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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. BRENT WILLIAM FEDERIGHI AND MICHAEL CARL HOFFMAN, Defendants.	Case No. C 05 5305 MMC COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission") alleges against Defendants Brent William Federighi and Michael Carl Hoffman (together, "Defendants"):

SUMMARY OF THE ACTION

1. This matter involves a scheme to defraud mutual fund shareholders and others through practices known as late trading and market timing in mutual fund shares by two hedge fund managers, Defendants Federighi and Hoffman.

2. From 2000 through 2003, Defendants, through a hedge fund they managed together, known as "Ilytat," and through a hedge fund Federighi later managed by himself, known as "Gage," repeatedly engaged in fraudulent "late trading" – placing orders to buy, redeem, or exchange mutual fund shares after the 4:00 p.m. eastern time market close while still receiving the current day's mutual

fund price. By engaging in late trading, defendants profited from market events that occurred after 4:00 p.m. but were not reflected in the price they paid for the shares. Defendants deliberately exploited a loophole in their broker's mutual fund order entry system to place over 3,000 fraudulent late trades (representing over 80% of their hedge funds' mutual fund trades) in over 400 different mutual funds, allowing them to obtain better prices for their mutual fund shares than ordinary investors received. As a result, Federighi and Hoffman caused losses of approximately $49 million to other mutual fund investors through their improper receipt of stale fund prices.

3. In addition to the fraudulent late trading, Hoffman and Federighi used deceptive techniques to market time numerous mutual funds that prohibited or limited such trading. "Market timing" refers to the practice of short-term buying, redeeming, or exchanging of mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Defendants knew that the mutual fund companies monitored activity in their funds and imposed restrictions on excessive trading. The mutual fund companies repeatedly warned them that their timing activities could not continue. Defendants used deceptive devices, including trading through multiple account numbers, to mask their timing orders and to defraud the mutual funds and their shareholders.

4. Defendants, who were acting as investment advisers, further failed to disclose to Ilytat's investors, and Federighi failed to disclose to Gage's investors, that they were late trading and market timing, and that the hedge funds' trading and performance were based on inherently risky and potentially unlawful and unsustainable trading practices. Defendants thus breached their fiduciary duties to investors in the hedge funds they managed.

5. The Commission seeks injunctions, disgorgement of ill-gotten gains plus prejudgment interest, and civil money penalties against Defendants.

JURISDICTION, VENUE, AND INTRADISTRICT ASSIGNMENT

6. This Court has jurisdiction over this action pursuant to Sections 21(d), 21(e), and 27 of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. §§ 78u(d), 78u(e), and 78aa], Sections 209(d) and 209(e) of the Investment Advisers Act of 1940 ("Advisers Act") [15 U.S.C.

§§ 80b-9(d) and 80b-9(e)], and Sections 42(d) and 42(e) of the Investment Company Act of 1940 ("Investment Company Act") [15 U.S.C. §§ 80a-41(d) and 80a-41(e)].

7. Defendants, directly or indirectly, have made use of the means and instrumentalities of interstate commerce or of the mails in connection with the acts, transactions, practices and courses of business alleged in this Complaint.

8. Venue is proper in this Court pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa], Section 214 of the Advisers Act [15 U.S.C. § 80b-14], and Section 44 of the Investment Company Act [15 U.S.C. § 80a-43] because acts, transactions, practices, and courses of business constituting violations alleged in this Complaint, including the purchase and sale of securities, occurred within the Northern District of California, and both Defendants can be found in, transacted business in, and/or are inhabitants of the Northern District of California. Assignment to the San Francisco Division of this Court is proper because a substantial part of the events or omissions that give rise to claims alleged in this Complaint occurred in San Francisco.

