UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA	:	**CRIMINAL NO.:**
v.	:	**DATE FILED**
BEACON ROCK CAPITAL, LLC **THOMAS GERBASIO**	: : :	**VIOLATIONS:** **15 U.S.C. §§ 78j(b), 78ff, and 17 C.F.R. § 240.10b-5 (securities fraud)** **18 U.S.C. § 2 (aiding and abetting)**

INFORMATION

COUNT ONE

THE UNITED STATES ATTORNEY CHARGES THAT:

Relevant Parties

At all times relevant to this information:

1. Defendant BEACON ROCK CAPITAL, LLC was a hedge fund based in Portland, Oregon ("BEACON ROCK"). A hedge fund is a private pool of investment capital organized into a limited partnership to invest in a portfolio made up of a variety of securities. Hedge fund investors must meet certain financial requirements in order to participate.

2. Defendant THOMAS GERBASIO worked in the mutual funds area at securities broker-dealers registered with the United States Securities and Exchange Commission ("SEC"). From in or about 1999 until in or about August 2002, defendant GERBASIO worked at Investec Ernst & Co. ("Investec") in New York, New York. In or about August 2002, Fiserv Securities Inc., ("Fiserv"), a Philadelphia-based broker-dealer, acquired certain components of Investec, including defendant GERBASIO's mutual funds group. This group became known as the "New York Market Timing Office." From in or about August 2002 until in or about May

2003, GERBASIO was in charge of Fiserv's New York Market Timing Office and continued to work in New York. In or about May 2003, Fiserv promoted defendant GERBASIO to head of its Mutual Fund Department, and defendant GERBASIO relocated to Philadelphia. Defendant GERBASIO maintained supervisory responsibility over the New York Market Timing Office until he left Fiserv in or about April 2004.

3. The primary business of defendant THOMAS GERBASIO's mutual funds group at Investec, and later at Fiserv, was to provide brokerage services to a limited number of "direct customers," including defendant BEACON ROCK. Defendant GERBASIO was never licensed to sell securities or to provide investment advice. As described in detail below, the objective of this relationship was to permit defendant BEACON ROCK, and others known and unknown to the United States Attorney, to evade and circumvent controls implemented by mutual funds seeking to restrict excessive trading.

Background

4. One of defendant BEACON ROCK's primary trading strategies involved "market timing" various mutual funds. "Market timing" is a mutual fund trading strategy which involves short-term purchases and sales of mutual fund shares. A market timing strategy generally attempts to take advantage of perceived inaccuracies in mutual fund share prices, which are typically calculated only once per day. One example of market timing is so-called "time zone arbitrage," which involves trading in mutual funds that invest in international securities. Such mutual funds typically calculate their share price - or per share net asset vale ("NAV") - as of the time of the close of markets in the United States. This calculation is performed using the most current market prices for the securities held by the mutual funds.

Because foreign securities markets typically close several hours before markets in the United States, the prices of international securities held by a mutual fund are frequently “stale,” that is, several hours old, by the time the NAV calculation occurs. Based on events that have transpired during this time lag, an investor, employing a market timing strategy, may conclude that the NAV of such a fund understates or overstates the current value of the fund’s securities, and engage in short-term trading to take advantage of this perceived disparity.

5. As set forth more fully below, from in or about December 1999 to in or about November 2003, defendants BEACON ROCK and THOMAS GERBASIO, and others known and unknown to the United States Attorney, engaged in a scheme to defraud mutual funds and their shareholders in connection with the short-term trading of mutual funds. Defendants BEACON ROCK and GERBASIO received, and/or were aware of, numerous warnings from mutual fund companies that such market timing was unwanted and potentially harmful to mutual fund shareholders, and that the mutual funds would not permit such trades. Nevertheless, to execute trades in contravention of the restrictions that mutual funds placed on such trading, defendant GERBASIO, and others at his direction, engaged in a number of deceptive and fraudulent practices designed to conceal the identity of defendant BEACON ROCK, and the nature of its trading activity. Defendant BEACON ROCK was aware that defendant GERBASIO and others were engaged in deceptive acts on its behalf. These practices included: (1) creating and using multiple account numbers and other identifiers; (2) structuring mutual fund purchases to remain under certain perceived thresholds; (3) opening additional accounts with at least one other clearing firm; and, (4) misrepresenting defendant BEACON ROCK’s trading strategy when confronted by mutual funds. Defendants BEACON ROCK and

GERBASIO, and others known and unknown engaged in this fraudulent scheme knowing that, absent such deceptive conduct, many mutual funds would refuse to accept defendant BEACON ROCK's trades, and they would not earn the millions of dollars in profits and fees that they ultimately earned. Through this scheme, defendant BEACON ROCK made in excess of 26,000 market timing trades, resulting in approximately $2.4 million in net trading profits. Defendant GERBASIO earned approximately $215,000 in compensation as a direct result of the illegal trading.

