

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 8592 / July 20,2005**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 52063 / July 20, 2005**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 2407 / July 20, 2005**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 26994 / July 20, 2005**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-11987**

**In the Matter of**

**CANADIAN IMPERIAL  
HOLDINGS INC. and CIBC  
WORLD MARKETS CORP.,**

**Respondents.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT OF  
1933, SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
SECTION 203(e) OF THE INVESTMENT  
ADVISERS ACT OF 1940, AND SECTIONS  
9(b) AND 9(f) OF THE INVESTMENT  
COMPANY ACT OF 1940**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), Section 203(e) of the Investment Advisers Act of 1940 (“Advisers Act”) and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against CIBC World Markets Corp. (“World Markets”) and Canadian Imperial Holdings Inc. (“CIHI”) (collectively “Respondents”).

**II.**

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, Section 203(e) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act (“Order”), as set forth below.

### III.

On the basis of this Order and Respondents’ Offer, the Commission finds<sup>1</sup> that:

#### A. Summary

1. CIHI and World Markets, which are subsidiaries of Canadian Imperial Bank of Commerce, Inc. (“CIBC”), participated in a scheme to defraud numerous mutual funds and their shareholders through late trading and deceptive market timing.

2. More specifically, CIHI and World Markets engaged in three types of conduct that violated the federal securities laws: a) CIHI financed hedge fund customers while knowing the hedge funds would use the leverage to late trade and deceptively market time mutual funds; b) CIHI provided, and World Markets arranged, improper financing for market timing hedge fund customers in violation of the margin and extension of credit requirements; and c) a team of World Markets registered representatives (“RR”) enabled numerous customers to late trade and deceptively market time mutual funds.

3. With respect to the financing, CIHI provided funds to at least two hedge fund customers knowing those hedge funds would use the leverage to late trade and market time through Security Trust Corporation (“STC”), a Trust Company in Phoenix, Arizona. A CIHI Managing Director wrote a due diligence memorandum to CIBC’s Credit Department in which he explicitly stated that STC’s ability to allow late trades provided “significant benefits to our customers.” Moreover, in addition to late trading, numerous CIHI officials understood that the hedge funds they were leveraging, in executing their market timing strategy, had to “hide” their activity, use “stealth” tactics, and otherwise “stay under the radar” of the mutual funds. By leveraging these entities while knowing they were engaged in deceptive market timing and late trading, CIHI participated in a scheme to defraud mutual funds and their long term shareholders, thus violating the antifraud provisions of the federal securities laws.

---

<sup>1</sup> The findings herein are made pursuant to Respondents’ Offer and are not binding on any other person or entity in this or any other proceeding.

4. Moreover, CIHI provided leverage to its hedge fund customers that violated the margin requirements. CIHI financed market timing hedge funds purportedly through the use of total return swaps (“TRSs”). These TRSs were extensions of credit in excess of 50% of the margin stock’s value. Thus, CIHI violated Section 7(d) of the Exchange Act and Regulation U promulgated by the Federal Reserve Board. In addition, because World Markets helped arrange this financing, World Markets violated Section 7(c) of the Exchange Act and Regulation T promulgated by the Federal Reserve Board. Moreover, because World Markets effected transactions in mutual funds for hedge funds in connection with which it arranged this financing, World Markets violated Section 11(d) of the Exchange Act.

5. Finally, from at least 1999 until January 2003, World Markets received over 1,000 letters and emails from mutual funds complaining about abusive trading by a team of RRs at World Markets. This team of RRs, led by an RR (hereinafter described as “Broker Doe”), used, among other tactics, multiple accounts, multiple RR numbers, and small trade size broken up across related accounts to deceive mutual funds and “stay under the radar” of the mutual funds’ internal timing monitors. Senior World Markets officials knew about this team of RRs’ deceptive market timing activities and took steps to assist them, ensuring that this team of significant business producers could continue to facilitate market timing. In addition, some of these RRs knowingly accepted numerous mutual fund orders from at least one of their timing customers after 4:00 p.m. ET, and processed those orders as though the customer had placed the order prior to 4:00 p.m. ET. As a result of these acts, World Markets violated the antifraud provisions of the federal securities laws and Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act.

## **B. Respondents**

6. CIHI is a New York-based company, incorporated in Delaware, that is not registered with the Commission. It is a subsidiary of CIBC, a Canadian financial and bank holding company. CIHI financed market timing hedge funds through the use of TRSs and loans. It also supported and provided financing for customers of World Markets, the broker-dealer subsidiary of CIBC. Both CIHI and World Markets, the broker-dealer, are wholly-owned subsidiaries of CIBC. As such, CIHI is a "person . . . under common control with a broker-dealer," making it a "person associated with a broker-dealer" subject to the Commission's jurisdiction under Section 15(b)(6) of the Exchange Act. See Section 3(a)(18) of the Exchange Act.

