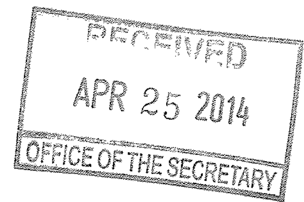

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15526

In the Matter of

AMBASSADOR CAPITAL MANAGEMENT, LLC

and

DEREK H. OGLESBY,

Respondents.

THE DIVISION OF ENFORCEMENT'S PRE-HEARING BRIEF

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A mutual fund can only hold itself out as a "money market mutual fund" provided it adheres to the requirements of Investment Company Act Rule 2a-7. The rule includes safeguards and other requirements specifically tailored to the unique features of money market funds – most notably the "fixed" net asset value. As the Division's expert, Professor Russell Wermers, will testify, the causes of the money market fund crisis of 2008 reinforce the purpose and importance of Rule 2a-7, both to money market funds and the global economy.

This case concerns an investment adviser, Respondent Ambassador Capital Management, LLC ("ACM"), and one of its employees, Respondent Derek Oglesby, who were either unwilling or unable to ensure that the Ambassador Money Market Fund ("AMMF" or "the Fund") complied with Rule 2a-7. The Fund's investors were primarily Michigan municipalities and other public entities. At the hearing, such investors will testify that they were drawn to the Fund precisely because it was a money market fund – one that touted a focus on "safety" and "capital preservation." Investors never knew (nor could they have known) that Respondents were causing the Fund to disregard provisions of Rule 2a-7.

For example, in May 2010, an amendment to the rule became effective that included a "stress testing" requirement. This provision required Respondents and the Fund to test the Fund's ability to maintain a stable net asset value based upon specified hypothetical events. The importance of this provision – particularly following the 2008 money market fund crisis – is obvious. Despite this, Respondents did not begin any such testing until 2011. Even then, the initial stress test ignored hypotheticals that were expressly required by Rule 2a-7.

Respondents also disregarded Rule 2a-7's general prohibition against investing more than five percent of total assets in any one issuer. This provision guards against a money market fund exposing itself to risk by failing to sufficiently diversify its portfolio. Over and

over again during the relevant time period, Respondents caused the Fund to exceed 5% of the total assets in an issuer or security. They never told the Fund's Board of Trustees about any of the "active breaches" of the diversification requirement. In other instances, Respondents omitted or seriously misrepresented to the Trustees the magnitude of "passive breaches" of the same requirement.

Respondents deceived the Fund's Trustees in other ways as well. In the midst of the Eurozone credit crisis, they misrepresented AMMF's exposure to Eurozone credit to the Trustees. These holdings perpetuated the Fund's exposure to Italy and other European countries – a reality that stood in stark contrast to what Respondents had told the Trustees. AMMF had the dubious distinction of being one of only a handful of U.S. institutional money market funds that continued holding certain Eurozone securities during the crisis.

In these and other respects, the Respondents caused numerous violations of key Rule 2a-7 requirements. Michigan municipalities that entrusted their money to the Fund – believing it to be a legitimate money market fund – had a right to know that the Fund was failing to adhere to fundamental statutory safeguards. That common sense proposition is expressly codified in the Investment Company Act.

In the end, Respondents had a choice: they did not have to call AMMF a money market fund. But having chosen to do so, and thus having chosen to avail themselves of the privileges that flowed from that decision (including attracting investors to the fund), they were legally required to cause the Fund's adherence to the concomitant responsibilities. This proceeding arises out of Respondents' failure to do so, and their deception of the Fund's trustees concerning issues impacting the safety and stability of the Fund.

I. FACTUAL SUMMARY

A. Money Market Funds

Professor Russell Wermers, the Division's expert, will testify that money market funds are different than other mutual funds in critical respects.[1] Money market funds issue and redeem shares at a constant $1 per share price. By contrast, other mutual funds have a "floating" net asset value that rises and falls with the market price of their underlying portfolio securities. A money market fund's fixed $1 share price affords investors a safe, short-term investment vehicle. Rule 2a-7 of the Investment Company Act codifies certain safeguards designed to ensure that a money market fund investor can redeem shares for the full $1 share value on demand.

The "fixed" nature of a money market fund's NAV is an economic fiction that the securities laws permit, provided the fund complies with the risk-limiting provisions of Rule 2a-7. In fact, as with all mutual funds, there is invariably a maturity and liquidity mismatch between a fund's assets and liabilities. During normal markets, this mismatch poses lower risks. In times of economic stress, however, the mismatch between a money market fund's assets and liabilities can cause unique challenges. In a major stress event, money market investors are likely to redeem *en masse*, which could cause something akin to a bank run, with resulting liquidations of assets at "fire-sale prices," further impairing the value of remaining unsold assets. This could force the fund to shifting the pricing of its shares to a variable or "floating" market value.[2] In that event, there is a risk of triggering a meltdown in which

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[1] This section is adapted from, and relies upon, the Division's Expert Report of Russell R. Wermers, Ph.D., pages 5-11.

