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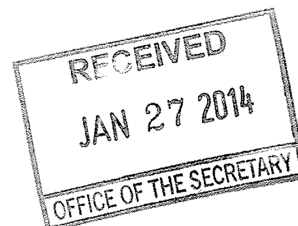
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15433

In the Matter of

CHARIOT ADVISORS, LLC
and
ELLIOTT L. SHIFMAN,

Respondents.



DIVISION OF ENFORCEMENT'S PREHEARING SUBMISSION

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Pursuant to Rule of Practice 222, and in compliance with the Court's September 26, 2013 Order, the Division of Enforcement ("Division") hereby makes its Prehearing Submission.

I. INTRODUCTION

In December 2008 and in 2009, Elliot Shifman and the advisory firm he owned and controlled, Chariot Advisors, LLC ("Chariot") (collectively "Respondents") misrepresented and omitted material facts about a proposed investment strategy they would employ in managing the Chariot Absolute Return Currency Portfolio (the "Chariot Fund" or "Fund"). Specifically, in presentations to the Chariot Fund's board of directors in December 2008 and in May 2009, Respondents represented that they would use a proprietary algorithmic currency trading program to manage substantially all of the Fund's investments. These statements were made in connection with Respondents' seeking Board approval of the advisory agreement between the Fund and Chariot, as required under Section 15(c) of the Investment Company Act of 1940. Shifman and Chariot made substantially similar misrepresentations in Chariot Fund's registration statement and prospectus that was with the Commission.

The ability to use an algorithmic trading program was a crucial component of Respondents' investment strategy. But, when Shifman and Chariot made these statements, they had no such proprietary trading program. At best, they were negotiating with third parties to develop such a program. In addition, just weeks after the December 2008 presentation to the board. Chariot and Shifman learned that the third party would not be able to create the trading program that had been presented to the board. Yet Respondents never told the board this fact. The May 2009 presentation to the board described the algorithmic trading program in substantially similar terms as did the December 2008 presentation, even though the third party

had told Respondents that such a trading program would not be created, and that a significantly different program would be adopted.

The Division alleges that these misrepresentations and omissions by Chariot violated Section 15(c) of the Investment Act, which requires a registered fund's board of directors to initially, and thereafter annually, evaluate and approve the fund's advisory agreement, and requires the fund's adviser to provide the board with information reasonably necessary to make that evaluation (hereafter, the "15(c) process"). The Division contends that these misrepresentations and omissions by Chariot violated Sections 206(1), 206(2) and 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 206(4)-8 thereunder and aided, abetted and caused the Fund's violations of Section 34(b) of the Investment Company Act. The Division further contends that Shifman willfully aided, abetted and caused violations of Sections 15(c) and 34(b) of the Investment Company Act, and Sections 206(1) and 206(2) of the Advisers Act.

II. RESPONDENTS AND OTHER RELEVANT PERSON AND ENTITIES

A. Respondents

1. **Chariot Advisors, LLC**, based in Raleigh, North Carolina, has been an investment adviser registered with the Commission since September 2008. Between September 2008 and August 2011, Chariot managed for its advisory clients the investment component of two variable annuities, called Vector I and II, offered by Midland National Life Insurance Company ("Midland"). Between July 2009 and August 2011, Chariot was also the investment adviser to the Chariot Fund, which was one of the funds offered within the Vector annuities. Chariot's current business is marketing financial products for Critical Math Advisors, LLC, a registered investment adviser that advises a registered fund within Northern Lights Variable

Trust ("Northern Lights"). Chariot reports $13.7 million in assets under management in its most recent Form ADV. It is registered with the Commission under the multi-state adviser exemption.

2. **Elliott L. Shifman**, a resident of Raleigh, North Carolina, was the sole owner and operator of Chariot from its founding in September 2008 until June 30, 2009, when he transferred ownership to Dana W. Gower ("Gower"). Trained as an actuary, Shifman is also the founder and principal of Outer Banks Financial, LLC, now known as OBF, LLC ("Outer Banks"), an unregistered entity through which he develops and markets variable annuities and sells investment signals. During the relevant period Shifman was a registered representative associated with SummitAlliance Securities, LLC ("SummitAlliance"), a registered broker-dealer, and holds Series 6 and 63 licenses.

