

INITIAL DECISION RELEASE NO. 340  
ADMINISTRATIVE PROCEEDING  
FILE NO. 3-12559

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

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In the Matter of	:	
	:	
TRAUTMAN WASSERMAN &	:	
COMPANY, INC.,	:	INITIAL DECISION
GREGORY O. TRAUTMAN,	:	January 14, 2008
SAMUEL M. WASSERMAN,	:	
MARK BARBERA,	:	
JAMES A. WILSON, JR.,	:	
JEROME SNYDER, and	:	
FORDE H. PRIGOT	:	

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APPEARANCES: Leon Baer Borstein for Respondent Gregory O. Trautman

Barry S. Zone and Jason Canales for Respondent Samuel M. Wasserman

David Gourevitch and Jacob S. Frenkel for Respondent Mark Barbera

Jeffrey M. Rubin for Respondent Forde H. Prigot

Alexander Vasilescu, Robert Murphy, Paul Gizzi, Sandeep Satwalekar, and Bennett Ellenbogen for the Division of Enforcement, Securities and Exchange Commission

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

The U.S. Securities and Exchange Commission (Commission) instituted this proceeding on February 5, 2007, by an Order Instituting Administrative and Cease-and-Desist Proceedings

Pursuant to Section 8A of the Securities Act of 1933 (Securities Act), Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act), Sections 9(b) and 9(f) of the Investment Company Act of 1940 (Investment Company Act), and Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 (Advisers Act) (OIP).

The remaining respondents are Trautman Wasserman & Company, Inc. (TWCO), Gregory O. Trautman (Trautman), and Samuel M. Wasserman (Wasserman).<sup>1</sup> TWCO did not file an Answer or defend the proceeding, thus, the Division requests that TWCO be held in default. (Tr. 52.)

A public hearing on October 9 through October 18, 2007, at which the Division called nineteen witnesses, including Trautman, Wasserman, Barbera, Wilson, and an expert, resulted in 2,757 pages of transcript.<sup>2</sup> The Division also introduced 130 exhibits, Trautman introduced four exhibits, and Wasserman introduced two exhibits.<sup>3</sup> I did not allow thirty-three Division exhibits into evidence. Pursuant to Rule 322 of the Commission's Rules of Practice, I granted a protective order and confidential treatment to the pending Offer of Settlement of Respondent Wilson and the financial statements of Wilson and Scott Christian (Christian), and allowed only Respondents' counsel access to those materials.<sup>4</sup> (Tr. 1008-11.) The Division's Post-Hearing Reply Brief was received on January 11, 2008.

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<sup>1</sup> The Commission issued an Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 9(b) of the Investment Company Act of 1940 as to Jerome Snyder (Snyder) on June 29, 2007. Trautman Wasserman & Co., Inc., 90 SEC Docket 3109 (June 29, 2007). On September 25, October 16, and October 18, 2007, I stayed the proceeding as to Respondents James A. Wilson, Jr. (Wilson), Forde H. Prigot (Prigot), and Mark Barbera (Barbera), respectively. Each respondent had reached an agreement in principle with the Division of Enforcement (Division) to settle the allegations against them. See 17 C.F.R. § 201.161(c)(2).

<sup>2</sup> The Division also presented testimony from four representatives of investment companies, three persons who had worked at TWCO, three Commission staff members, a representative of TWCO's clearing broker, a couple who had an account at TWCO, and a person who attended a meeting with the Respondents.

<sup>3</sup> I will cite to the transcript of the hearing as "(Tr. \_\_\_\_)." I will cite to the parties' exhibits as "(PX Ex. \_\_\_\_)," "(Trautman Ex. \_\_\_\_)," and "(Wasserman Ex. \_\_\_\_)," for the Division, Trautman, and Wasserman, respectively. I will cite to the Division's and Respondents' Post-Hearing Briefs as "(Div. Post-Hearing Br. \_\_\_\_)," "(Trautman Post-Hearing Br. \_\_\_\_)," "(Wasserman Post-Hearing Br. \_\_\_\_)," and "(Div. Reply Br. \_\_\_\_)."

<sup>4</sup> For background information on Wilson and Christian, see infra note 13 and accompanying text.

## ISSUES

The issues are whether between January 2001 and September 2003:<sup>5</sup>

1. TWCO, Trautman, and Wasserman willfully violated Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by knowingly and/or recklessly participating in a scheme by Wilson and TWCO's customers to defraud mutual funds and their shareholders by engaging in a late trading scheme that involved implicit, material false representations;
2. Alternatively, Trautman and Wasserman willfully aided and abetted and caused TWCO's and TWCO's customers' violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by being aware of Wilson's late trading scheme that involved implicit, material false representations and taking actions that furthered that scheme;
3. TWCO willfully violated Section 15(c) of the Exchange Act and Rule 10b-3 thereunder by engaging in a late trading scheme with its customers that involved implicit, material false representations;
4. Trautman and Wasserman willfully aided and abetted and caused TWCO's violations of Section 15(c) of the Exchange Act and Rule 10b-3 thereunder;
5. TWCO, Trautman, and Wasserman willfully aided and abetted and caused Bank of America's (BoA) violations of Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act; and
6. TWCO willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

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<sup>5</sup> A five-year statute of limitations applies to Commission proceedings under Section 15(b) of the Exchange Act. See Johnson v. SEC, 87 F.3d 484 (D.C. Cir. 1996); 28 U.S.C. § 2462. Trautman and Wasserman each raised the statute of limitations as an affirmative defense in their Answers. See 17 C.F.R. § 201.220(c); Laurie Jones Canady, 54 S.E.C. 65, 89 (1999). Application of the five year statute of limitations would limit the relevant period to February 6, 2002 through September 2003.

## FINDINGS OF FACT

### TWCO

TWCO was a Sub-chapter S corporation headquartered in New York, New York, and registered with the Commission as a broker-dealer on June 29, 1993.<sup>6</sup> (Tr. 2499-50; PX Ex. 54.) TWCO had branch offices in San Francisco, California, and East Hampton, New York. (Tr. 2057-58; PX Ex. 54.) There was at least one employee in San Francisco, and, although it is not clear, the East Hampton office may have been in Trautman's home. (Tr. 2492.) TWCO is no longer an operating entity. (Tr. 2114, 2284.) Trautman testified that TWCO withdrew its registration from the National Association of Securities Dealers (NASD) in November 2006. (Tr. 2284-85.)

In 2000, TWCO's primary business was raising venture capital from accredited investors for investments in private companies, and it had a retail brokerage business.<sup>7</sup> (Tr. 884, 1054, 1953.) In 2001, Trautman, a co-founder, president, and Chief Executive Officer (CEO) owned thirty-six percent, Wasserman, a co-founder and the chair of the board owned thirty-six percent, Barbera, the Chief Financial Officer (CFO) owned eighteen percent, and Douglas Greenwood (Greenwood), the managing director owned ten percent. (Tr. 86, 316, 597, 1043, 1893, 1955, 2543; PX Ex. 54 at 2.)

Trautman was in his mid-thirties during the relevant period. He began working in the securities industry in 1988 and graduated from Sarah Lawrence College in 1989. (PX. Ex. 114.) Trautman held Series 7, 24, 27, 55, and 63 licenses.<sup>8</sup> (PX Ex. 114 at 16, 18.) Trautman was associated with five broker-dealers before TWCO: he was discharged from The Stuart-James Co., Inc., in 1989 and was permitted to resign from Guilford Securities Inc., in January 1991.<sup>9</sup> (PX Ex. 114 at 7.) Trautman considers himself knowledgeable in arbitrage strategies and "a bit of a quant guy." (Tr. 2141.) He invited Wasserman to join him in 1999 when his former partner,

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<sup>6</sup> TWCO filed to withdraw its broker-dealer registration with the Commission on December 6, 2006. That application has not become effective because the Commission instituted this proceeding prior to the effective date. (Div. Post-Hearing Br. 71 n.11.)

<sup>7</sup> TWCO also had three or four people from First Boston who worked on collateralized debt obligations (CDO) transactions. (Tr. 1225, 2347.) Six of TWCO's registered representatives were independent contractors who worked for Klitzberg and Associates, located in Florida, and referred investors to hedge funds. (PX Ex. 54 at 2 n.2.)

<sup>8</sup> The NASD revoked Trautman's NASD registration on June 12, 2007, for failure to pay fines and/or costs in a case. (PX Ex. 114 at 41.)

<sup>9</sup> Trautman was associated with Spencer Trask Securities Inc., from May 1992 to May 1993, with GKN Securities Corp., from August 1991 to May 1992, and with Rosenkrantz Lyon & Ross Inc., from January 1991 to August 1991. (PX. Ex. 114 at 5-6.)

Robert Kramer, retired, and the firm, Trautman Kramer, had realized a few million dollars of unanticipated profit from a private equity investment. (Tr. 2018, 2420.) It is reasonable to assume that Trautman realized that Wasserman brought a solid reputation and industry contacts to TWCO. (Tr. 148, 1072, 1121.) The hope was that Wasserman would be able to build a group of private clients interested in Trautman's private equity businesses. (Tr. 2540-41.) Trautman named Wasserman TWCO board chair because he was older. (Tr. 2543.) Trautman is the sole owner of Trautman Wasserman Holding Company (TW Holding), an affiliated consulting company. (PX Ex. 54 at 2 n.1.) Trautman estimates his net worth at a negative \$1.1 million as of October 12, 2007. (Tr. 2293-94; Trautman Exs. T3, T3-A.) Trautman submitted a "Statement of Assets and Liabilities" as of September 20, 2006, and October 12, 2007. (Trautman Exs. T3, T3-A.) Neither statement is sworn nor signed.

Wasserman graduated from the University of Maryland School of Law in 1967, but he has never engaged in the practice of law. Wasserman earned his first securities license in 1960 and has worked his entire life in the securities industry. (Tr. 2740.) As an allied member of the New York Stock Exchange (NYSE) in the late 1980s, he was grandfathered in for a number of supervisory licenses. (Tr. 2524.) Wasserman headed the western division of Bache & Company from 1972 to 1975, became a southwest regional vice president for Lehman Brothers in 1980, managed Lehman Brothers' midtown New York office in 1983, and retired from Lehman Brothers in 1995 as head of the retail or high net-worth division. (Tr. 2055, 2518-20.) Wasserman maintained his licenses, but was in effect retired until he joined Trautman Kramer in March 1999. (Tr. 2738.) The original arrangement was to pay Wasserman an annual salary of \$750,000, but the firm could not afford it, so Wasserman agreed to accept an equal partnership with Trautman instead. (Tr. 2541-42.) Wasserman paid less than two dollars for his thirty-six percent equity share of TWCO. (Tr. 2023, 2520-21.) Wasserman was president of Trautman Wasserman Capital Advisers, Inc., a registered investment adviser from December 2000 through April 2001, and Trautman Wasserman Capitol Advisers, Inc, a registered investment adviser from January to June 2002. (OIP ¶ 8, Answer.)

