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8 **UNITED STATES DISTRICT COURT**
9 **DISTRICT OF ARIZONA**

10
11 **SECURITIES AND EXCHANGE**
COMMISSION,

12 Plaintiff,

13 v.

14 **SECURITY TRUST COMPANY,**
15 **N.A., GRANT D. SEEGER,**
WILLIAM A. KENYON, and
16 **NICOLE MCDERMOTT,**

17 Defendants.

Case No.

COMPLAINT FOR VIOLATIONS
OF THE FEDERAL SECURITIES
LAWS

18
19 Plaintiff Securities and Exchange Commission ("Commission")
20 alleges as follows:

21 **JURISDICTION AND VENUE**

22 1. This Court has jurisdiction over this action pursuant to
23 Sections 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933
24 ("Securities Act"), 15 U.S.C. §§ 77t(b), 77t(d)(1) & 77v(a), Sections
25 21(d)(1), 21(d)(3)(A), 21(e) and 27 of the Securities Exchange Act of
26 1934 ("Exchange Act"), 15 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e) &
27 78aa, and Sections 42(d), 42(e)(1) and 44 of the Investment Company Act
28 of 1940 ("Investment Company Act"), 15 U.S.C. §§ 80a-41(d),
80a-41(e)(1) & 80a-43. Defendants have, directly or indirectly, made use

1 McDermott, knew that the hedge funds were not a TPA or a retirement
2 plan account. The mutual funds expected that retirement plans and their
3 TPAs required several hours after the market closed to process trades
4 submitted by thousands of plan participants before market close, but the
5 hedge funds had no such business purpose for submitting their own trades
6 as late as five hours after market close.

7 5. In addition to late trading, defendants also assisted the hedge
8 funds in various strategies -- some devised by Seeger -- to conceal their
9 market-timing activities from mutual funds, including misrepresenting
10 that the hedge funds were retirement accounts, allowing the hedge funds
11 to trade in accounts marked with STC's tax identification number, and
12 "piggybacking" the hedge funds' timing trades on the trades of other STC
13 clients without their knowledge.

14 6. Late trading allowed the hedge funds to trade mutual fund
15 shares at the established 4:00 p.m. EST market close price based upon
16 events reported after close of the market or perceived market momentum
17 caused by after-hours trading. Market timing allowed the hedge funds to
18 engage in short-term trading that exploited inefficiencies in mutual fund
19 pricing. As a result of the late trading and market timing activities
20 facilitated by defendants, the hedge funds realized a profit of
21 approximately \$85 million. STC had a compensation arrangement with
22 the hedge funds that included a custodial fee as large as 1% (STC charged
23 most of its TPA clients a custodial fee of just .10%) and a 4% profit
24 sharing arrangement with respect to most of the hedge funds' trades. STC
25 received over \$5.8 million in direct compensation from the hedge funds.
26 Late trading and market timing harmed mutual fund shareholders who did
27 not participate in the scheme between STC and the hedge funds.

28 7. The Commission seeks to enjoin the individual defendants

1 from future violations of the federal securities laws alleged herein, and
2 seeks from all defendants to obtain civil money penalties for defendants'
3 violations, obtain disgorgement of all benefits received by defendants,
4 and require defendants to provide an accounting of their compensation
5 related to STC's improper late trading and market timing conduct.

6 **THE DEFENDANTS**

7 8. Security Trust Company, N.A., based in Phoenix, Arizona, is
8 an uninsured national banking association that provides trust and
9 custody-related services to high net-worth individuals, private trusts and
10 entities, and retirement plans and their administrators. STC does not hold
11 deposits, is not a public company and is not registered with the
12 Commission in any capacity. As of August 31, 2003, STC reported that it
13 had \$12.9 billion in assets under administration.

14 9. Grant D. Seeger, 40, resides in Phoenix, Arizona. He served
15 as STC's Chief Executive Officer from 1998 until his resignation on
16 October 5, 2003. Seeger established the relationship with the hedge
17 funds, negotiated higher fees for STC, and facilitated the late trading and
18 market timing schemes by, among other things, directing STC employees
19 to treat the hedge funds as a retirement plan and devising some of the
20 strategies used by the hedge funds to conceal their market timing trades.