Mutual Fund Trading

6. Mutual funds are investment companies that typically invest in portfolios of equity and/or debt securities. Mutual funds are owned by their investor-shareholders. The majority of mutual funds are "open end" funds, which continuously issue new shares to investors and stand ready to redeem any shares tendered by investor-shareholders. The price at which new shares are issued and redeemed is referred to as the NAV. The NAV is calculated by subtracting the mutual fund's total liabilities from its total assets and dividing by the number of shares outstanding.

7. While mutual funds will ordinarily issue shares directly to investors, investors typically may also purchase mutual fund shares through a securities broker-dealer. Broker-dealers frequently execute trades on behalf of their clients through a "clearing firm," an intermediary which processes transactions and performs back office functions on behalf of the broker-dealer.

8. As discussed below, many mutual funds actively attempted to detect and

block market timing. These mutual funds frequently sent reject or "kickout" letters and/or emails to stop such trades, citing the potential adverse impact that market timing presents to mutual fund shareholders, including diluting the value of a fund's shares, increasing the volatility of a fund's values, and increasing transaction costs.

Mutual Funds' Efforts To Stop Market Timing

9. Mutual funds frequently employ policies and procedures that are designed to detect and prevent market timing activity, and expressly or implicitly reserve the right to reject market timing transactions in their prospectuses. Some mutual funds' prospectuses specifically discourage or prohibit market timing activity altogether, or contain express limits on the numbers of "round trips," that is, purchases and redemptions, that an investor may engage in during a given time period. Other mutual funds expressly reserve in their prospectuses the right to reject transactions that the funds deem not to be in the best interests of the shareholders.

10. Persons employed by mutual funds to combat market timing are colloquially referred to by market participants as "market timing police." "Market timing police" typically endeavor to identify individuals engaged in market timing by tracking broker identification numbers and/or customer account numbers, and then demanding cessation of market timing trading. Because of the potential harm to mutual fund investors from market timing, mutual funds often refuse to accept purchase orders from accounts that have previously engaged in short-term trading in violation of the terms of a fund's prospectus or prior instructions from the fund.

Warnings Concerning Market Timing Abuses

11. Throughout the entire time defendant BEACON ROCK was engaged in

market timing, various mutual funds were sending warning letters, notices and/or emails almost daily to defendant THOMAS GERBASIO, and others at his broker-dealer, complaining about market timing activity and/or advising defendant GERBASIO's firm, that its clients would be prohibited from trading in specified mutual funds because of unwanted market timing activity. On numerous occasions mutual funds rejected attempted market timing trades. On at least one occasion, a mutual fund family terminated defendant GERBASIO's firm's ability to purchase any additional shares due to continued market timing following earlier warnings. Defendants BEACON ROCK and GERBASIO were aware of these warnings and regularly discussed strategies, via telephone, electronic mail, and other means, to avoid having their trades rejected by mutual funds.

Strategy To Evade Detection

12. During the relevant period, mutual funds were becoming increasingly sophisticated in their ability to detect and prevent market timing. In order to maintain and grow their market timing business in the face of increased sophistication on the part of mutual funds in combating market timing, defendant THOMAS GERBASIO, with the full knowledge and assent of defendant BEACON ROCK, employed a host of deceptive and fraudulent practices, which are described more fully below.

Use of Multiple Identifying Numbers

13. From at least August 2000 through in or about November 2003, defendants BEACON ROCK and THOMAS GERBASIO, together with others known and unknown to the United States Attorney, employed tactics designed to deceive and defraud the mutual funds, thereby enabling them to conduct market timing transactions that would otherwise

have been prohibited. One way in which defendants BEACON ROCK and GERBASIO circumvented restrictions that the mutual funds placed on their trading was to use multiple account numbers and multiple registered representative numbers ("Rep Numbers") (collectively, "Identifying Numbers") to conduct their market timing transactions.

14. Mutual funds that received trades placed by defendant THOMAS GERBASIO's group typically were not provided the name/identity of the client on whose behalf the order had been placed, but only (i) a code identifying the branch of the broker-dealer that had entered the order, (ii) a "Rep Number" identifying the representative at the broker-dealer who took the order, and (iii) the client's account number at the broker-dealer. Accordingly, when representatives of a mutual fund identified a market timing trade placed by defendant GERBASIO's group, they would frequently respond by banning future trades in the fund by the account number that placed the trade, the Rep Number that placed the trade, and/or the branch from which the trade was placed but could not identify the actual customer making the trades.

