SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

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| STATE OF NEW YORK, | : | |
| Plaintiff, | : | |
| -against- | : | **SUMMONS** |
| | : | Index No. |
| CANADIAN IMPERIAL HOLDINGS INC., CIBC BANK and TRUST COMPANY (CAYMAN) LIMITED, RUDY CAPITAL USA LLC, HUDSON RIVER INVESTMENTS LLC, and CIBC WORLD MARKETS CORP., | : | **Plaintiff Designates New York County as the Place of Trial.** |
| | : | |
| Defendants. | | |

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TO THE ABOVE-NAMED DEFENDANTS:

YOU ARE HEREBY SUMMONED to answer in this action and serve a copy of your answer, or if the complaint is not served with the summons, to serve a notice of appearance on the Plaintiff's attorney within twenty (20) days after the service of this summons, exclusive of the day of service. If this summons is not personally served upon you, or if this summons is served upon you outside of the State of New York, then your answer or notice of appearance must be served within thirty (30) days. In case of your failure to appear or answer, judgment will be taken against you by default, for the relief demanded in the complaint.

Filed: July 20, 2005

Dated: New York, New York
July 19, 2005

ELIOT SPITZER
Attorney General of the State of New York
*Attorney for Plaintiff*
120 Broadway - 23rd Floor
New York, New York 10271
(212) 416-6342

By: ______________________
CHARLES T. CALIENDO
Assistant Attorney General

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

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| STATE OF NEW YORK, | : | |
| Plaintiff, | : | |
| -against- | : | **COMPLAINT** |
| CANADIAN IMPERIAL HOLDINGS INC., CIBC BANK and TRUST COMPANY (CAYMAN) LIMITED, RUDY CAPITAL USA LLC, HUDSON RIVER INVESTMENTS LLC, and CIBC WORLD MARKETS CORP., | : | Index No. |
| Defendants. | : | |

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ELIOT SPITZER
Attorney General of the State of New York
*Attorney for Plaintiff*
120 Broadway - 23rd Floor
New York, New York 10271
(212) 416-6542

Of Counsel:

CHARLES T. CALIENDO
RICARDO E. VELEZ

Assistant Attorneys General

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| -against- | : | **COMPLAINT** |
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Plaintiff, by Eliot Spitzer, Attorney General of the State of New York (the "Attorney General"), on behalf of the People of the State of New York, complaining of the above-named defendants, alleges the following upon information and belief:

## PRELIMINARY STATEMENT

1. The Attorney General brings this action against various indirect subsidiaries of Canadian Imperial Bank of Commerce ("CIBC") for fraud, deception, false pretenses and concealment and suppression of material facts involving securities in violation of New York State's Martin Act and other statutes. The Attorney General additionally brings this action for common law fraud and aiding and abetting a breach of fiduciary duty.

2. This case involves fraud in connection with a strategy of trading mutual funds on a short-term basis known as "market timing." Defendants provided two services to numerous non-party "hedge funds" which were their clients: (a) securities brokerage services to execute rapid-fire purchases and sales of mutual fund shares; and (b) financing to conduct such activities.

3. Market timing causes damage to long-term shareholders. To discharge their fiduciary obligations, mutual funds seek to identify and reject harmful "timing" transactions in accordance with their legal rights to prevent shareholders from engaging in such activity and restrictions on short-term trading stated in prospectuses and/or fund company policies.

4. Defendants knowingly engaged in a series of subterfuges and false pretenses that were designed to and did evade the mutual funds' efforts to detect and prevent harmful market timing. These fraudulent schemes – known euphemistically as "flying under the radar" – enabled defendants' clients to reap substantial profits from market timing transactions that mutual funds would not have permitted had they known the truth. Such conduct goes well beyond executing an otherwise legal "market timing" strategy; it amounts to "run of the mill" securities fraud and is and always has been illegal.

5. Defendants also engaged in illegal "late trading" on behalf of their market timing clients. "Late trading" is a market timing strategy that involves market timers placing – and mutual funds, brokerage firms or other intermediaries accepting – orders for mutual fund shares after the 4:00 p.m. close of the financial markets. It enables a market timer to make trading decisions based on material information (*e.g.*, a corporate earnings announcement) released after the close that is predictive of the probable direction of – or determinative of actual – mutual fund share prices. Such information is not available to law abiding investors who must make their investment decisions prior to 4 p.m.

6. Many deceptive market timing and late trading transactions occurred for the benefit of CIBC's hedge fund clients in brokerage accounts controlled by and in the name of CIBC subsidiaries. CIBC-owned accounts were used to cement CIBC's control over the

movement of assets into or out of the accounts and reduce risk. Initially, these brokerage accounts were opened solely at a CIBC-owned broker-dealer. Later, defendants financed deceptive market timing transactions for the benefit of their clients in CIBC-owned and controlled accounts at unaffiliated broker-dealers.

7. Defendants' fraudulent conduct with respect to deceptive market timing activities financed at the CIBC broker-dealer included:

(a) establishing (on behalf of just ten hedge funds) more than 190 accounts, approximately 150 of which were in the name of CIBC subsidiaries, for the purpose of rotating market timing transactions between and among accounts to evade detection by mutual funds;

(b) assigning approximately 50 registered representative numbers to a single CIBC broker many or all of which were used to "fly under the radar" of mutual funds;

(c) approving the use of non-CIBC trading platforms (*e.g.*, Schwab and Fidelity) to process market timing transactions for hedge funds that had previously been blocked by mutual funds from trading at CIBC; and

(d) accepting mutual fund orders after the 4:00 p.m. close of the market to enable hedge funds to capitalize on post-4:00 p.m. information that would not have been available had the orders been processed lawfully.

8. Defendants' fraudulent conduct with respect to deceptive market timing transactions financed at non-CIBC broker-dealers included establishing (on behalf of just fifteen hedge funds) at least 400 accounts, including more than 300 accounts controlled by and in the name of CIBC subsidiaries, many or all of which were used for the purpose of rotating transactions to "fly under the radar." Defendants' fraudulent activities also included:

(a) financing market timing transactions at a trust company that defendants knew was intentionally engaging in schemes to conceal such activities from mutual funds;

(b) financing market timing transactions at a trust company that defendants knew was intentionally aiding their clients' "late trading;"

(c) financing a "pay to play" transaction that was used to induce a mutual fund manager to permit harmful market timing trades in breach of the manager's fiduciary duties to mutual fund shareholders; and

(d) approving creation of "special purpose" CIBC-subsidiaries designed to induce the false belief among mutual fund managers that market timing activities were not associated with CIBC or its market timing clients.

9. The Attorney General seeks recovery of damages suffered by long-term mutual fund shareholders as a result of these fraudulent activities, disgorgement of monies paid to defendants for engaging in them, restitution and other relief.

## PARTIES

10. Plaintiff is represented by Eliot Spitzer, Attorney General of the State of New York. Pursuant to Article 23-A of the General Business Law, the Attorney General oversees the offer, sale, issuance, promotion, advertisement, exchange, marketing, distribution and transfer of, or investment advice for, securities within and from the State of New York, and has authority to commence legal action when fraudulent activities have occurred or are about to occur. The Attorney General's principal office for oversight of the securities industry in New York State is located in New York County. Pursuant to sections 349 and 350-d of Article 22-A of the General Business Law, the Attorney General has the authority to obtain civil penalties for deceptive acts and practices in New York State. Pursuant to section 63(12) of the Executive Law, the Attorney General has the authority to obtain injunctive relief, restitution, and damages for repeated or persistent fraud in the conduct of business in or from New York State.

11. Defendant Canadian Imperial Holdings Inc. ("CIHI") is a corporation organized and existing under the laws of the State of Delaware. CIHI is and or was at all relevant times an indirect subsidiary of Canadian Imperial Bank of Commerce ("CIBC"), a financial institution organized under the Bank Act (Canada) with headquarters in Toronto, Canada that conducts business in the United States through "agencies" in New York and other states. CIHI's principal office is and/or was at all relevant times located in New York County. CIHI is and/or was at all relevant times the sole owner of defendants Rudy Capital USA LLC and Hudson River Investments LLC.

12. Defendant CIBC Bank and Trust Company (Cayman) Limited ("CIBC Cayman") is an offshore financial institution organized and existing under the laws of The Cayman Islands. CIBC Cayman's principal office is and/or was at all relevant times located in Grand Cayman, Cayman Islands. CIBC Cayman is and/or was at all relevant times a subsidiary of CIBC.

13. Defendant Rudy Capital USA LLC ("Rudy Capital") is and/or was at all relevant times a single member limited liability company organized under the laws of the State of Delaware. Rudy Capital's principal office is and/or was at all relevant times located in New York County. The managing member of Rudy Capital is and/or was at all relevant times CIHI.

14. Defendant Hudson River Investments, LLC ("Hudson River") is and/or was at all relevant times a single member limited liability company organized under the laws of the State of Delaware. Hudson River's principal office is and/or was at all relevant times located in New York County. The managing member of Hudson River is and/or was at all relevant times CIHI.

15. Defendant CIBC World Markets Corp. ("CIBC WMC") is a corporation organized and existing under the laws of the State of Delaware. CIBC WMC's principal office is

and/or was at all relevant times located in New York County. CIBC WMC is and/or was at all relevant times an indirect subsidiary of CIBC and a registered broker-dealer.

## STATUTORY AND LEGAL FRAMEWORK

16. The Attorney General brings this action pursuant to his statutory and common law authority and under the following provisions of law.

17. Article 23-A of the General Business Law of the State of New York, commonly referred to as the "Martin Act," and the regulations issued pursuant thereto, regulate the offer and sale of securities within and from the State of New York and authorize the Attorney General to investigate the conduct of persons and entities engaged in, *inter alia*, the issuance, exchange, purchase, sale, promotion, negotiation, advertisement or distribution within or from the State of New York of any securities or the rendering of investment advice with respect thereto.

18. The Martin Act proscribes fraudulent practices in connection with the sale of securities. Among the provisions relevant to this action are the following:

(a) General Business Law § 352(1), which prohibits fraud and fraudulent practices and provides, *inter alia*, that a violation of any section of Article 23-A of the General Business Law is a fraudulent practice and authorizes the Attorney General to investigate such practices;

(b) General Business Law § 352-c, which prohibits any person, partnership, or corporation from making any false representations, engaging in deception, fraud or false pretense, or concealing any material facts that the person knew, should have known, or made no reasonable effort to ascertain the truth; and

(c) General Business Law § 353, which authorizes the Attorney General to seek a permanent injunction enjoining any individual or entity who has taken part in, or has been concerned with, fraudulent practices from directly or indirectly engaging in the issue, sale, or offer of securities within or from the State of New York, and to seek restitution.

19. General Business Law § 349 declares unlawful any deceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service in the State of New York. Pursuant to General Business Law § 350-d, Plaintiff is entitled to a civil penalty of up to $500 for each of the defendants' violations of General Business Law § 349.

20. Section 63(12) of the Executive Law authorizes the Attorney General to seek an injunction barring repeated fraudulent and/or illegal conduct in the carrying on, conducting or transaction of business, and to seek restitution and damages.

21. Finally, as the State of New York's chief legal officer, the Attorney General brings this action pursuant to his *parens patriae* authority. Where, as here, the interests and well-being of the people of the State of New York are implicated, the Attorney General possesses *parens patriae* authority to commence legal actions for violations of state law. The State of New York has a quasi-sovereign interest in upholding the rule of law, in protecting the economic well-being of its residents and, with specific reference to the present action, in ensuring that the marketplace for the trading of securities functions fairly with respect to all persons who participate or consider participating therein.

## MARKET TIMING AND LATE TRADING

### I. Market Timing And Deceptive Market Timing Techniques

22. "Market timing" is the short-term trading of mutual fund shares. This type of trading was often conducted by sophisticated financial entities known as hedge funds. Typically, computerized trading "models" utilized by hedge funds signaled when to engage in rapid-fire buys and sells of mutual funds.

23. These "models" were often complex and varied depending upon the strategy being utilized. For purposes of illustration, a simple strategy might work as follows. When a model indicated financial markets would rise in the short-term, the hedge fund would fully invest in equity mutual funds to capitalize on the expectation that the stocks comprising the mutual funds' portfolios would rise and, consequently, the share prices of the mutual funds would also rise. When the model subsequently indicated that financial markets would suffer a short-term decline, the expectation changed – a drop in the share price of the mutual funds was anticipated. On a downward signal, therefore, the hedge fund would sell its fully-invested position in equity mutual funds, capture a short-term profit and typically invest the proceeds in a virtually riskless position in a money market fund. While resting in the security of the money market fund, the hedge fund would lie in wait for its next opportunity. When the model again predicted a short-term rise in financial markets, the hedge fund would sell its money market position and again buy equity mutual funds. When the model indicated the short-term upward rally was over, the hedge fund would sell its position in equity funds, again lock-in a profit and again return the proceeds to the safety of a money market fund.

24. These short-term exchanges of mutual fund shares – sometimes referred to as "roundtrips" – often occurred within a day, a few days or a few weeks of each other. Depending on the strategy, a hedge fund might engage in fifty or more "roundtrips" in less than a year allowing its money to safely rest in a money market fund most of the time. If a hedge fund "timed the market" right, therefore, it could dramatically reduce its stock market risk with little or no loss in upside potential.