7. World Markets is a New York-based broker-dealer subsidiary of CIBC. World Markets, through its CIBC Oppenheimer retail division, serviced high-net-worth individuals, money managers, and small corporations, including market timing hedge funds. In January 2003, World Markets sold its Oppenheimer retail division to Fahnestock & Co., Inc. (“Fahnestock”). World Markets is registered with the Commission as both a broker-dealer and investment adviser.

## **C. Facts**

## **Market Timing and Late Trading**

8. Market timing includes (a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal per se, can harm other mutual fund shareholders because it can dilute the value of their shares. Market timing can also disrupt the management of the mutual fund's investment portfolio and cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer.

9. Rule 22c-1(a) under the Investment Company Act requires investment companies issuing redeemable securities, their principal underwriters and dealers, and any person designated in the fund's prospectus as authorized to consummate transactions in securities issued by the fund to sell and redeem fund shares at a price based on the current net asset value ("NAV") next computed after receipt of an order to buy or redeem. Mutual funds generally determine the daily price of mutual fund shares as of 4:00 p.m. ET. In these circumstances, orders received before 4:00 p.m. must be executed at the price determined as of 4:00 p.m. that day. Orders received after 4:00 p.m. must be executed at the price determined as of 4:00 p.m. the next trading day.

10. "Late trading" refers to the practice of placing orders to buy or sell mutual fund shares after the time as of which a mutual fund has calculated its NAV (usually as of the close of trading at 4:00 p.m. ET), but receiving the price based on the prior NAV already determined as of 4:00 p.m. Late trading enables the trader to profit from market events that occur after 4:00 p.m. but that are not reflected in that day's price. In particular, the late trader obtains an advantage – at the expense of the other shareholders of the mutual fund – when he learns of market moving information and is able to purchase (or sell) mutual fund shares at prices set *before* the market moving information was released. Late trading violates Rule 22c-1(a) under the Investment Company Act and harms other shareholders when late trading dilutes the value of their shares.

## **CIHI Improperly Provided, and World Markets Improperly Arranged For, Credit to Their Hedge Fund Customers**

11. From 1998 to 2003, CIHI provided leverage to numerous hedge fund customers engaged in the late trading and/or market timing of mutual funds. At its height, CIHI had over \$2 billion in leveraged transactions on its books. CIHI provided this leverage through two financing vehicles, loans and TRSs.

12. Under the TRSs, both CIHI and the hedge fund would contribute money to a managed account, usually in ratios of 4:1 leverage, although in some instances this ratio was even higher. CIHI then placed the funds it contributed (i.e., 80% of the funds) ("the floating notional") as well as the funds the hedge fund customer contributed (i.e., 20% of the funds), in an account at a broker-dealer or trust company ("the managed account"). (The total amount of funds that CIHI and the customer contributed was known as the "total notional.") Although the managed accounts were in CIHI's name, and CIHI retained the power to liquidate the shares at any time, the hedge fund customer selected an investment manager to make all trading decisions.

CIBC's Credit Department had to approve these transactions. The funds in the managed accounts were invested in mutual funds with the purpose of timing those funds. World Markets effected transactions in mutual fund shares in the managed accounts. The hedge fund obtained all gains made by trading in the managed account, and the hedge fund also was required to pay for all trading losses in the managed account. In exchange, the hedge fund would pay CIHI LIBOR (e.g., interest) plus 95-205 basis points on the funds CIHI contributed to the managed account. CIHI officials acknowledged that the reason for the TRSs was to avoid the margin limitations set by applicable margin regulations.

13. Broker Doe introduced a number of his market timing customers to CIHI so that those market timing customers could obtain financing beyond what was allowed by the relevant margin regulations. When these customers entered into a purported TRS with CIHI, CIHI paid Broker Doe a referral/finders fee for this new financing business.

**CIHI Provided Financing to Hedge Fund Customers Knowing They Would Use The Leverage to Late Trade and Deceptively Market Time Mutual Funds**

14. In addition to violating the margin requirements, CIHI financed hedge funds knowing that those hedge fund customers used the leverage to late trade and deceptively market time mutual funds.

15. For example, in 2001, CIHI wanted to open managed accounts at STC on behalf of two hedge fund financing customers. The STC trading platform was designed primarily for processing trades by third party administrators for retirement plans. A CIHI Managing Director prepared a memorandum describing the "benefits" that STC provided for CIHI's market timing customers. In this memorandum, the Managing Director expressly indicated that CIHI customers will be able to submit trades for same day value to midnight [EST] based upon the published Net Asset Values ("NAVs"). The Managing Director indicated that a pricing list is prepared and submitted to customers who are then able to run their timing models against actual closing prices instead of the previous day before they submit trades. Further, the Managing Director pointed out that standard platforms required trades to be submitted before 4:00 p.m. by specific account number and broker reference.

16. The Managing Director also indicated that STC allowed customers to submit trades in a number of methods to reduce the chance that they would appear to be timing a specific mutual fund. The different types of investing were: 1) traditional account specific fund investing keeping account balances small; 2) using a number of multiple legal vehicles (i.e. different tax identification numbers) that rotate ownership of the mutual fund transferring balances between related accounts; 3) piggy backing non-12(b)1 accounts (i.e. 401K accounts) to invest in a pool of funds on a net basis as specific ownership is not known by the fund; and 4) piggy backing 12(b)1 accounts where a specific agreement is made with an RR to include the additional fund investments.

