INITIAL DECISION RELEASE NO. 672
ADMINISTRATIVE PROCEEDING
FILE NO. 3-15625

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of	:	
	:	
AMBASSADOR CAPITAL MANAGEMENT, LLC, and DEREK H. OGLESBY	:	INITIAL DECISION September 19, 2014
	:	

APPEARANCES: Robert M. Moye, Jonathan S. Polish, Amy S. Cotter, and Robin Andrews, representing the Division of Enforcement, Securities and Exchange Commission

Lawrence Iason, Miriam L. Glaser, and Gates S. Hurand, representing Respondents Ambassador Capital Management, LLC and Derek H. Oglesby

Richard D. Marshall, Eva C. Carman, and David W. Mindell, representing Respondent Ambassador Capital Management, LLC

BEFORE: Cameron Elliot, Administrative Law Judge

SUMMARY

This Initial Decision finds that Respondent Ambassador Capital Management, LLC (ACM) violated Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 (Advisers Act) by making misrepresentations about exposure to Italy to the Board of Trustees (Board) of Ambassador Money Market Fund (AMMF or the Fund), and violated Section 206(2) of the Advisers Act by making misrepresentations about compliance with portfolio diversification and maturity restrictions to the Board, that Respondent Derek H. Oglesby (Oglesby) aided and abetted and caused certain of these violations, that ACM and Oglesby caused AMMF's failure to comply with certain provisions of Investment Company Act of 1940 (Investment Company Act) Rule 2a-7 (Rule 2a-7), resulting in violations of Investment Company Act Rules 22(c)(1), 34(b) and 35(d), and that ACM caused AMMF's failure to implement adequate written compliance policies under Investment Company Act Rule 38a-1. This Initial Decision orders, as to ACM, a permanent bar from association with any investment company, a cease-and-desist order, and civil

penalties of $695,000, and as to Oglesby, a censure, a cease-and-desist order, and civil penalties of $126,000.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission (Commission) issued its Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on November 26, 2013, pursuant to Sections 203(e), 203(f), and 203(k) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act. ACM and Oglesby (collectively, Respondents) answered on January 10, 2014, and January 13, 2014, respectively.

A hearing was held on May 5-9, and 12-14, 2014, at the Commission's headquarters in Washington, D.C. The admitted exhibits are listed in the Record Index issued by the Office of the Secretary on September 2, 2014. The Division of Enforcement (Division) and Respondents filed post-hearing briefs and post-hearing reply briefs by July 15, 2014.[1]

B. Summary of Allegations

The instant proceeding concerns alleged misconduct and compliance failures in the operation of AMMF, a money market fund series offered by Ambassador Funds, AMMF's parent investment company, and managed by ACM, a registered investment adviser. The OIP alleges that ACM and Oglesby, an ACM portfolio manager, repeatedly made false statements to the Board regarding the level of risk in AMMF's portfolio. OIP at 1. Specifically, the OIP alleges that ACM and Oglesby failed to disclose to the Board that ACM regularly exceeded its own internal maturity restrictions on portfolio securities, that ACM failed to disclose that it repeatedly purchased portfolio securities without making a determination that the securities posed a minimal credit risk, that Oglesby made false and misleading statements to the Board regarding AMMF's exposure to asset-backed commercial paper potentially affected by the Eurozone crisis in 2011, and that ACM misled the Board regarding the issuer diversification of AMMF's portfolio. *Id.* at 4-8. The OIP further alleges that ACM is responsible for AMMF's failure to comply with three elements in Rule 2a-7 of the Investment Company Act: the condition on issuer diversification at the time of purchase, the implementation of written procedures for periodic stress testing, and the performance of periodic stress testing. *Id.* at 8-9. The OIP alleges that, due to these failures, AMMF should not have been held out as a money market fund and was not authorized to use the amortized cost method of valuing securities. *Id.* at 2.

---

[1] Citations to the transcript of the hearing are noted as "Tr. ___." Citations to exhibits offered by the Division and Respondents are noted as "Ex. ___." The Division's and Respondents' post-hearing briefs are noted as "Div. Br. ___." and "Resp. Br. ___.", respectively. The Division's and Respondents' post-hearing reply briefs are noted as "Div. Reply ___" and "Resp. Reply ___," respectively. Citations to the "Joint Stipulation of Facts" dated May 2, 2014, are noted as "First Stip. ___," and citations to the "Joint Stipulation of Facts" dated June 20, 214, are noted as "Second Stip. ___."

The OIP alleges that ACM willfully violated, and Oglesby willfully aided and abetted and caused ACM's violations of, Sections 206(1) and 206(2) of the Advisers Act; that ACM and Oglesby caused Ambassador Funds' violations of Rules 22c-1 and 31a-1 and Sections 34(b), 35(d), and 31(a) of the Investment Company Act; and that ACM caused Ambassador Funds' violations of Rule 38a-1 of the Investment Company Act. *Id.* at 9-10.

In their Answers, Respondents denied most of the key allegations, including the allegation that they misled the Board about the risk in AMMF's portfolio or caused AMMF to fail to adhere to the requirements of Rule 2a-7. They also each asserted eight affirmative defenses, including that the alleged acts of noncompliance with Rule 2a-7 were immaterial and that AMMF has liquidated and ACM no longer advises any money market funds. ACM Answer at 11; Oglesby Answer at 8.

II. FINDINGS OF FACT

The findings and conclusions herein are based on the entire record and on facts officially noticed pursuant to Rule 323 of the Commission's Rules of Practice (Rules). *See* 17 C.F.R. § 201.323. The parties' motion papers and all documents and exhibits of record have been fully reviewed and carefully considered. I applied preponderance of the evidence as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments, proposed findings, and conclusions that are inconsistent with this Initial Decision.

A. Background

1. Ambassador Funds and AMMF

Ambassador Funds is a Delaware business trust with its principal place of business in Detroit, Michigan. First Stip. ¶ 4. Ambassador Funds registered with the Commission as an open-end diversified management investment company in 2000, and it filed an application for deregistration as a registered investment company in May 2013. *Id.*

AMMF was an Ambassador Funds money market fund series which operated from 2000 until its "winding down" on June 29, 2012. First Stip. ¶ 5. Between January 1, 2009, and June 30, 2012, Ambassador Funds made a number of filings with the Commission on behalf of AMMF, identifying AMMF as a money market fund. First. Stip. ¶ 6. AMMF generally invested in commercial paper and asset-backed commercial paper, and it occasionally owned some agency bonds. Tr. 1602; First Stip. ¶ 8. As of October 3, 2011, AMMF held the securities of approximately 21 different issuers. First Stip. ¶ 13. The total value of the securities in AMMF's portfolio fluctuated significantly between 2009 and 2012, ranging from over $300 million to as little as $140 million. Ex. 18 at 4, 866.

AMMF was designed for and marketed to Michigan municipalities, and they constituted the vast majority of the Fund's investors. Tr. 292, 1427-28. Between 2009 and 2012, a substantial portion of the investments in AMMF regularly came from two Michigan municipalities: the City of Detroit and Washtenaw County. First Stip. ¶ 9; Ex. 55 at 6. As of August 31, 2011, over 65% of the Fund was held by these two entities. Tr. 148, Ex. 55 at 6.

While the Fund at that time had 113 shareholders, the top ten shareholders accounted for almost eighty percent of the Fund. Ex. 55 at 6. All of these top ten shareholders were Michigan municipalities. *Id*.

2. ACM

ACM is a Michigan limited liability company with its principal place of business in Detroit, Michigan. First Stip. ¶ 1. ACM registered with the Commission as an investment adviser in 1998. *Id*. It was formed to provide investment assistance to local governments, particularly in the state of Michigan, and its first client was the City of Detroit. Tr. 1465, 1466, 1484. ACM also provided investment advice to smaller Michigan municipalities, and it created AMMF so that it could manage the assets of these municipalities, the portfolios of which were too small to manage efficiently in separate accounts and which had few other alternatives because of the limitations imposed by Michigan Public Act 20 of 1943 (Public Act 20). Tr. 1468; Ex. 25 at 7. ACM's investor base has since expanded to corporate institutions, public funds, insurance companies, and foundations. Tr. 1480-81.

As of January 2014, ACM had approximately $1.3 billion in assets under management in 61 accounts. First Stip. ¶ 2. After AMMF closed, ACM no longer advised or managed any mutual funds or money market funds, and therefore it also no longer manages the funds of any Michigan municipalities. Tr. 1469, 1621; ACM Answer at 11. It now offers only separately managed fixed-income accounts for institutional investors, consisting primarily of pension plans, endowments, and public funds. Tr. 1479, 1621. ACM represents that it has no intention of acting as an investment adviser to a money market fund in the future. Tr. 1469, 1701-02.

ACM was the investment adviser to Ambassador Funds and AMMF from AMMF's formation in 2000 until its liquidation in June 2012. First Stip. ¶ 6; Tr. 1620-21. ACM was paid a management fee of .2% on the average net daily assets of AMMF. First Stip. ¶ 7. ACM agreed to waive AMMF's expenses, to the extent required, so that AMMF's one-day yield did not fall below .02%. First Stip. ¶ 7; Ex. 95 at 9. In 2011, but not 2009 or 2010, ACM waived fees totaling $2,300 in order to maintain that yield. Ex. 95 at 9; Ex. 97 at 2-3; Ex. 165 at 21-24.

Dykema Gossett PLLC (Dykema Gossett), a law firm based in Detroit, represented ACM in the formation of AMMF and advised on legal responsibilities related to its operation, including those imposed by amendments to Rule 2a-7. Tr. 286-88, 324-25. ACM also hired the law firm of Miller, Canfield, Paddock and Stone, P.L.C. (Miller Canfield), to represent it in connection with the examination of the Fund conducted by the Commission's Office of Compliance Inspections and Examinations (OCIE) in 2011, and in the subsequent investigation by the Commission. Tr. 1709, 1749; Ex. 70.

3. Oglesby

Oglesby is a resident of Bloomfield Hills, Michigan. First Stip. ¶ 3. He received a Bachelor of Science degree in mathematics from the University of Central Missouri. Tr. 1090. As a college intern and after his graduation, Oglesby worked for the investment management division of an insurance company. Tr. 1093-94.

Oglesby was hired by ACM in 2000 as a portfolio manager. Tr. 1095-96. He reported to Greg Prost (Prost), the chief investment officer of ACM. Tr. 1097. He described his initial role at ACM as "[m]ore of a credit analyst position" rather than that of a portfolio manager, but he also assisted in ACM's portfolio management process. *Id.* In the latter capacity, he analyzed the credit quality of the securities ACM purchased for its portfolios and assisted in managing the risks of those portfolios. *Id.*

Oglesby became the portfolio manager for AMMF in May 2010 when Kathryn Nurre (Nurre), a senior portfolio manager, left ACM. Tr. 1097, 1225, 1601, 1602. Oglesby is currently the Director of Quantitative Research at ACM and is responsible for managing the shorter-term portfolios for ACM. First Stip. ¶ 3; Oglesby Answer at 2.

4. <u>Other ACM Employees</u>

Brian Jeffries (Jeffries) formed ACM and serves as its President and CEO. Tr. 1462, 1482-83. Jeffries graduated from Central Michigan University with an undergraduate degree in finance in 1988. Tr. 1457. He also graduated from Michigan State University School of Law, but he has not taken the bar exam and has never practiced as a lawyer. Tr. 1459. In addition to his role as President and CEO, Jeffries was also a trustee of the Fund from its formation until its liquidation. Tr. 1468-69, 1470; Ex. 25 at 1.

Prost was hired as chief investment officer of ACM in January 2000. Tr. 1463-64, 1594. He also served as Vice President of the Fund. Tr. 291. Prost was the primary point of contact with the Michigan municipalities that invested in AMMF. Tr. 1617.

Nurre was hired by ACM in approximately 1999 as a portfolio manager. Tr. 1463-64. She was the portfolio manager of AMMF, as well as Secretary of the Fund, from 2000 until she left ACM in May 2010. Tr. 291, 1098, 1225, 1576; Ex. 25 at 5; Ex. 30 at 25. Prost replaced Nurre as Secretary. Ex. 30 at 26. According to the minutes from a special meeting of the Board held on May 13, 2010, Nurre decided to quit after Jeffries approached her to discuss modifying her role at ACM in light of AMMF's declining assets. Ex. 30 at 25. However, Guyna Johnson (Johnson) an employee of Standard & Poor's Financial Services LLC (S&P), testified that Prost told her Nurre had been fired due to her failure to comply with ACM's internal guidelines. Tr. 597.

Other portfolio managers employed by ACM during the relevant time periods include or have included Talmadge Gunn (Gunn) (2006 – present), Mike Vandenbossche (2012 – present), Mike Krushena (2012 – present), Gary Schaefer (Schaefer) (2000-2012), and Dawn Kurek, who served as a backup portfolio manager (approximately 2010-2011). Tr. 1151-52, 1596-98, 1640; Ex. 55 at 10. Treshell Flowers (Flowers) was employed by ACM as an analyst from approximately 2007 to 2010. Tr. 1117, 1639.

5. <u>Maria De Nicolo and Fund Services Group, LLC</u>

Maria De Nicolo (De Nicolo) served as chief compliance officer (CCO) of AMMF from 2004 until its liquidation. Tr. 671-72, Ex. 92 at 13. From 2004 to 2010, she was also the CCO of ACM. Tr. 672, 695-96. She stepped down from that role after Commission examiners suggested that there could be a potential conflict of interest in serving as CCO of both AMMF and ACM. Tr. 695. She was replaced as CCO of ACM by Valaise Smith, who is director of administration at ACM. Tr. 1600. De Nicolo's role as chief compliance officer of ACM and AMMF involved assisting in preparing compliance policies and procedures, including those procedures in board packages for review and approval, and reporting to the Board on the Fund's compliance. Tr. 672.

De Nicolo was hired by Monetta Financial Services as controller in 1992. Tr. 663. Monetta Financial Services is a registered investment advisor that manages the Monetta Funds, a family of mutual funds based in Wheaton, Illinois. Tr. 513, 663. De Nicolo became chief financial officer of the Monetta Funds in 1993. Tr. 664. She remained in that position until August 2003, when the accounting function of Monetta Financial Services was spun off into a new entity named Fund Services Group, LLC (FSG). Tr. 664, 666. De Nicolo testified that this was done so that accounting and administrative services could be provided not just to the Monetta Funds but to other, outside mutual funds. Tr. 667. FSG was also located in Wheaton, Illinois. Tr. 696. It was formed as a joint venture between ACM and Monetta Financial Services: each owned 45.5% of FSG. Tr. 666. De Nicolo owned between six and nine percent of FSG and was its President from 2003 to 2012, when FSG closed. Tr. 666, 674-75. The remainder of FSG was owned by its two other employees, accountants Christina Curtis (Curtis) and Lynn Waterloo. Tr. 666. BISYS Fund Services Limited Partnership was the original back-office administrator for the Fund. Tr. 296-97, 1167. It was replaced by FSG after FSG's formation in August 2003, and FSG remained the administrator for AMMF until the Fund's liquidation. Tr. 297-98, 671, 1167-68; Ex. 446.

FSG provided day-to-day accounting and administration services for AMMF. Tr. 668. Because De Nicolo was one of FSG's three employees, FSG also became involved in compliance functions after she became CCO of AMMF in 2004. Tr. 671-72. FSG assisted in preparing regulatory filings, purchase journals, and board packages, performed reporting and post-trade compliance checks, and sent daily accounting reports to ACM with information on the Fund's available cash, current holdings, securities with upcoming maturities, and net asset value (NAV). Tr. 668-69, 713, 1168-69; *see, e.g.*, Ex. 171. FSG also monitored and prepared daily reports on the Fund's compliance with Rule 2a-7 and S&P requirements for average maturity, issuer diversification, ratings, and liquidity. Tr. 710-712; Ex. 55 at 28. These compliance reports were provided to ACM on a weekly basis. Tr. 1216.

6. The Monetta Funds

At the Board meeting held on June 8, 2010, ACM recommended that AMMF cease to have a separate board of trustees and instead begin sharing a board with the Monetta Funds. Ex. 30 at 6. This change, pursuant to which AMMF would also share transfer and custodian fees with the Monetta Funds, was intended to substantially reduce the operating expenses of AMMF and generate a higher yield for the Fund's shareholders. *Id.* Jeffries testified that combining these administrative and trustee functions with the Monetta Funds saved AMMF approximately $100,000 per year. Tr. 1571. In July 2010, the existing trustees of AMMF resigned and were replaced by the Monetta Funds' trustees, who thereafter acted as the board of both the Monetta Funds and AMMF. Tr. 339, Ex. 30 at 6, 133; Ex. 94 at 5. Prior to the combination with the Monetta Funds, the Board consisted of Conrad Koski (Koski) (chairman), Nicholas De Grazia, Ronald Hall, Dennis Archer, Jeffries, and Prost. Tr. 286, 289; Ex. 30 at 25. After the combination, the Board consisted of Robert Bacarella (Bacarella) (chairman), John Guy (Guy), Marlene Hodges (Hodges), Mark Ogan, and Jeffries. Ex. 94.

The combination with the Monetta Funds also precipitated a change in the Fund's legal counsel. From its formation through the combination with the Monetta Funds, the Fund's counsel was Paul Rentenbach of Dykema Gossett. Ex. 25 at 17; Ex. 94 at 1. After the combination, Arthur Don (Don) and Richard Cutshall (Cutshall) of Greenberg Traurig LLP took over representation of the Fund and the independent trustees. Tr. 806. Don and Cutshall remained counsel for the Monetta Funds during all relevant times thereafter. Tr. 749, 807; Ex. 98 at 1.

7. Commission Examinations

The Commission conducted an examination of AMMF in 2009 to evaluate its compliance with federal securities laws. Ex. 30 at 106. The examination included an on-site review at ACM's Detroit offices from September 21 to September 25, 2009. *Id.* The examination culminated in a letter sent to Jeffries on May 18, 2010, which identified a number of deficiencies in the Fund's operation, including that the Fund may have broken the buck in 2008, violated Rule 2a-7's diversification rule in 2009, failed to maintain an independent credit analysis for an issuer, and failed to honor shareholder trades if placed after 12 p.m. *Id.* at 106-111.

OCIE also conducted a "sweep" examination of AMMF in November 2011 in a review of money market funds that held European commercial paper during the Eurozone crisis. Tr. 118; Ex. 478. The examination included an onsite inspection at ACM's office on November 16 and 17, 2011. Tr. 144. Marita Bartolini (Bartolini), assistant director of OCIE, led the examination. Ex. 478. In a memorandum summarizing the examination, Bartolini noted that ACM was targeted due to its portfolio holdings, high yield, poor compliance history, and concerns about a tax lien on Jeffries' personal assets. *Id.* at 1. The memorandum stated that AMMF rolled over half of its portfolio every day, keeping the Fund very liquid but limiting the Commission's ability to track its holdings. *Id.* at 2. The memorandum also documented Bartolini's concern that, during the onsite inspection, Prost appeared to be unaware of a report from that morning regarding the downgrade of several German banks, including one which acted as a guarantor for securities regularly purchased by ACM.[2] *Id.*; Ex. 112 at 26.

B. Rule 2a-7

1. Relevant Requirements

Rule 2a-7 was adopted in 1983 and allows investment companies that have portfolios consisting entirely of U.S. dollar denominated short-term debt instruments to use either the penny rounding pricing method or the amortized cost valuation method in computing their NAV,

[2] Prost testified that Bartolini asked him about the German bank downgrade first thing in the morning, before he had begun his daily review of the markets. Tr. 1632.

provided that they comply with certain conditions. Ex. 158 at 2; *see* 17 C.F.R. § 270.2a-7.[3] Responsibility for designing and effectuating the necessary compliance safeguards is placed on the fund's board, but the board is permitted to delegate certain responsibilities to the investment adviser. *See* Rule 2a-7(e).

At issue in this case are alleged failures of AMMF to comply with the following requirements of Rule 2a-7:

- A money market fund can only invest in securities that have been determined by the fund's board of directors to have a minimal credit risk. The determination must be based on factors pertaining to credit quality in addition to ratings assigned by nationally recognized statistical rating organizations (NRSROs). Rule 2a-7(c)(3)(i) (reflecting amendments effective May 5, 2010); *see* Ex. 2A.
- A money market fund must make a written record of its analysis and determination that a portfolio security presents minimal credit risk and the designated NRSRO rating (if any) used to determine the status of the security, and retain the written record for at least three years. Rule 2a-7(c)(11)(iii) (reflecting amendments effective May 5, 2010); *see* Ex. 2A.
- A money market fund cannot have more than five percent of its total assets invested in the securities of any one issuer, as measured at the time of purchase, subject to a "safe harbor" permitting a fund to purchase and hold for three business days First Tier securities of a single issuer which exceed five percent, but are less than twenty-five percent, of the portfolio's total assets. Rule 2a-7(c)(4)(i)(A).
- A money market fund must adopt procedures for periodic stress testing, at intervals determined by the board of directors, of the fund's ability to maintain a stable NAV based upon specific hypothetical events, including (a) a change in short-term interest rates; (b) an increase in shareholder redemptions; (c) a downgrade of or default on portfolio securities; and (d) the widening or narrowing of spreads between yields on an appropriate benchmark selected by the fund for overnight interest rates and commercial paper and other types of securities held by the fund. Rule 2a-7(c)(10)(v) (reflecting amendments effective May 5, 2010); *see* Ex. 2A.

Throughout the hearing and the parties' filings, references were made to so-called "active" and "passive" breaches of Rule 2a-7's five percent issuer diversification limit. For the purposes of this Initial Decision, an active breach is one where, at the time of purchase or rollover, the security pushes the Fund over the five percent limit on the assets of any one issuer.

[3] Rule 2a-7 has been amended twice during the time periods relevant to this Initial Decision. First, the Commission adopted a final rule amending Rule 2a-7 on March 4, 2010, with an effective date of May 5, 2010. *Money Market Fund Reform*, 75 Fed. Reg. 10060 (Mar. 4, 2010). The Commission also adopted a final rule amending Rule 2a-7 on August 14, 2014, which becomes effective on October 14, 2014. *Money Market Fund Reform*, 79 Fed. Reg. 47736 (Aug. 14, 2014) (to be codified at 17 C.F.R. pt. 270). This Initial Decision applies the versions of Rule 2a-7 in effect at the time of the relevant conduct.

Unless the safe harbor provision applies, an active breach is a violation of Rule 2a-7. Tr. 885; *see* Rule 2a-7(a)(1) ("acquisition" means a purchase or subsequent rollover), (c)(4)(i)(A) (diversification is to be evaluated "[i]mmediately after the [a]cquisition of any security"). A passive breach is one where, at the time of purchase, the security does not exceed five percent, but later, due to a decline in the Fund's assets (for example, as a result of shareholder redemptions or the maturing of other securities), the percentage rises to above five percent. Tr. 870, Ex. 112 at 17. Although a passive breach reduces a fund's diversification, it is not a violation of Rule 2a-7. Tr. 101-02; *see* Rule 2a-7(c)(4)(i)(A).

2. <u>Delegation of Rule 2a-7 Compliance Responsibilities to ACM</u>

At the organizational meeting of the Board held on May 4, 2000, the Board delegated responsibility to ACM to ensure that the Fund was in compliance with Rule 2a-7. Tr. 295; Exs. 20, 25. The Rule 2a-7 Guidelines and Procedures adopted at the meeting required ACM to, among other things:

- comply with Rule 2a-7's requirements regarding maturity, quality, and diversification;
- determine that an investment presents a minimal credit risk at the time of its acquisition in light of its credit rating and an analysis of factors relating to the credit quality of the security's issuer;
- prepare, maintain, and preserve a written record of the minimal credit risk determination as required by Rule 2a-7;
- notify the Board promptly in writing if at any time the Fund is not in compliance with Rule 2a-7 or the Rule 2a-7 Guidelines and Procedures; and
- maintain and preserve all records required by Rule 2a-7.

Ex. 20.

Koski, the chairman of the Board from 2000 to mid-2010, recalled that "the independent trustees relied on the principals of ACM to -- first of all, to maintain compliance in Rule 2a-7, to report at the quarterly board meetings that we were in compliance, and if we were not in compliance, to so inform the board." Tr. 296. Koski explained that he understood this to require ACM to report any compliance problems experienced by the Fund "at any point in time." Tr. 303. He testified that he would have expected that "any deviation from any of the compliance rules that [ACM was] obligated to comply with would have been brought to the board's attention." Tr. 345. Hodges, a trustee of the Monetta Funds and of AMMF from mid-2010 until its liquidation, also expected ACM to bring compliance matters to the Board's attention and discuss any variances. Tr. 537-38.

C. <u>ACM's Management of AMMF</u>

1. <u>General Investment Strategy and Process</u>

Oglesby and Prost testified that ACM's goal was to manage AMMF conservatively and invest only in high quality commercial paper, sacrificing yield where necessary. Tr. 1438, 1623-

25. This was also the impression of Guy, a member of the Board from 2010 to 2012. Tr. 446. Prost attributed AMMF's strong performance in spite of this conservative strategy to high-quality credit research, in particular the model-driven research developed by Oglesby, which enabled the Fund to stay away from problems that plagued other money market funds' performance. Tr. 1623-25.

One of the models developed by Oglesby was the Ambassador Leading Index, which was designed to show a macroeconomic picture of the market. Tr. 1103-1105, 1156. The model included macroeconomic inputs such as retail sales, consumer confidence, inflation, and unemployment rates. Tr. 1103-1105. Its goal was to predict two economic cycles: the gross domestic product cycle, which forecasted economic recessions, and the Federal Reserve cycle, which forecasted Federal Reserve-controlled interest rates. Tr. 1156. ACM used this model to determine the ideal weighted average maturity for AMMF. Tr. 1158-59. Weighted average maturity is a measure of risk; Oglesby testified that the longer the weighted average maturity of the Fund,[4] the higher the Fund's risk. Tr. 1162. When deciding whether to make a particular purchase for the Fund, Oglesby reviewed the Ambassador Leading Index, the current weighted average maturity of the Fund, Moody's Corporation (Moody's) and S&P ratings of the security, the security's trading history, and a credit analysis of the security. Tr. 1156, 1158, 1163.

In approximately 2007, Oglesby created the Ambassador Money Market Fund System. Tr. 1164; Ex. 55. He created the system so that ACM would have a pre-purchase compliance check to ensure that potential trades met S&P's guidelines for money market funds. Tr. 1165. The ACM trader or portfolio manager anticipating making a purchase entered the details of the security into the system, which calculated the purchase's impact on the Fund's liquidity and indicated whether the purchase would put the Fund out of compliance with any of the programmed guidelines. Tr. 1165-66. These programmed guidelines included both S&P and Rule 2a-7 requirements on daily liquidity, weekly liquidity, weighted average maturity, Moody's and S&P ratings, and five percent issuer diversification. Ex. 55; Tr. 1171-82, 1185-86. Oglesby testified that ACM's internal ratings and maturity restrictions were incorporated into the system in October 2011. Tr. 1186-87.

The system would give a result of "pass" or "fail," color-coded green or red, respectively, indicating whether the purchase of the security passed all of the programmed guidelines or failed one or more. Tr. 1187-88; Exs. 487-491. A security could "fail" one or more of the guidelines, however, and still be purchased. Tr. 1192. As an example of this, Oglesby described a security with a one-day maturity, the purchase of which would cause one issuer to exceed five percent of the Fund's total assets but would fall under Rule 2a-7's safe harbor provision. Tr. 1191-93. If, on the other hand, the system showed multiple securities simultaneously exceeding the five percent diversification rule (meaning that AMMF could not take advantage of the safe harbor provision), ACM would not make the trade. Tr. 1194.

[4] In order to calculate actual weighted average maturity, ACM multiplied the percentage each security represented in the total net assets of the Fund by the number of days to the maturity of that security. Tr. 1161-62.

Oglesby demonstrated the Ambassador Money Market Fund System for analysts at S&P, and he also showed OCIE the system during its November 2011 examination. Tr. 602, 1181-82, 1197-98. Two or three people from OCIE were present for the demonstration, which lasted at least 15 to 20 minutes. Tr. 1197-98. Oglesby recalled that they thought it was a well-built, impressive system. Tr. 1200.

2. Minimal Credit Risk

a. *Minimal Credit Risk Determination Process*

Oglesby was involved with the minimal credit risk determination process from the creation of the Fund. Tr. 1098-99, 1101. Also participating in the process at various points in time were Nurre, Prost, Gunn, Flowers, and Schaefer. Tr. 1103, 1499-1500, 1640; Ex. 19. Oglesby testified that every security that ACM purchased on behalf of the Fund was determined to present minimal credit risk. Tr. 1440. He described the risk determination process as including the following steps.

First, ACM verified the security's rating by Moody's and S&P and only proceeded if the security had at least an A1/P1[5] rating. Tr. 1099-1100. Second, ACM[6] looked at the security's trading history, including the frequency of trading, what types of position sizes the security traded, and the number and type of brokers trading the security. Tr. 1099-1100. Third, ACM reviewed the private placement memorandum for the security, and analyzed the structure of the commercial paper, its cash flow, available financial statements, and the creditworthiness of its guarantors, if any. Tr. 1101-02. Fourth, ACM looked at the Ambassador Leading Index. Tr. 1103-1105, 1156. Finally, ACM's credit committee discussed the securities proposed to be purchased and made the minimal credit risk determination. Tr. 1116-17. The credit committee was comprised of Oglesby, Prost, an ACM analyst, and, during their respective years of employment, Nurre, Gunn, and Schaefer. Tr. 1116. No minutes were taken at these meetings, which Oglesby agreed were informal and "sort of around the water cooler" discussions. Tr. 1324, 1326.