25. Mutual funds are not designed or marketed as short-term trading vehicles. Rapid trading by market timers injures long-term shareholders in at least three ways.

26. First, rapid traders increase transaction costs for the mutual fund as a whole. Shareholders who constantly buy and sell cost the fund more money in processing trades than those who buy and hold for the long-term.

27. Second, market timing allows frequent traders to profit at the expense of long-term investors. This effect, known as "dilution," works as follows. When a timer buys into an equity fund, a mutual fund portfolio manager will, generally speaking, either invest the timer's money in stocks or hold the funds in cash. If the share price of the mutual fund rises a few days later, the timer will typically redeem his shares in the equity fund, lock-in a profit and retreat to the safety of a money market fund. If the portfolio manager held the timer's money in cash during the timer's roundtrip, the mutual fund, in effect, simply gives the uninvested cash back to the timer, plus the timer receives a pro rata portion of the gain on the stocks in the mutual fund's portfolio. Allowing the timer to share in any portion of the increase in portfolio value is unfair because he contributed nothing to the gain. Since the timer's money remained in cash, the timer's "investment" was never put to work to earn a profit for all shareholders. To the contrary, the market timer darted into the equity fund at the last moment and clipped part of the upside that would otherwise have gone to buy and hold shareholders. When timers make numerous of these uninvested "roundtrips" in and out of the fund, they continually "pick off" pieces of long-term shareholders' profit. This substantially waters down – or "dilutes" – investment returns.

28. The third form of damage can result regardless of whether a timer's money is held in cash or invested by the mutual fund. In either instance, the mutual fund may incur

unnecessary costs associated with having to buy and sell securities or otherwise raise cash to meet timer redemptions. In the situation where a timer's cash was not invested, in order to give the timer his piece of the increase in value of the portfolio's shares, the mutual fund may have to either draw down on a line of credit or sell stocks to raise the money. Both options result in costs to long-term shareholders. Drawing on a line of credit causes the mutual fund to incur borrowing costs. When timers conduct numerous roundtrips, such costs can be substantial. Selling stocks can also cause substantial harm. A portfolio manager may have to sell stocks he just purchased into a falling market. This not only jettisons the *long-term* investment potential of the securities – the reason they were purchased in the first place – but causes the fund to incur otherwise unnecessary brokerage costs to sell the securities. These brokerage costs can also be substantial and are an utter waste because the securities were never given a meaningful opportunity to contribute to mutual fund returns. In addition, where the portfolio manager sells stocks that would have been held but for the timer's redemption, the fund may incur additional capital gains tax liabilities that are ultimately borne by long-term shareholders. These same adverse consequences may result when a portfolio manager has invested a timer's cash in stocks only to have to convert securities back to cash a short time later to meet the timer's redemption.

29. Significantly, mutual funds have the legal tools necessary to prevent shareholders from engaging in frequent short-term "roundtrips." And given the harmful effects, as fiduciaries, mutual fund managers have obligations to affirmatively use these tools to put a stop to market timing activities.

30. Many fund prospectuses expressly state: (a) the mutual fund has the absolute right to refuse to allow purchases of its shares (or exchanges between different funds in the same fund

family) by any shareholder; (b) the mutual fund has a numerical limit on the trades a given shareholder can execute in a fund; and/or (c) the mutual fund does not allow harmful "market timing" activities. Similarly, many fund companies' internal policies contain restrictions on short-term trading.

31. Many mutual funds honored their fiduciary obligations. They vigilantly attempted to enforce restrictions on market timing in their funds.

32. Other mutual funds were "two-faced." On one hand, they breached their fiduciary duties by entering into agreements that expressly permitted shareholders to "time" the funds. Such arrangements – sometimes referred to as "capacity" agreements – often permitted the timer to exceed restrictions on short-term trading in the relevant prospectus and/or internal fund company policies. The mutual fund manager's reward for breaching its obligations was the fees generated by the timing assets in its funds. In addition, in exchange for the right to rapidly trade in certain funds, some timers made "static" investments in the same or a different fund within the same fund family (*i.e.*, an investment that would not be rapidly traded) to induce mutual fund managers to breach their fiduciary obligations to long-term shareholders. These so-called "sticky money" investments generated additional fees for fund managers. On the other hand, even "two-faced" mutual fund managers attempted to enforce anti-market timing rules with respect to timers with which they did not have an express "capacity" agreement.

A. <u>The "Timing Police"</u>

33. Both vigilant and "two-faced" mutual funds (or their agents) typically employed personnel to ferret out "timers" and put a stop to their harmful short-term trading activities. Such employees were generally known as the "timing police." For a variety of reasons, however,

identifying market timing transactions among thousands of legitimate transactions could prove challenging.

34. The multi-trillion dollar mutual fund industry processes thousands of buy, sell and exchange transactions everyday on behalf of a multitude of institutions and individuals. Some customers purchase and sell shares in direct transactions with the fund company. Other customers, such as retirement plans and their beneficiaries, typically clear transactions indirectly through a trust company or other intermediary. Still other customers, such as hedge funds, typically clear their mutual fund transactions indirectly through brokerage firms. In the indirect clearing scenarios, mutual funds often do not know the identity of their shareholders. In the system for processing mutual fund transactions, many times it is the broker or intermediary who has superior information.

35. The specific transaction information given to a mutual fund by a broker varies. By way of example, sometimes the mutual fund is provided an anonymous account at the brokerage firm represented by a series of account numbers, but not the shareholder's identity. The mutual fund may not be provided with the registered representative's name associated with an account, but rather only the identification number assigned to the "rep" by the brokerage firm. In such situations, some timing police attempt to track suspected market timing transactions by "rep" number and/or account number. Other mutual funds may be aware of the shareholder's identity by name, by tax identification number or sometimes both. In such "fully disclosed" situations, timing police can track suspected market timing trades by name and "tax id," as well as account number and "rep" number.

36. In addition, timing cops are generally aware that many timers typically wanted to trade mutual funds in large dollar amounts to make the timing as profitable as possible. To reduce the burden of having to sift through an enormous amount of data, mutual funds often set minimum transaction thresholds to identify a suspected market timing transaction. If the dollar volume of a given trade falls below a certain level, the timing cops may not examine it to identify whether it was placed by a suspected timer. For example, the timing police might establish $300,000 as the transaction threshold. As a result, all trades that are above $300,000 and placed within a short period of time by the same registered representative or in the same account number might be investigated. If after further investigation a "timing" transaction was identified, it might be rejected and a so-called "stop" or "cease and desist" letter might be sent by the mutual fund to the broker. A typical stop letter said the following:

> We have noticed a pattern of excessive trading in these...accounts. As you know, mutual funds are intended to be long-term investments. Short-term trading hinders the portfolio manager's ability to adhere to the fund's investment strategy and may adversely affect performance....As stated in the prospectus, we reserve the right to restrict exchanges and share purchases that we do not feel are in the best interests of the funds or the majority of the shareholders....[W]e take this responsibility to our shareholders very seriously. Therefore, since your excessive trading could be detrimental to the fund, we have placed a stop purchase on your account and we have removed all of your exchange privileges....

B. "Flying Under The Radar"

37. Certain hedge funds and other market timers fraudulently evaded mutual fund-imposed restrictions designed to prevent market timing.

38. In situations where "capacity" agreements were not desirable or available, evading detection efforts by mutual funds was paramount to reaping the considerable profits to be made market timing funds. Consequently, an arrangement with a brokerage firm that was willing to

fraudulently manipulate its informational advantage over mutual funds to conceal, disguise and/or misrepresent the source of market timing activities was a coveted relationship. Over time, various pretenses were developed to hide or disguise market timing activities and thereby make them more difficult to detect and prevent. These schemes were known among market timers as "flying under the radar" of the mutual fund and brokers were paid handsome "wrap" fees for engaging in them – often as much as 1% to 2% of the dollar amount being timed.

39. One scheme is reminiscent of a "shell game" designed to deceive the timing police. After initially getting "caught" conducting market timing transactions in an account, the mutual fund would send the broker a "stop" letter. In an attempt to deliberately evade the trading restriction, the hedge fund and broker simply opened a new account, perhaps under a different "rep" number, and placed the market timing trades in the new account. If they got "caught" again, the broker would simply open a third account and so on. Alternatively, some timers would not wait for the timing cops to catch them and send a "stop" letter before opening a new account. Instead, in anticipation of the actions of the timing police, the timer would open perhaps five or ten accounts at the outset. Trades would be rotated between and among different accounts to "hide the ball." These practices were sometimes referred to among market timers as creating "also" accounts or "cloning." In both cases, the idea was to disguise the activities and trick the timing cops by creating the false impression that the harmful trading had stopped or was not occurring in the first place. Alternatively, the scheme was designed to create the false impression that the short-term trades were not being placed by the same shareholder. In this way, if the mutual fund prospectus and/or the fund company's anti-timing policy allowed a shareholder to

conduct four exchanges per year, by using ten accounts instead of just one, the timer might be able to get away with forty exchanges rather than the four the mutual fund intended to allot.

40. A related method of flying under the radar involved breaking the trades up into smaller dollar amounts to avoid detection by the timing police. The hedge fund (or the broker on the hedge fund's behalf) sometimes solicited corrupt "wholesalers" or other mutual fund employees to ascertain the dollar threshold at which timing police scrutinized suspected timing transactions. Alternatively, an experienced timer or timing broker could simply make an "educated guess" concerning the dollar threshold at which a given mutual fund would scrutinize suspected timing transactions. If, for example, the threshold was $1 million, rather than submit a single trade in the amount of $1 million on behalf of a hedge fund, the broker might submit five separate trades in the amount of $200,000 in the same account or different accounts to avoid detection by the timing police.

41. In instances where the shareholders' identity was "fully disclosed" to mutual funds by name and/or tax identification number, certain hedge funds would simply create multiple shell companies and give them different names that could not be readily connected by the timing cops. To further the illusion that the trading was not emanating from a single shareholder, hedge funds obtained separate tax identification numbers for the shell companies even though there was no legitimate purpose or need for them. The shell companies were often limited liability companies whose sole member was the "parent" hedge fund. The companies typically had no employees or operations independent from the "parent" hedge fund and did not file a separate tax return. Instead, the "parent" hedge fund filed a single consolidated tax return

on behalf of all the shell entities. The true purpose for having the separate tax identification number was to perpetuate the charade with the mutual fund.

42. Another method of flying under the radar was to clear transactions through intermediaries other than broker-dealers. For example, some market timers cleared trades through trust companies that typically processed mutual fund transactions for employees participating in corporate retirement plans. The idea was to hide the hedge funds' trades among the mass of retiree trades being processed legitimately. Still others used the clearing platforms at large mutual fund "supermarkets" such as Charles Schwab & Co., Inc. and Fidelity Investments (or their affiliates). These "supermarkets" often process mutual fund transactions in "omnibus" format in the ordinary course of business. "Omnibus" processing often means that purchase and sale orders of thousands of "supermarket" customers are aggregated and submitted to the mutual fund on a net basis. Timers cleared through these "supermarkets" in an effort to have their market timing trades go undetected in the multitude of combined transactions.

## II. Late Trading

43. The price at which an investor can buy or sell a stock listed on an exchange or traded in the over-the-counter market fluctuates during the trading day. By contrast, prices of mutual fund shares are set once a day after the market is closed.

44. The prices at which shares of a mutual fund are bought and sold is referred to as the net asset value or "NAV." A mutual fund's NAV is generally calculated as of 4:00 p.m. New York time, the closing time of the New York Stock Exchange. Orders to buy, sell or exchange mutual fund shares placed with a mutual fund, broker-dealer or other intermediary at or before

4:00 p.m. on a given day receive that day's price. Conversely, orders placed after 4:00 p.m. are supposed to be priced using the following day's price.

45. "Late trading" refers to a market timer placing – and a mutual fund, broker-dealer or other intermediary accepting – mutual fund orders after the 4:00 p.m. deadline and yet still receiving same-day pricing. Corporate earnings announcements, significant press releases and other events affecting the financial markets often occur after 4:00 p.m. Such material information can be predictive of the probable direction of – or determinative of actual – mutual fund share prices and, therefore, can play an important role in the market timer's decision-making process on whether to purchase or sell a mutual fund and/or engage in related "hedging" transactions. And such post-4:00 p.m. information is not available to law abiding investors who must place their mutual fund orders prior to or at 4:00 p.m. to receive that day's price.

46. Late trading occurred primarily because broker-dealers and other intermediaries fraudulently manipulated the industry-wide system for processing mutual fund transactions. While mutual fund shareholders are supposed to place orders at or before 4:00 p.m. to get that day's price, unlike the near instantaneous transmission of stock orders for execution, broker-dealers and other intermediaries could (and often did) transmit mutual fund orders to fund companies for execution after 4:00 p.m. Fund companies (or their agents) then tally the orders and calculate the NAV *as of* the 4:00 p.m. close of the market. This calculation often did not occur until 5:30 p.m. or later. To prevent "late trading," the broker-dealer or other intermediary makes an express or implied representation to the mutual fund that the order being transmitted was placed by the mutual fund shareholder at or before 4 p.m. and, therefore, is entitled to that day's pricing. In addition, the broker-dealer or other intermediary typically represented that

orders it forwarded to the mutual fund for processing complied with rules promulgated by the U.S. Securities and Exchange Commission. The SEC's "forward pricing rule" requires that orders placed at or before the market close receive that day's NAV while orders placed after the close receive the next day's NAV. See 17 C.F.R. § 270.22c-1.

