UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

SECURITIES AND EXCHANGE COMMISSION,	)	
Plaintiff,	)	
v.	)	Civil Action No.
MARTIN J. DRUFFNER, JUSTIN F. FICKEN, SKIFTER AJRO, JOHN S. PEFFER, MARC J. BILOTTI and ROBERT E. SHANNON,	)	
Defendants.	)	

COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission") alleges the following against defendants Martin J. Druffner, Justin F. Ficken, Skifter Ajro, John S. Peffer, Marc J. Bilotti and Robert E. Shannon:

SUMMARY

1. Defendants Druffner, Ficken, Ajro, Peffer and Bilotti were brokers in a Boston branch office of Prudential Securities, Inc. ("PSI"). From at least 2001 until they resigned in September 2003, they defrauded dozens of mutual funds and their shareholders by misrepresenting their own identities or the identities of their brokerage customers in order to

engage in thousands of market timing trades after the mutual funds in question had blocked them or their customers from such trading. Defendant Shannon, who also resigned in September 2003, was the manager of the PSI Boston branch office. He was responsible for approving the broker defendants' market timing trades and substantially assisted them in evading the restrictions on their trading. The broker defendants received substantial commissions from their market timing activities. For example, the group headed by Druffner (which included Ficken and Ajro) received nearly $5 million in gross commissions in 2002 alone, primarily derived from market timing activities.

2. Market timing refers to the practice of short-term buying and selling of mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal *per se*, can adversely affect mutual fund shareholders because it can dilute the value of their shares to the extent that a timer is permitted to buy and sell shares rapidly and repeatedly to take advantage of arbitrage opportunities. In addition, market timing raises transaction costs for the fund. Consequently, mutual fund managers often maintain policies and procedures to detect and prevent market timing. Here, most of the mutual funds in question tried to prevent market timing by prohibiting additional trades in their funds' shares after a customer had placed a certain number of trades. To enforce these limits, the mutual funds typically identified the customers and brokers placing trades in the funds' shares by tracking the broker identification numbers (known as "FA numbers" at PSI) and/or the customer account numbers.

3. Between 2001 and September 2003, at least 68 mutual fund companies sent letters to PSI concerning improper market timing transactions by brokers in the Boston branch and

imposing blocks on further market timing activity by the brokers and/or their customers. To circumvent the prohibition on further market timing trades, the broker defendants used at least two deceptive devices. First, they concealed their own identities by using multiple FA numbers issued by PSI. Second, they concealed their customers' identities by using multiple account numbers for the same customer. By placing trades using multiple FA numbers and multiple customer account numbers, the broker defendants were able to evade the blocks that had been placed on their market timing transactions.

4. Through the activities alleged in this Complaint, defendants Druffner, Ficken, Ajro, Peffer and Bilotti: (i) violated Section 17(a) of the Securities Act of 1933 ("Securities Act"); and (ii) violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder or, in the alternative, aided and abetted the uncharged violations of Section 10(b) and Rule 10b-5 by certain of their customers. In addition, defendant Shannon aided and abetted the other defendants' violations of Section 10(b) and Rule 10b-5.

5. Accordingly, the Commission seeks: (i) entry of a permanent injunction prohibiting the defendants from further violations of the relevant provisions of the Securities Act, the Exchange Act, and the rules thereunder; (ii) disgorgement of all ill-gotten gains, plus prejudgment interest; and (iii) the imposition of a civil penalty against each defendant due to the egregious nature of their violations.

JURISDICTION AND VENUE

6. The Commission seeks a permanent injunction and disgorgement of ill-gotten gains pursuant to Section 20(b) of the Securities Act [15 U.S.C. §77t(b)] and Section 21(d)(1) of the Exchange Act [15 U.S.C. §78u(d)(1)]. The Commission seeks the imposition of civil penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. §78u(d)(3)].

7. This Court has jurisdiction over this action pursuant to Sections 20(d) and 22(a) of the Securities Act [15 U.S.C. §§77t(d), 77v(a)] and Sections 21 and 27 of the Exchange Act [15 U.S.C. §§78u and 78aa]. Venue is proper in this District because many of the acts and transactions alleged in this Complaint occurred in this District and each of the defendants resides in this District.