Once ACM determined that a security posed a minimal credit risk, it was placed on the approved list. Tr. 1118. The approved list contained the issuer name, support institution name, Moody's and S&P ratings, dealers, regulation type, and industry category for each security on the list. First Stip. ¶ 11. By May 2012, the approved list also included the issuer's country, but that information was not provided on earlier versions of the approved list. *Compare* Ex. 473, *with* Ex. 474. The approved list was created and maintained on ACM's internal server, and only

[5] A P1 rating is a short-term rating for commercial paper securities assigned by Moody's, and an A1 rating is a comparable rating assigned by S&P. Tr. 1099-100, 1636. The highest ratings for short-term securities are A1+ and P1+. Tr. 563, 928-29.

[6] Oglesby testified that the trader led this step of the process. Tr. 1100-01. He appeared to use the term "trader" to refer to an ACM employee when he or she is executing trades for a fund, and the terms "trader" and "portfolio manager" were used somewhat interchangeably throughout the hearing. Tr. 1124, 1371, 1378.

securities on the approved list could be entered into the Ambassador Money Market Fund System for a pre-purchase compliance check. Tr. 1118, 1184; First Stip. ¶ 11. If needed, ACM would request that Bloomberg create a CUSIP (a unique identifier assigned to securities) for a security so that ACM could have information on the security included in its Bloomberg terminal feeds. Tr. 1119-1121. ACM's office had two Bloomberg terminals, which it reviewed every day to track the securities held by the Fund. Tr. 1113, 1133.

Oglesby testified that before a security was placed on the approved list, the credit committee always first made a minimal credit risk determination. Tr. 1122. The approved list was presented to and ratified by the Board on a quarterly basis. First Stip. ¶ 11. This practice meant that in between the quarterly Board meetings, ACM would sometimes add securities to the approved list and purchase them for the Fund before the updated approved list was reviewed and approved by the Board. Tr. 1553.

b. *Credit Research Reports*

After a security was placed on the approved list, Oglesby or an ACM analyst would write a credit research report for the security. Tr. 1118, 1122, 1327-28, 1640. These reports were generally one to two pages long and contained information on the security's rating and any changes to this rating, the issuer and its industry, the guarantor or support for the security, credit risks impacting the security, a financial analysis of the issuer and guarantor, and a brief conclusion. Exs. 19, 67; Tr. 1123-1129. Reports from 2009 through 2011 were admitted as exhibits in this proceeding. Exs. 19, 67. Oglesby performed the research underlying the minimal credit risk determination from 2000 until 2007, with Prost's assistance; Flowers took over the research from 2007 to 2010, with Oglesby's assistance; and Oglesby regained primary responsibility for the credit report research when Flowers left ACM in 2010. Tr. 1639. The 2009 reports were generally drafted by Flowers and signed by both her and Oglesby. Ex. 19; Tr. 1122. In 2010 and 2011, most reports were drafted by Oglesby and signed by him and Prost. Ex. 67; Tr. 1129. Oglesby signed nearly every report from 2009 to 2011, as either the drafter or approver.

The credit research reports were sometimes, though rarely, shared with the Board. Tr. 307-08; 523. Neither De Nicolo nor FSG reviewed the reports on a regular basis. Tr. 715-716. Some of the reports were shown to S&P; Johnson testified that she believed ACM did a "meaningful job" on the reports she reviewed and did not simply rely on a credit rating agency's rating. Tr. 640. After a report was written, it would go into a credit file for the security, along with supporting documents such as the private placement memorandum, financial statements, and pool reports, which contain detailed information on monthly changes in asset size and/or composition of the securities. Tr. 1112, 1130-31; Exs. 399-401, 403-11.

c. *Written Record of Minimal Credit Risk*

ACM's credit research reports contain two dates: the date of the data used for the report, and the date of the report's creation. Exs. 19, 67. For some reports, these dates were several months apart. *See* Ex. 410. Oglesby admitted that the credit research reports were prepared only after the credit risk determination was made. Tr. 1327-28. Based on the reports admitted as exhibits, there appears to have often been an additional delay – sometimes of several months – between when a security was placed on the approved list and when the corresponding credit report was created. For example, the minutes of the June 8, 2010, Board meeting indicate that Anglesea Funding LLC was added to the approved list during the previous quarter. Ex. 165 at 31. Taking Oglesby's testimony regarding the timing of the minimal credit risk determination as true, this means that the minimal credit risk determination for this security occurred sometime in the previous quarter, between April and June 2010. *See* Tr. 1122. The credit research report for Anglesea Funding LLC was not created until several months later, in August 2010. Ex. 67 at 14. Despite this delay, when the Board voted to approve Anglesea Funding LLC in June 2010 it was provided with a list of securities, prepared by the portfolio manager, indicating that "the credit files for these [securities] and all other approved commercial paper are available for review." Tr. 698; Ex. 165 at 31; Ex. 346 at 1-2; *see also* Tr. 1559-60. This language also appears on the approved list included in the packets for the November 2010, February 2011, April 2011, and August 2011 Board meetings. Ex. 93 at 32; Ex. 97 at 18; Ex. 98 at 44; Ex. 156 at 43. De Nicolo did not verify whether the credit files, which were created and retained by ACM, were in fact already in existence and available for the Board's review at the time it voted on the list of securities at each meeting. Tr. 698-99.

The conclusion section of the credit research reports was generally one to two sentences, and contained some description of the drafter's assessment of the security's risk. Exs. 19, 67. In 2009, when Flowers was the principal drafter, 36 out of 100 credit reports conclude that the risk of the security in question was "minimal"; another 49 describe the risk as "low," "slight," "some," "moderate" or "slight moderate"; and the remaining fifteen did not contain any explicit conclusions about risk. Div. Br. at 18, Ex. A. In 2010 and 2011, when Oglesby was the principal drafter, most reports concluded that the security presented a "minimal" credit risk, but fifty-two reports still described the risk as something other than "minimal." Div. Br. at 18, Ex. B. Oglesby agreed that not every report explicitly concluded that the issuer presented minimal credit risk. Tr. 1129. He explained:

> "[I]t would be really left up to the analyst to make a further gradation or further differentiation of the minimal credit risk of the security, the determination of the minimal credit risk. But all of the securities were under the structure and umbrella of minimal credit risk. Every security that we actually did a report on, what you see in front of you now, would have that."

Tr. 1130.

Prost testified that Flowers was encouraged to be more specific about gradations of risk within minimal credit risk securities, but that even securities whose report indicated a "moderate" credit risk were in fact minimal risk. Tr. 1641-43, 1698-1700. The very existence of a credit research report, according to Oglesby and Prost, meant that ACM had already determined that the security was a minimal credit risk. Tr. 1130, 1698; Resp. Br. at 24.

Oglesby admitted that he understood that Rule 2a-7 required a written record of the minimal risk determination. Tr. 1319. When asked to identify that record, he testified that it included the approved list, credit research reports, and "other things in the credit file" that were written down by ACM. Tr. 1328. Among these other things, according to Oglesby, were notes written on various pages in the credit file which were "representative" of the views of the credit committee when it considered whether a security was a minimal credit risk. Tr. 1326. The credit files provided by Respondents do not appear to contain any substantive notes by ACM analysts or portfolio managers. Exs. 399-401, 403-11. Oglesby testified that some items reviewed as part of the minimal credit risk determination process were not included in the credit file, but he did not specify what these were. Tr. 1131.

Jeffries, by contrast, testified that the two elements to the written record of ACM's minimal risk determination were "the updating of the approved list" and the credit research report. Tr. 1552-53. He clarified, however, that the approved list was "really a snapshot, something to be presented to the board in which to vote on, as opposed to providing them with a stack of credit memoranda to go through. And so that was really the purpose of the approved list." Tr. 1553. He first testified that he was not aware, and "never became aware," that there was a delay between the decision to invest in a security and the preparation of the corresponding credit research report. Tr. 1554, 1558-59. However, a May 18, 2010, delinquency letter directed to ACM after the Commission's September 2009 examination specifically reminded ACM that the "written analysis should be completed prior to the initial purchase of a security." Ex. 30 at 107. When shown the deficiency letter at the hearing, Jeffries admitted that the timing of the preparation of the credit research reports was raised by the Commission in 2010. Tr. 1559-60.

3. Rating by Standard and Poor's

In 2007, ACM approached S&P and requested that S&P review AMMF and assign it a rating. Tr. 554-55, 1146. S&P only rates money market funds if requested to do so. Tr. 560-61. Upon such a request, S&P will undertake a quantitative and qualitative review of a money market fund and assign it a rating based on S&P's opinion of its ability to maintain a stable NAV. Tr. 555-56, 563-64; Ex. 371. The rating does not represent compliance with any federal securities laws; its sole purpose is to indicate S&P's confidence that the fund is able to maintain its principal. Tr. 555; Ex. 48. The highest rating S&P assigns to a money market fund is AAAm. Tr. 561; Ex. 48. Of the 400 money market funds rated by S&P, approximately ninety-five percent are rated AAAm. Tr. 635. AMMF received an AAAm rating in 2007 and maintained that rating until ACM requested that S&P withdraw the rating prior to the Fund's liquidation in 2012. Tr. 565-66; Exs. 48, 413.

After a fund receives its initial S&P rating, S&P continues to monitor the fund on a weekly basis to ensure that it is complying with S&P's guidelines. Tr. 558-59. The weekly monitoring includes S&P's review of information provided by the fund's administrator on the securities held by the fund. Tr. 568. S&P uploads this information to a computer system which alerts the S&P analysts if the fund violates any of the pre-programmed rules. Tr. 568-69. These rules include S&P's restrictions on ratings, weighted average maturity, issuer diversification, and asset volatility. Tr. 569-70. S&P also prepares weekly compliance reports on its rated funds, which for AMMF were sent to FSG and then forwarded by FSG to Prost and Oglesby. Exs. 349, 351.

S&P's issuer diversification rule from 2007 onward did not mirror Rule 2a-7. Tr. 577-78. Instead, it prohibited both active and passive breaches; a fund was not permitted to hold more than five percent of its total net assets in the securities of any one issuer regardless of whether the percentage exceeded five percent as a result of a purchase or as a result of a change in the fund's total asset size. Tr. 570-72; 576-77. On November 1, 2011, S&P updated its criteria to clarify this and other S&P rules in order to improve transparency. Tr. 577-78, 599-600. Among these updates were defining the term "passive breach," identifying the steps a fund could take to come back into compliance after a passive breach, and laying out the consequences if a fund remained out of compliance after a ten-day cure period. *Id*. The new S&P criteria also mandated monthly stress testing. Tr. 600.

In addition to the weekly monitoring described above, S&P also conducts an in-depth annual review of its rated money market funds. Tr. 588. The review involves looking at a fund's management and operations as well as its portfolio's maturity, credit quality, liquidity, and diversification. *Id*. After in-person meetings with the fund's manager, S&P analysts prepare written reports and present them to S&P's money market committee for approval. Tr. 621. The annual review meetings for AMMF were conducted at ACM's office in Detroit. Tr. 586. Johnson was present for all of these meetings, along with a second S&P analyst. Tr. 587-88. ACM provided S&P with all of the information it requested in order to conduct these reviews. Tr. 644-45.

Johnson, a money market fund analyst in S&P's Chicago office, was the primary analyst assigned to AMMF. Tr. 554-55. When S&P's weekly monitoring revealed that AMMF had breached one or more of S&P's criteria, Johnson or another S&P analyst emailed either ACM or FSG to verify and obtain additional information on what precipitated the breach. Tr. 573. For example, on October 17, 2011, Johnson emailed Oglesby regarding three securities that exceeded S&P's issuer diversification requirement. Ex. 53. Oglesby's reply explained that the three securities were below five percent at the time of their purchase but exceeded five percent after some shareholder redemptions. *Id*. He noted that it was "our understanding that if a security is below 5% at the time of purchase the guideline will be satisfied." *Id*. Johnson testified that this was not an accurate interpretation of S&P's issuer diversification rules, but she did not recall whether anyone from S&P followed up on Oglesby's email. Tr. 577-78.

Similarly, on November 17, 2011, the backup S&P analyst emailed Curtis at FSG regarding two securities exceeding five percent. Ex. 45. Curtis explained that the securities exceeded five percent as a result of some large redemptions that had occurred in June and September of 2011. *Id*. This time S&P did alert Oglesby to this mistaken interpretation of S&P's issuer diversification rule: Johnson forwarded the email to Oglesby, noting that pursuant to the new S&P criteria, this would be termed a passive management breach. *Id*. Oglesby stated in response that "[g]oing forward, we have decided to manage the portfolio in a way that will lower our position sizes to account for potential increases in issuer concentration." *Id*.

4. <u>Internal Rating System</u>

Oglesby and Prost testified that at some point in 2010, ACM began to use an internal rating system which designated securities as Tier 1(A), Tier 1(B), and Tier 1(C). Tr. 1131, 1133-

34, 1345, 1644. Once implemented, the internal rating appeared on some, but not all, credit research reports. Tr. 1134; Div. Br. Ex. B. Oglesby and Prost testified that each of the tiers represented minimal credit risk securities; Oglesby described the tiers as subcategories within minimal credit risk. Tr. 1131, 1135-36, 1347-48. Oglesby defined the three internal tiers as equivalent to "good, better and best." Tr. 1134. "Good, it's still a minimal credit risk; better, just a little bit better than that; and best is essentially the super top tier, if there is a super top tier." *Id*. Oglesby did not know whether the "good, better, best" explanation of the rating system was written down by anyone at ACM. Tr. 1348-49.

Oglesby testified that when ACM first began using its internal rating system, the tiers were not connected to any guideline or restriction regarding how long of a maturity the security should have. Tr. 1143, 1344. Instead, the only function of the tiers was to give ACM "a better understanding of what is in the portfolio, what type of risk is associated under minimal credit risk," as part of ACM's efforts to improve the credit risk determination process. Tr. 1350. Oglesby recalled that the tiers were first connected to maturity restrictions in October 2011, at the suggestion of S&P during its annual meeting with ACM. Tr. 1143-44.

Johnson testified that ACM first explained the maturity restrictions to her during – not after – S&P's October 2011 annual review meeting. Tr. 614-615. Johnson's understanding was that the rating system was already tied to maturity restrictions at the time of the meeting, which occurred on October 4, 2011. Tr. 626, 653-54. Johnson recalled being concerned that, due to the departure of Flowers, Oglesby was the only person doing credit research and monitoring the approximately 200 securities on the approved list. Tr. 609-610. In response, ACM mentioned the existence of the maturity restrictions. Tr. 619, 626-27, 648-49. Johnson did not recall who specifically described the tiers and corresponding maturity restrictions, but testified that Gunn, Oglesby, and Prost would have been part of the conversation. Tr. 615. A follow-up email from Johnson sent on October 23, 2011, suggests that Oglesby spoke during this portion of the meeting. Ex. 374.

Anticipating questions from S&P's approval committee, Johnson requested and received from Oglesby additional information on the rating system after the meeting. Tr. 620-21. In an email to Oglesby on the afternoon of October 11, 2011, Johnson asked regarding the approved list: "I see the S&P ratings on this list, but when trading and the list is pulled, would a manager also know what the internal rating is? Or diversification and maturity restrictions which have been placed on the credit?" Ex. 50. Oglesby responded a few minutes later: "Yes, all managers know the internal ratings. I have included a revised approved list that includes the internal ratings. For MMF credits: Tier 1 (A) = no maturity restriction; Tier 1 (B) = 30 day maturity restriction; Tier 1 (C) = 7 day maturity restriction." *Id*. Oglesby testified that by "all managers" he meant everyone who could potentially manage the fund on a day-to-day basis, namely himself, Gunn, and Prost, and that "MMF" referred to AMMF. Tr. 1152, 1335. Johnson testified that this answer was consistent with what was said by ACM in the annual review meeting. Tr. 626.

Oglesby testified that his October 11 email reply to Johnson was the first time he told S&P about maturity restrictions associated with the tier rating system. Tr. 1147; Ex. 50. He explained that he used the word "restriction" in his email not to denote that the time periods were hard limits, but only because Johnson used the word "restriction" when posing her question in the original email. Tr. 1152-53. He described his decision to use the word "restriction" rather than "guideline" as semantics, and he testified that to him the word "restriction" meant the same thing as "suggestion" at the time he wrote the email. Tr. 1341-1343. Oglesby claimed that Johnson understood that the maturity limitations were guidelines rather than restrictions. Tr. 1341.

Johnson disagreed, explaining that she understood the internal rating as determining "how long the maturities of that particular security could be in the fund." Tr. 618. She testified that she was not informed that ACM portfolio managers could disregard the restrictions if they decided to do so. Tr. 626. She testified that this would have concerned her because it would not have adequately assuaged her concerns about how ACM was able to effectively monitor the large number of securities on the approved list, although she did not mention this concern during the investigation. Tr. 651-52, 656-57. She also would have been concerned that ACM was not being truthful in describing the restrictions. Tr. 656. Oglesby stated that he did not intend to mislead Johnson, and his understanding was that it would not matter to her whether the maturity limits were hard restrictions or soft guidelines. Tr. 1442.

On November 7, 2011, in advance of OCIE's on-site visit, OCIE sent a letter to ACM identifying certain materials that OCIE wanted to review as part of its examination of AMMF. Ex. 172. Oglesby assisted in collecting information in response to the letter. Tr. 1338. ACM's response to the letter used the word "restrictions" to describe the maturity limitations on Tier 1(A), 1(B), and 1(C) securities. Ex. 172 at 6. Thus, Bartolini testified that her understanding based on ACM's response was that Tier 1(C) securities "were subject to investments of no more than seven days." Tr. 207. Oglesby testified that he was unaware that ACM made this representation to OCIE. Tr. 1339-40.

Oglesby testified that despite his and ACM's use of the word "restriction" at various points in time, the maturity limitations were not hard limits and instead were a starting point for a portfolio manager to use when making decisions about the Fund's investments. Tr. 1144-45. A potential purchase which exceeded the internal maturity restriction and thus received a "fail" in the Ambassador Money Market Fund System would not necessarily be rejected; this would simply prompt ACM to investigate the reasons supporting the purchase of the security for a longer period of time. Tr. 1195-96, 1366-70. Oglesby identified a number of reasons why a manager might choose to buy a security with a maturity period longer than that prescribed in the restrictions. Tr. 1144-45. For example, he noted that some securities were not available in the time frame set forth in their tier, and he claimed that purchasing the security with a maturity a few days longer than the associated maturity restriction would be "totally acceptable" under such circumstances. Tr. 1145, 1196. He also suggested that the markets might change such that a particular security had a much steeper yield curve than its counterparts, which ACM would try to take advantage of even if that security's maturity was longer than that permitted by its tier. *Id.* According to Oglesby, ACM purchased securities outside the time frame set forth in the internal rating system only a small percentage of the time in any event. Tr. 1370.

Prost testified that as chief investment officer, he would "never allow" strict restrictions on maturity. Tr. 1645-46. He described the maturity restrictions as guidelines and noted that "if you are receiving enough yield and these are still high quality securities, we're not concerned" about purchases with maturities exceeding the guidelines. Tr. 1646. If a trader wanted to go outside of the maturity ranges, "[he] needed to get paid additional yield." Tr. 1703. He recalled telling Johnson during the October 2011 meeting that, with respect to the internal rating system, "we were putting in place a more granular look." Tr. 1647. He recalled that the maturity restrictions were incorporated into the internal rating system sometime "later in the year" in 2011. Tr. 1702-03.

ACM exceeded the maturity restrictions associated with each tier numerous times, both before and after October 2011. Ex. 174B-C; *see* Div. Br. at 19. Ten of these incidents occurred after October 2011 and involved the purchase of Tier 1(C) securities with maturities ranging from 10 to 45 days, in excess of the range of one to seven days assigned to that tier. Ex. 174C. For example, the October 2011 credit report of Scaldis Capital Ltd. assigns an internal rating of Tier 1(C) to the credit. Ex. 67 at 216. Oglesby agreed that this indicated that the one to seven day maturity guideline applied to the credit. Tr. 1359. However, in February of 2012, the Fund purchased Scaldis Capital Ltd. at a fourteen-day maturity. Ex. 13 at 87; Tr. 1361.

One particularly noteworthy pre-2011 credit research report, a June 2009 report for White Point Funding, Inc., contains a maturity restriction of one to three days. Ex. 31. Among the admitted exhibits is a second credit research report for White Point Funding, Inc., also dated June 2009, which does not contain a specific maturity restriction. Ex. 19B. Both are signed by Flowers as analyst and Oglesby as portfolio manager. Exs. 19B, 31. No internal tier rating appears on either report, as the reports pre-date the introduction of ACM's internal rating system. Exs. 19B, 31. The reports are identical except for the conclusion section. One report concludes that White Point Funding, Inc., "should only be purchased between 1-3 days to avoid long-term risk exposure." Ex. 31. The second report is vague regarding the maturity restriction, concluding instead that the credit "should only be purchased short-term to avoid long-term risk exposure." Ex. 19B. Prost testified that he did not know why the report was changed and claimed that in 2009, his opinion was that the security "easily" represented minimal credit risk. Tr. 1653-55. He testified that Flowers changed the report from "1-3 days" to "short-term" in June 2009. Tr. 1708. However, the report with the one to three day maturity restriction was forwarded to KPMG, the Fund's auditor, in August 2009 by De Nicolo. Tr. 717-19; Ex. 89. De Nicolo testified that she asked for and received the report from ACM after KPMG requested a copy in connection with their fiscal year-end audit. Tr. 717-19; Ex. 89. Throughout the second half of 2009, ACM repeatedly purchased the securities of White Point Funding, Inc., for maturities exceeding three days, including for maturities of 20, 21, 28, 29, 32, 63, and 90 days. Ex. 174A.

5. <u>Three Percent Limit on Longer-Maturity Securities</u>

After OCIE's November 2011 examination, Bartolini asked Prost to keep the Commission updated on any changes to the Fund's portfolio. Tr. 1691. On December 7, 2011, Oglesby emailed Prost a list of bullet points under the heading "Money Fund Management Updates." Ex. 106. Prost sent the list on to Bartolini later that day. Ex. 445. The bullet points identified various updates to ACM's management of the Fund, including: "Initiated 3% purchase limit to securities/issuers maturing more than 10 days." Exs. 106, 445. Oglesby testified that he did not recall whether he drafted the list at Prost's request and claimed he was unaware that the list was sent to the Commission. Tr. 1374-76. Prost disagreed, testifying that he told Oglesby that the updates would be forwarded to the Commission. Tr. 1728.

When asked whether the Fund adhered to the purchase limit described in his email, Oglesby disputed that it was a hard limit, labeling it a "goal" or "target." Tr. 1376-78. He explained:

> As a portfolio manager and trader, investment professional, our policies at Ambassador were not restrictive in nature. So if we thought of a better way to initiate or a better way to manage the fund, we would not constrict ourselves to maturity restrictions or, you know, purchase limits. It says "limit" in the e-mail, correct. I was speaking to a colleague in which this colleague would understand that the limit was not an actual hard limit.

Tr. 1378.

In the days following Oglesby's email, ACM conducted numerous trades on behalf of AMMF which exceeded the three percent purchase limit and had maturities longer than ten days. Tr. 1379-86; Ex. 13 at 29, 36; Ex. 14 at 21, 25, 35. The OIP makes no allegations regarding these trades. *See* OIP at 4-5.

D. <u>Active Breaches of Rule 2a-7 Diversification Requirements</u>

De Nicolo testified that during the Commission's September 2009 compliance examination of AMMF, she discovered she had previously been misreading Rule 2-a7's safe harbor provision for issuer diversification. Tr. 728-29. Prior to the 2009 examination, De Nicolo thought that the safe harbor provision could apply to more than one issuer; that is, that the Fund could purchase the securities of multiple issuers, each exceeding five percent at the time of purchase, as long as the securities were back below five percent within three days and the total amount the Fund invested in these issuers did not exceed 25%. *Id*.; Ex. 70.

Respondents contend that they relied on De Nicolo's interpretation of the safe harbor and as a result, they admit that "on a few occasions in 2009" ACM violated the issuer diversification rule. Resp. Br. at 26; Tr. 1565-67, 1657-58. De Nicolo acknowledged that she did not flag some purchases as noncompliant during this time, though they in fact were, due to her misinterpretation of the rule. Tr. 727. However, she never told ACM that particular purchases they were considering would be compliant, and she never instructed ACM on how much of a security to purchase. Tr. 728. Her role and that of FSG was limited to preparing reports and recording the Fund's transactions after the fact. *Id*. Jeffries agreed that it was ACM's investment team, including Nurre, Oglesby, Prost, Gunn, Schaefer, and Flowers, that was responsible for selecting the securities purchased by the Fund. Tr. 1499.

On May 18, 2010, the Commission sent a letter to Jeffries summarizing the deficiencies identified in the September 2009 compliance examination. Ex. 30 at 106. Among these deficiencies is the Commission's conclusion that:

> the Fund may not have complied with Rule 2a-7(c)(4)(i), because it did not adhere to the requirements for the "safe harbor" given that there were purchases of two separate securities on the same day that caused [AMMF]'s holdings of such securities to exceed the 5% threshold.

Ex. 30 at 110.

Prost claimed to have misunderstood the safe harbor provision until ACM received the May 2010 deficiency letter. Tr. 1657-58. He "received" this misunderstanding from De Nicolo. Tr. 1658. He recalled that De Nicolo sent ACM a note apologizing and acknowledging that she had misinterpreted the rule. Tr. 1659. He did not think that ACM was made aware of the misunderstanding prior to its receipt of the Commission's letter. Tr. 1658. De Nicolo disagreed, testifying that her new understanding of the safe harbor provision was communicated to ACM prior to its receipt of the letter. Tr. 729-30. Her testimony suggests that she recalled discussing her misunderstanding with ACM either in the exit interview with the Commission on September 25, 2009, or shortly thereafter. Tr. 727-730; *see also* Ex. 30 at 106 (noting that Prost and De Nicolo met with Commission staff during the exit interview to discuss a "portion" of the issues identified in the deficiency letter).

On May 21, 2012, Miller Canfield responded on ACM's behalf to an inquiry from the Commission regarding the 2009 issuer diversification violations. Ex. 70. The letter disclosed several dates on which AMMF invested, at the same time and measured at acquisition, over five percent of its assets in more than one issuer's securities that matured within three days (i.e., attempted to take advantage of the safe harbor rule but did so with multiple issuers). *Id.* These occurred on August 18, 2009, December 7, 2009, and December 18, 2009. *Id*. The letter also identifies two occasions – on February 12, 2009, and December 30, 2009 – when AMMF invested more than five percent of its total assets in a security that did not mature within three days. *Id*. ACM also generated several spreadsheets relating to the alleged 2009 active breaches. Tr. 1037. The spreadsheets identify four active breaches in 2009: August 12, 2009, December 7, 2009, December 18, 2009, and December 30, 2009. Ex. 466A. The materials indicate that the February 12, 2009, potential active breach was not actually a violation of Rule 2a-7 because the security was sold the next day, bringing it within the safe harbor provision. Div. Ex. 466A.

The Division's prehearing brief identifies active breaches occurring on three days in 2010: January 28, 2010, June 21, 2010, and December 17, 2010. Div. Prehearing Br. at 9; *see* Tr. 1867. These 2010 alleged violations are not identified in the OIP but are discussed by the Division's expert in his report, in which he concluded that each of the three were active breaches. Ex. 112 at 16-17. At the hearing, the Division's expert equivocated on this point, testifying that the trades at issue on December 17, 2010, "could very well have been active breaches" but he couldn't be sure because he only knew that they were above five percent at the end of the trading day, not whether they were also above five percent at the time of their purchase. Tr. 938-40.

E. Stress Testing

1. Performance and Adequacy of First Stress Test

On November 16, 2010, De Nicolo emailed Prost, copying Oglesby and Jeffries, attaching the Rule 2a-7 requirements for stress testing and asking Prost to provide a list of hypothetical stress testing scenarios so that she could include it in the Board package for the Board meeting to be held on November 19, 2010. Ex. 62; Tr. 739-41. Oglesby testified that it was around this time that he was first introduced to Rule 2a-7's new stress testing requirements. Tr. 1387-88. It is unclear what response to De Nicolo's email, if any, was provided by Prost or others at ACM. The only stress test information included in the board packet for the November 2010 meeting is a copy of Rule 2a-7(c)(10). Ex. 156 at 27-28.

De Nicolo reviewed the stress test requirements with the Board at the November 2010 meeting, and the "Board, with the assistance and input of counsel, discussed the frequency and intervals at which testing should be conducted" and "discussed the development of a stress-testing model" for the Fund. Ex. 468 at 5. The Board resolved that the stress test should be performed annually[7] and should cover all the hypothetical events stated in Rule 2a-7, with the first stress test results presented at the next Board meeting. *Id.* Guy, a trustee of the Board, described the discussion at the Board meeting as a "general discussion around how often stress testing would take place." Tr. 445. The minutes do not reflect any discussion of the specific scenarios to be included in the test.

On December 28, 2010, De Nicolo emailed Oglesby, copying Jeffries, Prost, and Curtis, reminding Oglesby that "per the discussion at the last Board meeting, [ ] a stress test needs to be performed on the Money Market Fund as of 12/31/10. The test/analysis can be done next week using the 12/31/10 portfolio and net asset level." Ex. 63. Curtis followed up with Oglesby on February 9, 2011, asking him to send the stress test results because they needed to be included in the Board package for the February 11, 2011, Board meeting. Ex. 168. The next day, Oglesby sent the stress test results to Jeffries and Prost, copying De Nicolo and Curtis, and asked: "Tell me what you think….should we go with it?" *Id.* De Nicolo did not recall seeing any correspondence or work product regarding stress testing prior to this email. Tr. 744-45.