47. To earn substantial fees, certain broker-dealers and other intermediaries abused this system. They gave hedge funds the ability to place orders after 4:00 p.m. (including, in some cases, to place orders after the time at which NAVs were actually *calculated*) by transmitting the illegal post-4:00 p.m. orders with other legitimate orders to be processed using that day's price. In so doing, these broker-dealers and other intermediaries breached their representations to mutual funds, violated the "forward pricing rule" and otherwise engaged in false pretenses in connection with the sale of securities under the Martin Act.

## THE FRAUDULENT PRACTICES OF THE DEFENDANTS

### I. Background

48. Canadian Imperial Bank of Commerce ("CIBC") and its subsidiaries engage in numerous commercial activities throughout the world. CIBC owns CIBC World Markets Corp. ("CIBC WMC"), a broker-dealer registered in the United States. ("CIBC" is sometimes used hereinafter as a reference to CIBC and/or one or more of its subsidiaries.) During the relevant time period, CIBC WMC had a separate business unit catering to institutions and high net worth individuals. This business unit was known by the trade style CIBC Oppenheimer. A former Managing Director at CIBC Oppenheimer, Michael Anton Sassano, III, and several other members of Sassano's team (collectively sometimes referred to as the "Sassano Group"), were

principally involved in conducting deceptive mutual fund transactions for – and/or accepting "late trades" from – hedge funds at CIBC Oppenheimer.

49. A separate area of the bank provided financing to hedge funds engaged in market timing, including clients of the Sassano Group. Former employees in CIBC's Equity Arbitrage Group financed deceptive market timing activities in brokerage accounts at CIBC Oppenheimer and other broker-dealers not affiliated with CIBC. Most of the accounts were in the name of CIBC subsidiaries and controlled by the Equity Arbitrage Group. Initially, the subsidiaries used were defendants Canadian Imperial Holdings Inc. ("CIHI") and CIBC Bank and Trust Company (Cayman) Limited ("CIBC Cayman"). Later, two additional "special purpose vehicles" were created for the express purpose of tricking mutual fund managers into believing market timing activities were not emanating from CIBC; those CIHI subsidiaries were defendants Rudy Capital USA LLC ("Rudy Capital") and Hudson River Investments LLC ("Hudson River").

50. Paul A. Flynn, a former CIBC Managing Director, and Jeffrey M. Haas, a former CIBC Executive Director, were principally involved in conducting the Equity Arbitrage Group's deceptive market timing activities. In addition, a former attorney in CIBC's legal department (the "Former CIBC Attorney") was complicit and a former CIBC Managing Director who ran the Equity Arbitrage area (the "Head of Equity Arbitrage") was also aware of or recklessly disregarded fraudulent market timing activities.

A. <u>The Sassano Group</u>

51. Michael Sassano was hired in 1995 as a broker at a CIBC Oppenheimer branch office located in New York City. Although Sassano was just 25 years old, he developed an impressive list of profitable market timing clients in short order.

52. By 1998, Sassano brought in more than $3.3 million in revenue for CIBC Oppenheimer. This revenue was generated in whole or in part from "wrap" fees paid by hedge funds to CIBC Oppenheimer for brokering mutual fund market timing transactions. Typical "wrap" fees amounted to 1% of total assets a given hedge fund had under management in CIBC Oppenheimer accounts.

53. Thereafter, Sassano was consistently one of the largest producers at the firm. From 1998 to 2002, CIBC Oppenheimer earned more than $40 million in gross revenues from Sassano's production alone, a substantial portion of which was derived from market timing. As Sassano's business grew, so did his group. Ultimately, Sassano had a team of more than ten registered representatives and assistants working under him. Sassano's stature within the firm reflected his production. CIBC made Sassano a Managing Director and he and his team had offices on the same floor as the senior most executives at CIBC Oppenheimer instead of with the branch manager and other brokers in Sassano's branch.

54. During the investigations conducted by the Attorney General's Office and the U.S. Securities and Exchange Commission, Sassano asserted his Fifth Amendment privilege against self-incrimination and refused to answer questions concerning market timing and late trading. Other members of the Sassano Group also asserted their Fifth Amendment privileges; they are former CIBC Oppenheimer brokers Dogan Baruh (Sassano's "right hand man"), Glenn Jerro, Bryan Hernandez and Peter Valverde-Garcia.

55. Knowledge of and substantial assistance with deceptive market timing activities at CIBC Oppenheimer was by no means limited to the Sassano Group, however. Certain of Sassano's fellow Managing Directors at CIBC Oppenheimer had knowledge of the Sassano

Group's deceptive market timing activities and provided substantial assistance in furthering the Sassano Group's schemes. Those individuals include the manager in Sassano's branch office ("Sassano's Branch Manager"), the "number two" executive at CIBC Oppenheimer to whom Sassano's Branch Manager and other branch managers were accountable (the "Head of Private Client Services") and the senior CIBC Oppenheimer officer who was responsible for, among other things, mutual fund marketing and variable annuities (the "Financial Services Director"). Other senior officers at CIBC were made aware of Sassano's deceptive market timing activities but failed to take action to curtail them.

56. CIBC sold CIBC Oppenheimer to an affiliate of Fahnestock & Co., Inc. ("Fahnestock") in January 2003 and CIBC retained a 35% ownership interest in the Fahnestock affiliate. Sassano and his team, Sassano's Branch Manager, the Head of Private Client Services, the Financial Services Director and various other CIBC Oppenheimer employees with knowledge of the Sassano Group's deceptive activities became Fahnestock employees. From January 2003 through and including May 27, 2003, CIBC WMC continued to clear deceptive market timing transactions for and provide other transition services to the Sassano Group.

B. Financing Of Market Timing <u>By The Equity Arbitrage Group</u>

57. While not directly involved with providing financing to market timers, Sassano was instrumental in getting the Equity Arbitrage Group's business off the ground. CIBC's financing of deceptive market timing activities began with Sassano's clients at CIBC Oppenheimer before it expanded to other broker-dealers.

58. In or about late 1998, Sassano introduced his clients to Flynn and Haas for the purpose of arranging leverage for market timing transactions. The introduction resulted in profitable financing relationships for the bank. Eventually, CIBC earned substantial fees by extending financing to many of Sassano's clients.

59. Some of the financing provided by CIBC was in the form of "plain vanilla" loans to the hedge fund. The proceeds of the loan were deposited into a CIBC Oppenheimer brokerage account that was used to conduct market timing transactions in mutual funds, and Sassano was the assigned registered representative. The brokerage account was owned by and in the name of the hedge fund or one of its affiliates and the hedge fund made all the trading decisions. To secure CIBC's loan, the hedge fund "pledged" the account to CIBC. In return for providing the loan, CIBC received interest payments.

60. Under the "plain vanilla" loan structure, the amount of leverage CIBC could provide was limited. Regulations T and U, adopted pursuant to provisions of the Securities Exchange Act of 1934, limited CIBC to, in effect, loaning just one dollar for every one dollar the hedge fund posted as collateral (*i.e.*, cash and/or the mutual fund shares). See 15 U.S.C. §§ 78g (c) & (d); 12 C.F.R. Parts 220 (Regulation T) & 221 (Regulation U) [hereinafter "Federal Margin Regulations"]. As the timing transactions became more profitable, Sassano's clients wanted to increase the amount they could borrow.

61. To avoid the Federal Margin Regulations, CIBC used so-called "total return swaps." In this structure, CIBC opened a brokerage account in the name of CIHI or CIBC Cayman. (CIBC Cayman was generally used when the hedge fund client was an offshore entity.) CIBC and the hedge fund would then deposit cash or securities into the account according to a

leverage ratio. For example, if the amount of financing provided was $75 million and the leverage ratio was 3 to 1, the hedge fund would deposit $25 million and CIBC would deposit $75 million. CIHI then appointed the hedge fund as investment adviser to manage the brokerage account. The brokerage account was referred to as a "Managed Account." CIHI then created a list of approved mutual funds that the investment adviser was permitted to market time in the Managed Account and established ceilings on the amount that could be invested in any one mutual fund family and/or mutual fund sector (*e.g.*, no more than 5% of the Managed Account balance could be invested in technology-related mutual funds). CIHI also established various controls over the Managed Account, including, most significantly, a strict rule that only CIBC employees (and not the hedge fund or broker-dealer) could authorize the transfer of funds or securities into or out of the Managed Account.

62. CIHI was the legal owner of the mutual funds in the Managed Account. It then entered into a separate contractual arrangement with the hedge fund to deliver to it the market timing profits. In other words, CIHI "swapped" the profits earned in the Managed Account it owned in exchange for a fee based on the amount of financing CIBC extended to the hedge fund. As the hedge fund made trading gains in the Managed Account, under the terms of the swap agreement, it could demand that CIBC increase the amount of financing. Successful market timing by one of its hedge fund clients was thus beneficial to CIBC because CIBC earned more fees as the amount of financing extended increased.

63. The risk to CIBC's hypothetical $75 million was *de minimus*. Before CIHI suffered any loss of its "collateral," $25 million in market timing losses would have to be sustained. This was highly unlikely for several reasons. First, since the hedge funds were short-

term trading mutual funds, the value of the Managed Account was invested in equity funds for only a short period of time. The remainder of the time the assets typically rested in a money market fund which was subject to limited risk. Second, CIHI typically insisted that the Managed Account be diversified across many different market sectors with no more than a small percentage of the account value invested in any one fund. Third, some hedge funds "hedged" the long positions in mutual funds using various "shorting" techniques. These short strategies limited downside potential in the Managed Account in the event the mutual fund investment turned sharply downward. Finally, CIHI had an absolute right to terminate the transaction when the value of the hedge fund's investment fell to 40% or less of the initial amount deposited by the hedge fund into the Managed Account. CIHI also received daily reporting of the positions in all of its Managed Accounts and knew its aggregate potential exposure at the end of any given trading day. Consequently, even assuming that a sophisticated hedge fund's timing strategy was so poor as to burn through 40% of its investment, CIHI could terminate the transaction before its hypothetical $75 million was ever truly at risk.

C. <u>Trouble Hiding Market Timing Trades</u>

64. With the structure in place for servicing market timers' brokerage and financing needs, CIBC embarked on building its market timing business. At the outset, the CIHI or CIBC Cayman Managed Account was opened at CIBC Oppenheimer through Sassano. Both the Sassano Group and the Equity Arbitrage area thrived.

65. By the end of 1999, Sassano's overall business had more than doubled from 1998; on his production alone, Sassano generated more than $6 million in revenues for CIBC Oppenheimer in 1999. Similarly, the Equity Arbitrage Group's revenue from financing market

timing transactions soared from $56,000 to $1,713,000 as the Flynn/Haas silo closed seven more deals in 1999 than in 1998. CIBC Oppenheimer also benefitted from the financing the Equity Arbitrage Group provided to Sassano's clients. First, as the amount of financing provided by CIBC increased, the "wrap fees" earned by CIBC Oppenheimer also increased. Second, CIBC Oppenheimer was paid a referral fee (a portion of which was shared with Sassano) from each financing transaction.

66. As the hedge funds' trading became more successful, a problem developed for CIBC. Many mutual fund "timing cops" began to detect CIBC's market timing activities and reject the transactions. By the end of 1999, more than ten mutual fund families had collectively sent CIBC Oppenheimer at least forty communications requesting that market timing activities conducted in at least sixty accounts cease. A CIBC employee summarized the situation in an e-mail dated October 6, 1999:

> The trading strategy for the CIBC...[managed] account is to go in and out of a wide variety of large, well-known mutual funds on a frequent basis to take advantage of small gains in the mutual funds. Any gains (or losses) in these trades are added to (or recovered from) the hedge fund's initial contribution [to the account]. The assets [in the account] are held at CIBC Oppenheimer and the daily mutual fund trades are processed with other normal customer flow in and out of mutual funds at CIBC Oppenheimer. **The problem: These trades have been very successful. Volumes have grown (across all counterparties [i.e., hedge funds]) to the point where CIBC Oppenheimer is beginning to experience difficulty in "hiding" its trading activities for these trades within its usual customer flow activity.** As such, we are being asked to consider whether or not we would allow these trades to be done through other brokers...and would like to have discussions with [a large broker-dealer] in the near future....

(Emphasis added) Action was taken to solve the problem.

