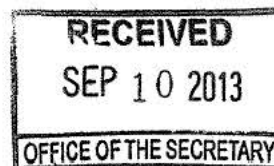


UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15433



In the Matter of

CHARIOT ADVISORS, LLC

and

ELLIOTT L. SHIFMAN,

Respondents.

ANSWER OF RESPONDENTS

Pursuant to Rule 220 of the SEC's Rules of Practice, Respondents hereby respond to the allegations of the Division of Enforcement in this matter as follows:

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].

Each of these allegations is completely inaccurate. 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 on the pleadings for failure to state a claim. 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, L.P. 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 in late 2008 and early 2009, and it commenced trading in March 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 gave Gemini’s representatives the hedge fund’s offering memorandum that made clear that the trading strategy 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 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?

¹ See Exhibit “A” (company description, available at <http://www.plimsollcapital.com/company.html>)

² See Exhibit “B” (October 20, 2008 email chain in which Mr. Shifman directs his staff to forward offering memorandum to Gemini).

³ See Exhibit “C” (October 20, 2008 email confirming conference call).

⁴ See Exhibit “D” (November 5, 2008 email exchange and questionnaire reflecting plans for sub-advisor arrangement).

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.

Gemini's representatives conducted an on-site due diligence 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 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.

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

⁵ See Exhibit "E" (November 21, 2008 email exchange discussing due diligence visit).

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 describes Headwind as a currency trading strategy it has been successfully trading since May 2003.⁸

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 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.

⁶ See Exhibit “F” (December 30, 2008 email from Randy DuRie to Mr. Shifman regarding closing high-frequency model and continuing Headwind program).

⁷ See Id.

⁸ See Exhibit A (Plimsoll company description).

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

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).

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.

⁹ See Exhibit "G" (July 5, 2009 email chain in which Mr. Shifman notes that the owner of Plimsoll "agreed months ago to accepting 50 bp on the fund....").

¹⁰ See Chariot Absolute Return Currency Portfolio Prospectus, available at <http://www.sec.gov/Archives/edgar/data/1352621/000091047209000419/nlvtcoverpage.htm>.

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. 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 considers additional trading strategies

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 both the hedge fund and 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

¹¹ See Exhibit "H" (May 7, 2009 email from Mr. Shifman to Randy DuRie).

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 Mr. DuRie, 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 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 all of the trading models being considered by Chariot Advisors at that time. After reviewing the results of Ms. Xu's trading, Mr. DuRie's trading, and others, 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.

¹² Id.

¹³ See Exhibit "I" (May 7, 2009 email from Mr. Shifman to a representative of Integral, the FX network interface provider).

¹⁴ See Exhibit "J" (Resume of Lisa Xu).

¹⁵ See Exhibit "K" (July 28, 2009 email from Kai Mao to Mr. Shifman recommending that he "allocate around 90%" to Ms. Xu's model)

Xu's model, and these traders began training on how to implement Ms. Xu's model.

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 trading using Ms. Xu's model. At the outset, Chariot Advisors 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. 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 trade. 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 model, it had access to multiple third-party algorithms or models (e.g., DuRie, Johnson), 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."

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.

¹⁶ See Exhibit "D" (November 5, 2008 email exchange and questionnaire reflecting possible plans to hire a trading assistant).

¹⁷ See Exhibit "L" (September 30, 2009 email from Mr. Shifman to traders).

¹⁸ See *Id.*

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. 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.

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.

III. SPECIFIC RESPONSES TO THE DIVISION'S ALLEGATIONS

Pursuant to Rule 220, Respondents respond to each of the Division's particular allegations as follows:

Paragraph (a): This proceeding relates to certain misrepresentations and omissions of material fact about a proposed investment strategy made by a registered investment adviser, Chariot Advisors, and its control person, Elliott L. Shifman, in connection with the process under Section 15(c) of the Investment

Company Act by which Chariot Advisors obtained the approval to be the investment adviser of a registered fund, the Chariot Absolute Return Currency Portfolio (the "Chariot Fund" or "Fund").

Response to Paragraph (a):

Respondents admit that Chariot Advisors was a registered investment adviser, and that Mr. Shifman controlled Chariot Advisors during part of the relevant period. Respondents deny the remaining allegations, and particularly deny that Chariot Advisors made misrepresentations and omissions of material fact about a proposed investment strategy.

Paragraph (b): *Under Section 15(c) of the Investment Company Act, a registered fund's board of directors is required annually to evaluate and approve the fund's advisory agreement, and the fund's adviser is required initially, and thereafter annually, to provide the board with information reasonably necessary to make that evaluation (hereafter, the "15(c) process").*

Response to Paragraph (b):

Respondents admit this Paragraph.