An attorney specializing in securities, who dealt with Wasserman professionally for over twenty-five years, and a religious figure, who has known Wasserman for the same period of time and who has worked with Wasserman on activities that assist others, submitted sworn statements opining that Wasserman is a person of high moral character.<sup>10</sup> (Exs. W-3.)

I allow Wasserman's sworn financial affidavit notarized on November 16, 2007, into evidence as Wasserman Ex. W-3. I find that the harm resulting from disclosure outweighs the benefits of disclosure and grant Wasserman's request that Wasserman Ex. W-3 receive confidential treatment.

TWCO had approximately fifty to sixty employees from 2001 to 2003. At TWCO, Trautman's main activities were dealing with the twenty to thirty companies in which TWCO had investments and handling the retail trading department. (Tr. 2290, 2696-98.) Wasserman

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<sup>10</sup> See Statements of Saul S. Cohen, retired partner Proskauer Rose, LLP, and Senior Rabbi Peter J. Rubenstein, Central Synagogue, New York, New York.

handled the firm's day-to-day operations, primarily with the brokers and the public securities business. (Tr. 2036.) His main activity was with TWCO's private client group. (Tr. 2697-98.) The partners did not keep secrets from each other; they met regularly to discuss private banking, but did not discuss mutual fund operations. (Tr. 1083, 1216, 2414-15, 2611-14.)

TWCO cleared transactions through the broker-dealer division of Banc of America Securities, a wholly owned subsidiary of BoA. The clearing agreement between BoA and TWCO was signed by Seth Gersch (Gersch) and Wasserman on October 15, 1999.<sup>11</sup> (PX Ex. 4.) BoA executed, cleared, and settled transactions, and provided confirmation statements, bookkeeping services, cashiering, and certain reporting functions for smaller broker-dealer firms (the introducing broker-dealer) around the country that did not have the capability or capital to perform these functions for themselves. (Tr. 513-15, 533-34, 561-62.) Complying with the rules, all duties not specifically covered and in the agreement, and customer-related duties, stayed with the introducing broker. (Tr. 531, 534-35.) BoA had no supervisory duties over TWCO, which was responsible for approving and transmitting orders. (Tr. 535-37.)

BoA's instructions for trading mutual funds specified that:

All orders should be received and time stamped by the close of the NYSE, 4 PM EST. With MFRS<sup>12</sup> you will have until 5:15 EST to enter and review those orders time stamped by 4 PM EST.

(Tr. 328, 524-25, 574-75; PX Exs. 1, 2, 3.) The time stamp shows the actual time the broker-dealer accepted the order. (Tr. 526.) The time after the close of the NYSE was to allow for processing orders received by 4:00 p.m. (Tr. 526.)

As part of an effort to grow the business, in early December 2000, TWCO hired Wilson to set up a new business at TWCO. (Tr. 2560-61.) Wilson was recommended to Wasserman by an employment firm; he knew Paine Webber had fired Wilson, but he trusted Wilson's manager who provided a favorable recommendation. (Tr. 2548-54.) Wilson, a productive mutual fund institutional trader, who had engaged in market timing mutual funds at Oppenheimer Inc. (Oppenheimer) and Paine Webber, became a TWCO Senior Vice President; Christian, came with him.<sup>13</sup> (Tr. 200, 205, 607, 1037, 1043, 1047, 1116, 2552; PX Ex. 222.) Wasserman accepted

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<sup>11</sup> Gersch assured Wasserman that BoA had significant experience in clearing for market timing businesses. (Tr. 2589-90.) BoA entered a settlement with the Commission on February 9, 2005, concerning its clearing operations during this period, Banc of America Capital Mgmt., LLC, 84 SEC Docket 3046 (Feb. 9, 2005). (Tr. 568-70.)

<sup>12</sup> Mutual Fund Order Entry.

<sup>13</sup> Wilson was age thirty in 2000. Following graduation in 1991 from Boston University with a B.A., Wilson worked for a law firm, then for Oppenheimer, which became CIBC World Markets, and then for Paine Webber where he was a senior vice president. Wilson holds Series 7 and 63 licenses. (Wilson Answer ¶9; Tr. 1033, 1038.) On April 4, 2007, Wilson pled guilty in

Wilson's representations that he was building a quality business and that his activities were unlike those of other market timers because he knew Wilson's former manager and believed his statements that he was told to fire Wilson, but that he would hire him back if he could. (Tr. 2551-52, 2565-66, 2575.)

Wilson and Christian did not want to be known publicly as market timers, and they referred to their clients as engaging in asset allocation. (Tr. 2449-50.) Wilson was a registered representative associated with TWCO from about December 2000 to January 2007. (Wilson Answer ¶2.) Wilson and Christian operated as a team with Wilson as the superior and Christian handling day-to-day operations. Wilson and Christian considered Wasserman and compliance personnel as their supervisors; Trautman agreed.<sup>14</sup> (Tr. 597, 600, 1025, 1038, 1047-48, 1227, 2577-78.) Wasserman, however, adamantly maintains that he did not run TWCO; he did not directly supervise Wilson's and Christian's mutual fund activities, rather, they were supervised by compliance, which reported to him; and that he received no complaints about them from 2001 to 2003, with the exception of one kick-out letter that Snyder showed him. (Tr. 2580-81, 2673-75, 2698-01.) According to Wasserman, next to Greenwood, he was the partner least involved in the overall business. (Tr. 2581.)

In a pre-employment interview, Wilson told Wasserman that, as part of his market timing activities, he wanted mutual fund managers to give him "capacity," the ability to freely trade within the mutual fund, to market time in mutual funds even if the fund's prospectus stated it did not allow market timing.<sup>15</sup> (Tr. 92, 348, 497, 1741.) Wasserman believed that Wilson's requests

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the Supreme Court of the State of New York to a violation of General Business Law § 352-c(6), a Class E felony for securities fraud. (Tr. 1027-29; PX Exs. 11, 13.)

Christian began working with Wilson at Paine Webber. (Tr. 607.) He was a Vice President at TWCO and was made a principal, because of his dedication and contributions to the firm, on January 1, 2003. (PX Exs. 20, 222.) As a result of the actions described in this Initial Decision, he was arrested on July 7, 2005, and pled guilty to securities fraud, a Class E felony, under New York State law. As part of his plea agreement, Christian agreed to testify and cooperate with the New York Attorney General (NYAG) and the Commission. (Tr. 427, 459-60.) Later, after Wilson pled guilty to a Class E felony and was given no jail time, Christian was allowed to re-plea to a misdemeanor and given an "unconditional discharge." (Tr. 461-64; PX Exs. 7, 10.) Christian paid \$250,000 as part of his settlement with the Commission. (Tr. 465.) Scott A. Christian, 85 SEC Docket 4345 (July 29, 2005).

<sup>14</sup> From July 1999 until December 2002, Snyder, a friend of Wasserman's since 1981, was TWCO's Senior Vice President and his duties included compliance. (Tr. 1863, 1913, 1915, 1920.) A succession of compliance officers reported to Snyder, and Snyder reported to Wasserman. (Tr. 1864, 2184.)

<sup>15</sup> Some mutual funds allowed broker-dealers to market time for their customers in exchange for maintaining a certain amount of assets, "sticky assets," invested in the funds. (Tr. 1510, 1565-66, 2710.)

that his clients receive capacity would be good for the mutual funds. (Tr. 2583.) Wilson also told Wasserman that he could raise a billion dollars in assets through his relationships with his clients. (Tr. 92, 499.)

Wilson explained to Wasserman that it was important that TWCO's clearing broker support the type of business that he conducted. (Tr. 90-91, 93, 485.) Wilson and Christian, with Wasserman present, met with representatives of BoA before they joined TWCO. According to Wilson, TWCO cleared through BoA as a third-party broker. BoA had the platform and selling agreements with the mutual fund companies. (Tr. 1040.) BoA appeared as the registered agent or executing dealer on TWCO's transfer agent system; BoA placed the trades directly with TWCO. (Tr. 1631.) TWCO traded both no-load funds and load funds. (PX Ex. 279 at 23.) TWCO's clients consisted of eight institutional clients, that included at least one bank and hedge funds, two individuals, and a Wilson Trautman Christian (WTC) proprietary account.<sup>16</sup> (Tr. 350, 1226, 2069, 2078.) All the clients used TWCO to trade in open-end mutual funds. (PX Ex. 279 at 7.) The hedge funds and almost all the clients made their own trading decisions, and TWCO acted as the agent or introducing broker in processing the trades through BoA. (Tr. 731-32, 1248, 1387-88, 2606.)

Mutual fund transactions are processed like other securities, but they differ in that trades time-stamped before 4:00 p.m. Eastern Time<sup>17</sup> are accumulated and priced, with rare exceptions, one time after 4:00 p.m., the close of trading on the New York and American Stock Exchanges, on conditions that existed at 4:00 p.m. (Tr. 516, 526, 573, 2096-97; PX Ex. 279 at 8-9, 17, 29.) Transactions in the securities of an open-end mutual fund are priced at the fund's net asset value (NAV), the market value of a fund share, computed by dividing the fund's aggregate net assets by the total number of fund shares outstanding.<sup>18</sup> (PX Ex. 279 at 8.) The expert testimony is that the futures markets trade until 4:15 p.m. Many equity index futures contracts resume trading at 4:30 p.m. and continue to trade throughout the night. Many equity markets have electronic

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<sup>16</sup> The institutional hedge fund customers were: Alastor Capital Management (Alastor), Beacon Rock Capital (Beacon Rock), Canadian Imperial Banking Corporation or Canadian Imperial Holding, Inc. (CIBC), DLR Advisers (DLR), Folkes Asset Management (Folkes), Johnson Capital Management (Johnson), Pentagon Capital Management (Pentagon), and Ritchie Capital Management (Ritchie). Jeffrey and Lisa Augen (the Augens) and Daniel Rosenthal (Rosenthal) had individual accounts. (Tr. 100-01, 107-08, 313-14.)

<sup>17</sup> All times are Eastern Time unless otherwise noted.

<sup>18</sup> In load funds, prices are quoted after adding the sales charge to the NAV.

NAV is calculated by most funds after the close of the exchanges each day by taking the closing market value of all securities owned plus all other assets such as cash, subtracting all liabilities, then dividing the result (total net assets) by the total number of shares outstanding.

Barron's Dictionary of Finance and Investment Terms, 361-62 (4th ed. 1995).

trading sessions from 4:00 p.m. to 5:30 p.m. (PX 279 at 17-18.) Mutual funds, however, do not trade after the market closes, generally at 4:00 p.m., after which the NAV is calculated that sets that day's price. (Tr. 866-67, 1743.) For example, Fidelity Investment's (Fidelity) seller-dealer agreement with BoA referred to Fidelity's adviser fund prospectuses that required that a security be purchased before the close of the NYSE, usually 4:00 p.m., to receive the next available price. (Tr. 1629-30.) Fidelity generated the NAV of its adviser funds between 4:00 p.m. and roughly 6:00 and 6:15 p.m. each day. (Tr. 1628-29.) Orders entered after 4:00 p.m., but before the NAV was calculated, would receive the next day's NAV. (Tr. 1635.)