21 10. William A. Kenyon, 57, resides in or near Phoenix, Arizona.
22 He served as STC's President from 1998 until his termination in October
23 2003. As STC's President, Kenyon oversaw all STC business units
24 involved in trading by the hedge funds, including trading, technology,
25 data management, and mutual fund services. Kenyon supervised the key
26 operational departments and personnel involved in effecting the hedge
27 funds' trades and, despite receiving complaints from employees about the
28 frequency and impropriety of those trades, permitted employees to

1 continue the improper activity. Kenyon acted recklessly by failing to
2 heed numerous red flags presented to him by STC employees.

3 11. Nicole McDermott, 34, resides in or near Phoenix, Arizona.
4 She was employed by STC from February 2000 until her termination in
5 October 2003. At the time of her termination, she was STC's Senior Vice
6 President for Corporate Services. As Senior Vice President, McDermott
7 supervised the employees who managed STC's client relationships and
8 STC's trading department, and she had daily meetings with Seeger and
9 occasional direct contact with the hedge funds. McDermott, as STC's
10 most senior operational manager, both performed and directed several
11 STC employees to perform tasks that enabled the hedge funds to conduct
12 late trading and market timing through STC.

13 RELATED ENTITIES

14 12. Canary Capital Partners, LLC, is a domestic hedge fund, and
15 Canary Capital Partners, Ltd., is an offshore hedge fund domiciled in
16 Bermuda, managed by an investment adviser, Canary Investment
17 Management, LLC, and its principal, Edward J. Stern. Hartz Trading,
18 Inc., is an entity formed by Stern and affiliated with the various Canary
19 funds. The foregoing entities are collectively referred to herein as "the
20 hedge funds."

21 THE FRAUDULENT SCHEME

22 A. STC Develops a Trade Processing Platform for TPAs of 23 Retirement Plans

24 13. In 1991, Seeger formed STC's predecessor, Security
25 Investment Management & Trust, to engage in securities sales to private
26 custodial accounts. In 1998, Seeger shifted STC's business to serving as
27 a custodian for retirement plans and their third party administrators, or
28 TPAs. At that time, STC developed an electronic trading platform that

1 allows retirement plan participants to trade multiple mutual funds in a
2 single day. The platform relies on STC's access to an interface sponsored
3 by the National Securities Clearing Corporation ("NSCC") that enabled
4 simultaneous trading in thousands of mutual funds through an NSCC
5 subsidiary corporation known as Defined Contribution Clearance &
6 Settlement. STC's platform was designed primarily for processing trades
7 made by TPAs.

8 14. STC's trade processing for TPAs involves several steps.
9 First, retirement plan sponsors collect orders for the purchase and sale of
10 mutual fund shares from plan participants during the day and then shut
11 off the participants' ability to enter trading orders at 4:00 p.m. EST, when
12 the markets close. Next, by approximately 6:30 p.m. EST, STC provides
13 its TPA clients with a file showing that day's net asset value or "NAV"
14 for all mutual funds that can be traded through its platform. TPAs then
15 create a trade file listing the trades for all plan participants and deliver
16 this file electronically to STC by approximately 9:00 p.m. EST. STC
17 processes these files through internal, proprietary databases and sends
18 them electronically to NSCC in a single, consolidated file. NSCC then
19 executes and settles the trades with the various mutual funds, and
20 provides confirmations to STC that are forwarded to the TPAs.

21 **B. The STC-Hedge Fund Relationship**

22 15. In April 2000, the hedge funds contacted Seeger with the
23 hope that STC would provide them with market timing capacity. During
24 due diligence discussions, representatives of the hedge funds explained
25 the hedge funds' business in detail to Seeger, including the fact that the
26 hedge funds were hedge funds and were engaged in market-timing
27 activities. McDermott, as a member of an internal STC committee that
28 approved all new business and from discussions with Seeger, learned that

1 the hedge funds were not a TPA. Therefore, STC, Seeger, and
2 McDermott all knew from the beginning that the hedge funds were a
3 private investment vehicle and not a retirement plan or a TPA.

4 **C. Late Trading**

5 16. "Late trading" refers to the practice of placing orders to buy
6 or sell mutual fund shares after close of market at 4:00 p.m. EST, but at
7 the mutual fund's NAV, or price, determined at the market close. Late
8 trading enables the trader to profit from market events that occur after
9 4:00 p.m. EST but that are not reflected in that day's price.

