MEMO# 16766

November 11, 2003

SEC AND MASSACHUSETTS FILE ENFORCEMENT ACTIONS AGAINST FORMER BROKERS FOR MARKET TIMING OF MUTUAL FUNDS

[16766] November 11, 2003 TO: COMPLIANCE ADVISORY COMMITTEE No. 96-03 INVESTMENT ADVISER MEMBERS No. 40-03 SEC RULES MEMBERS No. 154-03 SMALL FUNDS MEMBERS No. 65-03 RE: SEC AND MASSACHUSETTS FILE ENFORCEMENT ACTIONS AGAINST FORMER BROKERS FOR MARKET TIMING OF MUTUAL FUNDS The Securities and Exchange Commission and the Massachusetts Securities Division announced the filing of federal civil charges and a state administrative proceeding, respectively, against former brokers and branch managers employed by Prudential Securities, Inc. (PSI). The actions involve allegations that the brokers misrepresented their identities or the identities of their customers in order to continue to engage in the market timing of mutual funds after the mutual funds in question had issued warning or termination letters to the brokers or accounts allegedly included in the market timing. Enforcement Action by the SEC The SEC filed a civil action in federal court charging five former PSI brokers with violations of the antifraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 under the 1934 Act.1 The SEC's complaint also charges a former PSI branch manager with aiding and abetting the brokers' violations of Section 10(b) and Rule 10b-5. The complaint alleges that, between 2001 and September 2003, numerous mutual fund companies notified PSI of improper market timing transactions by the brokers and suspended or restricted the brokers or their customers from further trading in the mutual funds' shares. To evade these restrictions, the brokers allegedly used multiple PSI-issued brokerage identification numbers to conceal their own identities and opened multiple accounts to conceal a customer's identity. The complaint further alleges that the branch manager, who was aware of the mutual funds' concerns, failed to ensure that the brokers' trading complied with the mutual funds' policies, procedures, and prospectus disclosures as well as with an internal PSI policy relating to market timing of mutual funds. 1 See SEC v. Martin J. Druffner, Justin F. Ficken, Skifter Ajro, John S. Peffer, Marc J. Bilotti and Robert E. Shannon, No. 03- 12154 (D. Mass. Nov. 4, 2003). A copy of the complaint is available on the SEC's website at www.sec.gov/litigation/complaints/comp18444.htm. 2 The SEC is seeking injunctive relief, disgorgement, penalties, and such other relief as the court deems appropriate. Administrative Proceeding by the Massachusetts Securities Division The Massachusetts Securities Division has filed an administrative complaint charging three former brokers and two former branch managers of PSI with violations of the antifraud and failure to supervise

provisions of the Massachusetts Uniform Securities Act and regulations under that Act.2 The complaint alleges that, from approximately January 1, 1998 to the present, numerous mutual fund companies notified PSI of improper market timing transactions by the brokers and issued warning or termination letters to the brokers or accounts allegedly involved in the market timing. The complaint alleges that the brokers engaged in a fraudulent scheme to circumvent these warnings and the mutual funds' market timing restrictions by allegedly: (1) concealing their identities through the use of various identification numbers, some of which were specifically created to avoid market timing detection systems; (2) establishing multiple accounts for a single client; (3) transferring shares from detected accounts into newly opened accounts; and (4) avoiding detection by trading through wrap and omnibus accounts. The complaint further alleges that the branch managers knowingly encouraged and actively furthered this scheme and that they failed to: (1) reasonably supervise the brokers, (2) enforce PSI policies and procedures relating to market timing activity, and (3) implement any controls to ensure that the brokers did not engage in illegal market timing practices such as late trading. The Division is seeking a cease-and-desist order, payment of an administrative fine, revocation of the brokers' and branch managers' registrations, and such other actions as may be in the public interest and necessary and appropriate for the protection of Massachusetts investors. Though no mutual funds were named, the Division's complaint alleges that the brokers' market timing scheme "involved the complicity of certain mutual fund employees including, but not limited to, wholesalers and back office personnel." The complaint contains examples of: (1) advice that the brokers allegedly received from mutual fund employees on how to circumvent a fund's market timing detection systems, and (2) alleged "deals" made between the brokers and mutual fund employees, including cases in which mutual fund companies had already terminated the brokers' trading privileges in one or more funds but thereafter permitted the brokers to continue trading their funds. Rachel H. Graham Assistant Counsel 2 See In the Matter of Martin J. Druffner, Justin F. Ficken, Skifter Ajro, Michael Vanin and Robert Shannon (Mass. Reg. Docket No. E-2003-059, Nov. 4, 2003). A copy of the complaint is available on the Division's website at www.state.ma.us/sec/sct/sctpdf/prudentialcomplaint.pdf.