### **Market Timing**

There is no statute or rule that prohibits market timing. TWCO did not engage in market timing mutual funds before Wilson and Christian joined the firm. (Tr. 91, 456.) Market timers are short-term traders and usually sell their positions within a week of acquiring them. (PX Ex. 279 at 13.)

Market timing is a trading strategy designed to exploit net asset value (NAV) pricing errors that open-ended mutual funds occasionally make. Market timers buy funds when they believe that the actual NAV of the fund is higher than the NAV that will be reported and at which they (and all other investors) can trade. The profits that they make on these purchases if they are correct . . . are losses to existing shareholders. . . . The existing shareholders lose because the timers share in gains that the existing shareholders would otherwise exclusively enjoy.

. . .

Market timers may also sell funds in which they are invested when they believe that the actual NAV of the fund is less than the NAV that will be reported. . . . [T]he losses that the timers avoid are borne entirely by the remaining shareholders.

. . .

The dilution per share caused by market timing is the difference between the reported and actual NAV of the fund.<sup>19</sup>

. . .

The dilution losses come from purchases of funds at prices below their actual values and from sales of funds at prices above their actual values.

(PX Ex. 279 at 3-5, 20, 24.)

Using Trautman and Wasserman, Christian and Wilson endeavored to obtain capacity from mutual funds, arguing that TWCO's market timing was different in that it would not trade excessively, "overtrade," and that allowing TWCO to market time would benefit the mutual

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<sup>19</sup> Some mutual funds have third parties calculate their NAV. For example, State Street Bank and Trust Company, which handles custody, administration, and fund accounting for Pincus Warburg Credit Suisse (Credit Suisse), calculates the NAV of Credit Suisse funds. (Tr. 842.)

fund. (Tr. 2073-75, 2193-95, 2243-47, 2670-71, 2711.) TWCO developed a list of funds that allowed it to market time. (Tr. 1510.)

James Power Gordon, Jr. (Gordon), head of Federated Investors' (Federated) quantitative analysis group for equities, rejected TWCO's arguments.<sup>20</sup> Gordon concluded that the rapid trading of market timers had a negative impact on mutual fund returns. (Tr. 1131, 1135, 1137, 1142; PX Ex. 121.) Gordon advised Federated not to allow TWCO capacity to market time Federated funds. (Tr. 1151-52.) See Federated Inv. Mgmt. Co., 86 SEC Docket 2441 (Nov. 28, 2005).

### **Late Trading**

Customer orders submitted after 4:00 p.m. are called late orders. Late trading is a market timing strategy. It refers to the practice of buying, selling, or exchanging mutual fund shares based on orders received and executed after the markets close, usually after 4:00 p.m., at a price that reflected that day's NAV. (Tr. 1027-29, 1146-47, 1413-14, 2636-37; PX Ex. 279 at 16-17, 22.) Late traders use information gained after 4:00 p.m. to predict how the NAV of a security today will change the NAV of the security tomorrow. (PX Ex. 279 at 23.)

At a second meeting, BoA convinced Wilson and Christian that BoA would support the market timing activities of their clients. At the meeting, Matt Augugliaro (Augugliaro), who reputedly designed the BoA clearing platform, informed Wilson and Christian privately that the BoA system allowed trades to be entered until 6:30 p.m. and that Aurum Investments was using it to late trade. (Tr. 496, 505, 653-56.) The ability to trade after 4:00 p.m. was not part of BoA's formal presentation. (Tr. 149-50.) Augugliaro and Stewart Heller from BoA also told Trautman that TWCO clients would be able to enter orders until 5:30 or 6:30 p.m. (Tr. 2108-10.) Trautman was very comfortable with BoA procedures and testified he did not think TWCO was receiving a special service. (Tr. 2109, 2166-67, 2173.) Trautman claims to have been unaware that BoA's instructions for trading mutual funds required that orders be received and time stamped by 4:00 p.m. (Tr. 2176, 2179; PX Ex. 1, 2, 3.)

The expert testimony is that late traders, who execute buy orders when values rise after 4:00 p.m., tend to profit from buying undervalued funds because the NAV of those funds tend to rise on the next day. "Those who submit sell orders when values fall after 4:00 p.m. tend to

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<sup>20</sup> Gordon holds a B.S. and a Master's in Engineering from Cornell University, and an M.B.A. from the University of Chicago. (Tr. 1132.) Gordon rejected Trautman's arguments that TWCO's market timing could benefit Federated. (Tr. 1141-45, 1150.) Basically, Gordon believes that if market timers are successful, then fund shareholders lose, noting that he viewed the situation as a "zero sum gain" (i.e., for one party to gain, another party must lose; no new wealth is created). (Tr. 1143-45, 1149, 1160-61.) If market timers are wrong, then the fund can win. (Tr. 1160-61.) Trautman was aware from Gordon's email that Gordon disagreed with his positions and his assumption that market timers are wrong half the time. (Tr. 1146, 1166.)

avoid losses from holding overvalued funds because the NAVs of those funds tend to fall on the next day.”<sup>21</sup> (PX Ex. 279 at 17.)

Like market timers, late traders try to buy mutual funds that they believe are undervalued and sell mutual funds that they believe are overvalued. The late traders form their expectations based on information that they learn about values after the 4:00 PM deadline by which traders in mutual funds are supposed to submit their orders.

(PX Ex. 279 at 4.)

TWCO’s ability to conduct late trading was a way to attract new business that resulted in additional assets under management. (Tr. 658-59.)

### **Wilson’s Mutual Fund Trading at TWCO**

Wilson and Christian put in place at TWCO a market timing operation that had late trading ability using BoA’s clearing systems, which they considered provided an advantage, an “operational loophole” or an “operational arbitrage,” that other firms did not have. (Tr. 507, 589-91, 595, 1239.) Wilson admits that:

[O]n behalf of clients of [TWCO, he] and others at TWCO placed orders after 4:00 p.m. Eastern Time to exchange, purchase, and sell shares of mutual funds. . . . [and] time-stamped the trade order tickets before 4:00 p.m. Eastern Time, although the trade order was placed after 4:00 p.m.

(Wilson Answer at ¶ 1.)

Wilson engaged in late trading for most of his clients. (Tr. 350-51, 1058, 1105, 2635-36.) Wilson and Christian generally wrote up orders before 4:00 p.m. After 4:00 p.m. they falsely time-stamped most of those orders as having been received before 4:00 p.m. based on confirmations or their discretionary authority and they entered those orders until 6:30 p.m.<sup>22</sup> (Tr. 1175-76, 1193-94, 1408-11, 1769-92; PX Exs. 176, 322.)

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<sup>21</sup> Gordon agreed that there is a higher probability that a late trader would be right on the direction of the market when trading opened, given the information he or she gained after the market closed. (Tr. 1148-49.)

<sup>22</sup> On one occasion, Pentagon emailed Christian at 4:03 p.m. on May 17, 2001, “To go in, need SPM1 above 1291.30 AND NDM1 above 1942.50 [sic] Warn Pentagon if SPM1 is within 1 pt AND NDM1 is within 2.5 pts.” (PX Ex. 405). SPM1 refers to S&P futures and NDM1 refers to NASD futures. This email instructed TWCO to conduct the transaction if the S&P and NASD futures reached a certain level after 4:00 p.m. (Tr. 1416-40, 1453-68; PX Exs. 321, 321A, 322, 322B.)

Wilson's market timing customers used trading models that gave signals of when funds should be moved into and out of the market. These signals or triggers included changes after the market closed at 4:00 p.m., but before 6:30 p.m., in equity index futures of more than 1.5 percent and/or earning announcements. (Tr. 102-03, 108, 509, 693.) Beacon Rock,<sup>23</sup> CIBC, Pentagon, Ritchie, the WTC account, the Augens,<sup>24</sup> and Rosenthal typically placed orders or cancelled orders or exchanges with Wilson after 4:00 p.m., Wilson and/or Christian executed the orders, and the customers received that day's closing mutual fund price or NAV. (Wilson Answer ¶25; Tr. 105-07, 109-10, 659, 1020-21; PX Ex. 279 at 35-38.) From February 2001 until September 2003, TWCO placed approximately 9,500 trades for Ritchie, Pentagon, the WTC account, and Beacon Rock in eight mutual fund families where the fund prospectuses, between January 2002 and February 2003, stated that, to get that day's NAV, a trade must be placed by 4:00 p.m. and the NAV would be determined at the close of the NYSE's normal trading session, which is 4:00 p.m.<sup>25</sup> (Tr. 1692-1702, 1710-15; PX Exs. 402, 410.)

Wilson and Christian were the W and C in the WTC account name, but neither had a financial interest in the account. (Tr. 112, 1218.) The account was created in December 2001 so that Wilson could have a trading history if TWCO ever began a hedge fund. (Tr. 2332, 2341, 2461, 2742.) Barbera considered that TWCO, not the partners, directly owned the account. (Tr. 2465-66.) The initial investment was about \$500,000, and the source of funds was "Wilson's production." (Wilson Answer ¶ 42; Tr. 2332-33, 2487-88.) Trading in the WTC account initially mimicked market timing trading in the Alastor account. (Tr. 601, 2341.) Later, Trautman made the late trading decisions in the WTC account. (Wilson Answer ¶ 4; Tr. 1021-22, 2225-26.) When Trautman made the decision, he knew "broadly" the result of the NAV calculation. (Tr. 2257-58.) Trautman's investigative testimony is that fifty-five or sixty percent of the trades were profitable, and the account made about \$40,000 in three years. (Tr. 2274-75, 2342.) Barbera testified that the account realized a total \$30,000 to \$40,000 profit in twenty-seven of fifty-two transactions, or fifty-two percent. (Tr. 2488, 2507.)

Wilson and Christian averaged between two and three hundred trades a day in over one hundred different mutual fund families.<sup>26</sup> (Tr. 161, 163.) Some mutual funds are set up to allow

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<sup>23</sup> A consultant to Beacon Rock testified that late trading would be illegal in the futures market and that it would not be possible. (Tr. 755.) In 2002, Beacon Rock had about \$150 to \$200 million in assets under management, three or four principals, and just a handful of employees. (Tr. 779.)

<sup>24</sup> In 2002, Jeff Augen was president of TurboWorx, Inc. (TurboWorx), a private company for which TWCO raised several million dollars in investment capital. Trautman was Chairman of the Board of TurboWorx. (Tr. 857-60, 883-84, 966, 970.)

<sup>25</sup> The funds were Janus Mercury Fund, Invesco Technology Funds, The Nations International Equity Fund, The SEI International Trust, Credit Suisse International Focus Fund, Franklin Funds, Alliance Premium Growth Fund, and The Hartford Fortis Series Fund. (Tr. 1692.)

