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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.

RESPONDENTS' PREHEARING BRIEF

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Respondents respectfully submit this prehearing brief in this matter.

Respondents are charged with serious violations of the federal securities laws, including fraud and misrepresentations. Neither Chariot Advisors nor Mr. Shifman made any misrepresentations, nor did they fail to disclose any material information. At all times they acted with the best interests of investors in mind. Everything they did was prudent, reasonable, and in compliance with the relevant prospectus. The evidence simply does not support a finding of any violation by either Respondent, and the remedies sought by the Division are not warranted.

The Division contends that Respondents violated certain provisions of the securities laws through their role in the Chariot Absolute Return Currency Portfolio, a variable annuity trust ("VIT") developed by Gemini Fund Services, LLC during 2008 and 2009. The Division alleges that Mr. Shifman made false or misleading statements in two presentations made to the VIT's board during its approval of the investment management contract between the VIT and Chariot Advisors, LLC. The Division contends further that the prospectus drafted by the VIT's legal counsel and describing Chariot Advisors's proposed services for the VIT contained misrepresentations.

The Division's alleged misrepresentations fall into the following categories:

1. The Division contends that Chariot Advisors misrepresented its ability to implement its investment strategy, which the Division contends was to conduct algorithmic currency trading. [OIP Paragraphs c, d, 22, 24].
2. The Division contends that Chariot Advisors misrepresented that it would use an algorithm or "quantitative, proprietary trading models" to perform currency trading, and instead used an individual trader who was allowed to use discretion on trade selection and execution. [OIP Paragraphs e, f, 27, 30].

3. The Division contends that Chariot Advisors did not disclose to the VIT's board or investors the fact that it "did not have an algorithm or model capable of achieving" a "25% to 30% return." [OIP Paragraph 26].

None of these allegations has merit. Chariot Advisors had models consistent with what it described to the board and investors. Chariot Advisors never said it would use models in lieu of an individual trader, but rather, accurately stated that models would aid in the identification of trade selection. Finally, the Division's claim that Chariot Advisors failed to disclose it had no model capable of achieving a 25% to 30% return is a distorted view. Chariot Advisors never claimed or suggested to the board, an investor, or anyone else that it would achieve such a return.

As discussed more fully below, a careful review of the Division's contentions and the publicly available prospectus demonstrate that the Division's allegations should be dismissed. The documents and other evidence, moreover, will show that the statements made by Mr. Shifman and Chariot Advisors were in fact accurate and not misleading. They certainly never committed any "willful" violations, and they always acted in good faith with the best interests of investors in mind.

I. SUMMARY OF FACTS

A. Background

Sometime in the mid-2000s, representatives of Gemini approached Mr. Shifman and touted their ability to provide turn-key mutual fund product development. Mr. Shifman and the Gemini representatives had conversations on and off over several years about the possibility of creating a mutual fund or VIT.

In 2008, independent of his discussions with Gemini, Mr. Shifman formed a hedge fund adviser called Chariot Capital Management ("CCM") to manage the assets of a hedge fund called Chariot Absolute Return Fund, LP. CCM sought to profit from currency trading using a high-

frequency trading model developed and operated by a currency trading firm called Plimsoll Capital, LLC. Plimsoll describes itself as having "a proven track record in active currency management since 2002."[1] The hedge fund's offering occurred from summer 2008 until mid 2009, and it commenced trading in late January 2009 and trading ended July 31, 2009.

While raising capital for this hedge fund, Mr. Shifman decided to explore whether the hedge fund's trading strategy could be applied to a VIT, and he discussed this possibility with representatives of Gemini who arranged for him to present the idea to one of its boards for approval.

Mr. Shifman planned for a multi-strategy for the VIT, making allocations among different sub-signals similar to the sub-account version of the newly launched blend program Chariot was launching for the Vector Series Annuities. Mr. Shifman envisioned that Plimsoll's Armada program would be one of those sub-strategies at the time of the December 15, 2008 board meeting along with his own internally generated models.

Mr. Shifman gave Gemini's representatives the hedge fund's offering memorandum that made clear that one of the trading strategies anticipated to be used by the hedge fund belonged to Plimsoll.[2] Mr. Shifman also discussed this arrangement with Gemini's representatives in a call on October 20, 2008.[3] Gemini understood from the offering memorandum that models are constantly evolving because "trading approaches are continually changing, as are the markets."

In preparation for the board meeting, Gemini's counsel worked with Mr. Shifman to collect information about the intended operations of the proposed fund. Gemini's counsel, Thompson Hine, is a large, well-respected law firm that has substantial expertise in forming registered investment companies and in preparing the required disclosure documents, including

[1] See Respondents' Exhibit 59
[2] See Respondents' Exhibit 10
[3] See Respondents' Exhibit 11

the prospectus and registration statement. Mr. Shifman completed Thompson Hine's initial questionnaire on November 5, 2008, and then completed a second questionnaire on November 18, 2008. These documents reflect Mr. Shifman's concept for the VIT.