B. **Other Relevant Person and Entities**

1. **Dana W. Gower**, also a resident of Raleigh, North Carolina, purchased Chariot from Shifman on June 30, 2009. Since purchasing Chariot, Gower has been its owner, president, managing member, and chief compliance officer. For the year prior to purchasing Chariot, Gower worked in employee recruiting and as an independent registered representative for Nationwide Securities, LLC ("Nationwide"), a registered broker-dealer. Previously, for less than a year from April 2007 to March 2008, he was employed by Shifman at Outer Banks as a salesman, marketing variable annuities to registered representatives. While at Nationwide, Gower held Series 7 and 66 licenses.

2. **Northern Lights Variable Trust ("Northern Lights")**, a Delaware statutory trust headquartered in Omaha, Nebraska, is registered as an open-end management

investment company that serves as an umbrella to a series of registered funds. Northern Lights is in the business of creating registered funds and, thereafter, providing to those funds turnkey services, including fund governance through the Northern Lights Board of Trustees ("Northern Lights Board" or "Board"). Between December 2008 and August 2011, the Chariot Fund was a series of Northern Lights and the Northern Lights Board served as the Chariot Fund's board. Northern Lights is a series company, currently comprised of 18 variable annuities, or funds advised by multiple advisers. Fund shares are sold only on life insurance platforms and are offered to separate accounts of participating life insurance companies for the purpose of funding variable annuity contracts and variable life insurance policies. At the time the Chariot Fund was created, Northern Lights was comprised of 13 variable annuities. Although Northern Lights itself has no known disciplinary history, on May 2, 2013, the Commission issued an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order against the members of the Northern Lights Board, as well as two affiliates of Northern Lights, namely, Northern Lights Compliance Services, LLC and Gemini Fund Services, LLC ("Gemini"), for various disclosure, reporting, recordkeeping and compliance violations.

3. **Chariot Absolute Return Currency Portfolio** ("Chariot Fund") was a registered investment company and a series of the Northern Lights from June 30, 2009 until it was liquidated on August 31, 2011.

III. FACTS

A. Background

In 2006, Shifman developed for Midland two variable annuities, called Vector I and II, which he began selling to investors through Summit Alliance, with which he was associated as a

registered representative. Each Vector annuity allowed annuitants to invest their principal in approximately 80 different sub-accounts, which were essentially clones of retail mutual funds offered by various fund complexes. Approximately two years later, in September 2008, as part of his efforts to sell the Vector annuities, Shifman founded Chariot as a registered investment adviser in order to offer investment advice to investors in the Vector annuities. Shifman believed that the availability of Chariot's services would make the Vector annuities more appealing to investors, thus allowing him to increase his sales of the product. From November 2008 to August 2009, Chariot offered Vector annuity investors various risk-based models that allocated invested funds among the sub-account offerings. Chariot developed these models by purchasing trading signals from several independent technical analysts.

Shortly after founding Chariot, Shifman began developing the Chariot Fund as a mutual fund that would be offered to investors in the Vector variable annuities. Shifman believed that the Chariot Fund would make the Vector annuities more appealing to investors, thus enabling him to increase sales, because it would offer annuitants an opportunity to invest in currencies, an option that was not then among the asset classes available among the Vector sub-accounts. Shifman determined the Chariot Fund's investment objective would be to achieve absolute positive returns in all market cycles—a goal that he believed he could achieve by investing approximately 80% of the Fund's assets under management in short-term fixed income securities and using the remaining 20% of the assets to engage in algorithmic currency trading. Shifman's primary goal was to create an automated strategy for the Chariot Fund – what he described as a fully automated kind of performance strategy that removed human discretion.

B. <u>The December 2008 15(c) Submission</u>

In late 2008, Shifman approached Northern Lights with a request that it create the Chariot Fund as a series of Northern Lights, and approve Chariot to be the new Fund's adviser. On November 5, 2008, Shifman submitted responses to a new fund questionnaire to Northern Lights's counsel in which he indicated that the proposed fund would allocate 20% of its assets to currency trading, while keeping the remaining 80% invested in fixed income securities. With respect to currency trading, earlier in 2008, Shifman contacted Randy Durie, principal of Plimsoll Capital, a currency management firm. Durie previously had begun work on an algorithmic high-frequency currency strategy he called Armada, which he discussed with Shifman. Durie made it clear to Shifman that Armada was a work in progress and that the goals – split-second automated execution of hundreds or thousands of currency trades a day, each yielding a small profit – had not yet been met due to technology hurdles, and that the strategy was very expensive to run. In June 2008, Shifman asked Durie for Plimsoll's marketing materials for Armada, which included a PowerPoint presentation as well as a disclosure document.