D. Senior Management Approvals

67. Rather than comply with the demands of mutual funds to put a stop to timing activities, CIBC's senior management approved, recklessly disregarded and/or acquiesced in the use of numerous deceptive tactics and strategies by both the Sassano Group and the Equity Arbitrage Group. Senior management did the following to further CIBC's abilities to earn substantial fees from both the brokering and financing of deceptive market timing activities at CIBC Oppenheimer (*i.e.*, through Sassano) and the financing of deceptive market timing at non-CIBC broker-dealers and at a trust company:

(a) gave Sassano the exclusive right among CIBC Oppenheimer brokers to time mutual funds, including mutual funds that had repeatedly requested that Sassano's activities cease;

(b) approved, recklessly disregarded and/or acquiesced in the use by the Sassano Group of multiple registered representative numbers and accounts, including accounts in the name of CIBC subsidiaries, for "flying under the radar" at mutual fund companies;

(c) built Sassano an internal CIBC trading platform designed to process large numbers of mutual fund transactions and approved, recklessly diregarded and/or acquiesced in its use by the Sassano Group to "fly under the radar;"

(d) approved the use of non-CIBC trading platforms (*e.g.*, Schwab and Fidelity) to time mutual funds, including mutual funds that had repeatedly requested that Sassano's timing activities at CIBC Oppenheimer cease, knowing that the purpose was to disguise Sassano's activities and/or conceal them from mutual fund managers;

(e) ignored the repeated pleas of fund companies for assistance in putting a stop to the Sassano Group's deceptive market timing activities and, in certain cases, affirmatively misled fund companies concerning Sassano's timing activities;

(f) approved market timing transactions in variable annuities despite having been told by CIBC WMC legal and compliance officers that variable annuities are not appropriate vehicles for such transactions;

(g) approved hundreds of millions in financing to just fifteen hedge funds knowing or recklessly disregarding that more than 400 accounts, including more than 300 accounts controlled by and in the name of CIBC subsidiaries, were established to engage in deceptive "rotation" activities at numerous broker-dealers other than CIBC Oppenheimer;

(h) financed market timing transactions at a trust company knowing that the trust company was intentionally engaging in schemes to conceal such activities from mutual funds;

(i) financed market timing transactions at a trust company knowing the trust company was intentionally aiding their clients' "late trading," including late trading after NAV prices were calculated by mutual funds;

(j) financed a hedge fund's "sticky money" investment that was used to induce a mutual fund manager to grant market timing capacity in breach of the manager's fiduciary duties to mutual fund shareholders; and

(k) approved creation of "special purpose" CIBC-subsidiaries designed to induce the false belief among mutual fund managers that market timing activities were not associated with CIBC or its market timing clients.

## II. Deceptive Market Timing At CIBC Oppenheimer

### A. Sassano's "Restricted List"

68. CIBC Oppenheimer processed mutual fund trades centrally through CIBC Oppenheimer's Mutual Fund Operations area. Under CIBC Oppenheimer's clearing arrangements with mutual funds, the identity of its clients was not shared with fund families. The mutual fund typically saw only anonymous account and registered representative numbers associated with a given mutual fund transaction. If mutual fund employees had questions concerning a particular transaction, they would typically contact a CIBC Oppenheimer employee in Mutual Fund Operations. Alternatively, mutual fund employees sometimes contacted a separate CIBC WMC business unit devoted to promoting the sale of mutual funds at CIBC and maintaining good relations with fund families. This area was known as Mutual Fund Services.

69. In a memo dated November 3, 1999, an employee in the Mutual Fund Operations area informed the Head of Private Client Services, Sassano's Branch Manager, the director of firmwide operations (the "Director of Operations"), a senior officer in Mutual Fund Services (the "Head of Mutual Fund Services") and Sassano that numerous mutual fund companies had "contacted CIBC Opco Mutual Funds operations and/or [Mutual Fund Services] requesting the...practice of frequent market timing exchanges be stopped." Because Sassano's clients were receiving "total return swap" financing from CIBC, many of the stopped accounts were in the name of CIHI or CIBC Cayman. The memo stated that seven separate fund families had requested that Sassano's market timing transactions cease.

70. Rather than comply with these requests, the Head of Private Client Services approved (and subsequently enforced) an arrangement where Sassano was given the exclusive right among CIBC Oppenheimer brokers to conduct timing transactions in a "restricted list" of seventy two fund families. Despite their protests that timing stop, the seven fund families identified in the November 3, 1999 memo were on the approved "restricted list." This approval was given despite the fact that mutual funds informed CIBC Oppenheimer that Sassano's market timing transactions harmed the mutual funds' long-term shareholders, some of whom were also CIBC Oppenheimer clients.

71. Sassano's exclusive right to time at CIBC Oppenheimer, and the deceptive nature of the business, is documented in an undated confidential summary of CIBC's "Market Timing Business," which states:

> This business has a high level of confidentiality since Mutual Fund Companies discourage the trading of their funds. **Investment Advisors [*i.e.*, hedge funds] pay significant fees to broker/dealers due to the stealth nature of the**

> **business**. In order to control this activity, CIBC Oppenheimer has given Michael Sassano a monopoly within the firm....

(Emphasis added)

B. Multiple Account Numbers And "Breaking Up" Trades

72. To "fly under the radar" at mutual funds, the Sassano Group rotated trades through multiple accounts and/or broke-up trades in the same account or a series of accounts to evade detection by the timing police. Many of these accounts were in the name of CIHI or CIBC Cayman pursuant to financing arrangements with the Equity Arbitrage Group.

73. The Sassano Group referred to this fraudulent "procedure" as a "game." For example, in an exchange of e-mails between Dogan Baruh and Sassano, Baruh wrote:

> [A particular hedge fund client's] account [sic] were not on that list and therefore may not have gotten caught...Also, for [the client's] accounts a bunch of their trades didn't go through. [The fund company] stopped us. (We had a 2-1 deal verbally. I suggest we tell them they are fucking us nad [sic] that we will start trading their sticky money. [At two other fund companies] (we were playing the game with those) and now we are stopped on certain symbols....

74. The Sassano Group's "games" created such an overwhelming crush of orders that employees in the Mutual Fund Operations area had trouble handling the volume. In response to complaints, Dogan Baruh made the purpose of the scheme crystal clear:

> We obviously aren't trying to create more work for you guys by splitting these trades up. **We are trying to break them up so the fund companies do not think these are market timing accounts, even though they are....**

(Emphasis added) The head of Mutual Fund Operations signaled his complicity; instead of questioning the deceptive tactics in Baruh's e-mail, he replied: "I understand your methods."

75. Sassano's Branch Manager and the chief compliance officer in Sassano's branch (the "Sassano Branch Compliance Officer") were also aware of the Sassano Group's schemes.

For example, in an e-mail, the Sassano Branch Compliance Officer informed Sassano's Branch Manager:

> I think we are going to have a potential problem with the way Mike's group has been processing trades for some accounts. In an effort to draw less attention to the timing issue, Mikes [sic] group is placing several exchanges in small amounts in an attempt to go unnoticed. So basically, where once you had 2 transactions[,] an exchange out and an exchange in, now we have 20 in smaller increments. While it may work in the short term, one account...generated almost 1,900 trades in August, on an exception run that both Compliance and our regulators look at when they perform an audit. I'm not sure they are doing anything illegal, but I would think once the fund families catch on they will be pissed. Should we get [the Financial Services Director] involved to see what the potential issues to the firm could be?

76. No bona fide investigation was ever initiated nor disciplinary action taken against anyone in the Sassano Group.

77. Knowledge of and substantial assistance with Sassano's activities was not limited to his branch and the Mutual Fund Operations department, however. Senior management outside of Sassano's branch, including the Head of Private Client Services and the Financial Services Director, also knew about and supported Sassano's activities.

78. For example, Baruh asked the Head of Private Client Services to approve a special margin rate for one of Sassano's market timing clients. When the Head of Private Client Services inquired about the account number associated with the client, Baruh replied in an e-mail:

> There are three accounts (even though it is the same client) that add up to approx. $4,300,000. **The reason they have three separate account [sic] is to stay under the radar with mutual fund companies, otherwise it is the same entity.**

(Emphasis added) The Head of Private Client Services gave his approval for the margin rate in reply to Baruh's e-mail. The Head of Private Client Services was expressly made aware of the Sassano Group's deceptive activities on at least two other occasions.

79. The Sassano Group's deceptions were also known to or recklessly disregarded by senior management on the financing side of the bank, which owned and controlled many of the CIBC Oppenheimer accounts for which Sassano was the assigned broker.

80. For example, Paul Flynn explained in an e-mail to the Head of Equity Arbitrage:

> The swap with [a CIBC hedge fund client] which has approximately 73 million dollars in assets has 33 accounts in the name of CIBC Cayman Bank and Trust Company. We have been dealing with this issue directly with [the hedge fund] for about two months. [The hedge fund] would like to open new accounts with both CIBC WM[C] and [a non-CIBC broker-dealer]....We told [the hedge fund], [the non-CIBC broker-dealer] and CIBC WM[C] that we would be willing to open new accounts if they either closed accounts that would not be used going forward or increased the...amount of the loan. [The hedge fund] is one of the more aggressive Market Timers in our portfolio and the fact that they get "kicked-out" of accounts on a more consistent basis puts our structure at significant risk.

The Head of Equity Arbitrage forwarded the e-mail to the Head of Private Client Services at CIBC Oppenheimer and Sassano's Branch Manager stating:

> **[T]his particular client trades aggressively and uses small size to stay under the radar at the mutual funds**. It is very time consuming to manage all the account detail, for the size, and it puts the Cayman entity and therefore the business at risk with the [mutual] funds.

(Emphasis added)

C. <u>Multiple "Rep" Numbers</u>

81. The Sassano Group also used multiple registered representative numbers to "fly under the radar."

82. Broker-dealers, including CIBC Oppenheimer, typically issue at least one registered representative number to each of their brokers. These numbers are used for a variety of legitimate reasons including to ensure that revenues generated by a particular client account are credited to the broker assigned to the account. The commissions or fees earned in the account, after deducting the broker-dealers' share, are typically paid 100% to the responsible broker. Brokers sometime work in partnerships or teams, however, in which case more than one broker will be responsible for a given account. In such cases, in addition to each brokers' primary "rep" number, the broker-dealer will sometimes issue another "rep" number to designate the partnership or team. Typically, accounting personnel at the broker-dealer are told that the brokers in the partnership have agreed to split the revenues earned 50/50 or in some other specified percentages.

83. The Sassano Group, however, had as many as 50 registered representative numbers to use for the illegitimate purpose of deceiving mutual funds. Many "rep" numbers designated Sassano alone and others were in partnership with one or more other brokers. The Sassano Group accomplished their scheme by rotating trades through different accounts, sometimes with different "rep" numbers, to fool the timing police.

84. For example, Sassano and his team placed:

(a) more than $5 billion worth of transactions in a particular mutual fund family rotating transactions through up to 103 accounts in the name of CIBC subsidiaries and 14 registered "rep" numbers;

(b) more than $2.6 billion worth of transactions in a second mutual fund family rotating transactions through up to 74 accounts in the name of CIBC subsidiaries and 22 registered "rep" numbers;

(c) more than $1.9 billion worth of transactions in a third mutual fund family rotating transactions through up to 75 accounts in the name of CIBC subsidiaries and 11 registered "rep" numbers;

(d) more than $2 billion worth of transactions in a fourth mutual fund family rotating transactions through up to 88 accounts in the name of CIBC subsidiaries and 12 registered "rep" numbers; and

(e) more than $500 million worth of transactions in a fifth mutual fund family rotating transactions through up to 100 accounts in the name of CIBC subsidiaries and 18 registered "rep" numbers.

85. The Sassano Group also used registered representative numbers associated with former CIBC Oppenheimer employees to place market timing transactions and deceive mutual fund timing police. For example, Sassano's Branch Manager, the Head of Private Client Services, the Head of Mutual Fund Services and the Director of Operations were sent a February, 2002 e-mail in which a particular fund family detailed that Sassano was using eight different registered representative numbers to conduct market timing activities in its funds. At least five of those "rep" numbers were shared between Sassano and a former CIBC Oppenheimer broker who had long since left the firm.

86. Another example is seen in an October, 2001 e-mail to Sassano's Branch Manager in which a different former employee of CIBC Oppenheimer wrote:

> [C]ould you please at some point make sure my name is taken off of...[a particular] Rep #..., as that partnership [between Sassano and the former employee] crashed & burned a long time ago and I'd rather not...go to jail for churning mutual funds when I am just an innocent bystander...who is not making any money off it....

From November, 2001 – after the employee had left the firm – through 2003, Sassano and his team used this "rep" number to rotate up to or more than $1 billion of market timing transactions through 39 accounts in 30 different mutual fund families. Although the rep number was purportedly "shared" during this time, 100% of the payout went to Sassano.

87. Another scheme to avoid detection by the mutual funds involved Dogan Baruh and Glenn Jerro using their "primary" registered representative numbers to process market timing trades, but the payout on the account went 100% to Sassano. In an e-mail, Baruh explained:

> Glenn [Jerro] and I both have our own reps. I believe mine is 171, but was wondering if you would know what his is. Furthermore[,] we wanted to start using these rep[s] and open new accounts but have the 100% [sic] of the proceeds/commissions generated from those two reps to be credited to Mike's general rep number....

The primary purpose for the use of these rep numbers was to trick mutual funds into believing market timing activities were unconnected to Sassano. A sampling of Baruh's explicit e-mail instructions tells the story:

- <u>E-mail to members of the Sassano Group</u>: "Definitely do the buys under the jerro rep (271)[.] [T]hey [*i.e.*, fund family representatives] are looking into the Sassano name[.]"