In the initial questionnaire submitted on November 5, 2008,[4] Mr. Shifman separately informed Gemini's representatives that he was contemplating entering a sub-advisor arrangement with Plimsoll, but he clarified that the arrangement was not finalized because the fee agreement had not yet been confirmed. His specific response on the questionnaire is as follows:

> *Question 20: What is the size of the Adviser's investment team, including research analysts, portfolio managers and trading personnel? What role will each of them play in managing the assets of the Fund? Who are the primary portfolio managers?*
>
> Response: Will be three people in total. I will be the investment manager. We may have a sub-advisor if the fee agreement can be worked out (he is currently a 20/2 hedge fund manager for us). We will hire a trading assistant for day to day operations (not sure on the date). I am the primary portfolio manager.

Mr. Shifman had subsequent conversations with Andrew Rogers on whether the VIT could invest directly into the Hedge Fund. Mr. Rogers confirmed that while the VIT could not invest directly in the Hedge Fund Shares, a similar strategy could be used.

Gemini's representatives conducted robust due diligence, including an on-site visit on December 5, 2008.[5]

B. December 15, 2008 Board Meeting

Gemini organized a board meeting for December 15, 2008. At this meeting, Mr. Shifman explained to the board that he wanted to form a variable investment trust using strategies similar to the CCM / Plimsoll currency trading strategy. Mr. Shifman's presentation borrowed heavily from the materials created by Plimsoll for the hedge fund. In fact, the presentation used CCM's name and logos throughout the presentation.

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[4] See Respondents' Exhibit 14a
[5] See Respondents' Exhibit 16

Gemini's counsel and other representatives attended this meeting. Everyone at the meeting knew that Chariot Advisors was a new advisor with no performance history. Mr. Shifman explained that "Chariot Advisors, LLC plans to launch a clone of its hedge fund product offered by Chariot Capital Management." He also explained that CCM, too, had not commenced actual trading, and that it expected to launch in March 2009.

At this point in time, Mr. Shifman expected the new VIT would eventually use a variety of strategies for selecting currency trades, and that it would begin with Plimsoll's high-frequency strategy and a model developed in-house at Mr. Shifman's direction. Anyone familiar with the securities markets understands, as Mr. Shifman understood, that model-based trading systems must be continually developed, implemented, modified, and sometimes abandoned because, as the market changes, any given model's profitability waxes and wanes.

In the currency market, as in others, one trader might identify a profitable trading strategy, but after some period of time, many other market participants are likely to identify the same strategy. Others who identify the same strategy will impact the market and therefore the profitability of the strategy. Consequently, profitable strategies may come and go. Adam Smith's classic text, *The Wealth of Nations*, described this phenomenon at length. As Smith put it, profits on a newly discovered business opportunity "are commonly at first very high. When the trade or practice becomes thoroughly established and well known, the competition reduces them to the level of other trades." Book I, Chapter X, Part I, p. 136 (tendency of the rate of profit to fall).

Mr. Shifman expected that once multiple models were identified and running, Chariot Advisors could add additional value by managing the relative application of these models based on their performance and perceived future profitability. Chariot Advisors was already

performing a similar allocation service for investors in annuities who utilized Chariot Advisors's sub-account allocation service. With this service, Chariot Advisors recommends how variable annuity investors allocate their investable funds among the annuity's available sub-accounts.

C. The Sale of Chariot Advisors, LLC and the May 2009 Board Meeting

A couple of weeks after the December 15, 2008 board meeting, Plimsoll informed Mr. Shifman that they intended to discontinue the high-frequency strategy because of market conditions and high costs.[6] Plimsoll told Mr. Shifman that their medium-frequency trading program, called Headwind, would remain available.[7] Plimsoll described Headwind as a currency trading strategy it has been successfully trading since May 2003.[8] At that time, Mr. Shifman continued to anticipate that the overall strategy would be a blend between an allocation among Chariot's own models, Plimsoll models and other external models he expected to evaluate for inclusion in the menu of sub-strategies.

Also after the December 2008 board meeting, Mr. Shifman decided to sell Chariot Advisors to a business colleague, Dana Gower. Mr. Gower had substantial experience in the financial services sector, including ten years as a personal financial advisor with major organizations.

Mr. Shifman notified Gemini that he expected to use a medium-frequency, rather than high-frequency, trading strategy. He also notified them that Mr. Gower would become the new owner. In light of the change in control, Gemini scheduled Mr. Shifman and Mr. Gower to attend another board meeting on May 29, 2009.

At this second board meeting, Mr. Shifman discussed his proposed transition to Mr. Gower. His presentation described the intended strategy of the VIT and, while similar to the

[6] See Respondents' Exhibit 60
[7] See Id.
[8] See Respondents' Exhibit 59

December 2008 presentation, it now indicated that it would be "medium-frequency" rather than "high-frequency." High-frequency trading almost certainly would have required computerized execution of trades, but humans or computers can execute trades for a medium-frequency trading strategy.

At this point in time, Mr. Shifman had negotiated an agreement with Randall DuRie, the owner of Plimsoll, to pay Plimsoll 50 basis points in exchange for access to its currency trading models.[9] Mr. Shifman continued to refine his existing internally generating trading models.