Paragraph (c): *In December 2008 and again in May 2009, during the Chariot Fund's 15(c) process, Shifman, acting on behalf of Chariot Advisors, misrepresented Chariot Advisors's ability to implement the investment strategy Chariot Advisors proposed for the Chariot Fund—namely Chariot Advisors's ability to conduct algorithmic currency trading—and, as a result, misled the Fund's board about the nature, extent, and quality of services that Chariot Advisors could provide.*

Response to Paragraph (c):

Respondents deny this Paragraph in its entirety.

Paragraph (d): *In fact, at the time of Shifman's representations to the Board, Chariot Advisors had not devised or otherwise possessed any algorithms or computer models capable of engaging in the currency trading that Shifman described during the 15(c) process.*

Response to Paragraph (d):

Respondents deny this Paragraph in its entirety.

Paragraph (e): *Moreover, after the Fund launched in July 2009, Chariot Advisors initially did not use an algorithm to perform the Fund's currency trading as represented to the Fund's Board, but instead hired an individual trader who was allowed to use discretion on trade selection and execution.*

Response to Paragraph (e):

Respondents admit that the Fund launched in July 2009 and that it hired an individual trader. Respondents deny the remaining allegations in this Paragraph.

Paragraph (f): *Respondents' misconduct also led directly to misrepresentations and omissions in the Chariot Fund's registration statement and prospectus filed with the Commission.*

Response to Paragraph (f):

Respondents deny this Paragraph in its entirety.

Paragraph (g): *As a result, Respondents violated Sections 15(c) and 34(b) of the Investment Company Act, and Sections 206(1) and 206(2) of the Advisers Act, and Chariot Advisors violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.*

Response to Paragraph (g):

Respondents deny this Paragraph in its entirety.

RESPONDENTS

Paragraph 1. *Chariot Advisors has been registered with the Commission as an investment adviser since September 2008. Between July 2009 and August 2011, Chariot Advisors was the investment adviser to the Chariot Fund, a registered open-end investment company, which was a series of the Northern Lights Variable Trust ("Northern Lights"). Chariot Advisors is based in Cary, North Carolina.*

Response to Paragraph 1:

Respondents admit this Paragraph.

Paragraph 2. *Elliott L. Shifman was the sole owner and operator of Chariot Advisors from its founding in September 2008 until June 30, 2009. 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 resells investment signals. He is a registered representative associated with Summit Alliance Securities, LLC ("Summit Alliance"), a registered broker-dealer, and holds Series 6 and 63 licenses. Shifman, 48 years of age, is a resident of Raleigh, North Carolina.

Response to Paragraph 2:

Respondents admit this Paragraph.

OTHER RELEVANT ENTITIES

Paragraph 3. *Northern Lights is registered with the Commission as an open-end series management investment company. Organized as a Delaware statutory trust headquartered in Omaha, Nebraska, Northern Lights serves as an umbrella to a series of registered funds, 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.*

Response to Paragraph 3:

Respondents admit this Paragraph.

Paragraph 4. *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.*

Response to Paragraph 4:

Mr. Shifman admits this Paragraph. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

FORMATION OF CHARIOT ADVISORS

Paragraph 5. *In 2006, Shifman developed for Midland National Life Insurance Company ("Midland") two variable annuities, called the Vector I and II, which he sold to investors through Outer Banks and Summit Alliance. Each Vector series allowed annuitants to invest their principal in various sub-accounts.*

Response to Paragraph 5:

Mr. Shifman admits this Paragraph. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 6. In September 2008, Shifman founded Chariot Advisors as a registered investment adviser. Thereafter, Chariot Advisors offered Vector annuity investors various risk-based models that allocated invested funds among the various sub-accounts. Chariot Advisors developed these models by combining trading signals that it purchased from several independent technical analysts.

Response to Paragraph 6:

Respondents admit this Paragraph.

Paragraph 7. Shortly after founding Chariot Advisors, Shifman began developing the Chariot Fund as a mutual fund that would be offered to investors in the Vector I and II variable annuities.

Response to Paragraph 7:

Mr. Shifman admits that the Chariot Fund was a mutual fund that would be offered to investors in the Vector I and II variable annuities, but denies the remaining allegations in this Paragraph. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 8. Chariot Fund's initial investment objective was to achieve absolute positive returns in all market cycles 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 under management to engage in algorithmic currency trading.