[2] Rule 2a-7 requires the money market mutual fund board to consider floating shares when they estimate that assets have depreciated to the point of being worth $0.995 per share, or have appreciated to $1.005 per share.

investors that redeem later will be disadvantaged by earlier redemptions. Such a downward spiral could cause a money market fund to "break the buck," potentially spreading portfolio distress to other money market funds and, through the pricing down of all money market instruments, the financial system as a whole. This intrinsic fragility of a money market fund provides the impetus for Rule 2a-7, that is, to establish certain safeguards intended to protect investors:

Minimal Credit Risk. Rule 2a-7(c)(3) requires that the fund only invest in securities that have been determined to have "minimal credit risk." The fund cannot rely solely on ratings issued by credit agencies. Rather, the fund must make an independent determination that each portfolio security presents a minimal credit risk.[3] Under Rule 2a-7(c)(11)(iii), a Fund must maintain a written record of its determination that a portfolio security presents a minimal credit risk.

The 5% Rule. Rule 2a-7(c)(4), sometimes known as the "5% rule," establishes a 5% limit for investing in a single non-Government issuer as a portion of total net assets of the money market fund. This serves to limit risk from overly concentrated holdings and to promote diversification of money market fund holdings. An "active breach," which runs afoul of Rule 2a-7, occurs if the 5% limit is breached as a result of a purchase of securities from a single issuer. A "passive breach" occurs when the 5% limit is breached after the initial securities purchase – typically as a result of significant investor redemptions. While a passive breach is not – standing alone – a violation of Rule 2a-7, it increases concentration risk to the portfolio.

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[3] Money market funds typically hold securities to maturity instead of reselling them prior to that date. Thus, the maturity length is an important factor in determining the risk associated with the security.

Stress Testing. Rule 2a-7(c)(10), a new feature included in the May 2010 revisions to the Rule, requires a money market fund to engage in "stress-testing." This testing ensures that the fund would be able to maintain a stable NAV in case of certain delineated hypothetical events – such as increased investor redemptions and downgrades of portfolio securities. A copy of a fund's written report of the stress testing must be maintained and preserved for a specified period. Moreover, the results of the testing must be reported to the fund's Board of Trustees, along with an analysis of the likelihood of any of the catastrophic events occurring.

* * *

Rule 2a-7 presents a mutual fund with a choice: It can enjoy the benefits – and comply with the concomitant safeguards – of the rule. Or the fund can call itself something <u>other</u> than a "money market fund." Indeed, some funds with features and holdings very similar to a money market fund call themselves something other than a money market fund precisely because they do not want to be governed by Rule 2a-7's rigorous requirements.

The money market fund crisis of 2008 demonstrates how a downward spiral can quickly spread from one money market fund, infecting others. As Professor Wermers will testify, one day after Lehman Brother's collapse – on September 16, 2008 – the Reserve Primary Fund, which held about $750 million in commercial paper issued by Lehman Brothers, disclosed that it had broken the buck. In the wake of that announcement, other money market funds began experiencing vast outflows of investment capital, which ultimately totaled over $300 billion in redemptions. As credit markets began seizing up, money market funds struggled to sell securities quickly enough to meet such redemptions. This spiral precipitated many of the 2010 amendments to Rule 2a-7.

B. About Respondents and the Ambassador Money Market Fund

Respondent ACM, a registered investment adviser, is a Detroit-based investment advisory firm focused largely on fixed income investment management. During the relevant period, ACM managed between $900 million $1.1 billion in assets – about 75% of which was managed for Michigan municipalities and other Michigan public entities. Throughout its existence, ACM has been owned by its employees, including president/CEO Brian T. Jeffries, vice-president/chief investment officer Gregory A. Prost, and portfolio manager Respondent Derek H. Oglesby. In 2000, ACM created a money market fund as an investment option for its advisory clients. ACM served as the Fund's investment adviser. Respondents ACM and Oglesby were fiduciaries to AMMF and its board. As such they owed to the Fund and its Trustees an affirmative duty of utmost good faith, and full disclosure of all material facts.

ACM's Jeffries and Prost served on the Fund's first Board of Trustees, for which they earned fees. Respondent Oglesby oversaw the day-to-day operations of AMMF and served as its primary portfolio manager from 2010 until the fund's liquidation in 2012. Before 2010, he shared oversight of AMMF with another ACM portfolio manager. Beginning in 2003, ACM began outsourcing the Fund's administrative, accounting and compliance functions to Fund Services Group LLC ("FSG"). FSG received annual fees and expenses typically amounting to between $120,000 and $150,000. ACM had a significant ownership interest in FSG.

ACM marketed the Fund as a vehicle for "provid[ing] current interest income, consistent with maintaining liquidity and stability of principal." It held the fund out as "appropriate for investors who seek capital preservation; desire safety and liquidity; seek a modest level of income; look for a money market fund to diversify their investment portfolio; [and] have a short-term investment horizon." Numerous Michigan municipalities found these

investment goals to be consistent with their priorities. The treasurers of three municipalities will testify that the safety of taxpayers' principal was their foremost investment objective.

All money market funds carry inherent risks. But Professor Wermers will testify that because of AMMF's small number of investors (a subset of which represented a large portion of all investments), the Fund was particularly vulnerable. Washtenaw County's holdings often comprised more than 30% of the Fund's net assets; the holdings of three entities in Wayne County (the home of Detroit) frequently constituted another 20% of the Fund's holdings. This increased the risks associated with large redemptions by these investors. Such redemptions could have subjected remaining investors to a highly concentrated "basket" of securities.

