XW provide confirmation that Merrill’s records concerning their investment objectives, risk tolerance level, and current financial situation were accurate. Merrill also sought confirmation of Cheng’s assertion that “transactions in your [JO’s] account are initiated primarily at your [JO’s] direction” and that “you [JO] are aware of and are willing and able to assume these risks.”
14. Neither JO nor XW responded to any of the seven Merrill letters.
15. Despite not receiving a response from JO or XW to their letters, Merrill continued to allow Cheng to trade in the JO Accounts.
16. On October 14, 2011, Cheng signed a note (the “Cheng Note”) in which Cheng stated that he owed JO \$145,000. In the Note, Cheng acknowledged that he had made two separate payments of \$15,000 and \$10,000 to JO, and that he still owed JO \$120,000.
17. On October 14, 2011, Cheng added JO and XW to his Term Life Insurance policy with Transamerica Life Insurance Company as primary beneficiaries. Cheng did not disclose to Merrill the addition of his JO and XW as beneficiaries on his life insurance policy.
18. Cheng did not notify Merrill of either the Cheng Note or that Cheng had added JO as a beneficiary on Cheng’s life insurance Policy.

Merrill's Investigation

19. On July 6, 2012, JO's attorney sent a letter (the "JO Attorney Letter") to Merrill claiming damages as the result of wrongdoing by Cheng against JO. The JO Attorney Letter claimed that Cheng had received unwarranted profits and commissions, and that Cheng's disregard for JO's instructions to liquidate JO's Accounts lead to substantial capital losses in the JO Accounts.
20. In response to the Letter, Merrill initiated a Compliance inquiry into Cheng's activities. According to Merrill, Cheng admitted during the inquiry that he had added JO and XW to his Term Life Insurance policy as beneficiaries.
21. On October 2, 2012, Merrill issued and Cheng acknowledged receipt of a Letter of Admonishment. Merrill admonished Cheng for violating Merrill employee policies Section 12.2 ("Communication must be...Deliver[ed] via Firm-approved methods and systems"), Section 12.4.1 ("All internal and external electronic communications related to the business of the Firm must be sent through Firm-approved resources"), and Section 6.3 ("Employees are prohibited from giving or accepting gifts or gratuities in excess of Firm policies; and Any other financial involvement with a client that is not part of an employee's normal duties is discouraged and exceptions must be approved in advance by the Manager").

FINRA Arbitration of JO and XW's Complaint

22. On October 30, 2013, JO, XW, and other related entities filed a FINRA arbitration claim against Merrill and Cheng regarding "to recover damages caused by actions, misrepresentations, omissions, unsuitable investment recommendations, negligence, negligent supervision and failure to supervise."

23. At the conclusion of the FINRA arbitration, Merrill agreed to settle with JO and XW for \$450,000. On November 19, 2014, JO and XW signed a General Release at the conclusion of the FINRA arbitration, which released Merrill and Cheng from any liability in the future.
24. Cheng did not make a financial contribution to the Merrill settlement with JO and XW. Merrill funded the settlements.
25. On February 4, 2015, Merrill terminated Cheng for “[c]onduct including entering into personal financial transactions with a customer, using a personal email address to communicate with a customer and unauthorized trading in a customer account.”

FINRA Investigation into Cheng’s Conduct at Merrill

26. FINRA began investigation No. 2013039305101 into Cheng’s conduct at Merrill to determine whether violations of federal securities laws or FINRA, NASD, NYSE, or MSRB rules had occurred with respect to Cheng’s relationship with JO while being employed at Merrill.
27. On March 10, 2015, FINRA sent a letter to Cheng requesting that Cheng provide on-the-record (“OTR”) testimony at FINRA’s offices on April 9-10, 2015 for its investigation pursuant to FINRA Rule 8210.
28. On April 7, 2015, FINRA sent a second letter to Cheng, granting his request to reschedule his OTR testimony for May 5-6, 2015.
29. On April 30, 2015, FINRA sent a third letter to Cheng to inform him that his OTR interview would be postponed until May 28-29, 2015.
30. On June 2, 2015, FINRA sent a fourth letter to Cheng, again formally requesting Cheng’s OTR testimony, for the dates of June 29-30, 2015. The June 2, 2015 letter listed several

previously-made formal letter and email communications between FINRA and Cheng's counsel describing FINRA's attempts to reschedule the OTR testimony due to Cheng's cancellations and extension requests.