Response to Paragraph 8:

Mr. Shifman denies this Paragraph. The prospectus described the investment objective as follows: "The Portfolio seeks to achieve consistent positive absolute returns throughout various market cycles. The Portfolio's investment objective is a non-fundamental policy and may be changed by the Portfolio's Board of Trustees without a shareholder vote." This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

CREATION OF THE CHARIOT FUND

Paragraph 9. *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 Advisors as the new Fund's adviser.*

Response to Paragraph 9:

Respondents admit that Mr. Shifman asked the Northern Lights board to approve an investment advisory agreement between Chariot Advisors and Chariot Fund, but deny the remaining allegations in this Paragraph.

Paragraph 10. *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 investing the remaining 80% invested in fixed income securities.*

Response to Paragraph 10:

Mr. Shifman admits that on November 5, 2008, he emailed "a rough draft of the answers that the law firm asked," and that in response to the law firm's question, "How is the initial universe of securities in which the Fund may invest created?", Mr. Shifman responded: "Cash first. Then invest in currency. Deposit 20% of account at the prime broker, keep the remaining (80%) in fixed income at the custodian." Mr. Shifman states further that the questionnaire is a document that speaks for itself, and otherwise denies any remaining allegations of this Paragraph. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 11. *On November 13, 2008, counsel for the Board of Northern Lights ("Board") requested in a letter 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.*

Response to Paragraph 11:

Mr. Shifman admits the allegations in this Paragraph. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 12. *In connection with this request, counsel for the Board told Shifman that this information was needed pursuant to Section 15(c) of the*

Investment Company Act, which required that the Board request, and that Chariot Advisors provide, all information that is reasonably necessary in connection with the decision to approve the advisory agreement between Chariot Advisors and the Chariot Fund.

Response to Paragraph 12:

Mr. Shifman admits this Paragraph. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 13. *Shifman responded to the Board in writing and prepared a PowerPoint presentation, which he made to the Board at its December 15, 2008 meeting. 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." Shifman also indicated that an appropriate benchmark for the new fund's performance would be the S&P 500 Index.*

Response to Paragraph 13:

Mr. Shifman admits the allegations in this Paragraph except as to the last sentence. Mr. Shifman states that he asked counsel whether there was a compelling reason to use a benchmark other than the S&P 500, and that additional conversations about the appropriate benchmark occurred after the date of this questionnaire and before the prospectus became effective. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 14. *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.*

Response to Paragraph 14:

Mr. Shifman admits that he responded to the Board in writing and prepared a PowerPoint presentation, which he made to the Board at its December 15, 2008 meeting, but denies the remaining allegations in this Paragraph, particularly to the extent it mischaracterizes the presentation. Mr. Shifman states further that the presentation stated: "Chariot Advisors, LLC plans to launch a clone of it [sic]

hedge fund product offered by Chariot Capital Management in March 2009. The product will be a currency overlay product and called Chariot Absolute Return Currency Fund. Adding 'alpha' by trading a similar algorithm designed for Chariot Capital Management." This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 15. 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."

Response to Paragraph 15:

Mr. Shifman denies this Paragraph, and states that the presentation stated: "The Chariot Absolute Return Fund is a byproduct of extensive research of recent changes in FX market structure due to the adaptation of algorithmic and high-frequency trading." This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 16. The PowerPoint then listed bullet points describing what Shifman described as "competitive" features of the Fund based on its use of algorithmic trading. These included, among others: "(i) High Frequency Algorithmic Trading enables [Chariot Advisors] to seek out untapped sources of alpha while controlling drawdowns; (ii) Algorithmic trading models allow 24/5.5 access to the markets extending trading opportunities and minimizing emotions associated with non-systematic trading; (iii) Dynamic strategy model automatically adjusts trading behavior of sub-strategies to exploit current market conditions and volatility; and (iv) Intelligent execution Logic ensures best execution with minimum slippage." In return for these services, Shifman proposed that Chariot Advisors charge the Chariot Fund a 1.00% advisory fee on assets under management, plus a 0.60% distribution fee.

Response to Paragraph 16:

Mr. Shifman states that the PowerPoint is a writing that speaks for itself and must be read in its entirety and in context, and denies any allegations contained in this Paragraph to the extent they are inconsistent with the PowerPoint. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 17. Board records of its December 15, 2008 meeting confirm that Shifman's representations in person before the Board were substantially

similar to what he set forth in both the December 15(c) submission and his PowerPoint presentation. Those records indicate, among other things, that Shifman told the Board that the investment objective of the Chariot Fund is to seek consistent positive absolute returns through various market cycles and that Chariot Advisors would achieve this investment objective through two complementary strategies, namely, by investing primarily in short-term high quality fixed income securities and by engaging in proprietary foreign currency arbitrage. According to the Board records, Shifman represented that Chariot Advisors's currency trading strategy involves a computer model and algorithm that permit Chariot to make split-second trades and take advantage of currency arbitrage opportunities.