Soon after Shifman approached Northern Lights, on November 13, 2008, in conformity with Section 15(c) of the Investment Company Act, counsel for the Northern Lights Board requested certain information from Shifman for the Board's consideration of Chariot's proposed advisory contract at the Board's upcoming meeting scheduled for December 15, 2008. Counsel's November 13, 2008 letter (the "November 13 letter") informed Shifman that "Section 15(c) . . . requires that the Trustees [of the Board] request, and that the Adviser provide, all information that is reasonably necessary in connection with the decision to approve the agreement" between Chariot and the Chariot Fund. The November 13 letter further alerted Shifman that "[r]ules adopted by the [SEC] . . . require disclosure in proxy statements and shareholder reports of the material factors considered, and conclusions reached by the Trustees in deciding to approve the advisory

agreement." The specific information requested came within two categories: (i) the nature, extent, and quality of services to be provided by Chariot, and (ii) the costs of the services Chariot would provide and the profits it would realize. The November 13 letter closed with a reminder to Shifman of his duty to update the Board of any material changes: "Please note that the Adviser has a duty to update the Board of Trustees throughout the year if there is a material change in the information provided in this questionnaire . . . ."

Shifman responded to the Board in writing and prepared a PowerPoint presentation that he made to the Board at its December 15, 2008 meeting. Both the written submission and the PowerPoint borrowed heavily from the Armada materials Shifman had received from Durie, including numerous instances in which Shifman simply copied language wholesale and changed the name from Armada to Chariot. In the written submission, Shifman described the proposed new fund as "provid[ing] a currency arbitrage overlay on top of fixed income securities. The program is algorithmic in nature and searches for arbitrage opportunities on currency's [sic] in different markets," and indicated that an appropriate benchmark for the new fund's performance would be the S&P 500 Index.

Shifman's December 15, 2008 PowerPoint presentation to the Board gave further details on the Chariot Fund's proposed investment methodology. It stated that the Fund "will be a currency overlay product" and will "add[] 'alpha' by trading a[n] . . . algorithm" similar to one already used by an unrelated third party to trade the assets of a separate hedge fund Shifman also controlled. The PowerPoint further stated that, by using this methodology, the Fund would be a "byproduct of extensive research of recent changes in FX market structure due to the adaptation of algorithmic and high frequency trading." The PowerPoint then listed bullet points describing what Shifman

pitched as "competitive" features of the Fund based on its use of algorithmic trading. These included, among others:

- **High Frequency Algorithmic Trading** enables [Chariot] to seek out untapped sources of alpha while controlling drawdowns.
- Algorithmic trading models allow **24/5.5 access** to the markets extending trading opportunities and minimizing emotions associated with non-systematic trading.
- Dynamic strategy model **automatically adjust trading behavior** of sub-strategies to exploit current market conditions and volatility.
- **Intelligent execution Logic** ensures best execution with minimum slippage.

In return for these services, Shifman proposed that Chariot charge the Fund a 1.00% advisory fee. Shifman also proposed a 0.60% 12b-1 fee.

The Board minutes from that meeting confirm that Shifman's oral representations during the meeting were substantially similar to what he claimed in both the December 15(c) submission and his PowerPoint presentation. Those minutes state that Shifman:

> [E]xplained that the investment objective of Chariot is to seek consistent positive absolute returns through various market cycles. . . . [Shifman] noted that [Chariot] seeks to achieve its investment objective through two complementary strategies: (1) by investing primarily in short-term high quality fixed income securities and (2) by engaging in proprietary foreign currency arbitrage. Mr. Shiffman [sic] noted that the Adviser's currency trading strategy, which involves a computer model, utilizes a algorithmic application that will permit Chariot to make split-second trades to take advantage of currency arbitrage opportunities. . . .

Similarly, Andrew Rogers, the president of Gemini – the Northern Lights affiliate that served as the administrator for the Chariot Fund – attended the December 15, 2008 Northern Lights Board meeting. Rogers recalls Shifman describing the Fund's proposed trading strategy as using a "quantitative black box."

Following Shifman's presentation, the Northern Lights Board approved the Chariot Fund as a series of Northern Lights. It further concluded that Chariot's proposed management fee was acceptable in light of the quality of the services the Chariot Fund expected to receive from Chariot, and consequently approved the Fund's advisory agreement with Chariot. Two weeks later, on December 30, 2008, email correspondence shows that Durie notified Shifman that he was shutting Armada down due to its high cost and market conditions.