31. FINRA's "Addendum A To Request For Testimony," which was attached to each of the March 10, April 7, April 30, and June 2, 2015 letters from FINRA to Cheng or his counsel stated, "If you fail to appear and testify at the OTR you may be subject to a FINRA disciplinary action and the imposition of sanctions, including a bar from the securities industry, suspension, censure and/or fine." Additionally, the June 2, 2015 letter highlighted that it would be FINRA's final request for OTR testimony from Cheng, and "failure to appear on the date and at the time specified...may result in disciplinary action against Mr. Cheng."
32. Ultimately, Cheng failed to appear at FINRA's office to provide OTR testimony.
33. On June 18, 2015, Cheng submitted to a FINRA Letter of Acceptance, Waiver, and Consent ("AWC"), stemming from FINRA investigation No. 2013039305101. In the AWC, Cheng consented to the entry of FINRA's findings of fact and violative conduct, which included failing to appear at FINRA's office for the OTR testimony request and not observing high standards of commercial, honor, just and equitable principles of trade. Cheng also consented to the imposition of a bar from association with any FINRA regulated broker-dealer.
34. On June 30, 2015, Cheng's AWC was accepted by FINRA's National Adjudicatory Council ("NAC"). Subsequently, Cheng was barred from associating with any FINRA regulated broker-dealer in any capacity.

CONCLUSIONS OF LAW

CHENG ENGAGED IN DISHONEST OR UNETHICAL PRACTICES IN THE SECURITIES BUSINESS N.J.S.A. 49:3-58(a)(1), N.J.S.A. 49:3-58(a)(2)(vii)

35. The preceding paragraphs are incorporated by reference as though set forth verbatim herein.
36. Pursuant to N.J.S.A. 49:3-58(a)(2)(vii): “The bureau chief may by order deny, suspend, or revoke any registration if he finds: (1) that the order is in the public interest; and (2) that the applicant or registrant ... (vii) ... has engaged in dishonest or unethical practices in the securities, commodities, banking, insurance or investment advisory business, as may be defined by rule of the bureau chief.”
37. Cheng engaged in dishonest or unethical practices by communicating with JO through the use of Cheng’s private email account, in violation of Merrill’s employee policies requiring the use of firm-approved methods and systems for electronic communications.
38. Based upon the foregoing, and pursuant to N.J.S.A. 49:3-58(a)(1), the suspension of Cheng’s registration as an investment adviser representative and certain exemptions is in the public interest.

CHENG ENGAGED IN DISHONEST OR UNETHICAL PRACTICES IN THE SECURITIES BUSINESS N.J.S.A. 49:3-58(a)(1), N.J.S.A. 49:3-58(a)(2)(vii)

39. The preceding paragraphs are incorporated by reference as though set forth verbatim herein.
40. Pursuant to N.J.S.A. 49:3-58(a)(2)(vii): “The bureau chief may by order deny, suspend, or revoke any registration if he finds: (1) that the order is in the public interest; and (2) that the applicant or registrant ... (vii) ... has engaged in dishonest or unethical practices in the

securities, commodities, banking, insurance or investment advisory business, as may be defined by rule of the bureau chief.”

41. Cheng engaged in dishonest or unethical practices by adding JO and XW to his Term Life Insurance policy with Transamerica Life Insurance Company as primary beneficiaries, in violation of Merrill’s employee policies on relationships with clients.
42. Based upon the foregoing, and pursuant to N.J.S.A. 49:3-58(a)(1), the suspension of Cheng’s registration as an investment adviser representative and certain exemptions is in the public interest.