8. In connection with the conduct described in this Complaint, defendants directly or indirectly made use of the mails or the means or instruments of transportation or communication in interstate commerce.

DEFENDANTS

9. **Druffner**, age 34, joined PSI in 1996. During the relevant period, he was a financial adviser at PSI and led a group of financial advisers at the PSI Boston branch (the "Druffner Group") which included Ficken and Ajro. He lives in Hopkinton, Massachusetts.

10. **Ficken,** age 28, joined PSI in 1999. During the relevant period, he was a financial adviser at PSI and a member of the Druffner Group. He lives in Boston, Massachusetts.

11. **Ajro**, age 34, joined PSI in 2001. During the relevant period, he was a financial adviser at PSI and a member of the Druffner Group. He lives in Milford, Massachusetts.

12. **Peffer**, age 40, joined PSI in 1995. During the relevant period, he was a financial adviser at PSI and led a group of financial advisers at the PSI Boston branch (the "Peffer Group") which included Bilotti. He lives in Newburyport, Massachusetts.

13. **Bilotti**, age 33, joined PSI in 1999. During the relevant period, he was a financial adviser at PSI and a member of the Peffer Group. He lives in Charlestown, Massachusetts.

14. **Shannon**, age 51, joined PSI in 1996. He became branch manager of the PSI Boston branch in December 2001. He lives in Brookline, Massachusetts.

RELATED PARTIES

15. Prior to July 1, 2003, **Prudential Securities, Inc.** ("Prudential Securities") was a wholly-owned broker-dealer subsidiary of **Prudential Financial, Inc.** ("Prudential Financial"). Prudential Financial is a publicly-owned holding company, traded on the New York Stock Exchange, whose operating subsidiaries are insurance brokers and investment managers. On July 1, 2003, Prudential Financial transferred its ownership of Prudential Securities to **Wachovia Securities, LLC**, a joint venture subsidiary of **Wachovia Corporation** and Prudential Financial. During the relevant period, one of Prudential Financial's subsidiaries managed a family of Prudential mutual funds (the "Prudential Funds").

STATEMENT OF FACTS

PSI's Policies concerning Market Timing

16. Market timing refers to the practice of short-term buying and selling of mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal *per se*, can adversely affect mutual fund shareholders because it can dilute the value of their shares to the extent that a timer is permitted to buy and sell shares rapidly and repeatedly to take advantage of arbitrage opportunities. In addition, market timing raises transaction costs for the fund. Consequently, mutual fund managers often maintain policies and procedures to detect and prevent market timing.

17. In October 1999, Prudential Financial executives issued a memo prohibiting market timing by PSI financial advisers in funds associated with Prudential's "wrap fee" program. (A "wrap fee" program is an investment program that bundles or "wraps" a number of brokerage, advisory, research, consulting and management services together and covers them with a single fee based on the value of assets under management.) At that time, Prudential Funds defined market timing to include more than one trade per quarter or four trades per year. On November 15, 2000, Prudential Financial prohibited market timing by PSI financial advisers in the Prudential Funds.

18. On January 8, 2003, PSI announced to branch managers a policy that applied to market timing by financial advisers in all mutual funds available through PSI. The January 2003 policy required brokers to adhere to the restrictions on the frequency of trading that are set forth in each mutual fund's disclosure documents.

19. The January 2003 policy stated that "cases involving multiple or subsequent notices, or actual or attempted circumventions" of the policy would be reviewed for appropriate

disciplinary action. The January 2003 policy further stated that "the use of manipulative techniques designed to avoid detection of certain trading activity," such as "executing transactions through an 'also' number or joint production number in order to conceal the identity of the Financial Adviser, or opening new accounts to conceal the identity of the client" would subject financial advisers to disciplinary sanction.

<u>PSI's Policies and Practices concerning FA Numbers</u>

20. At all relevant times, PSI issued FA numbers to individual brokers or teams of brokers in order to track the payment of commissions.