C. In Late 2009, the Respondents Ignored Their Own Credit Risk Analyses and Caused Numerous Active Diversification Breaches of the 5% Rule.

Throughout 2009, Ambassador's yields declined along with the returns of many money market funds. For the quarter ending December 31, 2008, the Fund had returns to investors of 0.45%. Months later, the Fund's performance had slowed dramatically, plummeting to 0.10% for the quarter ending September 30, 2009. Its yield fell even further during the final quarter of 2009, to 0.05%.

During this time, the fund faced other challenges. Investors had started redeeming millions of shares. On August 31, 2009, the Fund had net assets of about $427 million. By the end of December 2009, it had lost more than $100 million of net assets through redemptions.

Respondents' trading activity from this period reveals how they chose to address the low returns and large redemptions: by loading-up on higher-yield securities while ignoring their own written risk analyses for such securities. ACM's procedures established internal credit risk analyses that designated issuers as one of three "tiers": Tier 1(A), Tier 1(B), or Tier 1(C). A "Tier 1(A)" rating reflected ACM's assessment that there was no maturity restriction

needed for the security.[4] A "Tier 1(B)" rating reflected an assessment that the security be held for a maximum of 30 days. A "Tier 1(C)" rating reflected Respondents' assessment that the credit risk was sufficiently significant to warrant a seven-day maturity restriction. Respondents developed these criteria in response to Rule 2a-7's requirement that an independent risk analysis be performed for portfolio securities to determine that they meet "minimal credit risk". In other words, in ACM's judgment, securities that ACM rated in these tiers constituted a minimal credit risk, provided they were purchased within the designated maturity restrictions.

Respondents repeatedly ignored their own internal risk analyses. For example, a June 2009 risk analysis signed by Respondent Oglesby warned that commercial paper offered by White Point Funding, Inc. was "structured with some risk factors due to its lack of diversification and the current credit crisis taking place globally." The analysis stated: "The portfolio is comprised of 100% credit cards and ***should only be purchased between 1-3 days*** to avoid long-term risk exposure. This credit represents risk." (emphasis added). This analysis reflected Respondents' assessment that if White Point securities were bought only with a 1-3 day maturity date, such an investment constituted "minimal credit risk" under Rule 2a-7.

White Point commercial paper offered the Fund returns of 0.50% to 1.0%, attractive given the investment alternatives at the time. ACM apparently found these higher yields irresistible. In the five months after Respondents performed their analysis, they caused the Fund to purchase more than $400 million of White Point commercial paper. Almost $100 million worth of these securities exceeded Respondents' 1-3 day maximum maturity period:

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[4] Money market funds typically hold securities to the maturity date instead of reselling them prior to that date. As a result, the maturity length is an important factor in determining the risk associated with the security. Longer maturity dates dictate that the security will be held in the fund's portfolio for a longer period of time and thus increases risk relative to shorter maturity dates.

- On June 29, 2009 – the same month as the risk analysis – ACM caused the Fund to buy $12 million of White Point commercial paper with a 16-day maturity period.
- On August 19, 2009, ACM caused the Fund to buy $11 million of White Point commercial paper with a maturity period of 90 days.

Even worse, some of these White Point purchases also caused active diversification breaches of the 5% rule, constituting an independent failure to comply with Rule 2a-7:

- On August 18, 2009, ACM caused the Fund to purchase more than $21 million in White Point securities – most with a 90-day maturity period.
- Days later, the Fund purchased an additional $12.8 million in White Point Securities.

Cumulatively, these holdings exceeded 7% of the Fund's net assets. This was just one of several active breaches by the Fund of the 5% rule. Other instances included:

DATE	SECURITIES PURCHASED IN VIOLATION OF 5% RULE
Aug. 18, 2009	• Ebury Finance
Dec. 7, 2009	• Beethoven Dresdner US • Ford • Hannover • Societe Generale NA • White Point Funding
Dec. 18, 2009	• Amstel Funding Corporation • Hannover
Jan. 28, 2010	• Paradigm Funding LLC asset-backed commercial paper (ABCP) (guaranteed by WestLB)
June 21, 2010	• Fairway Finance Corporation • Charta LLC
Dec. 17, 2010	• Louis Dreyfus Corporation • Bunge Asset Funding • Compass Securities

Throughout November and December 2009, Respondents purchased significant blocks of Amstel commercial paper with long maturity dates and commensurately high yields:

TRADE DATE	YIELD	AMOUNT INVESTED
Nov. 19, 2009	0.60%	$4 million
Dec. 3, 2009	1.25%	$3.99 million
Dec. 16, 2009	0.65%	$9 million
Dec. 17, 2009	1.25%	$4 million
Dec. 18, 2009	0.60%	$10 million

Given the Fund's anemic yield in December 2009, the relatively high yield for these securities was no doubt tempting. These purchases yet again were active breaches of the diversification requirement. In December 2009, the Fund had net assets of approximately $317 million. After the December 18, 2009 purchases of Amstel, such holdings amounted to more than 10% of the Fund's net assets.