<sup>26</sup> TWCO conducted approximately 81,500 mutual fund transactions from January 1, 2001, through September 2003. (Tr. 1371-73.)

short-term trading, but most are not. (Tr. 1164.) Many mutual funds determined that frequent trading was detrimental because, among other things, it increased the administrative tasks of servicing the accounts, resulted in short-term gains to the funds that were undesirable to shareholders, and made it difficult to implement investment strategies because fund managers were uncertain of their cash positions. (Tr. 825, 1732-33; PX Ex. 310.) Many mutual funds sent “kick-out” letters to broker-dealers that engaged in market timing contrary to the funds’ policies. (Tr. 621; PX Exs. 308, 308B, 309, 309B, 310, 311.) The kick-out letters would freeze the accounts. Typically, a fund would assess a penalty of one percent and charge another one percent to redeem the shares in an account. (Tr. 621.) For example, preventing market timing was a high priority item at Credit Suisse, and it began to monitor daily trade flows, contacting intermediaries about those flows, and instituted a policy of allowing a maximum of three round trips during a thirty-day period.<sup>27</sup> (Tr. 826-28, 841.) Credit Suisse had a selling agreement with BoA; Credit Suisse did not know the name of the underlying party on the TWCO account. (Tr. 831-32, 844.) Its letters, banning further activity in an account, were at the account number level. (Tr. 832; PX Ex. 310.) If the same customer traded under a different number, Credit Suisse’s policies were ineffective.<sup>28</sup> Between June 28, 2001, and May 7, 2002, TWCO made sixty-six purchases in Credit Suisse funds, totaling \$10.5 million in twenty-seven different accounts, and sold all of its positions. (PX Ex. 310A.) In this same approximate period, TWCO received twenty letters from Credit Suisse referencing excessive trading and blocking Pentagon accounts. (PX Ex. 310A.)

Other funds imposed minimum holding periods. TWCO’s trading activity resulted in just over three hundred market timing or kick-out letters to TWCO from approximately forty fund complexes in 2000 through 2003, “which meant that the account was frozen, and [their customers] were no longer allowed to exchange in the fund family” or that the account would be frozen if more than one or two additional transactions occurred in the account. (Tr. 162, 1114, 1472; PX Exs. 207, 239.) These letters occurred when trading exceeded the limits set out in the fund’s prospectus or when a fund imposed new policies in an attempt to stop market timing. (Tr. 162.) Fidelity began monitoring all its funds in 2001 because it considered market timing disruptive to fund shareholders and resulted in excessive transaction costs. (Tr. 1579, 1632.) Fidelity’s adviser fund prospectuses limited exchanges to four per year, and it considered one buy and sell within a thirty-day period a disruptive or market timing transaction.<sup>29</sup> (Tr. 1580-81.)

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<sup>27</sup> A round trip is a purchase and redemption of the same dollar amount in an account. (Tr. 827.) These policies were not published, but the Credit Suisse prospectuses stated that the funds had the ability to refuse trades. (Tr. 826.) When the second round occurred, it triggered a “banned letter” from Credit Suisse to the intermediary or BoA, which placed the trade through the NSCC Fundserv Processing System. (Tr. 828; PX Ex. 310.)

<sup>28</sup> When Credit Suisse became aware that customers, it thought it had banned, continued to trade using different account numbers, it ratcheted up its policies and began banning broker-dealer firms and, by late 2002, banning individual representatives with broker-dealers. (Tr. 840.)

<sup>29</sup> Fidelity has two series of mutual funds. Its retail funds are sold directly to customers, and its adviser funds are sold through intermediaries. (Tr. 1595-96.) When Fidelity found that a buy

GE Asset Management (GE Asset) considered two exchanges within a thirty-day period or four exchanges within a year to be market timing. (Tr. 1731.) GE Asset sent kick-out letters when it identified an account that it considered a market timer. (Tr. 1733, 1738; PX Exs. 239, 311.) Later, when it became aware that the customer was continuing to trade through other accounts, it would restrict branches, registered representatives, and eventually firms. (Tr. 1738, 1742.) TWCO received warning letters about market timing in its customer accounts from Fidelity, Credit Suisse, GE Asset, and other fund families. (Tr. 1585-93, 1658, 1673-75; PX Exs. 239, 254, 308, 308A, 308B, 309, 309A, 309B, 310, 310A, 310B, 311.)

Between April 5, 2001, and May 28, 2003, after Fidelity sent kick-out letters, TWCO entered seventeen purchases of Fidelity funds for Ritchie in eight different accounts, totaling approximately \$2.324 million, and sold fourteen of those positions. (Tr. 1667-70; PX Exs. 308A, 310.)

Between June 28, 2001, and May 7, 2002, after Credit Suisse sent kick-out letters, TWCO entered sixty-six purchases of Credit Suisse funds for Pentagon in twenty-seven different accounts, totaling \$10.5 million, and sold all of those positions. (Tr. 1660-64; PX Exs. 310, 310A.)

Between July 19, 2001, and October 1, 2002, after Fidelity sent kick-out letters, TWCO entered thirty-three purchases of Fidelity funds for Pentagon in twelve different accounts, totaling approximately \$5.358 million, and sold twenty-one of those positions. (Tr. 1672-73; PX Exs. 309A, 310.)

Between November 17, 2001, and October 8, 2002, after GE Asset sent out kick-out letters, TWCO entered seventy-one purchases of GE funds for Pentagon in twenty-one accounts, totaling approximately \$10.53 million, and sold all of those positions. (Tr. 1673-77; PX Exs. 310, 311, 311A.)

In most cases, BoA received the kick-out letters and forwarded them to TWCO's director of compliance, who dealt with mutual funds, and he delivered copies and discussed them with Wilson and Christian.<sup>30</sup> (Tr. 1023, 1869-72; PX Ex. 239.) To operate under the radar and avoid detection by mutual funds looking for active market timers, TWCO adopted techniques such as multiple accounts for the same client, making trades of less than \$300,000, using multiple

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and sell of a certain amount occurred within a thirty-day period, it sent a warning letter to the shareholder and adviser on the account asking them to stop market timing. If a second round trip occurred in the account, Fidelity would freeze the account for ninety days and only allow redemptions. (Tr. 1581-88; PX Ex. 239.) Fidelity did not have the ability to impose restrictions on the customer because the accounts were held with an intermediary. (Tr. 1584, 1589.) BoA was the broker-dealer registered on the TWCO accounts at Fidelity. (Tr. 1589-90.)

<sup>30</sup> At various times, Snyder, John Ruggerio, Jenna Hansen, and Prigot served as TWCO's compliance director. (Tr. 1024.)

numbers for registered representatives, and misidentifying accounts as house accounts when Wilson and Christian were representatives on the accounts. (Tr. 168-69, 632, 1108, 1473-74, 1869-72; PX Exs. 190, 338.)

The volume of kick-out letters decreased markedly in about mid-2002 when Wilson and Christian ceased doing “under the radar trading” in mutual funds whose prospectuses did not allow it, and began doing ninety-five percent of their trades in mutual funds that allowed market timing. (Tr. 166-68.)

### **TWCO’s Revenues From Mutual Fund Activities**

TWCO had total revenue of approximately \$32.5 million, including \$22.7 million in mutual fund revenue, for the period of 2001, 2002, and the first nine months of 2003. (Tr. 1395-96; PX Ex. 313.) A comparison of TWCO’s revenues from its mutual fund operations with its total revenues for the years 1998 through 2005 is as follows:

	<u>Mutual Fund Revenue (\$)</u>	<u>Total Revenue (\$)</u>
1998	78,072	5,030,826
1999	20,008	7,313,269
2000	210,652	4,203,022
2001	5,769,120	8,492,975
2002	9,955,909	13,267,450
2003	8,841,213	12,284,437
2004	2,042,163	6,548,211
2005	882,798	4,801,212

(PX Ex. 255B.)

The 1999 and 2000 Total Revenue figures are not comparable. In 1999, TWCO included revenues from its investment banking activities, which included fees from investment banking clients and consulting, etc., on the books of the broker-dealer. (Tr. 2618.) After 1999, the results of TWCO’s non-broker-dealer activities, such as investment banking and private equity investments, no longer appeared on TWCO’s books, but on the books of TW Holding. (Tr. 2423-25.) TW Holding, a corporation owned by Trautman, was treated as if ownership was the same as TWCO. (Tr. 2040-46.) According to Barbera, TW Holding had a tax loss carry forward that made it impractical to change the formal form of ownership. (Tr. 2500-01.) To some degree, revenue from TWCO was used for TW Holding, which was not profitable from 2001 through 2003. (Tr. 2616-17.) Wilson understood that the private equity portfolio took a lot of

TWCO money. (Tr. 1057.) It is not clear whether the private equity interests have any significant value. Wasserman is hopeful that some private equity investments made with Trautman will be profitable. (Tr. 2740.)

Approximately seventy percent of mutual fund revenues went to expenses, primarily Wilson's and Christian's salaries and clearing fees. (Tr. 2427-28.) TWCO's audited financial statements for the year ended December 31, 2002, reported a net loss of \$701,803, which was primarily attributable to an increase in employee compensation and benefits. The source of TWCO's revenue was:

Compensation and fees:	\$12,892,245
Trading profits	148,428
Interest and other dividend income	120,254
Other income	104,064
Total revenue	<u>\$13,264,991</u>

(PX Ex. 54 at 2-3.)

Dr. Lawrence Harris (Dr. Harris), an expert in market timing and late trading called by the Division, reviewed TWCO's mutual fund operation business records for the period between February 14, 2001, and September 10, 2003, and concluded that late trading strategies most likely generated most of the trading orders and that TWCO's mutual fund trading was "extraordinarily successful."<sup>31</sup> (Tr. 732-34; PX Ex. 279 at 5.) The basis for his conclusion was the short periods between purchases and subsequent sales, and the strong correlations between purchases and subsequent price increases. In addition, TWCO's trades were extraordinarily successful in that fund prices rose the next day 60.3 percent of the time. (PX Ex. 279 at 5, 44.) Dr. Harris also concluded that TWCO's market timing and, in particular, late trading resulted in about \$20 million in revenues to TWCO and caused dilution losses to mutual fund and existing shareholders in the order of \$100 million. (Tr. 733-34; PX Ex. 279 at 6, 38, 45.)

TWCO's mutual fund department was profitable from its inception in 2000, and, in 2002, it was the firm's largest source of revenue. (Tr. 1052, 1054, 1107.) According to Barbera, Wilson and Christian received the vast majority of the revenue that TWCO received from the mutual fund activity.<sup>32</sup> (Tr. 2430.) Wilson's compensation from TWCO was almost \$4 million in 2001, \$5.5 million in 2002, and almost \$3.5 million in 2003. Christian's comparable figures were \$210,624, \$740,125, and \$884,109. (PX Ex. 82A.) For the years 2001 through 2003,

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<sup>31</sup> Dr. Harris received his Ph.D. in economics from the University of Chicago. He presently holds the Fred V. Keenan Chair in Finance at the University of Southern California. (Tr. 664-65; PX Ex. 279.)

