

SEC Charges Eight Mutual Fund Directors for Failure to Properly Oversee Asset Valuation

On December 10, 2012, the U.S. Securities and Exchange Commission (the “SEC”) instituted public administrative and cease-and-desist proceedings eight (8) former trustees of five (5) Memphis, TN-based mutual funds for an alleged failure to specify a fair valuation methodology and conduct a review of the appropriateness of that method. Sections 9(b) and 9(f) of the Investment Company Act of 1940, as amended (the “1940 Act”) place the burden on fund directors to determine the fair value of fund securities for which market quotations are not readily available. The SEC claims that the Respondents caused the respective funds to violate Rules 22c-1, 30a-3(a) and 38a-1 under the 1940 Act by failing to provide a delegated valuation committee any meaningful and substantive guidance in ascertaining the way in which fair values were established. The order goes on to state that because the fair-valued securities made up more than 60% of the funds’ net asset values in most instances, the failure on the part of the Respondents was especially intolerable. The SEC, in its order, further contends that the Respondents breached federal securities laws by failing to uphold internal control over financial reporting.

“While it is understood that fund directors typically assign others the daily task of calculating the fair value of each security in a fund’s portfolio, at a minimum they must determine the method, understand the process, and continuously evaluate the appropriateness of the method used,” said William Hicks, Associate Regional Director of the SEC’s Atlanta Regional Office.

The SEC ordered a public hearing before an Administrative Law Judge. The entire SEC Administrative Proceeding may be accessed electronically at: <http://www.sec.gov/litigation/admin/2012/ic-30300.pdf>. The corresponding SEC Press Release may be found electronically on the SEC’s website at the following link: <http://www.sec.gov/news/press/2012/2012-259.htm>.

New York-Based Fund Manager Charged with Fraudulent Trading

On December 11, 2012, the U.S. Securities and Exchange Commission (the “SEC”) charged Steven B. Hart (“Hart”), a New York-based fund manager, with allegedly conducting illicit trading schemes involving both matched and insider trading activities, as well as fraudulently misrepresenting two (2) securities purchase agreements. The SEC action, filed in the U.S. District Court for the Southern District of New York, alleges Hart violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940.

According to the SEC’s complaint, between January 2008 and June 2009, Hart allegedly used his position at Octagon Capital Partners, LP (“OCP”) to direct thirty-one (31) matched trades between two (2) investment funds for which he had control of trading activities. The SEC contends that Hart purchased small amounts of stock through OCP at market price and then sold the shares to his employer’s fund, for which he served as portfolio manager, at an above-market-price during premarket trades to ensure that the trades matched. The SEC holds that Hart, acting within his position as portfolio manager, later sold the acquired stock on the open market at a loss, thereby generating approximately \$586,338 in ill-gotten gains for OCP.

HIGHLIGHTS

SEC claims Memphis fund directors failed to provide accurate net asset valuations

SEC charges New York-based fund manager with fraudulent trading schemes

FINRA fines Pruco Securities for mispricing fund orders

ICI and Chamber of Commerce lawsuit on CFTC Rule 4.5 amendments dismissed by court

The SEC further alleges that Hart was solicited to invest in numerous securities offerings and despite an agreement to keep the offering's information private, he traded on the material nonpublic insider information. As a result of these activities, the SEC holds that OCP profited \$244,733 in illicit gains between June 2007 and March 2011.

The complete SEC Complaint may be accessed at by following the following link:

<http://www.sec.gov/litigation/litreleases/2012/lr22567.htm>.

Pruco Securities LLC Settles Mutual Fund Order Mispricing Charges with FINRA

On December 21, 2012, Pruco Securities, LLC ("Pruco") submitted a Letter of Acceptance, Waiver and Consent (the "AWC") to the Financial Industry Regulatory Authority ("FINRA") regarding the firm's violations of Rule 22c-1 of Investment Company Act of 1940, as amended, whereby complete mutual fund orders that are properly received prior to 4:00 p.m. are priced on the day the order is received. According to the AWC, Pruco allegedly priced more than 850,000 paper and facsimile orders one-to-two market days after it received the complete orders prior to the 4:00 p.m. deadline.

"Pruco's inadequate supervision and pricing system resulted in thousands of customers receiving inferior prices for more than seven years," stated Brad Bennett, Executive Vice President and Chief of Enforcement at FINRA. "Broker-dealers must ensure that their systems provide customers with accurate pricing for all products that the firms offer."

The full Letter of Acceptance, Waiver and Consent may be accessed on the FINRA website at: <http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=32850>.

Court Dismisses Lawsuit Over Amendments to CFTC Rule 4.5

On December 12, 2012, the United States District Court for the District of Columbia dismissed the lawsuit filed by the Investment Company Institute ("ICI") and the Chamber of Commerce of the United States of America (the "Chamber"). The lawsuit, originally filed on April 17, 2012, challenged the U.S. Commodity Futures Trading Commission's ("CFTC") amendments to Rules 4.5 and 4.27 under the Commodity Exchange Act, as

amended ("CEA") by arguing that the CFTC adopted the rules in an arbitrary and capricious manner in violation of the Administrative Procedures Act ("APA") and did not conduct the requisite cost-benefit analysis required under the CEA and the APA. The Court was not persuaded by the arguments made by the ICI and Chamber of Commerce and dismissed the lawsuit by ruling that "the CFTC fulfilled its obligation under the CEA to consider the costs and benefits of its proposed rule."

On December 27, 2012 the ICI and Chamber submitted a notice of appeal to the United States Court of Appeals for the District of Columbia Circuit. According to David Hirschmann, President and CEO of the Chamber's Center for Capital Markets Competitiveness, "the District Court's decision fell far short of well-established D.C. Circuit precedent requiring agencies to adequately measure the costs imposed by capital markets regulations on businesses, investors, and the economy as a whole, and to weigh them against the desired benefits."

For further reference:

Court's Decision:

[http://www.chamberlitigation.com/sites/default/files/cases/files/2012/Memorandum%20Opinion%20-%20ICI%20v.%20CFTC%20\(D.C.%20District%20Court\).pdf](http://www.chamberlitigation.com/sites/default/files/cases/files/2012/Memorandum%20Opinion%20-%20ICI%20v.%20CFTC%20(D.C.%20District%20Court).pdf)

Notice of appeal: <http://www.ici.org/pdf/26806.pdf>

ICI article on notice of appeal:

http://www.ici.org/cftc_challenge/appeal/12_news_noticeofappeal

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