On the afternoon of February 11, 2011, Oglesby emailed the stress test results to De Nicolo and Curtis, copying Jeffries and Prost, for inclusion in the Board package for that day's meeting. Ex. 64; Ex. 463 at 159; Tr. 1396, 1495. This was the first Rule 2a-7 stress test performed on the Fund, although AMMF did informal stress tests as part of its portfolio management activities, which did not meet the requirements of the stress tests mandated by Rule 2a-7. Tr. 1396, 1489-90. Oglesby designed the test and discussed it with Prost. Tr. 1267-69, 1443-44, 1666. Jeffries agreed that Oglesby had primary responsibility for the first stress test. Tr. 1492-93. Oglesby did not have any discussion with De Nicolo about whether a lawyer should weigh in on the stress test and its compliance with Rule 2a-7. Tr. 1395. Oglesby also did not recall anyone from ACM seeking the input of an attorney in reviewing the stress test. Tr.

[7] This was changed to quarterly at the February 2012 meeting. Ex. 476 at 11.

1395-96. De Nicolo testified that she understood it to be ACM's responsibility to determine the design and contents of the stress test. Tr. 745.

The first stress test's results consist of a one-page document with two graphs and a short narrative explanation of the parameters and results of the test. Ex. 463 at 159. According to this document, the test attempted to "model the impact of interest rate shocks, liquidity shocks, and credit shocks" on the Fund. Ex. 64 at 2. The results do not specifically reference shareholder redemptions. Tr. 1762. The Division claims that the first stress test was deficient because it failed to include a test for an increase in shareholder redemptions and it failed to test concurrent occurrences of the codified hypothetical events. Div. Reply at 18. Respondents dispute that the first stress test did not test for an increase in shareholder redemptions, claiming that the test evaluated the effect of an increase in shareholder redemptions by testing the portfolio's response to a "fire sale," on the theory that redemptions beyond the Fund's liquidity could require it to sell its holdings at a loss. Resp. Br. at 32; Resp. Reply at 16; Tr. 1282-83, 1397-98, 1444.

During the investigation, when asked then about the changes between the first stress test and later tests, Oglesby testified that the "earlier stress test was not taking into account the redemptions and purchases, hypothetical redemptions and purchases of the fund." Tr. 1400, 1721; Div. Br. at 24. At that time, Oglesby agreed that the redemption "should have been" included in the test, but claimed that "[w]e were just not instructed to do so." Tr. 1401.

During the hearing, however, both Oglesby and Prost testified that an increase in shareholder redemptions was shown in the results by charting what would happen if fifty percent of the portfolio widened by 500 basis points. Tr. 1283, 1666. Oglesby explained that this scenario, represented by the fourth bar on "Alternative Stress Test Scenarios" graph, demonstrated what would happen if the interest rate increased by five percent for half of the securities in the portfolio. Tr. 1287. He testified that a number of things could cause this to occur, including significant downgrades of the securities in the portfolio, negative credit events, shareholder redemptions, or some combination of these factors. Tr. 1288-90. With respect to shareholder redemptions, Oglesby explained:

> "When you think about how would you structure a stress test stressing redemptions, if you have redemptions in the fund, as long as you have cash and/or liquidity to support the redemption, there will be no valuation change in the fund. The only way that a redemption could cause a valuation change in the fund is if you don't have that liquidity and you had to actually sell. So this event, you're actually in the act of selling at an extreme lower -- extremely low amount versus relative to where you purchased the security. So that's why this example speaks specifically to redemptions."

Tr. 1290. Oglesby testified that this bar of the graph also covered downgrades, another scenario mandated by Rule 2a-7:

> Q: To what extent, if any, would [the fourth bar on the stress test graph] also address a scenario involving a large drop in value for another cause, such as a downgrade or default?

> A: There would be no reason to sell. The only reason why we're selling is because we need liquidity. So an extreme -- a downgrade, yes, the yield of that security would increase, so, yes, it -- it could be a part of the scenario as well.

Tr. 1290-91.

Prost's explanation of the first stress test was similar. He claimed that the test for widening fifty percent of the portfolio by 500 basis points covered a shareholder redemption scenario because "the issue with redemptions is that you would not have enough liquidity, and, therefore, you would have to sell securities. And that's not necessarily bad unless . . . the price on the securities have dropped for some reason." Tr. 1666-67. He recalled discussing with Oglesby in early 2011 the need to test for four different scenarios, and he believed one of those was redemptions, though he did not recall with confidence the details of the conversation. Tr. 1719-20, 1725-26, 1762-63.

The results of the first stress test were presented to the Board at the meeting held on February 18, 2011. Ex. 97 at 8. Oglesby reviewed the results and noted that the portfolio could sustain a loss of nearly $800,000 caused by a single issuer's default. *Id*. He also reviewed the scenarios in which the Fund's NAV might deviate from $1.00. *Id*. The minutes do not indicate the discussion of any other hypothetical scenarios, including shareholder redemptions. *Id.* at 7-8. No one present at the meeting suggested that the test was untimely or inadequate. Tr. 1291-92.

Stress test results were next presented to the Board in February 2012. Tr. 1402; Exs. 95, 334. Those and subsequent test results differ in form from the first stress test results. Exs. 95, 334. Prost testified that this change was due to S&P's release of a standard stress test format it recommended for its rated money market funds, which ACM decided to use for AMMF. Tr. 1765. Among other changes, the later test results explicitly reference redemptions. Tr. 1496, 1765-66; Ex. 60. A stress test methodology circulated by Oglesby in November 2011 indicates that the revised stress test model showed the impact of the following scenarios:

- Parallel interest-rate shifts of plus/minus 200 basis points in 50 basis point increments
- Asset decreases or redemptions of 10%, 15%, 20%, 25% out to 75%.
- Largest Historical 5 business day net redemption
- A downgrade on the largest issuer exposure (excluding sovereign government issuers rated "AA-[") or higher)
- The widening and narrowing of credit spreads (based on current market conditions).

Ex. 318 at 5.

2. <u>Stress Test Updates to the Fund's Rule 2a-7 Guidelines and Procedures</u>

The admitted exhibits include three different versions of AMMF's Rule 2a-7 Guidelines and Procedures. The first have an effective date of 2000 (Ex. 20); the second reflect amendments through December 9, 2005 (Ex. 16); and the third were revised on November 17, 2011, but indicate an effective date of August 27, 2010 (Ex. 15).

The guidelines with an amended date of December 2005 include the handwritten note: "incorporate final rules issued by SEC 2/23/2010." Ex. 16. Attached to the guidelines is a document on Dykema Gossett letterhead entitled "Final Rule Amendments Affecting Money Market Funds." A handwritten note on the memorandum states: "Included in the 8/27/2010 Ambassador Board material. Final rule amendments incorporated into Fund's Rule 2a-7 Guidelines and Procedures." *Id*. The Dykema Gossett memo includes a short section on stress testing, noting that the Board must adopt procedures providing for periodic testing to be done at intervals deemed appropriate by the Board. *Id.*

The Commission requested a copy of AMMF's Rule 2a-7 guidelines and procedures during its November 2011 sweep examination of AMMF and other money market funds. Tr. 789. De Nicolo testified that at this time she discovered that she did not have a copy and called legal counsel to request one. *Id*. Cutshall sent her a copy of the guidelines on November 16, 2011, which he described as the "2010-revised Ambassador Rule 2a-7 Guidelines." Ex. 73. De Nicolo reviewed these and determined that the guidelines did not actually incorporate the changes required by the 2010 amendments to Rule 2a-7; the guidelines were simply the 2005 guidelines with the Dykema Gossett memo and the handwritten notes described above. Tr. 790-92; Ex. 73. De Nicolo asked Cutshall to update the guidelines to ensure that all the current Rule 2a-7 requirements were included. Ex. 73; Tr. 791. Cutshall responded, noting that "[i]t looks (and I pulled the August 2010 Board materials to be sure) as though Dykema never followed-through on making any of the updates." Ex. 73. The minutes of the August 27, 2010, Board meeting do not contain any indication that the Dykema Gossett memo was formally or informally incorporated into the Fund's existing Rule 2a-7 guidelines. Ex. 94 at 18. De Nicolo testified that despite this, ACM was already operating under the revised procedures set forth in the Dykema Gossett memo. Tr. 791.

De Nicolo requested that Cutshall provide a revised draft of the guidelines for the Commission by the following day, November 17, 2011, and De Nicolo sent the new version of the guidelines to ACM on November 18, 2011. Ex. 61, 73; Tr. 793-94. The revised draft contained a short section on stress testing. Ex. 15. It described the fundamentals of the testing, lists the hypothetical events to be analyzed, and notes the basic elements to be included in the stress test reports. *Id*.

Bartolini testified that when she asked for the Fund's current Rule 2a-7 guidelines during the November 2011 sweep examination, she was given the 2005 guidelines with the attached Dykema Gossett memo. Tr. 157-59. She testified that she expressed concern to De Nicolo about the fact that the guidelines appeared to be outdated and lacked evidence of formal adoption by the Board. Tr. 159-60. After that, she received the new guidelines with the revised date of November 17, 2011. Tr. 160. Bartolini was still concerned because she knew there had been no Board meeting on November 17. Tr. 160-61; Ex. 92.

Cutshall testified that the revised guidelines were reviewed by the Board at their next regularly scheduled meeting, and he claimed that the Board "adopted them, or ratified them, retroactivity effective to August 2010, when that board took its -- took office, and since we were informed that -- these policies and procedures had been followed at that time." Tr. 813. However, the minutes of the next Board meeting, which took place on February 13, 2012, do not contain any discussion or resolutions related to the revised Rule 2a-7 guidelines. Ex. 95 at 5-21. It appears that the guidelines were not actually ratified by the Board until the meeting held on May 21, 2012. Ex. 95 at 3.

F. Representations to the Board

The OIP alleges that ACM and Oglesby misled the Board on four matters: exposure to European issuers during the Eurozone crisis, issuer diversification, compliance with internal maturity restrictions, and minimal credit risk determinations. OIP at 1, 4-8. ACM and Oglesby claim that they tried to provide the Board with accurate information and never knowingly misled or attempted to lie to the Board. Resp. Reply 1-11; Tr. 1446. Oglesby disputes that he was the speaker of certain of the comments reflected in the minutes of the Board meetings, and both he and ACM challenge the accuracy of some statements in the meeting minutes. *Id*.

1. General Practices for Board Meetings and Minutes

AMMF Board meetings were held at ACM's offices in Detroit until mid-2010, when AMMF began sharing a board with the Monetta Funds. Ex. 29 at 1; Ex. 30 at 2; Ex. 94 at 1; Tr. 517, 1648. Thereafter, combined Board meetings of AMMF and the Monetta Funds were held at Monetta's offices in Wheaton, Illinois. Tr. 517.

De Nicolo prepared the agenda for each Board meeting, which legal counsel reviewed and finalized. Tr. 696. The first item on the agenda was the review of the minutes of the prior quarter's meeting. Tr. 696-97; Ex. 27 at 1; Ex. 92 at 1. The Board would then separately consider the Monetta Funds and AMMF. *See*, *e.g.*, Ex. 92 at 1-2. The agenda for meetings both before and after the combination with the Monetta Funds contained the following standard AMMF subject matters and bulleted items for the Board's consideration:

(1) Investment Performance and Financial Reporting

- AMMF's ranking to other mutual funds
- Contributions and withdrawals summary
- Expense ratio
- Projected versus actual expenses
- Annual financial reports
- Fees paid to affiliates of ACM

(2) Rule 2a-7 Compliance Matters/Approval of Use of Amortized Cost Method

- Mark-to-market pricing comparison
- Rule 2a-7 compliance report
- Review of portfolio's transactions during the quarter
- Creditworthiness of repurchase agreement counterparties

(3) Compliance Reporting

- Approve list of commercial paper issuers
- Liquidity determination
- Anti-money laundering report
- Quarterly asset diversification test report
- Rule 17a-7 and 17e-1 reporting
- Report on internal stress testing (beginning with November 14, 2011 meeting)

Ex. 30 at 4-5; Ex. 92 at 1. Meeting agendas before the combination with the Monetta Funds reflect a slightly different order of events, with Compliance Reporting first, Investment Performance and Financial Reporting second, and Rule 2a-7 Compliance last. Ex. 27 at 1-2; Ex. 30 at 4-5.

When the location of the Board meetings changed to Illinois in mid-2010, Oglesby and Prost began participating by phone from ACM's offices in Detroit rather than attending the meetings in person. Tr. 1217-1218, 1308, 1648. Jeffries generally continued to attend in person, joining Oglesby and Prost on the phone only on the few occasions he did not travel to Illinois. Tr. 1217-18, 1469-70. Jeffries and Oglesby were present, physically or telephonically, at all Board meetings. Tr. 1220, 1469-70. Prost attended all meetings prior to the Monetta Funds combination, but subsequently he missed at least one meeting. Tr. 1648.

Prior to the meetings, a packet containing various items to be discussed at the next meeting was circulated to the Board. Tr. 311. The packets included the meeting agenda, the prior meeting's minutes, the approved list, the list of securities added to and removed from the Fund since the last Board meeting, a quarterly performance summary comparing AMMF's yield to other money market funds, a summary of all subscriptions and withdrawals from the Fund, and a purchase journal showing all of the Fund's purchases for the previous quarter. Tr. 310, 315-18, 322-23, 354; Ex. 463. De Nicolo assembled the board packet, but certain of the items were prepared by ACM, including the approved list and the list of securities added to and removed from the Fund since the previous meeting. Tr. 697-700, 1228; Ex. 346 at 2.

The purchase journal included in each board packet was generated by FSG and listed all trades (both purchases and sales) made for AMMF for the previous quarter, including the trade date, the name of the security, the rate and maturity date, the quantity, the price, and the broker. Tr. 675, 707-08; Exs. 11-13. Koski testified that he did not review the purchase journals in detail, and he did not expect that the other Board members did so. Tr. 323. Hodges confirmed that she reviewed the purchase journals but did not study or analyze them, and she expected that the other Board members did the same. Tr. 537. At each meeting, the Board resolved that the securities listed on the journal were purchased in accordance with creditworthiness guidelines, were of eligible quality, and presented minimal credit risks. *See, e.g.*, Ex. 92 at 9.

Oglesby testified that he participated only in the investment advisor portion of the Board meetings. Tr. 1220. Jeffries testified that Oglesby and Prost were usually called in to make general commentary about the marketplace, availability of supply, interest rates, and macroeconomic issues; he claimed that it was always De Nicolo who led discussions on compliance. Tr. 1477-78. Cutshall testified that Prost and Oglesby usually left the meetings after they made their presentations and before the compliance discussion took place. Tr. 837-38. He noted that Board meetings typically, but not always, followed the order of the meeting agenda. Tr. 826. De Nicolo agreed that Prost and Oglesby left the meeting "most of the time" before the compliance discussion. Tr. 797-98.

The Fund's legal counsel generally took the official minutes for the Board meetings. However, for two meetings in 2011 – August 8 and November 14, 2011 – the official minutes were recorded by Karen Blake, a professional stenographer, who attended the meetings in person. Tr. 749-50, 825-26; Ex. 92 at 4; Ex. 98 at 1. The Fund's legal counsel still took notes during these two meetings, but the stenographer was used to try to reduce the legal fees incurred in preparation of the minutes. Tr. 750, 759, 815-16. The minutes were intended to be a summary of the topics covered and decisions made at each meeting. Tr. 1307-08; 1471. Cutshall testified that "there would be times where, based on the organizational structure of the agenda and the materials in the board packet, certain information might be moved or appear slightly out of order." Tr. 826. He agreed that the organization of the minutes was best described as topical rather than perfectly chronological. Tr. 826-27.

2. Exposure to European Issuers

In June 2011, S&P downgraded Greek sovereign debt to a rating of "CCC." Ex. 112 at 19. This precipitated a crisis commonly known as the "Eurozone crisis," in which the debt of certain European countries was downgraded and investments in some European entities were perceived as riskier. *Id*.; Tr. 747. As a result of this crisis, the Board was "reticent and cautious" when it came to investing in Eurozone countries in mid-2011. Tr. 532.

a. *August 8, 2011 Board Meeting*

At the Board meeting following the beginning of the Eurozone crisis, ACM discussed its potential impact on the Fund. Tr. 748-49, Ex. 98. The minutes reflect that Prost, Oglesby, and Jeffries were the ACM participants at the meeting. Ex. 98 at 3; Tr. 1221. The final minutes of the August 2011 Board meeting state as follows:

> The Board of Ambassador welcomed Messrs. Prost and Oglesby to the meeting. Mr. Oglesby reviewed the performance of the Fund. He indicated that the past year has been extremely difficult. He noted that record low interest rates continue, but that yield is up slightly in the last few weeks. Mr. Oglesby discussed Europe's [role] in the current market environment. He noted ACM is avoiding Greece, Spain, Italy and other countries seen as higher-risk investments by ACM. The Board and Mr. Oglesby also discussed the current interest rate environment and ACM's thoughts on the yield curve and interest rate outlooks.

Ex. 98 at 3.

Oglesby remembered bits and pieces of the August 2011 meeting but had no recollection of the details of what was said. Tr. 1218. Despite his lack of memory, he did not think that he made the statement reflected in the minutes, nor did he think that Prost did so, because the statement was not true. Tr. 1222-23. He explained:

> Well, we owned Italian securities at that time, and it would make no sense in saying avoiding a particular country. We didn't buy any Greece or Spain securities, and we did own Italian securities. So it just did not – it wouldn't have made sense.

Tr. 1222. Oglesby testified that as portfolio manager of AMMF at the time, he knew "exactly what was in the portfolio" and that the Italy-related securities owned by AMMF at the time were Arabella Finance LLC,[8] Romulus Funding Corporation,[9] and ENI Finance USA.[10] Tr. 1223-24. He recalled that ACM was not completely avoiding Italy in August 2011 but was instead in the process of reducing AMMF's exposure to certain markets by lowering the maturities of the securities it purchased for the Fund. Tr. 1224. He noted that while Greece and Spain were "clearly out of the realm of what we deemed as minimal credit risk," ACM felt that Italy was different. Tr. 1222-23.

Prost testified that he did not independently recall the meeting, but he believed that he spoke the entire time and that Oglesby did not speak. Tr. 1667-68. He testified that because the Eurozone crisis was ongoing, it was logical that he would have spoken to the Board about it. Tr. 1669. He confirmed that the Fund did not own any Greece or Spain-based securities at the time, but that it did hold securities based in Italy. *Id*. Prost did not think the statement to the contrary in the minutes was an accurate description of what was said at the meeting, regardless of the alleged speaker. Tr. 1670. He noted that ACM "had been in discussion about Italy just prior to that, because we had taken the two asset-backed securities down to overnight." Tr. 1670. He also seemed to suggest that the Board would not have insisted upon such specifics about the Fund's investment strategy, explaining that "[t]he Board had never questioned anything we had ever done. We didn't have any reason to speak that way." *Id*.

Jeffries participated in the August 2011 meeting by telephone but had no recollection of what was discussed. Tr. 1474-75; Ex. 340. De Nicolo attended the meeting in person, and she testified that she believed that the minutes accurately reflected the discussion regarding the

[8] A credit research report for Arabella Finance LLC, dated July 2011, assigned it an internal rating of Tier 1(C) and concluded that the security represented minimal risk. Ex. 404. The report described the credit support as a letter of credit from a financial institution associated with Italy. *Id.*

[9] A credit research report for Romulus Funding Corporation, dated May 2011, assigned it an internal rating of Tier 1(C) and concluded that the security represented "moderate risk." Ex. 405. The report described the credit support as a letter of credit from an Italian banking group. *Id.*

[10] A credit research report for ENI Finance USA Inc., dated March 2011, assigned it an internal rating of Tier 1(B) and concluded that the security represented minimal risk. Ex. 406. The report described the credit support as a guarantee from its Italian parent, an integrated energy group. *Id.*

Eurozone crisis and ACM's investment strategy. Tr. 748-49. Hodges testified that she did not recall whether the statements were made by Prost or Oglesby, but she believed that it was someone from ACM. Tr. 533, 1310. She was certain that the Board was told that ACM was avoiding Greece, Spain, and Italy. Tr. 1309-10.

On October 11, 2011, the stenographer sent De Nicolo her draft minutes for the August 2011 Board meeting. Ex. 88. The draft contains the following paragraph on Oglesby's statements regarding ACM's Eurozone investment strategy:

> Mr. Oglesby reviewed the performance of the Fund. The last year has been very tough. Liquidity is better, but as a result, rates are lower, and we have record low interest rates. The short term markets have been hard, but Europe has played a huge [role] in that risk assessment. They are trying to stay away from Greece, Spain, Italy and other countries doing poorly in the credit area. Finding gains on the approval list is a challenge. Positioning is being done on long term and short term. They are forced to buy European paper, but are picking the better countries: England and Germany. Trying to stay liquid and active.

Ex. 88 at 13.

De Nicolo was the principal editor of the AMMF section of the minutes. Tr. 754. She testified that she made all edits that she felt were appropriate based on her memory at the time; she did not take notes at the meetings. Tr. 754-55. After making revisions to the stenographer's draft, De Nicolo sent the minutes on to Bacarella, president of the Monetta Funds and chairman of the Board. Tr. 754. She incorporated Bacarella's edits into the draft and on October 19, 2011, sent the draft on to Cutshall. Ex. 75 at 1; Tr. 1410. Her email to Cutshall notes that Bacarella reviewed and revised only the Monetta performance section of the minutes. Ex. 75; Tr. 1410-11.

The draft sent to Cutshall reflects minor changes in the paragraph summarizing Oglesby's statements on the Fund's European strategy. Ex. 75 at 15. However, the key component remained unchanged – the draft minutes identify Oglesby as explaining that ACM was "trying to stay away from Greece, Spain, Italy and other countries doing poorly in the credit area and are focused on the better countries such as England and Germany." *Id.*; Tr. 755. De Nicolo testified that she thought this was an accurate representation of what had been discussed at the meeting, and claimed that she otherwise would have changed the statement. Tr. 755-57.

On November 4, 2011, Cutshall sent a redline copy of the minutes back to De Nicolo, showing the edits he made to the draft minutes. Ex. 76. Although Cutshall had not met Oglesby or Prost in person prior to the August 2011 meeting, he had attended four meetings of the Fund at which they were present telephonically, and he testified that he recognized Oglesby's voice and could tell him and Prost apart. Tr. 815, 832-33. Cutshall's revised draft includes a number of changes to the paragraph in question, though the countries identified and the speaker of the statements remain unchanged. *Id.*; Tr. 758-59. Notably, he changed the sentence "They are trying to stay away from Greece, Spain, Italy, and other countries doing poorly in the credit area" to "[Ogesbly] noted ACM is avoiding Greece, Spain, Italy and other countries seen as higher-risk investments by ACM." Ex. 76 at 18, 98 at 3. He testified that this language was more precise and accurate based on his recollection of the meeting and his own contemporaneous notes. Tr. 814-15, 820. Hodges agreed that her understanding was not that ACM was "trying" to stay away from the identified countries but that it "was avoiding" the countries. Tr. 1310. Cutshall's revised draft, including this change, was voted on and approved at the next Board meeting. Ex. 92; Tr. 823.

b. *AMMF's Investments Between August and November 2011*

Between August 8, 2011, and the next Board meeting held in November 2011, ACM purchased millions of dollars of the securities of Arabella Finance LLC, Romulus Funding Corporation, and ENI Finance USA for the Fund, all issuers with exposure to Italy. Ex. 483; Tr. 1736-37. Oglesby was in charge of buying and selling securities for the Fund during this time frame. Tr. 1414.

c. *November 14, 2011 Board Meeting*

The next Board meeting occurred on November 14, 2011. Ex. 92. According to the minutes, Jeffries, Prost and Oglesby were again the ACM participants at the meeting, with Oglesby and Prost participating telephonically and Jeffries attending in person. Tr. 1225-27, Ex. 92.

The minutes of the November 2011 meeting reflect the following update on AMMF's exposure to European markets:

> The Board reviewed, with the assistance of materials prepared by Ms. De Nicolo, the Money Market Fund's purchases during the quarter, and discussed the investment options available to the Money Market Fund. Mr. Oglesby assisted in this review, discussing general market conditions, the options available to the Money Market Fund and the foreign and domestic short-term fixed income markets, noting for the Board the Money Market Fund's limited exposure to European markets, including that the Money Market Fund has no assets issued in the Greek market place and had minimal second-hand exposure to the Italian market (and that the asset in question would be off the books of the Money Market Fund as of mid-November, after which time the Money Market Fund would have no exposure to the Italian market). He also noted that ACM has been shortening the weighted average of the maturity of the portfolio, and increasing the credit strength.

Ex. 92 at 9-10.

Oglesby testified that he did not have a clear recollection of what was discussed at the November 2011 meeting. Tr. 1225-26. While reviewing the meeting minutes did not refresh Oglesby's precise memory of the excerpted portion of the meeting, he agreed that it was something he might have said. Tr. 1229. He also stated that he believed the statement in the minutes was accurate. Tr. 1415. As of that date, he testified that it was true that the Fund did not have any assets issued in the Greek marketplace and had minimal secondhand exposure to the Italian market. Tr. 1229. However, he reiterated that he did not remember personally making the statements and testified that he did not recall whether Prost participated in the meeting and might have made the statements. Tr. 1230-31, 1254-55.

Prost believed that Oglesby spoke during this portion of the meeting. Tr. 1677, 1730-33. He claimed that he normally led discussions, with Oglesby sometimes but not always participating. Tr. 1729-30. He agreed that it had been Oglesby who said that the Italian assets would be "off the books" by mid-November, and he acknowledged that this was a subject that Oglesby would have discussed with the Board, although he did not believe that the minutes quoted Oglesby's statements verbatim. Tr. 1733-35, 1776. De Nicolo testified that she did not have a clear memory of this part of the meeting but had no reason to doubt that the minutes were accurate. Tr. 761-62. Jeffries did not recall the meeting and could not confirm whether the minutes were accurate in attributing the statements regarding European exposure to Oglesby. Tr. 1524-25.

Hodges testified that it was her understanding from the discussions at the November 2011 meeting that ACM was avoiding the countries that were most at risk to the Eurozone crisis, which she identified as Portugal, Italy, Spain, and Greece. Tr. 535-36. She pinpointed "Italy in particular" as a country ACM was avoiding due to inherent risk. Tr. 536. She recalled that the Board understood ACM's discussion to mean that the Fund was staying away from Italy, and that the minimal secondhand exposure discussed at the meeting was "very short, limited" and "going away." Tr. 1310, 1312-13, 1316. She did not recall who from ACM was speaking at this time. Tr. 1311. Guy testified that the minutes are consistent with his independent recollection. Tr. 482.

d. *ENI Finance USA*

The "limited secondhand exposure" described in the minutes was through securities issued by ENI Finance USA. Tr. 1229-30, 1679-80. ENI, the parent of ENI Finance USA, is an Italian utility company partially sponsored by the Italian government. Tr. 1233-35; Ex. 406. Oglesby described ENI Finance USA as comparatively less risky than other securities due to the fact that ENI was a utility company rather than a financial institution. Tr. 1232. He explained that ENI Finance USA received revenues from the cash flows of a U.S.-based utility company in the Gulf of Mexico. Tr. 1235. A March 2011 credit research report for ENI Finance USA indicated that the security qualified as a government-related issuer because of its 30.3% direct and indirect ownership by the Italian state. Ex. 406. Oglesby personally performed the research on ENI, including the research done as part of the minimal credit risk determination process. Tr. 1235-36.

The purchase journal for the last quarter of 2011 shows a purchase of four million shares of ENI Finance USA on November 14, 2011. Ex. 92 at 61. The purchase journal also shows a purchase of five million shares of ENI Finance USA on November 9, 2011, with a maturity date of November 16, 2011. Ex. 92 at 61. The purchase journal lists only the date of the purchase, not the precise time it occurred. Ex. 92 at 61. However, Oglesby testified that ACM purchased ENI Finance USA securities on the same day of, but prior to, the November 14, 2011, Board meeting. Tr. 1415-16. This is possible, but somewhat unlikely; the Board meeting began at 9:13

a.m., and the journal lists ENI Finance USA as the seventh of ten purchases on that day. Ex. 92 at 4.

According to Oglesby, the statement in the minutes regarding the asset being "off the books" meant that the November 14 purchase of ENI Finance USA would mature in mid-November, and ACM would let the security expire. Tr. 1230. This is corroborated by the purchase journal, which indicates that the ENI Finance USA securities purchased on November 14 had a maturity date of November 18, 2011. Ex. 92 at 61. Oglesby testified that ACM decided to stop purchasing the securities of ENI Finance USA after the November 14 purchase because the long-term debt of European issuers and equity markets had become volatile. Tr. 1231. Prost gave a similar explanation, testifying that "volatility had gotten high enough that there was a concern that the market was going to act irrationally, and we thought it would be better to just be completely out." Tr. 1681.