D. As the Fund Continued Struggling in 2010, Respondents Continued Subjecting Its Investors to Risk.

According to the minutes of the May 2010 meeting of the Board of Trustees, ACM's Brian Jeffries reported on the decline in assets in the Fund since the prior fall. He reported that assets under management were at about $190 million, down from a high of about $550 million. This reduction in the Fund's assets, Jeffries told the Trustees, meant a decline in fee income to ACM, which forced it to reduce compensation and cut expenses significantly.

During this Trustee meeting, ACM presented two projections based upon different portfolio scenarios – one at $200 million and a worst-case scenario of $150 million. The analysis reflected that at $150 million, the Fund's viability was imperiled – with a projected spike in the Fund's effective expense ratio and a projected negative yield to investors.

Given the realities the Fund faced in May 2010, this was not a far-fetched scenario. Throughout 2010, the financial environment for money market funds continued to

deteriorate, and AMMF was no exception. For the first quarter of 2010, it earned a yield to investors of just 0.01%. Around the same time, the Fund continued to shrink. March 2010 brought a $50 million decline; in April the Fund dropped another $74 million.

These massive cash outflows took their toll. By the time of the May meeting, the Fund's net assets had been dropping at an alarming rate, dipping below $200 million. Meanwhile, the Trustees focused on reducing expenses. According to the May 2010 Board Meeting minutes, ACM in turn established a goal to maintain a minimum annualized yield to the Fund's investors.

The evidence reflects that to meet this goal, Respondents were increasingly willing to take on additional risk in order to increase returns. Throughout 2010, the "average days to maturity" of the Fund's securities climbed noticeably, from 25 days in mid-February, to 35 days by mid-April, to 40 days by December. While longer maturity periods meant more risk, it also meant that ACM generally received higher returns on those securities.

Respondents' risk-taking and yield-chasing reflected a decision to hitch the Fund's destiny to a few relatively risky securities – hoping that higher yields on such securities would stimulate the Fund's overall yield. To implement this apparent strategy, Respondents' caused or allowed many of the Fund's holdings to approach the 5% limit.

On December 17, 2010, Respondents made three purchases that constituted active breaches of the 5% requirement. In addition, several securities already owned by the Fund exceeded the 5% limit after several investor redemptions occurred on that day.

Respondents tried whitewashing this incident at the next meeting of the Fund's Trustees. According to the Minutes from the February 8, 2011 meeting:

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

(emphasis added).

This report to the Trustees was incomplete and misleading. The active breaches – the existence of which Respondents' hid from the Trustees – exposed ACM's lack of controls for avoiding such Rule 2a-7 violations. Moreover, the sheer number of active breaches and passive breaches that were triggered on that date demonstrated the serious risks Respondents were taking with the Fund's holdings. The truth of the matter was that the redemptions had caused ***multiple*** breaches for ***multiple*** issuers. These breaches were caused not only by unexpected redemptions, as Respondents led the board to believe, but also because of the Fund's heavily concentrated and undiversified holdings. But the Respondents' misrepresentations served to downplay the breach as an aberrational, one-time event.

E. Throughout 2011, Respondents Ignored Their Own Credit Risk Analyses – Causing the Fund to Purchase Risky Securities – and Hid Such Risk-Taking from the Trustees.

In June 2011, money market funds found themselves ensnared in an unfolding Eurozone crisis. The crisis began when Standard & Poor's downgraded Greek sovereign debt to a rating of "CCC." The global economy's reaction was swift and dramatic, adversely impacting the flow of capital. Amidst this tumult, Derek Oglesby and Greg Prost participated in the August 8, 2011 meeting of the Fund's Trustees. According to the meeting minutes, Oglesby and Prost assured the Trustees that "ACM is avoiding Greece, Spain, Italy and other countries seen as higher-risk investments by ACM."

There is no evidence that Respondents actually avoided investing in securities from Italy, or had any intention of ever doing so. The ***very day*** Respondents made those statements to the Trustees, they caused the Fund to buy $10 million of commercial paper issued by Romulus Funding Corporation, an asset-backed program sponsored by Intesa Sanpaolo, an Italian bank. In their internal credit risk analysis from mid-2011, Respondents noted that "Italy still remains a concern within the European Union and with Intesa having the same rating as the sovereign, the bank is vulnerable to any downgrade of the country." Critically, these warnings by Respondents ***preceded*** the Eurozone crisis.

But Respondents' subsequent trading in the midst of the crisis reflected no compunctions about embracing such risks. In the three weeks following the Trustee meeting, Respondents made four additional purchases of Romulus commercial paper on the Fund's behalf, totaling more than $46 million. Although ACM had represented to the Trustees that they had identified credit risk associated with Eurozone securities, and thus that they would be avoiding such investments, they continued to purchase them. The Trustees would have found ACM's subsequent actions significant to Respondents' compliance with the crucial "minimal credit risk" requirement of Rule 2a-7.

After this Trustee meeting, Respondents continued purchasing other securities that – as reflected in their own previously written risk analyses – had strong connections to Italy and other Eurozone countries:

- One day after the meeting, Respondents caused the Fund to purchase $11 million of securities issued by ENI Finance USA Inc. In their internal risk analysis, Respondents described ENI's parent as "a Government-Related Issuer (GRI), given its 30.3% direct and indirect ownership by the Italian state."