Response to Paragraph 17:

Mr. Shifman lacks knowledge and information sufficient to form a belief as to the truth of the allegations in this Paragraph, and therefore denies the same. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

Paragraph 18. Following Shifman's presentation, the Board approved the Chariot Fund as a series of Northern Lights. It further concluded that Chariot Advisors's proposed management fee was acceptable in light of the quality of the services the Chariot Fund expected to receive from Chariot Advisors, and consequently approved the Fund's advisory agreement with Chariot Advisors.

Response to Paragraph 18:

Mr. Shifman admits this Paragraph. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

TRANSFER OF CHARIOT ADVISORS

Paragraph 19. After the Northern Lights Board approved the Chariot Fund and its advisory agreement with Chariot Advisors but before the Fund launched, Shifman took steps to sell Chariot Advisors. On May 18, 2009, Shifman entered an agreement to transfer ownership of Chariot Advisors, effective June 30, 2009.

Response to Paragraph 19:

Respondents admit that Mr. Shifman took steps to sell Chariot Advisors and that he entered an agreement to transfer ownership of Chariot Advisors on May 18,

2009 effective June 30, 2009, but lacks knowledge and information sufficient to form a belief as to the truth of the remaining allegations in this Paragraph, and therefore denies the same.

Paragraph 20. *The pending change of control of Chariot Advisors prompted the Board to reconsider Chariot Advisors's advisory contract with the Fund. At the Board's request, Shifman made a second 15(c) submission on May 26, 2009.*

Response to Paragraph 20:

Respondents admit this Paragraph.

Paragraph 21. *The second 15(c) submission contained essentially the same claims about Chariot Advisors 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 Advisors charge the Fund a 1.50% advisory fee on assets under management and a 0.40% distribution fee, justifying the increase in the advisory fee by representing that the Fund's investment strategy required more work to implement than he had earlier anticipated. Additionally, the second 15(c) submission explained that, with the change of control of Chariot Advisors, the new owner rather than Shifman would operate Chariot Advisors and manage the Fund.*

Response to Paragraph 21:

Respondents state that the second 15(c) submission is a writing that speaks for itself and must be read in its entirety and in context, and denies any allegations contained in this Paragraph to the extent they are inconsistent with that document.

Paragraph 22. *With the second 15(c) submission, Chariot Advisors 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 be advised by Chariot Advisors and have the same investment strategy as the Chariot Fund. The proposed prospectus also 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.

Response to Paragraph 22:

Respondents deny this Paragraph except to state that the quoted language is for the Fund's prospectus. Respondents further respond by stating that the prospectus is a writing that speaks for itself and must be read in its entirety and in context, and denies any allegations contained in this Paragraph to the extent they are inconsistent with those documents.

Paragraph 23. *As part of the second 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.*

Response to Paragraph 23:

Mr. Shifman admits that in May 2009 he prepared and presented a presentation similar to but different from the presentation used at the December 2008 board meeting. Mr. Shifman denies the remaining allegations in this Paragraph. Mr. Shifman states further that the presentations are writings that speak for themselves and must be read in their entirety and in context, and denies any allegations contained in this Paragraph to the extent they are inconsistent with those documents. This Paragraph does not relate to Chariot Advisors, and it therefore neither admits nor denies this Paragraph.

MISREPRESENTATIONS

Paragraph 24. *Contrary to what Shifman told the Board, Chariot Advisors did not have an algorithm or model capable of conducting the currency trading that he described for the Chariot Fund.*

Response to Paragraph 24:

Respondents deny this Paragraph in its entirety.

Paragraph 25. *The ability to conduct currency trading for the Chariot Fund was particularly significant for the Fund's performance because, in the absence of an operating history by which to judge the Fund's performance, the Board focused instead on Chariot Advisors's reliance on models in evaluating the advisory contract.*

Response to Paragraph 25:

Respondents lack knowledge and information sufficient to form a belief as to the truth of the allegations in this Paragraph, and therefore deny the same.