DEFENDANTS

9. Hoffman, age 42, lives in San Francisco, California. He started the Ilytat hedge fund in 1998, managing the fund with Federighi until they closed it in 2002. Hoffman received compensation (in the form of advisory and performance fees) from Ilytat in exchange for advising Ilytat on which securities to buy and sell. Hoffman was also an investor in Ilytat. Before starting Ilytat, Hoffman was a portfolio manager for an emerging markets mutual fund from 1994 to 1998, and managed an emerging markets account for a financial services firm from 1989 to 1994.

10. Federighi, age 34, lives in San Francisco, California. He joined Hoffman at Ilytat in 1999, shortly after Hoffman founded the fund and managed Ilytat with Hoffman until the fund closed in 2002. Federighi then opened a new hedge fund, Gage, which he managed until it closed in 2003. Federighi received advisory and performance fees from Ilytat and Gage in exchange for advising each as to which securities to buy and sell. Federighi was also an investor in Ilytat and Gage. Before joining Ilytat, Federighi was a registered representative at a broker-dealer registered with the Commission. Federighi has held the series 3, 7, 63, and 65 securities licenses.

RELATED ENTITIES

11. The Ilytat hedge fund ("Ilytat") was founded by Hoffman in 1998 and operated until August 2002, investing largely in domestic mutual funds and domestic and international equities. Federighi joined Ilytat in 1999 and together Hoffman and Federighi operated Ilytat's affiliated funds, including one for domestic investors (managed by a U.S.-based investment adviser, Ilytat, LLC) and one for offshore investors (managed by a Cayman Islands-based investment adviser). In May 2001, Ilytat's domestic and offshore funds had a total of approximately $130 million in assets. Hoffman and Federighi were the sole members of Ilytat, LLC, which was registered with the State of California as an investment adviser, and maintained its only office in San Francisco.

12. The Gage hedge fund ("Gage") was started by Federighi in September 2002. Like Ilytat, Gage operated affiliated funds, including a domestic and an offshore fund, both of which were managed by Federighi. A California-registered investment adviser, Gage Capital, LLC, served as the investment adviser for the domestic fund. Federighi was the sole member of Gage Capital, LLC, which maintained its only office in San Francisco. When Gage closed in October 2003, it managed approximately $55 million in assets in its domestic and offshore funds.

13. Bear, Stearns & Co., Inc., a New York-based brokerage firm and investment bank, served as prime broker for Ilytat and Gage through its wholly owned subsidiary, Bear, Stearns Securities Corp. (together "Bear Stearns"), a broker-dealer registered with the Commission. Under the prime brokerage arrangement in place during the relevant period, Bear Stearns provided Ilytat and Gage with trade clearing, margin financing, stock lending in connection with short sales, and cash and securities position reporting.

FACTS

Illegal Late Trading

14. The price of a mutual fund's shares is based on the value of the securities (and other assets) held by the mutual fund, and each fund is required by the Commission's regulations to calculate each trading day the value of the fund's holdings, or net asset value ("NAV"). Generally, the funds in which Ilytat and Gage traded calculated the price of their shares as of the close of the

major United States securities exchanges and markets (4:00 p.m. eastern time). As the Commission's regulations further require, the price received by the investor for shares of the fund is the price the fund next calculates after receipt of the order. Consequently, trades placed by an ordinary investor after 4:00 p.m. eastern time in the funds Ilytat and Gage traded received the NAV next calculated by the mutual fund *after* the investor placed the order, which was the NAV calculated as of 4:00 p.m. on the close of the following trading day.

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

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

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

18. Defendants knew that orders Ilytat or Gage placed in the MFRS to trade mutual fund shares after 4:00 p.m. would still receive that day's NAV, instead of the next day's NAV (as ordinary mutual fund investors would have received). Indeed, Defendants sought to exploit the MFRS system in order to obtain a better price for the shares they traded than they otherwise would have received. By placing orders after 4:00 p.m. while receiving prices for fund shares based on a fund's pre-4:00

p.m. NAV, Defendants exploited their access to information announced after 4:00 p.m. that could affect securities prices. Hoffman touted Ilytat's ability to thus late trade to a representative of at least one Ilytat investor.