17. Thereafter, CIHI opened managed accounts at STC for both hedge fund customers, who then market timed mutual funds and submitted trades after 4:00 p.m. EST. In doing so, the hedge funds enhanced their returns with the leverage provided by CIHI.

18. CIHI was well aware that mutual funds disliked the market timing they were financing, and actively attempted to shut it down. For example, in an undated “confidential” memo entitled “Market Timing Business,” CIHI officials wrote “[t]his business has a high level of confidentiality since Mutual Fund Companies discourage the trading of their funds. Investment Advisors pay significant fees to broker/dealers due to the stealth nature of the business.” Then, arguing in favor of limited disclosure about its business, CIHI wrote, “[w]e believe our future success is directly related to keeping this information confidential given the stealth nature of the underlying investment strategy.”

19. Initially, CIHI generally opened its managed accounts for its customers at World Markets. However, “once the business grew to a certain volume” CIHI began opening managed accounts at other broker-dealers, because World Markets “could no longer ‘hide’ the market timing transactions in with normal business flow.” By opening managed accounts at other broker-dealers, CIHI’s financing customers could evade mutual funds’ efforts to block market timing coming through World Markets.

#### **CIHI Created Subsidiaries Without the “Canadian Imperial” Name to Hide Market Timing**

20. Over time, even the fact that CIHI had opened managed accounts at other broker-dealers did not prevent the “Canadian Imperial” name from becoming known to mutual funds as a notorious market timer. This was because the managed accounts at other broker-dealers were in CIHI’s name. Consequently, CIHI began looking for ways to keep the “Canadian Imperial” name off the managed accounts. It did so by creating new subsidiaries, without the “Canadian Imperial” name, to book the purported TRSs (meaning the subsidiary’s name, not CIHI, would be on the managed accounts). CIHI also created hedge funds that CIHI wholly-owned and financed but which lacked the “Canadian Imperial” name and which then entered into purported TRS transactions with CIHI’s market timing finance customers.

21. More specifically, in September 2002, CIHI officials proposed creating new subsidiaries in which to book their mutual fund timing TRSs. As a CIHI business manager explained, the new entities would be used to book the mutual fund swap business and were needed because, “we’re at a point where we need to book purchases of assets (mutual funds and annuities) in multiple vehicles in order to reduce CIHI’s ownership perception to the ‘street.’”

22. A number of senior officials who reviewed this proposal raised questions “whether we are violating any securities laws or regulations and/or running some reputational or customer-relation risk.” One even questioned “[w]hy do we want to do this in the first place? What does it mean to ‘reduce CIHI’s ownership perception to the ‘street’? Are we trying to skirt some law here?”

23. Notwithstanding these concerns, in December 2002, CIHI created two new subsidiaries, Hudson River Investments LLC (“Hudson”) and Rudy Capital USA LLC (“Rudy”). There was no doubt about the reason for their creation. According to Rudy’s “Company Description,”

The purpose of the entity was to expand the existing mutual fund swap activity business conducted by the Equity Arbitrage desk in New York. [i.e. CIHI] Due to the size of the book in CIHI, it was deemed necessary to book the purchase of mutual funds to reduce CIHI’s perception to the street. There was concern that with the growth of this business, fund managers may exercise their right to turn us away because of the size of our positions as well as the number of transactions. Rudy Capital would help us to reduce perception to the street and potential fund manager resistance.

24. Nevertheless, one problem remained: CIHI had formed both Rudy and Hudson as single member LLC’s, and therefore these entities retained the tax identification number of the single member, which in this instance was CIHI. Mutual funds could (and did) block excessive trading based on tax identification number, and more importantly, many mutual funds already knew CIHI’s tax identification number. Thus, CIHI obtained a new tax identification number for both Rudy and Hudson. Despite the separate tax identification numbers, neither Rudy nor Hudson filed separate tax returns during this time. Rather, CIHI’s tax returns reported both entities’ tax information.

25. Thereafter, CIHI entered into one TRS with a market timing hedge fund, and then did a back-to-back TRS with Rudy. This enabled the managed accounts to be in Rudy’s name. The hedge fund then used this leverage to market time mutual funds.

#### **CIHI Created Hedge Funds Without the “Canadian Imperial” Name**

26. In addition to its subsidiaries Rudy and Hudson, CIHI also created at least two hedge funds, Emu Capital (“Emu”) and Miura Capital (“Miura”), as a way to avoid having the “Canadian Imperial” name on the managed accounts. In the Emu deal, CIHI purchased shares of Emu Capital, set up specifically for the transaction. CIHI funded the purchase of the hedge fund with 80% of its own funds and 20% of its hedge fund customer’s funds. CIHI and its customer then entered into a purported TRS on the returns Emu generated. The customer chose Emu’s portfolio manager and bore the risk and benefits of the market timing strategy, while CIHI received a fixed funding fee. Then Emu, a wholly-owned subsidiary of CIHI, invested in mutual funds pursuant to its portfolio manager’s market timing strategy. The mutual funds were purchased in the name of Emu rather than in the name of CIHI or CIBC.

