

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2638 / August 22, 2007

INVESTMENT COMPANY ACT OF 1940
Release No. 27932 / August 22, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12734

In the Matter of

MICHAEL CARL
HOFFMAN,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER PURSUANT TO
SECTION 203(f) OF THE INVESTMENT
ADVISERS ACT OF 1940 AND SECTIONS
9(b) AND 9(f) OF THE INVESTMENT
COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 (“Advisers Act”) and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against Michael Carl Hoffman (“Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 203(f) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. These proceedings arise out of a practice known as "late trading" in mutual fund shares by the hedge fund Respondent co-managed, known as Ilytat. From 2000 through September 2002, Ilytat repeatedly engaged in late trading – placing orders to buy, redeem, or exchange mutual fund shares after the 4:00 p.m. Eastern time market close while still receiving the current day's mutual fund price. Respondent's business partner discovered that Ilytat could late trade and began the practice. By engaging in late trading, Respondent's hedge fund, Ilytat, profited from market events that occurred after 4:00 p.m. but were not reflected in the price Ilytat paid for the mutual fund shares. Ilytat made use of a loophole in its clearing broker's mutual fund order entry system by placing approximately 2,700 late trades in various mutual funds (representing about 84% of Ilytat's mutual fund trades), allowing it to receive a price to which it was not entitled. Ilytat's late trading caused dilution to other mutual fund investors because Ilytat received stale prices for the mutual fund shares it trades. That is, Ilytat's late trading allowed it to receive a price to which it was not entitled, resulting in a transfer of money from the mutual funds and their shareholders to Ilytat.

Respondent

2. Respondent, age 44, lives in San Francisco, California. He started the Ilytat hedge fund in 1998 and co-managed it until it closed it in 2002. Respondent was also an investor in Ilytat.

Related Entities

3. Ilytat was founded by Hoffman in 1998 and operated until August 2002, investing largely in domestic mutual funds and domestic and international equities. A business partner joined Respondent in managing Ilytat in 1999. In May 2001, Ilytat had approximately \$130 million in assets. Ilytat's investment adviser, Ilytat, LLC, was registered with the State of California as an investment adviser and maintained its only office in San Francisco. Hoffman and his partner were members of Ilytat, LLC.

4. Bear, Stearns Securities Corp. ("Bear Stearns") is a broker-dealer registered with the Commission that served as prime broker for Ilytat during the relevant period, providing Ilytat with trade processing, clearance, financing, and other services.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Facts

5. The price of a mutual fund's shares is based on the value of the securities (and other assets) held by the mutual fund, and each fund is required by the Commission's regulations to calculate each trading day the value of the fund's holdings, or net asset value ("NAV"). Generally, the funds in which Ilytat traded calculated the price of their shares as of the close of the major United States securities exchanges and markets (4:00 p.m. Eastern time). As the Commission's regulations further require, the price received by the investor for shares of the fund is the price the fund next calculates after receipt of the order. Consequently, trades placed by an ordinary investor after 4:00 p.m. Eastern time in the funds Ilytat traded received the NAV next calculated by the mutual fund *after* the investor placed the order, which was the NAV calculated as of 4:00 p.m. on the following trading day.

6. In or around late 1999 or early 2000, Bear Stearns provided Ilytat with access to a proprietary software system, known as the Mutual Fund Routing System ("MFRS"), which was part of a computer network that automatically forwarded mutual fund orders to the appropriate mutual funds for processing. Direct access to MFRS allowed Ilytat personnel to enter mutual fund orders directly into MFRS, bypassing human intervention by anyone at Bear Stearns.

7. Ilytat entered orders into MFRS after 4:00 p.m., which were sent to mutual funds for processing as if they were entered before 4:00 p.m. Thus, Ilytat placed trades for mutual fund shares after 4:00 p.m. through its direct access to MFRS and still received prices for the shares based on that day's NAV, instead of the next day's NAV (the price an ordinary mutual fund investor would have received).

8. Dealer agreements between Bear Stearns and various mutual funds stipulated that Bear Stearns would process trades at the appropriate pre- or post-4:00 p.m. price. In addition, mutual funds relied on Bear Stearns as a distributor to sell their shares at the appropriate price, which was the next day's NAV for trades placed after 4:00 p.m. Furthermore, mutual funds included disclosures in their prospectuses informing shareholders that the price they were entitled to receive in purchasing, redeeming, and exchanging their shares was the NAV next calculated after placing their orders.

9. Respondent learned that orders Ilytat placed to trade mutual fund shares after 4:00 p.m. would still receive that day's NAV, instead of the next day's NAV (as ordinary mutual fund investors would have received). Indeed, Ilytat used the MFRS system in order to receive a price to which it was not entitled. By placing orders after 4:00 p.m. while receiving prices for fund shares based on a fund's pre-4:00 p.m. NAV, Ilytat exploited its access to information announced after 4:00 p.m. that could affect securities prices. Respondent explained Ilytat's ability to thus late trade to a representative of at least one Ilytat investor.

10. From late November 2000 through September 2002, when Ilytat closed, Ilytat placed approximately 2,700 trades into MFRS after 4:00 p.m., or about 84% of the approximately 3,300 mutual fund trades entered into MFRS on behalf of Ilytat during that time,

each of which improperly received prices based on the same day's NAV. These trades, for the purchase, redemption, or exchange of securities issued by investment companies registered with the Commission pursuant to Section 8(a) of the Investment Company Act, were entered into MFRS after 4:00 p.m. but were priced as if the orders were entered before 4:00 p.m.

11. Respondent, by using the ability to enter trades after 4:00 p.m., which he understood would be priced as if entered before 4:00 p.m., caused Bear Stearns to fail to price the mutual fund shares at a price based on the NAV next calculated after Bear Stearns received the order from Ilytat.

12. As a result of the conduct described above, Respondent willfully aided and abetted and caused Bear Stearns' violations of Rule 22c-1(a), as adopted under Section 22(c) of the Investment Company Act, which requires certain mutual funds, persons designated in such issuers' prospectuses as authorized to consummate transactions in any such security, their principal underwriters, or dealers in the funds' securities, to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to buy or redeem.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in Respondent Hoffman's Offer.

Accordingly, pursuant to Section 203(f) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Hoffman cease and desist from committing or causing any violations and any future violations of Rule 22c-1(a) under the Investment Company Act;

B. Respondent Hoffman be, and hereby is barred from association with any investment adviser, with the right to reapply for association after eighteen (18) months to the appropriate self-regulatory organization, or if there is none, to the Commission;

C. Respondent Hoffman be, and hereby is prohibited 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, with the right to reapply for association after eighteen (18) months to the appropriate self-regulatory organization, or if there is none, to the Commission;

D. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-

regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

E. IT IS FURTHERED ORDERED Respondent shall, within 120 days of the entry of this Order, pay a civil money penalty in the amount of \$100,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Michael Carl Hoffman as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Helane L. Morrison, Regional Director, Securities and Exchange Commission, San Francisco Regional Office, 44 Montgomery Street, Suite 2600, San Francisco, California 94104-4691.

By the Commission.

Nancy M. Morris
Secretary