D. The VIT's Prospectus

Gemini's counsel began preparing a fund prospectus in late 2008. When it was filed, the prospectus contained representations consistent with Mr. Shifman's intentions for the VIT, and he therefore had no concerns about the prospectus. The prospectus accurately stated that the VIT's investment objective was "to achieve consistent positive absolute returns throughout various market cycles."[10] Mr. Shifman intended the absolute return fund to be a beneficial alternative for investors compared to stock and bond funds, which at the time were experiencing significant volatility. To achieve this objective, the VIT would employ these strategies:

- *investing primarily in short-term high quality fixed income securities; and*
- *engaging in proprietary foreign currency trading.*

In Mr. Shifman's opinion, these strategies matched his expectation for the VIT.

The prospectus provided more details about the currency trading strategy:

> *The Advisor will seek profits by forecasting short-term movements in exchange rates and changes in exchange rate volatility* ***aided by*** *quantitative models.*

(emphasis added).

[9] See Respondents' Exhibit 48
[10] See Respondents' Exhibit 47

By its own clear language, the prospectus describes how models would "aid" the adviser's identification of trading opportunities. The prospectus never stated that these models would be the exclusive means of identifying trading opportunities, and never stated that trading would occur through models, algorithms, or computers, as the Division seems to believe.

The prospectus further described these models that the adviser intended to use as an "aid" to forecasting, with the following disclosures:

- *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.*

These disclosures were consistent with how Chariot Advisors intended to trade (medium-frequency), and accurately described Mr. Shifman's expectation for how the adviser would attempt to identify trading opportunities. An early draft of the prospectus indicated that trading would be high-frequency, but this was changed when the strategy changed.

Based on the prospectus, investors in the VIT knew the VIT had no history of operations and that the adviser had not managed a mutual fund. Gemini's counsel made this clear with the following disclosures:

- *The Portfolio is a new mutual fund and has no history of operations. In addition, the Advisor has not previously managed a mutual fund.*
- *Because the Portfolio has not commenced investment operations, no performance information is available for the Portfolio at this time.*

The prospectus also warned investors about the risks associated with the proposed strategies with the following disclosures:

- *As with all mutual funds, there is the risk that you could lose money through your investment in the Portfolio. Although the Portfolio will seek to meet its investment objective, there is no assurance that it will do so.*

- *The Advisor's objective judgments, based on its investment strategy, about the attractiveness and potential appreciation of particular investments in which the Portfolio invests may prove to be incorrect and there is no guarantee that the Advisor's investment strategy will produce the desired results.*

In contrast to the Division's allegations, nothing in the prospectus states or suggests that either trade selection or trade execution will be conducted solely by computers without human involvement. In fact, the Respondents believed that a completely automated trading system would be inferior if not a breach of their duty to investors. There is always a need for human discretion, review, and supervision of any model based trading. Human monitoring and intervention is imperative for many issues that can arise in automated trading environments to deal with issues that computers might not be capable of handling, such as loss of connectivity to the internet, rejected trades, and evaluation of the suitable allocation among sub-strategies. Gemini's counsel drafted clear disclosures of the restrictions placed on the VIT's trading activity in a section prominently marked "INVESTMENT RESTRICTIONS." These restrictions were:

- *Borrowing Money. The Portfolio will not borrow money, except: (a) from a bank, provided that immediately after such borrowing there is an asset coverage of 300% for all borrowings of the Portfolio; or (b) from a bank or other persons for temporary purposes only, provided that such temporary borrowings are in an amount not exceeding 5% of the Portfolio's total assets at the time when the borrowing is made.*

- *Real Estate. The Portfolio will not purchase or sell real estate....*

- *Commodities. The Portfolio will not purchase or sell commodities....*

- *Loans. The Portfolio will not make loans to other persons....*

- *Concentration. The Portfolio will not invest 25% or more of its total assets in a particular industry or group of industries.... This limitation is not applicable to investments in obligations issued or guaranteed by the U.S. government, its agencies and instrumentalities or repurchase agreements with respect thereto.*

- *Margin Purchases. The Portfolio will not purchase securities or evidences of interest thereon on "margin...."*

- *Illiquid Investments. The Portfolio will not invest 15% or more of its net assets in securities for which there are legal or contractual restrictions on resale and other illiquid securities.*

None of these restrictions prohibited human trade selection or human trade execution.

The lead attorney at Thompson Hine was Joanne Strasser, who is well-regarded in the industry and has substantial experience in this area. Ms. Strasser had a long relationship with Gemini and the VIT's board. It is inconceivable that a prospectus prepared by someone of Ms. Strasser's stature and experience would be fraudulent.

After filing the initial draft of the prospectus, Gemini's counsel revised the prospectus to address comments raised by the SEC staff. Counsel filed the final version of the prospectus and registration statement on June 5, 2009.

E. Chariot Advisors sought additional trading strategies consistent with the prospectus and board presentations

As they approached the launch date for the VIT, Mr. Shifman continued his pursuit of additional trading strategies that could be employed by the hedge fund and the VIT. Throughout the first half of 2009, Mr. Shifman still planned to use Plimsoll's "Headwind" program run by Mr. DuRie in the hedge fund and evaluated it's inclusion in the VIT. In April 2009, Plimsoll added a trader named Ture Johnson who had developed a fully-automated trading model, meaning Mr. Johnson's computer program performed both trade selection and trade execution without human intervention. Mr. Shifman monitored the test performance of both the Headwind and Mr. Johnson's programs.

