UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15141

In the Matter of

MOHAMMED RIAD AND
KEVIN TIMOTHY SWANSON

Respondents.

DIVISION OF ENFORCEMENT'S RESPONSE TO RESPONDENTS' SECOND MOTION TO DISMISS

Respondents have moved to dismiss the proceeding on the grounds that the impartiality of the Commissioners might reasonably be questioned. Specifically, Respondents complain that: (1) the Commission's Release of proposed rule 18f-4 [7 CFR 270.18f-4] under the Investment Company Act of 1940 ("the Investment Company Act"), Rel. No. IC-3235, referred to the settlement of two related proceedings which had facts which are "identical" to those at issue in this appeal[1]; and (2) a ruling for Respondents in this appeal would "severely undermine" the Commission's rationale for adoption of the proposed rule. (Resp. Br. at pp. 2-3, 4-5) These arguments both fail for the reasons explained below.

Facts

Section 18 of the Investment Company Act limits a fund's ability to make leveraged investments or issue senior securities which incur obligations to persons other than the fund's shareholders. (*See* Release at p. 7) Proposed rule 18f-4 is intended, among other things, to allow

[1]Those proceedings are *In re Claymore Advisors, LLC*, Rel. No. IA-3519, IC-30308 (Dec. 19, 2012); *In re Fiduciary Asset Management, LLC*, Rel. No. IA-3520, IC-30309 (Dec. 19, 2012).

funds to make leveraged investments, and invest in senior securities, provided that funds have assets available to meet their obligations and establish formalized risk management programs for such transactions. (*Id.* at p. 9)

The Commission's December 11, 2015 Release of proposed rule 18f-4 is 420 pages long, and contains an 18 page section describing a "Need for a New Approach." That section describes the Commission's goal to protect investors from losses and to establish "an updated and more comprehensive approach" to funds' use of derivatives given the dramatic growth of such investments, and their complexity, over the past twenty years. (*See* Release at pp. 33-51) Respondents concede that only a single paragraph in that section describes the related, settled proceedings. (*See* Resp. Br. at p.2) The Release also describes certain other settled proceedings in which investors suffered losses as a result of derivative investments, as well as the significant derivative investment losses incurred by a private investment fund which was not regulated by the Commission. (*See* Release at pp. 44-48)

Respondents do not contest the accuracy of any of the statements describing the settlements of two related proceedings. The Commission merely stated that "a registered closed-end fund pursued an investment strategy involving written out-of-the-money put options and short variance swaps" which "led to substantial losses for the fund in September and October 2008," "on five written put options and variance swaps, contributing to a 72.4% two-month decline in the Fund's net asset value." (Resp. Br. at p. 2, *quoting* Release at p. 45-46 and footnotes 124-125) None of these facts is in dispute in Respondents' appeal to the Commission.[2]

[2] To the contrary, Respondents' Opening Brief begins by conceding that they began investing fund assets in derivatives in 2007, and that the fund "ultimately lost nearly $45 million during the Financial Crisis in 2008 when the market moved in unprecedented ways." (Resp. Opening Br. at 1)

Moreover, the Release did not describe any of the Commission's findings regarding the conduct of the respondents in those proceedings or any violations of the relevant statutes and rules. The Release made no reference to this proceeding involving Respondents, let alone the conduct with which they were charged. And nothing in the Commission's release suggested that the respondents in the related proceedings were found to be liable merely because the fund invested in derivatives, and suffered losses thereafter.

Legal Standard

The principles of due process clearly apply to administrative adjudications like this appeal. *Antoniu v. SEC*, 877 F.2d 721, 724 (8th Cir. 1989) (*citing Amos Treat & Co. v. SEC*, 306 F.2d 260, 264 (D.C. Cir. 1962)). As the court recognized in *Antoniu*, the U.S. Supreme Court has determined that due process requires "an absence of actual bias" in such proceedings, *In re Murchison*, 349 U.S. 133, 136 (1955), as well as "the appearance of justice," *Offutt v. U.S.*, 348 U.S. 11, 14 (1954).

"Mere familiarity with the facts of a case gained by an agency in the performance of its statutory role does not, however, disqualify a decisionmaker." *Hortonville Joint School Dist. No. 1 v. Hortonville Educ. Ass'n*, 426 U.S. 482, 493 (1976) (*citing Withrow v. Larkin*, 421 U.S. 35, 47 (1975) and *FTC v. Cement Institute*, 333 U.S. 683, 700-703 (1948)). "Nor is a decisionmaker disqualified simply because he has taken a position, even in public, on a policy issue related to the dispute, in the absence of a showing that he is not 'capable of judging a particular controversy fairly on the basis of its own circumstances.'" *Hortonville Joint School Dist.*, 426 U.S. at 493 (*quoting U.S. v. Morgan*, 313 U.S. 409, 421 (1941)).

Respondents have not cited any decisions holding that facts similar to those present here create the appearance of bias. (*See* Resp. Br. at 4) To the contrary, the only cases cited by

Respondents involved the personal involvement of individual SEC Commissioners which was deemed to violate the appearance of justice. In *Antoniu*, the Court of Appeals determined that an SEC Commissioner had delivered a speech addressing the merits of an industry bar against an individual while an enforcement action seeking an industry bar against the same individual was pending before the Commission. And in *Amos Treat*, a Commissioner who formerly held the position of Director of the Division of Corporate Finance had recommended that the Division of Enforcement initiate an investigation against the respondent, which resulted in the very administrative proceeding in which the Commissioner subsequently participated.