- A few days after the meeting, Respondents caused the Fund to buy $8 million of securities issued by Arabella Finance LLC. In their internal risk analysis, Respondents had described Arabella's sponsor, UniCredit Bank AG, as "an Italy-based, pan-European banking organization" From the time of the meeting through September 2011, Respondents bought more than $40 million of Arabella securities for the Fund.
- In the weeks that followed the August 8, 2011 meeting, the Fund purchased tens of millions of dollars in other securities with significant Eurozone exposure, including Dexia Delaware, LLC (described in Respondents' internal risk analysis as "one of the top fifteen banking groups in the euro zone") and Compass Securitization (whose sponsor Respondents described as a "German universal bank")

Throughout this period, Respondents continued to keep the Trustees in the dark about the Fund's true exposure to the Eurozone crisis. According to the minutes for the November 14, 2011 Trustee meeting:

> Mr. Oglesby assisted in this review, discussing general market conditions, the options available to the Money Market Fund and the foreign and domestic short-term fixed income markets, noting for the Board the Money Market Fund's limited exposure to European markets, including that ***the Money Market Fund has no assets issued in the Greek marketplace and had minimal second-hand exposure to the Italian market*** (and that the asset in question would be off the books of the Money Market Fund as of mid-November, after which time the Money Market Fund would have no exposure to the Italian market).

(emphasis added). In fact, the ***same day*** Respondents made this statement, they also made a $4 million investment for the Fund in ENI Finance securities. That investment was on top of the $5 million of ENI securities already owned by the Fund. Respondents themselves had previously stated, in their internal credit risk documentation, that ENI's parent corporation had "direct and indirect ownership by the Italian state." Such risks notwithstanding – and

contrary to what they told the Fund's Trustees – Respondents bought more than $70 million of ENI securities for the Fund in December 2011 alone.

F. A $25 Million Redemption Caught Respondents by Surprise.

As Respondents apparently knew, tip-toeing up to the 5% limit without crossing it does not violate Rule 2a-7. But such a strategy was nonetheless risky, since it increased the risk of an overly concentrated portfolio in the wake of unanticipated redemptions. On September 30, 2011, the City of Detroit made a $25 million redemption – more than 10% of the Fund's total net assets. The Fund's holdings were already highly concentrated. This unexpected and large withdrawal only exacerbated the risky and undiversified nature of the Fund's investments, triggering "passive breaches" for almost half of the Fund's holdings.

Respondents immediately set about spinning the magnitude and significance of this event. In a letter to the file, later provided to the Trustees, Oglesby insisted that the "situation was unavoidable and unintentional," and that "the Fund was back in compliance" by the following business day. Respondents made similar representations at the next board meeting, assuring the Trustees that the breach was only limited to securities of "a single issuer," which by the next business day had reverted below the 5% threshold.

Respondents' representations to the Fund's trustees about these passive diversification breaches were inaccurate and misleading in two important respects. First, the breaches persisted well beyond October 3, 2011. Second, the breaches were not limited to the securities of "a single issuer." Rather, the redemption caused 5% breaches for fully 10 of the 21 issuers represented in the Fund's holdings. As with their other misrepresentations to the Trustees, Respondents succeeded in concealing their risk-taking strategies and decisions.

In the last months of 2011, investors withdrew another $100 million from the Fund. By year end, the Fund's holdings amounted to less than $170 million – precariously close to the $150 million doomsday scenario previously shared with the Trustees.

II. THE EVIDENCE WILL ESTABLISH RESPONDENTS' VIOLATIONS

As detailed below, the Respondents caused AMMF to fail to comply with various provisions of Rule 2a-7, as set forth in **Section A**. There is no direct cause of action under the Investment Company Act for violations of Rule 2a-7 itself. Failure to comply with the Rule, however, exposes an investment company to causes of actions pursuant to violations of other provisions of the Investment Company Act, as set forth in **Sections B through E**.

A. The Risk-Limiting Provisions of Rule 2a-7

Portfolio Quality Condition – Rule 2a-7(c)(3). As noted above, a money market fund must limit its portfolio investments to: "securities that the fund's board of directors determines present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by a Designated NRSRO)" (emphases added). The fund cannot rely solely on credit ratings; it must make an independent determination that the portfolio security presents a minimal credit risk. Here, AMMF's Board delegated this "minimal credit risk" determination to ACM, and ratified ACM's determinations at Board meetings.

Pursuant to its delegated obligations under this provision, ACM imposed internal restrictions on the holding period for certain classifications of portfolio securities. ACM represented to Standard & Poor's that these designations constituted a part of ACM's independent credit analysis for these holdings to qualify as a minimal credit risk. As noted above, however, ACM regularly exceeded these internal maturity restrictions. *See* Expert

Report of Russell Wermers at 14-15. ACM never disclosed to Standard & Poor's or to the Fund's board that they routinely disregarded their own internal maturity restrictions. ACM also lacked any internal procedures to ensure its adherence to its own restrictions. Moreover, ACM sometimes purchased portfolio securities without having made any determination of minimal credit risk (which obviously made it impossible to maintain a record of that non-determination, as required by Rule 2a-7).