The evidence will show that in early May 2009, Mr. Shifman was preparing to allocate a portion of the VIT's assets to these two strategies. He discussed with the owner of Plimsoll providing both a manual trading interface for human trading (through a "GUI") for the Headwind strategy and an automated trading interface (through an "API") that would allow Mr. Johnson's automated program to execute currency trades.[11] Mr. Shifman understood that an API was needed because Mr. Johnson's program was fully automated. They also discussed how trading in the hedge fund would allow them to "work out some of the kinks" before they transitioned to the VIT. Mr. Shifman noted that he looked forward to launching the VIT on June 30, 2009.[12]

The evidence also will show that in early May 2009 Mr. Shifman intended to utilize multiple models, including those managed by Plimsoll as developed by Mr. Johnson, as well as an in-house model.[13]

In addition to making plans to use Plimsoll's trading models, Mr. Shifman paid a recruiter to find someone capable of developing additional models for Chariot Advisors. He used Huxley Associates, a well-known recruiter specializing in talent in this area. The recruiter recommended several candidates, including Lisa Xu. To Mr. Shifman, her resume suggested she was a perfect fit. Her resume described her experience in high-frequency trading design, trading system applications, trading software development, and indicated that she had been in charge of "algorithm system trading development" at "one of the world's largest hedge funds."[14]

In light of this experience, Mr. Shifman interviewed Ms. Xu. He decided that, among the candidates, she had the best background and skill set. She expressed interest in working for Chariot Advisors, and she told Mr. Shifman that she had a trading model that she could apply to

[11] See Respondents' Exhibit 34
[12] Id.
[13] See Respondents' Exhibit 35
[14] See Respondents' Exhibit 61

the currency market. Mr. Shifman proceeded cautiously by asking her to "paper" or test trade, meaning that he established an account that tracked hypothetical trading activity without actual trade execution. The results from Ms. Xu's test trading were promising.

Mr. Shifman retained a Duke University PhD candidate to evaluate trading model results. After reviewing the results of Ms. Xu's trading and Plimsoll's trading, the PhD candidate suggested they allocate substantially all of the VIT's currency trading assets to Ms. Xu's model because it appeared to be the most promising.[15]

Expecting he could automate Ms. Xu's model in order to expand the scope of trading activity, Mr. Shifman hired a programmer to code Ms. Xu's model. Mr. Shifman believed that a computer implementing Ms. Xu's model without human involvement would be able to generate profits nearly around the clock. Mr. Shifman also retained additional traders whom he expected could replicate Ms. Xu's model, and these traders began training on how to implement Ms. Xu's model. Mr. Shifman placed an ad to hire additional traders to implement Ms. Xu's model. The ad read "support a highly experienced FOREX trader".

Although Ms. Xu had touted her experience in high-frequency trading applications, Mr. Shifman made clear to Ms. Xu that he was pursuing a medium-frequency trading strategy, which could be implemented by human or computer, at that time.

On June 30, 2009, the registration statement went effective, and Mr. Shifman closed on the sale of Chariot Advisors, LLC to Mr. Gower.

F. The VIT Commences Trading

In July 2009, Chariot Advisors allocated assets to the VIT. Chariot Advisors commenced management of the VIT, and consistent with the prospectus, proceeded to invest primarily in short-term fixed-income securities. With respect to currency trading, and consistent with the

[15] See Respondents' Exhibit 62

prospectus, Chariot Advisors began trading using Ms. Xu's model. At the outset, Chariot Advisers took the extra precaution of allocating limited amounts of the VIT's $17 million to Ms. Xu's model. It did this to confirm that Ms. Xu's model worked as well with real money as it did with paper. Ms. Xu trained the assistant traders on her "algorithmic system". Several assistant traders were tested to ensure that they could follow Lisa's system. In Ms. Xu's powerpoint training presentation, Ms. Xu referred to her system as "Algorithmic indicators" for entry and exit. Ms. Xu touted the system as a way to "eliminate human emotions". Unfortunately, as Ms. Xu began trading with real money, her performance results were far less impressive as they had been on paper. As these performance problems surfaced, Mr. Shifman also learned that Ms. Xu had not relied solely on objective rules that could be coded by the programmer. Chariot Advisors stopped Ms. Xu's trading when it determined that she had misrepresented her trading approach.

Chariot Advisors and Mr. Shifman always acted appropriately and in the best interests of investors, but the Division attempts to portray Respondents' exemplary conduct as a violation. While Chariot Advisors was disappointed to learn that Ms. Xu had misrepresented her trading strategy, she did not trade in a manner that contradicted the prospectus because the prospectus does not prohibit human-based trading. Respondents terminated Ms. Xu, not because she violated the prospectus, but because they did not believe her strategy would be profitable in the real market. In addition, the Respondents acted with reasonable prudence: they took appropriate steps to identify a candidate who engaged in model-based trading, they vetted her strategy using test trades, they tested her strategy using a reasonable allocation of the VIT's assets to confirm the strategy would work in the real market while minimizing the amount of capital at risk.

As noted by the Division in the OIP, shortly after dismissing Ms. Xu, Chariot Advisors activated Plimsoll's trading model. The Division makes no allegations about Chariot Advisors's operations after this point in time.