27. CIHI structured the Miura deal similarly. Specifically, CIHI entered into a purported TRS with a hedge fund customer on the total returns of market timing activity done by Miura, a hedge fund CIHI owned, but whose trading and investment strategies the customer directed. As in the Emu deal, this allowed the customer to enjoy the risk and benefits of a

leveraged market timing strategy without having either its name or the name of CIHI or CIBC associated with the trading.

### **World Markets Enabled Its Customers to Deceptively Market Time and Late Trade Mutual Funds**

28. World Markets, through a team of RRs led by Broker Doe, and their managers and supervisors, actively assisted market timing customers in deceiving mutual funds. World Markets received over 1,000 letters and emails from mutual funds notifying World Markets and Broker Doe's team of RRs that their customers' market timing trading activities violated the terms of the mutual funds' prospectuses and otherwise harmed the funds' performance and other shareholders. The RRs, however, repeatedly ignored these letters and emails, and continued to work with timers up until the point when mutual funds threatened to terminate their dealer agreements with World Markets. Even then, Broker Doe's team of RRs did not always stop, resulting in mutual funds terminating their dealer agreement with World Markets or refusing to accept any trades from the branch office to which Broker Doe was assigned.

29. Broker Doe's team of RRs used the following deceptive practices on behalf of their customers: (1) they accepted mutual fund orders after 4:00 pm EST with the understanding that those trades would be entered to receive that day's NAV; (2) after mutual funds had blocked trading by certain customer accounts, the RRs opened new accounts for those customers so they could continue to market time the mutual funds that had previously blocked them; (3) because mutual funds sometimes blocked certain RRs because their customers timed the funds, the RRs created new RR numbers to disguise their identity and the identity of their customers; (4) they broke up trades into smaller amounts so that mutual funds would not detect the customers' trading activity; (5) they used annuities to market time mutual funds; and (6) they used other broker-dealers that had other trading platforms, such as Charles Schwab & Co., Inc. ("Schwab") and FMR Corp. ("Fidelity"), to continue market timing mutual funds that had blocked their customers' trading through World Markets.

30. Specifically, from at least August 2001 to November 2002, RRs in Broker Doe's group took trades from one market timing customer after 4:00 pm EST, with the understanding that those trades would receive that day's NAV. Typically, the customer would fax its proposed trades to the RRs before the market closed. Thereafter, the customer would call and instruct the RRs whether or not to execute the proposed trades. Many of these calls occurred after 4:00 pm, allowing the customer to observe the after-hours markets. Moreover, the RRs sometimes cancelled those trades after 4pm at the request of one of their market timing customers.

31. World Markets could not locate trading spreadsheets that the aforementioned customer sent in 2002. World Markets treated these spreadsheets as order tickets. These spreadsheets were books and records that World Markets, as a broker-dealer, was required to make and keep current.

32. The RRs' market timing business was well known to upper level management at World Markets. Indeed, World Markets' management made Broker Doe's team of RRs the only



group of RRs permitted to engage in the market timing business. At various times thereafter, World Markets' management reprimanded other RRs trying to market time on behalf of their customers, noting such behavior was the exclusive purview of Broker Doe and his team.

33. Additionally, after a mutual fund had blocked a particular customer account because it was engaged in market timing, Broker Doe and his team of RRs opened additional accounts for the customer to disguise the identity of the account holder so that the customer could continue to market time that same fund. For example, between November 13, 2001 and November 27, 2001, Broker Doe and his team of RRs timed one mutual fund through two brokerage accounts for the same customer. On November 28, 2001, the mutual fund contacted World Markets to block those accounts due to "a pattern of excessive trading." To evade those trading restrictions, between December 4, 2001 and December 6, 2001, Broker Doe and his team of RRs timed the same mutual fund in eight different accounts for the same customer. On December 7, 2001, the fund blocked those eight accounts, again due to "excessive trading." Finally, to evade the November and December blocks, on December 14, 2001, Broker Doe and his team of RRs traded the mutual fund in two more accounts for the same customer, which led the mutual fund to ultimately block these two new accounts from further trading as well.

34. Broker Doe's team also used multiple RR numbers to deceive mutual funds about the source of market timing trades. Mutual funds often identified abusive market timing through the RRs who facilitated this trading. Using alternative RR numbers allowed the RRs to "disguise" their identity and fool the mutual funds into believing that the fund had not previously blocked the RR, and his customers, from abusive trading. This became increasingly important as Broker Doe's team's business grew and mutual funds began to identify their RR numbers as the source of abusive trading. All told, Broker Doe and his group had over 50 individual or shared RR numbers at World Markets.