C. The May 2009 15(c) Submission

After the Northern Lights Board approved the Chariot Fund and its advisory agreement with Chariot but before the Fund launched, Shifman took steps to sell Chariot to Gower, who was a former employee of Shifman's. On May 18, 2009, Shifman entered an agreement to transfer ownership of Chariot to Gower, effective June 30, 2009. The pending change of control of Chariot prompted the Northern Lights Board to reconsider Chariot's advisory contract with the Fund. At the Board's request, Shifman made a second 15(c) submission on May 26, 2009.

The second 15(c) submission contained essentially the same claims about Chariot and the Chariot Fund that Shifman advanced in the December 15(c) submission except that in the second written submission Shifman now stated that "[t]he Fund invests in 80% diversified Treasuries or other AAA securities and currency." Shifman also proposed that Chariot charge the Fund a 1.50% advisory fee and a 0.40% 12b-1 fee, justifying the increase in the advisory fee by representing that the Fund's investment strategy required more work to implement that he had earlier anticipated. Additionally, the May 2009 15(c) submission made clear that, with the change of control, Gower rather than Shifman would operate Chariot and manage the Fund. With the May 2009 15(c) submission, Chariot also provided to the Board a proposed prospectus for a proposed mutual fund for which Shifman was attempting to obtain the approval of the Northern Lights Board. As

described in the proposed prospectus, the envisioned mutual fund was to have the same investment strategy as the Chariot Fund and be managed by Chariot. Like the 15(c) submission for the Chariot Fund, the proposed prospectus misrepresented Chariot's ability to engage in algorithmic currency trading. The prospectus stated:

> Electronic and algorithmic trading have dramatically changed many of the traditional assumptions and processes in the currency markets. The adviser believes that currency markets are rarely efficient in the short-term, and that it is possible to generate excess returns by exploiting various short-term structural inefficiencies and non-random price action in the FX market. Using high frequency market data, the adviser has created models of the FX market that it believes are able to analyze the price formation process of exchange rates in real-time.

As part of the May 15(c) submission, Shifman prepared and presented to the Northern Lights Board at its May 2009 meeting a PowerPoint presentation substantially similar to the PowerPoint used at the December 2008 meeting. Among other things, the PowerPoint contained essentially the same claims as the December 2008 submission concerning the competitive benefits of algorithmic trading. The May 2009 meeting minutes of the board confirm that Shifman reiterated claims that Chariot would use "models"—perhaps as many as four or five models—to achieve an absolute return for the Fund. The minutes also confirm that Shifman justified to the Board the advisory fee increase by saying that he had underestimated the amount of work involved in connection with the Fund's investment strategy which he claimed was "very time consuming."

D. Misrepresentations

Contrary to what Shifman told the Board during the 15(c) process, Chariot did not have an algorithm or model capable of conducting the currency trading envisioned for the Chariot Fund. In fact, at the same time Shifman made the respective Chariot's 15(c) submissions and

Board presentations, he was still trying to figure out how to develop such an algorithm and was unsure whether Chariot could do so or whether Chariot would have to obtain an algorithm, or the services of a third party with an algorithm, for the Fund. For instance, Shifman had not yet found anyone to develop a currency trading model by mid-May 2009 when he contracted to sell Chariot to Gower. At best, at the time of the December 2008 presentation, Shifman he been had in discussions with Randy Durie regarding a high frequency, algorithmic trading program that Durie referred to as Armada. But Armada was a work in progress and had not been finalized when Shifman made his presentation to the Board. Moreover, just two weeks after the December 2008 presentation to the Board, Durie told Shifman that Durie was stopping development of Armada because the program was not workable. Shifman never alerted the Chariot board of this development.

As of the May 2009 15(c) submission, Chariot did not have a model and it was "in flux" as to who would provide models to Chariot. Shifman was "looking at a lot of people," and as of the board meeting on May 29, 2009, he still had not determined who the model provider would be and was "still kind of working it out." According to Shifman, at the time of the board meeting, he wanted to make automated models for the currency trading strategy and that he was "trying to figure out how to get that done." Yet Shifman reused the same PowerPoint presentation to the Board, which had been created primarily using Durie's marketing materials for Armada, the strategy he closed at the end of 2008. Despite making a few changes, the Board minutes for that minute reflect that Shifman told them the strategy was "the same" as it had been in December 2008.

