

**MEMO# 18011**

September 20, 2004

## **BROKERAGE FIRM SETTLES SEC ENFORCEMENT ACTION RELATING TO LATE TRADING OF MUTUAL FUNDS**

[18011] September 20, 2004 TO: BOARD OF GOVERNORS No. 58-04 BROKER/DEALER ADVISORY COMMITTEE No. 26-04 CHIEF COMPLIANCE OFFICER COMMITTEE No. 7-04 COMPLIANCE ADVISORY COMMITTEE No. 90-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 83-04 SEC RULES MEMBERS No. 136-04 SMALL FUNDS MEMBERS No. 102-04 RE: BROKERAGE FIRM SETTLES SEC ENFORCEMENT ACTION RELATING TO LATE TRADING OF MUTUAL FUNDS The Securities and Exchange Commission has issued an order making findings and imposing penalties in an enforcement proceeding against a registered broker-dealer.\* The SEC's enforcement action involved allegations that the broker-dealer allowed mutual fund customers to change mutual fund orders after the 4:00 p.m. Eastern Time market close, creating the risk that such customers could unfairly capitalize on late-breaking news at the expense of other mutual fund investors. The broker-dealer consented to the entry of the SEC Order without admitting or denying the SEC's findings. The SEC Order finds that since at least January 2001, the broker-dealer engaged in a practice of allowing mutual fund customers to place mutual fund orders after 4:00 p.m. ET, the time as of which the funds calculated their net asset values for that day. Specifically, the broker-dealer allowed mutual fund customers to place substitute mutual fund orders after 4:00 p.m. ET when one of these client's original pre-4:00 p.m. mutual fund orders was rejected by the broker-dealer's computer system because it could not be processed as submitted. The SEC Order notes that from at least 1998 to September 2003, the broker-dealer's internal policy provided for a 4:00 p.m. ET cutoff time for the entry of mutual fund orders. According to the SEC Order, an internal investigation by the broker-dealer in the fall of 2003 identified hundreds of occasions since 2001 in which the broker-dealer's personnel contacted customers after the 4:00 p.m. \* See In the Matter of Charles Schwab & Co., Inc., SEC Release Nos. 34-50360 and IC-26595, Admin. Proc. File No. 3- 11648 (Sept. 14, 2004) ("SEC Order"). The SEC Order also censures the broker-dealer and imposes a cease and desist order. Copies of the SEC order and accompanying press release are available at <http://www.sec.gov/litigation/admin/34-50360.htm> and <http://www.sec.gov/news/press/2004-128.htm>, respectively. 2 market close and allowed the customer to submit a substitute order in a different fund while still receiving the current day's price. The SEC Order does not find that the broker-dealer's personnel entered into any improper agreements with customers allowing the substitute orders, or that the broker-dealer's customers engaged in a scheme to exploit the broker-dealer's order entry process or circumvent its controls. The SEC Order notes that the broker-dealer's personnel did not receive any additional compensation in exchange for processing the substitute orders and that senior management at the broker-dealer was not aware of the practice of allowing

substitute trades after market close. Further, the SEC Order notes that the broker-dealer has implemented a number of enhancements to its systems, policies and procedures, and internal controls relating to the processing of mutual fund shares. As a result of the conduct generally described above, the SEC Order finds that the broker-dealer willfully violated Rule 22c-1(a) under the Investment Company Act of 1940, which requires orders for mutual fund shares placed after the 4:00 p.m. market close to receive the next day's fund price. The broker-dealer consented to a civil money penalty of \$350,000. Jane G. Heinrichs Assistant Counsel

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