21. In June 2002, PSI issued a policy tightening its procedures for issuing additional FA numbers to brokers and teams of brokers. The June 2002 policy required PSI's regional managers (who outrank branch managers) to approve the issuance of all FA numbers. By June 2002, however, the broker defendants had already obtained sufficient FA numbers to carry out their scheme.

<u>Market Timing by the Druffner Group</u>

22. The Druffner Group's customers included six hedge funds whose common investment objective was market timing in mutual fund shares. The largest of these customers was a non-U.S. entity that maintained more than $200 million in assets at PSI in 2003. This customer typically sent facsimiles to the Druffner Group each morning detailing hundreds of mutual fund trades which the customer might do that day. The customer then called the Group each afternoon at approximately 3:30 p.m. Eastern Standard Time (one-half hour before the close

of trading for the day) to "activate" certain of its trading orders. The Group's other hedge fund customers also called the Group near the end of the day's trading to place market timing trades in mutual funds.

23. From at least 2001 until September 2003, numerous mutual fund companies sent hundreds of notices to PSI's operations department complaining about market timing by the Druffner Group. PSI's operations department forwarded many of the notices to Shannon and to the Group itself. The mutual funds' notices typically warned the Druffner Group that its trading violated the mutual funds' policies and suspended or restricted particular FA numbers or customer accounts from further trading in the mutual funds' shares.

24. For example, on September 4, 2002, one mutual fund sought to suspend market timing trades by Ajro and notified PSI's operations department about four FA numbers that he had used to "blatantly tim[e] in and out of" the funds. Two weeks later, the mutual fund contacted PSI's operations department again, complaining that "over the last few months," Ajro and Ficken had "continued to trade and market time . . . using different rep IDs for every new trade." The mutual fund added that "their activity has even increased in the two weeks since I sent you" the prior notice. In response to the notices from the mutual fund, PSI's operations department stated that it had blocked the FA numbers previously identified by the mutual fund but that Ajro and Ficken "may have more rep numbers . . . please feel free to continue to send me e-mails." The mutual fund responded to PSI's operations department that same day with ten additional FA numbers that it had identified as used by Ajro and Ficken, stating that they "appear to be creating a new rep ID every time they do a new trade." The mutual fund added,

"[W]hen new business comes in under these rep IDs, no broker name appears on the trade. We have to call Prudential each time to confirm who it is, and [it is] either Skifter Ajro, Justin Ficken, or both as a shared trade." The mutual fund concluded, "If there is more you can do, please do so. They are causing a lot of aggravation over here . . ."

25. Other mutual fund companies made comparable complaints to PSI's operations department about the Druffner Group's use of multiple FA numbers to evade trading restrictions. One mutual fund wrote to PSI's operations department on May 2, 2002 noting that Ajro's privileges had already been revoked but that he was now using "different rep numbers." A second mutual fund complained to PSI on August 21, 2002 about a new account traded by the Druffner Group, and PSI responded by instituting blocks on three Druffner Group FA numbers associated with Druffner and Ajro and by sending notice of the blocks to Defendant Shannon. A third mutual fund company wrote to PSI's operations department on December 26, 2002 identifying 12 FA numbers used by Ajro and Druffner to market time the mutual fund's shares and stating that it "will not accept any future business" from Ajro and Druffner, "regardless of their rep ids." The mutual fund added that "the continued disregard of our notice has left [the mutual fund] with no choice but to block these reps from any activity to protect the interest of our other shareholders." A fourth mutual fund identified multiple FA numbers for each of Druffner, Ficken, and Ajro (as well as for Peffer and Bilotti) and asked PSI to block the brokers from trading in certain of the mutual fund's funds, noting, "I have added the names and Rep IDs we have on file, but I would like all rep combinations blocked."

26. Despite the hundreds of warning notices, Druffner, Ficken and Ajro continued to engage in market timing trades, including many trades in the very same mutual funds that had restricted their trading privileges. To evade the mutual funds' restrictions, they concealed their identities and their customers' identities by placing trades using FA numbers and customer account numbers that the mutual funds had not yet identified or blocked. To assist the scheme, they opened some accounts for the same customer under several different names which concealed the beneficial owner of the account.