Portfolio Diversification Condition – Rule 2a-7(c)(4). A money market fund may invest no more than 5% of its portfolio in the securities of any one issuer immediately after acquisition of the security. As noted above, ACM repeatedly made purchases for AMMF that caused breaches of the 5% threshold at the time of purchase. These diversification breaches constituted clear violations of Rule 2a-7, which made them intrinsically important. Moreover, the breaches amounted to red flags that the Fund lacked the diversified holdings necessary to withstand unanticipated redemptions or any other event that could have compromised the Fund's stability. However, Respondents never informed the AMMF board of these myriad active breaches or the risks they placed on the Fund.

Stress Testing Condition – Rule 2a-7(c)(10)(v). Under this provision, a money market fund must have written procedures providing for periodic stress testing of the money market fund's ability to maintain a stable net asset value per share based upon specified hypothetical events, including:

- a change in short-term interest rates;
- an increase in redemptions;
- a downgrade of or default on portfolio securities;

- the widening or narrowing of spreads between yields on an appropriate benchmark the fund has selected for overnight interest rates and commercial paper and other types of securities held by the fund; and
- concurrent occurrences of these events.

The Fund conducted no stress testing whatsoever until February 2011. Moreover, this stress test, overseen by Respondent Oglesby, failed to test for either: (a) an increase in redemptions; or (b) a downgrade of or default on portfolio securities. Further, the Fund appears to have lacked written stress testing procedures until May 2012 – about two years after the requirement went effective.

B. ACM Violated the Investment Company Act's Compliance Rule.

Respondents' operation of the Fund also led to violations of Rule 38a-1, the compliance rule for registered investment companies. That provision requires a registered investment company to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund, and to provide for oversight of compliance by the fund's investment adviser. *See Compliance Programs of Investment Companies and Investment Advisers*, IC Act Release No. 26299, 2003 SEC LEXIS 2980 (Dec. 17, 2003) (38a-1 Adopting Release). In the Adopting Release, the Commission stated that an investment company's failure "to have adequate compliance policies and procedures in place will constitute a violation of our rules independent of any other securities law violation." *Id.* at *8. Rule 38a-1 permits the Commission to address the failure of an adviser or fund to have in place adequate compliance controls before that failure has a chance to harm clients or investors. *Id.*

The Fund's written compliance policies and procedures delegated to ACM responsibility: (a) for compliance with Rule 2a-7; and (b) for keeping the Trustees fully informed about any compliance failures. ACM failed to fulfill both of these compliance responsibilities, and thus failed to implement these existing policies and procedures designed to prevent violations of the federal securities laws. In addition, ACM never adopted procedures to ensure compliance with their internal maturity restrictions – part of ACM's attempts to comply with Rule 2a-7's minimal credit risk requirement. Lastly, ACM failed to adopt any procedures implementing stress testing protocols, required under the May 2010 amendments, for nearly two years.

C. ACM and Oglesby Violated the Investment Company Act's Books and Records Provisions.

ACM and Oglesby caused the Fund's failure to maintain the books and records required by Section 31(a) of the Investment Company Act and Rule 31(a)-1. Rule 31(a)-1(b)(12) requires each registered investment company to maintain and keep current "other records," including documents "required by the applicable rule or rules." Rule 2a-7(c)(11)(iii) requires, in turn, that funds maintain a written record of determination of minimal credit risk for portfolio securities for a period of at least three years. Between 2009 and 2011, numerous credit files for AMMF portfolio securities lacked any record that ACM had conducted a meaningful of a minimal credit risk determination. In the event that ACM conducted a credit risk determination and imposed various internal restrictions, there is no evidence in the credit files of the reasons ACM changed its views about maturity restrictions. ACM and Oglesby thus caused AMMF's failure to comply with the conditions set forth in Rule 2a-7 regarding books and records.

D. ACM and Oglesby Violated the Investment Company Act's Pricing Rule.

AMMF's failure to adhere to Rule 2a-7 rendered it ineligible to use the amortized cost method of pricing its securities, but it continued to do so anyway.[5] Investment Company Act Rule 22c-1 requires registered investment companies to sell and redeem shares only "at a price based on the current net asset value of such security." Rule 2a-7 provides an exception, however, permitting money market funds to instead use the amortized cost method to value its securities, provided the fund complies with Rule 2a-7. The amortized cost method allows a money market fund to value its securities at a cost adjusted for any premium paid or discount received at purchase. Such pricing enables money market funds to generally maintain a stable price of $1 per share.

Here, AMMF repeatedly failed to follow the risk-limiting provisions of Rule 2a-7, but continued to use the amortized cost method for valuing its portfolio securities, instead of the market NAV. As a result, the Fund violated Rule 22c-1 of the Investment Company Act. The actions of Respondents caused the Fund to deviate from Rule 2a-7, causing the Fund's Rule 22c-1 violations. For each day that the Fund did not meet the conditions of 2a-7(c), redeeming investors should have had shares redeemed at market NAV, calculated in accordance with Rule 22c-1, not at the amortized-cost price of $1 per share.