<sup>32</sup> Third-party clearing fees (direct clearing expenses) were deducted from revenues and then Wilson received sixty percent minus a portion of prorated expenses. (Tr. 112-13, 1052, 2352, 2431, 2445-47, 2619-20; PX Ex. 139.)

TWCO paid Wilson and Christian compensation of approximately \$10.4 million and \$1.8 million, respectively.<sup>33</sup> (Tr. 115, 465; PX Exs. 54 at 5.) TWCO's W-2 forms show that Trautman received annual salaries of \$100,769, \$240,000, and \$231,871, in 2001, 2002, and 2003, respectively.<sup>34</sup> Wasserman's comparable annual compensation was \$85,000, \$245,000, and \$180,000 for those respective years. (PX Ex. 82A.)

The undisputed evidence is that approximately seventy percent of the revenue that TWCO earned from mutual fund trading went to Wilson and Christian and expenses, and that the \$9,040,000 TWCO retained was invested in TWCO and in private equity investments; the partners received salaries but no bonuses. (Tr. 2291-92, 2350-53, 2430-31, 2477-80, 2483-84, 2622-23.) "[N]et revenues after direct expenses from the mutual fund operation paid a fair amount of the operating expenses of the Trautman Wasserman entities . . . ." (Tr. 2511-12.)

### CONCLUSIONS OF LAW

**1. & 2. Between January 2001 or February 6, 2002, and September 2003, did TWCO, Trautman, and Wasserman willfully violate Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, or alternatively, did Trautman and Wasserman willfully aid and abet and cause TWCO's and TWCO's customers' violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder?**

The OIP alleges violations of Section 17(a) of the Securities Act. Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5 prohibit fraudulent conduct in the public or private offer, purchase, or sale of securities by use of the means of interstate commerce.<sup>35</sup> See United States v. Naftalin, 441 U.S. 768, 773 n.4, 778

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<sup>33</sup> Christian received a salary of \$36,000 and medical benefits from TWCO, and a percentage of Wilson's share of the gross commissions. (Tr. 112, 114, 2688.)

<sup>34</sup> According to Trautman, his annual salary from 2001 through 2003 was \$250,000. (Tr. 2291.)

<sup>35</sup> Section 17(a) of the Securities Act prohibits:

any person in the offer or sale of any securities or any security-based swap agreement . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly --

- (1) To employ any device, scheme, or artifice to defraud, or
- (2) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- (3) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(1979). To establish a violation of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5, the Division must show: (1) misrepresentations or omissions of material facts, or other fraudulent devices; (2) made in connection with the offer, sale, or purchase of securities; and (3) that respondent acted with scienter, a mental state embracing intent to deceive, manipulate, or defraud. See Aaron v. SEC, 446 U.S. 680, 685, 697, 701-02 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). Scienter may be established by a showing of recklessness. See Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990); David Disner, 52 S.E.C. 1217, 1222 n.20 (1997). Recklessness is defined as “an extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers and sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it.” SEC v. Dain Rauscher, Inc., 254 F.3d 852, 856 (9th Cir. 2001) (quoting Hollinger, 914 F.2d at 1568-69); Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir. 1977) (quoting Franke v. Midwestern Oklahoma Dev. Auth., 428 F. Supp. 719, 725 (W.D. Okla. 1976), cert. denied, 434 U.S. 875 (1977)). Proof of scienter may be demonstrated by circumstantial evidence. See Herman & MacLean v. Huddleston, 459 U.S. 375, 390 n.30 (1983).

Negligence, defined as the failure to exercise reasonable care, is sufficient to establish violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. See Aaron, 446 U.S. 680, 695-96 (1980); PIMCO Advisors Fund Mgmt. LLC, 341 F. Supp. 2d 454, 458 (S.D.N.Y. 2004); SEC v. Hughes Capital Corp., 124 F.3d 449, 453 (3d Cir. 1997); Ira Weiss, 86 SEC Docket 2588, 2605 (Dec. 2, 2005).

## **TWCO**

TWCO is in default and the allegations in the OIP as to TWCO are deemed true because it did not file an Answer and has not otherwise defended the proceeding. See 17 C.F.R. § 201.155. Even if TWCO was not in default, I find it violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5 because the actions of Wilson, a senior vice president, and Christian, a vice president, and others at TWCO are imputed to TWCO. A corporation acts through its officers and directors; their knowledge can provide the corporation with scienter for the purpose of Section 17(a)(1) of the Securities Act and Section 10(b)(5) of the Exchange Act and Rule 10b-5. See, e.g., C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988); A.J. White & Co. v. SEC, 556 F.2d 619, 624 (1st Cir. 1977); SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1096 n.16 (2d Cir. 1972); Kirkland v. E.F. Hutton and Co., Inc., 564 F. Supp. 427, 447 (E.D. Mich. 1983); SEC v. Blinder, Robinson & Co., Inc., 542 F. Supp. 468, 476-77 n.3 (D. Colo. 1982); Robert M. Fuller, 56 S.E.C. 976, 987 n.26 (2003).

Wilson and Christian violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5 because, for almost three years, they knowingly, or

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Section 10(b) of the Exchange Act prohibits, under similar conditions as Section 17(a), in connection with the purchase or sale of any security, the use of any manipulative or deceptive device or contrivance. Rule 10b-5 prohibits, under similar conditions, the same conduct as in subsections (1), (2), and (3) of Section 17(a).

recklessly, engaged in a scheme to defraud investment companies by making false and misleading representations and omitting material information in connection with the purchase, sale, and exchange of mutual funds.<sup>36</sup> Wilson and Christian employed a myriad of false and misleading activities as part of the fraudulent scheme. Most prominently, Wilson admits that he and others at TWCO “time-stamped the trade order tickets before 4:00 p.m., although the trade order was placed after 4:00 p.m.” (Wilson Answer at ¶ 1.) Wilson and Christian knew, or were reckless in not knowing, that this scheme was in direct violation of the BoA instructions for trading mutual funds which stated, “[a]ll orders should be received and time stamped by the close of the NYSE, 4 PM EST.” (PX Exs. 1, 2, 3.) A Commission examination of twelve months of trade tickets and exchange sheets, from 2001 to 2003, found that TWCO engaged in late trading, and that “on a sample basis,” 152 mutual fund orders that TWCO received and executed after 4:00 p.m. received the current day’s NAV. (Tr. 1406-12; PX Exs. 54 at 1, 309, 329.) Virtually all TWCO’s mutual fund trades were late trades that included a false representation that TWCO had a firm order by 4:00 p.m. (Tr. 1175-76, 1193-94, 1408-09, 1769-92, 2656; PX Exs. 176, 322.)

Wilson and Christian committed further acts of fraud by, among other things, duplicitously opening new accounts and continuing to trade in those accounts after a customer’s account received a kick-out letter that prohibited further trading. (Tr. 1479-85, 1489-98, 1688-90; PX Exs. 107, 109, 308, 309, 310, 311.) Christian admits that he deceived the mutual fund companies by opening new accounts to continue doing business. (Tr. 173.) Wilson and Christian and others at TWCO, under their control and direction, established numerous accounts for the same customer, established house accounts to hide the identity of registered representatives, and took other measures to allow customers to continue trading in mutual fund shares when the fund specifically requested that the customer stop trading. Specifically, Wilson and Christian had TWCO establish multiple accounts to trade under the radar for Alastor, Beacon Rock, DLR, Folkes, Johnson, and Ritchie. (Tr. 187.) A Commission examination, dated February 26, 2004, concluded that TWCO opened multiple duplicate customer accounts in which it executed numerous trades by circumventing restrictions imposed by mutual funds. (Tr. 1473-74, 1688; PX Exs. 54 at 1, 338.) For example, it arranged for Pentagon to be the account agent on sixty-eight accounts held with five account names, for Ritchie to be the account agent on thirty-five accounts with six account names, and for Folkes to be the account agent on fifteen accounts with one account name.<sup>37</sup> (Tr. 1475-77; PX Ex. 338.)

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<sup>36</sup> “Willfully . . . means intentionally committing the act which constitutes the violation.” Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Gearheart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)). One need not be aware that he or she is violating the law. See id.

<sup>37</sup> Broker dealers can request separate account numbers for the same client for valid reasons. (Tr. 186-87.) Those situations did not exist here. Wilson testified that TWCO did not engage in under the radar activities, but he admitted he did not want his name disclosed to mutual funds and directed that TWCO’s compliance director take all calls from mutual funds. (Tr. 1108-13; PX Ex. 363.)

## Trautman

I find Trautman's testimony not credible because it is often inconsistent and/or false. For example, Trautman denies knowing that mutual fund orders had to be placed by 4:00 p.m. and that the NYSE generally closed at 4:00 p.m. despite over fifteen years of securities experience, earning several securities licenses, and being a principal of TWCO that earned a major portion of its revenue from mutual fund trading. (Tr. 2102-04, 2118.) Trautman further denies knowing that TWCO's ability to enter trades after 4:00 p.m. for customers who would receive that day's price was a major selling point for TWCO even though Trautman "was involved in the firm's business on a daily basis," considered Wilson and Christian "wildly successful," and talked with them and visited their nearby office almost daily. (Tr. 1065, 2089, 2093, 2106.) Trautman knew TWCO's customers had until 5:30 or 6:30 p.m. to confirm or cancel their orders, but he denies that customers could change an order after 4:00 p.m. because he does not consider a cancellation to be a change of a purchase order. (Tr. 2096-2102.) Trautman also denies that he authorized trades in the WTC account and Augens account after 4:00 p.m. based on market news that occurred after 4:00 p.m., when the persuasive evidence is that he did so. (Tr. 865-66, 868-69, 974-75, 979, 2215.) In investigative testimony, Trautman denied that anyone at TWCO ever traded after 4:00 p.m. because he considers his trading activities in several accounts at TWCO as "confirming" and because TWCO's mutual fund operations did not trade, but followed, clients' instructions. (Tr. 2221, 2224-25, 2228-31.) Trautman claims that his investigative testimony was false because he learned later that he and other TWCO partners funded the WTC account. (Tr. 2231.) Trautman did not think TWCO was allowing a customer to place a new order after 4:00 p.m. and receive that day's NAV as the price, so he does not recall considering whether its operations were permissible. (Tr. 2282.)

I find that Trautman violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5 based on his knowing or reckless participation in a fraudulent scheme that involved material omissions or misrepresentations in the offer, sale, or purchase of mutual funds during the relevant period. I reject Trautman's position that he is not culpable because he lacked scienter and his conduct was not reckless. (Trautman Post-Hearing Br. 59.)