Oglesby could not recall whether the Board was told that ENI Finance USA was the issuer referenced at the November 2011 Board meeting. Tr. 1420-21. Hodges did not recall being informed of this. Tr. 1314. While the purchase journal for the Fund was included in the board packet for every meeting, De Nicolo noted that she would not be able to tell, based on the name of a security, whether it had exposure to European risk, or which country it might be exposed to. Tr. 763-64. Koski, though not on the Board at this time, testified that Prost and the ACM portfolio managers did not discuss specific securities unless asked by the Board. Tr. 316-17.

e. *AMMF's Purchase Activity After the November 2011 Board Meeting*

After the November 14, 2011 Board meeting, there was a 12-day period during which the Fund no longer held the securities of Arabella Finance, Romulus Funding, or ENI Finance USA. Tr. 1417, 1770; Ex. 483. On November 22, 2011, Prost emailed Jeffries the current holdings report for AMMF, noting that the Fund did not have any direct exposure to Italian issuers but had indirect exposure through non-Italian European banks with business in Italy. Ex. 322. This information was relayed by Jeffries to OCIE later that day. Ex. 390; Tr. 1738-39.

After the twelve-day hiatus, ACM's concerns about ENI Finance USA changed, according to Oglesby, in late November or early December 2011. Tr. 1231-32, 1417. Oglesby testified that this was due to the fact that the European Central Bank and the Federal Reserve signaled that they were going to shore up the financial system, and Oglesby felt that this move reduced risk instantaneously in the marketplace. Tr. 1232, 1417. In support of ACM's decision to re-invest in ENI Finance USA, Respondents have submitted a number of news articles containing updates on the Eurozone crisis and Italian debt. Exs. 434-442. The articles range in date from November 17, 2011, to December 8, 2011. *Id.*

Prost provided a similar explanation for ACM's decision to re-invest, explaining that "by December 1st, the European Union as a whole telegraphed their move to shore up their banks." Tr. 1682. He also noted that interest rates were rising aggressively in Europe throughout most of November and dropped substantially on November 30, 2011. Tr. 1681-82. Both Oglesby and Prost also followed the stock market generally and monitored the stock price of ENI Finance

USA, the increase in which Prost testified was a "small part" of ACM's decision to resume purchasing the security. Tr. 1236, 1682, 1704-05. A demonstrative introduced by Respondents' counsel at the hearing shows the stock price of "ENI US Equity" declining sharply between November 16 and November 25, and gradually increasing thereafter. Ex. 492. Oglesby testified that the evidence "in writing" of his change in opinion regarding the risk associated with ENI Finance USA was the Fund's renewed purchasing of the security and the approved list; that is, the ENI Finance USA credit research report had not been updated in light of the Eurozone crisis. Tr. 1418-19. When asked the same question, Prost agreed that the credit research report for ENI Finance USA was dated March 2011 and had not been updated thereafter in light of the Eurozone crisis. Tr. 1706-07.

ACM resumed purchasing ENI Finance USA on December 1, 2011, when it purchased nine million shares of the security. Ex. 92 at 63. It made additional purchases of ENI Finance USA throughout the rest of the month, generally holding around $8,000,000 of the security at any given time. Ex. 92 at 63-67. Oglesby testified that ACM did not tell the Board about its change of opinion regarding the risk associated with purchases of ENI Finance USA. Tr. 1420. This was confirmed by Hodges, who testified that she was not told that ACM changed its approach to purchasing Italian or other Eurozone securities after the November 2011 meeting. Tr. 537. Prost explained that conversations with the Board were focused on financial institutions, and ACM "didn't even think about" informing the Board about the decision to resume investing in ENI Finance USA. Tr. 1774-75. Hodges testified that she would have been concerned if she had known that ACM had actually purchased securities with Eurozone or Italian exposure. Tr. 536. Guy agreed that he would have wanted to know if ACM changed its approach with respect to Eurozone securities generally. Tr. 482-83.

Oglesby's December 7, 2011, email to Prost, containing the bulleted list forwarded to Bartolini as an update on the Fund's portfolio, included the representation that the Fund had reduced exposure to Italian banks to 0% and had 4.3% exposure to Italy. Exs. 106, 445. Prost testified that the 4.3% Italy exposure was through overnight purchases of ENI Finance USA. Tr. 1691-92. The purchase journal for December 2011 indicates that the Fund purchased ENI Finance USA at one-day maturities on December 5, 6, and 7, but that it repeatedly purchased the security only at longer maturities starting on December 8, 2011. Ex. 92 at 64-66.

f. *February 13, 2012 Board Meeting*

The minutes of the next Board meeting, held on February 13, 2012, reflect additional representations attributed to Oglesby and Prost regarding the Fund's exposure to European issuers. The minutes state in relevant part:

> Responding to questions from the Board, Messrs. Prost and Oglesby discussed the current foreign debt risks and opportunities in the current marketplace. They noted that the Money Market Fund's exposure to many European issuers, as well as the Money Market Fund's weighted average maturity, were both reduced during the fourth quarter of 2011.

> ACM discussed its views on LIBOR and foreign markets in general. At the Board's request, ACM discussed the ratio of the domestic investments to foreign investments held in the Money Market Fund's portfolio. ACM informed the Board that while the Money Market Fund no longer held any securities issued by Italian banks and that its French exposure had been reduced, the Money Market Fund had increased its holdings in Asia and the United Kingdom.

Ex. 95 at 9; Tr. 1422.

3. <u>Diversification and the September 30, 2011 Redemption</u>

a. *Redemption and Oglesby's Letter*

On September 30, 2011, the City of Detroit redeemed $25 million in AMMF shares, causing a 10% decline in AMMF's net assets on that date. First Stip. ¶ 12. Oglesby testified he received Detroit's request by phone immediately before noon, which is the latest a shareholder could request to withdraw money from the Fund and receive the money on the same business day. Tr. 1255-56, 1258. Oglesby described the redemption as unusual both due to its size and the lack of notice given by Detroit. Tr. 1256, 1258. Prost confirmed that shareholders usually gave notice at least a day in advance before making a large redemption. Tr. 1663. Despite the lack of notice, Oglesby testified that the Fund honored the redemption and did not have to sell any securities to do so. Tr. 1260-61, 1291.

Oglesby testified that ACM had made several purchases earlier that morning on behalf of the Fund. Tr. 1259. Again, the timing of these purchases cannot be confirmed by the purchase journal, which lists only the date. Ex. 13 at 24. However, trade tickets show that five of the six purchases were made during the 10:00 o'clock hour that morning; the sixth, which did not cause a passive breach, was purchased at 12:20 p.m. Ex. 90. Oglesby claimed that all of the morning purchases would have been cleared using the Ambassador Money Market Trading System, and each would have passed the five percent diversification check at the time of purchase. *Id.* However, when he later entered Detroit's redemption in the system, trades that were in compliance with the five percent diversification rule at the time of their purchase that morning turned red (indicating that they were above five percent) due to the decrease in the Fund's total assets. Tr. 1258, 1262.

Oglesby testified that the "fails" he saw in the trading system prompted him to call FSG, and he spoke to both Curtis and De Nicolo. Tr. 1260-62, 1494. After learning about the redemption's impact on the Fund's portfolio, De Nicolo suggested that Oglesby draft a letter explaining what had happened. Tr. 767-70, 1261. De Nicolo wanted Oglesby to draft the letter so that she could include it in the next board packet and explain the situation to the Board. Tr. 767. She noted that otherwise, someone looking at the compliance reports might think there were several active breaches of the five percent rule, when in fact the violations were passive because ACM purchased the securities in question earlier in the morning, before the redemption. Tr. 768. De Nicolo testified that she also wanted the letter to go to KPMG so they could do the diversification testing required to issue their certification at the end of the quarter. Tr. 770. She did not tell Oglesby what language to use in the letter and did not see it before it was signed. Tr. 771.

Oglesby's letter, addressed "To Whom It May Concern" and dated October 3, 2011, describes the redemption as follows:

> On Friday, September 30, 2011, at approximately 11:59am est, one minute before the shareholder services deadline, an uncharacteristically large $25 million redemption was made in the Ambassador Money Market Fund. This redemption caused several issuer percentages to climb above the 5% issuer limit. Prior to the redemption, several security purchases were made that were well within the 5% issuer guideline and had maturity dates of October 3 (1 business day). Given the inopportune timing of the redemption (i.e.- late-in-the-day for cash settle, month-end and quarter-end) any attempt at a sale to comply with the 5% issuer rule could have resulted in unnecessary stress to the Fund and unwarranted losses. We were aware of the 5% issuer limit rule, but this situation was unavoidable and unintentional. Monday, October 3, the Fund was back in compliance.

Exs. 54, 412.

Oglesby testified that the "majority, if not all" of the securities purchased on the morning of September 30 had one-day maturities and would mature the following Monday, October 3, 2011. Tr. 1262-63. For that reason, Oglesby believed that any compliance issue that might exist would correct itself by October 3. Tr. 1263. The purchase journal and trade tickets show six trades on September 30, 2011: Compass Securitization, Anglesea Fund, Romulus Fund, Arabella Finance, Antalis US, and Louis Dreyfus. Ex. 13 at 24; Ex. 90. All but Compass Securitization had a maturity date of October 3, 2011; Compass Securitization had a maturity date of October 4, 2011. *Id*. During the November 2011 sweep examination, De Nicolo provided Bartolini with a report showing the Fund's holdings as of September 30, 2011. Ex. 100. According to the report, at the end of the day on September 30, 2011, fifteen of the twenty-two issuers in the Fund's portfolio exceeded five percent of the total assets, nine as a result of Detroit's redemption. *Id*. Among these nine are five of the six trades made on September 30, 2011: Louis Dreyfus, Angelsea Funding LLC, Arabella Finance, Romulus Fund, and Antalis US. *Id*.

ACM did not inform Johnson about the redemption during S&P's annual review of the Fund in October 2011. Tr. 631-32. She testified that the redemption would have been relevant to S&P's analysis and rating of the Fund's management. Tr. 632. No one at S&P recalled receiving a copy of Oglesby's letter regarding the redemption, and the letter was not located in S&P's search of relevant records. Tr. 632-33. However, ACM told Bartolini that it had shared the letter with S&P in order to make sure S&P was "fully informed of issues" with the Fund. Tr. 189.

b. *November 14, 2011 Board Meeting*

The minutes of the Board meeting held on November 14, 2011, contain the following statement in the "Compliance Reporting" section:

> The Board was informed by ACM that, as a result of an uncharacteristically large one-day redemption of $25 million, which redemption occurred at 11:59 a.m. Eastern Standard Time (or one minute before the shareholder services deadline), the percentage of Money market Fund assets invested in the securities of a single issuer climbed to above 5% with respect to several issuers. However, all purchases made prior to such event were made within the 5% limitation and, following the maturity of certain securities in the Money Market Fund's portfolio on October 3, 2011 (the next business day after the redemption), *no more than 5% of the assets of the Money Market Fund were invested in the securities of any one issuer*. ACM stated it was aware of the issue following the redemption on September 30, 2011, but stated that it believed that, due to the timing of the redemption (being late in the day on a date that was both a month- and quarter-end), ACM believed that attempted sales to return all holdings to within the 5% limitation was both unwarranted and could subject the Money Market Fund and its investors to unnecessary risks. ACM also noted its belief that this was a one-time occurrence. The Board expressed concern of this matter, but understood the unique circumstances surrounding the event.

Ex. 92 at 11-12 (italics added).

Oglesby has no memory of discussing the Detroit redemption at the November 2011 meeting, nor does he recall Prost doing so. Tr. 1264, 1266. He claimed that he was not participating in the meeting during this discussion because he and Prost had been excused from the meeting, as an earlier page of the minutes indicated. Tr. 1264-65, Ex. 92 at 10. He noted that the description in the minutes closely mirrored the language in his October 2011 letter, and Respondents contend that the Board may not have discussed the letter but only reviewed it, or that the person drafting the minutes used, and incorrectly paraphrased, the letter. Tr. 1265; Resp. Br. at 16.

Oglesby admitted that the statement "no more than 5% of the assets of the Money Market Fund were invested in the securities of any one issuer" was not accurate. Tr. 1266. He explained that this was not what his letter was meant to convey; he claimed that his statement that the Fund would be "back in compliance" the following Monday meant that the securities purchased on September 30, 2011, would mature on that date, not that no issuers above five percent would remain in the portfolio as of that date. Tr. 1263, 1266-67. He acknowledged that several issuers remained over five percent on and after October 3, 2011. Tr. 1266-67.

Hodges testified that she remembered discussing this issue at the November 2011 meeting. Tr. 530. She believed De Nicolo spoke about the redemption, and recalled that someone from ACM participated in the discussion. Tr. 530. She took comfort in the representation that as of October 3, 2011, no more than five percent of the assets of the Fund were invested in the securities of any one issuer. Tr. 530-31. She felt that this represented adherence to ACM's policies and procedures. Tr. 531. Guy also recalled that more than one person discussed the redemption at the November 2011 meeting, including someone from ACM. Tr. 476. He did not recall being aware that at the time of the Detroit redemption, there were already other securities in the Fund that exceeded five percent as a result of passive breaches, and he was also unaware that some securities remained over five percent after October 3, 2011. Tr. 477. He and Koski both testified that they would have wanted to know that some of Fund's holdings exceeded five percent, regardless of whether they accounted for five percent at the time of purchase or through a drop in the Fund's total assets. Tr. 345-46, 477.

De Nicolo did not recall anyone at the meeting informing the Board that at the close of business on October 3, 2011, no more than five percent of the Fund's assets were invested in any one issuer. Tr. 781-85. She agreed that this statement was incorrect, and she claimed that if she had heard such a statement, she would have corrected it. Tr. 785, 797. De Nicolo did recall one of the Board members at the November meeting asking her a question about Oglesby's letter, and her responding that a large eleventh-hour withdrawal, without notice, was an exceptional occurrence. Tr. 779. She did not believe that she stated or suggested that there had never been other large redemptions in the Fund, and she claimed she was only trying to communicate that a large, unexpected redemption was "unique." Tr. 780-81.

Cutshall testified that the statements attributed to ACM were made by an ACM attendee participating by telephone. Tr. 827. He believed it was Oglesby, but wasn't certain. Tr. 828, 837. Regardless of the statements' placement in the meeting minutes, Cutshall believed they were made by someone from ACM. Tr. 830, 837-38. He agreed that the September 30, 2011, redemption was viewed as a compliance issue, but maintained that it was not De Nicolo who made the presentation on the Detroit redemption. Tr. 838-40. Cutshall testified that ACM knew the most about the redemption and its effect on the Fund, and that it would have been appropriate for someone to stay at a meeting later than normal to explain issues or answer questions. Tr. 839.

c. *February 18, 2011 Board Meeting*

ACM had disclosed another passive breach, also as a result of redemptions, to the Board during a previous Board meeting held on February 18, 2011. As reflected in the minutes:

> The Board was informed that, as a result of redemptions that occurred in the Money Market Fund on December 17, 2010, the Money Market Fund's holdings of a particular issuer's securities exceeded five percent of the Money Market Fund's portfolio. The Board was informed that there were no purchases of such issuer's securities that triggered this position, that the securities matured, and the Money Market Fund's holdings of such issuer's securities consequently was reduced below five percent of its portfolio, on the following business day.

Ex. 97 at 6.

4. Credit Risk of AMMF's Investments

The Division alleges that ACM knowingly deceived the Board about the risk of AMMF's investments by withholding the fact that ACM failed to comply with its internal maturity restrictions and failed to conduct a minimal credit risk determination prior to purchasing a security. OIP at 4.

Prost confirmed that the Board was not told about the instances that ACM purchased securities with maturities exceeding its internal maturity guidelines; he stated that he did not intend to conceal this from the Board but that discussions about purchases of particular securities would have been more "granular" than the "big picture" presentations given by ACM. Tr. 1649. All three trustees who testified at the hearing – Guy, Hodges, and Koski – stated that they expected that ACM would have informed them if it were not adhering to its internal maturity restrictions. Tr. 334, 437-38, 463-64, 524.

Koski testified that he had no understanding of whether ACM followed the maturity guidelines, but stated that he "would assume that if they said it should be short-term, they would follow their own guidelines." Tr. 333-34. He testified that he did not know why ACM would go beyond the maturity guidelines, and stated that as a Board member, he would have expected to have been informed if ACM was routinely making investments that went beyond the maturity restrictions. Tr. 334. If ACM were doing so, Koski felt it was a compliance matter that should have been brought to the Board's attention. Tr. 336-37. Hodges agreed, testifying that she expected "any variance or noncompliance with, for whatever reason, from the stated policies and procedures would be presented" to the Board by ACM. Tr. 531-32. Hodges and Koski also testified that they thought ACM was abiding by Rule 2a-7 requirements regarding minimal credit risk determinations. Tr. 330, 522.

G. <u>Other Fact Witnesses</u>

1. <u>David Joire</u>

David Joire (Joire), a senior counsel in the Division of Investment Management at the Commission, testified about the purpose, adoption, and content of Rule 2a-7. He explained that mutual funds generally calculate their NAV by looking at the daily value of their portfolio, subtracting liabilities, and dividing by the number of outstanding shares. Tr. 48-49. Money market funds, which are a type of mutual fund, are permitted to use different valuation methods if they comply with the requirements of Rule 2a-7. Tr. 48-49; *see* 17 C.F.R. § 270.2a-7. Joire noted that the Commission believes that investors expect money market funds to be secure investments, and thus a money market fund must comply with the risk-limiting provisions of Rule 2a-7 in order to hold itself out as a money market fund. Tr. 51. Among these provisions is the requirement that the Fund determine minimal credit risk. Tr. 52. Joire testified that the Commission clarified the scope of the minimal credit risk determination in two letters released by Commission staff in 1989 and 1990. Tr. 54-56. The letters note that the Board should consider macroeconomic factors which might affect the issuer or guarantor's current and future credit quality, the strength of the issuer's or guarantor's industry within the economy and relative to economic trends, the issuer's or guarantor's market position within its industry, cash flow adequacy, the level and nature of earning, financial leverage, asset protection, the quality of the issuer's or guarantor's accounting practices in management, and the likelihood and nature of event risks. Tr. 55-56. Joire noted that the requirement that the minimal credit risk determination be documented was added in 1993 as a result of the Commission's concerns that some money market funds lacked records sufficient for the Commission to confirm that the fund's determination of minimal credit risk was adequate. Tr. 60-61.

Joire also testified regarding his understanding of Rule 2a-7's stress testing requirement. He noted that the testing scenario of "widening or narrowing of spreads between yields on an appropriate benchmark" referred to a comparison of a fund as its portfolio becomes more or less creditworthy. Tr. 64. He testified that the requirement that a fund's adviser assess the fund's ability to withstand "the events and concurrent occurrences of those events" referred to the various hypothetical scenarios identified in Rule 2a-7(c)(10)(v). Tr. 66. Joire noted that Rule 2a-7(e) governs the degree to which a money market fund's board can delegate responsibilities to the investment adviser. Tr. 74-75. He explained that the provision permits the board to delegate the performance of all but a handful of Rule 2a-7's requirements, among which is the creation of written stress testing procedures. Tr. 77; Rule 2a-7(e).

2. <u>AMMF Shareholders</u>

The treasurers of two municipalities which were shareholders of AMMF – Kent County and the City of Rochester Hills – testified at the hearing. The treasurers were responsible for investing the municipalities' excess funds, the amount of which fluctuated depending on the timing of their receipt of tax revenue. Tr. 364-65, 396-97. Kent County's excess funds ranged from $3 million to $400 million, of which no more than five to six percent was invested in AMMF. Tr. 364-65, 382. Rochester Hills invested a similar percentage of its excess funds in AMMF – $7.5 million in 2009 and $9 million in 2010, out of approximately $125 million total. Tr. 408. The treasurers testified that when investing their municipality's money in AMMF, they were most concerned first with safety, then with liquidity, and finally with yield. Tr. 372, 399. Kent County's treasurer noted that diversification was part of his concept of safety. Tr. 372. Both treasurers acknowledged that they had other investment options available, and Rochester Hills' treasurer testified that he choose AMMF because it had a good reputation and was an AAA-rated fund. Tr. 383, 405.

The treasurers explained that investments made by Michigan municipalities are subject to Public Act 20. Tr. 365. Public Act 20 limits the types of investments a Michigan municipality may make, either directly or through a mutual fund. Tr. 366, 378-79; 2014 Mich. Legis. Serv. P.A. 20. It permits investments in commercial paper but requires that any such investment be a Tier 1 security with a maximum maturity of 270 days. Tr. 366-67. The treasurers testified that the investment policies of many Michigan municipalities, including their own, imposed further restrictions on the types of investments permitted, including prohibitions on investing in mutual funds other than those that maintain a stable one dollar NAV (i.e., money market funds). Tr. 371, 374, 400-01. Kent County's treasurer noted that while the county's investment policy could have permitted it, consistent with Public Act 20, to invest in all mutual funds, he restricted its investments to money market funds because of concerns about safety, liquidity, and the ability to quickly and accurately determine the value of the county's investment. Tr. 371-72.

The municipalities' investment policies included a listing of their priorities of safety, diversification, liquidity, and yield. Tr. 377-78, 402; Ex. 32 at 53-54. Kent County's policy limited investments in any one issuer of commercial paper to twenty-five percent; Rochester

Hills' policy capped such investments at five percent. Tr. 385, 403; Ex. 34 at 69. The treasurers provided copies of their policies to ACM prior to investing in AMMF and received back signed acknowledgements of receipt. Tr. 376, 401-02. Both treasurers testified that they would have had to withdraw their money from AMMF if the Fund had been unable to maintain a stable NAV. Tr. 380, 403-04.

H. Expert Reports and Testimony

1. Respondents' Expert

Respondents' expert, Eric Zitzewitz (Zitzewitz), analyzed four days in 2009 on which there may have been active breaches of Rule 2a-7's diversification limits: August 12, December 7, December 18, and December 30, 2009. Ex. 466 at 7-8. To determine the effect of the potential active breaches on the risk of AMMF, he estimated the expected variance of returns using the Fund's actual holdings on each of the four days and compared it with the expected variance of three alternative, Rule 2a-7-compliant portfolios with varying levels of risk. *Id*. at 9. Zitzewitz concluded that the potential active breaches had a "very minimal effect on the riskiness of the Fund." *Id*. at 11. He noted that because each of the excess components of the issuers above five percent were small, curing the breaches would have required shifting only a small portion of the Fund's portfolio. *Id*. at 11-12. Zitzewitz also calculated the Fund's NAV on the four days identified above and on two additional days which ACM later concluded were not active breaches (February 12, 2009, and August 18, 2009), by matching the days on which there were potential active breaches to the closest day for which market values were available. *Id*. at 7-9, 12. He concluded that the Fund's NAV was not close to the thresholds for breaking the buck on any of these days. *Id*. at 13; Tr. 996.

Zitzewitz also examined the Fund's diversification on various dates between 2009 and 2012 using a measure called the Herfindahl index. Ex. 466 at 13. The Herfindahl index measures a portfolio's concentration, and a high level of concentration implies limited diversification. *Id*. at 13-14. Zitzewitz concluded that the Fund could have been substantially more concentrated than it was during this period and still have been consistent with Rule 2a-7's diversification requirements. Tr. 982, 985-96; Ex. 466 at 15. He reached this conclusion by charting the Herfindahl index of (1) a fund with twenty issuer positions of five percent each, (2) a fund with twenty-five percent of its portfolio in one issuer and the remaining in fifteen different issuers (i.e., a fund which takes advantage of the Rule 2a-7 diversification safe harbor), and (3) AMMF. Ex. 466 at 14-15, 33; Tr. 983. He noted that AMMF was below both of the Rule 2a-7-compliant benchmark funds throughout the time period noted, with the exception of three months in 2011. Ex. 466 at 15. However, he testified that it was possible to be in compliance with Rule 2a-7 and be well above the benchmarks if the total asset size of the portfolio decreased; similarly, a fund can have low concentration on the Herfindahl index and still be out of compliance with Rule 2a-7. Tr. 984.

Zitzewitz also compared the credit quality of AMMF's holdings between October 2011 and May 2012 with those of other money market funds with comparable prime holdings and fewer than $400 million in assets, which he considered to be peers of AMMF, even though AMMF's average size was closer to $200 to $250 million. Tr. 986, 1000. He reviewed the peer funds' Forms N-MFP for two proxies of credit quality: whether the security was designated as First Tier and whether the security was rated A or better. Ex. 466 at 16. He noted that during this time period, 100% of the Fund's assets were First Tier securities, compared with 95% of the holdings of the peer funds. *Id.*; Tr. 987. All of AMMF's holdings were reported as being rated A or better, and Zitzewitz concluded that this was a much larger share of its portfolio than its peer funds. Ex. 466 at 17. However, the peer funds did not consistently report the rating information for their securities, so Zitzewitz was not able to determine precisely how many of the securities in the peer funds' portfolios were also rated A or better. Ex. 466 at 16-17; Tr. 1056-57.

2. <u>Division's Expert</u>

Dr. Russell Wermers (Wermers) testified as an expert witness for the Division on the characteristics of AMMF that the Division asserts made the Fund particularly risky. Ex. 112. Wermers concluded that AMMF was uniquely vulnerable to the inherent risks of money market funds because it had a relatively small number of investors and investments at any given point in time, and many of its investors were Michigan municipalities subject to similar economic pressures. Ex. 112 at 10-11. He testified that these features were exacerbated by ACM's violation of "several important tenets of Rule 2a-7." *Id*. at 11.

Wermers opined on a number of topics not covered by Respondents' expert, including ACM's minimal credit risk determinations, the failure to adopt or implement compliance procedures, the adequacy of the stress tests conducted by ACM, and the alleged misrepresentations made to the Board. Tr. 1004-05. With respect to ACM's minimal credit risk determination, Wermers concluded that ACM lacked written documentation reflecting minimum credit risk for several of the securities held by AMMF. Ex. 112 at 13. He reviewed ACM's credit files and in many instances saw little evidence of any independent written analysis by ACM. *Id*. His report quotes testimony given by Oglesby during the Division's investigation which appears to confirm that ACM's credit committee did not document its credit risk determination. *Id*. Oglesby stated: "I believe previous testimony essentially saying we don't have documentation of a credit committee approving a name. Really the only documentation is the final product, which is the approved list, unfortunately." *Id*. Wermers concluded that ACM's internal rating system failed to constitute the independent credit analysis required under Rule 2a-7(c)(3)(i), and he saw no evidence of written procedures supporting the determination of the internal ratings. *Id*. Wermers observed that there were several occasions on which ACM bought securities with maturities exceeding those associated with the internal ratings. *Id*. at 14.

Wermers opined that stress testing is designed to inform a fund's advisor and board of the risks various stresses pose to the shareholders of the Fund. Ex. 112 at 22. He noted that AMMF's first stress test included only some "simple" analysis of the following scenarios: (1) parallel shifts in the yield curve, from -2% to +2%, paired with (2) assumed redemptions up to 75%; and (3) the downgrade of a single issuer. *Id*. at 22-23. Wermers opined that because the downgrade scenario assumed only an increased yield as a result of a downgrade of 0.5% per year on five percent of the Fund's holdings, it "significantly diminished the reliability of the stress testing." Ex. 112 at 23. He concluded that the test failed to include at least two elements required by Rule 2a-7 – the impact of unexpected investor redemptions and "concurrent" stress events. *Id*. at 22; Tr. 894.

Wermers also concluded that ACM appeared to pay little attention to many warning signals regarding AMMF's heightened risks, which included active and passive breaches, the May 2010 Commission deficiency letter, and various unexpected redemptions by investors. Ex. 112 at 23. Wermers opined that the number of securities in AMMF's portfolio which exceeded five percent as a result of passive breaches was significantly higher than any other prime money market fund during the period between November 2010 and December 2013. *Id*. at 24. He identified thirty-two days in 2010 and 2011 on which at least one passive breach occurred, and concluded that ACM was apparently "blindsided repeatedly" by large redemptions. *Id*. at 23-24 & n. 65. Wermers suggested that given this volatility in the Fund's total asset size, ACM should have refrained from purchasing assets from a single issuer that placed them close to the five percent diversification limit. *Id*. at 26.

Wermers reviewed the minutes of the Board meetings held on February 18, 2011, August 8, 2011, and November 14, 2011. Tr. 860-62, 864-65, 872-73, 876, 959-60. He concluded that at these meetings, ACM and Oglesby made misrepresentations and failed to disclose information to the Board on what he deemed to be two important matters: AMMF's Eurozone exposure, and its lack of diversification and resulting passive breaches. Ex. 112 at 3-4. He opined that these matters concerned "the safety and security of the fund, and also directly relate to the fund's compliance with Rule 2a-7." *Id*. at 4. With respect to materiality, he noted that the alleged misrepresentation to the Board regarding the number of passive breaches still in the portfolio as of October 3, 2011 (after the Detroit redemption), was very economically material. Tr. 871. He noted that having several issuers consistently above five percent increased the Fund's exposure to negative credit events. Tr. 872. Wermers also disagreed with the Respondents' contention that the economic picture changed around December 1, 2011, such that it was reasonable for the Fund to resume purchasing Italian securities. Tr. 881. He concluded that market signals at that time were very mixed, and certain metrics, including the value of the euro versus the dollar, indicated that the health of the Euzozone was actually worsening. Tr. 882. Wermers felt that ACM's decision to continue investing in Eurozone securities was material. Tr. 883.

Finally, Wermers disagreed with Zitzewitz that a hindsight analysis of risk was an appropriate measure of the materiality of the active breaches. Tr. 888. He testified that materiality was best tested by looking at the type of fund, its concentration and diversification, and its redemption risks, to determine how much it risked breaking the buck. Tr. 888, 891-92. Given these factors, Wermers concluded that the active breaches were also very economically material. Tr. 892.

