

MEMO# 18479

January 28, 2005

FORMER BROKERS SETTLE SEC CHARGES, PLEAD GUILTY TO NEW YORK CRIMINAL CHARGES RELATING TO LATE TRADING, MARKET TIMING

[18479] January 28, 2005 TO: CHIEF COMPLIANCE OFFICER COMMITTEE No. 9-05 COMPLIANCE ADVISORY COMMITTEE No. 9-05 SEC RULES MEMBERS No. 18-05 SMALL FUNDS MEMBERS No. 12-05 RE: FORMER BROKERS SETTLE SEC CHARGES, PLEAD GUILTY TO NEW YORK CRIMINAL CHARGES RELATING TO LATE TRADING, MARKET TIMING The Securities and Exchange Commission has issued an order making findings and imposing disgorgement, penalties, and sanctions in an enforcement proceeding against two former registered representatives ("Respondents") of a broker-dealer firm ("Firm").¹ The Respondents consented to entry of the SEC Order without admitting or denying the SEC's findings. In addition, the Attorney General of New York announced that the Respondents have pleaded guilty to related state criminal charges.² Both actions allege that the Respondents engaged in late trading of mutual fund shares on behalf of certain customers. The SEC Order also alleges that the Respondents fraudulently used various devices to conceal their customers' market timing of mutual fund shares. The SEC Order and the New York criminal charges are summarized below.

I. SEC Order A. Findings The SEC Order finds that, from early 2000 through approximately September 2003, the Respondents fraudulently engaged in market timing and late trading of mutual fund shares on behalf of institutional customers of the Firm. With respect to market timing, the SEC Order finds that the Respondents used various deceptions to evade detection of ongoing market timing, including: (1) establishing multiple accounts for timing customers; (2) using multiple registered representative numbers and multiple branch codes; and (3) establishing relationships

¹ See In the Matter of Lawrence S. Powell and Delano N. Sta.Ana, SEC Release Nos. 34-51017, IA-2342 and IC-26722, Admin. Proc. File No. 3-11794 (Jan. 11, 2005) ("SEC Order"). Copies of the SEC Order and accompanying press release are available at <http://www.sec.gov/litigation/admin/34-51017.htm> and <http://www.sec.gov/news/press/2005-4.htm>, respectively. The broker-dealer also is registered with the Commission as an investment adviser.

² See Kaplan Brokers Plead Guilty to Late Trading (press release issued by Office of New York State Attorney General Eliot Spitzer, Jan. 11, 2005), which is available at http://www.oag.state.ny.us/press/2005/jan/jan11a_05.html.

² with multiple clearing firms. With respect to late trading, it finds that the Respondents routinely permitted customers to place orders with tentative trading instructions and then confirm those orders after 4:00 p.m. EST. According to the SEC Order, the Respondents were aware that their customers were taking advantage of news after the market close in determining whether to effect

transactions. The SEC Order further finds that on numerous occasions the Respondents requested that their clearing firms cancel orders, sometimes by falsely stating that an order had been entered in error. As a result of the conduct generally described above, the SEC Order finds that the Respondents willfully violated the antifraud provisions of Section 10(b) of the Securities Exchange Act and Exchange Act Rule 10b-5. It further finds that the Respondents willfully aided and abetted and caused the Firm's violations of Rule 22c-1 under the Investment Company Act and of the antifraud provisions of Section 15(c)(1) of the Exchange Act. B. Terms of the SEC Order In determining to accept the settlement offer, the SEC considered the Respondents' cooperation with the SEC staff. Pursuant to the SEC Order, each Respondent will pay \$255,000 in disgorgement and prejudgment interest and \$120,000 in civil money penalties. The SEC Order also: (1) imposes a cease and desist order on each Respondent; (2) bars each Respondent from association with any broker, dealer or investment adviser; and (3) prohibits each Respondent from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter. II. New York Criminal Charges The Attorney General of New York filed felony complaints alleging that the Respondents placed numerous mutual fund orders on behalf of the Firm's clients after 4:00 p.m. EST and that the orders received the current day's price.³ The complaints further allege that the Respondents fraudulently caused numerous mutual funds to accept orders to buy and sell fund shares for the Firm's benefit. According to the Attorney General's press release, the Respondents pleaded guilty to a violation of New York's Martin Act, General Business Law Section 352-c(6), which is punishable by a maximum of one to four years in state prison. Rachel H. Graham Assistant Counsel 3 See *State of New York v. Lawrence S. Powell*, Felony Complaint No. __ (NY Crim. Ct. Jan. __, 2005), available at <http://www.oag.state.ny.us/press/2005/jan/Powell.pdf>, and *State of New York v. Delano N. Sta.Ana*, Felony Complaint No. __ (NY Crim. Ct. Jan. __, 2005), available at <http://www.oag.state.ny.us/press/2005/jan/Sta.Ana.pdf>. The two complaints are substantively identical.