E. ACM and Oglesby Violated the Investment Company Act's Naming Rules.

Section 35(d) of the Investment Company Act prohibits a registered investment company from adopting as a part of its name or title any word or words that are materially

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[5] As discussed in the Final Rule for the 2010 Amendments to Rule 2a-7, "Under the amortized cost method, portfolio securities generally are valued at cost plus any amortization of premium or accumulation of discount. The basic premise underlying money market funds' use of the amortized cost method of valuation is that high-quality, short-term debt securities held until maturity will eventually return to their amortized cost value, regardless of any current disparity between the amortized cost value and market value, and would not ordinarily be expected to fluctuate significantly in value." (http://www.sec.gov/rules/final/2010/ic-29132.pdf).

deceptive or misleading. Negligently causing a violation of Section 35(d) is sufficient for liability. *See Howard v. SEC*, 376 F.3d 1136, 1142-43 (D.C. Cir. 2004). Rule 2a-7(b)(2) provides that "[i]t shall constitute the use of a materially deceptive or misleading name within the meaning of (Section 35(d) of the Act) ... for a registered investment company to adopt the term 'money market' as part of its name ... unless such registered investment company meets the conditions [of Rule 2a-7]." Even after ACM and Oglesby caused the Fund's failure to comply with Rule 2a-7, the Fund continued to hold itself out as a money market fund. Accordingly, the Fund violated Section 35(d), which Respondents caused.

Section 34(b) of the Investment Company Act prohibits making any untrue statement of a material fact in any report, account, record, or other document filed or required to be kept under Section 31(a) of the Act. Section 34(b) also prohibits any person filing or keeping those documents from omitting to state any fact necessary in order to prevent the statements made in those documents from being misleading. Rule 2a-7(b)(1) states that a money market fund failing to meet the conditions of the rule makes an untrue statement of material fact by holding itself out as a money market fund in any registration statement, application, or other document filed or transmitted pursuant to the Investment Company Act. As noted above, ACM and Oglesby caused AMMF's departures from Rule 2a-7. Accordingly, they also caused violations of Section 34(b) by continuing to identify AMMF as a money market fund in Commission filings.

F. Respondents Violated Section 206(1) and Section 206(2) of the Investment Advisers Act.

Section 206(1) of the Advisers Act prohibits any investment adviser from, directly or indirectly, employing any device, scheme, or artifice to defraud any client or prospective client. Section 206(2) of the Advisers Act prohibits any transaction, practice, or course of

business which operates as a fraud or deceit upon any client or prospective client. Scienter is required for a violation of Section 206(1); negligence is sufficient for Section 206(2). *See Steadman v. SEC*, 603 F.2d 1126, 1134 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *see also SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 184–92 (1963).

Section 206 establishes a statutory fiduciary duty for investment advisers to act for the benefit of their clients. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979). Investment advisers and their associated persons are fiduciaries. *Fundamental Portfolio Advisors, Inc.*, 56 S.E.C. 651, 684 (2003); *see Capital Gains*, 375 U.S. at 191-92, 194, 201. An adviser's fiduciary duties include "an affirmative duty of utmost good faith, and full and fair disclosure of all material facts." *Capital Gains*, 375 U.S. at 191-94. Materiality does not require proof that accurate disclosure would have caused the reasonable investor to change his decision, only that the omitted fact would have assumed actual significance in the deliberations of a reasonable investor. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Investment advisers to registered investment companies "owe to the board... of the funds they manage the highest fiduciary duties." *SEC v. Treadway,* 430 F. Supp. 2d 293, 338 (S.D.N.Y. 2006).

Oglesby aided and abetted and caused ACM's violations of Section 206(1) and 206(2). To establish aiding and abetting liability, the Commission must show: (1) the existence of an independent primary wrong; (2) actual knowledge or reckless disregard by the alleged aider and abettor of the wrong and of his/her role in furthering it; and (3) the aider and abettor substantially assisted in the accomplishment of the primary violation. *See In the Matter of vFinance Investments, Inc., et al.*, Exchange Act Rel. No. 62448, 2010 SEC LEXIS 2216, *41 (July 2, 2010) (Commission Opinion). In administrative proceedings, the Commission applies a "recklessness" standard for aiding and abetting liability. *Id.* at *46; *see also Voss, et al. v. SEC,*

222 F.3d 994, 1004-06 (D.C. Cir. 2000). The recklessness standard is satisfied when the respondent fails to use due diligence to investigate a circumstance with unusual factors or ignores red flags and suggestions of irregular conduct. *See Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004).

Respondents ACM and Oglesby were fiduciaries to AMMF and its board. Respondents repeatedly violated this fiduciary duty through the conduct described above. ACM's misleading statements to, and facts withheld from, the AMMF Board, constituted violations of Section 206(1) and (2). Oglesby's misleading statements to, and facts withheld from, the AMMF Board affirmatively assisted ACM's violations. *SEC v. Espuelas*, 698 F. Supp. 2d 415, 433 (S.D.N.Y. 2010) ("A defendant provides substantial assistance only if [he] affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed") (internal quotation marks and citations omitted). For "causing" liability, three elements must be established: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his act or omission would contribute to the violation. *In the Matter of Robert M. Fuller*, Exchange Act Rel. No. 48406, 2003 SEC LEXIS 2041 (Aug. 25, 2003), *petition for review denied*, 95 F. App'x. 361 (D.C. Cir. 2004).

Failure to Disclose Lack of Minimal Credit Risk Analysis. Respondents failed to disclose to the Trustees that Respondents had disregarded their own minimal credit risk determinations in the course of selecting holdings for the Fund. Reasonable members of a money market fund's board of trustees would have found such practices to be important in determining a fund's security and liquidity, as well as compliance with Rule 2a-7.