III. DISCUSSION AND CONCLUSIONS OF LAW

A. <u>Sections 206(1) and 206(2) of the Advisers Act</u>

ACM violated, and Oglesby willfully aided and abetted and caused ACM's violations of, Sections 206(1) and 206(2) of the Advisers Act. Section 206 provides in relevant part:

> It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—(1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

15 U.S.C. § 80b-6. Section 206 imposes a fiduciary duty on an investment adviser to act at all times in the best interest of its advisory funds and its investors, and includes an obligation to provide "full and fair disclosure of all material facts" to investors and independent trustees of the funds. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191, 194, 200–01 (1963). To establish that ACM violated Sections 206(1) and (2) of the Advisers Act, the Division must prove that ACM was an investment adviser, that it engaged in fraudulent activities by jurisdictional means, and that it breached its fiduciary duty by making false or misleading statements or omissions of material fact at least negligently. *SEC v. Gotchey*, 981 F.2d 1251 (4th Cir. 1992); *SEC v. Merrill Scott & Assoc., Ltd.*, 505 F. Supp. 2d 1193 (D. Utah 2007); *see Capital Gains Research Bureau, Inc.*, 375 U.S. at 191-92. To establish a violation of Section 206(1), the Division must prove that ACM acted with scienter. *SEC v. Steadman*, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992).

To establish that Oglesby aided and abetted ACM's violations, the Division must prove the existence of ACM's violations, Oglesby's knowledge of the primary violations, and substantial assistance by Oglesby in the achievement of ACM's violations. *See SEC v. DiBella*, 587 F.3d 553, 566 (2d Cir. 2009); *see also vFinance Investments, Inc.*, Exchange Act Release No. 62448, 2010 SEC LEXIS 2216, *41 (July 2, 2010). The knowledge or awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant. *See Geman v. SEC*, 334 F.3d 1183, 1195-96 (10th Cir. 2003); *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990). If Oglesby aided and abetted the violations, he was also the cause of them. *See Sharon M. Graham*, 53 S.E.C. 1072, 1085 n. 35 (1998), *aff'd* 222 F.3d 994 (D.C. Cir. 2000). Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. *See KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1175 (2001), *recon. denied*, Exchange Act Release No. 44050, 2001 SEC LEXIS 422 (Mar. 5, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).

1. <u>Registered Investment Adviser and Interstate Commerce</u>

ACM has been registered as an investment adviser since 1998. First Stip. ¶ 1. ACM used instrumentalities of interstate commerce by, among other things, making statements to AMMF shareholders over the telephone and using mail and e-mail to send documents and information which made representations about AMMF's portfolio holdings and ACM's management strategy. Tr. 620-21, 1255; Exs. 50, 445.

2. <u>Misrepresentations</u>

The OIP alleges that the following omissions and misstatements were made by ACM and/or Oglesby: (1) ACM and Oglesby failed to disclose that ACM regularly purchased securities at maturities exceeding its internal restrictions; (2) ACM and Oglesby failed to disclose that ACM repeatedly purchased securities without making a determination that the security posed a minimal credit risk; (3) Oglesby made false and misleading statements to the Board regarding AMMF's exposure to Eurozone countries; and (4) ACM deceived the Board in November 2011 regarding the diversification of its portfolio. OIP at 1-2, 4-8.

a. *Internal Maturity Restrictions*

The OIP alleges that ACM failed to disclose to the Board that it regularly exceeded internal maturity restrictions on the securities in the Fund's portfolio, and that Oglesby did not inform the Board that ACM often purchased Tier 1(C) securities at maturities longer than seven days, the maturity restriction associated with that tier. OIP at 5. The Division alleges that ACM also failed to disclose noncompliance with Tier 1(B) maturity restrictions on two securities between November 2010 and February 2011. Div. Br. at 20; Ex. 174B. Respondents do not dispute that ACM did not tell the Board when it purchased securities with maturities exceeding those associated with the securities' internal ratings, nor that ACM made such purchases on a number of occasions. Resp. Br. at 20; Tr. 1648-49; *cf.* Ex. 174A-C. Rather, they claim that the maturity restrictions were flexible guidelines such that deviations from the prescribed periods were an expected part of ACM's investment policy, not violations that should have been disclosed to the Board. Resp. Br. at 20.

Oglesby's testimony that the difference between the words "restriction" and "guideline" was mere semantics – in effect, that these words were synonymous – is not credible, and Respondents' argument that the maturity restrictions were not really restrictions is not convincing. Tr. 1341. In 2011, Oglesby and ACM used the word "restriction," not "guideline" or "recommendation," to refer to the maturity limitations when responding to inquiries from both S&P and OCIE. Exs. 50, 172. Oglesby and ACM also used the term "restriction" internally, with Oglesby building a "Maturity Restriction" compliance check into the Ambassador Money Market Fund System, which would result in a "fail" if a security's maturity exceeded that of its designated tier. Ex. 490; Tr. 1187-88. Oglesby's testimony that ACM only rarely deviated from the maturity restrictions suggests that ACM traders were expected to abide by the restrictions. Tr. 1370. There is no documentary evidence that the restrictions were actually guidelines and that traders were permitted to disregard the "fail" that would result in the Ambassador Money Market Fund System if they had a reason to do so. Hodges understood that the internal maturity restrictions involved "adhering to a time frame." Tr. 523-24. The evidence proves that the internal maturity restrictions were in fact intended to restrict ACM traders from purchasing securities at maturities outside the prescribed periods, and ACM failed to disclose to the Board nonconformities with this policy.

Respondents also insist that maturity restrictions were not associated with Tiers 1(A), 1(B), and 1(C) until October 2011, and that they made no actionable omissions by failing to disclose purchases exceeding the maturity restrictions prior to that date. Resp. Br. at 18, 20-21. This purported implementation date is implausible. Johnson testified that she understood that the maturity restrictions were already in place at the time of her October 4, 2011, meeting with ACM, and Oglesby's contemporaneous email to Johnson contains no suggestion that the restrictions were only a few days old. Tr. 653-54; Ex. 50. Bartolini also believed, based on her communications with ACM and her review of the credit files, that the internal maturity restrictions were in place during 2010. Tr. 267. Furthermore, there is limited utility in having a rating system with no practical effect on the management of the Fund. Nonetheless, with some exceptions, Prost and Oglesby were generally credible witnesses, and there is no documentary evidence inconsistent with October 2011 as the date the tiers became associated with maturity restrictions. Accordingly, Respondents' failures to disclose to the Board their deviations from ACM's internal maturity restrictions are limited to the eleven instances of non-compliance with the Tier 1(C) maturity restrictions from October 2011 onward. Ex. 174C.

The OIP also alleges that ACM failed to disclose to the Board that the Fund violated the maturity limitation set forth in a June 2009 credit research report for White Point Funding, Inc., which concludes that the issuer's securities "should only be purchased between 1-3 days to avoid long-term risk exposure." OIP at 5; Ex. 31. This report is the only 2009 credit research report that includes a maturity limitation. *See* Ex. 19. ACM made sixteen purchases of White Point Funding, Inc., between June 29 and December 21, 2009, when the June 2009 credit research report was in effect, and the securities were held by the Fund for periods ranging from five to ninety days. Ex. 174A. Respondents argue that the language in the credit research report did not create a maturity restriction, and Prost testified that the analyst who drafted the report was mistaken about the issuer's level of risk, which he described as "easily minimal credit risk." Resp. Reply at 9; Tr. 1654-55. A second credit research report for White Point Funding, Inc., also dated June 2009, concludes only that the security "should only be purchased short-term." Ex. 19 at 100. In July 2010, White Point Funding was assigned a Tier 1(A) rating, indicating that it had no maturity restriction. Ex. 67B; see Ex. 50.

Flowers drafted the majority of the credit research reports in 2009, including the two reports for White Point Funding, Inc. Ex. 19. These two reports articulated the only maturity restrictions at that time for any approved issuer. In view of this, and in view of the uncertainty over which maturity restriction Flowers actually recommended ("short-term" or "1-3 days"), the most plausible explanation is Prost's: that the reports simply reflect Flowers' attempt to be more specific and granular in her conclusions regarding the issuer, and that they were not intended to restrict ACM's ability to purchase the issuer's securities at various maturities. Tr. 1699. ACM therefore did not fail to disclose to the Board its failure to abide by the maturity limitations set forth in the June 2009 credit research reports for White Point Funding, Inc.

b. *Minimal Credit Risk Determination*

The OIP alleges that ACM failed to disclose that it purchased securities for AMMF without making a determination that the security posed a minimal credit risk.[11] OIP at 2, 4, 6.

---

[11] ACM was required both to make minimal credit risk determinations, and to document those determinations. Rule 2a-7(c)(3); Rule 2a-7(c)(11)(iii). Although the OIP does not explicitly refer to Rule 2a-7(c)(3), it does refer to Rule 2a-7(c)(11), and it alleges that ACM "repeatedly purchased portfolio securities without *making* a determination that the securities posed a minimal credit risk." *See* OIP at 6 (italics added). This allegation, which appears in a section of the OIP addressing ACM's "withholding information from the Board," is fairly read as a claim that ACM violated Section 206 by omitting to inform the Board that it had failed to properly make minimal credit risk determinations prior to purchasing securities for AMMF's portfolio. OIP at 4, 6. The

The OIP notes that ACM's credit analyses often omitted any finding that the security represented "minimal" and not some other level of risk, and it alleges that in 2010 and 2011, ACM purchased asset-backed commercial paper for AMMF from more than fifteen issuers without making a minimal credit risk determination. OIP at 6. The OIP also suggests, and the Division argues, that purchases outside the internal maturity restrictions represented more than minimal credit risk; these appear to be among the alleged 2010 and 2011 violations with respect to the asset-backed commercial paper of at least fifteen issuers. OIP at 2, 5; Div. Br. at 19-20, 37; *see also* Ex. 112 at 14-15.

Rule 2a-7(c)(3)(i) requires money market funds to only invest in securities that the board of directors determines present minimal credit risk, and in order to have made the alleged material misrepresentations regarding the Fund's compliance with Rule 2a-7(c)(3), ACM must have purchased securities for the Fund without complying with its requirements. Rule 2a-7(c)(3)(i); OIP at 2, 5. The minimal credit risk determination cannot be based solely on ratings issued by credit agencies; it must also include consideration of factors pertaining to credit quality. *See* Rule 2a-7(c)(3)(i). As set forth in the Division of Investment Management's letter to registrants dated May 8, 1990, and as recited in the 2010 deficiency letter, the Commission has suggested[12] that the following elements may be included in the independent credit analysis required by Rule 2a-7(c)(3): (i) a cash flow analysis; (ii) an assessment of the issuer's ability to react to future events, including a review of the issuer's competitive position, cost structure, and capital intensiveness; (iii) an assessment of the issuer's liquidity, including bank lines of credit and alternative sources of liquidity to support its commercial paper; and (iv) a "worst case scenario" evaluation of the issuer's ability to repay its short-term debt from cash sources or asset liquidations in the event that the issuer's backup credit facilities are unavailable. Ex. 159 at 3. The Board delegated responsibility for making the minimal credit risk determination to ACM, and it ratified ACM's determinations at the quarterly Board meetings by voting to approve the version of the approved list in effect at the time. Ex. 20 at 1; First Stip. ¶ 11.

Oglesby testified that ACM's minimal credit risk determination process included a review of the security's rating, its trading history, its private placement memorandum and financial statements, and an evaluation of the current macroeconomic environment using the Ambassador Leading Index. Tr. 1099-1105. He explained that this process involved an analysis of the security's cash flow, the creditworthiness of its guarantors, and the security's structure; each of these is among the factors suggested in the Commission's guidance on independent credit analyses. Tr. 1101-02; Ex. 159 at 3. Oglesby testified that after considering these factors, the final risk determination was made at an informal meeting of the credit committee and, if approved, the security was then placed on the approved list and a credit report was drafted. Tr. 1116-18. Prost also briefly described the process, noting that the analysis included a review of

---

Division's post-hearing brief, read liberally, also contends that ACM violated Section 206 by failing to disclose its inadequate documentation of minimal credit risk determinations. Div. Br. at 17. This allegation does not appear in the OIP, however broadly read, and is therefore immaterial.

[12] This letter is referenced in hearing exhibits and was described by Joire, but is not in the record itself, and is apparently not binding in any event. Tr. 16, 56-57.

the security's ratings and its support and structure. Tr. 1640. ACM's process satisfied the requirement of Rule 2a-7(c)(3)(i) that credit risk determinations must consider credit quality and agency ratings. Therefore, the question is whether I find credible Respondents' claim that this robust credit risk analysis actually occurred and resulted in a determination of minimal credit risk for each security purchased for the Fund.

The Division claims that the credit research reports are deficient, and that this deficiency indicates that Respondents failed to make an adequate minimal credit risk determination. Div. Reply at 12-13. However, the Division has failed to present any written or testimonial evidence to refute Oglesby and Prost's testimony that the minimal credit risk determination occurred prior to the creation of the reports, and that reports were only created if the credit committee had already evaluated the factors described above and concluded that the securities presented minimal risk. While some reports might fail to properly *document* ACM's minimal risk determination, in violation of Rule 2a-7(c)(11), this failure has no bearing on whether ACM actually *made* the determination. Admittedly, the Division's skepticism is reasonable – ACM could easily have prepared credit research reports as part of the credit committee's deliberative process, particularly after OCIE admonished it to do so "prior to the initial purchase of a security." Ex. 159 at 2. But in the absence of any persuasive evidence to the contrary, and given the fact that Oglesby and Prost were generally credible, the record shows that ACM did not violate Rule 2a-7(c)(3), and thus did not commit any related violations of Sections 206(1) or 206(2).

The Division contends that: (1) Respondents represented to OCIE and S&P that the internal maturity restrictions constituted part of ACM's independent credit analysis; (2) the internal maturity restrictions were in fact part of ACM's minimal credit risk determination; and (3) the securities presented minimal credit risk only if purchased within the maturity restrictions. Div. Br. at 19-20, 37. As explained *infra*, the evidence shows that an internal rating by ACM indicated that the security had been found to present minimal credit risk. However, the Division has otherwise presented no evidence to support its argument that a violation of internal maturity restrictions constituted a violation of Rule 2a-7(c)(3)(i), and in particular they cite to no evidence of Respondents' representations to OCIE and S&P. Div. Br. at 37. Thus, while I have found that Respondents failed to disclose that they disregarded the internal maturity restrictions, I do not find that this means they also committed and failed to disclose a violation of Rule 2a-7(c)(3)(i).

c. *Exposure to Eurozone Countries*

ACM and Oglesby misled the Board regarding AMMF's exposure to Eurozone countries during the fall of 2011. I find that Oglesby made the statements regarding ACM's strategy for Eurozone exposure which are attributed to him at the Board meeting held on August 8, 2011, specifically the representation that ACM was avoiding Greece, Spain, and Italy due to the Eurozone crisis. I do not find plausible that either the content of the relevant statements or their speaker were incorrectly recorded in the minutes. De Nicolo, the principal editor of this portion of the minutes, believed them to be accurate at the time she reviewed and edited them in the fall of 2011. Tr. 754-57. Cutshall, the only person testifying at the hearing who took contemporaneous notes at the Board meetings, also believed the minutes to be accurate. Tr. 814-

16. Hodges was quite firm in her belief that it was represented to the Board at the August 2011 meeting that ACM was avoiding Greece, Spain, Italy, and other struggling Eurozone countries. Tr. 1309-10. Respondents note that the Schedule of Portfolio Investments reviewed at the next Board meeting indicated that Romulus Funding Corporation was an Italian security, and they suggest that if the August 2011 minutes were accurate, one of the Board members would have objected after reviewing the schedule. Resp. Reply at 2. However, the schedule does not identify the other two securities with Italian exposure – it in fact labels Arabella Finance LLC as German – and in any event, there is no evidence that the Board reviewed the schedule in detail. *Id.*, Ex. B. I am not convinced that this single document in the board packet casts doubt on the accuracy of the minutes or the other attendees' recollections.

Respondents admit that the Fund continued to consistently purchase the securities of Romulus Funding Corporation, Arabella Finance LLC, and ENI Finance USA between August and November 2011, but note that they purchased the securities at short maturities. Resp. Br. at 4. I find the statement that ACM was "avoiding" or "trying to avoid" Italy to be a misrepresentation of ACM's investment strategy regardless of the length of the securities' maturities. The Fund held the securities of issuers with Italian risk on every single day between August 8, 2011, and November 18, 2011; it was thus untrue to represent to the Board that ACM was avoiding Italy or investments in Italian securities. Ex. 176B.

I also find that Oglesby made the statement attributed to him at the Board meeting held on November 14, 2011, regarding the Fund having only "minimal second-hand exposure to the Italian market" which would be "off the books" by mid-November. Prost testified that Oglesby was the one that made this statement (or a similar representation) at the meeting, and no witnesses other than Oglesby himself had a different recollection. Tr. 481-82, 761-62, 1524-25, 1733-35. I am unable to confirm the time on November 14, 2011, at which the purchase of $4 million of ENI Finance USA was made; thus, I am unable to determine whether Oglesby's statements were technically inaccurate at the time they were made. The Division contends that it was also inaccurate to describe the exposure of ENI Finance USA as "second-hand" in light of its direct and indirect ownership by the Italian state. Div. Reply at 6. However, I find plausible Prost's explanation that "second-hand" was meant to indicate that the security was not issued directly by an Italian financial institution. Tr. 1776; Ex. 406.

Nonetheless, his statements clearly suggest that ACM's strategy did not involve the purchase of Italian securities on an ongoing basis; the obvious implication was that the strategy included more than a twelve-day pause in purchasing ENI Finance USA. Thus, ACM's failure to communicate its abrupt change of opinion regarding Italian securities from December 1, 2011, onward led the Board to believe that ACM would continue to avoid Italy. This omission was misleading, because ACM made repeated purchases of ENI Finance USA, first at one-day and later at four and six-day maturities, throughout the end of the 2011. Ex. 92 at 63-66. There is no evidence that Oglesby or anyone else from ACM ever communicated ACM's reevaluation of the risk of certain Italian securities to the Board. Instead, the Board was simply told by Prost and Oglesby at the next meeting, in February 2012, that the Fund's exposure to "many European issuers" was reduced during the fourth quarter of 2011, and ACM stated that the Fund no longer held any securities issued by Italian banks. Ex. 95 at 9. While these statements were at least arguably true, by failing to disclose the full story regarding ACM's Eurozone strategy, ACM cultivated the misleading impression that ACM continued to avoid Italian securities in December 2011. *See SEC v. Mudd*, 885 F.Supp. 2d 654, 666 (S.D.N.Y. 2012) ("'half- truths' – literally true statements that create a materially misleading impression. . . will support claims for securities fraud."). While the board packet for the February 2012 meeting included the approved list and the purchase journal for the previous quarter, which listed the renewed purchases of ENI Finance USA, these documents included no indication that ENI Finance USA had exposure to Italy, and their disclosure failed to correct the manifestly misleading impression that the Fund continued to avoid, in addition to securities directly issued by Italian banks, securities with indirect Italian exposure. Ex. 92 at 10, 63-66; Tr. 323, 537, 763-64.

d. *Portfolio Diversification*

The OIP alleges that ACM misled the Board in November 2011 regarding the impact of the September 2011 redemption by Detroit on the Fund's diversification. OIP at 7-8.[13] The evidence shows that ACM misled the Board regarding the level of diversification in AMMF's portfolio at that time.

Respondents agree that the description of the Fund's diversification in the November 2011 meeting minutes is incorrect – the minutes state that no more than five percent of the Fund's assets were invested in any one issuer as of October 3, 2011, when in fact the securities of several issuers remained above five percent. Resp. Reply at 6. Respondents again claim that the minutes inaccurately recorded this portion of the meeting. *Id*. They note that the language used in the minutes and in Oglesby's letter explaining the incident was strikingly similar, and suggest that either the Board reviewed the letter but did not discuss it at the meeting, or that whoever drafted the minutes referred to and incorrectly paraphrased the letter. Resp. Br. at 16. The letter was included in the board packet for the November 2011 meeting, and De Nicolo confirmed that the letter was discussed at the meeting. Ex. 58 at 29; Tr. 779. I agree that the extremely similar language in the two documents suggests that the letter was read to or reviewed by the Board at the meeting and/or used in the preparation of that meeting's minutes.

The letter itself contains no explicit inaccuracies. While it could be more clearly worded, the letter's representation that the Fund was "back in compliance" can be fairly read to mean only that the purchases made on the morning of September 30, 2011, which climbed to above five percent as a result of the Detroit redemption later that day, were back below five percent by the following Monday; the letter does not unambiguously state that the entire portfolio was below five percent on that date, which all parties agree was inaccurate. The former interpretation of the letter is an accurate representation of the Fund's portfolio on October 3, 2011. Ex. 13 at 24; Ex. 100.

In contrast, the minutes – which presumably reflect the Board's actual understanding, as opposed to what they understood just from Oglesby's letter – contain an objectively false

[13] The Division contends that ACM also misled the Board regarding a passive breach in December 2010 and failed to disclose numerous other passive and active breaches, but these allegations do not appear in the OIP and are therefore immaterial. *Compare* OIP at 4-8 *with* Div. Prehearing Br. at 11-12, 24.

statement regarding the Fund's diversification on and after October 3, 2011. Resp. Reply at 6. There is conflicting evidence and testimony with respect to who participated in the associated discussion. Oglesby maintains that he had already left the meeting by the time the Compliance Reporting portion of the meeting took place, which is where the inaccurate statement is located in the minutes. Tr. 1264-65; Div. Ex. 92 at 11. According to the minutes, Oglesby and Prost were in fact excused from the meeting after the Rule 2a-7 Compliance portion of the meeting, immediately before Compliance Reporting. Ex. 92 at 10. On the other hand, Cutshall insisted that the minutes accurately pinpoint ACM as the speaker of the inaccurate statement regarding diversification, and testified that he believed it was Oglesby who spoke. Tr. 830. Cutshall suggested that either the minutes were not in chronological order, or that the minutes inaccurately stated that Oglesby and Prost left the meeting, when they in fact stayed for the Compliance Reporting because ACM knew the most about the redemption. Tr. 830, 837-39. Hodges and Guy also believed that someone from ACM participated in this Detroit redemption discussion at some point, but neither had a clear recollection. Tr. 476, 530. De Nicolo testified that she discussed and fielded a question from a Board member regarding Oglesby's letter; she did not recall anyone – from ACM or otherwise – making the statements reflected in the minutes. Tr. 779-85. De Nicolo did recall explaining that a large eleventh-hour withdrawal was a one time, exceptional occurrence. Tr. 780. The minutes appear to attribute this statement merely to "ACM." Ex. 92 at 11.

However, I am not persuaded that the Board minutes inaccurately recorded either the content or the speaker of the relevant statements. Hodges and Guy both recalled the discussion of the Detroit redemption and believed someone from ACM participated. As described by De Nicolo and Cutshall, the draft minutes were subjected to a robust review and editing process that would be expected to catch any inaccuracies at a time when the attendees' memories were fresh. Tr. 754-55, 824. As approved by the Board at the following Board meeting, the minutes are clear that "ACM stated" and "ACM noted" various things about the Detroit redemption; they do not suggest that the letter was read during the meeting by someone other than an ACM representative or that an ACM representative was not actually present for the discussion. Ex. 95 at 6-7; Ex. 92 at 11. Nothing in the record refutes Oglesby's testimony that he and Prost had left the meeting by the time the statements were made, and the sole remaining ACM representative was Jeffries. Ex. 92 at 4-5. Jeffries testified that he was not aware at the November meeting that the Detroit redemption caused securities other than those purchased that morning to rise above five percent, suggesting that he subjectively believed – and might have spoken – the misrepresentations reflected in the minutes. Tr. 1535, 1538. He also admitted to listening to the discussion of the Detroit redemption and approving the minutes of the November 2011 meeting as the official recording of that discussion. Tr. 1541. I find by a preponderance of the evidence that someone from ACM, likely Jeffries, made the inaccurate statement regarding the Detroit redemption reflected in the November 2011 meeting minutes.

3. <u>Materiality</u>

The standard of materiality under Section 206 is whether a reasonable investor would have considered the information important in deciding whether to invest. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32, 240 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Materiality is proved by showing that disclosure of the misstated or omitted facts would have significantly altered the total mix of information available to the investor. *See SEC v. Ginsburg*, 362 F.3d 1292, 1302 (11th Cir. 2004) (quoting *TSC Indus.*, 426 U.S. at 449). Materiality does not require proof that accurate disclosure would have caused the reasonable investor to change his decision, but only that the omitted fact would have assumed actual significance in the deliberations of the reasonable investor. *TSC Indus.*, 426 U.S. at 449.

Each of ACM's and Oglesby's misstatements and omissions impacted the Board's understanding of the level of risk in AMMF's portfolio, ACM's strategy for managing such risk, and AMMF's compliance with applicable law; as such, each was materially important to the Board's ability to oversee the Fund and approve its investments. With respect to ACM's failure to disclose its lack of adherence to the internal maturity restrictions, Prost admitted that the interest rate risk of a security rises as its maturity increases. Tr. 1612-13. In addition, securities with longer maturities are more difficult to sell prior to maturity, increasing the risk that the Fund, if forced to sell securities, would have to do so at a loss. Tr. 998-99. The Board believed that ACM was following its internal maturity restrictions, holding Tier 1(C) securities for time periods shorter than Tier 1(A) securities, and ACM's omissions prevented the Board from fully understanding the Fund's level of maturity risk and approach to handling such risk. Tr. 523-24. In the absence of any disclosure to the contrary, the Board also believed that ACM was following its own internal procedures for managing the Fund. Tr. 334, 463-64, 524. These misimpressions, which directly resulted from ACM's misleading omissions on the subject of its internal maturity restrictions, were plainly material.

For similar reasons, the misrepresentations regarding the Fund's exposure to the Eurozone crisis during the latter half of 2011 were also material. The Eurozone crisis directly impacted the risk that the issuers of the Fund's Italian securities might default and therefore be unable to repay the Fund's principal and interest. Tr. 125, 145, 532, 747-79, 1610-11. Prost admitted that the "ultimate fear is default risk"; if enough issuers defaulted, the Fund risked breaking the buck. Tr. 1280-81, 1610. Jeffries also acknowledged that breaking the buck was a serious, negative event. Tr. 1565. The Board needed to be adequately informed of the Fund's investments before it could make an informed decision to approve them in light of the ongoing Eurozone crisis. Both Hodges and Guy testified that as Board members, they would have wanted to know if ACM was continuing to purchase Italian securities. Tr. 482-83, 536. Misrepresenting ACM's Eurozone strategy deprived the Board of the information it needed to analyze the Fund's risk of holding the securities of a defaulting issuer and, ultimately, of breaking the buck.

Finally, ACM's misrepresentations regarding the Fund's diversification after the 2011 Detroit redemption were clearly material. While the passive breaches were not violations of Rule 2a-7(c)(4), the level of concentration in AMMF's portfolio impacted its risk. Tr. 891-92; 981. By overstating AMMF's diversification, ACM effectively misrepresented to the Board the Fund's level of concentration risk and ACM's management of the Fund with respect to passive breaches. Hodges testified that while a single passive breach would not have concerned her, she would have wanted to know if there were several investments in the portfolio that were in passive breach. Tr. 473-74. This was the exact situation on October 3, 2011, and the Board was instead informed that no securities remained above five percent. This false statement was clearly material.

4. <u>Scienter</u>

In order to establish a violation of Section 206(1), the Division must establish that the Respondents acted with scienter. Scienter is defined as a "mental state embracing the intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976); *Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980). A finding of recklessness satisfies the scienter requirement. *David Disner*, 52 S.E.C. 1217, 1222 & n.20 (1997); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990) (citing eleven circuits holding that recklessness satisfies scienter in Section 10(b) and Rule 10b-5 actions), *cert. denied*, 499 U.S. 976 (1991). Recklessness, in the context of securities fraud, is "highly unreasonable" conduct, "which represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1978) (quoting *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977)); *see also S.W. Hatfield, CPA*, Exchange Act Release No. 69930 2013 WL 3339647 at *21 (Jul. 3, 2013).

The standard of care for a registered investment adviser is based on its fiduciary duty. *See Transamerica Mortg. Adviser, Inc. v. Lewis*, 444 U.S. 11, 17 (1979); *Capital Gains Research Bureau*¸ 375 U.S. at 191-92. Investment advisers have an "affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts.'" *Capital Gains Research Bureau*, 375 U.S. at 194 (citations omitted); *SEC v. Blavin*, 760 F.2d 706, 711-12 (6th Cir. 1985). Respondents were required to "employ reasonable care to avoid misleading" clients. *See Capital Gains Research Bureau*, 375 U.S. at 194; *SEC v. Moran*, 922 F. Supp. 867, 895-96 (S.D.N.Y. 1996). Ultimately, the standard is one of "reasonable prudence, whether it usually is complied with or not." *Vernazza v. SEC*, 327 F.3d 851, 861 (9th Cir. 2003) (citation omitted). As applicable here, an investment adviser has a "professional duty to investigate the information upon which his recommendations [are] based." *Blavin*, 760 F.2d at 712.