35. Broker Doe also traded in small dollar amounts to stay "under the radar screen" of the mutual funds. Broker Doe opened multiple accounts for his timing customers in order to spread timing money across multiple accounts, instead of trading one large lump sum, which would surely be a "red flag" to mutual funds.

36. World Markets Mutual Fund Operations Department was well aware that Broker Doe's team used multiple accounts as a deceptive device. For example, one RR wrote to the Mutual Fund Operations Department concerning identical trades in multiple customer accounts. Apologizing for the increased work these trades were causing the Mutual Fund Operations Department, the RR wrote, "We obviously aren't purposefully trying to create more work for you guys by splitting these trades up. We are trying to break them up so the fund companies do not think these are market timing accounts, even though they are." The Director of Mutual Fund Operations replied, "I understand your methods."

37. Similarly, World Markets' Head of Private Client Services knew that Broker Doe's team used multiple accounts to deceive mutual funds. In June 2002, one RR emailed the Head of Private Client Services asking for a lower margin rate for a customer, explaining, "[t]here are three accounts (even though it is the same customer) that add up to approx. \$4,300,000. The reason they

have three separate accounts is to stay under the radar with the mutual fund companies, otherwise it is the same entity.” (emphasis added) Satisfied with the explanation, this senior official approved the lower margin rate.

38. Broker Doe also used platforms at other broker-dealers as a way to deceive mutual funds. Specifically, Broker Doe and his team opened accounts at Fidelity and Schwab on behalf of his market timing customers as another means of evading mutual fund blocks. Specifically, after mutual funds had repeatedly blocked certain customers’ trading through World Markets, Broker Doe and his team directed their customers’ trades through accounts they opened at Schwab and Fidelity so that the mutual funds would not immediately identify the customer as the same abusive market timer who traded through World Markets. Upper management at World Markets, including the Head of Financial Services and Head of Private Client Services, knew that Broker Doe had opened these accounts at Schwab and Fidelity to continue timing funds that had previously blocked or rejected Broker Doe’s customers’ trades.

39. For example, after a mutual fund objected to Broker Doe’s timing for a customer through World Markets, Broker Doe and his team directed the customer’s market timing through Schwab. The same mutual fund, however, then detected market timing through the Schwab platform and determined that the trading was done by Broker Doe and his customer. The mutual fund then contacted World Markets about its discovery. Upon learning that their trading through Schwab had been detected, the Head of Financial Services emailed the Head of Private Client Services, telling him that the fund’s discovery “proves that the Schwab account isn’t as concealing as we think.” (emphasis added) The next day, upon learning of trading in the fund through Schwab, Broker Doe’s Branch Manager wrote the Head of Private Client Services, “so much for stealth trading.” (emphasis added) Despite these emails, Broker Doe and his customers continued to use Schwab and Fidelity to market time mutual funds.

40. At Broker Doe’s request, World Markets also established numerous selling agreements with mutual fund families that previously had no relationship with CIBC. World Markets understood that Broker Doe wanted these agreements so that his team’s customers could then time these funds – and that is precisely what they did.

41. Moreover, in some of the selling agreements themselves, World Markets made representations that its RRs did not provide market timing services to its customers. For example, in the agreement allowing World Markets to sell one particular fund, when asked “does your firm employ market timing services or utilize a market timing strategy,” World Markets responded “No.” That response was false. Moreover, World Markets obtained the dealer agreement with this fund specifically at Broker Doe’s request.

42. On at least three other occasions, World Markets also lied to mutual funds that had complained about Broker Doe’s market timing activity. In each email, World Markets’ management assured the complaining mutual fund that “[e]ngaging in market timing practices is not a business we condone nor support.” (emphasis added) In response to one such email, Broker Doe’s Branch Manager called the author a “kiss a\*\*,” [*sic*] who replied, “whatever it takes my friend....whatever it takes.” In another example, the Director of Mutual Fund

Operations responded, “You really are a salesman.....” The author replied, “i do what i can.....just another case of promising the firm’s ‘first born’ for the ‘privilege’ of doing business!” [sic]

43. World Markets also approved Broker Doe and his team’s use of annuities as another vehicle in which to market time mutual funds. World Markets’ management was fully aware that Broker Doe used annuities as an additional platform in which to engage in market timing for his customers, and that variable annuity companies, like mutual funds, did not like it.

44. Broker Doe’s customers used annuities to stay under the radar of mutual fund companies. For example, in an October 2001 email relaying that they had successfully stayed off the timing reports of one annuity firm, Broker Doe exhorted his team to “stay on top of why and how to keep under the radar [and] don’t get lazy penetrate more.” One way they did so was to have their customers create separate legal entities, akin to subsidiaries, to create additional avenues for trading. For example, one customer created numerous affiliated entities so that when an annuity company stopped trading by one entity, the customer could resume trading using a “new” entity. This customer did so after an RR in Broker Doe’s group recommended this strategy.