II. RESPONSE TO THE DIVISION'S ALLEGATIONS THAT CHARIOT ADVISORS AND MR. SHIFMAN MADE MISREPRESENTATIONS

The Division alleges three categories of misrepresentations:

1. The Division contends that Chariot Advisors misrepresented its ability to implement its investment strategy, which the Division contends was to conduct algorithmic currency trading. [OIP Paragraphs c, d, 22, 24].
2. The Division contends that Chariot Advisors misrepresented that it would use an algorithm or "quantitative, proprietary trading models" to perform currency trading, and instead used an individual trader who was allowed to use discretion on trade selection and execution. [OIP Paragraphs e, f, 27, 30].
3. The Division contends that Chariot Advisors did not disclose to the VIT's board or investors the fact that it "did not have an algorithm or model capable of achieving" a "25% to 30% return." [OIP Paragraph 26].

By comparing the Division's contentions with the actual statements made in the board presentations and the prospectus and registration statement, it becomes clear that the Division's theory of liability rests entirely on a series of false premises that are inconsistent with the prospectus and other documents, and even inconsistent with some of the Division's other allegations.

A. Chariot Advisors Did Not Misrepresent Its Ability to Implement Its Strategy

The Division contends that the board presentations misrepresented Chariot Advisors's "ability to implement its investment strategy." [OIP Par. c]. The Division further contends that

the board presentations falsely claimed that Chariot Advisors had the ability to conduct "algorithmic trading." [OIP Par. c, 24]. The Division theorizes that this alleged claim was false because, it contends, Mr. Shifman "did not have an algorithm or model capable of conducting the currency trading that he described for the Chariot Fund." OIP Par. 22, 24.

The Division's theory that Chariot Advisors "did not have the ability to implement its investment strategy" is based on the false premise that its strategy was to "conduct algorithmic currency trading." The actual disclosures in the registration statement and prospectus accurately described the VIT's investment strategy. The prospectus told investors that the VIT would seek to profit from "investing primarily in short-term high quality fixed income securities" and "engaging in proprietary foreign currency trading." The VIT in fact engaged in these strategies.

The Division's theory that Chariot Advisors did not have the ability to conduct "algorithmic trading" also stands on a false premise that the models would execute trades. The prospectus in fact disclosed that Chariot Advisors would use models to "aid" its identification of trading opportunities. Chariot Advisors had models for this purpose. It had its own models, it had access to multiple third-party algorithms or models (e.g., Plimsoll), and before launching the VIT, it had Ms. Xu's model. Using any of these models would have been consistent with the representations made in the prospectus.

In pursuing its investment objectives, Chariot Advisors was not limited to the use of any particular kind of model, and in fact, could use any model it deemed appropriate so long as it did not violate the specific terms of the prospectus.

Not only did Chariot Advisors have its own model, it had negotiated access to others. Plus, many other firms offer models for trading, and Chariot Advisors could have selected

among any of them to implement its strategy. Chariot Advisors in fact evaluated many models, and used several, over the life of the VIT.

B. Chariot Advisors Made No Misrepresentations About Using an Individual Trader

The Division contends that, "after the Fund launched in July 2009, Chariot Advisors initially did not use an algorithm to perform the VIT's currency trading as represented to the VIT's Board, but instead hired an individual trader who was allowed to use discretion on trade selection and execution." OIP Par. e. The Division implies three problems in connection with using an individual trader. First, the Division implies that the prospectus prohibited trade selection by an individual. Second, the Division implies that the prospectus prohibited trade execution by an individual. Finally, the Division implies that the individual trader did not use an algorithm or model. Each of these implications is false.

First, nothing in the prospectus prohibited the VIT from using individuals to select trades. Rather, the prospectus said the adviser would "seek profits by forecasting short-term movements in exchange rates ... **aided by** quantitative models." (emphasis added). This representation simply reflects Chariot Advisor's intent that the models would "aid" in identifying profit opportunities.

Second, nothing in the prospectus stated that all trading or execution will be conducted by computers or machines. The prospectus does not speak to the method of execution. It does make clear that trading will be medium frequency, rather than high frequency, which is consistent with human rather than automated trading. The models did not, as the Division now implies, need to **trade** without human involvement. Moreover, in the November 5, 2008

questionnaire, Mr. Shifman informed Gemini's counsel of his intention to hire a trading assistant, which would be unnecessary if trading was to be exclusively automated or computerized.[16]

Finally, the Division's suggestion that the individual trader did not use an algorithm or model is belied by the Division's own allegations that she used a "technical analysis, rules-based approach." By definition, an "algorithm" is a "rules-based approach," and that is what Respondents understood she would employ. The evidence shows that Mr. Shifman understood Ms. Xu was using a model right up to the final days before she was terminated. For example, Mr. Shifman emailed the traders he hired to implement Ms. Xu's model, and he told them, "Obviously many of us are experiencing profitability issues with the model. Thank you for communicating back and forth with Lisa on your questions."[17] In response to concerns about profitability of the model, Mr. Shifman told the traders: "Starting tomorrow, please make $10,000 trades (both live and demo for consistency) until we can work out these issues. I am open to suggestions on possible filters that Lisa may be able to add to the model to better our results."[18]

If she also used "intuition," that would not make the prospectus false. The prospectus simply states that models will "aid" in identifying trading opportunities, and certainly does not preclude the use of "intuition." In addition, the Respondents do not dispute that they strove to "automate" as much of the currency trading as possible, both in trade selection and trade execution, but their preference for "automation" should not be mistaken as a representation to the board or investors that they would exclusively use "automation." The latter never occurred, and indeed, the board minutes and prospectus say otherwise.