Through its agents, ACM acted with scienter with respect to its misstatements and omissions about ACM's Eurozone strategy in the fall of 2011. *See Montford and Company, Inc.*, Advisers Act Release No. 3829, 2014 WL 1744130, at *14 (May 2, 2014). ACM knew that the statements made at the August 2011 Board meeting were not an accurate description of its investment strategy for Italian securities; indeed, both Prost and Oglesby agreed that the meeting minutes did not accurately describe ACM's Eurozone investment strategy in the fall of 2011. Tr. 1222-23, 1669. In addition, ACM's failure to update the Board on its sudden change of opinion regarding the riskiness of ENI Finance USA fell woefully short of its obligation to provide a full and fair disclosure of all material facts. Even if, as Prost testified, ACM believed ENI Finance USA to be a strong, safe issuer in December 2011, ACM knew that the Board was interested in the Fund's Eurozone strategy, which is why it was discussed at the November 2011 Board meeting. Tr. 1692. The risk of misleading the Board into thinking that ACM would continue to avoid the Eurozone was obvious, ACM's failure to update the Board was an extreme and inexplicable departure from the standard of care, and ACM was accordingly reckless in failing to disclose to the Board ACM's change in opinion and change in purchase strategy. ACM therefore violated Sections 206(1) and 206(2) with respect to the misrepresentations about the Fund's Eurozone strategy made at the August 2011 and November 2011 meetings.

In contrast, I find that ACM acted only negligently with respect to its misrepresentations about the diversification of the Fund's portfolio after the Detroit redemption. ACM purchased securities for the Fund and was responsible for deciding how much of a security to purchase. Tr. 728. As manager of the Fund, ACM was responsible for managing its portfolio, and FSG provided ACM with information on its holdings every day. Tr. 1216. Prost was aware in November 2009 that the safe harbor only applied to one security at a time. Ex. 30 at 106; *see also* Tr. 727-30. The evidence demonstrates that someone from ACM, likely Jeffries, nonetheless made patently false statements regarding the diversification of ACM's portfolio after the Detroit redemption at the November 2011 Board meeting. However, there is no indication that ACM or Jeffries acted intentionally or recklessly in making the misrepresentations. I credit Jeffries' testimony that he was not involved with the Fund's trading activity, and that he did not know that the Detroit redemption caused several additional securities to rise above five percent. Tr. 1483, 1534-35. I therefore find that ACM acted negligently, and violated only Section 206(2) with respect to the misrepresentation about the Fund's diversification made at the November 2011 Board meeting.

I also find that ACM acted negligently, but not recklessly or intentionally, with respect to its omissions regarding ACM's failure to adhere to its internal maturity restrictions. ACM knew that its traders did not always abide by the internal maturity restrictions, and Respondents do not contest that ACM failed to disclose this fact to the Board. Tr. 1143-46, 1645-46; Resp. Br. at 20-21. ACM should have realized that the Board understood the maturity restrictions to function as actual restrictions, and it was unreasonable to expect the Board to believe otherwise. *See* Tr. 523-24. However, the evidence showing what ACM told the Board regarding the internal restrictions is scant, and there is insufficient evidence to conclude that the danger of the Board misunderstanding the rigidness of the restrictions was known or obvious to ACM. Thus, I find that ACM violated only Section 206(2) with respect to its omissions regarding the internal maturity restrictions.

5. <u>Aiding and Abetting</u>

I find that Oglesby willfully aided, abetted, and caused ACM's violations of Section 206(1) and 206(2) with respect to ACM's misrepresentation of its Eurozone strategy in the fall of 2011. From May 2010 on, he was the portfolio manager of AMMF and was therefore well-acquainted with its holdings and management strategy. Tr. 1225, 1097, 1601-02. His inaccurate statements at the August 2011 Board meeting, and his failure to correct the misimpression directly caused by his statements at the November 2011 Board meeting, far more than substantially assisted in ACM's violations. He knew the falsity of the statements documented in the minutes of the August 2011 meeting, and as the ACM representative who updated the Board on ACM's evolving Eurozone strategy at the subsequent Board meeting, he was at least reckless in failing to notify the Board that the strategy he described at the November 2011 Board meeting abruptly changed only seventeen days later. Certainly he was capable of doing so, as demonstrated by his letter regarding the September 30, 2011, redemption and passive breaches. Ex. 58 at 29.

On the other hand, Oglesby did not substantially assist in the commission of ACM's misrepresentations with respect to the Fund's diversification. There is insufficient evidence that he was present during the portion of the November 2011 Board meeting at which the inaccurate statement regarding the Fund's diversification was made. Similarly, the Division has failed to prove that Oglesby substantially assisted in misleading the Board regarding ACM's adherence to its internal maturity restrictions. As noted, the evidence pertaining to ACM disclosures about its internal maturity restrictions is scant, and there is insufficient evidence that Oglesby had anything to do with them.

B. Investment Company Act

The OIP alleges that Ambassador Funds violated several provisions of the Investment Company Act and its Rules, that ACM caused all of these violations, and that Oglesby caused four of them. OIP at 9-10. It is undisputed that, at all relevant times, Ambassador Funds was a registered open-end investment company and that the Fund was Ambassador Funds' prime money market fund series. ACM Answer at 2; Oglesby Answer at 1; First Stip. ¶¶ 4, 5. The alleged Investment Company Act violations are not of anti-fraud provisions, and do not require a showing of scienter. *See SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (scienter is not required to violate Rule 22c-1); *Fundamental Portfolio Advisers, Inc.*, 56 S.E.C. 651, 670 (2003) (scienter is not required to violate Section 34(b)); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976) ("When a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances . . . we are quite unwilling to extend the scope of the statute to negligent conduct."). "Causing" liability is established by proof that a person was "a cause of [another's] violation, due to an act or omission the person knew or should have known would contribute to such violation." 15 U.S.C. § 80a-9(f)(1); *see Adrian C. Havill*, 53 S.E.C. 1060, 1070 n.26 (1998) (construing similar provision of the Securities Exchange Act of 1934). Negligence is sufficient to establish liability for causing a primary violation that does not require proof of scienter. *See KPMG Peat Marwick LLP*, 54 S.E.C. at 1175.

1. Rule 38a-1

Rule 38a-1 provides that registered investment companies must "[a]dopt and implement written policies and procedures reasonably designed to prevent violations of the Federal Securities Laws" by the investment company. 17 C.F.R. § 270.38a-1(a)(1). The Division alleges that ACM violated this provision by failing to timely cause "the Fund" to adopt written procedures for stress testing, as required by the May 5, 2010, amendments to Rule 2a-7(c)(10)(v). Div. Br. at 38, 41; *Money Market Fund Reform*, 75 Fed. Reg. 10060 (Mar. 4, 2010). It also alleges that ACM violated this provision by failing to properly implement stress testing in February 2011 in accordance with Rule 2a-7(c)(10)(v), to keep the Board informed of the Fund's lack of compliance with Rule 2a-7 generally, and to adhere to ACM's internal maturity restrictions. Div. Br. at 38, 41, 47. The OIP alleges that ACM, but not Oglesby, caused Ambassador Funds' Rule 38a-1 violations. OIP at 10.

There was no Rule 38a-1 violation arising from any lack of compliance with ACM's maturity restrictions, for two reasons. First, although the OIP alleges a violation of the maturity restrictions on multiple occasions, the allegations only appear in a section of the OIP pertaining to failure to disclose the maturity restriction violations to the Board. OIP at 4-5. The OIP alleges a consequent Section 206 violation, but it cannot fairly be read to separately accuse Respondents of violating the maturity restrictions as a predicate for violating Rule 38a-1. Second, the evidence shows that the maturity restrictions were imposed only by ACM. Ex. 50; Ex. 172 at 6. There is no evidence that the maturity restrictions were part of Ambassador Funds' "written policies and procedures." 17 C.F.R. § 270.38a-1(a)(1). There was also no Rule 38a-1 violation arising from ACM's failure to keep the Board informed of the Fund's lack of compliance with Rule 2a-7 generally, because that allegation is not found in the OIP. *See* OIP at 10.

Rule 2a-7(c)(10)(v)(A) states that "[w]ritten procedures shall provide for" periodic testing. 17 C.F.R. § 270.2a-7(c)(10)(v)(A); 75 Fed. Reg. 10060 (Mar. 4, 2010). The OIP alleges that "AMMF did not fully implement written stress testing procedures until May 21, 2012," but does not allege that Respondents caused any tardiness. OIP at 9. Respondents contend that they did not cause any tardiness, a point the Division does not address. Resp. Br. at 33 n.25; Div. Reply at 18-19. Although Oglesby's apparent alacrity in conducting the first stress test suggests that stress tests could have been performed much earlier than February 2011, I find that neither ACM nor Oglesby caused the Fund to violate Rule 2a-7(c)(10)(v)(A) by failing to *timely* implement written stress testing procedures. *See* Ex. 168 (two days between stress test reminder and stress test completion). It is therefore immaterial whether the Fund was actually tardy in implementing written stress testing procedures.

Rule 2a-7(c)(10)(v)(B) states that "[w]ritten procedures shall provide for" reports to the investment company's board on the results of such testing. 17 C.F.R. § 270.2a-7(c)(10)(v)(B). One element of such a report is an "assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year." 17 C.F.R. § 270.2a-7(c)(10)(v)(B)(2). The OIP alleges that the February 2011 stress test was deficient because Oglesby omitted analysis of an increase in shareholder redemptions and of a downgrade of portfolio securities, two considerations explicitly spelled out in Rule 2a-7(c)(10)(v)(A). OIP at 9; 17 C.F.R. § 270.2a-7(c)(10)(v)(A).

The Division contends that Oglesby did not adequately account for shareholder redemptions, as well as concurrent stress events, but does not contend that Oglesby failed to account for a downgrade of portfolio securities. Div. Br. at 24-25; Div. Reply at 18-19. The OIP, however, does not explicitly allege that ACM failed to assess AMMF's ability to withstand concurrent stress events that are reasonably likely to occur within the following year. OIP at 9. It is therefore immaterial whether ACM failed to assess concurrent stress events, because that allegation is not found in the OIP, and whether ACM failed to stress test for a downgrade of portfolio securities, because the Division no longer advances that allegation. Accordingly, the only allegation in suit regarding Rule 38a-1 is whether ACM (but not Oglesby) adequately stress tested for an increase in shareholder redemptions.

The Board held two regular meetings after May 5, 2010, without taking action on Rule 2a-7(c)(10)(v). Exs. 94, 471. The June 8, 2010, meeting minutes contain no mention of Rule 2a-7(c)(10)(v). Ex. 471. The August 27, 2010, meeting minutes record a discussion of stress testing, as well as a promise from De Nicolo and Jeffries that a stress testing report would be provided at the next Board meeting, but with no Board action taken. Ex. 94 at 18-19. As noted, the Board adopted a resolution at its November 19, 2010, meeting, requiring stress testing at least annually, and otherwise simply incorporating Rule 2a-7(c)(10)(v)(A). Ex. 468 at 5. The Board also directed that the first stress test be performed based on the Fund's books for the fiscal year ending December 31, 2010, with the results presented at the next regular Board meeting. *Id.*

Oglesby designed, conducted, and was primarily responsible for the February 2011 stress test. Tr. 1267-69, 1443-44, 1492-93, 1665. The February 18, 2011, Board presentation stated that the test modeled "interest rate shocks, liquidity shocks, and credit shocks," with no explicit mention of shareholder redemptions. Ex. 463 at 159. The primary scenario, called the "Interest Rate Stress Test," was presented by single-line chart and assumed an "instantaneous, parallel rate shift," which Oglesby explained had the effect of causing "every security along each maturity [to] increase at the same time," that is, "increasing [the yield of] each security by the same amount." *Id.*; Tr. 1273-75. Two "Alternative Stress Test Scenarios" were presented in a second chart, "50% of Portfolio Widens by 500bps," in which half the securities in the portfolio increased their yield by fifty percent, and "Default ($1MM)," in which one or more securities defaulted. Ex. 463 at 159; Tr. 1279-83.

Respondents contend that the "50% of Portfolio Widens by 500bps" scenario satisfied the "increase in shareholder redemptions" component of the stress testing required by Rule 2a-7(c)(10)(v)(A). Resp. Br. at 32; Resp. Reply at 17; 17 C.F.R. § 270.2a-7(c)(10)(v)(A). This contention lacks merit.

Subjectively, shareholder redemptions were not on Oglesby's mind at the time he analyzed the scenario. The presentation to the Board did not use the term "redemption," even though Oglesby was on notice as early as November 2010 that any stress test must analyze an increase in shareholder redemptions. Ex. 62; Ex. 463 at 159. Oglesby testified during the investigation that the February 2011 stress test did not account for shareholder redemptions. Tr. 1400-01. He testified during the hearing that the scenario could constitute a stress test of downgrades, a credit event, or other factors: "I think the reason is irrelevant. The point is the rates are increasing, and the value is dropping for the securities." Tr. 1288-90. Oglesby did not explain at the hearing why the scenario assumed a yield increase of 500 basis points in fifty percent of the portfolio, rather than some other combination of yield increase and portfolio percentage. Tr. 1288-90. His chosen combination seems to have been arbitrary rather than grounded in a realistic shareholder redemption situation; indeed, he testified (facetiously) that a hypothetical cause of such a scenario would be "[n]uclear fallout." Tr. 1289. His later stress tests, by contrast, explicitly considered different redemption situations at various parallel interest rate shifts. Ex. 60; Ex. 318 at 5.

Objectively, the "50% of Portfolio Widens by 500bps" scenario could indeed represent a situation where shareholder redemptions exceed the Fund's available cash by an amount equal to fifty percent of portfolio value, with a resulting "fire sale" of half the portfolio at a reduced price equivalent to a 500 basis point rise in yield. Tr. 1282-83, 1290, 1666-67. In that respect, the "50% of Portfolio Widens by 500bps" scenario could be construed as a test of a hypothetical massive shareholder redemption.

But the nature and extent of the analysis did not sufficiently comport with Rule 2a-7(c)(10)(v), because it did not tell the Board what Rule 2a-7(c)(10)(v) suggests it should have.[14] Rule 2a-7(c)(10)(v)(A) requires consideration of a minimum of four specific "hypothetical events." 17 C.F.R. § 270.2a-7(c)(10)(v)(A). Rule 2a-7(c)(10)(v)(B)(1) requires a report on the "magnitude of each hypothetical event that would cause" the Fund's NAV to deviate sufficiently to "break the buck." 17 C.F.R. § 270.2a-7(c)(10)(v)(B)(1). Rule 2a-7(c)(10)(v)(B)(2) requires "an assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year." 17 C.F.R. § 270.2a-7(c)(10)(v)(B)(2). Although not explicitly stated, it stands to reason that the events "reasonably likely to occur within the following year" are the hypothetical events analyzed in the stress test.

Rule 2a-7(c)(10)(v) is silent on stress test methodology but not on outputs. Taken as a whole, Rule 2a-7(c)(10)(v) suggests that any stress testing must provide at least three outputs for each hypothetical scenario analyzed, namely, the magnitude of each hypothetical event or combination of events that will cause the fund to break the buck, the effect on the fund of hypothetical events that are reasonably likely to occur within the following year, and the ability of the fund to withstand such hypothetical events. Thus, as to an increase in shareholder redemptions from AMMF, a proper stress test report would identify the redemption percentage at which AMMF would break the buck, the largest redemption percentage reasonably likely in the following year, and the effect on AMMF's NAV of the largest redemption percentage reasonably likely in the following year. Neither the February 2011 stress test nor the February 2012 stress test provided any of these numbers, although the OIP's allegations only pertain to the February 2011 test. Ex. 463 at 159; Ex. 65; OIP at 9. Instead, the February 2011 stress test analyzed an unrealistic scenario that was not intended as a test of the Fund's ability to withstand an increase in shareholder redemptions, and which conveyed little information of use to the Board.

Accordingly, the Fund violated Rule 2a-7(c)(10)(v). As noted, Oglesby was responsible for the stress testing and was on notice at the time that ACM needed to test for an increase in shareholder redemptions. Ex. 62. Thus, Oglesby should have known that his omission would cause the Fund's violation. ACM therefore caused the Fund's violation of Rule 2a-7(c)(10)(v). The Board's November 19, 2010, directive to conduct a stress test, although austere, is fairly construed as a written policy or procedure designed to prevent violations of the securities laws. Accordingly, Ambassador Funds adopted a written procedure, and then failed to implement that procedure in accordance with Rule 38a-1 between February 18, 2011, and February 7, 2012, when Oglesby documented the February 2012 stress test, and ACM caused Ambassador Funds' violation. Ex. 65.

[14] Zitzewitz did not opine on this issue, and Wermers' opinion on it is conclusory. Ex. 112 at 22; Ex. 466. Moreover, effective October 14, 2014, the stress test requirements will change substantially. *See Money Market Fund Reform*, 79 Fed. Reg. 47736 (Aug. 14, 2014) (to be codified at 17 C.F.R. pt. 270) (new 17 C.F.R. § 270.2a-7(g)(8)).

2. Sections 34(b) and 35(d)

Section 34(b) makes it unlawful "for any person to make any untrue statement of a material fact in any . . . record, or other document filed or transmitted pursuant to this title or the keeping of which is required pursuant to Section 31(a)," or "to omit to state therein any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they were made, from being materially misleading." 15 U.S.C. § 80a-33(b). It is an untrue statement within the meaning of Section 34(b) when a registered investment company "hold[s] itself out to investors as a money market fund or the equivalent of a money market fund" in any document filed pursuant to the Investment Company Act, unless the registered investment company meets the conditions of Rule 2a-7(c)(2)-(5). 17 C.F.R. § 270.2a-7(b)(1) (citing 15 U.S.C. § 80a-24(b)). The Investment Company Act requires registered open-end investment companies to file "sales literature" with the Commission. 15 U.S.C. § 80a-24(b)

Section 35(d) makes it unlawful "for any registered investment company to adopt as part of the name or title of such company, or of any securities of which it is the issuer, any word or words that the Commission finds are materially deceptive or misleading." 15 U.S.C. § 80a-35(d). It is materially deceptive or misleading within the meaning of Section 35(d) for a registered investment company to "adopt the term 'money market' as part of . . . the name or title of any redeemable securities of which it is the issuer," unless the registered investment company meets the conditions of Rule 2a-7(c)(2)-(5). 17 C.F.R. § 270.2a-7(b)(2).

The OIP, fairly read, alleges that Ambassador Funds violated Section 34(b) by "hold[ing] itself out to investors as a money market fund" at the same time that it failed to comply with Rule 2a-7(c)(3) and (4), and that ACM and Oglesby caused Ambassador Funds' violation. OIP at 10. The Division contends that Respondents caused "the Fund" to identify itself "as a money market fund in numerous commission filings despite the Fund's failure to comply with the provisions of Rule [2a-7(c)(3) and (4)]." Div. Br. at 40. The OIP alleges that Ambassador Funds violated Section 35(d) by "adopt[ing] the term 'money market' as part of its name or [adopting] a name that suggests that it is a money market fund," and that ACM and Oglesby caused Ambassador Funds' violation. OIP at 10. The Division contends that Respondents caused "the Fund" to violate Rule 2a-7(c)(3) and (4), and to "hold the Fund out" as a money market mutual fund. Div. Br. at 39-40.

The parties have stipulated that Ambassador Funds made "a number" of filings between January 1, 2009, and June 30, 2012, which identified the Fund as a money market fund. First Stip. ¶ 6. This is sufficient to conclude that Ambassador Funds held out the Fund[15] as a money

[15] Ambassador Funds is a registered investment company; AMMF is a money market fund series rather than a registered investment company. OIP at 2; ACM and Oglesby Answers at 2. Thus, technically, Section 34(b) applies only to Ambassador Funds. 15 U.S.C. § 80a-33(b). The distinction is of little significance here, both because AMMF is the only series Ambassador Funds ever had, and because series "function as separate investment companies." Tr. 1468-69; *Vaughn Weimer*, Advisers Act Release No. 2512, 2006 SEC LEXIS 1019, at *4 n.3 (May 5, 2006). Respondents apparently do not contest this issue. *See* Tr. 487.

market fund in 2009. It is undisputed that the Fund's name was Ambassador Money Market Fund. ACM and Oglesby Answers at 2. This is sufficient to conclude that Ambassador Funds adopted the term "money market" as part of the Fund's name.[16]

As explained *supra*, Ambassador Funds did not violate Rule 2a-7(c)(3), and only Rule 2a-7(c)(4) is at issue. Thus, Ambassador Funds violated Sections 34(b) and 35(d) if it failed to comply with Rule 2a-7(c)(4) at relevant times, and ACM and Oglesby caused the violations if they knew or should have known that their acts or omissions would contribute to the violations.

The Division alleges that ACM purchased securities for the Fund that violated Rule 2a-7(c)(4) on three days in 2009.[17] Div. Br. at 37-38. Rule 2a-7(c)(4) provides, as applicable here, that a money market fund "shall not have invested more than five percent of its Total Assets in securities issued by the issuer of the security." 17 C.F.R. § 270.2a-7(c)(4)(i)(A). As noted, Rule 2a-7(c)(4)'s safe harbor permits investment of up to twenty-five percent of total assets in a single issuer for up to three business days after acquisition, provided that the fund "may not invest in the securities of any one issuer in accordance with the foregoing proviso in this paragraph at any time." *Id.*

Respondents do not dispute that the Fund violated Rule 2a-7(c)(4) on three occasions in 2009. Resp. Br. at 30. On August 12, 2009, the Fund purchased Ebury Finance, LLC and White Point Funding, Inc., which caused the Fund to hold greater than five percent of its total assets in both issuers on August 12, 2009. Ex. 159 at 5; Ex. 466A. On December 7, 2009, the Fund purchased Beethoven Dresdner US, Ford, Hannover, Societe Generale NA, and White Point Funding, which caused the Fund to hold greater than five percent of its total assets in all five issuers on August 12, 2009. Tr. 726; Ex. 70 at 2; Ex. 466A.[18] On December 18, 2009, the Fund purchased Amstel Funding Corp. and Hannover, which caused the Fund to hold greater than five percent of its total assets in both issuers on December 18, 2009. Ex. 70 at 2; Ex. 466A.

It is also undisputed that ACM selected the Fund's purchases and executed trades on its behalf, and it necessarily follows that ACM's acts contributed to the Fund's violations. Tr. 1499. Respondents argue that ACM is nonetheless not liable for the Fund's violations because ACM did not know the Fund had committed them. Resp. Br. at 26-27. But actual knowledge is not the sole test; ACM caused the Fund's violations if ACM "should have known" that its acts "would contribute" to the violations. 15 U.S.C. § 80a-9(f)(1); *see Adrian C. Havill*, 53 S.E.C. at 1070

[16] There is no evidence that Ambassador Funds adopted the term "money market" for its own name, as opposed to AMMF's name. However, Section 35(d) applies to Ambassador Funds to the extent it adopted the term "money market" for "any redeemable securities of which it is the issuer," that is, for AMMF shares. 15 U.S.C. § 80a-35(d). This provision is not alleged in the OIP – the OIP refers only to adopting the term as part of a registered investment company name – but as with Section 34(b), the distinction is of little significance here. OIP at 10.

[17] It appears that the Division has abandoned the argument that there were also Rule 2a-7(c)(4) violations in 2010. Div. Prehearing Br. at 9; OIP at 8; Div. Br. 37-38; Div. Reply at 17-19.

[18] Ex. 466A lists Beethoven Dresdner US and Ford as Silver Tower US Fund and FCAR Owner Trust.

n.26. It is undisputed that De Nicolo was CCO of ACM during the entirety of 2009, and that she mistakenly believed that the safe harbor could apply to more than one issuer at a time. Tr. 727-29, 1554; Resp. Br. at 26. However, she should have known that the safe harbor was restricted to one issuer at a time; that limitation is unequivocally clear from Rule 2a-7(c)(4)'s text. Certainly the CCO of both an investment company and an investment adviser, charged specifically with keeping abreast of the laws and regulations governing their conduct, should have known such an unambiguous provision.

ACM's officers and portfolio managers, as associated persons of ACM, had fiduciary duties to the Fund. *See Fundamental Portfolio Advisors, Inc.*, 56 S.E.C. 651, 684 (2003). A fiduciary unaware of the laws governing exercise of his duty is no fiduciary at all, and it follows that a fiduciary has an obligation to make herself aware of such laws. *See* 17 C.F.R. § 275.204A-1(a)(1) (investment adviser must adopt code of ethics requiring supervised persons to comply with applicable securities laws). ACM's officers and portfolio managers should have known the details of Rule 2a-7(c)(4)'s safe harbor and whether the Fund complied with it, independently of De Nicolo, and it is no excuse to say that they had no actual knowledge. *See Navellier v. Sletten*, 262 F.3d 923, 945 n.11 (9th Cir. 2001) (fiduciary under Investment Company Act has obligation to inform himself of material facts). In any event, there is no explicit evidence that De Nicolo ever communicated her misunderstanding of the safe harbor to Nurre, the Fund's portfolio manager in 2009, or that anyone at ACM relied on De Nicolo's misunderstanding in selecting and executing the Fund's trades.

Respondents also argue that Oglesby did not cause the Fund's violations of Rule 2a-7(c)(4) because he was not the Fund's portfolio manager in 2009. Resp. Br. at 27. The Division makes no effort to refute this argument, and it is supported by the record. Tr. 1225; Div. Reply at 16-18. To be sure, Oglesby contributed to the Fund's violations, because he drafted or approved the 2009 credit research reports, many of which he signed as "portfolio manager." Ex. 19. But there is no evidence that he decided or helped decide how much of a particular issuer to purchase in 2009, and he thus had no reason to know that any particular purchase would cause a Rule 2a-7(c)(4) violation.

Therefore, ACM caused the Fund's violations of Rule 2a-7(c)(4), but Oglesby did not. Because there were three Rule 2a-7(c)(4) violations total in 2009, ACM, but not Oglesby, caused Ambassador Funds to violate Section 34(b) three times in 2009, and Section 35(d) three times in 2009.

3. <u>Section 31(a) and Rule 31a-1</u>

Section 31(a) and Rule 31a-1 provide that registered investment companies must "maintain and preserve such records" as prescribed by the Commission, including "[j]ournals (or other records of original entry)," which are construed as "documents which reflect the information required by the applicable rule or rules in appropriate sequence and in permanent form." 15 U.S.C. § 80a-30(a)(1); 17 C.F.R. § 270.31(a)-1(b)(1), (12). Such records include the "determination that a portfolio security presents minimal credit risks," which must be maintained for three years "from the date that the credit risks of a portfolio security were most recently reviewed." 17 C.F.R. § 270.2a-7(c)(11)(iii). The OIP alleges that "ACM's credit analyses for portfolio securities often omitted any finding that the security represented minimal credit risk," and that ACM and Oglesby caused Ambassador Funds' violations of Section 31(a) and Rule 31a-1. OIP at 6, 10. The Division contends that ACM and Oglesby were responsible for creating minimal credit risk determination records pursuant to Rule 2a-7(c)(11)(iii), that "numerous credit files" lacked records of minimal credit risk determinations between 2009 and 2011, and that by failing to create such records, ACM and Oglesby caused "the Fund's" failure to comply with Section 31(a) and Rule 31a-1. Div. Br. at 41-42.

As shown *infra*, ACM seemingly violated Rule 2a-7(c)(11)(iii) repeatedly throughout 2009, 2010, and 2011. I conclude, however, that the OIP did not properly plead Rule 2a-7(c)(11)(iii) violations.

Rule 2a-7(c)(11)(iii) does not state that all written records of credit risk determinations shall be maintained and preserved for three years. *See* 17 C.F.R. § 270.2a-7(c)(11)(iii). Instead, Rule 2a-7(c)(11)(iii) requires maintenance of written records of credit risk determinations of "portfolio securit[ies]" for at least three years "from the date that the credit risks of a portfolio security were most recently reviewed." 17 C.F.R. § 270.2a-7(c)(11)(iii). Rule 2a-7(c)(11)(iii) does not set forth any time period for maintenance of written credit risk determinations predating "the date that the credit risks of a portfolio security were most recently reviewed."[19] It follows that for Rule 2a-7(c)(11)(iii) to be violated on any particular day, "the date that the credit risks of a portfolio security were most recently reviewed" must be established for that portfolio security relative to that day. It also follows that if records of credit risk determinations predating "the date that the credit risks of a portfolio security were most recently reviewed" are deficient or nonexistent, Rule 2a-7(c)(11)(iii) is not violated with respect to those earlier records.

Societe Generale's records illustrate the point. Societe Generale's credit risk was documented in August 2009, August 2010, and July 2011, based on data collected in August 2009, December 2009, and December 2010, respectively. Ex. 19 at 86; Ex. 67 at 17-18. The credit risk was found to be "moderate" at each review. Ex. 19 at 86; Ex. 67 at 17-18. Because it is undisputed that the credit risk documentation occurred sometimes months after the credit risk determination, I find that ACM's credit risk "review," within the meaning of Rule 2a-7(c)(11), took place on or near the date the data was collected. As discussed *infra*, a "moderate" credit risk is not a minimal credit risk. In September 2009, during OCIE's examination, the most

[19] The ostensible purpose of Rule 2a-7(c)(11)(iii) is to require a fund to "document the minimal credit risk determination with respect to all securities in the fund's portfolio," and, presumably, to maintain that determination for three years. *Technical Revisions to the Rules and Forms Regulating Money Market Funds*, 61 Fed. Reg. 66621, 66626 (Dec. 18, 1996). OCIE's May 2010 deficiency letter asserted that "a written record of the minimal credit risk determination" must be maintained "for not less than three years from the date of determination." Ex. 159 at 2. This assertion is not consistent with the language of Rule 2a-7(c)(11)(iii), although it is entirely consistent with the Rule's purpose. The Rule's language just undermines its purpose. The language in the new version of the Rule is the same. *See Money Market Fund Reform*, 79 Fed. Reg. 47736 (Aug. 14, 2014) (to be codified at 17 C.F.R. pt. 270) (new 17 C.F.R. § 270.2a-7(h)(3)).

recent credit risk review of Societe Generale had been in August 2009. Ex. 19 at 86. ACM was obliged to maintain the August 2009 credit research report for three years from August 2009, or until it conducted another review (in this case, in December 2009), whichever came first. ACM was not obliged to maintain any credit research reports predating August 2009, because Rule 2a-7(c)(11)(iii) only covers the most recent review, and says nothing about maintaining records of earlier reviews.