Paragraph 26. *The Chariot Fund's ability to conduct currency trading was also important because the Fund's performance was benchmarked to the S&P 500 Index. Shifman 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 meant that the Fund's currency trading needed to achieve 25% to 30% return. That Chariot Advisors did not have an algorithm or model capable of achieving such a return was never disclosed to the Board or investors in the Fund.*

Response to Paragraph 26:

Respondents deny this Paragraph in its entirety.

Paragraph 27. *On June 5, 2009, the Chariot Fund filed with the Commission a registration statement and prospectus on Form N-1A that contained Shifman's claims among other things, that 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.

Response to Paragraph 27:

Respondents admit that the Chariot Fund filed with the Commission a registration statement and prospectus on Form N-1A, but deny the Division's characterization of the language in the registration statement and prospectus. Respondents state further that the registration statement and prospectus are writings that speak for themselves and must be read in their entirety and in context, and deny any allegations contained in this Paragraph to the extent they are inconsistent with those documents.

Paragraph 28. *The registration statement and prospectus were prepared and filed based on information provided by Shifman, who reviewed the registration statement and prospectus before they were filed with the Commission. On June 30, 2009, the Chariot Fund's Registration Statement and Prospectus became effective. Also on June 30, 2009, Chariot legally changed ownership to its new owner.*

Response to Paragraph 28:

Respondents admit that Mr. Shifman reviewed the prospectus. Respondents further admit that on June 30, 2009, the Chariot Fund's Registration Statement and Prospectus became effective. Also on June 30, 2009, Chariot legally changed ownership to its new owner. Respondents deny the remaining allegations contained in this Paragraph.

Paragraph 29. *On July 15, 2009, the Chariot Fund was launched. Chariot Advisors funded the Chariot Fund by reallocating approximately \$17 million in assets in clients' annuities to the Fund, which was a sub-account on Midland's variable annuity platform.*

Response to Paragraph 29:

Respondents admit this Paragraph.

Paragraph 30. *Because Chariot Advisors 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 an individual trader who was not using an algorithm. Shifman had interviewed the trader prior to her being hired and knew that, for trading, she used a technical analysis, rules-based approach that combined a few market indicators with her own intuition.*

Response to Paragraph 30:

Respondents deny this Paragraph.

Paragraph 31. *The trader traded currencies for the Fund until September 30, 2009 when she was terminated due to poor trading performance. Subsequently, Chariot Advisors employed a third party who utilized a computer algorithm to conduct currency trading on behalf of the Chariot Fund.*

Response to Paragraph 31:

Respondents admit this Paragraph.

VIOLATIONS

Paragraph 32. *As a result of the conduct described above, Chariot Advisors willfully violated Section 15(c) of the Investment Company Act, which 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.*

Response to Paragraph 32:

Respondents deny this Paragraph.

Paragraph 33. *As a result of the conduct described above, Shifman willfully aided and abetted and caused Chariot Advisors's violations of Section 15(c) of the Investment Company Act.*

Response to Paragraph 33:

Respondents deny this Paragraph.

Paragraph 34. *As a result of the conduct described above. Chariot Advisors and Shifman willfully aided and abetted and caused the Chariot Fund's violations of Section 34(b) of the Investment Company Act, which 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.*

Response to Paragraph 34:

Respondents deny this Paragraph.

Paragraph 35. *As a result of the conduct described above. Chariot Advisors willfully violated Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 promulgated thereunder, which prohibits any investment adviser to a pooled investment vehicle from making any untrue statement of a material fact or omitting to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle.*

Response to Paragraph 35:

Respondents deny this Paragraph.

Paragraph 36. *As a result of the conduct described above, Shifman willfully aided and abetted and caused Chariot Advisor's violations of Sections 206(1) and 206(2) of the Advisers Act.*

Response to Paragraph 36:

Respondents deny this Paragraph.

Respondents deny all allegations in the Division's Allegations unless expressly admitted herein.

AFFIRMATIVE DEFENSES

1. The Division's Allegations fail to state a claim on which relief can be granted.
2. Respondents acted in honest and reasonable reliance on the advice and experience of others, including legal professionals, as to matters within the area of their expertise and experience.

3. Respondents reserve the right to plead additional affirmative defenses as this case proceeds into discovery.

PRAYER FOR RELIEF

1. Respondents deny that the Division is entitled to any relief whatsoever and request an Initial Decision dismissing all claims and denying all relief requested by the Division.

2. Respondents request reimbursement of their attorneys' fees and costs pursuant to the Equal Access to Justice Act.

3. Respondents request an order that the Division issue a retraction of its press release and remove from the Commission's web site any references to the false allegations contained in the Order Instituting Proceedings.

This 10th day of September, 2013.



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