The ability to conduct currency trading for the Chariot Fund as described to the Board was particularly significant for the Fund's performance. In fact, the minutes to the May 29, 2009

board meeting state that in the absence of an operating history by which to judge the Chariot Fund's performance, the Northern Lights Board focused instead on Chariot's reliance on models in evaluating the advisory contract. Shifman benchmarked the Fund's performance to the S&P 500 Index. He believed that for the Fund to achieve a return comparable to that which he expected of the S&P 500 Index while having 80% of the Fund's assets invested in fixed income securities, the Fund's currency trading needed to achieve a 25% to 30% return. Shifman never disclosed to the Board during the 15(c) process that Chariot did not have an algorithm or model capable of achieving such a return.

E. Chariot's Sale to Gower and the Fund's Launch

Shifman began discussions with Gower to sell Chariot to him by at least late April 2009. On May 18, 2009, Shifman and Gower entered an agreement to sell Chariot to Gower with a closing date of June 30, 2009. On the same day, Gower became an employee of Shifman's other entity, Outer Banks, to provide him income while he worked with Shifman to learn Chariot's business and become Chariot's new owner. On June 5, 2009, the Chariot Fund filed with the Commission a registration statement and prospectus on Form N-1A that repeated Shifman's claims that, among other things, the Chariot Fund would use quantitative, proprietary trading models for currency trading. Specifically, the prospectus stated:

> The Advisor will seek profits by forecasting short-term movements in exchange rates and changes in exchange rate volatility aided by quantitative models. . . . The Advisor identifies potential foreign currency trading investment opportunities by using proprietary medium-frequency trading models that the Advisor believes will produce superior risk-adjusted returns in a variety of market conditions. The proprietary currency trading models use statistical analysis to uncover expected profitable trading opportunities. Large volumes of trading statistics are continually captured, monitored and evaluated before trading occurs. The models seek to identify pricing inefficiencies and other non-random price

> movements that signal potentially profitable trading opportunities. The strategy attempts to profit from short-term pricing fluctuations using medium-frequency trading rather than from longer-term price trends.

While it appears that this registration statement and prospectus were prepared and filed with the Commission by counsel for Northern Lights, the evidence also indicates that they were drafted based on information provided by Shifman to the Board. Evidence also shows that Shifman reviewed both before they were filed with the Commission.

As with Shifman's claims in the 15(c) submissions, the claims in the registration statement and prospectus that Chariot possessed and would use proprietary trading models were false. At the time the prospectus was filed, Shifman was "working to get models made." On June 30, 2009, the Chariot Fund's Registration Statement and Prospectus, filed with the Commission on June 5, 2009, went effective. Also, on June 30, 2009, the sale of Chariot to Gower closed, and Gower took control of the entity.

On July 5, 2009, Shifman sent an e-mail to his brother, a mathematician with whom Shifman was working to develop an algorithm. In this email, which he describes to his brother as containing "a lot of notes to [himself] to see if things stick," he states that he has "5 traders in the loop right now" and needs to choose among them. He admits that "[w]e have no knowledge of the processes and really own nothing. If they decide they do not want to trade we are out of business." Shifman then goes on in the email at length to evaluate the positives and negatives of the five traders under consideration, including the trader, Lisa Xu ("Xu"), described in more detail below, whom he eventually hired to trade the Fund's currency after the Fund's launch. Among the negatives of Xu's trading, Shifman writes that "[s]he is trading manually now and who knows if we can automate." Shortly thereafter, on July 15, 2009, the Chariot Fund was

launched. Because it was added to Midland's variable annuity platform, it was funded immediately with $17 million in assets by Chariot reallocating to the Fund assets in clients' annuities.

Because Chariot possessed no algorithm, for at least the first two months after the Fund's launch, currency trading for the Fund was under the control of Xu, an individual trader who worked from her home in Chicago. Shifman hired Xu to conduct the Fund's currency trading and paid her as an employee of Outer Banks.[1] Both Shifman and Xu admitted during the investigation that Xu explained her trading approach to Shifman, which Xu explained was a technical analysis, rules-based approach in which she combined elements of Taoism with a few market indicators and her own intuition. Gower also interviewed Xu in mid-June 2009 prior to her hire and knew that Xu exercised "a lot of human decision" in her trading. Xu traded currencies for the Fund until September 30, 2009, when she was terminated based on her poor trading performance. Thereafter, on October 12, 2009, Gower hired another trader, Randy DuRie, to conduct currency trading for the Fund. DuRie appears to have used an algorithm as Shifman originally envisioned for the Fund. During the period that the Fund was being managed without an algorithm, Chariot earned approximately $40,000 in advisory fees.