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[16] See Respondents' Exhibit 14a
[17] See Respondents' Exhibit 63
[18] See Id.

Even assuming *arguendo* that using "intuition" in combination with the rules-based approach conflicted with the prospectus, neither Mr. Shifman nor Mr. Gower knew that Ms. Xu combined "intuition" into her approach when she was trading. Rather, they understood that she would be following a model, algorithm or formula for trading, and that it would involve objective criteria that other traders could replicate. Mr. Shifman acted consistently with this understanding when he hired two programmers to write computer source code that would automate Ms. Xu's algorithm. Mr. Shifman also hired other traders whom he expected to replicate Ms. Xu's trading model.

Mr. Shifman and Mr. Gower reasonably believed that Ms. Xu would be trading using a model, as she had represented, and they had no reason to believe she might also use intuition.

Furthermore, the Division's own allegations contend that within a couple months of launching, "Chariot Advisors employed a third party who utilized a computer algorithm to conduct currency trading on behalf of the Chariot Fund." [OIP Par. 31]. This allegation proves Chariot Advisors's ability to do what the Division contends it could not do. The Division deceptively skirts over the fact that the "third party" referenced in this Paragraph is the very same third party, Plimsoll / Mr. DuRie, that Mr. Shifman referenced in the first board presentation in December 2008.

In sum, the VIT could do and did do what it said it would do in the prospectus. Not only could it and did it seek profits by forecasting short-term movements in exchange rates and changes in exchange rate volatility, it could and did use models to aid its effort to seek such profits.

C. Chariot Advisors made no misrepresentations about returns

The Division contends that Chariot Advisors did not disclose to the board or investors in the VIT the fact that it did not have an algorithm or model capable of achieving a 25% to 30%

return. The Division deceptively creates the false impression in its allegations that Chariot Advisors claimed it could achieve such returns. No such claim ever occurred.

There were no representations in the prospectus that Chariot Advisors would achieve a "25% to 30% return" on currency trading (nor any other specific return). There was no document containing such a representation. There was no oral statement containing such a representation. Chariot Advisors never promised or even suggested to investors or the board that it could achieve any specific return on currency trading, much less a return that matched the S&P 500.

Indeed, the only representation about returns is a statement in the prospectus that the adviser would "seek" to achieve "positive absolute returns." This representation stands in stark contrast to the Division's claim that Chariot Advisors claimed a 25% to 30% return. Even in stating the adviser would seek positive absolute returns, the prospectus made very clear that it could provide no assurance it would meet this objective and it also warned investors they could lose money.

The Division theorizes that selecting the S&P 500 as a benchmark implied a representation that the fund would meet or exceed the benchmark. That certainly was not Mr. Shifman's intention, it was not Gemini's understanding, and the prospectus does not claim or suggest anything of the sort. In fact, as Gemini was developing the VIT, Mr. Shifman asked Gemini's representatives whether there was a more appropriate benchmark. Gemini did not believe a different benchmark should be used, and rather, agreed that the S&P 500 was acceptable. Not Gemini, not Gemini's counsel, and not Gemini's board interpreted the selection of the S&P 500 as a benchmark the same way the Division has done. Indeed, as experienced investment professionals, they knew well that Chariot Advisors was not promising such returns.

In the end, the Respondents' actions were at all times designed to benefit investors. At each step of the way, they proceeded in good faith and with investors' interests in mind. They hired lawyers, compliance specialists, and a leading fund formation consulting outfit. They spent considerable time and money vetting the various trading models they considered, and Mr. Shifman personally lost a large sum of money on his efforts to launch the VIT. Chariot Advisors implemented a fee waiver during the first year of the VIT. They commenced trading with only a small amount of the VIT's capital. Due to their cautious approach, the VIT lost less than 0.16% on the $17 million fund from currency trading during this period. To put this in perspective, an investment of $1,000 only lost $1.60.

They terminated Ms. Xu when they learned that her trading failed to conform to her representations to them. These actions reflect the Respondents' good faith efforts to do what was best for investors and to comply with the applicable laws and regulations.

III. LEGAL ANALYSIS

The relief requested by the Division should be denied in its entirety. No underlying violations occurred, and there is absolutely no basis for the Division's claim of "willful" violations, or "aiding and abetting" violations. In the end, the Division's theories fail because they are simply a house of cards built on false premises and lacking any evidentiary foundation or support.

A. Respondents did not violate the Investment Advisers Act

The Division asserts claims against Chariot Advisors under §§ 206(1) and 206(2) of the Advisers Act, which make it unlawful for an investment adviser to use interstate commerce directly or indirectly, "to employ any device, scheme, or artifice to defraud" a "client" or "prospective client" or "to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

Courts have interpreted § 206 to require the same substantive elements as a claim under § 17(a) of the Securities Act. *See SEC v. Pimco Advisers Fund Mgmt. LLC*, 341 F. Supp. 2d 454, 470 (S.D.N.Y. 2004). Thus, to make out a violation of § 206, the Division must prove that an investment adviser made a material misrepresentation or materially misleading omission. *See, e.g., Vernazza v. SEC*, 327 F.3d 851, 858 (9th Cir. 2003); *SEC v. Lauer*, No. 03-80612-CIV-Johnson 2008 WL 4372896, at *24 (S.D. Fla. Sept. 24, 2008), *aff'd*, 478 F. App'x 550 (11th Cir.), cert. denied, 133 S.Ct. 545 (2012).