- <u>E-mail to head of Mutual Fund Operations</u>: "[M]ake sure that everyone in the [Mutual Fund Operations] group knows what happens when they supply the fund families with the name on the rep. We are having a difficult time having the trades go through already, and if we help out the funds in tracking us down it will be that much harder."

- <u>E-mail to head of Mutual Fund Operations</u>: "If they [*i.e.*, fund family representatives] call to ask what rep this is give them rep Jerro. If they ask if it is timing tell them no."

88. In all, Baruh's rep number was used to rotate up to $129 million worth of market timing transactions through 104 accounts (many of which were in the name of CIBC subsidiaries) in 40 different mutual fund families. Jerro's rep number – in just a four month period – was used to rotate numerous transactions through up to 54 accounts.

89. Baruh elaborated on the fraudulent use of registered "rep" numbers in an e-mail to his fellow Sassano team member and a Mutual Fund Operations employee:

> Any way we can get Mike's name off the...accounts [of particular clients] and yet have him get paid? I am finding out that some of these...issues are occuring [sic] because of the "bad reputation" michael has had with the fund family. Two options: 1) We will need to enter the trades under a different rep [number],...while still keeping Mike's name on our side[; and/or] 2) remove Mike's name so that these accounts are no longer associated with Mike's name however he still gets credit for the accounts.

90. Baruh also shared the specifics of the Sassano Group's schemes with clients. For example, in a telephone conversation between Baruh and a trader at a hedge fund to which CIBC provided financing, Baruh explained the following:

Baruh: [A particular mutual fund company implemented the policy that] they're not going to accept new money from Mike Sassano based on the fact that in the past he had abused their funds so bad....

* * *

Baruh: He's got such a reputable name...

Trader: (Laughter)

* * *

Trader: Hey now, are you guys, are you guys doing anything so that, umm, you can open accounts that his name is not attached to?

Baruh: We can do it, but for some reason [this particular fund company] seems to have caught on. Like, I've done trades not under Mike's name, so Mike's name don't [sic] come up.

Trader: Uh-huh.

Baruh (whispering): I can't really talk right now 'cause my manager is in here, so I don't want to tell him more, more about this....

* * *

Baruh: But...I'll get back, I'll get back a trade a few days later and [they'll] be like "Who's rep 000?" for example, you know, and you're like

> "That's nobody" and then they know that it's a trick that we played on them...

D. The MFES System

91. Over time, the Sassano Group's transaction volume grew so large that the Mutual Funds Operations area could not effectively handle the order flow. Sassano sought, and CIBC Oppenheimer's senior management approved, the creation of a special computerized system for the purpose of processing the market timing transactions of Sassano's clients. The system was called the "Mutual Fund Exchange System" or "MFES."

92. Hedge funds used MFES for certain transactions, but could also have their orders processed manually. The clients using MFES accessed a special password-protected web site on the Internet and populated a spreadsheet with their trades for that day. Sassano and/or a member of his team then accessed the site and downloaded the trade sheets to a CIBC computer server. A special computer program written by CIBC then performed an automated check of certain data (*e.g.*, proper ticker symbol) and members of Sassano's team performed certain manual reviews for errors. Once satisfied the trades were in order, Sassano or a member of his team would transmit the trades for processing by the mutual funds. If a client wanted, or there were problems with MFES, trades could also be processed manually.

93. MFES helped Sassano and his team rotate a large volume of trades through multiple accounts and registered rep numbers to avoid detection by the mutual funds. Many accounts were in the name of CIHI or CIBC Cayman and controlled by the Equity Arbitrage Group. MFES also helped the Sassano Group "break up" client trades to stay below the threshold at which timing police might scrutinize suspected market timing transactions.

94. A mutual fund company notified the Head of Mutual Fund Services of this fraudulent practice in an e-mail:

> Mike Sassano has been market timing in a number of [our] International Funds. His office has been notified in the past about our market timing policy....[Our fund company] does not allow any market timing in International Funds. It appeared that for a while Michael and his team were following the guidelines until we ran an exchange report for all of Mike Sassano's accounts. At that time [we] discovered a number of accounts where market timing in International Funds continued (apparently Michael was keeping trades under the dollar threshold that he felt would draw attention to the timing).

95. Another example involves a Managed Account in the name of CIBC Cayman which was established pursuant to a financing arrangement with a hedge fund. During the period from September 25, 2002 to February 4, 2003, the Sassano Group placed purchase and sell orders in the approximate aggregate amount of $50,000 in a mutual fund. Instead of placing the order in a single $50,000 transaction, the trades were broken up into ten separate transactions of approximately $5000 apiece. The only purpose for breaking up the trades was to avoid detection of market timing activities.

96. A further example involves a different Managed Account in the name of CIBC Cayman which was established pursuant to a financing arrangement with the same hedge fund. During the period from October 17, 2002 to May 13, 2003, the Sassano Group placed purchase and sell orders in the approximate aggregate amount of $120,000 in a different mutual fund. Instead of placing the order in a single $120,000 transaction, the trades were broken up into twenty separate transactions of approximately $6000 apiece. The only purpose for breaking up the trades was to avoid detection of market timing activities.

97. During the approximately five years Sassano was employed at CIBC Oppenheimer, the Sassano Group executed approximately $156 billion worth of transactions

("broken up" and otherwise) in 106 different mutual fund families using hundreds of accounts and up to or more than 50 registered rep numbers.

E. Approval Of Other Trading Platforms

98. Because numerous mutual funds were demanding that CIBC cease market timing, CIBC Oppenheimer looked for other trading platforms to conceal Sassano's market timing activities. Ultimately, CIBC Oppenheimer opened accounts to place "under the radar" mutual fund trades on behalf of Sassano's clients at Charles Schwab & Co., Inc. and Fidelity Investments (or their affiliates) and at a third discount broker.

*Schwab Trading Platform*

99. By 1999, CIBC Oppenheimer had already received at least forty communications from mutual funds requesting that market timing activities cease. Sassano first approached Schwab about using its trading platform to conduct market timing activities in late 1999. "Wrap fees" would be earned by CIBC Oppenheimer regardless of whether a CIBC Oppenheimer platform or some other clearing platform was used to execute the trades.

100. In early 2000, a meeting was held between Sassano's Branch Manager, the Head of Private Client Services, the Financial Services Director, the Director of Operations, Sassano and a senior lawyer in CIBC Oppenheimer's legal department to discuss establishing the Schwab clearing platform. Sassano's stated purpose for wanting to use the Schwab clearing platform was to enable his clients to trade mutual funds with which CIBC did not have a selling agreement.

101. The true purpose for establishing the Schwab relationship, however, was to use Schwab's "omnibus" clearing platform to disguise Sassano's activities and/or conceal them from

mutual funds, including funds that had already requested that Sassano stop market timing at CIBC.

102. Sassano's motives are reflected in a series of e-mail exchanges with a former Schwab employee. The Schwab employee advised Sassano: "As I have mentioned several times, Schwab is becoming extremely cautious when it comes to working with mutual fund timers. We want to work with CIBC, but it is imperative that you adhere to our trading requirements." Sassano subsequently represented:

> [W]e will never trade a single fund more than 2 times in the course of a year. We will be responsible and prudent, however, the model dictates weather [sic] we can be long or neutral, not us. But again, we will not buy the fund more than 2 times a year.

The Schwab employee inquired: "Is it o.k. to release your name and number to fund company [sic] if they have questions about your intentions?" Sassano's emphatic reply appeared in capital letters: "NO."

103. The participation of CIBC Oppenheimer's senior management in Sassano's scheme is demonstrated by the nature of the Schwab account for which they gave their approval and a series of e-mails.

104. CIBC's senior management approved the use of accounts in a Schwab business unit designed for registered investment advisors. Such advisors typically make trading decisions for clients and rely on Schwab's "RIA channel" for back-office support and record-keeping services. Senior management knew that trading decisions were made by Sassano's market timing clients, not by CIBC Oppenheimer; in other words, CIBC Oppenheimer did not have investment discretion with respect to the hedge funds' market timing accounts as an "RIA" typically would. Sassano's clients had no real need for Schwab's RIA services.

105. Senior management's participation in Sassano's scheme is seen more directly by their reaction to an e-mail from a particular fund family. An alert employee at the fund company, which had already sent numerous "stop" communications to CIBC Oppenheimer, was not fooled by Sassano's scheme of trading through Schwab. In an e-mail dated November 8, 2001, he wrote to the head of CIBC Oppenheimer Mutual Fund Services:

> Unfortunately, we've noticed some market timing coming in through Schwab's RIA platform in [an international fund] ($3.7 million came in on Nov 5 and left 2 days later). After digging further with Schwab, we discovered that the broker of record was Mr. Sassano.
>
> We wanted to make you aware that:
> 1) he's still timing assets in our funds despite our repeated requests to curb his activity, and
> 2) he is doing business away from CIBC and going through Schwab.

106. Of course, senior CIBC Oppenheimer executives were already aware because they assisted Sasssano in setting up his "under the radar" trading capability through Schwab's RIA channel. The Financial Services Director received the November 8, 2001 fund company e-mail and forwarded it to the Head of Private Client Services with the following message:

> Everyone at [the fund company] up to the President is involved in this. They are a strategic partner and it will be detrimental to our relationship. **It also proves that the Schwab account isn't as concealing as we think....**

(Emphasis added)

107. The Head of Private Client Services forwarded the November 8, 2001 fund company e-mail to Sassano's Branch Manager who replied simply:

**[S]o much for stealth trading.**

(Emphasis added)

108. Other fund companies were fooled, however. In all, the Sassano Group used the anonymity of Schwab's "omnibus" platform to:

(a) obscure up to or more than 6000 "roundtrips" in an aggregate transaction volume of more than $10 billion at numerous mutual funds;

(b) obscure up to or more than 500 "roundtrips" in an aggregate transaction volume in excess of $1 billion in twenty-five fund families with which CIBC maintained selling agreements; and

(c) obscure up to or more than 250 "roundtrips" in an aggregate transaction volume in excess of $350 million in fund families that had already sent "stop" letters to CIBC Oppenheimer seeking to halt the Sassano Group's timing activities.

This trading resulted in substantial dilution to long-term mutual fund shareholders.

109. CIBC Oppenheimer senior management approved further non-CIBC trading platforms to assist Sassano with "stealth trading."

*Fidelity Platform*

110. Sassano first sought approval to use Fidelity's "omnibus" platform to trade mutual funds shortly after the Schwab relationship was established. As with Schwab, CIBC Oppenheimer ultimately established an account in the registered investment advisor channel at Fidelity even though CIBC did not make investment decisions for Sassano's clients.

111. In all, the Sassano Group used the anonymity of Fidelity's "omnibus" platform to:

(a) obscure up to or more than 3000 "roundtrips" in an aggregate transaction volume of more than $3.9 billion at numerous mutual funds;

(b) obscure up to or more than 300 "roundtrips" in an aggregate transaction volume in excess of $450 million in twenty-three fund families with which CIBC maintained selling agreements; and

(c) obscure up to or more than 250 "roundtrips" in an aggregate transaction volume in excess of $380 million in fund families that had already sent

> "stop" letters to CIBC Oppenheimer seeking to halt the Sassano Group's timing activities.

This trading resulted in substantial dilution to long-term mutual fund shareholders.

112. CIBC Oppenheimer's senior management approved a third non-CIBC trading platform at another discount brokerage firm to assist Sassano with "stealth trading."

F. Further Discussions About Concealing Sassano's Activities

113. Over time, some mutual fund companies had caught on to Sassano's schemes. Since account numbers at Sassano's CIBC Oppenheimer branch were identified by the three digit prefix "033," some mutual funds found it more expedient to simply disallow all trades associated with brokers in the "033" branch. Nevertheless, consistent with senior management's approval of the deceptive activities already occurring at CIBC Oppenheimer and through Schwab and Fidelity, senior management attempted to further Sassano's deceptive market timing capabilities.

114. For example, Dogan Baruh sent Sassano's Branch Manager the following e-mail dated September 19, 2002:

> [W]e discussed the possibility of maybe having some new rep numbers, but more importantly maybe setting up our own Super Branch.
>
> The reason for this is because the Sassano name is so well known in the mutual fund business that at times it becomes a hindrance. Therefore if we had new rep numbers, and to take it one step further, those reps still got paid out to Mike but had a special coding such as just his initials **it would shield us from the Fund Companies**.

(Emphasis added) Instead of rejecting the deception out of hand, Sassano's Branch Manager passed the request along to Operations asking whether creation of a "Super Branch" was possible. The Director of Operations responded: "If the funds find out we are screwing around they will throw us out." Sassano's Branch Manager replied with a statement that sums up the reason for senior management's support of Sassano's deceptive methods:

> They are throwing us out anyway, maybe we can prolong the agony[.] **[W]e sure could us[e] the revenue.**

(Emphasis added)

115. The Super Branch idea was rejected because it was too difficult from an operations standpoint. But, other methods of hiding from the funds were discussed as well. For example, the Head of Private Client Services inquired whether Sassano's accounts could begin with a three-digit code other than the "033" number already identified with market timing by mutual funds. In an e-mail to the Director of Operations dated October 25, 2002, the Head of Private Client Services wrote:

> [M]ike [Sassano] asked about us establishing a separate superbranch for him. I told him that was impossible. [I]s there a way to set up a fifferent [sic] 3 digit start to his accounts?