F. <u>The Fund's Closure</u>

Between the Fund's launch in July 2009 and 2010, the Fund's performance was negative. By the first quarter of 2011, its assets had declined from approximately $17 million to approximately $11 million. Given this asset size, Gower realized the Fund was too small to be profitable. At Gower's request, on June 29, 2011, the Fund filed with the Commission a

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[1] Although Shifman sold Chariot to Gower effective June 30, 2009, he remained involved in Chariot's operations through at least the end of September 2009.

supplement to its prospectus, disclosing that it would close and that all shares would be redeemed on August 31, 2011.

IV. LEGAL ANALYSIS

A. Chariot Violated Section 15(c) of the Investment Company Act and Shifman Aided and Abetted and Caused Those Violations.

Section 15(c) of the Investment Company Act, among other things, makes it the duty of an investment adviser of a registered investment company to furnish to the investment company's board of directors such information as may reasonably be necessary for the directors to evaluate the terms of the investment advisory contract. While Section 15(c) does not define what is "reasonably necessary" for the fund directors to evaluate the terms of an advisory contract, courts have identified a number of factors that are relevant to the board's analysis, including: (i) the adviser's cost in providing the service; (ii) the nature and quality of the adviser's services; (iii) the extent to which the adviser realizes economies of scale as the fund grows larger; (iv) the profitability of the fund to the adviser; (v) fee structures for comparable funds; and (vi) fall-out benefits accruing to the adviser or its affiliates from offering or marketing the fund with its fund family. See, e.g., Gartenberg v. Merrill Lynch Asset Management, Inc., 694 F.2d 923, 930 (2d Cir. 1982); see also Jones v. Harris, 559 U.S. 335, 345-46 (2010) (concluding that *Gartenberg* was correct in . . . "[that] to face liability under § 36(b), an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining").

Chariot willfully violated Section 15(c) of the Investment Company Act when, Chariot, acting through Shifman, misrepresented to the Northern Lights Board that Chariot had the

capability to conduct algorithmic currency trading on behalf of the Chariot Fund. In fact, Chariot did not have such capability at the time of either 15(c) submission. This misrepresentation is particularly significant because the algorithm was supposed to derive nearly all of the Chariot Fund's returns (which were benchmarked to the S&P 500 Index) by trading currencies with 20% of its assets while the other 80% were invested in low yielding short-term fixed-income securities or money market funds. During the relevant period, Chariot actually invested 80% or more of its assets in low yielding short-term fixed-income securities or money market funds.

The elements required to establish aiding and abetting liability for violations of the federal securities laws are: (1) primary violations of the provisions charged, (2) substantial assistance by the aider and abettor of the conduct that constituted the violations, and (3) that the assistance was provided with the requisite scienter which may be satisfied by showing that the aider and abettor knew of, or recklessly disregarded, the wrongdoing and his or her role in furthering it. Brendan E. Murray, IAA Rel. No. 2809, 2008 WL 4964110, *5 (Nov. 21, 2008) (opinion of the Commission). Similarly, causing requires: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew or should have known that his or her act or omission would contribute to a non-scienter based primary violation, or the respondent acted recklessly for scienter-based primary violations. See KPMG Peat Marwick LLP, 54 S.E.C. 1135 (2001), petition denied, KPMG, LLP v. SEC, 289 F.3d 109, 120 (D.C. Cir. 2002) (construing "cause" provision of Section 21C of the Exchange Act); Scott G. Monson, Rel. IC-28323 (June 30, 2008) (Commission opinion construing ICA Section 9(f)). By making the 15(c) submissions and accompanying board presentations that

contained material misrepresentations and omissions, Shifman knowingly aided and abetted and caused Chariot's violation of Section 15(c) of the Investment Company Act.

B. Chariot Violated Sections 206(1) and 206(2) of the Advisers Act and Shifman Aided and Abetted and Caused Those Violations.