A fact is material only if there is a substantial likelihood that a reasonable investor in making an investment decision would consider it as having significantly altered the total mix of information available. *Basic Inc.*, 485 U.S. at 224, 231-32 (1988).

Further, with respect to claims under § 206(2) of the Advisers Act, the Division must prove that the respondent acted negligently. *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963) (scienter not required under § 206(2)). And under § 206(1), the Division must prove that the defendant acted with scienter. *See Messer v. E.F. Hutton & Co.*, 847 F.2d 673, 677-78 (11th Cir. 1988) (citing *Steadman v. SEC*, 603 F.2d 1126, 1134 (5th Cir. 1979)). This means that the Division must establish that respondents acted with "an intent . . . to deceive, manipulate, or defraud." *Aaron v. SEC*, 446 U.S. 680, 686 (1980). Severe recklessness may constitute scienter but "is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1282 n.18 (11th Cir. 1999).

Rule 206(4)-8 became effective on September 10, 2007, and prohibits investment advisers to pooled investment vehicles from (1) making false or misleading statements to investors or prospective investors in those pools or (2) otherwise defrauding those investors or prospective investors. Its scope was modeled on §§ 206(1) and (2) of the Investment Advisers Act, and as such, it should be read to be coextensive with those sections of the Advisers Act. *See* SEC Release No. 2628, 2007 WL 2239114, at *4 (Aug. 3, 2007) (noting that "[a]dvisers to pooled investment vehicles attentive to their traditional compliance responsibilities will not need to alter their communications with investors" in response to the SEC's adoption of Rule 206(4)-8).

There simply were no misrepresentations in this case, and certainly no material misrepresentations. The board received a very high level description of what Chariot Advisors and Mr. Shifman expected the VIT would do. To the extent the Division intends to argue that the board did not know all the facts, the board's agents certainly knew the details, and it is well established that disclosure to an agent is imputed to a principal. *See Mut. Life Ins. Co. of N.Y. v. Hilton-Green*, 241 U.S. 613, 622 (1916) ("The general rule which imputes an agent's knowledge to the principal is well established. The underlying reason for it is that an innocent third party may properly presume the agent will perform his duty and report all facts which affect the principal's interest.").

B. Respondents did not violate the Investment Company Act

Section 15(c) of the Investment Company Act makes it the duty of an investment adviser to a registered investment company to furnish such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser to such company.

Chariot Advisors complied with its obligations to furnish the information requested by the board in connection with its evaluation of the contract between Chariot Advisors and the VIT. The responses to the board's questions were accurate and provided the board the information it sought in its evaluation of the contract.

Section 34(b) of the Investment Company Act makes it unlawful for any person to make any untrue statement of a material fact in any registration statement, or other document filed or transmitted pursuant to the Investment Company Act, or for any person so filing or transmitting to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading.

As discussed at length above, the registration statement filed on behalf of the VIT accurately described how Chariot Advisors intended to manage the VIT, and how it in fact traded the VIT's assets.

There simply was no violation of these provisions of the Investment Company Act.

C. Mr. Shifman did not aid or abet or cause any alleged violation.

The Division claims that Mr. Shifman aided and abetted or caused Chariot Advisors's alleged violations of §§ 206(1) and (2) of the Advisers Act and §§ 15(c) and 34(b) of the Investment Company Act. To make out a claim for aiding and abetting, the Division must prove three elements: (1) a primary securities law violation, (2) knowledge, or recklessness in not knowing, that the respondents' role was part of an overall activity that was improper or illegal, and (3) knowing and substantial assistance in the achievement of the primary violation. *See, e.g., Graham v. SEC*, 222 F.3d 994, 1000 (D.C. Cir. 2000); *IIT, an Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980).

Similarly, three elements must be established for "causing" claim: (1) a primary securities law violation, (2) that the respondent "knew, or should have known, that his conduct

would contribute to the violation," and (3) "an act or omission by the respondent that was a cause of the violation." *In the Matter of Daniel Bogar*, Admin. Proc. File No. 3-15003, Release No. 502, 2013 WL 3963608, at *20 (Aug. 2, 2013). The Division's claims for aiding and abetting and for causing fail.

The first element in both an aiding and abetting claim and a causing claim is that there is a primary violation of the Advisers Act. As discussed above, there was no primary violation by Chariot Advisors. Without a primary violation, no claim for aiding and abetting or causing can stand against Mr. Shifman.

The second element in an aiding and abetting claim is that the respondent had knowledge, or was reckless in not knowing, that his role was part of an overall activity that was improper or illegal. While recklessness may satisfy the intent requirement, to show recklessness, the Division must prove that Mr. Shifman "encountered 'red flags,' or 'suspicious events creating reasons for doubt' that should have alerted [him] to the improper conduct of the primary violator," or there was a danger so obvious that they must have been aware of it. *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004). Similarly, for a causing claim, the Division must prove that the respondent knew or should have known that his conduct contributed to the primary violation. With respect to primary violations alleged under § 206(1), the Division must prove scienter—negligence is not sufficient. *In the Matter of Daniel Bogar*, 2013 WL 3963608, at *20.