27. Indeed, from at least 2001 until September 2003, Druffner, Ficken and Ajro entered into thousands of market timing transactions in dozens of mutual funds, including the Prudential Funds, using numerous FA numbers and dozens of account numbers. The Druffner Group's trading generated nearly $5 million in gross commissions in 2002 alone, primarily from market timing activities, and by mid-2003, the Group was generating approximately $500,000 each month in commissions for PSI.

<u>Market Timing by the Peffer Group</u>

28. The Peffer Group's customers included two hedge funds whose investment objectives were market timing in mutual funds. The larger of these customers was a hedge fund located in the Netherlands Antilles that maintained more than $15 million in assets at PSI in 2003. This customer typically called Peffer or Bilotti between approximately 3:30 p.m. and 3:45 p.m. Eastern Standard Time (one-half hour or fifteen minutes before the close of trading for the day) with instructions to buy or sell positions in mutual funds with a certain geographic focus

(*e.g.*, Asia or Europe) in response to market events in the given region. Both Peffer and Bilotti placed these trades on behalf of the customer in dozens of mutual funds.

29. From at least 2001 until September 2003, Peffer and Bilotti received numerous letters from mutual fund companies notifying them that their ability to engage in transactions for the Netherlands customer in all or some of the company's mutual funds had been blocked. Nevertheless, Peffer and Bilotti continued to place market timing trades for the Netherlands customer as well as other customers. To evade the mutual funds' restrictions, they concealed their identities and their customers' identities by placing trades using FA numbers and customer account numbers that the mutual funds had not yet identified or blocked

30. Indeed, from at least 2001 until September 2003, Peffer and Bilotti entered into thousands of market timing transactions in dozens of mutual funds using numerous FA numbers and numerous account numbers, including fifteen different accounts for the Netherlands customer alone. The Peffer Group's market timing trades generated approximately $1 million in commissions for PSI during 2002 alone.

<u>Shannon's Substantial Assistance to the Brokers' Market Timing</u>

31. As manager of the PSI Boston branch from December 2001 until September 2003, Shannon was responsible for monitoring and approving the trades placed by brokers, the FA numbers assigned to brokers, and the new account numbers opened by or on behalf of clients. Shannon also was responsible for ensuring that brokers placed trades for their customers in

conformity with all existing PSI policies and procedures concerning, among other things, short-term trading in mutual funds.

32. Shannon received or was copied on hundreds of letters from mutual funds complaining about the broker defendants' market timing and notifying PSI that blocks had been placed on the broker defendants' trading in the funds' shares. Nevertheless, Shannon did not ensure that the broker defendants' trading conformed with the mutual funds' policies, procedures or prospectus disclosures. Likewise, after consulting with others at PSI, he did not enforce PSI's January 2003 policy requiring its brokers to adhere to the restrictions on frequency of trading set forth in the mutual funds' disclosure documents.

33. Shannon was also responsible for reviewing all trades placed in the PSI Boston branch and for approving all brokerage accounts established for the branch's customers. As a result, he knew or was reckless in not knowing that the broker defendants were evading the mutual funds' restrictions and PSI's policies by using multiple FA numbers and multiple customer accounts to continue placing market timing trades. Indeed, in the spring of 2002, he discussed with one customer the fact that its market timing trades were being effected through fifteen different customer accounts.

34. In addition, the broker defendants' market timing trades were sometimes so voluminous that they overwhelmed the PSI Boston branch office's operations department. When that happened, the broker defendants sent their orders to the PSI mutual fund exchange desk in New York to be entered. At least by mid-2003, Shannon was required to approve – and did approve – the market timing orders sent to the PSI mutual fund exchange desk in New York,

even though he knew or was reckless in not knowing that the broker defendants were evading the mutual funds' restrictions and PSI's policies by using multiple FA numbers and multiple customer accounts to continue placing market timing trades.