Sections 206(1) and 206(2) of the Advisers Act prohibit an investment adviser from engaging "in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client." These provisions impose on investment advisers a fiduciary duty to act in "utmost good faith," to fully and fairly disclose all material facts, and to use reasonable care to avoid misleading clients. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191, 194 (1963). The Supreme Court defined that duty in Capital Gains as "[an] affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' the" investment adviser's clients. Id. at 194. Materiality is defined by the same standard used for the antifraud provisions of the Securities Act of 1933 ("Securities Act") and the Exchange Act. Steadman v. SEC, 603 F.2d 1126, 1130 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). Thus, misrepresented or omitted information is material under Section 206 if a reasonable client or prospective client would consider it important. Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006) (holding that the term "client" in the Advisers Act refers to the fund and not the fund's individual investors). To establish a violation, scienter is required for Section 206(1) but not for Section 206(2). SEC v. Steadman, 967 F.2d 636, 647 (D.C. Cir. 1992).

Chariot made misrepresentations and omissions of material fact to its client, the Chariot Fund, when it told the Northern Lights Board that it had the capability to conduct algorithmic

currency trading. In fact, as discussed above, it had no such capability. Shifman, on behalf of Chariot, made these misrepresentations knowing that they were false. Accordingly, Shifman aided, abetted, and caused Chariot's violations of Sections 206(1) and 206(2) of the Advisers Act.

C. Chariot and Shifman Aided and Abetted and Caused the Chariot Fund's Violations of Section 34(b) of the Investment Company Act.

Section 34(b) of the Investment Company Act makes it unlawful for any person "to make any untrue statement of a material fact" in a document filed or transmitted pursuant to the Act. The same section makes it unlawful to omit from any such document any fact necessary in order to prevent the statements made therein from being materially misleading. Brown v. Bullock, 194 F. Supp. 207, 231 (S.D.N.Y. 1961); see also SEC v. Advance Growth Capital Corp., 470 F.2d 40, 52 (7th Cir. 1972). Establishing a willful violation of Section 34(b) does not require proof of scienter. Advance Growth Capital Corp., 470 F.2d at 52 (1972); In re Fundamental Portfolio Advisors, Inc., Securities Act Rel. No. 8251, AP File No. 3-9461 (July 15, 2003) (opinion of the Commission).

The Chariot Fund violated Section 34(b) by making an untrue statement of a material fact in the registration statement and prospectus it filed with the Commission on June 5, 2009. Specifically, the Fund falsely stated that the Fund's adviser, Chariot, had the capability to conduct algorithmic currency trading with a portion of the Fund's assets. In the registration statement, the Fund also falsely stated, among other things, that by "[u]sing high-frequency market data, the Advisor has created models of the FX [currencies] market that it believes are able to analyze the price formation process of exchange rates in real time." In fact, Chariot had not created any such models and did not otherwise have the capability to conduct algorithmic

currency trading. Shifman, on behalf of Chariot, was the source of this misrepresentation when he provided false and misleading information to the Fund concerning Chariot's ability to trade a portion of the Fund's assets using an algorithm. Shifman knew the information was false when he provided it to the Fund. Accordingly, Shifman and Chariot aided and abetted and caused the Fund's violation of Section 34(b) of the Investment Company Act.

D. Chariot Violated Section 206(4) of the Advisers Act and Rule 206(4)-8 Thereunder.

Section 206(4) of the Advisers Act makes it unlawful for any investment adviser to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. Rule 206(4)-8 prohibits any investment adviser to a pooled investment vehicle from: (i) making false or misleading statements to investors or prospective investors in a pooled investment vehicle; (ii) omitting to state to investors or prospective investors in a pooled investment vehicle a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; or (iii) otherwise defrauding investors in those vehicles. The false or misleading statements must be material, meaning that a reasonable investor would consider the statement important. SEC v. The Nutmeg Group, 2011 WL 5042094 (N.D. Ill. Oct. 19, 2011). A "pooled investment vehicle" means any investment company as defined in Section 3(a) of the Investment Company Act, including but not limited to any issuer that "holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities." Violations of Section 206(4) and Rule 206(4)-8 thereunder do not require proof of scienter. SEC v. Steadman, 967 F.2d at 647 (D.C. Cir. 1992); Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, SEC Release No. 33-8766, IA-2628 (Aug. 3, 2007).

The Chariot Fund was an investment company under Section 3(a) of the Investment Company Act, and therefore a pooled investment vehicle, because it was engaged primarily in "the business of investing, reinvesting, or trading in securities." Chariot, as the Fund's adviser, violated Section 206(4) and Rule 206(4)-8 thereunder by charging the Fund a management fee based on a service that Chariot was not in fact providing. As a result, the Fund's investors were defrauded because they were charged a fee based on services not rendered. They were also defrauded because Chariot knew that the Fund had misrepresented (based on Chariot's own representations to the Fund) that Chariot was using an algorithm as a principal investment strategy.