The Director of Operations replied: "What is [he] trying to do...hide himself from the funds...." The Head of Private Client Services replied: "I assume that's what he's trying-i am okay with saying no, we can't. [I] would love a good reason though...."

116. The obvious fraudulent intent was apparently not enough of a reason because the discussion continued. In an e-mail dated November 5, 2002 to the Director of Operations and copied to the Head of Private Client Services and the Financial Services Director, Sassano's Branch Manager wrote:

> [W]e were discussing giving Sassano a new range for accounts. I know in the grand scheme (pun) of things were [sic] are not creating a new radar screen, however it would be very helpful to [the Financial Services Director] because the letters he is getting lately is [sic] shutting down all 033 trades in an effort to stop Mike....

G. Affirmatively Misleading Fund Companies

117. In addition to having been made aware of the specifics of Sassano's deceptive methods, the Head of Mutual Fund Services actively misled at least one mutual fund concerning Sassano's market timing activities.

118. In response to an inquiry from a fund company, the Head of Mutual Fund Services wrote in a February 5, 2002 e-mail, which was copied to Sassano's Branch Manager and the Financial Services Director:

> [W]e too are sensitive to the effects excessive trading activities have to mutual funds and their shareholders. **Engaging in market timing practices is not a business we condone nor [sic] support**. Your help in identifying those brokers who are excessively trading [your funds], will ensure that going forward, this activity will cease at CIBC Oppenheimer. We will enforce every measure necessary to ensure that [your funds] will receive only long term money from CIBC Oppenheimer.

(Emphasis added)

119. In reply, Sassano's Branch Manager wrote simply: "kiss ass." The Head of Mutual Fund Services replied: "whatever it takes my friend....whatever it takes."

120. The Head of Mutual Fund Services knew the statement that CIBC does not condone or support market timing was false. He knew Sassano had an exclusive on the business at CIBC, that mutual funds rejected Sassano's transactions on numerous occasions and that CIBC built Sassano a system to process scores of market timing transactions. The Head of Mutual Fund Services did not need the fund company's assistance in identifying the CIBC brokers who the fund company suspected of market timing. In fact, he had earlier been informed by an employee in the Mutual Fund Operations area that the broker of record was "[y]our friend [Michael Sassano]. The one who's holiday party you will be attending."

121. The Head of Mutual Fund Services directed at least one of his subordinates to send a similarly deceitful e-mail to at least one other fund company.

H. Ignoring Fund Companies' Pleas To Stop Timing

122. In an e-mail dated March 5, 2002 to Sassano's Branch Manager, the Head of Private Client Services and the Financial Services Director, the Head of Mutual Fund Services wrote:

> [I]n addition to [Mutual Fund A], [Mutual Fund B]...has threatened to stop taking business from NY if the timing doesn't stop; [Mutual Fund C] the same. [W]e just got a letter from [Mutual Fund D] indicating that they have terminated our agreement....[Mutual Fund E], [Mutual Fund F] and [Mutual Fund G] are just a few other examples of firms "begging" us to stop timing....fyi, [a large broker-dealer] and others have gone or are going to zero tolerance on this business.

The pleas of mutual fund companies were largely disregarded. In fact, despite CIBC Oppenheimer's receipt of at least 1120 "stop" communications from numerous mutual fund families, no bona fide effort was made to create effective compliance procedures. As a result, timing continued in many fund families that had complained about Sassano's activities, and the Sassano Group was free to use deceptive timing techniques to evade detection by many more.

123. Senior management also ignored other fund companies that expressly documented incidents of Sassano "flying under the radar." Numerous communications from a particular fund company provide an example.

124. By December, 2000, the fund company had communicated with CIBC several times to request that Sassano's market timing activities cease. When those requests were not heeded, a fund company compliance officer contacted a senior compliance officer at CIBC WMC

to complain. The CIBC WMC compliance officer sent an e-mail dated December 28, 2000 to, among others, Sassano's Branch Manager, the Financial Services Director and Sassano stating:

> I received a phone call yesterday from...a...Compliance [officer] at [a particular fund company], who indicated that [the fund company] will no longer tolerate frequent exchange activity in its funds due to the harm caused to the [fund] family and ultimately its shareholders....Please comply with his request so that our relationship with [the fund family] is not harmed in any way.

125. In fact, Sassano did not stop market timing in this fund family. During 2001 and 2002, the Sassano Group engaged in $196 million in timing transactions in this fund family rotating trades through up to 101 separate accounts and 18 registered rep numbers.

126. On April 3, 2002, the same fund company compliance officer again contacted the same compliance officer at CIBC WMC and stated that the fund company wants no further investments in its funds by Sassano's clients. The CIBC WMC compliance officer stated that the fund company was not the first to call with complaints about Sassano's timing activities and assured the fund company compliance officer that CIBC WMC would do everything in its power to stop the activity.

127. In an e-mail dated April 3, 2002, the CIBC WMC compliance officer informed Sassano's Branch Manager, Sassano, the Head of Mutual Fund Services, a senior officer in the CIBC Oppenheimer legal department and the CIBC Oppenheimer officer who oversaw branch compliance nationwide (the "National Branch Compliance Officer") about the fund company's demand that market timing activity cease.

128. The fund company's demands were ignored and the timing activities did not stop. The fund company sent additional communications to CIBC Oppenheimer demanding that timing activities cease on May 1, 2002, June 28, 2002, and September 27, 2002.

129. The same fund company compliance officer again contacted the same CIBC WMC compliance officer. He explained that the fund family had "had it" with Sassano who continued to time their funds despite repeated fruitless communications with CIBC. The CIBC WMC compliance officer told the fund company compliance officer that whatever it takes to preclude Sassano from making further investments in the their funds would be done.

130. In an e-mail dated November 14, 2002, the CIBC WMC compliance officer informed the Head of Private Client Services, the National Branch Compliance Officer, the Financial Services Director, the Head of Mutual Fund Services, Sassano's Branch Manager and two senior lawyers at CIBC of the conversation:

> Yesterday I received a call from...[a compliance officer] at [a particular fund company]. The purpose of his call was to once again communicate to CIBC that [the fund company] would no longer tolerate the market timing activity that Michael Sassano engages in on behalf of his clients through [their fund family]. Since 4/3/02, I have received three different letters (attached below) from [the fund company] requesting that Michael "make no further investments in [their funds]." [The fund company compliance officer] was particularly disturbed during yesterday's phone call as he indicated that [the fund company] has been communicating this issue to CIBC for the past 5 years with no success. He noted that...their fund prospectus prohibits such market timing activity, and that he would hate to see CIBC's relationship affected by Sassano's behavior. **He believes that Michael is deliberately attempting to conceal his association with this activity by creating numerous RR #s and breaking up the orders to smaller amounts so that the market timing activity goes undetected.**

(Emphasis added)

131. Neither the author or any recipients of the e-mail did anything to investigate the fund company's allegations. Had they bothered to look, those recipients who were not already aware could easily have discovered that the Sassano Group was engaging in these and other deceptive activities at not just this fund company, but many others too.

132. Instead, the Sassano Group's market timing activities in this fund family continued. After the sale of CIBC Oppenheimer to an affiliate of Fahnestock in January, 2003, CIBC WMC continued to process mutual fund orders for the Sassano Group through May, 2003. Most recipients of the CIBC WMC compliance officer's November 14, 2002 e-mail became Fahnestock employees along with Sassano and his team. In yet another e-mail dated April 28, 2003, which was forwarded to the Head of Mutual Fund Services, a representative of the same fund company identified five accounts in which market timing in the fund family was conducted and twenty-two registered representative numbers used by the Sassano Group for timing.

I. Variable Annuities

133. Despite knowledge of Sassano's concealing activities and the repeated communications attempting to stop Sassano's timing activities in mutual funds, senior management at CIBC Oppenheimer approved timing in variable annuities. This approval was given despite objections from the legal and compliance departments that variable annuities are not an appropriate vehicle in which to conduct market timing transactions.

134. As early as 2000, Sassano and his team identified variable annuities as another method for their clients to conduct market timing activities. CIBC also provided financing to hedge funds to market time variable annuities.

135. As with mutual funds, several insurance companies had sent letters to CIBC Oppenheimer requesting that market timing activities cease. As summarized by a member of CIBC's Credit Department, at least one CIBC client was:

> having difficulties in getting barred from annuit[ies]...[because] the annuity market is much smaller than the standard mutual fund market, **thereby making it more difficult to camouflage market timing activity**. (Emphasis added)

136. Sassano was not deterred as evidenced by his praise for the resourcefulness of a member of his team:

> [W]e didn't show up on any timing list! Good job Glen[n], stay on top of why and how to keep under the radar[.] [D]on't get lazy penetrate more.

137. Subsequently, a senior CIBC Oppenheimer officer wrote a memo dated June 14, 2002 to her superior, the Financial Services Director, who was ultimately in charge of variable annuities at CIBC. Quoting a passage from a letter from an annuity company, the memo stated:

> 'Annuity products are not designed for frequent trading activities; they are designed and priced for long-term. Because of the nature of annuity investment vehicles, frequent trading negatively affects all of our customer contract values and hurts fund performance.' There have been far too many trades placed by Glen[n] Jerro and Dogan Baruh in this fashion. Their activity has recently begun to spark a concern among the carrier relationships we currently have signed selling agreements with. I do not feel that it is appropriate to accept this business practice as normal activity....

138. A meeting ensued among Sassano, the Financial Services Director, the Head of Private Client Services, the director of Compliance at CIBC WMC and a senior lawyer in the legal department. The Head of Private Client Services and the Financial Services Director were told explicitly that variable annuities are not an appropriate vehicle in which to conduct market timing activities. The Head of Private Client Services and the Financial Services Director ignored that admonition and approved an arrangement whereby Sassano and his team were permitted to conduct market timing transactions in variable annuities other than the top ten variable annuity companies with which CIBC did business.

139. CIBC's financing and clearing of market timing transactions in variable annuities resulted in substantial dilution and other harm to long-term shareholders.

## III. Late Trading At CIBC Oppenheimer

140. During the relevant time, CIBC Oppenheimer employed approximately 600 registered representatives nationwide. CIBC Oppenheimer procedures required that those 600 reps submit (and preserve) written mutual fund order tickets and that such orders be processed centrally by the Mutual Fund Operations Department located in New York City rather than at the individual branch office level. The reps did not have the capability to enter mutual fund orders directly into their desktop computers.

141. Things were different for the "number two" producer at the firm. For much of Sassano's market timing transactions, conventional order tickets were not used. Instead, his hedge fund clients faxed "trade sheets" to the Sassano Group for processing. And unlike other CIBC Oppenheimer brokers, members of the Sassano Group did have the ability to enter mutual fund orders at their desktops after 4:00 p.m. New York time. They used this ability to enable their clients to "late trade," including in accounts in CIBC's name and controlled by the Equity Arbitrage Group.

142. The "trade sheets" contained proposed mutual fund transactions and were typically faxed by hedge funds prior to 4:00 p.m. Such "orders" were conditional, however, and clients could cancel, change or modify after 4:00 p.m. the preliminary instructions they had sent before 4:00 p.m. Hedge funds did so, and members of the Sassano Group sometimes discarded the trade sheets.