10 17. In early discussions with STC, the hedge funds learned that
11 they could submit trades through STC as late as 9:00 p.m. EST and still
12 receive that day's NAV for the mutual funds traded because of STC's
13 trade processing procedures for TPAs. Seeger specifically confirmed this
14 fact to the hedge funds.

15 18. In May 2000, the hedge funds opened several accounts at
16 STC to test their ability to trade through STC's platform. Seeger and
17 McDermott directed STC employees to treat the hedge funds just like a
18 TPA for a retirement plan. As a result, on account applications to mutual
19 funds, which required STC to describe the hedge funds, STC employees
20 represented that the hedge funds were a defined contribution plan. STC
21 further represented the hedge funds to be a defined contribution plan
22 when coding trades that STC sent to the NSCC, which settled mutual
23 fund trades made through STC. These material representations were false
24 and misleading. McDermott, Kenyon, and STC employees involved in
25 administering the hedge funds' accounts knew that the hedge funds were
26 not a TPA and that their trades did not involve retirement or defined
27 contribution plans. Employees understood the hedge funds to be a
28 "family account," a "hedge fund," or a "private investment manager."

1 19. From May 31, 2000 to July 10, 2003, the hedge funds
2 effected mutual fund trades at STC in 397 mutual funds through 22
3 master accounts and 136 sub-accounts. Approximately 99% of these
4 trades were sent to STC after 4:00 p.m. EST, and 82% were sent between
5 6:00 p.m. EST and 9:00 p.m. EST. The hedge funds used the late trading
6 capability provided by STC by preparing proposed trade orders during the
7 day, and then making adjustments to the orders at around 4:30 p.m. EST
8 and again at 6:30 p.m. EST based on after-hours trading data. The hedge
9 funds would occasionally wait to finalize and send their trade file to STC
10 until the last minute (i.e., just before 9:00 p.m. EST) in case any
11 additional potentially market-moving news came out.

12 20. In October 2000, an STC employee raised the issue of the
13 hedge funds' late trading through STC with Seeger, Kenyon and
14 McDermott and questioned whether the "SEC wouldn't have a problem
15 with our trading practices." A short time later, STC obtained an
16 addendum to its Custody Agreement with the hedge funds. The
17 addendum, which was no more than an effort to shield STC, indicated
18 that "all Instructions delivered to Security Trust Company on any
19 Business Day shall have been received by [the hedge funds] from the
20 Client-Shareholder by the close of trading (currently 4:00 p.m. EST)."
21 However, this did not occur until October 2000 and did not apply to the
22 hedge funds because, unlike a TPA collecting orders from retirement plan
23 participants, the hedge funds themselves (and not a purported "client-
24 shareholder") were the ultimate decision-maker on their trades. Seeger,
25 Kenyon and McDermott knew that the hedge funds were not a retirement
26 plan or TPA and had no basis to believe that the addendum applied to the
27 hedge funds or would eliminate late trading by the hedge funds.
28 Defendants knew or were reckless in not knowing that the hedge funds

1 made trading decisions well after market close. Neither Seeger, Kenyon,
2 nor McDermott took any further action to prevent further late trading or
3 to investigate whether the hedge funds continued to effect late trades
4 through STC.

5 **D. Market Timing**

6 21. "Market Timing" refers to the practice of short term buying
7 and selling of mutual fund shares in order to exploit inefficiencies in
8 mutual fund pricing.

9 22. STC's trading platform not only enabled the hedge funds to
10 conduct late trading but also facilitated their market timing activities.
11 Mutual funds often attempt to deter, police, or forbid market timing, but
12 during its three-year relationship with the hedge funds, STC employed
13 various methods to attempt to conceal the hedge funds' market timing
14 activity from the mutual fund families. Seeger devised several of the
15 methods STC used to conceal the market timing activity. Each of the
16 methods of concealment was materially false and misleading. McDermott
17 was intimately familiar with those methods and helped to implement
18 some of them.

19 23. The first method, employed immediately when the hedge
20 funds became STC's client, required STC employees to open accounts for
21 the hedge funds with numerous mutual funds to be traded through STC.
22 The hedge funds then effected trades through these accounts to determine
23 which mutual funds would not detect or actively police timing. This
24 "shotgun" approach immediately distinguished the hedge funds from
25 STC's other clients because it required STC employees to deal with
26 numerous complaints from mutual fund companies about market timing
27 activity. These complaints prompted STC and the hedge funds in October
28 2000 to enter into a "best practices" agreement, which McDermott

1 drafted. The agreement, among other things, contained several provisions
2 designed to reduce the likelihood that the mutual funds would detect the
3 hedge funds' trades. The hedge funds continued to trade through multiple
4 accounts during their entire relationship with STC.