V. RELIEF REQUESTED

A. Cease-and-Desist

Section 203(k) of the Advisers Act, and Section 9(f) of the Investment Company Act authorize the Commission to enter an order requiring any person that violated or is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing such violation and any future violation of the same provision, rule or regulation. Accordingly, based upon the evidence that will be presented at the hearing in this matter, the Court should order Respondents Chariot and Shifman to cease and desist from committing or causing violations of and any future violations of Sections 15(c) and 34(b) of the Investment Company Act of 1940, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

B. Civil Penalties and Disgorgement Plus Prejudgment Interest

Section 203(i) of the Advisers Act and Section 9(d) of the Investment Company Act allow the Commission to impose a civil penalty in proceedings instituted pursuant to Sections

203(e) and 203(f) of the Advisers Act and Section 9(b) of the Investment Company Act, respectively. Section 21B of the Exchange Act provides similar authority with respect to proceedings instituted under Section 15(b)(6) of the Exchange Act. Section 21B of the Exchange Act authorizes the Commission to impose a civil penalty in a proceeding instituted pursuant to Section 15(b)(6) of the Exchange Act. Accordingly, based upon the evidence that will be presented at the hearing, the Court should order that the Respondents pay civil penalties.

Section 203(j) of the Advisers Act, Section 9(e) of the Investment Company Act and Section 21B of the Exchange Act, allow the Commission to seek an order requiring disgorgement, including prejudgment interest, in administrative proceedings in which the Commission may impose a money penalty. The Commission may also seek disgorgement and prejudgment interest in the cease-and-desist proceedings pursuant to Section 9(f)(5) of the Investment Company Act. Accordingly, based upon the evidence that will be presented at the hearing, the Court should order that the Respondents pay disgorgement plus prejudgment interest.

C. **<u>Bar</u>**

Under Section 203(e) of the Advisers Act, the Commission can censure, suspend, revoke the registration, or otherwise limit the activities of any investment adviser who has willfully violated or aided and abetted violations of the federal securities laws or any rules or regulations, thereunder. Section 203(f) of the Advisers Act authorizes the Commission to censure, suspend, bar, or otherwise limit the activities of any person associated with any investment adviser. Section 15(b)(6) of the Exchange Act empowers the Commission similarly with respect to any person associated with a broker-dealer (as was Shifman) at the time of the conduct. Under Section 9(b) of the Investment Company Act, the Commission can prohibit, conditionally or

unconditionally, either permanently or for such period of time as it in its discretion shall deem appropriate in the public interest, any person from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, if such person, among other things, willfully violated or willfully aided and abetted violations of the Securities Act or Investment Company Act.

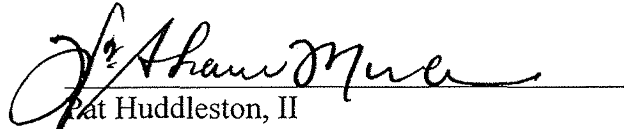
In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), which became effective on July 22, 2010, provided collateral bars in each of the several statutes regulating different aspects of the securities industry. Although Shifman's wrongdoing occurred before July 22, 2010, the Commission has determined that sanctioning a respondent with a collateral bar for pre-Dodd-Frank wrongdoing is not impermissibly retroactive, but rather provides prospective relief from harm to investors and the markets. John W. Lawton, Advisers Act Release No. 3513 (Dec. 13, 2012), 105 SEC Docket 61722, 61737; see also Alfred Clay Ludlum, III, Advisers Act Release No. 3628 (July 11, 2013), 2013 WL 3479060, at *1, 6; Johnny Clifton, Securities Act Release No. 9417 (July 12, 2013), 2013 WL 3487076, at *1, 13; Tzemach David Netzer Korem, Exchange Act Release No. 70044 (July 26, 2013), 2013 WL 3864511, at *1, 7.

Accordingly, based upon the evidence that will be presented at the hearing in this matter, the Court should bar Respondent Shifman from the securities industry.

VI. CONCLUSION

For the foregoing reasons, and based on the evidence to be presented by the Division at the hearing, the Court should find that Respondents violated the provisions of the securities laws set forth in the OIP and grant relief as requested herein.

This 24th day of January, 2014



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