Finally, for aiding and abetting, the Division must prove knowing and substantial assistance in the primary violation. Mere awareness and approval of the primary violation are insufficient to prove the element. *Armstrong v. McAlpin*, 699 F.2d 79, 92 (2d Cir. 1983). And inaction on the part of an aider and abettor is not sufficient to satisfy this prong of the standard unless "it was designed intentionally to aid the primary fraud or it was in conscious and reckless

violation of a duty to act." *Id.* at 91. Similarly, for causing liability, the Division must prove that the respondent's action or inaction was actually the cause of the violation.

The Division simply cannot prove these elements. Mr. Shifman acted reasonably in the circumstances and not with knowledge of any improper or illegal activity, and he did not provide any substantial assistance to any violations.

IV. THE DIVISION'S REQUESTED RELIEF SHOULD BE DENIED

A. A cease-and-desist order is inappropriate.

The Division bears the burden of proving that a C&D order is appropriate. *See Steadman v. SEC*, 603 F.2d 1126, 1137–40 (5th Cir. 1979). The Commission must consider the following factors: (1) "the egregiousness of the defendant's actions," (2) "the isolated or recurrent nature of the infraction," (3) "the degree of scienter involved," (4) "the sincerity of the defendant's assurances against future violations;" (5) "the defendant's recognition of the wrongful nature of his conduct," and (6) "the likelihood that the defendant's occupation will present opportunities for future violations." *Steadman*, 603 F.2d at 1140; *In the Matter of David F. Bandimere & John O. Young*, Release No. 507, Administrative Proceeding File No. 3-151214, 2013 WL 5553898, at *78 (Oct. 8, 2013). In addition to the *Steadman* factors, the Commission is to consider "the recency of the violation, the resulting harm to investors in the marketplace, and the effect of other sanctions." *Bandimere*, 2013 WL 5553898, at *78.

None of these factors supports a conclusion that a cease and desist order against Chariot Advisors or Mr. Shifman is in the public interest, and therefore such a sanction should not be imposed here.

B. Disgorgement is not appropriate

Disgorgement is also an inappropriate remedy under the facts presented here. "Disgorgement is an equitable remedy designed to deprive [respondents] of all gains flowing

from their wrong." *SEC v. AMX, Int'l, Inc.*, 872 F. Supp. 1541, 1544 (N.D. Tex. 1994) (citations omitted). Essentially, violators are returned to the position in which they "would have been absent the misconduct." *In the Matter of OptionsXpress, Inc., Thomas E. Stern & Jonathan I. Feldman*, SEC Release No. 490, 2013 WL 2471113, at *82 (June 7, 2013) (Murray, C.A.L.J.).

Disgorgement is inappropriate when a person has nothing to disgorge, as is the case here. Chariot Advisors received only the fees called for by the prospectus, and those fees were not increased or inflated as a result of any misstatement or other misconduct. Indeed, Chariot Advisors implemented a fee waiver during the first year. Mr. Shifman did not receive any ill-gotten gains, and in fact, he lost money in his efforts to convert Ms. Xu's trading model to a fully-automated computer program. Therefore, there was no improper windfall from the alleged violations. There is nothing to disgorge, and this remedy should be dismissed. *See SEC v. Berry*, 2008 WL 4065865, at *10 (N.D. Cal. Aug. 27, 2008) (striking prayer for disgorgement when the "defendant has not been unjustly enriched and there is nothing for her to disgorge.").

C. Penalties are not appropriate

Factors to consider in assessing whether a penalty is in the public interest include the following:

> (A) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;
>
> (B) the harm to other persons resulting either directly or indirectly from such act or omission;
>
> (C) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior;
>
> (D) whether such person previously has been found to have violated securities laws; and
>
> (E) the need to deter such person and other persons from committing such acts or omissions.

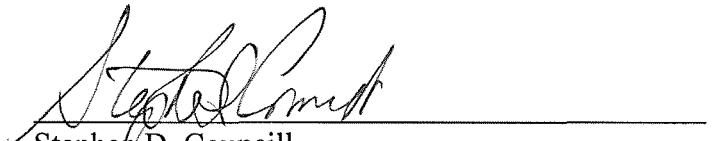
See, e.g., Advisers Act Section 203.

Each of these factors argues against the imposition of a penalty. The Respondents' conduct did not involve fraud or deceit. There was no harm to investors or others. Neither Respondent was unjustly enriched. Neither Respondent is a recidivist. There simply is no need to deter any future acts or commissions. Finally, Chariot Advisors has already suffered negatively from the institution of this proceeding, and it cannot bear the cost of a monetary sanction.

V. CONCLUSION

For the reasons set forth above, Respondents respectfully requests that the Court find in favor of the Respondents. Neither Chariot Advisors nor Mr. Shifman made any misrepresentations to the board or investors, nor did they fail to disclose any material information. They at all times acted in what they believed to be the best interests of investors. Everything they did was prudent, reasonable, and in complete compliance with the prospectus. The evidence simply does not support a finding of any violation by either Respondent, and the remedies sought by the Division are not warranted.

This 24th day of January, 2014.



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