My conclusion is based on the following:

1. In February 2002, Christian made Trautman aware that Beacon Rock might possibly invest \$200 million with TWCO. (Tr. 230-31; PX Ex. 20.) I accept as true Kelly Hollingsworth's (Hollingsworth) testimony that in July 2002, Trautman told Blake Singer (Singer), a principal of Beacon Rock, that TWCO's internal compliance department, as well as outside counsel, had examined the issue in a meeting to explore the legality of TWCO's late trading.<sup>38</sup> (Tr. 761-63, 1065-66, 1071-72, 2166-68.) TWCO never had inside legal counsel, and

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<sup>38</sup> In February 2002, Trautman thought that Beacon Rock might potentially invest \$100 or \$200 million with TWCO, and Beacon Rock did open an account in March 2002 in which it late traded one hundred percent of the time. (Tr. 111, 230-31, 2170, 2654; PX Ex. 20.)

Trautman knew there were no legal or compliance opinions supporting TWCO's mutual fund operations.<sup>39</sup> (Tr. 1971, 2181-82, 2499.)

2. Trautman, TWCO's president and a major shareholder, is a smart, inquisitive person who held an array of securities licenses, including supervisory licenses, and he had twelve years of industry experience during the relevant period. Based on his background and his support for, and participation in, Wilson's operations, Trautman knew, or was reckless in not knowing, that TWCO's clearing agreement with BoA and the terms of many mutual fund prospectuses, with which Wilson entered trades, specified that trades had to be entered by 4:00 p.m. and that Wilson engaged in late trading.<sup>40</sup> The Janus Mercury Fund prospectus stated, "In order to receive a day's price, your order must be received by the close of the regular trading session of the NYSE." (PX Ex. 401.) Despite this requirement, at Wilson's request, Trautman arranged a late trade in the amount of \$100 million with Warren Lammert (Lammert), the fund's manager for TWCO's client, Ritchie. (Tr. 444-46, 2195-97, 2327-28.)

3. In addition, given his background, experience, and first-hand observations, it was fraudulent for Trautman to represent that Wilson's late trading was due to an operational loophole or "time arbitrage," where customers took advantage of stale pricing. (Tr. 2134-35, 2141.) The evidence is that, unlike other arbitrage situations, TWCO's customers got the stale price by breaking rules that were generally applicable to other broker-dealers. (Tr. 212-15; PX Exs. 160, 161.) TWCO's efforts to falsify and conceal its late trading activities belies Trautman's defense that TWCO's late trading was possible because of a legitimate arbitrage opportunity. (Tr. 2098-99.)

4. Trautman advocated that the funds should allow TWCO capacity, regardless of the language in their prospectuses that indicated the funds would not engage in such activity, at meetings and in other communications. (Tr. 2244-47.) TWCO used the capacity it was given to engage in late trading. (Tr. 1089-90.) Outside of a single conversation with Lammert, Trautman failed to mention to mutual fund representatives that TWCO would use the capacity to conduct late trades for which it would receive the 4:00 p.m. price. (Tr. 348-70.)

5. The Augens invested \$250,000 with TWCO based on Trautman's representation that TWCO's investment strategy of investing in an S&P 500 indexed mutual fund at the NAV for

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<sup>39</sup> Based on my observations of her demeanor, I believe Hollingsworth's version of events rather than Trautman's denial that he made the false representations because, as noted, I question Trautman's credibility. (Tr. 761, 2155-57, 2320-21.)

<sup>40</sup> There is no evidence that anyone at TWCO ever looked at a fund prospectus. (Tr. 650.) Credit Suisse required that trades be entered by 4:00 p.m. to the next available (calculated) NAV. (Tr. 842-44.) The following investment companies required that trading orders be received by 4:00 p.m. in the fund prospectuses in which TWCO traded: Janus Investment Fund, Invesco Sector Funds, Inc., Alliance Premier Growth Fund, Inc., SEI International Institutional Trust, Nations Fund, Inc., Credit Suisse International Focus Fund, Inc., Franklin Custodian Funds, Inc., and Hartford-Fortis Series Fund, Inc. (Tr. 1702; PX Ex. 401.)

that day, if the futures market increased by over one and a half percent after 4:00 p.m., resulted in profits thirteen of fifteen times over a twelve-month period. (Tr. 862, 903, 973-74, 980, 985, 2249-50; PX Ex. 229.) The Augens made the investment because Trautman offered an opportunity to buy at the 4:00 p.m. price, using information after the close, and represented that this investment opportunity was only possible because of TWCO's relationship with BoA. (Tr. 866, 868-69, 956, 974-75, 979.) Trautman engaged in late trading in the Augens account, the CIBC account, and the WTC account. (Tr. 1065-69, 1793-94, 2152-53, 2178, 2200-04, 2221, 2325.)

6. Trautman represented to Jeffrey Augen that TWCO's late trades were legal without obtaining any legal analysis either inside or outside TWCO, and TWCO personnel did not consider whether late trades were legal until after the NYAG issued subpoenas. (Tr. 951, 964-65, 1840-41.)

7. Trautman was engaged in TWCO's activities on a daily basis, and he admits regularly visiting Wilson's and Christian's offices at 6:00 or 6:30 p.m. when, by all accounts, Christian was feverishly entering transactions. Thus, he observed TWCO's late-trading activities. (Tr. 1065-66, 2335, 2354.)

8. Trautman knew that TWCO entered orders after 4:00 p.m., but before the funds posted their NAV for the day, yet he failed to obtain a legal opinion on the legality of TWCO's mutual fund activities. (Tr. 2016, 2254, 2458-64.) Moreover, Trautman failed to follow up and obtain copies of a legal opinion and a Commission "no-action letter" that he was told found TWCO's mutual fund trading an acceptable legal practice. (Tr. 2251-54, 2260.)

9. Even after the NYAG issued subpoenas on this issue and Trautman stated to Wilson that TWCO might have acted illegally, Trautman suggested continuing late trades for TWCO's largest client on a limited basis. (Tr. 1080-81, 1269.)

### **Wasserman**

I find that Wasserman gave credible testimony based on my observations of his demeanor and comparing his responses on direct and cross examination. Wasserman's position is undisputed that: (1) he relied on Snyder, a trusted friend and business associate for twenty years and TWCO Chief Administrative Officer, as well as TWCO's compliance officers, to keep him informed of any compliance issues; (2) Snyder showed him one kick-out letter resulting from Wilson's and Christian's mutual fund activities and he told Snyder to get them to stop; and (3) he never received any other complaints about Wilson and Christian. (Tr. 1863-64, 2584, 2632.)

Snyder believes that Wasserman knew how Wilson did business because "[y]ou can't be a chairman of a company and not be aware of at least most of what is going on." (Tr. 1916.) His belief, however, is not based on any conversations with Wasserman, and the evidence is that the topic at board meetings was the firm's banking activities; there is no evidence the board discussed the firm's mutual fund operations. (Tr. 2319.) Snyder has a high opinion of Wasserman's business ethics. (Tr. 1913-14.)

Wilson believed that Wasserman knew about his activities, but was surprised when Wasserman told him, in July 2002, that “he didn’t entirely understand maybe or know what [Christian and I were] doing as far as how we were entering our trades.” (Tr. 1023, 1092-93, 1916.)

As opposed to Trautman, there is no evidence that Wasserman was involved in the details of TWCO’s mutual fund operations. (Tr. 1916.) I accept Wasserman’s explanation that he has never presented himself as a securities lawyer and that Wilson might have used the fact that he went to law school to impress prospective clients. (Tr. 2655.) Wilson had, in fact, informed Beacon Rock in the beginning of its relationship with TWCO that Wasserman had a legal background. (Tr. 1072.)

The evidence is that Wasserman participated in TWCO’s mutual fund operations by soliciting capacity for TWCO with mutual funds and attending meetings, at Wilson’s request, with clients and prospective clients. Wasserman’s testimony is that, while he solicited capacity for TWCO, he believed Wilson’s claim that granting TWCO capacity would benefit a mutual fund. (Tr. 2582-83.) Wasserman admits that he gave what appear to be incriminating answers at a meeting with Singer of Beacon Rock in July 2002. However, according to Wasserman, he understood Singer’s question about late trading, a term he had not heard before, to be whether TWCO could enter orders after 4:00 p.m. in an operational sense. (Tr. 2644, 2647-49.) Wasserman understood Singer’s question “had nothing to do with when you would make a decision, but it was entering orders from an operational point of view, could that be done after the close.” (Tr. 2644.) Wilson said BoA would allow an order to be entered after 4:00 p.m., and Wasserman’s position was that TWCO would do what BoA allowed. (Tr. 2644.) Later, Wasserman asked Wilson why BoA allowed some firms to enter orders after 4:00 p.m., and Wilson said it was an operational decision by firms as to when they entered orders. (Tr. 2644-45.) Given these facts, Wasserman was negligent by his lack of inquiry and understanding as to how Wilson and Christian were conducting a business that accounted for almost seventy percent of TWCO’s revenue, and by brushing off Christian’s concerns and suggestion that TWCO obtain a legal opinion about those operations by saying, “But you have to understand that when there’s a legal opinion you have to follow those instructions.” (Tr. 247-48.)

I find that Wasserman did not have scienter because he did not act with intent to deceive, manipulate, or defraud; he was not reckless because his actions were not such an extreme departure from the standards of ordinary care that he either knew or conditions were so obvious that he must have known; but Wasserman was negligent in that, given his background in the industry, his position at TWCO, and the facts described in this Initial Decision, he failed to exercise reasonable care. For the reasons stated, I find that Wasserman willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.

**3. & 4. Between January 2001 or February 6, 2002, and September 2003, did TWCO willfully violate Section 15(c) of the Exchange Act and Rule 10b-3 thereunder, and did Trautman and Wasserman willfully aid and abet and cause those violations?**

Section 15(c)(1)(a) of the Exchange Act states that:

No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security . . . otherwise than on a national securities exchange of which it is a member, or any security-based swap agreement . . . by means of any manipulative, deceptive, or other fraudulent device or contrivance.

Rule 10b-3 makes it:

unlawful for any broker or dealer, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, to use or employ, in connection with the purchase or sale of any security otherwise than on a national securities exchange, any act, practice, or course of business defined by the Commission to be included within the term “manipulative, deceptive, or other fraudulent device or contrivance,” as such term is used in Section 15(c) of the Act.

I find that the fraudulent conduct of TWCO’s officers and directors caused TWCO, a registered broker-dealer, to willfully violate Section 15(c) of the Exchange Act and Rule 10b-3 thereunder, for the same reasons that TWCO willfully violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5.

Aiding and abetting violations of the securities laws involve three elements: (i) a primary violation by another party; (ii) awareness or knowledge by the aider and abettor that his or her role was part of an overall activity that was improper; and (iii) that the aider and abettor knowingly and substantially assisted in the conduct that constituted the primary violation. See Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d 1004, 1009 (11th Cir. 1985); Investors Research Corp. v. SEC, 628 F.2d 168, 178 (D.C. Cir. 1980); Woodward v. Metro Bank of Dallas, 522 F.2d 84, 94-97 (5th Cir. 1975).