19. From late November 2000 through September 2002, when Ilytat closed, Federighi, on behalf of Ilytat, knowingly or recklessly entered, or caused others at Ilytat to enter, approximately 2,700 trades into MFRS after 4:00 p.m., or about 84% of the approximately 3,300 mutual fund trades entered into MFRS on behalf of Ilytat during that time, each of which improperly received prices based on the same day's NAV. These trades, for the purchase, redemption, or exchange of securities issued by investment companies registered with the Commission pursuant to Section 8(a) of the Investment Company Act [15 U.S.C. § 80a-8], were entered into MFRS after 4:00 p.m. but were priced as if the orders were entered before 4:00 p.m. Hoffman knew, or was reckless in not knowing, that Federighi was entering, or was causing others at Ilytat to enter, late trades into MFRS on behalf of Ilytat.

20. During the period that Gage operated, from at least October 2002 through at least October 2003, Federighi, on behalf of Gage, knowingly or recklessly entered, or caused others at Gage to enter, approximately 870 trades after 4:00 p.m., or about 82% of the approximately 1,050 mutual fund trades entered into MFRS on behalf of Gage, each of which improperly received prices based on the same day's NAV. These trades, for the purchase, redemption, or exchange of securities issued by investment companies registered with the Commission pursuant to Section 8(a) of the Investment Company Act [15 U.S.C. § 80a-8], were entered into MFRS after 4:00 p.m. but were priced as if the orders were entered before 4:00 p.m.

21. Defendants, by using the MFRS as a fraudulent device to late trade in the manner described above, caused approximately $49 million in dilution to the affected mutual funds. That is, by receiving a price they were not entitled to, Ilytat's and Gage's late trading resulted in a transfer of $49 million from the funds and their shareholders to Ilytat or Gage.

Deceptive Market Timing

22. "Market timing" is the practice of short-term buying, redeeming, or exchanging of mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing harms mutual fund shareholders when it dilutes the value of their shares. Market timing may also increase transaction costs for the fund, or force the fund's portfolio manager to prematurely liquidate holdings the fund would otherwise have held, in order for the fund to generate cash to meet redemptions requested by the market timers. Consequently, many funds limit the number of purchases, redemptions or exchanges shareholders are permitted to make, inform shareholders through their prospectuses that timing and excessive trading are prohibited, and attempt to identify and to block the trading practices of market timers.

23. Defendants, through Ilytat, and Federighi, through Gage, made frequent market timing trades in mutual fund shares through Bear Stearns. Mutual funds frequently identified Ilytat and Gage accounts as "market timing" accounts and blocked the accounts from further trading. For example, between 2000 and 2003, Bear Stearns forwarded to Ilytat and Gage numerous emails from various mutual fund families notifying them that accounts Ilytat or Gage used had engaged in market timing, and which further stated that the funds were requesting that Bear Stearns block future orders to purchase the funds. The appendix to this complaint identifies examples of trades placed in accounts maintained by Ilytat and Gage subsequent to receiving notices from mutual fund families concerning restrictions on market timing. Other funds announced in their prospectuses that they prohibited market timing by limiting the number of purchases, redemptions or exchanges of their shares. Ilytat and Gage eluded the limitations and blocking efforts of these mutual fund families by engaging in deceptive practices to place trades in those fund families' mutual fund shares.

24. Ilytat, and later Gage, used Bear Stearns' MFRS to enter orders for timed trades. The orders transmitted to mutual funds from Bear Stearns through the MFRS only identified the account *number* for which the trade had been placed, as opposed to identifying the name of the account holder who had placed the trade. Consequently, mutual funds were only able to identify by account number,

and not by the name of the owner of the account, accounts which they believed were engaging in improper market timing.