Thus, had OCIE found problems with Societe Generale's pre-August 2009 credit research reports, it could not have found a deficiency under Rule 2a-7(c)(11)(iii). Similarly, had OCIE found problems with the August 2009 credit research report, but Societe Generale was not held as a portfolio security after, say, July 31, 2009, it could not have found a deficiency under Rule 2a-7(c)(11)(iii). If the OIP specifically alleged a violation of Rule 2a-7(c)(11)(iii) in September 2009, it could only have been based on Societe Generale's August 2009 credit risk review, which was the date its credit risk had been "most recently reviewed." If the OIP specifically alleged a violation of Rule 2a-7(c)(11)(iii) in January 2010, it could only be based on Societe Generale's December 2009 credit risk review, which was the date (relative to January 2010) its credit risk had been "most recently reviewed," and could not be based on the August 2009 credit research review. If the OIP specifically alleged a violation of Rule 2a-7(c)(11)(iii) in November 2011, the date of OCIE's second examination of ACM, it could only be based on Societe Generale's December 2010 credit risk review, which was the date (relative to November 2011) its credit risk was "most recently reviewed," and not on the August 2009 or August 2010 credit research reports. If Societe Generale was not held in 2009, then there could have been no violation in 2009.

The strangest consequence of Rule 2a-7(c)(11)(iii)'s language, however, is the need to identify the date the records were examined or reviewed. Suppose that OCIE obtained and examined ACM's August 2009 report for Societe Generale in September 2009. Suppose further that the OIP alleged that: (1) ACM documented Societe Generale's minimal credit risk in August 2009; (2) AMMF held the security in September 2009; and (3) AMMF violated Rule 2a-7(c)(11)(iii) in September 2009 by maintaining a written record of "moderate risk" while holding Societe Generale, based upon a review of AMMF's records in September 2009. This would appear to be sufficient to state a claim.

Suppose instead the same scenario, except that the OIP alleged that the review took place in September 2011. The most recent credit research report would have been in July 2011, and there would have been no duty to maintain the August 2009 credit research report. Accordingly, there could not have been a violation of Rule 2a-7(c)(11)(iii) in September 2009. ACM could have destroyed the August 2009 credit research report without consequence, and it was mere happenstance that it did not. It should not be penalized for exceeding the requirements of Rule 2a-7(c)(11) by maintaining credit research reports that need not be maintained.

The OIP is accordingly fatally ambiguous, because it does not identify examination dates, or anything like examination dates. The record reveals two examination dates, in September 2009 and November 2011, but this does not cure the ambiguity in pleading. The OIP has other problems, as well. It asserts that to comply with Rule 2a-7(c)(11)(iii), "a money market fund must make a written record of its analysis and determination . . . and retain the written record for at least three years." OIP at 6. This assertion misstates the law, as explained *supra*. The OIP also appears to conflate the duty to *make* a minimal credit risk determination with the duty to *document* it; as noted, these duties are distinct. *Compare* 17 C.F.R. § 270.2a-7(c)(3)(i) *with* 17 C.F.R. § 270.2a-7(c)(11)(iii). For example, a subsection entitled "ACM Purchased Securities for AMMF Without Making a Minimal Credit Risk Determination" has three paragraphs. OIP at 6. The first paragraph asserts both that ACM did not "mak[e] a determination that the securities posed a minimal credit risk," and that Rule 2a-7(c)(11)(iii) requires a written record of such a determination. *Id.* The second paragraph references Rule 2a-7(c)(11)(iii) and asserts that "[t]hroughout 2009 and 2010, many ACM credit analyses concluded that a security presented 'risk,' 'some risk,' or 'moderate risk.'" *Id.* The third paragraph, however, omits reference to Rule 2a-7(c)(11)(iii) entirely, and asserts that "ACM purchased asset-backed commercial paper for AMMF from more than 15 issuers without *making a determination*" of minimal credit risk. *Id.* (italics added). In short, the first two paragraphs arguably address Rule 2a-7(c)(11)(iii), but only as to 2009 and 2010, while the third paragraph, which discusses 2011 reports, has nothing to do with Rule 2a-7(c)(11)(iii).

I conclude that the OIP does not clearly state a claim for a violation of Rule 2a-7(c)(11)(iii). Neither the Division nor Respondents address this defect, however. The Division contends that Rule 2a-7(c)(11)(iii) requires maintenance of written records of minimal credit risk determinations for all portfolio securities for at least three years. Div. Br. at 42. Respondents contend, among other things, that the mere existence of a credit research report, regardless of its substance, satisfies Rule 2a-7(c)(11)(iii). Resp. Reply at 12. Out of an abundance of caution, and in the interest of judicial efficiency, I have resolved the disputed Rule 2a-7(c)(11)(iii) issues, even though I conclude that they are immaterial.

a. *Legal Principles*

Rule 2a-7(c)(3)(i) limits a money market fund's investments to securities that the fund's board of directors determines present "minimal credit risks" and that are Eligible Securities at the time of acquisition. 17 C.F.R. § 270.2a-7(c)(3)(i). The term "minimal credit risk" is not defined in Rule 2a-7, nor does the Rule prescribe any methodology for determining what constitutes a minimal credit risk. Wermers' expert report cited nine factors to consider in evaluating credit risk, some of which were recited in the May 2010 deficiency letter, but there is no evidence that they are legally binding. Ex. 112 at 12; Ex. 159 at 3.

Nevertheless, some basic requirements are discernible from the Rule. An Eligible Security, as pertinent here, is one (1) that has received a rating from a "Requisite NRSRO" in one of the two highest short-term rating categories, or (2) that is unrated but the Board has determined is of "comparable quality" to a rated Eligible Security. 17 C.F.R. § 270.2a-7(a)(12)(i), (ii). A Requisite NRSRO is one that the Board has determined issues "sufficiently reliable" credit ratings, among other requirements. 17 C.F.R. § 270.2a-7(a)(11), (23). Eligible Securities are either First Tier or Second Tier. 17 C.F.R. § 270.2a-7(a)(14), (24). A First Tier security: (1) has received the highest short-term rating for debt obligations from a Requisite NRSRO; (2) is unrated but the Board has determined is of "comparable quality" to a rated First Tier security; (3) is a security issued by a registered money market fund; or (4) is a government security. 17 C.F.R. § 270.2a-7(a)(14), (16) (citing 15 U.S.C. § 80a-2(a)(16)). A Second Tier security is any Eligible Security other than a First Tier security. 17 C.F.R. § 270.2a-7(a)(24). A money market fund may not acquire a Second Tier security with a remaining maturity greater than forty-five days, and may not invest more than three percent of total assets in Second Tier securities (measured immediately after acquisition). 17 C.F.R. § 270.2a-7(c)(3)(ii).

The minimal credit risk determination must be based on "factors pertaining to credit quality in addition to any rating assigned to such securities by a Designated NRSRO." 17 C.F.R. § 270.2a-7(c)(3)(i). A Designated NRSRO is one that the Board has determined issues "sufficiently reliable" credit ratings, but, unlike a Requisite NRSRO, the Board does not rely on its ratings in determining whether the particular security falls in the First Tier. 17 C.F.R. § 270.2a-7(a)(11), (23). The Board may delegate minimal credit risk determinations and determinations that a security is First Tier or Second Tier, but must establish and periodically review written guidelines and procedures for making those determinations. 17 C.F.R. § 270.2a-7(e). The written record of the determination that a portfolio security presents minimal credit risks, and the Designated NRSRO ratings, if any, used to determine the security's status as an Eligible Security, First Tier security, or Second Tier security, must be maintained. 17 C.F.R. § 270.2a-7(c)(11)(iii). Minimal credit risk determination records are subject to inspection by the Commission. 17 C.F.R. § 270.2a-7(c)(11)(viii).

In sum, the minimal credit risk determination and documentation process must include the following,[20] among other things:

- A money market fund may not invest in a security unless it has been determined to present minimal credit risk. Therefore, the minimal credit risk determination for a portfolio security must be made before acquisition.
- Similarly, a portfolio security's status as either First Tier or Second Tier, and therefore its status as an Eligible Security, must be determined before acquisition.
- A money market fund must maintain a written record documenting: (1) that it made a minimal credit risk determination for all portfolio securities before acquisition; (2) the ratings assigned to each portfolio security by all Designated NRSROs as of acquisition; and (3) the guidelines and procedures for making minimal credit risk determinations and, if applicable, for determining that an unrated security is an Eligible Security.
- A money market fund must also maintain a written record documenting the determination of a portfolio security's status as either First Tier or Second Tier. This may presumably be satisfied by a written policy of only investing in rated securities, securities issued by registered money market funds, and government securities, along with sufficient documentation to show that the portfolio security falls within one of those three categories.
- A money market fund's written records must be sufficient for Commission examiners to determine whether the fund has complied with Rule 2a-7.

---

[20] The language in the new version of the Rule is the same. *See Money Market Fund Reform*, 79 Fed. Reg. 47736 (Aug. 14, 2014) (to be codified at 17 C.F.R. pt. 270) (new 17 C.F.R. § 270.2a-7(d)(2)(i)).

The question presented under Rule 2a-7(c)(11)(iii), and consequently under Section 31(a) and Rule 31a-1, is whether Ambassador Funds maintained a written record documenting that minimal credit risk determinations were made for all portfolio securities before acquisition, sufficient for Commission examiners to determine whether the Fund complied with Rule 2a-7. OIP at 6, 10. Respondents argue that minimal credit risk determinations were "memorialized in writing by the addition of the security and its NRSRO rating to the Approved List," in combination with the credit research reports and the minutes of the Board meetings at which the approved list was reviewed and ratified. Resp. Br. at 22-24; Resp. Reply at 13. The testimony of Oglesby and Jeffries support this position. Tr. 1328, 1553. Nothing in Rule 2a-7(c)(11)(iii) limits the required records to any particular format, and I agree with Respondents that the Rule may be satisfied by looking to records other than simply the credit research reports.

b. *2009*

The 2009 credit research reports are relatively complete, although some reports dating from 2008 and in effect in early 2009 are not of record. Ex. 19. The evidence from 2009 is otherwise thin compared to 2010 and 2011. The Fund's holdings at any particular time can be gleaned from the purchase journal, which covers only June through December. Ex. 12. The only approved list from 2009 is the one dated April 30, 2009, and there are no Board minutes from 2009 of record. Ex. 473. Oglesby testified that approved lists were maintained on ACM's computers. Tr. 1118. Exhibit 473, which also includes an approved list from November 2006, lacks Bates numbers and was not discussed during the hearing. It is a reasonable inference that its two approved lists were printed out contemporaneously, probably in preparation for Board meetings, and maintained in hard copy. Because ACM purchased securities for the Fund before receiving Board approval for them, it is possible the approved list changed in the calendar quarter after April 30, 2009. Tr. 1553. If so, there would need to be a written record of such a change, and there is not. Accordingly, I find that the April 30, 2009, approved list was Board-approved and in effect for one calendar quarter, that is, until July 31, 2009.

The April 30, 2009, approved list does not reveal whether or how minimal credit risk determinations had been made. The 2009 Board minutes, were they of record, might provide considerably more detail than the approved list alone. Out of an abundance of caution, I have limited analysis of the Fund's 2009 portfolio securities to those not on the 2009 approved list, and which were purchased within the quarter the approved list was in effect, that is, between April 30 and July 31, 2009. Because the purchase journal has no entries predating June 1, 2009, this means the only time period analyzed is June 1 through July 31, 2009.

Comparing the 2009 approved list, the pertinent credit research reports, and the purchase journal, the Fund held two portfolio securities in 2009 without a sufficient written record of minimal credit risk. *See generally* Exs. 12, 19, 473. The Fund purchased Sharp Electronics on June 17, 2009. Ex. 12 at 7-8. Sharp Electronics was not on the approved list, and its credit research report was "as of" June 30, 2009, and contained no explicit credit risk determination. Ex. 19 at 84; Ex. 473. The Fund purchased White Point Funding in June and July 2009. Ex. 12 at 6-23. White Point Funding was not on the approved list, and its credit research report stated that it represented either "risk" or "some risk," depending on the version. Ex. 19B; Ex. 31. Its next credit research report, "as of" April 2010, stated that it represented minimal risk. Ex. 67 at 263.

Respondents argue that the "existence of a credit research report meant that ACM had determined that the security met the minimal-credit-risk standard." Resp. Br. at 24; *see* Resp. Reply at 12-13. This is beside the point; as noted, the minimal credit risk determination must be in writing and must be sufficient for Commission examiners to establish that the Fund complied with Rule 2a-7. The whole point of the written record requirement is that Commission examiners should not have to orally inquire of employees whether and how they made minimal credit risk determinations. Admittedly, in many instances, a credit research report established compliance with Rule 2a-7(c)(3)(i), but this was not the case with respect to the two securities cited *supra*. Sharp Electronics, the most egregious example, was not on the approved list, its credit research report drew no conclusions about credit risk, and it had no credit research report even in effect for its June 17, 2009, purchase. White Point Funding was not on the approved list and its credit research report stated that it had "risk" or "some risk," rather than minimal risk.

Such written records are insufficient to satisfy Rule 2a-7(c)(11)(iii). Written records silent on the issue of credit risk necessarily do not document minimal credit risk determinations, and Sharp Electronics was therefore held as a portfolio security without the requisite written minimal credit risk determination. Written records which refer to credit risk, without explicitly using the term "minimal credit risk," may document minimal credit risk determinations, if the totality of the written records so demonstrate. Respondents argue that use of terms such as "risk" or "some risk" was "merely designed to remind [ACM] that these securities posed slightly higher risk than other securities that were also within the minimal credit risk standard." Resp. Reply at 12 (citing Tr. 1128-30, 1641-44). But, again, this must be apparent from the written records. "Risk" conveys no meaning at all, and "some risk" is simply not the same as "minimal risk." Nor is it otherwise apparent from ACM's written records whether some means some compared to all securities or some just compared to securities possessing minimal credit risk. White Point Funding was therefore also held as a portfolio security without the requisite written minimal credit risk determination.

c. *2010*

The record regarding 2010 is more complete, but still shows multiple instances of inadequate documentation. At each 2010 Board meeting, as well as the February 2011 meeting, the Board resolved, retroactively, that the securities purchased during the previous quarter presented "minimal credit risks." Ex. 94 at 12; 464 at 9; 468 at 4; 470 at 3; Ex. 471 at 3-4. These resolutions were based on "materials prepared by Ms. De Nicolo" and purchase records, employed the same boilerplate language in each set of minutes, and were clearly just pro forma. There is no written indication that any resolution was based on consideration of "credit quality in addition to any rating assigned to such securities by a Designated NRSRO," or even the input of ACM's investment team. At the August and November 2010 meetings, the Board endorsed approved lists after hearing Oglesby's, Jeffries', and Prost's views, but the approved lists were not attached to their associated meeting minutes and are otherwise not of record. Ex. 94 at 14-15; Ex. 468 at 11-12. In short, the written records of the 2010 approved lists and the associated

Board meeting minutes convey nothing meaningful about ACM's minimal credit risk determinations, and are entitled to virtually no weight.

The Fund purchased Dexia Delaware in January, February, March, April, and May 2010. Ex. 11 at 2, 6, 7, 8, 11, 16, 17, 18, 21, 23, 24, 29, 32, 33, 34, 35, 41, 46, 47, 51, 57, 61, 64, 68, 70, 72, 76, 78, 80, 82, 83, 88, 93. Dexia Delaware's credit research report "as of" June 2009 contained no explicit credit risk determination. Ex. 19 at 34. The Fund also purchased Dexia Delaware in June, July, August, September, and October 2010. Ex. 11 at 97, 109, 113, 118, 123, 128, 133, 138, 143, 148, 153, 160, 164, 168, 171, 175, 176, 180, 186. Dexia Delaware's credit research report "as of" June 2010 contained no explicit credit risk determination, but stated that ACM "was comfortable with this issuer," which is equivalent, under the circumstances, to finding minimal credit risk. Ex. 67 at 92. The Fund purchased Landesbank Hessen-Thuringen in August 2010. Ex. 11 at 159. Landesbank Hessen-Thuringen's credit research report "as of" December 2009 contained no explicit credit risk determination. Ex. 67 at 149. The Fund purchased United Technologies in June 2010. Ex. 11 at 101. United Technologies' credit research reports "as of" both June 2009 and June 2010 contained no explicit credit risk determinations. Ex. 19 at 96; Ex. 67 at 252-53. To be sure, the credit research reports for Dexia Delaware and United Technologies stated that they possessed Tier 1(A) ratings by ACM, but ACM possessed no written records in 2010 explaining what Tier 1(A) meant. Ex. 19 at 34; Ex. 67 at 92, 93, 252; Exs. 50, 172. The Fund held these securities without adequate written minimal credit risk determinations.

The Fund purchased Korea Development Bank in January, February, March, May, and November 2010. Ex. 11 at 6, 27, 38, 46, 81, 86, 92, 204, 236. Korea Development Bank's credit research report "as of" December 2009 stated that it represented "low risks" and had a Tier 1(A) ACM rating. Ex. 67 at 147. Low risk is not the same as minimal risk, and it is otherwise not apparent from ACM's written records whether low means low compared to all securities or low just compared to securities possessing minimal credit risk.

The Fund purchased RBS Holdings in April, May, and October 2010. Ex. 11 at 72, 73, 83, 84, 182, 185. RBS Holdings' credit research report "as of" December 2009 stated that it represented "moderate" risk.[21] Ex. 67 at 12. The Fund purchased BTM Capital in January, February, March, August, September, and October 2010. Ex. 11 at 2, 9, 20, 22, 29, 46, 50, 157, 179, 184, 194. BTM Capital's credit research reports "as of" August 2009 and March 2010 stated that it represented "moderate" risk. Ex. 19 at 20; Ex. 67 at 60. The Fund purchased Lloyds TSB Bank in June and July 2010. Ex. 11 at 104, 105, 112, 122, 123. Lloyds TSB Bank's credit research report "as of" December 2009 stated that it represented "moderate" risk. Ex. 67 at 26. The Fund purchased Societe Generale at least once each month of 2010. Ex. 11 at 1, 5, 14, 18, 19, 22, 23, 25, 29, 32, 37-44, 48, 53-56, 61, 73, 79, 84, 86, 93, 96, 97, 98, 100-05, 107-10, 126, 154, 161, 162, 174, 176, 180-82, 184, 186, 189, 192, 195, 196, 201, 203, 207, 209, 210, 216, 223-25, 227, 232-34. Societe Generale's credit research reports "as of" December 2009 and December 2010 stated that it represented "moderate" risk. Ex. 67 at 17-18. The Fund purchased

[21] There is no credit research report for "RBS Holdings," but there is for Royal Bank of Scotland. Ex. 67 at 12. Giving Respondents the benefit of the doubt, I assume that RBS Holdings and Royal Bank of Scotland are the same security.

Credit Agricole in October 2010. Ex. 11 at 198. Credit Agricole's credit research report "as of" December 2009 stated that it represented "slightly moderate" risk. Ex. 67 at 31. As with "low risk," "risk," and "some" risk, "moderate" and "slightly moderate" risk are not the same as minimal risk.

The Fund purchased Natixis in February, March, May, June, July, October, November, and December 2010. Ex. 11 at 25, 39, 88, 95, 100, 101, 108, 130, 182, 193, 207, 213, 217, 221, 225, 229, 233, 237. Natixis' credit research reports "as of" December 2009 and December 2010 characterized it only as "stable." Ex. 67 at 181-82. This conveys nothing about degree of risk.

The Fund purchased Bank of Nova Scotia in November 2010. Ex. 11 at 214. Bank of Nova Scotia's credit research report "as of" December 2009 stated that the bank "enjoys one of [ACM's] highest risk score ratings for international financial institutions," and "[t]he credit is highly rated." Ex. 67 at 41-42. This is close enough to "minimal credit risk" to satisfy Rule 2a-7(c)(3)(i) and (c)(11)(iii).

The Fund purchased Rabobank in January, February, March, April, May, September, and October, and November 2010. Ex. 11 at 8, 10, 13, 14, 15, 17, 199, 22, 24, 36, 40, 46, 47, 51, 56, 58, 61, 63, 70, 78, 79, 177, 196, 203, 220. Rabobank's credit research report "as of" December 2009 characterized its risk as "very low relative to its peer group," which is close enough to "minimal credit risk" to satisfy Rule 2a-7(c)(3)(i) and (c)(11)(iii). Ex. 67 at 35. The Fund also purchased Rabobank in December 2010. Ex. 11 at 220.

d. *2011*

In contrast to 2009 and 2010, the records from 2011 include Board meeting minutes which document discussion of approved lists. The February 2011 meeting minutes memorialized Oglesby "discussing the credit risk associated with" the issuers ACM sought to add to the approved list, and cited to the "top two ratings by [NRSROs]," but with no explicit mention of credit quality. Ex. 97 at 5-6. The April 2011 meeting minutes did not memorialize any discussion about credit risk, other than a cite to the "top two ratings by [NRSROs]" and a reminder to ACM to do its due diligence. Ex. 93 at 5. The August 2011 meeting minutes were, in pertinent part, virtually identical to the April 2011 meeting minutes, except for a reference to a security which experienced a "credit downgrade," with no further elaboration. Ex. 98 at 5-6. The October 2011 meeting minutes were also, in pertinent part, virtually identical to the April 2011 meeting minutes. Ex. 92 at 10. As with the 2010 meeting minutes, there is no indication in the 2011 meeting minutes that any resolution retroactively ratifying the previous quarter's purchases was based on consideration of "credit quality in addition to any rating assigned to such securities by a Designated NRSRO." Ex. 92 at 9; Ex. 93 at 5; Ex. 97 at 4; Ex. 98 at 4-5. The written records of the 2011 approved lists and the associated Board meeting minutes accordingly convey nothing meaningful about ACM's minimal credit risk determinations.

However, ACM communicated to examiners no later than November 16, 2011, when the onsite examination began, that its tiers identified "Maturity Restrictions" on its "credit issuer approval list," which is sufficient written documentation for examiners to conclude that tier ratings applied to securities already determined to present minimal credit risk. Tr. 139-140, 144;

Ex. 172 at 3, 6. This is the earliest ACM possessed sufficient written documentation of its tier classification system to satisfy Rule 2a-7(c)(11)(iii); earlier documentation, such as Oglesby's email to Johnson on October 11, 2011, was insufficiently specific. Ex. 50. Thus, a security purchased on or after November 16, 2011, if it had a tier classification at the time, had sufficient documentation to meet the requirements of Rule 2a-7(c)(11)(iii).

The Fund purchased BTM Capital in January, February, April, October, November, and December 2011. Ex. 13 at 2, 7, 8, 24, 27, 30, 33, 39, 41, 44, 47, 49, 65, 68, 70, 75. BTM Capital's credit research reports "as of" March 2010 and March 2011 stated that it represented "moderate" risk. Ex. 67 at 60, 61. The Fund purchased Landesbank Hessen-Thuringen in July 2011. Ex. 13 at 17. Landesbank Hessen-Thuringen's credit research report "as of" December 2010 contained no explicit credit risk determination. Ex. 67 at 150. The Fund purchased Hannover Funding in every month of 2011 except May and December, but not later than November 2, 2011. Ex. 13 at 1, 2, 4, 6, 8, 12, 14-22, 25, 26, 28, 38-40. Hannover Funding's credit research report "as of" June 2010 stated that it represented "minimal" risk, but its April 2011 report stated that it represented "low" risk. Ex. 67 at 133-34. Its April 2011 report also classified it as Tier 1(B). Ex. 67 at 134. Thus, Hannover Funding's documentation in January through April 2011 was adequate, but not in May through November. The Fund purchased Rabobank in June and December 2011. Ex. 13 at 17, 36. Rabobank's credit research report "as of" December 2010 contained no explicit credit risk determination. Ex. 67 at 36. The Fund purchased Romulus Funding in every month of 2011 except December, but not later than November 8, 2011. Ex. 13 at 1-3, 5, 7, 8-29, 37-40. Romulus Funding's credit research report "as of" July 2010 stated that it represented "minimal" risk, but its April 2011 report stated that it represented "moderate" risk. Ex. 67 at 209-10. Its April 2011 report also classified it as Tier 1(C). Ex. 67 at 209. Thus, Romulus Funding's documentation in January through April 2011 was adequate, but not thereafter. The Fund purchased Intesa Sanpaolo in April 2011. Ex. 13 at 9. Intesa Sanpaolo's credit research report "as of" December 2010 contained no explicit credit risk determination. Ex. 67 at 144. The Fund purchased Societe Generale in January, February, March, April, and May 2011. Ex. 13 at 2, 4, 7, 9, 10, 38, 39. Societe Generale's credit research report "as of" December 2010 stated that it represented "moderate" risk. Ex. 67 at 18. The Fund purchased Natixis in January, February, May, and December 2011. Ex. 13 at 1, 2, 9, 33-36, 39, 40. Natixis' credit research report "as of" December 2010 characterized it only as "stable." Ex. 67 at 182. The Fund purchased Standard Chartered in April and December 2011. Ex. 13 at 8, 34. Standard Chartered's credit research report "as of" December 2010 stated that it represented "low" risk. Ex. 67 at 225. The Fund purchased Compass Securitization in every month of 2011 except December, including nine purchases in November prior to November 16, 2011. Ex. 13 at 1-31, 37-40. Compass Securitization's credit research report dated September 2010 stated that it represented "minimal credit risk," and its credit research report "as of" August 2011 stated that it represented "moderate" risk, although with a Tier 1(C) classification. Ex. 67 at 77-78. Thus, Compass Securitization's documentation was inadequate in September and October 2011, and in November 2011 up to November 15, 2011, but was otherwise adequate.

The Fund purchased Sumitomo Mitsui in June and November 2011. Ex. 13 at 12, 13, 30. Sumitomo Mitsui's credit research report "as of" December 2010 characterized it as "a solid credit in this environment," which is too vague to satisfy Rule 2a-7(c)(11)(iii). Ex. 67 at 176. The Fund purchased Westdeutsche Landesbank in July 2011. Ex. 13 at 15. Westdeutsche

Landesbank's credit research report[22] "as of" December 2010 characterizes it as "reliable," but contains no explicit credit risk determination, and is too vague to satisfy Rule 2a-7(c)(11)(iii). Ex. 67 at 80.

The Fund purchased Dexia Delaware in 2011. *E.g.*, Ex. 13 at 38. Dexia Delaware's credit research reports "as of" June 2010 and March 2011 contained no explicit credit risk determinations, but stated that ACM "was comfortable with this issuer," which is equivalent, under the circumstances, to finding minimal credit risk. Ex. 67 at 92, 93. The Fund purchased AllianceBernstein in February 2011. Ex. 13 at 1. AllianceBernstein's credit research report "as of" December 2010 stated that ACM saw "minimal levels of risk in its operations," which is equivalent to finding minimal credit risk. Ex. 67 at 7. The Fund purchased Bank of Nova Scotia in November 2011. Ex. 13 at 32. Bank of Nova Scotia's credit research report "as of" December 2010 states that "[t]he credit is highly rated." Ex. 67 at 42. This is close enough to "minimal credit risk" to satisfy Rule 2a-7(c)(3)(i) and (c)(11)(iii).

The Fund purchased United Technologies on November 23, 2011. Ex. 13 at 31. United Technologies' credit research reports "as of" June 2011 contained no explicit credit risk determination. Ex. 67 at 254. It did, however, classify United Technologies as Tier 1(A). *Id.* Accordingly, there was no Rule 2a-7(c)(11)(iii) violation in 2011 in connection with United Technologies.

In sum, although ACM's written documentation of minimal credit risk determinations was in many instances inadequate, no Rule 2a-7(c)(11)(iii) violations have been proven, and no Section 31(a) or Rule 31a-1 violations have been proven.

4. <u>Rule 22c-1</u>

Rule 22c-1 provides that "[n]o registered investment company issuing any redeemable security . . . shall sell, redeem, or repurchase any such security except at a price based on the current [NAV] of such security." 17 C.F.R. § 270.22c-1(a). Rule 2a-7 permits an exception where share price may be calculated using the amortized cost method, provided that Rule 2a-7 is satisfied. 17 C.F.R. § 270.2a-7(c). Accordingly, it is a violation of Rule 22c-1 for a registered investment company issuing any redeemable security to sell, redeem, or repurchase any security at a price calculated using the amortized cost method, without also satisfying all necessary conditions of Rule 2a-7(c). Rule 22c-1 imposes no materiality requirement. *See Parnassus Investments*, Initial Decision Release No. 131, 1998 SEC LEXIS 1877, at *47 n.28 (Sep. 3, 1998). Thus, Rule 22c-1 may be violated even if the amortized cost calculation and the market-based NAV calculation yield exactly the same share price.