As explained below, the Commission's Release does not demonstrate any actual bias against the Respondents' appeal, or the appearance of any injustice. Nor does the Release suggest that the Commissioners are incapable of judging this appeal fairly on the merits.

Argument

First, in proposing a new rule for derivatives investments made by investment companies, the Commission's Release merely cited the related, settled proceedings, along with orders in several other proceedings and other market developments. It did so solely for the factual proposition that investments in derivatives can result in substantial investor losses. Even in this proceeding, Respondents do not contest that proposition. The underlying facts of the related, settled proceedings are as relevant to the Commission's Release as any of the other factual findings in the section entitled "Need for a New Approach." The Release does not mention any of the charges or findings in those settled proceedings, never mentions the pending administrative proceeding against the Respondents, and does not draw any conclusions about the merits of the charges against Respondents in this proceeding.

Second, the Commission's proposed Rule relates to the risk-limiting provisions of Section 18 of the Investment Company Act, not to any of the statutory antifraud provisions or rules under which Respondents were found liable by the Administrative Law Judge. In fact, the Division of Enforcement did not allege any Section 18 violations against the Respondents in the Order instituting this proceeding. So the proposal, or even the adoption, of the proposed Rule under Section 18 adds nothing to the Commission's consideration of Respondents' actions in this appeal. The proposed Rule would be equally justified if no proceedings had been brought against Respondents, or if Respondents were to prevail in their appeal.

Third, the Respondents in this matter are not challenging the Commission's findings of liability against the other respondents in the related proceedings, or the justifications for the proposed rule regarding derivative investments by funds. Respondents are appealing only the findings by the Administrative Law Judge in the Initial Decision that they personally violated several provisions of the Investment Company Act and the Investment Advisers Act. So Respondents' contention that reversing the Initial Decision would undermine the "Need for a New Approach" described in the Release is simply not true. (Resp. Br. at p.3)

Finally, it is well-established that even the acceptance of an offer of settlement in a related proceeding does not constitute the prejudgment of a respondent's litigated proceeding.[3] *See, e.g.*, *John Thomas Cap. Mgmt. Grp. LLC*, Exchange Act Rel. No. 71415, 2014 WL 294551 at n.11 (Jan. 28, 2014) (denying petition for interlocutory review of order and rejecting claim of prejudgment based upon findings applicable to co-respondents) (citing cases). For the same

[3] In fact, consistent with other settlements accepted by the Commission, the related settled proceedings expressly provide that "[t]he findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in any other proceeding." *See In re Claymore Advisors, LLC*, Rel. No. IA-3519, IC-30308 at p. 2 n. 1; *In re Fiduciary Asset Management, LLC*, Rel. No. IA-3520, IC-30309 at p. 2 n.1.

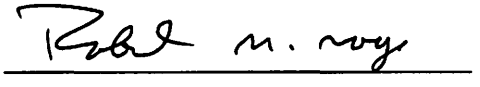
reasons, the Commission's mere reference to a settlement in a Release should not constitute a prejudgment of a related, litigated action. Respondents cannot demonstrate that anything in the Release addresses the merits of the charges against them, or that any of the Commissioners have been personally and improperly involved in this proceeding. Nor can Respondents demonstrate that the Release somehow renders the Commissioners incapable of fairly judging the merits of their appeal. Accordingly, the Commission's Release simply does not raise any of the same concerns about the appearance of justice which were found to be present in *Antoniu*, or the due process concerns which were at issue in *Amos Treat*.

* * *

For all of the foregoing reasons, the Commission should deny Respondents' Second Motion to Dismiss.

Dated: February 11, 2016.

Respectfully submitted:



Robert M. Moye (MoyeR@sec.gov)
Benjamin J. Hanauer (HanauerB@sec.gov)
Jeffrey A. Shank (ShankJ@sec.gov)

U.S. Securities and Exchange Commission
Chicago Regional Office
175 West Jackson Boulevard, Suite 900
Chicago, Illinois 60604
(312) 353-7390
(312) 353-7398 (fax)

Attorneys for the Division of Enforcement

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CERTIFICATE OF SERVICE

Robert M. Moye, an attorney, certifies that on February 11, 2016, he caused the Division of Enforcement's Response to Respondents' Second Motion to Dismiss to be served by email delivery and UPS delivery upon:

Richard D. Marshall (Richard.marshall@kattenlaw.com)
Katten Muchin Rosenman LLP
575 Madison Avenue
New York, New York 10022
(212) 940-8765
(212) 940-8776 (fax)

Attorney for Respondents
Mohammed Riad and Kevin Timothy Swanson

By: _____

Robert M. Moye

Attorney for the Division of Enforcement

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
CHICAGO REGIONAL OFFICE
SUITE 900
175 WEST JACKSON BOULEVARD
CHICAGO, ILLINOIS 60604

ROBERT M. MOYE
SENIOR TRIAL COUNSEL
DIVISION OF ENFORCEMENT

Tel.: (312) 353-1051
Fax: (312) 353-7398
moyer@sec.gov

February 11, 2016

VIA OVERNIGHT DELIVERY

Jill M. Peterson, Assistant Secretary
Office of the Secretary
U.S. Securities & Exchange Commission
100 F Street NE, Mail Stop 1090
Washington, DC 20549

Re: ***In the Matter of Mohammed Riad and Kevin Timothy Swanson, (AP File No. 3-15141)***

Dear Ms. Peterson:

Enclosed for filing in the above-referenced matter please find the original and three copies of the Division of Enforcement's Response to Respondents' Second Motion to Dismiss.

If you have any questions, please call me at (312) 353-1051.

Sincerely,

Robert M. Moye

Enclosures

Copy to: Richard Marshall, Esq. (by email)