Affirmative Misrepresentations

15. Defendant THOMAS GERBASIO repeatedly instructed subordinates to mislead mutual funds about the nature of defendant BEACON ROCK's and other customers' trades. On a number of occasions, mutual funds contacted defendant GERBASIO's firm to inquire about customer trades. At defendant GERBASIO's direction, employees falsely denied that customers, such as defendant BEACON ROCK, were market timing. Defendant GERBASIO gave this instruction knowing that if the mutual funds determined that a particular customer was timing the fund, they would likely reject the trade, take action to further restrict trading by the customer, and/or ban the customer from the fund.

Multiple Account Numbers

16. Another key component of the scheme to evade detection was the use of multiple account numbers. To accommodate its market timing, defendants BEACON ROCK and THOMAS GERBASIO, together with others known and unknown to the United States Attorney, opened in excess of thirty (30) different accounts at defendant GERBASIO's broker-dealer firm between in or about December 2002 and in or about November 2003.

17. These multiple accounts were used in two primary ways. First, in various instances in which a mutual fund had blocked trading by a specific account, defendants BEACON ROCK and THOMAS GERBASIO, together with others known and unknown to the United States Attorney, would utilize one or more different accounts for defendant BEACON ROCK to execute market timing trades in the very same mutual fund. In other instances, defendants BEACON ROCK and GERBASIO, together with others known and unknown to the United States Attorney, utilized the multiple BEACON ROCK accounts so that they could rotate the accounts that were used to place market timing trades and thereby better avoid detection by the mutual funds. As defendants BEACON ROCK and GERBASIO well knew, had the mutual funds been aware that the trades at issue were short term trades, and/or that the trades originated from the very clients whose short-term trading they had sought to prohibit, the mutual funds would not have agreed to the trades.

Limit Trade Amounts

18. Another component of the scheme to evade detection was to structure trades in amounts unlikely to draw fund scrutiny. Defendant THOMAS GERBASIO, together with others known and unknown to the United States Attorney, repeatedly recommended to

defendant BEACON ROCK that it place trades in amounts that fell below the funds' "radar" so that the funds would not detect the prohibited market timing trades. As described above, defendants BEACON ROCK and GERBASIO also used the multiple accounts to divide large investments into several smaller investments made at one time through separate accounts with no apparent relation. This strategy increased the amount that defendant BEACON ROCK could market time a fund insofar as the smaller amounts were less likely to draw scrutiny.

<u>Use Of An Affiliated Broker-Dealer</u>

19. Another way in which defendants BEACON ROCK and THOMAS GERBASIO sought to evade detection of their market timing was by opening additional accounts at another broker-dealer that had no other market timing business. In or about April 2001, defendant GERBASIO introduced defendant BEACON ROCK representatives to an individual at another broker-dealer for the express purpose of opening additional accounts to facilitate market timing. The stated purpose of this arrangement was to enable defendant BEACON ROCK to place trades that would be "under the radar" of mutual funds by utilizing a new and unknown firm. Defendant GERBASIO indicated that he would act as a "consultant" to this broker-dealer and would be compensated by that firm, without the knowledge of his employer. Defendant BEACON ROCK opened accounts at this broker-dealer in order to facilitate its market timing strategy.

Statutory Violation

20. From in or about December 1999 up to and including in or about November 2003, in the Eastern District of Pennsylvania and elsewhere, defendants

BEACON ROCK CAPITAL, LLC and
THOMAS GERBASIO,

unlawfully, willfully, and knowingly, directly and indirectly, by the use of means and instrumentalities of interstate commerce, the mails, and the facilities of national securities exchanges, used, and employed, and aided and abetted the use and employment of, manipulative and deceptive devices and contrivances, in violation of Title 17, Code of Federal Regulations, Section 240.10b-5, by: (a) employing devices, schemes, and artifices to defraud; (b) making untrue statements of material facts and omitting to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (c) engaging in acts, practices, and courses of business which operated and would operate as a fraud and deceit upon a person, in connection with the purchase and redemption mutual fund shares.

In violation of Title 15, United States Code, Sections 78j(b) and 78ff; Title 17, Code of Federal Regulations, Section 240.10b-5; and Title 18, United States Code, Section 2.

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PATRICK L. MEEHAN
United States Attorney