Failure to Disclose Active and Passive Breaches. The active breaches that Respondents largely hid from the Fund's Trustees constituted not only clear Rule 2a-7 noncompliance, but also warnings that the Fund lacked the diversified holdings necessary to withstand unanticipated redemptions. Even though the passive breaches did not – standing alone – constitute violations of Rule 2a-7, such breaches reflected the Fund's exposure to increased risk due to its heavily concentrated holdings. This was particularly true for AMMF, which had a relatively small number of investors, a small subset of which owned a large share of the Fund. Such concentration increased the risk for "lumpy redemptions," as reflected in the occasionally volatile fluctuations in the Fund's assets under management. Further, the passive breaches reflected ACM's inability to predict the timing of large redemptions.

Misrepresentations about Eurozone Exposure. As noted above, Respondents misled the Trustees about the Fund's exposure to Italian-affiliated issuers and the Eurozone generally. AMMF's continued ownership of securities from Italian issuers was material. The fact that this issue was raised and discussed during the board meeting reflects its significance. This type of discussion by a money market fund's board in the throes of such a crisis made perfect sense, given money market funds' unique vulnerabilities. Notably, the Fund was in the small minority of money market funds that held Eurozone securities during this timeframe. *See* By September 2011, the Fund stood alone as the lone U.S. Prime institutional money market fund that held certain Eurozone securities.

III. REMEDIES

The public interest requires sanctioning Respondents for their misconduct. In determining the sanctions to be imposed in the public interest, courts and the Commission consider: the egregiousness of the actions; the isolated or recurrent nature of the infractions;

the degree of scienter involved; the sincerity of a respondent's assurances against future violations; a respondent's recognition of the wrongful nature of his or her conduct; and the likelihood that a respondent's occupation will present opportunities for future violations. *See Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981) (*quoting SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also may consider a sanction's deterrent effect. *See In the Matter of Schield Management Co., et al.*, Exchange Act Rel. No. 53201 (Jan. 31, 2006), 2006 WL 23162, at *8.

Cease and Desist Orders. Section 203(k) of the Advisers Act and Section 9(f) of the Investment Company Act authorize the Court to issue cease-and-desist orders. Respondents' violations raise a sufficient risk of future violations to support the entry of such an order. *See In the Matter of KPMG Peat Marwick LLP*, Exchange Act Rel. No. 43862 (Jan. 19, 2001), 54 S.E.C. 1135, 1183-91 (the showing for a cease-and-desist order is "significantly less than that required for an injunction," and "absent evidence to the contrary," a single past violation may raise "a sufficient risk of future violation").

Disgorgement and Prejudgment Interest. Section 203(k)(5) of the Advisers Act and Section 9(f)(5) of the Investment Company Act authorize the Court to impose disgorgement and reasonable interest of ill-gotten gains. To determine the appropriate amount of disgorgement, the Division need only show a reasonable approximation of the profits from the violative conduct. *See SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989). Here, Respondent ACM received management fees from the Fund despite the numerous undisclosed violations of the federal securities laws, and Respondent Oglesby received a salary based on his management of the Fund's portfolio. They continued receiving such compensation only by concealing from the Board their securities laws violations. *See, e.g., SEC*

v. Black, No. 04 C 7377, 2009 WL 1181480, at *2 (N.D. Ill. Apr. 30, 2009) ("Disgorgement of salaries and other forms of compensation may be an appropriate remedy.") (citing cases). The Division respectfully requests that the Court order the Respondents to disgorge an appropriate portion of the fees and personal income the Respondents kept earning because they hid from the Trustees evidence of their malfeasance.

Civil Penalties. The public interest would be best served by imposing civil penalties upon the Respondents for their misconduct. Courts determining appropriate civil penalties consider: (1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to other persons resulting either directly or indirectly from such act or omission; (3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior; (4) the need to deter such person and other persons from committing such acts or omissions; and (5) such other matters as justice may require.

Associational Bar. Under Section 203(f) of the Advisers Act and Section 9(b) of the Investment Company Act, as amended by Section 925 of the Dodd-Frank Act, the Commission may bar or suspend registered persons from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. *See In the Matter of John W. Lawton*, Advisers Act Rel. No. 3513 (December 13, 2012), 2012 WL 6208750 (collateral bars imposed pursuant to Section 925 of Dodd-Frank are not impermissibly retroactive as applied in proceedings based on pre-Dodd-Frank conduct). Based on Derek Oglesby's violations, the imposition of an associational bar is appropriate in order to preclude his continued employment in the securities industry. *See, e.g., In re Fundamental Portfolio Advisors, Inc. et al.*,

Securities Act Rel. No. 8251 (July 15, 2003), 80 SEC Docket 1851 (permanent associational bar ordered against portfolio manager who misled investors about a risky investment strategy).

IV. CONCLUSION

The Division of Enforcement respectfully requests that the Court accept the documentary and testimonial evidence that will be presented at the hearing, find that Respondents engaged in the violations described in the Order Instituting Proceedings, and impose appropriate sanctions.

Dated: April 23, 2014

Respectfully submitted,

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