

MEMO# 16828

November 28, 2003

SEC, OCC, AND NEW YORK ANNOUNCE ACTIONS AGAINST INTERMEDIARY RELATING TO LATE TRADING AND MARKET TIMING

[16828] November 28, 2003 TO: COMPLIANCE ADVISORY COMMITTEE No. 103-03 SEC RULES MEMBERS No. 170-03 SMALL FUNDS MEMBERS No. 74-03 RE: SEC, OCC, AND NEW YORK ANNOUNCE ACTIONS AGAINST INTERMEDIARY RELATING TO LATE TRADING AND MARKET TIMING The Securities and Exchange Commission and the Attorney General of New York announced the filing of federal and state enforcement actions against a national banking association (“bank”), which effects and processes trades in mutual fund shares for retirement plans, and the bank’s former CEO, president and senior vice president (collectively, “former executive officers”). The Office of the Comptroller of the Currency, the bank’s primary regulator, also announced that it issued an order requiring the bank to begin a process that will result in dissolution of the bank by March 31, 2004. Enforcement Action by the SEC The SEC filed a civil action in federal court alleging that, over a period of more than three years, the bank and its former executive officers facilitated fraudulent late trading and market timing of mutual fund shares by a group of related hedge funds.¹ The complaint alleges that the defendants: (1) repeatedly misrepresented to mutual funds that the hedge funds were a retirement plan account; (2) permitted the hedge funds to submit trades several hours after the 4:00 pm EST market close using the bank’s electronic trading platform, which was designed for the processing of trades made by third party administrators; and (3) employed various strategies (some devised by the former CEO) to conceal the hedge funds’ market-timing activities from the mutual funds, including “piggybacking” the hedge funds’ trades on the trades of other bank clients without the clients’ knowledge. The complaint further alleges that the hedge funds effected trades in 397 mutual funds over the period, approximately 99% of which were sent to the bank after 4:00 pm EST, and that the bank received a 4% profit share on most of the hedge funds’ trades. 1 See SEC v. Security Trust Company, N.A., Grant D. Seeger, William A. Kenyon, and Nicole McDermott, Case No. ____ (D. Ariz. Nov. 24, 2003). A copy of the SEC’s complaint is available on the SEC’s website at <http://www.sec.gov/litigation/complaints/comp18479.pdf>. 2 The SEC’s complaint charges the bank and the former executive officers 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 Exchange Act. The complaint also charges: (1) the bank with violating Rule 22c-1 under the Investment Company Act of 1940, which in effect requires that purchases or sales of mutual fund shares be priced at the current NAV next calculated after receipt of the order; and (2) the former CEO with

violating Section 37 of the Investment Company Act, which prohibits theft of a fund's assets. The SEC is seeking injunctive relief, disgorgement, penalties, and such other relief as the court may determine to be just and necessary. Enforcement Action by the Attorney General The Attorney General filed a criminal action in New York County against the former executive officers for assisting in the illegal late trading of mutual fund shares by a group of related hedge funds.² The allegations in the felony complaint generally mirror the late trading allegations in the SEC's complaint, as discussed above. The felony complaint further identifies six mutual funds and alleges that the defendants' actions resulted in larceny of more than \$1 million from those mutual funds. The felony complaint charges the defendants with securities fraud, grand larceny, and falsification of business records under New York's Martin Act. According to the Attorney General's press release, the maximum permissible sentence upon a conviction for each of the most serious charges is 8 1/3 to 25 years imprisonment. Order by the OCC The OCC issued an order requiring the bank to begin a process that will result in dissolution of the bank by March 31, 2004 ("Dissolution Order").³ In so doing, the OCC modified the terms of a consent order it had issued on October 29, 2003 ("Initial Order"), after an examination of the bank.⁴ Among other things, the Initial Order: (1) required the bank to cease and desist from assisting or participating in activities involving late trading and market timing of mutual fund shares; (2) placed restrictions on the bank's assets; and (3) required the bank to submit a three-year strategic plan for the OCC's review and approval. The OCC issued the Dissolution Order after determining that the bank would be unable to submit an acceptable strategic plan based on the bank's current financial condition and its future financial prospects. Rachel H. Graham Assistant Counsel 2 See *State of New York v. Grant Seeger, William Kenyon, and Nicole McDermott*, Felony Complaint No. ____ (N.Y. Crim. Ct. Nov. 24, 2003). A copy of the felony complaint is available on the Attorney General's website at http://www.oag.state.ny.us/press/2003/nov/stc_complaint.pdf. 3 See *In the Matter of Security Trust Company, N.A., Modification of Consent Order Dated October 29, 2003* (OCC No. 2003-138; Nov. 24, 2003). A copy of the Dissolution Order is available on the OCC's website at <http://www.occ.treas.gov/ftp/eas/ea2003-138.pdf>. 4 See *In the Matter of Security Trust Company, N.A., Consent Order* (OCC No. 2003-136; Oct. 29, 2003). A copy of the Initial Order is available on the OCC's website at <http://www.occ.treas.gov/ftp/eas/ea2003-136.pdf>.

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