The OIP alleges that ACM and Oglesby caused Ambassador Funds to violate Rule 22c-1, and the Division contends that "each day that the Fund did not meet the conditions of 2a-7, the Fund was required to provide redeeming shareholders a share price calculated with the current market NAV." OIP at 9-10; Div. Br. at 38-39. The OIP, by contrast, alleges violations based on both purchases and redemptions. OIP at 9-10. Counting Rule 22c-1 violations by the number of

[22] This security is apparently listed in the purchase journal as "WestLB Securities." Ex. 13 at 15.

days on which redemptions occurred, rather than counting both purchases and redemptions, prejudices Respondents least, and I accept the Division's contention. As noted, Ambassador Funds violated the stress testing requirements of Rule 2a-7(c)(10)(v) and the diversification requirements of Rule 2a-7(c)(4), ACM caused the violations of Rule 2a-7(c)(4), and Oglesby and ACM caused the violation of Rule 2a-7(c)(10)(v). As the person who conducted the Fund's stress test, and consequently calculated its NAV, Oglesby should have known that the Fund could not sell, redeem, or repurchase shares at a price based on the amortized cost method unless the Fund satisfied Rule 2a-7. Thus, if Ambassador Funds violated Rule 22c-1, Oglesby and/or ACM, as appropriate, caused the violation. Any day on which Ambassador Funds redeemed any AMMF shares, and was in violation of either of these provisions, was a day on which Ambassador Funds violated Rule 22c-1, and on which Respondents caused the violation.

Ambassador Funds violated Rule 2a-7(c)(4) on August 12, December 7, and December 18, 2009, and violated Rule 2a-7(c)(10)(v) between February 18, 2011, and February 7, 2012. Clearly, AMMF sold shares in 2009, and Rochester Hills invested in AMMF in December 2009. Tr. 408; Ex. 59 at 4. However, there is no evidence of record that AMMF sold, redeemed, or repurchased shares on August 12, December 7, or December 18, 2009, and Ambassador Funds therefore did not violate Rule 22c-1 on those days. AMMF's "Daily Fund Position Summary" shows that, between February 18, 2011, and February 7, 2012, the Fund redeemed shares on eighty-five days. Ex. 91 at 287-530. Thus, Ambassador Funds violated Rule 22c-1 eighty-five times, and ACM and Oglesby caused each violation.

IV. SANCTIONS

The Division requests, as to ACM and Oglesby, cease-and-desist orders, disgorgement and prejudgment interest, civil penalties, and direct and collateral bars. Div. Br. at 43-48. The Division seeks disgorgement of ACM's quarterly management fees for every quarter in which ACM violated the law, and of Oglesby's prorated salary for each quarter in which Oglesby violated the law. Div. Br. at 44-45. As to civil penalties, the Division urges a third-tier penalty for Respondents' misrepresentations regarding Eurozone exposure, second-tier penalties for Respondents' misrepresentations regarding diversification and violations of Investment Company Act Sections 34(b) and 35(d) and Rule 22c-1, and a first-tier penalty for each violation of Investment Company Act Section 31(a) and Rules 31a-1 and 38a-1. Div. Br. at 46-48.

A. Willfulness and the Public Interest

In determining sanctions, the Commission considers such factors as:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981) (quoting *SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. *Marshall E. Melton*, 56 S.E.C. 695, 698 (2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. *Schield Mgmt. Co.*, 58 S.E.C. 1197, 1217-18 & n.46 (2006). The Commission's inquiry into the appropriate sanction to protect the public interest is a flexible one, and no one factor is dispositive. *Gary M. Kornman*, Advisers Act Release No. 2840, 2009 WL 367635, at *6 (Feb. 13, 2009), *pet. denied*, 592 F.3d 173 (D.C. Cir. 2010).

The record evidence pertinent to sanctions is sufficient, and there is no need for further briefing on the subject. *See* Resp. Reply at 28. Overall, Respondents' misconduct was egregious. Although Respondents did not cause any actual harm to the Fund, they created at least some risk of substantial harm. Managing a mutual fund's risk is vital to its proper operation. ACM did not properly manage the Fund's risk: it unduly exposed the Fund to the securities known to be risky at the time, passively breached the issuer diversification rules, and failed to evaluate the Fund's risk by stress testing. It was "especially serious" that Respondents misled the Board about the Fund's Eurozone exposure, because such conduct violated the antifraud provisions of the Advisers Act. *Melton*, 56 S.E.C. at 713. Respondents' multiple violations were necessarily recurrent, and in some instances, such as the failure to implement stress testing, long-lasting.

The degree of scienter varied with the violation. Respondents acted with scienter with respect to their Eurozone disclosures, but only with negligence with respect to their misrepresentations regarding the Fund's issuer diversification and internal maturity restrictions, and the various regulatory violations. Although this mitigates their overall conduct, the other factors generally weigh in favor of cease-and-desist orders. Also, the scienter-based violation supports associational bars, and substantial civil penalties, while the negligence-based violations support lower civil penalties, as explained *infra*.

Respondents do not recognize the wrongful nature of their misconduct, and indeed, they "genuinely do not believe that their conduct was unlawful." Resp. Br. at 35. In view of the evidence that they intentionally misled the Board, their belief cannot possibly be genuine, and this factor weighs particularly heavily in favor of a severe sanction. Their occupations also obviously present opportunities for future violations. Respondents argue that they no longer operate a money market fund, and do not intend to do so in the future. Resp. Br. at 35. Although this mitigates their misconduct under the Investment Company Act, it carries no weight under the Advisers Act. There was no proven harm to investors or the marketplace, but the violations were relatively recent, and sanctions will clearly have a deterrent effect.

In sum, there was no proven harm to investors or the marketplace, Respondents have provided relatively sincere assurances against future violations of the Investment Company Act but not the Advisers Act, and the degree of scienter is generally higher with respect to the Advisers Act violations than with respect to the Investment Company Act violations. The other factors, however, all weigh in favor of substantial sanctions. Overall, heavy sanctions are warranted as to the Advisers Act violations and lighter, but still significant, sanctions are warranted as to the Investment Company Act violations.

Respondents' arguments against sanctions are not persuasive. Their principal argument is that that any sanction will be "career-ending" and "will bankrupt them." Resp. Br. at 36;

Resp. Reply at 27. This is not at all clear from the record, especially because Respondents offered no evidence of ability to pay. *Cf.* Resp. Br. at 38 (alluding to inability to pay). Indeed, Monetta Financial Services obtained new business in 2010 notwithstanding a censure and civil penalty in 2005. *See Monetta Financial Services, Inc.*, 58 S.E.C. 818, 824 (2005). ACM has lost business as a result of this proceeding, and it may lose more in the future, but Respondents do not explain how any such lost business will be traceable directly to the sanction, as opposed to the mere fact that they have been found liable for fraud. Tr. 1622-23. For instance, the associational bar the Division seeks against ACM should cause no direct loss of business, because ACM no longer advises mutual funds.

Respondents argue that ACM is a "minority-owned success story in downtown Detroit." Resp. Reply at 28. This factor is relevant, but merits little weight. Certainly ACM continues to make money in a city working hard to keep and develop successful businesses, but business success built even in part on fraud is not legitimate success. Admittedly, there is no record evidence that ACM has ever violated the Advisers Act or Investment Company Act other than as found here. *See Martin B. Sloate*, 52 S.E.C. 1233, 1236 (1997) (considering respondent's "otherwise unblemished career" in the sanctions analysis). But even relatively limited antifraud violations during an otherwise law-abiding career can justify heavy sanctions. *See Donald L. Koch*, Advisers Act Release No. 3836, 2014 WL 1998524, at *3, *20-21 (May 16, 2014); *see also James C. Dawson*, Advisers Act Release No. 3057, 2010 WL 2886183, at *5 (Jul. 23, 2010) ("Securities professionals have an obligation to obey the law.").

Respondents argue that they should not be sanctioned for violating Rule 2a-7(c)(4), because no investment adviser has been sanctioned for such a violation before. Resp. Reply at 27. This is beside the point; the Commission generally might not vigorously pursue Rule 2a-7(c)(4) violations, but nothing precludes it from doing so in appropriate cases.

Some requested sanctions may only be imposed for willful misconduct. *E.g.*, 15 U.S.C. § 80b-3(e)(6) (registration revocation requires proof of willful violation of securities laws). Respondents unquestionably acted willfully. *See* 15 U.S.C. § 80b-3(i) (2010); *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (a finding of willfulness does not require intent to violate the law, but merely intent to commit the act which constitutes the violation); *Koch*, 2014 WL 1998524, at *13 n.139 (scienter demonstrates willfulness). Proof of willfulness does not require proof that a respondent knew that his conduct violated the law. *Koch*, 2014 WL 1998524, at *13 n.139; *cf.* Resp. Br. at 37. Oglesby intended to commit the acts which constituted each of his violations: he intentionally misled the Board about the Fund's Eurozone exposure, and he conducted the February 2011 stress test. Because Oglesby conducted the February 2011 stress test, ACM communicated its internal maturity restrictions in some fashion to the Board, and someone at ACM, likely Jeffries, purposefully told the Board about the September 30, 2011, redemption, ACM also intended to commit the acts which constituted each of its violations.

B. <u>Cease-and-Desist Order</u>

Advisers Act Section 203(k) authorizes the Commission to impose a cease-and-desist order for violations of the Advisers Act and against any person who caused such violations, whether willful or not. *See* 15 U.S.C. § 80b-3(k)(1). The Commission requires some likelihood of future violation before imposing a cease-and-desist order. *KPMG Peat Marwick LLP*, 54

S.E.C 1135, 1185 (2001), *recons. denied*, 55 S.E.C. 1 (2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002). However, absent evidence to the contrary, "a finding of a [past] violation raises a sufficient risk of future violation," because "evidence showing that a respondent violated the law once probably also shows a risk of repetition that merits our ordering him to cease and desist." *Id.*

As to the Advisers Act violations, a cease-and-desist order is undeniably warranted as to both ACM and Oglesby. As to the Investment Company Act violations, there was no scienter, investors were not harmed, and Respondents offered relatively sincere assurances against future violations, although not sufficiently sincere to persuasively eliminate the "risk of future violation" required under *KPMG Peat Marwick LLP*. On balance, however, the public interest factors weigh in favor of a cease-and-desist order. I have placed particular weight on Respondents' utter lack of recognition of the wrongful nature of their conduct. Cease-and-desist orders are appropriate as to both the Advisers Act violations and the Investment Company Act violations.

C. Censure and Associational Bar

Advisers Act Section 203(e)(6) authorizes the Commission to impose an associational bar against an investment adviser found to have aided and abetted a violation of the Advisers Act. *See* 15 U.S.C. § 80b-3(e)(6). As to ACM, the public interest factors clearly weigh in favor of an associational bar. The Division requests a bar only against ACM's association with an investment company, which would preclude it from "operating or advising a mutual fund," but otherwise allow it to continue to function as an investment adviser. Div. Br. at 48. Such a bar is appropriate as a remedial measure and will have minimal collateral consequences on ACM.

Advisers Act Section 203(f) authorizes the Commission to impose an associational bar against an associated person of an investment adviser found to have aided and abetted a violation of the Advisers Act. *See* 15 U.S.C. § 80b-3(e)(6), (f). As to Oglesby, the public interest factors seemingly weigh in favor of a permanent associational bar. The Commission has long held that "conduct that violates the antifraud provisions of the securities laws is especially serious and subject to the severest of sanctions under the securities laws." *Melton*, 56 S.E.C. at 713; *see also Koch*, 2014 WL 1998524, at *20; *Michael T. Studer*, 57 S.E.C. 890, 898 (2004). Oglesby's misconduct betrayed the trust of the Board and of the Fund's investors, and under different circumstances, there is no question that Oglesby's conduct would merit permanent direct and collateral bars.

Under the narrow and specific circumstances present here, however, I cannot in good conscience impose a bar or suspension. In litigated, non-"follow on" administrative proceedings, the Commission commonly sanctions control persons and officers of regulated entities for misconduct. *E.g.*, *Koch*, 2014 WL 1998524; *Johnny Clifton*, Exchange Act Release No. 69982, 2013 WL 3487076 (Jul. 12, 2013); *vFinance Investments, Inc.*, Exchange Act Release No. 62448, 2010 WL 2674858 (Jul. 2, 2010); *Gregory O. Trautman*, Exchange Act Release No. 61167A, 2009 WL 6761741 (Dec. 15, 2009); *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515 (Dec. 21, 2007). Such sanctions are sometimes imposed for failure to supervise, that is, even when the control person did not engage in misconduct directly. *E.g.*, *Ronald S. Bloomfield*, Exchange Act Release No. 71632, 2014 WL 768828 (Feb. 27, 2014); *Angelica Aguilera*, Initial Decision Release No. 501, 2013 WL 3936214 (Jul. 31, 2013), *finality order*, Exchange Act Release No. 71121, 2013 WL 6665235 (Dec. 18, 2013). The Commission also sanctions lower ranking persons associated with regulated entities, whose conduct was either not endorsed by, or was expressly disavowed by, their organizations. *E.g.*, *Robert L. Burns*, Advisers Act Release No. 3260, 2011 WL 3407859 (Aug. 5, 2011); *Guy P. Riordan*, Exchange Act Release No. 61153, 2009 WL 4731397 (Dec. 11, 2009); *Ofirfan Mohammed Amanat*, Exchange Act Release No. 54708, 2006 WL 3199181 (Nov. 3, 2006).

This proceeding presents a different situation: a litigated, non-follow on administrative proceeding against a lower ranking person where higher ranking persons fully supported their subordinate's actions, without also naming the higher ranking persons as respondents or sanctioning the higher ranking persons through settled proceedings. *Compare Brendan E. Murray*, Advisers Act Release No. 2809, 2008 WL 4964110 (Nov. 21, 2008) (litigated proceeding sanctioning managing director of investment adviser for fraud), *with James A. DeMatteo*, Advisers Act Release No. 2556, 2006 WL 2787267 (Sep. 26, 2006) (settled proceeding sanctioning president of investment adviser for fraud). It is a mystery why Jeffries and Prost were not named as respondents in this proceeding, at minimum for failure to supervise. *See* 15 U.S.C. § 80b-3(e)(6). The evidence against Oglesby is concededly stronger than it is against Jeffries and Prost, but the record clearly shows that they believe Oglesby behaved properly, and in some instances that they directly engaged in misconduct themselves. Prost signed most of the credit research reports Oglesby drafted in 2010 and 2011, suggesting that he participated in the internal maturity determinations, as well. *See* Ex. 67. Prost believed shareholder redemptions were adequately examined in the February 2011 stress test. Tr. 1665-67. He believed that he, not Oglesby, had spoken about Eurozone exposure in the August 2011 Board meeting. Tr. 1668-70. Prost testified that the decision to purchase ENI Finance USA, or not, was made by both him and Oglesby, and that neither he nor Oglesby concealed ENI Finance USA positions from the Board. Tr. 1680-81, 1696. As noted, Jeffries, not Oglesby, was likely the individual responsible for misleading the Board about the Fund's Eurozone exposure. Jeffries opined that Oglesby had the "utmost integrity" and was "very competent." Tr. 1569. Oglesby remains with ACM, without being demoted after the demise of the Fund. Tr. 1625-26; First Stip. ¶ 3.

I do not mean to minimize the seriousness of Oglesby's misconduct. He repeatedly demonstrated a "disregard for the well-established fiduciary duty he owed his clients." *Montford*, 2014 WL 1744130, at *19. But the record demonstrates conclusively that Jeffries and Prost disregarded their fiduciary duty as well. To be sure, the civil penalty against ACM is, in effect, a civil penalty against Jeffries and Prost, ACM's owners, as explained *infra*, and ACM's civil penalty is substantially more than Oglesby's. But an associational bar is a sanction different in kind from a civil penalty, and is arguably even more of a "penalty." *See Johnson v. SEC*, 87 F.3d 484, 489-92 (D.C. Cir. 1996). Nor do I mean to criticize counsel. I remain appreciative of the professional comportment and impressive advocacy by both sides' trial teams. Tr. 1885-86. But it is simply unjust to eject Oglesby from his chosen profession while his superiors, who were similarly culpable, continue to advise investors without even a glimmer of recognition that the company they own committed fraud. Accordingly, based on the particular facts of this case, Oglesby will be censured under Advisers Act Section 203(f), but not barred or suspended.

D. Civil Penalties

Under Investment Company Act Section 9(d) and Advisers Act Section 203(i), the Commission is authorized to impose a civil penalty where, as here, the respondent has willfully aided and abetted violations of the Investment Company Act, the Advisers Act, or any rules or regulations thereunder. *See* 15 U.S.C. § 80a-9(d)(1)(B) (2006); 15 U.S.C § 80b-3(i)(1)(B) (2006).[23] A three-tier system establishes the maximum civil money penalty that may be imposed for each violation: a first-tier penalty is permissible for each statutory violation; a second-tier penalty is permissible where the respondent's unlawful act or omission involves fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and a third-tier penalty is permissible where (A) such state of mind is present (first prong), and (B) the misconduct directly or indirectly (1) resulted in substantial losses, (2) created a significant risk of substantial losses to other persons, or (3) resulted in substantial pecuniary gain to the person who committed the misconduct (second prong). 15 U.S.C § 80a-9(d)(2); 15 U.S.C § 80b-3(i)(2). The Commission must determine how many violations occurred to impose civil penalties under the statutes. *See Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012). Because all violations occurred between March 2009 and March 2013, the maximum first-tier civil penalties are $7,500 for Oglesby and $75,000 for ACM, the maximum second-tier penalties are $75,000 for Oglesby and $375,000 for ACM, and the maximum third-tier penalties are $150,000 for Oglesby and $725,000 for ACM. 17 C.F.R. § 201.1004.

Several considerations bear on the amount of a penalty. In considering whether a penalty is in the public interest, the Commission considers six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) previous violations; (5) deterrence; and (6) such other matters as justice may require. 15 U.S.C. § 80a-9(d)(3); 15 U.S.C. § 80b-3(i)(3). "Not all factors may be relevant in a given case, and the factors need not all carry equal weight." *Robert G. Weeks*, Initial Decision Release No. 199, 2002 WL 169185, at *58 (Feb. 4, 2002). In addition to these statutory factors, courts consider:

> (1) the egregiousness of the violations at issue, (2) defendants' scienter, (3) the repeated nature of the violations, (4) defendants' failure to admit to their wrongdoing; (5) whether defendants' conduct created substantial losses or the risk of substantial losses to other persons; (6) defendants' lack of cooperation and honesty with authorities, if any; and (7) whether the penalty that would otherwise be appropriate should be reduced due to defendants' demonstrated current and future financial condition.

---

[23] In 2010, the cease-and-desist provisions of the Advisers Act and Investment Company Act were amended to eliminate the need to prove willfulness and to require proof only of causing liability, as opposed to aiding and abetting liability, but the applicable legal standard otherwise remained the same. *See* 15 U.S.C. § 80a-9(d)(1)(B)(ii) (2010); 15 U.S.C § 80b-3(i)(1)(B)(ii) (2010); *Graham*, 53 S.E.C. at 1085 n.35 (finding of aiding and abetting necessarily implies that respondent caused the primary violations).

SEC v. Lybrand, 281 F. Supp. 2d 726, 730 (S.D.N.Y. 2003), *aff'd*, 425 F.3d 143 (2d Cir. 2005).

The Division seeks third-tier penalties for the Advisers Act Section 206 violations regarding "misrepresentations to the [Board] regarding the Fund's exposure to Eurozone investments," but does not specify the number of violations. Div. Br. at 46-47. Although there were arguably two violations, based on misrepresentations at two Board meetings, in August 2011 and November 2011, the evidence suggests that ACM's Eurozone misrepresentations were part of a scheme extending into 2012 to deceive the Board about the Fund's Italian holdings. Accordingly, I find one violation of Section 206(1). This violation satisfies the first prong, because it was committed with scienter, a "mental state embracing intent to deceive, manipulate, or defraud." *Aaron*, 446 U.S. at 686 n.5.

The violation does not satisfy the second prong, however. No investor lost money, and Respondents' ill-gotten gains are unproven, as explained *infra*. Respondents' misrepresentations created some risk of multi-million dollar losses by, for example, even one default on a Eurozone investment. But the evidence does not show that the degree of risk was significant. As noted, the record demonstrates that Respondents made minimal credit risk determinations, even as to Eurozone securities, and the Fund's 2011 purchase journal shows that such securities were often held for one week or less, particularly later in 2011. *See generally* Ex. 13; *see also* Ex. 466 at 7-8.

Accordingly, the Eurozone exposure misrepresentations are subject to second-tier penalties. Applying the statutory public interest factors: there was fraud, there was no harm to others or (proven) unjust enrichment, Respondents have a clean disciplinary history, and a substantial penalty will deter Respondents and others from future violations. Applying those *Lybrand* factors which do not overlap with the statutory factors: the violations were egregious and just barely recurrent, Respondents have utterly failed to admit wrongdoing, Respondents were cooperative and generally honest, and there is no evidence of Respondents' financial condition. On balance, the various factors suggest a civil penalty of approximately half of the maximum, or $40,000 for Oglesby and $200,000 for ACM.

The Division seeks a second-tier penalty for the Advisers Act Section 206(2) violation regarding passive breaches of the diversification rule. Div. Br. at 47. There was only one such violation alleged in the OIP, occurring at the November 2011 Board meeting, Oglesby did not aid and abet it, and it involved only negligence, as explained *supra*. Thus, the maximum penalty is $75,000 as to ACM. The analysis is essentially the same as for the Eurozone exposure misrepresentations, except that the passive breach misrepresentation was not recurrent. Accordingly, the various factors suggest a civil penalty against ACM of slightly less than half the maximum, or $35,000.

The Division seeks second-tier penalties for the violations of Investment Company Act Sections 34(b) and 35(d) and Rule 22c-1. Div. Br. at 47. As noted, there were three violations of Section 34(b) and three violations of Section 35(d), which ACM caused but Oglesby did not, and eighty-five violations of Rule 22c-1, which both ACM and Oglesby caused. The Division argues, without evidentiary support, that Respondents acted in "reckless disregard of a regulatory requirement," that is, with scienter, for civil penalty purposes. Div. Br. at 47. I am not persuaded. What little evidence exists of Oglesby's state of mind regarding Rule 22c-1 does not support a finding that his departures from the standard of care were extreme, and there is literally no evidence of the state of mind of Nurre, the Fund's portfolio manager in 2009, when the Section 34(b) and Section 35(d) violations occurred.

Thus, these violations only support first-tier penalties. The Division also seeks first-tier penalties for the Rule 38a-1 violation arising from failure to implement written stress testing procedures. Div. Br. at 47-48. The Division apparently only seeks a one-time penalty for this violation, which is reasonable. *Id.* No Rule 38a-1 violation arose from failure to adhere to ACM's internal maturity restrictions, and the Division's request for first-tier penalties on that basis is rejected. Div. Br. at 47.

I consider all these violations together. Applying the statutory public interest factors: there was no fraud, there was no harm to others or (proven) unjust enrichment, Respondents have a clean disciplinary history, and a substantial penalty will deter Respondents and others from future violations. Applying those *Lybrand* factors which do not overlap with the statutory factors: the violations were recurrent, Respondents have utterly failed to admit wrongdoing, Respondents were cooperative and generally honest, and there is no evidence of financial condition.

The egregiousness of the violations is of greatest weight, because most of them were only technical violations. Zitzewitz's unrebutted opinion was that on the days when the Fund allegedly broke the buck, the market-based NAV was very close to the amortized-cost NAV. Ex. 466 at 13. Any violation of Rule 22c-1 was therefore technical and not egregious. The same is true of the Rule 38a-1 violation, which involved a stress test presented to the Board, without apparent dissatisfaction from that body. The Section 34(b) and Section 35(d) violations were more serious, because they involved, in essence, misrepresentations to investors and potential investors. However, they were not particularly egregious, because they involved only brief and minor deviations from Rule 2a-7(c)(4)'s diversification requirement. On balance, the various factors suggest a low civil penalty of $1,000 per violation for Oglesby and $5,000 per violation for ACM, or $86,000 total for Oglesby and $200,000 total for ACM.

In summary, the appropriate civil penalties are:

Oglesby: Eurozone misrepresentations (Section 206)	$40,000
Oglesby: Rule 22c-1 and 38a-1 violations	(85 + 1) x $1,000 = $86,000
ACM: Eurozone misrepresentations (Section 206)	$200,000
ACM: passive breach misrepresentation (Section 206(2))	$35,000
ACM: Sections 34(b) and 35(d)	6 x $5,000 = $30,000
ACM: Rule 22c-1 and 38a-1 violations	(85 + 1) x $5,000 = $430,000

E. Disgorgement

The Division seeks an order requiring disgorgement of ill-gotten gains by Respondents, pursuant to Investment Company Act Section 9(f)(5) and Advisers Act Section 203(k)(5). Div. Br. at 44-45; 15 U.S.C. § 80a-9(f)(5); 15 U.S.C. § 80b-3(k)(5). Disgorgement is an equitable remedy that requires a violator to give up wrongfully obtained profits causally related to the proven wrongdoing. *See SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989).

It returns the violator to where he or she would have been absent the misconduct and deters others from violating the securities laws. *Id.*; *see Zacharias v. SEC*, 569 F.3d 458, 471 (D.C. Cir. 2009). The amount of the disgorgement need only be a reasonable approximation of profits causally connected to the violation. *See Laurie Jones Canady*, 54 S.E.C. 65, 84 n.35 (1999) (quoting *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996)), *pet. denied*, 230 F.3d 362 (D.C. Cir. 2000). Once the Division shows that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden shifts to Respondents to demonstrate that the Division's disgorgement figure is not a reasonable approximation. *Guy P. Riordan*, Securities Act Release No. 9085, 2009 WL 4731397, at *20 (Dec. 11, 2009), *pet. denied*, 627 F.3d 1230 (D.C. Cir. 2010). The consequence of uncertainty as to the disgorgement amount falls on the wrongdoer whose illegal conduct created the uncertainty. *See First City Fin. Corp.*, 890 F.2d at 1232.

After the parties filed their post-hearing briefs, the Commission reaffirmed these principles in *Jay T. Comeaux*, Exchange Act Release No. 72896, 2014 WL 4160054, at *3 (Aug. 21, 2014). *Comeaux* also clarified that the standard for disgorgement is but-for causation and has nothing to do with the public interest; in essence, disgorgement is always in the public interest. *Id.* at *3 & n.18, *5. For present purposes, *Comeaux*'s greatest significance lies in its suggestion that "violative conduct [that] allowed the defendant to continue receiving compensation" may warrant disgorgement of all such compensation. *Id.* at *3 n.25 (collecting cases).

As in *Comeaux*, the Division here contends that "Respondents were able to continue receiving such compensation only by concealing their violations of the securities laws from their municipal investors and the Board." Div. Br. at 44; *see* 2014 WL 4160054, at *4. This contention is not supported by the record. Koski viewed ACM, Jeffries, and Prost as "careful." Tr. 348. Hodges was concerned about violations and ensuring that they were remedied, but did not express a view about whether disclosure of violations would have made her want to terminate ACM. *E.g.*, Tr. 527-28. Guy considered ACM's investment strategy to be "conservative" and had no reason to think Oglesby's stress test was noncompliant, even though it plainly was noncompliant with the Board's written directive. Tr. 446, 454. Guy had a "high opinion" of ACM, considered Jeffries "a man of honesty and integrity," and would not have served on the Fund's Board if he thought there was "any problem with the way it was run." Tr. 491-92. As noted, ACM supported, and continues to support, Oglesby.

In short, there is insufficient evidence to conclude that Respondents were able to continue receiving management fees and salary only by concealing their violations. Certainly it is possible that the Board would have terminated ACM had it known the full scope of ACM's misconduct, but it is only a possibility, and there was essentially no possibility that Oglesby would have been terminated by ACM, as subsequent events demonstrate. The record evidence of pecuniary gain to ACM and Oglesby pertains only to management fees and salary, and some fraction of such funds might be considered ill-gotten. *E.g.*, *Trautman*, 2009 WL 6761741, at *23 (finding half of respondent's compensation to be ill-gotten). But the Division offers no basis on which to set that fraction, nor is any principled basis apparent from the record. Div. Br. at 44-45.

To be sure, numerous cases have found it appropriate to order disgorgement of salary, commissions, and the like, where violative conduct allowed the respondent to continue receiving such compensation. *See Comeaux*, 2014 WL 4160054, at *3 n.25, and cases cited therein. But the record here is insufficient to conclude that, but for the violative conduct, ACM would not have continued receiving compensation, and as to Oglesby the record conclusively refutes that contention. I find that the Division has not carried its initial burden under *Comeaux* of proving an appropriate amount of disgorgement.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Record Index issued by the Secretary of the Commission on September 2, 2014.

VI. ORDER

IT IS ORDERED that, pursuant to Section 203(f) of the Advisers Act, Derek H. Oglesby is CENSURED.

IT IS FURTHER ORDERED that, pursuant to Section 203(e) of the Advisers Act, Ambassador Capital Management, LLC is permanently BARRED from association with any investment company.

IT IS FURTHER ORDERED that, pursuant to Section 203(k) of the Advisers Act, Ambassador Capital Management, LLC shall CEASE AND DESIST from committing or causing, and Derek H. Oglesby shall CEASE AND DESIST from committing, aiding and abetting, or causing the commission of, any violations or future violations of Sections 206(1) and 206(2) of the Advisers Act and Rules 22c-1, 38a-1, and 31a-1 and Sections 31(a), 34(b), and 35(d) of the Investment Company Act.

IT IS FURTHER ORDERED that, pursuant to Section 203(i) of the Advisers Act and Section 9(b) of the Investment Company Act, Ambassador Capital Management, LLC shall PAY A CIVIL MONEY PENALTY in the amount of $695,000.

IT IS FURTHER ORDERED that, pursuant to Section 203(i) of the Advisers Act and Section 9(b) of the Investment Company Act, Derek H. Oglesby shall PAY A CIVIL MONEY PENALTY in the amount of $126,000.

Payment of penalties shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission. The payment, and a cover letter identifying the Respondent(s) and Administrative Proceeding No. 3-15263, shall be delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Bld., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

Cameron Elliot
Administrative Law Judge