CHENG ENGAGED IN DISHONEST OR UNETHICAL PRACTICES IN THE
SECURITIES BUSINESS

N.J.S.A. 49:3-58(a)(1), N.J.S.A. 49:3-58(a)(2)(vii), N.J.A.C. 13:47A-6.3(a)(28), N.J.A.C. 13:47A-6.3(a)(42), and N.J.A.C. 13:47A-6.3(a)(43)

43. The preceding paragraphs are incorporated by reference as though set forth verbatim herein.
44. Pursuant to N.J.A.C. 13:47A-6.3(a): “Dishonest or unethical practices” as used in N.J.S.A. 49:3-47 et seq., shall include... (28) Failing to comply with any applicable provision of the Conduct of Rules of FINRA ... (42) Borrowing money or securities from a client ... (43) Loaning money to a client....”
45. Cheng engaged in dishonest or unethical practices by signing an agreement in which he stated that he owed JO \$145,000. In the agreement, Cheng acknowledged that he had paid \$15,000 and \$10,000 to JO, and that he still owed JO \$120,000, in violation of N.J.A.C. 13:47A-6.3(a)(28), N.J.A.C. 13:47A-6.3(a)(42), N.J.A.C. 13:47A-6.3(a)(43), and FINRA Rule 3240.
46. The foregoing conduct is cause, pursuant to N.J.S.A. 49:3-58(a)(2)(vii), to suspend Cheng’s investment adviser representative registration.

47. Based on the foregoing, the suspension of Cheng's registration as an investment adviser representative and certain exemptions is in the public interest and necessary for the protection of investors.

CHENG IS THE SUBJECT OF AN ORDER OF A SELF-REGULATORY
ORGANIZATION EXPELLING HIM FROM A NATIONAL
SECURITIES ASSOCIATION

N.J.S.A. 49:3-58(a)(1)

N.J.S.A. 49:3-58(a)(2)(vi)

48. The preceding paragraphs are incorporated by reference as though set forth verbatim herein.

49. Pursuant to N.J.S.A. 49:3-58(a): "The bureau chief may by order deny, suspend, or revoke any registration if he finds: (1) that the order is in the public interest; and (2) that the applicant or registrant ... (vi) ... is the subject of an order of ... a self-regulatory organization ... suspending or expelling him from a national securities ... association"

50. Having consented to a bar from association with any FINRA regulated broker-dealer, Cheng has effectively been expelled from a national securities association. This is cause, pursuant to N.J.S.A. 49:3-58(a)(2)(vi) to suspend the registration of Cheng.

51. Based upon the foregoing, and pursuant to N.J.S.A. 49:3-58(a)(1), the suspension of Cheng's registration as an investment adviser representative and certain exemptions is in the public interest and necessary for the protection of investors.

AFFINITY CAPITAL MANAGEMENT, LLC'S OFFICER, DIRECTOR OR
PERSON CONTROLLING AFFINITY CAPITAL MANAGEMENT, LLC IS THE
SUBJECT OF AN EFFECTIVE SUSPENSION ORDER OF THE BUREAU

CHIEF N.J.S.A. 49:3-58(a)(1)

N.J.S.A. 49:3-58(a)(2)(v)

52. The preceding paragraphs are incorporated by reference as though set forth verbatim herein.

53. Pursuant to N.J.S.A. 49:3-58(a)(2)(v): “The bureau chief may by order deny, suspend, or revoke any registration if he finds ... (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer or director, any person occupying a similar status or performing similar functions, or any person controlling the broker-dealer or investment adviser: ... (v) is the subject of an effective order of the bureau chief denying, suspending, or revoking registration as an agent”

54. As Cheng is the subject of this Consent Order suspending his investment adviser representative registration with the Bureau, the Bureau Chief may suspend Affinity Capital Management LLC’s registration as an investment adviser pursuant to N.J.S.A. 49:3-58(a)(2)(v).

