

MEMO# 17925

August 27, 2004

SEC FILES FRAUD CHARGES AGAINST BROKER-DEALER AND RELATED PARTIES FOR FACILITATING LATE TRADING AND MARKET TIMING IN MUTUAL FUNDS

[17925] August 27, 2004 TO: CHIEF COMPLIANCE OFFICER COMMITTEE COMPLIANCE ADVISORY COMMITTEE No. 83-04 SEC RULES MEMBERS No. 120-04 SMALL FUNDS MEMBERS No. 92-04 RE: SEC FILES FRAUD CHARGES AGAINST BROKER-DEALER AND RELATED PARTIES FOR FACILITATING LATE TRADING AND MARKET TIMING IN MUTUAL FUNDS The Securities and Exchange Commission announced the filing of a civil enforcement action against a registered broker-dealer; three of its executives, including the president; and the firm's parent company.* The SEC alleges that the defendants fraudulently facilitated late trading and market timing in mutual funds by certain of the broker-dealer's customers. With respect to late trading, the complaint alleges that the defendants entered into written agreements (negotiated by one of the executives and approved by the president) that enabled select institutional customers to receive same-day pricing on mutual fund trades placed or confirmed with the broker-dealer after 4:00 p.m. EST. The complaint states that, from June 2002 through September 2003, the defendants facilitated over 12,000 late trades in over 600 mutual funds for these customers. The complaint also alleges that the broker-dealer continued to accept late trades even after receiving a subpoena in July 2003 from the New York Attorney General's office asking for documents relating to late trading or market timing activities. With respect to market timing, the complaint alleges that the broker-dealer employed various methods to conceal timing activity by certain customers. According to the complaint, the broker-dealer received hundreds of "kick-out" letters from mutual funds, which would note a particular client identifier (i.e., customer account number, representative code, or office code) and indicate that a trade was rejected because of impermissible market timing or excessive trading. The complaint alleges that the executives, who knew about the kick-out letters, authorized and/or provided customers with multiple client identifier numbers in order to * See SEC v. JB Oxford Holdings, Inc., National Clearing Corporation, James G. Lewis, Kraig L. Kibble, and James Y. Lin, Civil Action No. CV 04-7084 PA (VBKx) (C.D. Cal. Aug. 24, 2004). A copy of the SEC's complaint and accompanying release are available on the SEC's website at <http://www.sec.gov/litigation/complaints/comp18850.pdf> and <http://www.sec.gov/litigation/litreleases/lr18850.htm>, respectively. 2 disguise the customers' timing activity and prevent detection by the funds being timed. The complaint further alleges that the defendants negotiated timing capacity on behalf of two customers with at least one mutual fund, even though the executives knew the arrangement was contrary to the fund's prospectus disclosures. The complaint charges the defendants with

violations of the antifraud provisions in Section 17(a) of the Securities Act of 1933 and Section 10(b) of, and Rule 10b-5 under, the Securities Exchange Act of 1934. The complaint also charges the broker-dealer with violating Rule 22c-1 under the Investment Company Act of 1940. The SEC is seeking injunctive relief, disgorgement, civil monetary penalties, and such other and further relief as the Court may determine to be just and necessary. The SEC also requests that the Court bar the president from serving as an officer or director of a public company. Rachel H. Graham Assistant Counsel

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