#### **Although the Market Timing and Late Trading was Profitable for CIHI and World Markets, It Harmed Mutual Funds and Their Shareholders**

45. CIHI and World Markets profited from their market timing businesses. For example, CIHI grossed approximately \$43 million over five years in the form of interest on its financing (both swaps and loans) of market timing hedge fund customers. World Markets earned approximately \$28 million in the form of wrap fees paid by its market timing hedge fund customers. World Markets also received millions in 12b-1 fees from the mutual funds that were timed by its hedge fund customers. Moreover, numerous mutual funds and their shareholders suffered hundreds of millions of dollars in dilutive harm caused by the late trading and abusive market timing trading done by customers and CIHI and World Markets.

#### **D. Legal Section: CIHI and World Markets Violated Numerous Provisions of the Federal Securities Laws**

##### **CIHI Violated the Securities Laws**

46. As a result of the conduct described above, CIHI willfully violated Section 17(a) of the Securities Act. Section 17(a) of the Securities Act makes it unlawful for any person in the offer or sale of securities to employ any device, scheme or artifice to defraud; to obtain money by means of any untrue statement or omission of material fact; or to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser. CIHI actively participated in a fraudulent scheme by financing hedge fund customers knowing those hedge funds would use CIHI’s financing to deceptively market time and late trade mutual funds. Moreover, CIHI went to great lengths to hide CIHI’s and its customers’ market timing activities. For example, CIHI created seemingly unaffiliated subsidiaries and hedge funds in whose name

managed accounts were opened, enabling CIHI's customers to hide their association with CIHI and continue to market time mutual funds. CIHI also provided financing to customers knowing that managed accounts CIHI established would (and did) late trade mutual funds.

47. As a result of the conduct described above, CIHI willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit, in connection with the purchase or sale of securities, the use of any manipulative or deceptive device, including any device, scheme or artifice to defraud; making any untrue statement of material fact or omitting to state a material fact when doing so makes the statement made misleading; or engaging in any act, practice or course of business which operates or would operate as a fraud. CIHI actively participated in a fraudulent scheme by financing hedge fund customers knowing those hedge funds would use CIHI's financing to deceptively market time and late trade mutual funds. Moreover, CIHI went to great lengths to hide CIHI's and its customers' market timing activities. For example, CIHI created seemingly unaffiliated subsidiaries and hedge funds in whose name managed accounts were opened, enabling CIHI's customers to hide their association with CIHI and continue to market time mutual funds. CIHI also provided financing to customers knowing that managed accounts CIHI established would (and did) late trade mutual funds.

48. As a result of the conduct described above, CIHI willfully aided and abetted and caused violations of Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act, which requires certain mutual funds, persons designated in such issuers' prospectuses as authorized to consummate transactions in any such security, their principal underwriters, or dealers in the funds' securities, to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to buy or redeem. Specifically, CIHI financed certain customers, and opened managed accounts at STC for certain customers, knowing those customers would (and did) use CIHI's financing to late trade mutual funds. In doing so, CIHI substantially assisted violations of Rule 22c-1.

49. As a result of the conduct described above, CIHI willfully violated Section 7(d) of the Exchange Act and Regulation U promulgated by the Federal Reserve Board., which prohibits, *inter alia*, the unlawful extension of credit. Regulation U prohibits a person other than a broker-dealer (i.e., a lender) from extending credit for the purpose of buying or carrying margin stock if the credit is secured directly or indirectly by margin stock, in an amount that exceeds the maximum loan value of the margin stock, which is 50% of its current market value. As noted above, CIHI extended credit to hedge fund customers in excess of 50% of the margin stock's value through what it characterized as TRSs to market time mutual funds.

### **World Markets Violated the Securities Laws**

50. As a result of the conduct described above, World Markets willfully violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer and sale of securities. Section 17(a) of the Securities Act makes it unlawful for any person in the offer or sale of securities to employ any device, scheme or artifice to defraud; to obtain money by means of any untrue statement or omission of material fact; or to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser. World Markets

participated in a scheme to defraud mutual funds and their shareholders by using multiple deceptive devices to facilitate its customers' market timing and late trading of mutual funds. More specifically, after mutual funds blocked customers' market timing trading, World Markets' RRs created new accounts for their customers, created new RR numbers, and used platforms at other broker-dealers to deceive mutual funds about the source of their customers' market timing trading, and the activities of its customers. World Markets also took numerous trades from one market timing customer after 4:00 p.m. EST, and then submitted those orders as though the customer had placed the order prior to 4:00 p.m. ET., thereby ensuring those trades received that day's NAV. In doing so, World Markets harmed the mutual funds and their remaining shareholders by diluting the mutual funds' next day NAV.

