

MEMO# 16945

January 8, 2004

SEC FILES EMERGENCY ENFORCEMENT ACTION AGAINST MARKET TIMER, OBTAINS TEMPORARY RESTRAINING ORDER

[16945] January 8, 2004 TO: COMPLIANCE ADVISORY COMMITTEE No. 2-04 SEC RULES MEMBERS No. 4-04 SMALL FUNDS MEMBERS No. 1-04 RE: SEC FILES EMERGENCY ENFORCEMENT ACTION AGAINST MARKET TIMER, OBTAINS TEMPORARY RESTRAINING ORDER The Securities and Exchange Commission recently filed a civil action in federal court against a broker-dealer firm and its president and 95% owner, alleging that they reaped profits of approximately \$175 million from improper late trading and market timing activity in various mutual funds over a period of more than two years.¹ As requested by the SEC, the court issued a temporary restraining order freezing the assets of the defendants, prohibiting the destruction of documents, and granting expedited discovery. According to the SEC's complaint, the firm at all relevant times was a self-clearing broker-dealer registered with the SEC and, as a self-clearing firm, was permitted to submit client trades received before the 4:00 p.m. EST market close to the National Securities Clearing Corporation ("NSCC") after 4:00 p.m. The complaint alleges that the president, who was trading on his own behalf and therefore making trading decisions, routinely sent trades for his own account to the NSCC one to two hours after 4:00 p.m., despite having no legitimate reason for doing so. The complaint further alleges that the firm created false internal records in which the order time for its post-4:00 p.m. trades was entered as 3:59 p.m. With respect to market timing, the SEC's complaint alleges that the president, trading through the firm, engaged in a scheme involving market timing of various mutual fund investments totaling from \$400-500 million. According to the complaint, the executive knew, or was reckless in not knowing, that the funds' prospectuses either prohibited or discouraged market timing. The complaint further alleges that the executive made long-term investments in hedge funds sponsored by a registered investment adviser in return for timing capacity of \$220 million in mutual funds managed by the adviser. ¹ See SEC v. Daniel Calugar and Security Brokerage, Inc., Case No. CV-S-03-1600-RCJ-RJJ (D. Nev. Dec. 22, 2003). 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 SEC's complaint charges the defendants with violations of the antifraud provisions of Section 17(a) of the Securities Act of 1933 and of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The SEC is seeking injunctive relief, disgorgement, penalties, and such other relief as the court may determine to be just and necessary. Rachel H. Graham Assistant Counsel

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