143. A sampling of recorded telephone conversations involving Dogan Baruh and Bryan Hernandez provide examples of the conditional nature of the orders and the value of post-4 p.m. information to hedge funds:

| Time/ Date | Telephone Conversation | |
|---|---|---|
| 4:03 p.m. 9/25/01 | Baruh | "Hey. Any trades?" |
| | Hedge Fund | "No, not yet." |
| | Baruh | "Alright, I'll keep it...You still have time." |
| | Hedge Fund | "Yeah. Hang on. In case it...We're actually a little bit of [sic] a rally here after the close and a..." |
| | Baruh | "I see it...Let me know." |
| | Hedge Fund | "Yeah, I will." |
| | Baruh | "Ok. Bye." |
| 4:06 p.m. 11/14/02 | Hedge Fund | "Those trades are good to go." |
| | Baruh | "Good to go?" |
| | Hedge Fund | "Yeah, two sheets, right? |
| | Baruh | "Dell just came out with numbers, just so you know." |
| | Hedge Fund | "Yeah?" |
| | Baruh | "It's startin' to sell off, but ok." |
| | Hedge Fund | "Oh, yeah?" |
| | Baruh | "A little bit from where it was at 4 o'clock. It's trading about seventy cents down. It came in-line. I still have time obviously so if you want to change, give me a call." |
| | Hedge Fund | "Ok...For now, go ahead and do it." |
| 4:10 p.m. 1/4/02 | Baruh | "Hi. It's Dogan." |
| | Hedge Fund | "Hey Dogan." |
| | Baruh | "How you doin'?" |
| | Hedge Fund | "How you doin', man?" |
| | Baruh. | "Alright." |
| | Hedge Fund | "Good." |

| | | |
|---|---|---|
| | Baruh | "Any trades today?" |
| | Hedge Fund | "Yeah. I think we're doin' nothin' here." |
| | Baruh | "Ok." |
| | Hedge Fund | "So...." |
| | Baruh | "I'll throw these out." |
| | Hedge Fund | "Have a good weekend." |
| 4:13 p.m.<br><br>6/3/02 | Hedge Fund | "Hey. Is Dogan there?" |
| | CIBC Employee | "He is on a conference call. Can I help you." |
| | * * * | [Irrelevant Matter Omitted] |
| | CIBC Employee | "Can I have him call you back?" |
| | Hedge Fund | "It's gotta be urgent. I'm gonna, I'm gonna try and send him a few more redemptions to do." |
| | CIBC Employee | "...Hang on a second...Bryan can help you." |
| | * * * | [Irrelevant Matter Omitted] |
| | Hedge Fund | "I'm going to send you a few more redemptions." |
| | Hernandez | "A few more redemptions?" |
| | Hedge Fund | "Yeah." |
| | Hernandez | "How many pages?" |
| | Hedge Fund | "Just one page. Maybe like four or five." |
| | Hernandez | "Ok." |
| | * * * | [Irrelevant Matter Omitted] |
| | Hernandez | "Alright. No problem." |
| | Hedge Fund | "I'll get 'em right out." |

| | | |
|---|---|---|
| 4:26 p.m.<br><br>8/22/01 | Hedge Fund | "Hey, Dogan. Any chance we can go in on that stuff? Or is it too late?" |
| | Baruh | "Yeah – I'm gonna have to take it out of the garbage, but yeah." |
| | * * * | [Irrelevant Matter Omitted] |
| | Hedge Fund | "You still have 'em?" |
| | Baruh | "Yeah." |
| | Hedge Fund | "Or do you need me to resend 'em?" |
| | Baruh | "I got it." |
| | Hedge Fund | "Ok." |
| | Baruh | "Everything?" |
| | Hedge Fund | "Yeah. Everything." |
| | Baruh | "Ok." |
| 4:32 p.m.<br><br>6/3/02 | Hedge Fund | "Hey. Is Dogan there?" |
| | Hernandez | "No, he left already....It's Bryan." |
| | Hedge Fund | "Hey. Could we possibly get some more stuff done?" |
| | Hernandez | "How much more?" |
| | Hedge Fund | "Couple more exchanges and ahh maybe a couple more redemptions." |
| | Hernandez | "Alright....Yeah, send 'em on over to me. You going to send 'em right now?" |
| | Hedge Fund | "Yeah. I'll send 'em, I'll send 'em in like two minutes." |
| | Hernandez | "Send 'em right now." |
| | Hedge Fund | "Ok." |
| 4:49 p.m.<br>11/20/01 | Hedge Fund | "We're sort of indifferent either way, but if you could tear those trades up, that'd be fine." |
| | Baruh | "Yes I can." |
| | * * * | [Irrelevant Matter Omitted] |
| | Baruh | "All of it?" |

| | | |
|---|---|---|
| | * * * | [Irrelevant Matter Omitted] |
| | Hedge Fund | "Just do the first page and tear up the second, third and fourth." |
| | Baru: | "You wanna keep the first page..." |
| | Hedge Fund | "Yeah. Just do those two AIM exchanges." |
| | Baruh: | "And then cancel the other ones?" |
| | Hedge Fund | "Yeah. Cancel all the sales and the exchanges in [the deal that was financed by CIBC]." |
| | Baruh | "Ok." |

144. The services provided by the Sassano Group to its hedge fund clientele were not limited to just taking late mutual fund orders. The Sassano Group also solicited them. The following telephone recording of a conversation on August 16, 2001 at 5:08 p.m. between Baruh and a hedge fund trader provides an example:

Baruh: [First name of trader at hedge fund.]

Hedge Fund: Dogan. Hey, what's up?

Baruh: Hey, um, I just ahh, some people have been calling to cancel their trades. I just wanna know if you guys wanna also cancel or if you're happy with what you're doing.

Hedge Fund: Oh, ahhh. Hang on a second....[Speaking to fellow hedge fund employee] Hey...Dogan's saying he's getting a lot of calls to cancel trades...

Baruh: Not a lot. But some.

* * *

Hedge Fund: Ok. Well, we're not right now.

Baruh: Ok, that's fine. I just wanted to make sure, you know.

Hedge Fund: Alrighty. Thanks.

## IV. Financing Deceptive Market Timing At Other Broker-Dealers

145. The hedge funds to which the Equity Arbitrage Group provided financing did not limit their deceptive activities to just CIBC's captive broker-dealer. Beginning at the end of 1999, as CIBC Oppenheimer began experiencing difficulty hiding market timing transactions, Sassano's clients wanted to use other brokers to clear their trades. But, they still wanted financing from CIBC. Ultimately, CIBC's Credit Department approved the opening of "Managed Accounts" at unaffiliated broker-dealers.

146. From 1999 through 2003, multiple "Managed Accounts" in the name of CIHI and CIBC Cayman were opened at various broker-dealers to engage in the same or similar methods of hiding or disguising market timing transactions that occurred at CIBC Oppenheimer. Flynn and Haas had absolute control over and had to approve the "rotation" of money and/or mutual fund positions between and among these accounts to deceive mutual funds. They did so knowing the fraudulent purpose of such transactions.

147. In connection with "swap" financing, there were at least 300 accounts opened at various non-CIBC brokerage firms or other clearing platforms in the name of CIHI or CIBC Cayman. The swap transactions that had the most accounts available for "flying under the radar" include:

| Hedge Fund Manager | Deal | Number of Accounts |
|---|---|---|
| Hedge Fund A | Swap Financing Transaction Number 1 | 27 accounts at a large broker-dealer in the name of CIHI |
| Hedge Fund A | Swap Financing Transaction Number 2 | 37 accounts at a large broker-dealer in the name of CIHI |

| | | |
|---|---|---|
| Hedge Fund A | Swap Financing Transaction Number 3 | 29 accounts at a large broker-dealer in the name of CIBC Cayman |
| Hedge Fund A | Swap Financing Transaction Number 4 | 83 accounts at a large broker-dealer in the name of CIHI |
| Hedge Fund A | Swap Financing Transaction Number 5 | 39 accounts at a large broker-dealer in the name of CIHI |
| Hedge Fund B | Swap Financing Transaction Number 1 | 48 accounts at a large broker-dealer in the name of CIBC Cayman<br><br>41 accounts at Fahnestock in the name of CIBC Cayman |

148. An example of the Equity Arbitrage department's knowledge of the concealing activities of hedge funds that managed accounts in CIBC's name appears in a telephone conversation between Haas and a timing broker at a non-CIBC broker-dealer:

Broker: [A hedge fund to which CIBC provided financing] had like 10 accounts opened for the longest time with us. It was actually I think a total of 14 or 16 accounts that they had opened with us. And you know we played every trick we could and the net result is we got stopped out of a lot of funds.

Haas: Ok.

Broker: So in an attempt to get back into the game....we talked about opening new accounts....

* * *

Broker: See, we're going to put 'em into a new "also" number....

Haas: Ok.

Broker: ...which doesn't mean anything on your end because you guys are still going to look at the accounts the way you've always looked at the accounts.

Haas: Right.

Broker: But the fund families look at the accounts like all new entities and in order for us to put 'em in these new "also" numbers we have to say it's a new client.

Haas: Ok.

Broker: So we have to get the money out of the old accounts and then back into the new accounts, but I can't just journal it because if I journal it, they'll just assume it's the same client....

Haas: Ok.

* * *

Broker: ....I can wire the money, you see it and turn around and wire it back.

Haas: That's exactly what we want to do.

149. Another example is seen in a conference call between a hedge fund trader, a non-CIBC timing broker and Haas, Flynn and one other individual. An issue arose where the broker had transferred money between CIBC Managed Accounts for the purpose of "flying under the radar." Chastising the broker for violating CIBC's rules, Haas explained the Equity Arbitrage Group's complete understanding of the purpose of moving money between accounts:

Haas: [A]ny money that's moved around amongst any of these accounts needs to be signed off either by Paul or myself....I want to understand...why these transfers occurred without...the sign off we required....

* * *

Broker: [T]he way we do the daily business, when we, because of the challenges that we're having with this type of business, we, we try to circumvent some of those by opening up numerous accounts....

Haas
(interrupting): [W]e have a ton of this business. And we know the activity that goes through and we know, we know the ins-and-outs of setting up multiple accounts and transferring money around. Okay and we want to work with people and we want to accommodate that....

150. Knowledge of deceptive market timing activities at other broker-dealers was not limited to Flynn and Haas. Their boss, the Head of Equity Arbitrage, also knew and approved or recklessly disregarded their actions. After being informed by Flynn that an aggressive market timing hedge fund wanted to open new Managed Accounts at both CIBC Oppenheimer and another broker-dealer, the Head of Equity Arbitrage wrote:

> **[T]his particular client trades aggressively and uses small size to stay under the radar at the mutual funds**. It is very time consuming to manage all the account detail, for the size, and it puts the Cayman entity and therefore the business at risk with the [mutual] funds.

(Emphasis added)

151. Members of the Credit Department were also aware of the concealing activities of hedge funds at non-CIBC broker-dealers. For example, a member of the Credit Department expressed concern in an e-mail relating to the potential lack of diversification of CIBC's collateral (*i.e.*, the mutual funds). Haas wrote in a reply e-mail to Flynn and various members of the Credit Department:

> [A]s a practical matter, the [hedge fund] managers are not going to trade small [mutual] funds due to the fact that their chances of being identified as timing the market are significantly increased and **their whole strategy is based upon their ability to trade under the radar of the fund families**.

(Emphasis added)

152. CIBC also approved a $27 million line of credit with Atlantique Capital Advisors, LLC and/or its affiliates, a hedge fund in which CIBC knew Sassano (and/or a close family

member) had a substantial interest. The Equity Arbitrage Group opened 15 accounts at CIBC Oppenheimer, 15 accounts at Fahnestock and 22 accounts at another large broker-dealer in the name of CIBC Cayman so Atlantique could transact "under the radar" of mutual funds.

## V. Financing Late Trading And Deceptive Market Timing At Security Trust Company

### A. Late Trading

153. CIBC caused financing to be provided to two hedge funds, Canary Capital Partners, LLC and/or its affiliates ("Canary") and Samaritan Asset Management Services, LLC and/or its affiliates ("Samaritan"), that CIBC knew were engaged in late trading at Security Trust Company ("STC").

154. STC was, during the relevant time period, a Phoenix, Arizona-based company that, among other things, processed mutual fund trades for pension plans and retirement systems. STC had no legitimate reason to provide clearing services to hedge funds engaged in market timing activities. Nevertheless, STC processed market timing transactions for two different hedge funds, Canary and Samaritan. Both hedge funds received substantial loans from CIBC to conduct deceptive market timing transactions through STC. In addition, STC gave Canary and Samaritan access to STC's electronic trading platform to enable them to illegally place mutual fund orders after the 4:00 p.m. close of the market, including to place orders after mutual funds had calculated NAVs.

155. In October 2001, Paul Flynn visited STC's offices in contemplation of CIBC providing financing to Canary (at the time, a new CIBC client) for market timing activities that would occur through STC. After the trip, Flynn prepared a memorandum that expressly

acknowledges Canary's and Samaritan's late trading ability. The memorandum was copied to Haas and the Head of Equity Arbitrage, among others.

156. In the memo, Flynn described a meeting he had with STC executives in which they discussed STC's "Same Day/Late Day Trading Platform and the benefits this proprietary platform brings to [CIBC's] Mutual Fund Market Timing Clients." Flynn wrote, unlike "[s]tandard platforms [that] require trades to be into [sic] before 4:00 p.m.," CIBC's clients using STC's platform "are able to submit trades for same day value" after 4:00 p.m. "based upon published Net Asset Values (NAVs)."

157. Flynn and Haas clearly knew that the deadline for mutual fund orders was 4:00 p.m. New York time as evidenced by, among other things, an e-mail Haas wrote to Flynn and others:

> All [mutual fund] shareholders are given the right to have daily liquidity **(all mutual fund/annuity trades have to be in by 4 pm**, thus a mutual fund manager has an idea as to daily redemptions and will manage his cash position in addition to actual liquidation of equity positions accordingly)[.]

(Emphasis added)

158. In January, 2002, notwithstanding knowledge of the illicit trading practices at STC, CIBC approved a multi-million dollar line of credit to finance Canary's market timing and late trading activities at STC.

B. Deceptive Timing At STC

159. In addition to describing the benefits of "late trading," Flynn's memo also detailed how STC assisted Canary and Samaritan in deceiving mutual funds to reduce the chances that mutual funds would detect their market timing activities. Flynn wrote:

> [T]he company allows our clients to submit trades in a number of methods to reduce the chance that they would appear to be timing a specific mutual fund. The different types of investing are as follows: 1) Traditional account specific fund investing keeping account balances small; 2) Using a number of multiple legal vehicles (i.e., different Tax ID numbers) they rotate the ownership of the mutual fund transferring balances between related accounts; 3) Piggy backing non-12(b)1 accounts (i.e. 401k etc.) to invest in pools of funds on a net basis as specific ownership is not known by the fund; and 4) Piggy backing 12(b)1 accounts were [sic] a specific agreement is made with a broker to include the additional fund investments....