51. As a result of the conduct described above, World Markets willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit, in connection with the purchase or sale of securities, the use of any manipulative or deceptive device, including any device, scheme or artifice to defraud; making any untrue statement of material fact or omitting to state a material fact when doing so makes the statement made misleading; or engaging in any act, practice or course of business which operates or would operate as a fraud. World Markets engaged in a fraudulent scheme by using multiple deceptive devices to facilitate its customers' market timing and late trading of mutual funds. More specifically, after mutual funds blocked customers' market timing trading, World Markets' RRs created new accounts for their customers, created new RR numbers, and used platforms at other broker-dealers to deceive mutual funds about the source of their customers' market timing trading, and the activities of its customers. World Markets also took numerous trades from one market timing customer after 4:00 pm EST, and then submitted those orders as though the customer had placed the order prior to 4:00 p.m. ET., thereby ensuring those trades received that day's NAV. In doing so, World Markets harmed the mutual funds and their remaining shareholders by diluting the mutual funds' next day NAV.

52. As a result of the conduct described above, World Markets willfully violated Section 15(c) of the Exchange Act and Rule 10b-3 thereunder, which prohibit broker-dealers from effecting transactions in, or inducing or attempting to induce, the purchase or sale of securities (other than on a national securities exchange of which it was a member) by means of a manipulative, deceptive, or other fraudulent device or contrivance. World Markets effectuated transactions in the purchase or sale of securities using fraudulent devices to hide its customers' market timing and late trading of mutual funds in funds with which it had Dealer Agreements. More specifically, after mutual funds blocked customers' market timing trading, World Markets' RRs created new accounts for their customers, created new RR numbers, and used platforms at other broker-dealers to deceive mutual funds about the source of their customers' market timing trading, and the activities of its customers. World Markets also took numerous trades from one market timing customer after 4:00 pm EST, and then submitted those orders as though the customer had placed the order prior to 4:00 p.m. EST., thereby ensuring those trades received that day's NAV. In doing so, World Markets harmed the mutual funds and their remaining shareholders by diluting the mutual funds' next day NAV.

53. As a result of the conduct described above, World Markets willfully violated Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act, which requires certain

mutual funds, persons designated in such issuers' prospectuses as authorized to consummate transactions in any such security, their principal underwriters, or dealers in the funds' securities, to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to buy or redeem. World Markets, by virtue of dealer agreements with the mutual funds, was a dealer within the meaning of Rule 22c-1. World Markets, through RRs in Broker Doe's team, accepted and executed trades after the close of the United States equity markets at a price other than the current NAV which was next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security. As a result of the conduct described above, World Markets willfully violated Rule 22c-1 under the Investment Company Act.

54. As a result of the conduct described above, World Markets willfully violated Section 7(c) of the Exchange Act and Regulation T promulgated by the Federal Reserve Board, which prohibits the unlawful extension of credit to customers. Regulation T governs the extension of credit by broker-dealers. Regulation T also prohibits broker-dealers from willfully arranging the extension of credit that violates the limitations set forth in Regulation U. World Markets violated Regulation T because Broker Doe and his team "arranged" for CIHI to extend credit to World Markets' customers that violated Regulation U.

55. As a result of the conduct described above, World Markets willfully violated Section 11(d) of the Exchange Act, which prohibits any broker-dealer from effecting a transaction in which it has, among other things, arranged for the direct or indirect extension of credit on any security (other than an exempted security) which was a part of a new issue in the distribution of which it participated as a member of a selling syndicate or group within 30 days prior to the transaction. Because open-ended mutual fund shares are continuously in distribution, they are considered a "new issue." Rule 11d1-2 permits a broker-dealer to extend, maintain, or arrange for the extension or maintenance of credit on mutual fund shares if the customer has owned the securities for at least thirty days. Thus, in order for a broker-dealer's arranging for the extension of credit in connection with the purchase of mutual fund shares to be proper, the shares must have been held by the buyer for thirty days prior to the extension of credit. World Markets, while acting as a broker-dealer, arranged for the extension of credit to customers that had held the subject mutual fund shares for less than 30 days prior to the credit extension (indeed, the mutual funds shares were not purchased through World Markets until after the extension of credit). In so doing, World Markets violated Section 11(d)(1) of the Exchange Act.

56. As a result of the conduct described above, World Markets willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, which require registered brokers and dealers to make and keep current specified books and records. World Markets could not locate trading spreadsheets that a certain customer sent in 2002. World Markets treated these spreadsheets as order tickets under Rule 17a-3(a)(6). Whether executed or not, these spreadsheets were books and records that World Markets, as a broker-dealer, was required to maintain. Thus, World Markets' failure to make and keep current order tickets violated Rule 17a-3.

**E. Respondents Remedial Efforts**

57. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondents and cooperation afforded the Commission staff by Respondents during its investigation. This cooperation included conducting an independent internal investigation, sharing the results of that investigation with the Commission's staff, and obtaining the resignations of certain supervisory personnel and others.

**F. Undertakings**

Respondents undertake to:

58. Ongoing Cooperation. Respondents shall cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, Respondents have undertaken:

- a. To produce, without service of a notice or subpoena, any and all documents and other information requested by the Commission's staff;
- b. To use its best efforts to cause their employees to be interviewed by the Commission's staff at such times as the staff reasonably may direct;
- c. To use its best efforts to cause their employees to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and
- d. That in connection with any testimony of Respondents to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, Respondents:
  - i. Agree that any such notice or subpoena for Respondents' appearance and testimony may be served by regular mail on their attorney, Weil, Gotshal & Manges, 767 Fifth Avenue, New York, NY 10153, attn: Jonathan Polkes, Esq.; and
  - ii. Agree that any such notice or subpoena for Respondents' appearance and testimony in an action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure.