25. Bear Stearns typically assigned its institutional customers, such as hedge funds like Ilytat and Gage, account numbers beginning with "102." When mutual funds became aware of repeated short-term trading by those accounts, they frequently blocked such accounts from further trading. In order to hide Ilytat's and Gage's identity from mutual funds and to continue market timing, Federighi requested that Bear Stearns provide Ilytat and Gage with multiple, non-consecutively numbered accounts. In a May 2001 email to a Bear Stearns employee, Federighi referenced an upcoming meeting, stating:

> topics we would like to discuss are: acquiring new 'bin #'s'. these are the account #'s that are transmitted to mutual fund families. we want bin #'s that are outside the 102 account range and therefore deemed traditional 'timer' activity. the new bin #'s should be in a range in which traditional mutual fund flows come from.

26. In June 2001, Bear Stearns assigned four, non-consecutively numbered accounts that began with "105" to Ilytat. In total, Ilytat attempted to elude detection by trading mutual funds in more than a dozen accounts at Bear Stearns.

27. In November 2002, Bear Stearns again issued three new 105 accounts at Federighi's request, this time consecutively numbered. In response to Federighi's request for "scattered" and "random" account numbers, Bear Stearns opened two new, non-consecutively numbered accounts beginning with "105" for Ilytat.

28. When Ilytat closed in 2002, its accounts, including the 105 accounts, were transferred to Gage. Further, in July 2003, Federighi again emailed Bear Stearns requesting yet more new account numbers and seeking "other options" besides the scattered 102 and 105 account numbers.

29. Two Bear Stearns employees, discussing Federighi's latest request, characterized it as an attempt to "fool" mutual funds "to do market timing," and they concluded that Bear Stearns was not able to assign additional accounts in ranges other than 102 and 105. The next month, Bear Stearns assigned Gage two new, non-consecutively numbered accounts beginning with "105." The following month, Gage closed its doors.

30. Federighi knew, or was reckless in not knowing, that his requests for and use of multiple account numbers was for the purpose of disguising his market timing on behalf of Ilytat and Gage, to deceive and defraud the mutual funds and their shareholders. Hoffman knew, or was reckless in not knowing, that Federighi, on behalf of Ilytat, was using multiple, non-consecutively numbered accounts in order to circumvent market-timing restrictions, and that trades for mutual fund shares were entered into these multiple accounts on behalf of Ilytat to deceive and defraud the mutual funds and their shareholders.

Fraud on Defendants' Own Hedge Fund Investors

31. Defendants were investment advisers to Ilytat, and failed to disclose to certain Ilytat investors that a significant portion of the hedge fund's transactions involved late trading or market timing. Defendants further failed to inform those investors that, because Defendants resorted to deceptive practices and exploited weaknesses in Bear Stearns' system to carry out such transactions, these strategies were risky and likely not sustainable.

32. Similarly, Federighi was an investment adviser to Gage, and failed to disclose to certain Gage investors that a significant portion of the hedge fund's transactions involved late trading or market timing. Federighi further failed to inform those Gage investors that, because he resorted to deceptive practices and exploited weaknesses in Bear Stearns' system to carry out such transactions, these strategies were risky and likely not sustainable.

33. Defendants knew, were reckless in not knowing, and should have known, that they were failing to disclose material information to Ilytat's investors. Similarly, Federighi knew, was reckless in not knowing, and should have known, that he was failing to disclose material information to Gage's investors.

34. Defendants thus breached their fiduciary duties to Ilytat's investors, and Federighi breached his fiduciary duty to Gage's investors.