5 24. The second method, called the "omnibus" approach, was
6 launched in 2000 and involved opening five omnibus accounts (i.e., an
7 account that contains trading for multiple clients or a master account that
8 contains multiple subaccounts) for the hedge funds at STC through which
9 the hedge funds' trades were rotated in an attempt to evade detection by
10 the mutual funds.

11 25. The third method, called the "taxpayer ID" approach, was
12 also launched in 2000 and involved opening mirror accounts for the five
13 omnibus accounts using STC's taxpayer identification number. Devised
14 by Seeger, this approach sought to impede efforts by mutual fund
15 companies to detect market timers by their tax identification numbers.

16 26. The fourth method, called "piggybacking," was launched in
17 2001 and was also devised by Seeger. It involved setting up a
18 sub-account within the account of one of STC's TPA clients and
19 attaching the hedge funds' mutual fund trades to the trades of this client
20 without its knowledge. The hedge funds employed the piggybacking
21 strategy in at least two STC client accounts. In addition, hedge funds
22 formed by Samaritan Asset Management and unaffiliated with the hedge
23 funds employed the piggybacking strategy in at least two other STC client
24 accounts. The mutual funds that the hedge funds traded through
25 piggybacking had previously ejected the hedge funds for market timing,
26 and the hedge funds hoped they could continue to trade these funds under
27 the name of another STC client. The hedge funds relied on STC to
28 identify the accounts of other clients that had large holdings in

1 international funds. McDermott directed employees to locate additional
2 accounts at STC that the hedge funds could piggyback, but she knew or
3 was reckless in not knowing that those account holders were not aware of
4 and had not approved the hedge funds' piggybacking. In June 2002,
5 McDermott notified Seeger and Kenyon of her desire to locate additional
6 mutual funds in which the hedge funds could piggyback so as to ensure
7 the continued viability of STC's arrangements with the hedge funds. An
8 STC employee informed Kenyon about the piggybacking, and suggested
9 that Kenyon contact a securities lawyer. Kenyon did not do so.

10 27. Seeger and McDermott routinely instructed STC employees
11 to stonewall mutual fund inquiries concerning the hedge funds' timing
12 activity by playing dumb, stalling, and concealing the hedge funds'
13 identity from the mutual funds. McDermott, known at STC as "Seeger
14 Jr.," told STC employees to do all they could for the hedge funds because
15 the account was very important to STC.

16 28. Despite methods employed by defendants to conceal the
17 hedge funds' market timing, STC employees continued to receive a
18 stream of complaints by mutual funds. Some complaints made very clear
19 to defendants that the mutual funds objected to the hedge funds' use of
20 the defined contribution trading platform when in fact the hedge funds
21 were not a defined contribution plan. STC employees expressed concerns
22 about these complaints to Kenyon, but he permitted the hedge funds'
23 timing activity to continue. Kenyon did not direct STC employees to
24 investigate the hedge funds' trading activity. Nor did Kenyon contact the
25 mutual funds traded by the hedge funds to inquire further about the basis
26 for the mutual funds' complaints.

27 29. Despite the complaints from the mutual funds, STC
28 continued to submit the hedge funds' trades through STC's trading

1 platform until the hedge funds ended their relationship with STC in July
2 2003. Over the course of their relationship, STC received over \$5.8
3 million in direct compensation from the hedge funds, which was the
4 direct result of a highly profitable fee arrangement that Seeger negotiated.
5 Kenyon closely monitored STC employees to make sure that the hedge
6 funds immediately paid STC's invoices.

7 30. By facilitating the hedge funds' ability to conduct late trading
8 and market timing and thereby to garner substantial profits at the expense
9 of other mutual fund shareholders, Seeger unlawfully abstracted moneys
10 belonging to those mutual funds. Seeger converted these funds both for
11 the hedge funds' use in the form of trading gains and for his own use in
12 the form of a 4% profit-sharing fee for STC on the hedge funds' gains.

13 **FIRST CLAIM FOR RELIEF**

14 **FRAUD IN THE OFFER OR SALE OF SECURITIES**

15 **Violations of Section 17(a) of the Securities Act**

16 **(Against All Defendants)**

17 31. The Commission realleges and incorporates by reference ¶¶
18 1 through 30 above.