**Independent Distribution Consultant**

59. Respondents shall retain, within 60 days of the date of entry of this Order, the services of an Independent Distribution Consultant not unacceptable to the staff of the Commission. The Independent Distribution Consultant's compensation and expenses shall be

borne exclusively by Respondents. Respondents shall cooperate fully with the Independent Distribution Consultant and shall provide the Independent Distribution Consultant with access to their files, books, records, and personnel as reasonably requested for the review.

60. Respondents shall require that the Independent Distribution Consultant develop a Distribution Plan for the distribution of the \$125 million in disgorgement and penalty, and any interest or earnings thereon, according to a methodology developed in consultation with Respondents and acceptable to the staff of the Commission.

61. Respondents shall require that the Independent Distribution Consultant submit a Distribution Plan to Respondents and the staff of the Commission no more than 150 days after the date of entry of this Order.

62. The Distribution Plan developed by the Independent Distribution Consultant shall be binding unless, within 180 days after the date of entry of the Order, Respondents or the staff of the Commission advises, in writing, the Independent Distribution Consultant of any determination or calculation from the Distribution Plan that it considers to be inappropriate and states in writing the reasons for considering such determination or calculation inappropriate.

63. With respect to any determination or calculation with which Respondents or the staff of the Commission do not agree, such parties shall attempt in good faith to reach an agreement within 210 days of the date of entry of this Order. In the event that Respondents and the staff of the Commission are unable to agree on an alternative determination or calculation, the determinations and calculations of the Independent Distribution Consultant shall be binding.

64. Within 225 days of the date of entry of this Order, Respondents shall require that the Independent Distribution Consultant submit the Distribution Plan for the administration and distribution of disgorgement and penalty funds pursuant to Rule 1101 [17 C.F.R. § 201.1101] of the Commission's Rules Regarding Disgorgement and Fair Fund Plans. Following a Commission order approving a final plan of disgorgement, as provided in Rule 1104 [17 C.F.R. § 201.1104] of the Commission's Rules Regarding Disgorgement and Fair Fund Plans, Respondents shall require that the Independent Distribution Consultant, with Respondents, take all necessary and appropriate steps to administer the final plan for distribution of disgorgement and penalty funds.

65. Respondents shall require that the Independent Distribution Consultant, for the period of the engagement and for a period of two years from completion of the engagement, not enter into any employment, consultant, attorney-customer, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Respondents shall require that any firm with which the Independent Distribution Consultant is affiliated in performance of his or her duties under this Order not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-customer, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.



66. For good cause shown, and upon receipt of a timely application from the Independent Distribution Consultant or Respondents, the Commission's staff may extend any of the procedural dates set forth above.

#### IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b)(6) and 21C of the Exchange Act and Sections 9(b) and 9(f) of the Investment Company Act against CIHI, and pursuant to Section 8A of the Securities Act, Sections 15(b)(4) and 21C of the Exchange Act, Section 203(e) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act, against World Markets, it is hereby ORDERED that:

A. Respondents shall pay, on a joint and several basis, disgorgement and prejudgment interest in the amount of \$100 million, and a civil money penalty in the amount of \$25 million, for a total payment of \$125 million;

B. Respondent CIHI shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Sections 7(d) and 10(b) of the Exchange Act and Rule 10b-5 thereunder, Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act of 1940, and Regulation U promulgated by the Federal Reserve Board regarding the extension of margin credit;

C. Respondent World Markets shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Sections 7(c), 10(b), 11(d), 15(c) and 17(a) of the Exchange Act and Rules 10b-3, 10b-5, and 17a-3 thereunder, Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act of 1940, and Regulation T promulgated by the Federal Reserve Board regarding the extension of margin credit;

D. Respondents shall, within 30 days of the entry of this Order, pay on a joint and several basis, disgorgement and prejudgment interest in the total amount of \$100 million, and civil money penalties in the amount of \$25 million, for a total payment of \$125 million, to the United States Treasury. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) wired, hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies CIHI and World Markets as Respondents in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Mark K. Schonfeld, Regional Director, Division of Enforcement, Securities and Exchange Commission, Northeast Regional Office, 3 World Financial Center, New York, NY, 10281.

E. There shall be, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund established for the funds described in Section IV.A and D ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that they shall not, after offset or reduction in any Related Investor Action based on Respondents' payment of disgorgement in this action, argue that they are entitled to, nor shall they further benefit by offset or reduction of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in this Order instituted by the Commission in this proceeding.

F. Respondents shall comply with the undertakings enumerated in paragraphs 59-66 above.

By the Commission.

Jonathan G. Katz  
Secretary