

MEMO# 20787

January 16, 2007

Update on Recent Mutual Fund Enforcement and Litigation Matters

[20787]

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TO: BROKER/DEALER ADVISORY COMMITTEE No. 4-07
BROKER/DEALER ASSOCIATE MEMBERS No. 1-07
CLOSED-END INVESTMENT COMPANY MEMBERS No. 6-07
COMPLIANCE MEMBERS No. 2-07
SEC RULES MEMBERS No. 7-07
SMALL FUNDS MEMBERS No. 7-07 RE: UPDATE ON RECENT MUTUAL FUND ENFORCEMENT AND LITIGATION MATTERS

Following is a summary of recent mutual fund enforcement and litigation matters.

CEO of Registered Investment Adviser and Fund Trustee Settles SEC Charges Relating to Directed Brokerage

The Securities and Exchange Commission recently settled an administrative enforcement action against a former CEO of a registered investment adviser and trustee of mutual funds advised by the adviser (the "Respondent"). [\[1\]](#) The action related to charges that the adviser entered into arrangements with over 80 broker-dealers under which the broker-dealers promoted sales of the mutual funds in exchange for either cash or brokerage commissions from the funds' portfolio transactions. The adviser allegedly did not adequately inform the funds' board of trustees of the conflicts of interest presented by these arrangements. The Respondent allegedly knew of these arrangements and did not adequately disclose or ensure that anyone else disclosed the conflicts of interest they created to the funds' board.

The Respondent neither admitted nor denied the findings, but consented to the entry of a settlement order finding that he willfully aided and abetted and was a cause of the adviser's violation of Section 206(2) of the Investment Advisers Act. He was ordered to pay \$75,000 in civil penalties.

Federal District Court Dismisses SEC Lawsuit Against Fund Executives Relating to Market Timing

The U.S. District Court for the District of Massachusetts has dismissed an action in which the Securities and Exchange Commission had alleged that two former executives of a fund distributor committed fraud and aided and abetted fraud by the distributor. [2] The executives allegedly entered into, approved, and permitted arrangements allowing certain preferred customers to engage in short-term trading in certain mutual funds, while at the same time offering those funds for sale using prospectuses that represented that such short-term trading was prohibited. The court found that the SEC's complaint did not provide the detail required to support allegations of fraud, and therefore dismissed the action with prejudice. [3]

NASD Settles With Fund Administrator and Wholesaler Over Allegations Relating to Directed Brokerage

A mutual fund administrator and wholesaler (the "Respondent") recently entered into a settlement agreement with NASD relating to directed brokerage. [4] According to the Letter of Acceptance, Waiver and Consent (the "AWC"), the Respondent arranged for a brokerage affiliate to receive over \$25 million in directed brokerage commissions generated from the funds' portfolio trades. In exchange, the Respondent gained increased exposure and access to the brokerage sales force in connection with sales and marketing of the funds. NASD found that these arrangements violated NASD Rule 2830(k)(3), which prohibits directed brokerage in exchange for preferential sales of a mutual fund. According to the AWC, the Respondent also sponsored a sales recognition program that offered training programs at luxury resorts to brokers who sold certain amounts of the funds, in violation of NASD Rule 2830(l)(5), which governs non-cash compensation.

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[Attachment](#)

endnotes

[1] See *In the Matter of Lawrence J. Lasser*, SEC Release No. 40-2578, IA-2578, Admin. Proc. File. No. 3-12527 (Jan. 9, 2007), available at <http://www.sec.gov/litigation/admin/2007/ia-2578.pdf>.

[2] See *SEC v. James Tambone and Robert Hussey*, Civil Action No. 06-10855-NMG (D. Mass. Dec. 28, 2006), a copy of which is attached to this memorandum. An SEC press release on the dismissal is available at

<http://www.sec.gov/litigation/litreleases/2007/lr19962.htm>.

[3] As the district court explained, this action was almost identical to a case filed by the SEC on Feb. 9, 2005, which was dismissed without prejudice on Jan. 27, 2006 for the same reason. The second complaint included several additional paragraphs, but none of the new information cured the deficiencies of the first complaint.

[4] See *In re Evergreen Investment Services, Inc.*, NASD Letter of Acceptance, Waiver and Consent No. EAF0400970002 (November 3, 2006), a copy of which is attached to this memorandum.

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