

MEMO# 19610

January 20, 2006

SEC SETTLES WITH BROKER-DEALER AND OFFICER RELATING TO LATE TRADING AND MARKET TIMING

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19610] January 20, 2006 TO: BOARD OF GOVERNORS No. 3-06 CHIEF COMPLIANCE OFFICER COMMITTEE No. 2-06 COMPLIANCE MEMBERS No. 4-06 SEC RULES MEMBERS No. 8-06 SMALL FUNDS MEMBERS No. 6-06 RE: SEC SETTLES WITH BROKER-DEALER AND OFFICER RELATING TO LATE TRADING AND MARKET TIMING The Securities and Exchange Commission has announced that a former registered broker-dealer and one of its officers (together, “Defendants”) agreed to settle charges alleging that they defrauded mutual fund investors through improper late trading and market timing.* In December 2003, the SEC filed an emergency action in federal court seeking an asset freeze, preliminary injunction, and other relief against the Defendants. The SEC’s complaint alleges that from at least 2001 to 2003, the officer reaped profits of approximately \$175 million through improper late trading and market timing, principally through two investment advisers to two groups of mutual fund companies. The complaint alleges that the officer routinely transmitted trading decisions for his own account through the broker-dealer one to two hours after 4:00 p.m. EST (the close of the market), and that the broker-dealer created false internal records to show the trades were entered at 3:59 p.m. EST. The SEC’s complaint further alleges that from at least March 2001 to September 2003, the Defendants engaged in extensive market timing of the mutual funds despite knowing that the prospectuses for those funds either prohibited or discouraged timing and that timing was not available to most investors. The complaint also alleges that the officer agreed to make long- term investments (also known as “sticky assets”) in one of the adviser’s hedge funds in exchange for the adviser permitting him to market time its funds. * See Daniel Calugar and Security Brokerage, Inc. to Pay Over \$150 Million to Settle SEC Fraud Action for Late Trading and Market Timing, SEC Litigation Release No. 19526 (Jan. 10, 2006) (SEC v. Daniel Calugar and Security Brokerage, Inc, Case No. CV-S-03-1600-RCJ-RJJ (D. Nev. Jan. 10, 2006)), available at <http://www.sec.gov/litigation/litreleases/lr19526.htm>. A copy of the SEC’s complaint is available on the SEC’s website at <http://www.sec.gov/litigation/complaints/comp18524.pdf>. 2 The complaint alleges that the Defendants violated the antifraud provisions of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 under the Exchange Act. The final judgment, which is subject to approval by the federal district court, permanently enjoins the Defendants from future violations of the antifraud provisions of the federal securities laws and orders the officer to pay a total of \$153 million in disgorgement and penalties. The officer also consented to the issuance of an SEC order, based on the

entry of the injunction in the federal court action, that will permanently bar him from association with any broker or dealer. The broker-dealer ceased to be a registered broker-dealer in November 2003. The Defendants consented to the final judgment and the SEC order without admitting or denying the allegations. Jane G. Heinrichs Associate Counsel

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