Howard v S.E.C., 376 F.3d 1136 (D.C. Cir. 2004), is a lead case concerning the “awareness” or “knowledge” required to support allegations of aiding and abetting. There, the court found that for aiding and abetting, there must be proof that the person was aware or had knowledge of wrongdoing or, in the absence of knowledge, that an aider and abettor had a state of mind close to conscious intent. See Howard, 376 F.3d at 1142-43 (citing Graham v. SEC, 222 F.3d 994 1006 (D.C. Cir. 2000); see also Wonsover, 205 F.3d at 411. Recklessness is sufficient to satisfy the scienter requirement for aiding and abetting and causing liability. See Howard, 376 F.3d at 1152.

I find that Trautman willfully aided and abetted and caused these violations because he knew, or was reckless in not knowing, that his activities were a part of an overall activity that was improper and his conduct substantially assisted in the commission of TWCO's violations. I find that Wasserman did not aid and abet and cause TWCO's violations of Section 15(c) of the Exchange Act and Rule 10b-3 because he did not have the level of awareness required and he did not know that his role substantially assisted in the violations.

**5. Between January 2001 or February 6, 2002, and September 2003, did TWCO, Trautman, and Wasserman willfully aid and abet and cause BoA's violations of Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act?**

Investment Company Act Rule 22c-1 provides:

(a) No registered investment company issuing any redeemable security, no person designated in such issuer's prospectus as authorized to consummate transactions in any such security . . . or dealer in any such security shall sell, redeem, or repurchase any such security except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security; *Provided, That:*

...

(2)(b) For the purposes of this section, (1) the current net asset value of any such security shall be computed no less frequently than once daily, Monday through Friday, at the specific time or times during the day that the board of directors of the investment company sets . . . .

The evidence is conclusive that TWCO entered transactions, when it received the orders after 4:00 p.m., with mutual funds that required that the broker-dealer receive orders by 4:00 p.m.<sup>41</sup> The fraudulent actions of TWCO caused primary violations of Investment Company Act Rule 22(c) because they caused the funds to sell shares to customers who placed orders after 4:00 p.m. at a price that was next computed based on information as of 4:00 p.m.

The three prerequisites for aiding and abetting violations of the securities laws set out above are applicable to this situation. TWCO substantially assisted in the conduct that constituted the primary violation by conduct it knew, or was reckless in not knowing, was part of a scheme to defraud mutual fund shareholders. The undisputed expert evidence is that TWCO's mutual fund activities during the relevant period caused dilution losses to mutual fund and existing shareholders on the order of \$100 million. (Tr. 733-34; PX Exs. 279 at 6, 38, 45.)

For these reasons, I find that TWCO and Trautman willfully aided and abetted and caused violations of Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act. I find that Wasserman did not aid and abet and cause the violations because he did not have the required level of awareness. See Howard, 376 F.3d at 1142-43 (citing Graham v. SEC, 222 F.3d 994, 1006 (D.C. Cir. 2000); see also Wonsover, 205 F.3d at 411.

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<sup>41</sup> See supra note 40.

**6. Between January 2001 or February 6, 2002, and September 2003, did TWCO willfully violate Section 17(a) of the Exchange Act and Rule 17a-3?**

Section 17(a) of the Exchange Act requires that every registered broker or dealer make and keep records for prescribed periods, furnish copies thereof, and make and disseminate reports as the Commission shall prescribe. Rule 17a-3, a books and records rule, details the records that a registered broker or dealer must maintain. Information contained in the required records must be accurate. See Sinclair v. SEC, 444 F.2d 399, 401 (2d Cir. 1971); James F. Novak, 47 S.E.C. 892, 897 (1983) (citing Lowell Niebuhr & Co, Inc., 18 S.E.C. 471, 475 (1945); Richard O. Bertoli, 47 S.E.C. 148, 150 n.11 (1979).

Rule 17a-3(a)(6)(i) requires that brokers and dealers shall make and keep current:

A memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. The memorandum shall show the terms and conditions of the order or instructions and of any modification or cancellation thereof; the account for which entered; the time the order was received; the time of entry; the price at which executed; the identity of each associated person, if any, responsible for the account; the identity of any other person who entered or accepted the order on behalf of the customer or, if a customer entered the order on an electronic system, a notation of that entry; and, to the extent feasible, the time of execution or cancellation. . . . The term *time of entry* shall mean the time when the member, broker or dealer transmits the order or instruction for execution.

Scienter is not required to violate Section 17(a) and the rules thereunder. See SEC v. Drexel Burnham Lambert Inc., 837 F. Supp. 587, 610 (S.D.N.Y. 1993), aff'd, SEC v. Posner, 16 F.3d 520 (2d Cir. 1994).

The evidence is conclusive that TWCO did not make and keep current a memorandum of each transaction showing accurately the time the order was entered, the terms and conditions of the order, and other material information. This conduct caused TWCO to willfully violate Section 17(a) of the Exchange Act and Exchange Act Rule 17a-3.

## SANCTIONS

Consideration of the following sanctions is appropriate in view of my findings and conclusions.

### **Revocation of TWCO's Broker-Dealer Registration**

Section 15(b)(4) of the Exchange Act authorizes the Commission to “censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer” where a broker-dealer has been found to have willfully violated a provision of the Securities Act or Exchange Act, or is unable to comply with such provisions, if it finds such action to be in the public interest. The criteria for making public interest determinations are:

[t]he egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the [respondent's] assurances against future violations, the [respondent's] recognition of the wrongful nature of his conduct, and the likelihood that the [respondent's] occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981); see also Joseph J. Barbato, 53 S.E.C. 1259, 1282 n.31 (1999); Donald T. Sheldon, 51 S.E.C. 59, 86 (1992), aff'd, 45 F.3d 1515 (11th Cir. 1995). Deterrence is also a factor to be considered. See McCarthy v. SEC, 406 F.3d 179, 189 (2d Cir. 2005.)

The Division recommends that the Commission revoke TWCO's broker-dealer registration. (Div. Post-Hearing Br. 64-69.)

The record, described in the Findings of Fact, is replete with egregious actions that TWCO committed through its agents. TWCO's legal status is unclear, but it has lost its standing with the NASD and defaulted in this proceeding. Accordingly, it is in the public interest to revoke TWCO's registration.

### **Barring Trautman and Wasserman from Association With a Broker or Dealer, and Prohibiting Them from Serving in Certain Offices, and Barring Wasserman from Association With an Investment Adviser**

Section 15(b)(6)(A) of the Exchange Act states:

With respect to any person who is associated . . . at the time of the alleged misconduct, . . . with a broker or dealer . . . the Commission, by order, shall censure, place limitations on the activities or functions of such person, or suspend for a period not exceeding 12 months, or bar such person from being associated with a broker or dealer, . . . if the Commission finds . . . that such censure, placing of limitations, suspension, or bar is in the public interest and that such person--

...

[from subparagraph D of paragraph (4)] Has willfully violated any provision of the Securities Act of 1933, . . . the Investment Company Act of 1940, . . . this title, the rules or regulation under any of such statutes . . . .

[from subparagraph E of paragraph (4)] Has willfully aided, abetted, . . . the violation by any person of any provision of the Securities Act of 1933, . . . the Investment Company Act of 1940, . . . this title, the rules or regulation under any of such statutes . . . .

Section 9(b) of the Investment Company Act authorizes the Commission, where there has been a violation of certain securities statutes, to:

prohibit, conditionally or unconditionally, either permanently or for such period of time as it in its discretion shall deem appropriate in the public interest, any person 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 . . . .

Section 203(f) of the Advisers Act is very similar to the provisions, quoted above, of Section 15(b)(6)(A) of the Exchange Act.

The Steadman factors are relevant in making the public interest determination.

The Division recommends that the Commission bar Trautman and Wasserman from association with any broker or dealer and prohibit them 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. (Div. Post-Hearing Br. 64, 68-69.) The Division also recommends that the Commission bar Wasserman from association with an investment adviser. (Div. Post-Hearing Br. 69.)

Trautman's conduct while associated with a broker-dealer was egregious.<sup>42</sup> He violated provisions of the Securities Act and Exchange Act and aided and abetted violations of the Investment Company Act and rules under those statutes. TWCO's and Trautman's antifraud violations involved many mutual funds and thousands of public investors in those funds. The profit to Wilson, Christian, and TWCO was considerable. All the evidence, except Trautman's sworn testimony, indicates that Trautman was actively involved in every aspect of TWCO's daily operations for the entire relevant period. Because he founded the firm and was CEO, everyone reported to Trautman, who was a close friend of Barbera, who exercised financial control and who was involved in most aspects of TWCO's business. (Tr. 1057, 1083, 2562, 2581.) Trautman made statements that had no basis in fact, such as, TWCO had a "secret sauce" it used that enabled it to make successful mutual fund investments and that late trading was legal. (Tr. 897-98, 905.) Trautman did not pause in his activities even after Jeff Augen and Gordon of

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<sup>42</sup> In October 2007, Trautman was a widower with three minor children, one of whom has significant medical problems. (Tr. 2283-84.) He had no full-time employment and no health insurance. (Tr. 2295, 2363-64.)

Federated, on separate occasions, explained to him why they disagreed with his investment theory and his position that market timing benefited a mutual fund. (Tr. 901-03, 1140-43.)

Trautman has a history of serious regulatory infractions. In 1997, the NASD censured Trautman and others and ordered them to pay, jointly and severally, a \$100,000 fine and to pay restitution not to exceed \$70,453. (Tr. 1974-79; PX Ex. 114 at 29.) In 2002, Trautman signed a settlement concerning allegations that TWCO had committed net capital violations by having less than \$100,000 on March 30 and April 30, 2001. (Tr. 2001-02; PX Ex. 117.) In 2004, the NASD fined Trautman \$200,000, including disgorgement of \$35,000 in partial restitution, suspended him from association with any NASD member in any capacity for thirty-one days, suspended him from association with any NASD member as a general securities principal for six months, and barred him from association with any NASD member as a Series 55 equity trader. (Tr. 1997; PX Ex. 114 at 33-34.) The allegations were that Trautman and TWCO committed fraud, among other things. (Tr. 2010-11; PX Ex. 114 at 33.)

Trautman committed egregious violations of the securities laws and regulations over an extended period, his conduct was knowing or reckless, he gave false and/or inconsistent testimony under oath, and he has a record of regulatory infractions. Based on his demeanor and considering all the evidence in the record, I find there is a high likelihood of future violations if he is allowed to remain in the securities industry. I find therefore that it is in the public interest to bar Trautman from association with a broker or dealer, and prohibit him 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.