55. Based upon the foregoing and pursuant to N.J.S.A. 49:3-58(a)(1), the suspension of Affinity Capital Management, LLC’s registration and certain exemptions is in the public interest.

THEREFORE, based on the foregoing findings of facts and conclusions of law, **IT IS** on this 19th day of May, 2017, **HEREBY ORDERED AND AGREED** that:

56. Cheng’s investment adviser representative registration is suspended for five (5) years from the effective date of December 16, 2016.

57. Affinity’s investment adviser registration is suspended for five (5) years from the effective date of December 16, 2016.

58. Cheng and Affinity may reapply to the Bureau for registration, upon expiration of the aforementioned five (5) year suspension subject to the terms of this Consent Order being complied with. If Cheng is not acting as an investment adviser representative in another jurisdiction for at least two years prior to his application for registration, such investment


adviser representative registration will be contingent upon qualification by examination, and any other requested registrations may be contingent upon qualification by examination.

59. If Cheng and Affinity apply for registration with the Bureau and their registrations are accepted, at the Bureau's discretion, their registration will be subject to and conditioned upon Cheng and/or Affinity's retention of a Compliance Consultant, not objectionable to the Bureau, to ensure Cheng and Affinity's timely and accurate regulatory filings. This condition would be applicable to any investment adviser controlled by Cheng that applies for registration with the Bureau.
60. Should Cheng apply for registration with another entity, Cheng's registration may be conditioned upon a Heighted Supervision Agreement signed by the employing firm and supervisor.
61. The terms of any consultant agreement or heightened supervision agreement will be finalized during their registration process.
62. Cheng and Affinity are denied all exemptions contained in N.J.S.A. 49:3-50, subsection (a), paragraph 9, 10, 11, and subsection (b).
63. Cheng and Affinity are denied all exemptions to the registration requirements provided by N.J.S.A. 49:3-56(b), N.J.S.A. 49:3-56(c), and N.J.S.A. 49:3-56(g).
64. Cheng and Affinity are hereby jointly and severally assessed a civil monetary penalty in the amount of ten thousand dollars (\$10,000.00), pursuant to N.J.S.A. 49:3-70.1.
65. Payment is to be made by certified check, bank check, or an attorney trust account check payable to the "State of New Jersey, Bureau of Securities," and delivered to the Bureau of Securities, 153 Halsey Street, 6th Floor, Newark, NJ 07102, to the attention of the Bureau

Chief, upon execution of this Consent Order. The penalty payment shall be deposited into the Securities Enforcement Fund, pursuant to N.J.S.A. 49:3-66.1.


General Provisions

66. Nothing in this Consent Order is intended to limit or supersede any authority or remedy available to the Bureau Chief under the Securities Law. Notwithstanding the foregoing, all issues in controversy regarding the specific conduct described herein are resolved on the terms set forth in this Consent Order.
67. No employee or official of, or person representing, the Bureau or the State of New Jersey has made any additional promise or representation to Respondents regarding this Consent Order.
68. This Consent Order shall not bind any person not a party thereto. Each of the undersigned has read this Consent Order, understands it, and agrees to be bound by its terms.
69. Respondents agree that solely for the purpose of this matter or future proceedings to enforce this Consent Order that this Consent Order shall have the same effect as if prove and ordered after a full hearing pursuant to N.J.S.A. 52:14B-1 et seq.
70. Respondents consent to the entry of this Consent Order and voluntarily waive an opportunity for a hearing after reasonable notice within the meaning of N.J.S.A. 49:3-58(c)(2).
71. Pursuant to N.J.A.C. 1:1-19.1(d), this Consent Order shall be deemed the final decision as to Respondents.



Amy Koplen, Deputy Chief
New Jersey Bureau of Securities


**WE HEREBY CONSENT TO THE CONTENT
AND FORM OF THIS ADMINISTRATIVE
CONSENT ORDER:**



Kai Chong Cheng

Dated: 5/18/17

Affinity Capital Management, LLC

By: 

Kai Chong Cheng, President and
Managing Member

Dated: 5/18/17