19 32. Defendants, by engaging in the conduct described above,
20 directly or indirectly, in the offer or sale of securities by the use of means
21 or instruments of transportation or communication in interstate commerce
22 or by use of the mails:

- 23 a. with scienter, employed devices, schemes, or artifices
24 to defraud;
- 25 b. obtained money or property by means of untrue
26 statements of a material fact or by omitting to state a
27 material fact necessary in order to make the statements
28 made, in light of the circumstances under which they

1 were made, not misleading; or
2 c. engaged in transactions, practices, or courses of
3 business which operated or would operate as a fraud or
4 deceit upon the purchaser.

5 33. By engaging in the conduct described above, defendants
6 violated, and unless restrained and enjoined will continue to violate,
7 Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a).

8 **SECOND CLAIM FOR RELIEF**
9 **FRAUD IN CONNECTION WITH THE**
10 **PURCHASE OR SALE OF SECURITIES**
11 **Violations and Aiding and Abetting Violations of**
12 **Section 10(b) of the Exchange Act and Rule 10b-5 thereunder**
13 **(Against All Defendants)**

14 34. The Commission realleges and incorporates by reference ¶¶
15 1 through 30 above.

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

- 21 a. employed devices, schemes, or artifices to defraud;
- 22 b. made untrue statements of a material fact or omitted to
23 state a material fact necessary in order to make the
24 statements made, in the light of the circumstances
25 under which they were made, not misleading; or
- 26 c. engaged in acts, practices, or courses of business
27 which operated or would operate as a fraud or deceit
28 upon other persons.

1 violated Rule 22c-1, 17 C.F.R. § 270.22c-1, promulgated under Section
2 22(c) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(c).

3 **FOURTH CLAIM FOR RELIEF**

4 **LARCENY**

5 **Violations of Section 37 of the Investment Company Act**

6 **(Against Defendant Seeger)**

7 43. The Commission realleges and incorporates by reference ¶¶
8 1 through 30 above.

9 44. Defendant Seeger, by engaging in the conduct described
10 above, stole, unlawfully abstracted, unlawfully and willfully converted to
11 his own use or to the use of another, or embezzled the moneys, funds,
12 securities, credits, property, or assets of a registered investment company.

13 45. By reason of the foregoing, defendant Seeger violated, and
14 unless restrained and enjoined will continue to violate, Section 37 of the
15 Investment Company Act, 15 U.S.C. § 80a-36.

16 **PRAYER FOR RELIEF**

17 WHEREFORE, the Commission respectfully requests that the
18 Court:

19 **I.**

20 Issue findings of fact and conclusions of law that the defendants
21 committed the alleged violations.

22 **II.**

23 Issue a judgment, in a form consistent with Fed. R. Civ. P. 65(d),
24 permanently enjoining defendant Seeger and his officers, agents, servants,
25 employees and attorneys, and those persons in active concert or
26 participation with any of them, who receive actual notice of the order by
27 personal service or otherwise, and each of them, from violating Section
28 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule

1 10b-5 thereunder, and Section 37 of the Investment Company Act.

2 **III.**

3 Issue judgments, in a form consistent with Fed. R. Civ. P. 65(d),
4 permanently enjoining defendants Kenyon and McDermott and their
5 officers, agents, servants, employees and attorneys, and those persons in
6 active concert or participation with any of them, who receive actual notice
7 of the order by personal service or otherwise, and each of them, from
8 violating Section 17(a) of the Securities Act and Section 10(b) of the
9 Exchange Act and Rule 10b-5 thereunder.

10 **IV.**

11 Order defendants to disgorge all ill-gotten gains from their illegal
12 conduct, together with prejudgment interest thereon, and order defendants
13 to provide an accounting.

14 **V.**

15 Order all defendants to pay civil penalties under Section 20(d) of
16 the Securities Act, 15 U.S.C. § 77t(d) and Section 21(d)(3) of the
17 Exchange Act, 15 U.S.C. § 78u(d)(3), and also order defendants STC and
18 Seeger to pay civil penalties under Section 42(e) of the Investment
19 Company Act, 15 U.S.C. § 80a-41(e).

20 **VI.**

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

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VII.

Grant such other and further relief as this Court may determine to be just and necessary.

DATED: November 24, 2003

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Attorneys for Plaintiff
Securities and Exchange Commission