

**MEMO# 17074**

February 6, 2004

## **SEC AND NEW YORK ANNOUNCE ACTIONS AGAINST FORMER BANK EXECUTIVE RELATING TO LATE TRADING AND MARKET TIMING**

[17074] February 6, 2004 TO: COMPLIANCE ADVISORY COMMITTEE No. 17-04 SEC RULES MEMBERS No. 23-04 SMALL FUNDS MEMBERS No. 17-04 RE: SEC AND NEW YORK ANNOUNCE ACTIONS AGAINST FORMER BANK EXECUTIVE RELATING TO LATE TRADING AND MARKET TIMING The Securities and Exchange Commission and the Attorney General of New York have announced federal and state enforcement actions against a former bank executive, who is alleged to have fraudulently arranged financing for hedge funds that were engaged in unlawful market timing and late trading of mutual funds. Enforcement Action by the SEC According to a Commission release, the agency instituted administrative proceedings against the former executive based on allegations by the Commission's Division of Enforcement that, from 2001 to 2003, the former executive arranged for hedge funds to receive financing from a bank affiliate. 1 The Division alleges that the former executive knew or was reckless in not knowing that the hedge funds were engaged in late trading and deceptive market timing of fund shares through an electronic trading platform operated by a national banking association. 2 After participating in a due diligence review of the banking association in September 2001, the former executive allegedly prepared a memorandum stating, among other things, that: (1) the banking association's platform would permit clients to "submit trades for same day value" after 4:00 p.m.; and (2) the banking association "allows our clients to submit trades in a number of methods to reduce the chance that they would appear to be timing a specific mutual fund." 1 See In the Matter of Paul A. Flynn, SEC Release Nos. 33-8360, 34-49177, IA-2212, IC-26345 (Feb. 3, 2004). A copy of the release is available on the SEC's website at <http://www.sec.gov/litigation/admin/33-8360.htm>. 2 Enforcement actions were previously brought against one of the hedge funds, the banking association, and former executive officers of the banking association. See Institute Memorandum to Accounting/Treasurers Members No. 39-03, Board of Governors No. 43-03, Compliance Advisory Committee No. 69-03, Director Services Committee No. 19-03, Primary Contacts - Member Complex No. 72-03, SEC Rules Members No. 117-03, and Small Funds Members No. 47-03 [16497], dated Sept. 4, 2003 (describing settlement of fraud charges by Canary Capital Partners, LLC); Institute Memorandum to Compliance Advisory Committee No. 103-03, SEC Rules Members No. 170-03, and Small Funds Members No. 74-03 [16828], dated Nov. 28, 2003 (describing civil and criminal charges against Security Trust Company, N.A. and its former CEO, president, and senior vice president). 2 The Division alleges that the former executive

substantially assisted violations of: (1) the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934; and (2) Rule 22c-1 under the Investment Company Act of 1940, which requires that all purchases or sales of fund shares be priced based on the NAV next calculated after receipt of the order. A hearing will be scheduled before an administrative law judge to determine if the allegations are true and what sanctions, if any, are appropriate in the public interest. Enforcement Action by the Attorney General The Attorney General filed a felony complaint in New York state against the former executive, based upon allegations that generally mirror those outlined in the Commission's release.<sup>3</sup> The felony complaint further identifies two mutual funds and alleges that the defendant, acting in concert with executive officers at the banking association and two hedge funds, stole property from those mutual funds in excess of \$1 million. The former executive is charged with five felonies, including two counts of grand larceny in the first degree and one count of scheme to defraud in the first degree. According to the Attorney General's press release, the former executive could face up to 25 years in prison if convicted of the most serious charge. Rachel H. Graham Assistant Counsel 3 See State of New York v. Paul A. Flynn, Felony Complaint No. \_\_ (NY Crim. Ct. Feb. 3, 2004). The complaint and the press release issued by the New York Attorney General announcing this action are available on the Attorney General's website at [http://www.oag.state.ny.us/press/2004/feb/feb03b\\_04.html](http://www.oag.state.ny.us/press/2004/feb/feb03b_04.html).

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