FIRST CLAIM FOR RELIEF

Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder
(Fraud in Connection with the Purchase or Sale of Securities)

35. Paragraphs 1 through 34 are re-alleged and incorporated by reference.

36. Defendants by engaging in the conduct described above, directly or indirectly, in connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter:

a. employed devices, schemes, or artifices to defraud;

b. made untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

c. engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

37. By engaging in the conduct described above, Defendants violated, and unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

SECOND CLAIM FOR RELIEF

Violations of Sections 206(1) and 206(2) of the Advisers Act
(Investment Adviser Fraud or Breach of Fiduciary Duty)

38. Paragraphs 1 through 34 are re-alleged and incorporated by reference.

39. Defendants, as persons who, for compensation, engaged in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, and as persons associated with an investment adviser, by use of the means and instrumentalities of interstate commerce or of the mails, directly or indirectly: employed a device, scheme or artifice to defraud a client or prospective client; and engaged in transactions, practices and courses of business which operated as a fraud or deceit upon a client or a prospective client.

40. By engaging in the conduct described above, Defendants violated, and unless restrained and enjoined will continue to violate, Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§ 80b-6(1) and (2)].

THIRD CLAIM FOR RELIEF

Violations of Section 37 of the Investment Company Act
(Larceny on a Mutual Fund)

41. Paragraphs 1 through 34 are re-alleged and incorporated by reference.

42. Defendants, by engaging in the conduct described above, stole, unlawfully abstracted, unlawfully and willfully converted to their own use or to the use of another, or embezzled the money, funds, securities, credits, property, or assets of a registered investment company.

43. By reason of the foregoing, Defendants violated, and unless restrained and enjoined will continue to violate, Section 37 of the Investment Company Act [15 U.S.C. § 80a-36].

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

A. Enter permanent injunctions restraining each Defendant and his respective agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, including facsimile or overnight delivery service, from directly or indirectly engaging in violations of Section 10(b) of the Exchange Act [15 U.S.C.§ 78j] and Rule 10b-5 [17 C.F.R. § 240.10b-5] promulgated thereunder, Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C.§§ 80b-6(1) and (2)], and Section 37 of the Investment Company Act [15 U.S.C. § 80a-37];

B. Order each Defendant to disgorge his ill-gotten gains, plus prejudgment interest;

C. Order each Defendant to pay appropriate civil monetary penalties pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)], Section 209(e) of the Advisers Act [15 U.S.C. § 80b-9(e)], and Section 42(e) of the Investment Company Act [15 U.S.C. § 80b-41(e)];

D. Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of the Court; and

E. Grant such additional relief as the Court may determine to be just and necessary.

Dated: December 22, 2005

Respectfully submitted,

Robert J. Durham
Attorney for Plaintiff
SECURITIES AND EXCHANGE COMMISSION

Appendix

Examples of Market Timing Transactions

Fund Family	Date of Notice	Account(s) Identified in Fund Family's Notice	Account(s) Subsequently Used to Market Time Fund Family
Alliance/Bernstein Funds	November 4, 2002	105-62350	105-58950
Evergreen Funds	January 4, 2001	102-21896	102-20135
Evergreen Funds	May 29, 2003	102-20135	105-26577
Federated Funds	January 14, 2002	105-04006	102-20135
Guardian Funds (Park Avenue Funds)	January 16, 2001	102-21896	102-20135 102-22352
John Hancock Funds	January 9, 2001	102-22352	105-32050
Loomis Sayles Funds	July 9, 2001	102-20135	102-22363
MFS Funds	June 18, 2003	105-26557	105-62350 102-22352 102-20135
Northern Funds	July 29, 2003	105-58950	102-22352 105-62350
Pimco Funds	December 12, 2000	102-22352	102-22363
Scudder Funds	August 29, 2002	102-22352	102-20135 105-26557 105-28012
Scudder Funds	September 24, 2003	105-26557	102-22352 105-59085
Seligman Funds	July 10, 2001	102-22352	105-32050
State Street Research Funds	February 11, 2002	105-21291 105-21723	105-26577 105-58950
SSGA (State Street Global Advisors) Funds	April 22, 2002	102-22352	105-26557
Wells Fargo Funds	August 1, 2003	102-20135	105-62350 105-59085