The differences between Trautman and Wasserman's violations and their demeanor and presentations in this proceeding result in a substantial difference in sanctions. The evidence establishes that TWCO used Wasserman, his reputation, and his industry contacts, and that Wasserman has suffered substantial financial losses and damage to his professional reputation as the result of his relationship with TWCO. Wasserman did not know of TWCO's illegal activities and he did not act recklessly. Considering his demeanor, his direct testimony, and responses to cross-examination, I accept as genuine Wasserman's shock at learning that regulators considered TWCO's activities illegal and his belief that he did nothing wrong because no one, in particular Mr. Snyder, who he knew and trusted, told him that illegal activities were occurring. (Tr. 2638, 2747-49.) In forty-seven years in the securities industry, Wasserman had a single regulatory action resolved against him in 1992, which he attributes to the actions of a representative that he supervised. (Tr. 2535-37; PX Ex. 141.)

The evidence is compelling that Wasserman has suffered as a result of his negligence. Wasserman estimates that he owes attorney's fees in excess of \$400,000. His present position is unpaid and he has had to borrow funds.<sup>43</sup> (Tr. 2739-40.) In Wasserman's protected sworn financial statement, his attorneys' fees to one firm exceeds the total compensation he received from TWCO. (PX Ex. 82A; Wasserman Ex. W-3.) The sanctions at issue here are remedial. I

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<sup>43</sup> When he was unemployed, from 1995 until March 1999, Wasserman assisted an adult son without medical insurance who died in 1998. (Tr. 2733, 2738-39.) He was looking to get back into the industry when Trautman invited him to join his firm.

consider the likelihood that Wasserman will commit future violations if he is allowed to participate in the securities industry in a non-supervisory capacity to be nil.

Wasserman's personal situation, however, does not outweigh the fact that his negligence resulted in egregious antifraud violations of the securities statutes, people in positions of responsibility must be held to the highest standards, and, as noted, sanctions serve to deter others from similar violations. I find a bar from association to be too harsh and that it is in the public interest to bar Wasserman from association with a broker or dealer or investment adviser in a supervisory position given what occurred here and in the previous incident where he was found at fault.

### **Cease and Desist**

Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 9(f) of the Investment Company Act authorize the Commission to order a person, who has committed a violation, to cease and desist from committing or causing such violation and any future violation of the same provision or regulation. The Commission has found the following factors, similar to Steadman, relevant for determining whether a cease-and-desist order is appropriate:

the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the respondent's opportunity to commit future violations, . . . whether the violation is recent, the degree of harm to investors or to the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings.

KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1192 (2001), reconsideration denied, 55 S.E.C. 1 (2001), petition denied, 289 F.3d 109 (D.C. Cir. 2002).

The Division recommends that the Commission order TWCO, Trautman, and Wasserman to cease and desist from any future violations. (Div. Post-Hearing Br. 64, 70-71.)

A cease-and-desist order is: (1) not required for TWCO since its broker-dealer registration will be revoked; (2) appropriate against Trautman for the same reasons that a bar from association was found to be in the public interest, in particular, the high likelihood of future violations, and (3) not required against Wasserman because there is a very low likelihood of future violations and the supervisory bar is sufficient in the public interest.

### **Disgorgement**

Section 8A(e) of the Securities Act, Section 21C(e) of the Exchange Act, and Section 203(k) of the Advisers Act authorize the Commission to enter an order requiring an accounting and disgorgement, including reasonable interest, in any cease-and-desist proceeding. Section 9(e) of the Investment Company Act authorizes the Commission to enter an order requiring an accounting and disgorgement, including reasonable interest, in any proceeding in which the Commission may impose a penalty under the Investment Company Act.

The Division recommends several disgorgement amounts:

1. Trautman and Wasserman, jointly and severally, should be ordered to disgorge \$9,040,000, plus prejudgment interest from October 1, 2003, through the date of the disgorgement order. This amount represents forty percent of the \$22.6 million, which the Division's expert calculates as TWCO's total earnings from its mutual fund operations.<sup>44</sup> (PX Ex. 279 ¶¶108-25) (Div. Post-Hearing Br. 73-74.)

2. Alternatively, the Division recommends that Trautman and Wasserman each disgorge thirty-eight percent of the \$9,040,000 in mutual fund revenues that TWCO retained, or \$3,435,200 each. (Div. Post-Hearing Br. 74.)

3. Finally, the Division recommends that, at a minimum, TWCO should be ordered to disgorge \$22.6 million or the amount of TWCO's assets, whichever is smaller; and Trautman and Wasserman should be ordered to disgorge their compensation for the relevant period, \$1,373,799.75 for Trautman and \$511,000 for Wasserman. (Div. Post-Hearing Br. 74.)

Disgorgement is defined as “an equitable remedy designed to deprive [respondents] of all gains flowing from their wrong.” SEC v. AMX, Int'l, Inc., 872 F. Supp. 1541, 1544 (N.D. Tex. 1994) (citations omitted). A violator is returned to where he or she would have been absent the misconduct. Disgorgement deprives a wrongdoer of his or her ill-gotten gains and deters others from violating the securities laws. SEC v. First City Fin. Corp., 890 F.2d 1215, 1230-32 (D.C. Cir. 1989.) “The effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable. The deterrent effect of an SEC enforcement would be greatly undermined if securities law violators were not required to disgorge illicit profits.” Manor Nursing Ctrs., 458 F.2d 1082 at 1104.

Rule 630(a) and (b) of the Commission's Rules of Practice provide:

The Commission may, in its discretion, or the hearing officer may, in his or her discretion, consider evidence concerning ability to pay in determining whether disgorgement, interest or penalty is in the public interest.

...

Any Respondent who asserts an inability to pay disgorgement, interest or penalties may be required to file a sworn financial disclosure statement and to keep the statement current.

The persuasive evidence is that TWCO's mutual fund activities caused TWCO, after payments to Wilson and Christian, to realize ill gotten gains of approximately \$9 million, and that, collectively, investors in mutual funds suffered substantial financial losses. (Tr. 2292, 2480; PX Ex. 255-A, 255-B; Div. Post-Hearing Br. 74.) Neither TWCO nor Trautman have submitted sworn financial statements that show an inability to pay. (Trautman Exs. T-3, T-3A.) Wasserman submitted a sworn financial statement. (Wasserman Ex. W-3.)

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<sup>44</sup> The forty percent comes from the sixty-forty split between TWCO and Wilson of mutual fund revenues after expenses.

Based on this evidence, I order disgorgement against TWCO and Trautman in the minimum amounts recommended by the Division, with prejudgment interest, and I order Wasserman to disgorge \$25,000, with prejudgment interest.

### **Civil Money Penalties**

Section 21B(a) of the Exchange Act and Section 9(d) of the Investment Company Act authorize the Commission to impose civil money penalties. The statutes set out a three-tiered system for determining the maximum civil penalty for each “act or omission.” See Mark David Anderson, 56 S.E.C. 840, 863 (2003) (imposing a civil penalty for each of the respondent’s ninety-six violations).

A second-tier penalty is permissible if the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. A third-tier penalty is permissible for violations that, in addition, “directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.” Section 21B(b)(3)(B) of the Exchange Act. Section 21B(c) of the Exchange Act specifies the following as public interest considerations: (1) whether the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm caused to others; (3) the unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require.

The Division recommends third-tier penalties against TWCO in the amount of \$500,000, against Trautman in the amount of \$1,373,799, and against Wasserman in the amount of \$511,000. (Div. Post-Hearing Br. 76-78.) The Division notes that a per-occurrence calculation would result in an astronomical result, and that TWCO “is defunct and has negligible assets.”<sup>45</sup> (Div. Post-Hearing Br. 78.)

The conduct of TWCO and Trautman merits a third-tier penalty, however, given their financial condition I find it appropriate to assess a \$500,000 civil penalty against TWCO and the same amount against Trautman. I find that Wasserman’s negligent conduct does not merit the imposition of a penalty, and, alternatively, his sworn financial affidavit shows an inability to pay. (Wasserman Ex. W-3;) 17 C.F.R. § 201.630(a).

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<sup>45</sup> Violations committed by a natural person after February 2, 2001, but before February 14, 2005, have a maximum penalty per occurrence of \$6,500 in the first tier; \$60,000 in the second tier; and \$120,000 in the third tier. Violations committed by any other person (TWCO) after February 2, 2001, but before February 14, 2005, have a maximum penalty per occurrence of \$60,000 in the first tier; \$300,000 in the second tier; and \$600,000 in the third tier. See Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, ch. 10, sec. 31001, § 3701(a)(1), 110 Stat. 1321-358; 28 U.S.C. § 2461 (effective Mar. 9, 2006); 17 C.F.R. §§ 201.1001, .1002.

## RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items described in the record index issued by the Secretary of the Commission.

## ORDERS

I ORDER that the sworn financial affidavit of Samuel M. Wasserman is received in evidence as Wasserman Exhibit W-3, and that, pursuant to Commission Rule of Practice 322, Wasserman Exhibit W-3, is covered by a protective order;

I FURTHER ORDER, pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934, that the registration of Trautman Wasserman & Company, Inc., be, and it hereby is, revoked;

I FURTHER ORDER, pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, and Section 9(f) of the Investment Company Act of 1940, that Gregory O. Trautman cease and desist from: (1) committing or causing any violations or any future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder; and (2) aiding or abetting any violations or any future violations of Section 15(c) of the Securities Exchange Act of 1934, and Rule 10b-3 thereunder, and Section 22(c) of the Investment Company Act of 1940 and Rule 22c-1 thereunder;

I FURTHER ORDER, pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, that Gregory O. Trautman is barred from association with a broker or dealer and 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;

I FURTHER ORDER, pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, and Section 203(f) of the Investment Advisers Act of 1940, that Samuel M. Wasserman is barred from association with a broker or dealer or investment adviser in any supervisory capacity;

I FURTHER ORDER, pursuant to Section 8A(e) of the Securities Act of 1933, Section 21C(e) of the Securities Exchange Act of 1934, Section 203(k) of the Investment Advisers Act of 1940, and Section 9(e) of the Investment Company Act of 1940, that Trautman Wasserman & Company, Inc., shall disgorge the amount of its assets not exceeding \$9,040,000, Gregory O. Trautman shall disgorge \$1,373,799.75, plus prejudgment interest from October 31, 2003, through the date this Order is issued; and Samuel M. Wasserman shall disgorge \$25,000, plus prejudgment interest from October 31, 2003, through the date this Order is issued;

I FURTHER ORDER, pursuant to Section 21B(a) of the Securities Exchange Act of 1934 and Section 9(d) of the Investment Company Act of 1940, that Trautman Wasserman & Company, Inc., shall pay a civil money penalty in the amount of \$500,000 and that Gregory O. Trautman shall pay a civil money penalty in the amount of \$500,000.

Payment of the disgorgement, prejudgment interest, and civil penalty shall be made on the first day following the day this initial decision becomes final. Payment shall be made by certified check, United States Postal money order, bank cashier's check, or bank money order, payable to the U.S. Securities and Exchange Commission. The payment, and a cover letter identifying Respondents and the proceeding designation, shall be delivered to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Brenda P. Murray  
Chief Administrative Law Judge