FIRST CLAIM FOR RELIEF
(Violations of Section 17(a) of the Securities Act
by Defendants Druffner, Ficken, Ajro, Peffer and Bilotti)

35. Plaintiff repeats and realleges paragraphs 1 through 34 above.

36. As set forth above, defendants Druffner, Ficken, Ajro, Peffer and Bilotti, directly and indirectly, acting intentionally, knowingly or recklessly, in the offer or sale of securities by the use of the means or instrumentalities of transportation or communication in interstate commerce or by use of the mails: (a) employed devices, schemes, or artifices to defraud; (b) obtained money or property by means of untrue statements of material fact or omissions to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and (c) engaged in transactions, acts, practices or courses of business which operated as a fraud or deceit upon purchasers of securities.

37. As a result, defendants Druffner, Ficken, Ajro, Peffer and Bilotti violated Section 17(a) of the Securities Act [15 U.S.C. §77q(a)], and their violations involved fraud, deceit, or deliberate or reckless disregard of regulatory requirements and resulted in substantial losses or significant risk of substantial losses to other persons, within the meaning of Section 20(d) of the Securities Act [15 U.S.C.§77t(d)].

SECOND CLAIM FOR RELIEF
(Violations of Section 10(b) of the Exchange Act and Rule 10b-5
by Defendants Druffner, Ficken, Ajro, Peffer and Bilotti
or, in the alternative, Aiding and Abetting the Uncharged Violations of
Section 10(b) and Rule 10b-5 by Certain of Their Customers)

38. Plaintiff repeats and realleges paragraphs 1 through 37 above.

39. As set forth above, defendants Druffner, Ficken, Ajro, Peffer and Bilotti, directly or indirectly, acting intentionally, knowingly or recklessly, by the use of the means or instrumentalities of interstate commerce or of the mails, in connection with the purchase or sale of securities: (a) employed devices, schemes or artifices to defraud; (b) made untrue statements of material fact or omitted to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) engaged in acts, practices or courses of business which operated as a fraud or deceit upon certain persons.

40. As a result, defendants Druffner, Ficken, Ajro, Peffer and Bilotti violated Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 [17 C.F.R. §240.10b-5] thereunder, and their violations involved fraud, deceit, or deliberate or reckless disregard of regulatory requirements and resulted in substantial losses or significant risk of substantial losses to other persons, within the meaning of Section 21(d)(3) of the Exchange Act [15 U.S.C. §78u(d)(3)].

41. In the alternative, defendants Druffner, Ficken, Ajro, Peffer and Bilotti knowingly or recklessly provided substantial assistance to, and thus aided and abetted, the uncharged violations of Section 10(b) of the Exchange Act and Rule 10b-5 committed by certain of their customers in connection with the market timing transactions alleged above.

THIRD CLAIM FOR RELIEF
(Aiding and Abetting the Other Defendants' Violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by Defendant Shannon)

42. Plaintiff repeats and realleges paragraphs 1 through 41 above.

43. As set forth above, defendant Shannon knowingly or recklessly provided substantial assistance to the market timing activities of defendants Druffner, Ficken, Ajro, Peffer and Bilotti.

44. As a result, defendant Shannon aided and abetted the violations of Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 [17 C.F.R. §240.10b-5] thereunder by defendants Druffner, Ficken, Ajro, Peffer and Bilotti.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

A. Enter a permanent injunction restraining the defendants and their respective agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, including facsimile transmission or overnight delivery service, from directly or indirectly engaging in violations of Section 17(a) of the Securities Act [15 U.S.C. §77q(a)] and Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 thereunder [17 C.F.R. §240.10b-5];

B. Order each defendant to disgorge his ill-gotten gains, plus pre-judgment interest;

C. Order each defendant to pay an appropriate civil monetary penalty pursuant to Section 20(d) of the Securities Act [5 U.S.C. §77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. §78u(d)(3)]; and

D. Award such other and further relief as the Court deems just and proper.

Respectfully submitted,

David P. Bergers
Associate District Administrator

Frank Huntington (Mass. Bar #544045)
Senior Trial Counsel

Stuart P. Feldman (Mass. Bar No. #559147)
Branch Chief

Beth Lehman (Mass. Bar #652712)
Staff Attorney

Attorneys for Plaintiff
SECURITIES AND EXCHANGE COMMISSION
73 Tremont Street, Suite 600
Boston, MA 02108
(617) 424-5900 ext. 201 (Huntington)
(617) 424-5940 fax

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