160. As of October, 2001, CIBC had already extended loans to finance Samaritan's market timing activities at STC. As of January, 2002, the value of CIBC's collateral held at STC in connection with Samaritan transactions was more than $37 million. Notwithstanding knowledge of Samaritan's deceptive market timing activities at STC, CIBC maintained these lines of credit.

161. CIBC's reward for financing these illicit market timing activities was the $10,228,000 in fees from the loans and other transactions it engaged in with Canary and Samaritan. The CIBC-financed Canary and Samaritan market timing and late trading through STC resulted in substantial dilution and other harm to mutual fund shareholders.

## VI. Financing A "Sticky Money" Arrangement

162. CIBC aided and abetted the breach of a mutual fund manager's fiduciary duty to shareholders by financing a "sticky money" arrangement.

163. In or about late 2002, one of CIBC's hedge fund clients cut a deal with a mutual fund manager to market time in violation of the prospectus and the mutual fund manager's fiduciary obligations to shareholders. In exchange for this "negotiated space," the hedge fund would make a "sticky money" investment in the mutual fund being timed (*i.e.*, a "buy and hold" investment that would not be traded on a frequent basis). A 2:1 ratio of "sticky money" to timing

assets was agreed upon. Put another way, the mutual fund manager would permit the hedge fund to frequently trade one dollar for every two dollars of "sticky money" the hedge fund invested.

164. The hedge fund explained the "sticky money" arrangement to the Equity Arbitrage Group and sought financing from CIBC to leverage the trade and maximize the profit potential. CIBC obliged and amended one of its existing swap arrangements with the hedge fund to finance the trade. CIBC's knowledge of the *quid pro quo* was summarized by a member of CIBC's Credit Department in a credit memorandum:

> In this type of trade, the investment in mutual funds is kept static (certain mutual funds will allow market timers **on condition that** the [hedge fund] keeps a certain amount of investments static).

(Emphasis added) Ultimately, CIBC financed $130 million of static assets so that the hedge fund could market time $65 million worth of the mutual fund.

165. CIBC's assistance with the hedge fund's purchase of "timing capacity" did not stop there. The hedge fund did not want the exposure to market risk that comes with a "sticky asset" investment in a mutual fund. To the contrary, timers look for short-term trading capacity for the express purpose of avoiding the long-term market risk to which ordinary investors are subject, while at the same time preserving upside potential.

166. Consequently, the hedge fund looked to "hedge" the risk inherent in the static asset investment. In other words, the hedge fund looked for a way to become indifferent with respect to whether the static investment in the mutual fund – referred to as the "long" position – rose in value or declined in value. The solution was to "short" the "basket" of stocks that comprised the mutual fund portfolio (*i.e.*, make an investment that would increase in value even

if the stocks declined in value). This "long/short" strategy was executed for the hedge fund by CIBC and worked as follows.

167. The hedge fund obtained from the mutual fund manager the confidential portfolio holdings of the mutual fund. These holdings were communicated to CIBC. A CIBC trading desk then borrowed the stocks in the mutual fund portfolio from third parties, sold them and undertook an obligation to return the shares to the third-party lenders at some future date. When the stock had to be returned, the CIBC trading desk would purchase shares in the market or otherwise arrange to "cover" the short position. If the value of the stocks declined during this borrowing period, while money was lost on the "long" side of the trade (*i.e.*, the "static" investment in the mutual fund declined in value), a nearly equal amount of money was made on the "short" side of the trade. Conversely, if the value of the stocks increased, while money was made on the "long" side of the trade (*i.e.*, the "static" investment in the mutual fund rose in value), a nearly equal amount of money was lost on the "short" side of the trade. In this way, with respect to its static investment, the hedge fund became indifferent to upward or downward fluctuations in the share price of the mutual fund. With risk of loss of its static investment out of the way, the hedge fund then conducted short-term trades in the mutual fund to earn market timing profits.

168. The short side of the trade required periodic adjustments. As the mutual fund portfolio changed because the portfolio manager bought and sold investments, the "short" position was no longer in the right stocks. To ensure that the hedge was as perfect as possible, the hedge fund obtained updated mutual fund portfolio holdings and CIBC "freshened up" the so-called "short baskets" monthly to reflect the changing composition of the fund portfolio.

169. In addition to the substantial fees CIBC earned for providing the "sticky money" financing, it earned an additional $1,226,788 for executing the short side of the trade.

## VII. Financing Deceptive Market Timing Through The Use Of Special Purpose Vehicles

170. In September, 2002, Flynn and Haas requested approval to create new trading vehicles to help conceal market timing activities from mutual funds. The idea was to create subsidiaries of CIHI without the words "Canadian Imperial" or the "CIBC" initials in the name to fool mutual funds into thinking market timing activity conducted in the new entities was not associated with CIBC. In addition, the subsidiaries obtained new tax identification numbers even though there was no legitimate business purpose or need for them; their true function was to aid in "flying under the radar" of mutual funds.

### A. The New Initiative Approval Process

171. The Equity Arbitrage Group's request to create these new subsidiaries underwent the New Initiative Approval Process ("NIAP") at CIBC. One purpose of NIAP was to bring proposals to create new entities to the attention of senior management in each area of the bank that would be affected.

172. NIAP approved the new entities, but a CIBC compliance officer was assigned to – in the words of a senior finance officer – "tak[e] a closer look." The compliance officer prepared a document entitled "Questions regarding CIHI Legal Entities," in which the following questions were posed:

> "Why do we want to do this in the first place? What does it mean to "reduce CIHI's ownership perception to the "street"? Are we trying to skirt some law here?"

"Risks associated with this proposal: a. **What's the worst that could happen if the funds find out that we've skirted their concentration requirements (e.g., general reputational concerns, monetary fines, etc.)?** b. What other risks should we be considering?"

(Emphasis added) These questions were left unanswered.

173. Having received approval, Flynn, Haas, the Former CIBC Attorney and other members of the Equity Arbitrage Group chose the entity names. By design, none of the names considered had the words "Canadian" or "Imperial" or the initials "CIBC." Ultimately, Rudy Capital USA LLC (named for Flynn's dog "Rudy") and Hudson River Associates LLC were chosen and the two entities were incorporated in Delaware in late 2002.

B. New Tax ID Numbers

174. Selecting a name that had no ostensible relationship with CIBC was not necessarily sufficient for purposes of evading detection by timing police. Because many mutual funds had already stopped timing activity in CIHI Managed Accounts, the timing police may have been tracking CIBC's market timing trades based upon tax identification number. As a CIBC employee phrased it in an e-mail unrelated to creation of the new entities:

> At the very least, the assets at the mutual fund can be identified as our (or our hedge funds' assets) by tax ID number (this is how mutual funds identify our assets and kick us out).

Consequently, obtaining new tax identification numbers would aid in the deception.

175. New tax identification numbers had no legitimate business purpose. The new entities created were single member limited liability companies with CIHI as the sole member. The new entities had no employees or business operations separate from CIHI. The subsidiaries did not need to file separate tax returns. One consolidated tax return was filed for CIHI that

included the activities of CIHI's subsidiaries. The true function of the additional tax identification numbers was to "fly under the radar" of the mutual funds.

176. An e-mail exchange between the Former CIBC Attorney and various CIBC employees demonstrates that there was no legitimate need for new tax id numbers. A member of the legal department e-mailed the Former CIBC Attorney regarding "Rudy and Hudson River:"

> ....Just an FYI, since these entities are single member LLC's they are not required to have a tax id number.

The Former CIBC Attorney replied:

> I understand that they are not required to have a tax ID #, but did we get one for them anyway?

177. The other member of the legal department then forwarded the Former CIBC Attorney's request to a CIBC employee responsible for obtaining tax identification numbers, who replied:

> Single member LLC's are not required to have EINs. The results of each of theses [sic] entities would flow up and be reported by CIHI on its tax return. In the past when I have called for an EIN on a single member LLC I have had difficulty in getting one issued by the IRS, and ultimately did not get one.

178. But, the Former CIBC Attorney insisted, and ultimately new tax identification numbers were issued for both Rudy Capital and Hudson River.

C. The Rudy Capital/Hudson River Deception Is <u>Cut Short By The Attorney General's Investigation</u>

179. In June, 2003, at least four accounts were opened at a large broker-dealer in the name of Rudy Capital and more than $100 million was deposited to conduct market timing and related transactions for the ultimate benefit of Canary. An internal CIBC company description

that was distributed for a Rudy Capital board meeting confirmed the illicit purpose for which the entity was formed:

> The purpose of the entity was to expand the existing mutual fund swap activity business conducted by the Equity Arbitrage desk in New York. Due to the size of the book in CIHI, it was deemed necessary to book the purchase of mutual funds in multiple vehicles to reduce CIHI's perception to the street. **There was concern that with the growth of this business, fund managers may exercise their right to turn us away because of the size of our positions as well as the number of transactions. Rudy Capital would help to reduce perception to the street and potential fund manager resistance.**

(Emphasis added)

180. The scheme to deceive mutual funds using Rudy Capital and Hudson River was, however, cut short by the commencement of the Attorney General's investigation. Upon receipt of a subpoena from the Attorney General's office, Canary terminated all its market timing relationships, including the financing arrangements with CIBC using Rudy Capital.

181. In less than sixty days, however, market timing activities in Rudy Capital caused substantial dilution to shareholders in several mutual funds and CIBC generated $228,883.38 in revenues.

## FIRST CAUSE OF ACTION

182. The acts and practices of the Defendants alleged herein violated Article 23-A of the General Business Law, in that they involved the use or employment of a fraud, deception, concealment, suppression, or false pretense, engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of securities or commodities.

## SECOND CAUSE OF ACTION

183. The acts and practices of the Defendants alleged herein violated Article 23-A of the General Business Law, in that they involved the use or employment of a representation or statement which was false, where the person who made such representation or statement: (i) knew the truth; or (ii) with reasonable effort could have known the truth; or (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representation made, and where such acts or practices were engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of securities or commodities.

## THIRD CAUSE OF ACTION

184. The acts and practices of the Defendants alleged herein violated Article 23-A of the General Business Law, in that Defendants engaged in an artifice, agreement, device or scheme to obtain money, profit or property by a means prohibited by section 352-c of the General Business Law.

## FOURTH CAUSE OF ACTION

185. The acts and practices of the Defendants alleged herein violated Article 22-A of the General Business Law in that Defendants engaged in deceptive acts and practices prohibited by section 349 of the General Business Law.

## FIFTH CAUSE OF ACTION

186. The acts and practices of the Defendants alleged herein constitute conduct proscribed by section 63(12) of the Executive Law, in that Defendants engaged in repeated

fraudulent or illegal acts or otherwise demonstrated persistent fraud or illegality in the carrying on, conducting or transaction of a business.

**SIXTH CAUSE OF ACTION**

187. The acts and practices of the Defendants alleged herein constitute fraud under the common law of the State of New York.

**SEVENTH CAUSE OF ACTION**

188. The acts and practices of the Defendants alleged herein constitute aiding and abetting a breach of fiduciary duty under the common law of the State of New York.

189. Plaintiff has been irreparably harmed and has no other adequate remedy at law.

**WHEREFORE**, Plaintiff demands judgment against Defendants as follows:

A. That Defendants be permanently restrained and enjoined from engaging in any fraudulent practices in violation of Article 23-A of the General Business Law and Section 349 of the General Business Law or proscribed by section 63(12) of the Executive Law;

B. That Defendants be permanently restrained and enjoined from directly or indirectly engaging in the sale, offer to sell, purchase, offer to purchase, promotion, negotiation or distribution of any securities;

C. That Defendants and any of their agents or others acting on their behalf be permanently restrained and enjoined from conducting market timing transactions or financing market timing transactions in any mutual funds or variable annuities;

D. That Defendants, pursuant to General Business Law §§ 349 & 353(3) and Executive Law § 63(12), pay restitution of monies obtained directly or indirectly by means of, and damages caused directly or indirectly by, the fraudulent acts complained of herein;

E. That Defendants, pursuant to General Business Law §§ 349 & 353(3) and Executive Law § 63(12), disgorge all compensation received for (i) brokering late trades, (ii) brokering deceptive market timing trades, (iii) financing late trades, (iv) financing deceptive market timing trades and/or (v) financing market timing transactions (whether late, deceptive or otherwise) in violation of Federal Margin Regulations;

F. That Defendants pay civil penalties pursuant to General Business Law § 350-d;

G. That each of the Defendants pay Plaintiff costs and additional allowances in the maximum amount allowable under General Business Law § 353(1) and CPLR § 8303(a)(6);

H. That Defendants pay punitive damages; and

I. That the Court award such other and further relief to Plaintiff as the Court may deem just and proper in the circumstances.

Dated: New York, New York
July 19, 2005

ELIOT SPITZER
Attorney General of the State of New York
*Attorney for Plaintiff*
120 Broadway - 23rd Floor
New York, New York 10271
(212) 416-6542

By: [signature]
CHARLES T. CALIENDO
RICARDO E. VELEZ
Assistant Attorneys General