

MEMO# 16805

November 21, 2003

SEC AND NEW YORK FILE SUIT AGAINST ADVISER AND ITS FOUNDERS FOR MARKET TIMING AND SELECTIVE DISCLOSURE OF FUND HOLDINGS

[16805] November 21, 2003 TO: COMPLIANCE ADVISORY COMMITTEE No. 102-03 SEC RULES MEMBERS No. 164-03 SMALL FUNDS MEMBERS No. 71-03 RE: SEC AND NEW YORK FILE SUIT AGAINST ADVISER AND ITS FOUNDERS FOR MARKET TIMING AND SELECTIVE DISCLOSURE OF FUND HOLDINGS The Securities and Exchange Commission and the Attorney General of New York each announced the filing of civil charges against a registered investment adviser and its two founders, one of whom formerly served as President and the other as Chairman and CEO of the adviser (collectively, “former executive officers”).¹ The complaints are summarized below. The federal and state actions are generally predicated on the same alleged misconduct. In particular, both complaints allege that the former executive officers permitted select customers – including a hedge fund in which the former President had a substantial interest – to engage in extensive short-term trading in mutual funds advised by the adviser, including in a fund managed by the former President. The complaints allege that these arrangements were: (1) inconsistent with disclosures in the funds’ prospectuses relating to limitations on investors’ ability to exchange fund shares; (2) not disclosed to fund shareholders; and (3) specifically permitted to continue even after the adviser began placing limitations on the trading of other known and suspected market timers. The SEC’s complaint further alleges that the former Chairman and CEO deliberately and repeatedly provided material, nonpublic information about a fund’s portfolio holdings to a broker-dealer firm, whose customers used this information to engage in market timing of the funds. The SEC’s complaint charges the adviser and the former executive officers with violations of the antifraud provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisers Act of 1940. The SEC’s complaint also charges the adviser with violating Section 204A of the Advisers Act for failing to prevent the misuse of nonpublic information and charges the former Chairman and CEO with aiding and abetting that violation. The SEC is seeking injunctive relief, including an injunction prohibiting the former executive 1 See SEC v. Gary L. Pilgrim, Harold J. Baxter, and Pilgrim Baxter & Associates, Ltd., No. 03-CV-6341 (E.D.Pa. Nov. 20, 2003) and State of New York v. Pilgrim Baxter & Associates, Ltd., Gary L. Pilgrim, and Harold J. Baxter (N.Y. Sup. Ct. Index No. __, Nov. 20, 2003). A copy of the SEC’s complaint is available on the SEC’s website at www.sec.gov/litigation/complaints/comp18474.htm. A copy of the Attorney General’s complaint is available on the Attorney General’s website at

www.oag.state.ny.us/press/2003/nov/pilgrim_baxter.pdf. 2 officers from acting in various capacities for any mutual fund; disgorgement; penalties; and such other relief as the court deems appropriate. The Attorney General's complaint charges the adviser and the two former executive officers with violations of New York's Martin Act, General Business Law, and Executive Law. The Attorney General is seeking injunctive relief, including an injunction prohibiting the former executive officers from directly or indirectly engaging in activities relating to the purchase or sale of securities; disgorgement of all fees earned during the period that illegal activity was permitted (estimated by the Attorney General to exceed \$250 million) and of all profits from such activity; restitution; penalties; and such other relief as the court deems just and proper in the circumstances. Rachel H. Graham Assistant Counsel

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