

Legal NewsSM

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Legal News: Investment Management Update is part of our ongoing commitment to providing up-to-the minute information about pressing concerns or industry issues affecting our clients and our colleagues.

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Legal News: Investment Management Update is available on a monthly basis to provide articles of interest affecting investment advisers, hedge funds, and mutual funds.

Non-Enforcement Matters

SEC Proposes Plain-English Disclosure for Investment Advisers

The U.S. Securities and Exchange Commission (SEC) announced on February 13, 2008 that it will propose rule amendments that would require investment advisers to prepare brochures giving information about themselves in plain English to be provided to clients and prospective clients. The brochures would be available to the public on the SEC's Investment Adviser Public Disclosure Web site.

The brochures would provide investors with more information about advisers' business practices, including the types of advisory services they provide, fees they charge, and the risks the clients can anticipate. The brochures also would disclose advisers' disciplinary history and conflicts of interest, including the use of affiliates to execute transactions, the use of client brokerage to obtain "soft dollars benefits," and their interests in certain transactions. The proposal also would address developing areas of concern such as conflicts of interest arising out of the side-by-side management of clients who pay performance fees (such as hedge funds) and those who do not, conflicts of interest arising from an adviser's receipt of compensation from issuers of financial products the adviser recommends to clients, and qualifications of an adviser's employees who give advice to clients.

The proposal would entail amendments to Part 2 of Form ADV, the adviser brochure, and related rules under the Investment Advisers Act of 1940. Comments on the proposed amendments should be received by the SEC no later than 60 days after they appear in the *Federal Register*.

SEC, FINRA, and NASAA Seek Ways to Protect Senior Investors

The SEC, Financial Industry Regulatory Authority (FINRA), and North American Securities Administrators Association (NASAA) announced that they will be attempting to identify practices used by financial services firms to protect older investors from fraud and investment in unsuitable securities, and then will make information about such practices publicly available. This action is part of a greater initiative by these groups to improve investment services provided to seniors.

The SEC, FINRA, and NASAA will be seeking input from all interested persons to identify supervisory, compliance, and other practices used by financial services firms to best serve their older customers. In particular, the group will be examining:

- Marketing and advertising to seniors
- Account opening
- Product and account review
- Ongoing review of the relationship and appropriateness of products
- Discerning and meeting the changing needs of customers as they age
- Surveillance and compliance reviews
- Training of firm employees

The information assembled will be made available to the public to help financial services firms better serve senior investors.

Other components of the group's broader initiative on senior investors include targeted examinations, enforcement of securities laws in cases of fraud against seniors, and active investor education and outreach.

SEC to Visit Newly Registered Investment Advisers Within One Year of Registration

The SEC recently announced a pilot program in which it will conduct examinations of newly registered investment advisers within a year of their registration. In the past, the SEC would place newly registered investment advisers on their usual examination schedule, which typically meant that the SEC would not examine them until four or five years after the initial registration date. The SEC will use this initial examination to review the investment adviser's business plan, existing and prospective clients, and the chief compliance officer.

Enforcement Matters

SEC Disciplines President of Investment Adviser for Defrauding Clients

Peter J. Dawson has been barred by the SEC from association with any investment adviser for defrauding investors while he was president and sole shareholder of BMG Advisory Services Ltd., an

investment adviser. (See, SEC, Investment Advisers Act of 1940 Rel. No. 2706, Feb. 15, 2008.)

Mr. Dawson admitted to defrauding investors and obtaining money and property by means of materially false and misleading statements. According to Mr. Dawson's allocution affidavit, he persuaded clients to surrender annuities or mortgage their residences to obtain cash to place with him for investment. However, rather than investing such funds, Mr. Dawson used the money to pay other investors and his own expenses. Mr. Dawson pled guilty to two counts of grand larceny and one count of scheme to defraud and is currently incarcerated in the Nassau County Correctional Center in New York.

SEC Disciplines President of Investment Adviser and Officer of Broker-Dealer for Defrauding Clients

Kangsan Kim has been barred by the SEC from association with any investment adviser or broker-dealer for defrauding investors while he was president of Unus Capital Management, Inc. (Unus), an investment adviser. (See, SEC, Securities Exchange Act of 1934 Rel. No. 57334 and Investment Advisers Act of 1940 Rel. No. 2706, Feb. 14, 2008.) Mr. Kim was disciplined by default after he failed to answer the SEC's Order Instituting Proceedings and the SEC's subsequent Motion for Default.

The SEC found that from July 2001 through at least September 2005, Mr. Kim engaged in false and fraudulent representations and concealment of material facts to obtain funds from clients to be invested for them by Unus. During this time, Mr. Kim also served as chief financial officer of PeopleN Investment, Inc., which purported to be a brokerage house through which Unus clients could buy and sell securities. Contrary to his representations, however, Mr. Kim used the clients' funds for his own business purposes, payments on his residence, entertainment, and operation of a "Ponzi" scheme. In separate criminal proceedings, Mr. Kim pled guilty to one count of wire fraud and was sentenced to a prison term of 52 months and ordered to pay restitution of \$3.8 million.

SEC Disciplines Owner of Investment Adviser and Associated Person With Broker-Dealer for Misleading Investors

Jeffrey L. Gibson has been barred by the SEC from association with any investment adviser or broker-dealer for misleading investors while he was a part owner and associated person of Gibson Gaither Wealth Management Advisors, an investment adviser, and an associated person with H. Beck, Inc., a broker-dealer. (See, SEC,

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Securities Exchange Act of 1934 Rel. No. 57266 and Investment Advisers Act of 1940 Rel. No. 2700, Feb. 4, 2008.)

The SEC found that Mr. Gibson and Investment Property Management, LLC, (IPM) which he wholly owned and controlled, sold limited partnership interests in American Car Wash Fund, LP (ACW) and then misappropriated approximately \$450,000 of the limited partners' contributions. ACW purportedly was organized to acquire and manage coin-operated car-wash businesses in northern Georgia, but Mr. Gibson used limited partners' contributions to purchase other commercial properties and pay fees to himself and IPM in excess of amounts set forth in ACW's private placement memorandum. According to the SEC, Mr. Gibson misled limited partners in letters that described rates of return, dividends, and purchases of various properties but did not disclose the misappropriation of funds by Mr. Gibson and IPM.

Investment Adviser/Broker-Dealer Disciplined for Mutual Fund Market-Timing Scheme

Justin F. Ficken has been barred by the SEC from association with any investment adviser or broker-dealer for defrauding more than 50 mutual funds and their shareholders by placing and concealing thousands of market-timing trades while working as a broker at Prudential Securities, Inc. (See, SEC, Securities Exchange Act of 1934 Initial Decision Rel. No. 345, Feb. 20, 2008.)

According to the SEC, Mr. Ficken, who was registered as an investment adviser and broker-dealer, helped clients make market-timing trades of mutual fund interests and used multiple fictitious trading accounts to conceal the market-timing trades when mutual funds asked him to stop. The SEC found that Mr. Ficken's actions were egregious and recurrent and that he acted with a high degree of scienter.

Investment Adviser Sentenced for Investment Adviser Fraud and Mail Fraud

Frank J. Russo was sentenced on February 25, 2008 to 18 years in prison after pleading guilty to investment adviser fraud and mail fraud. (*United States of America v. Frank J. Russo* (U.S. Dist. Ct. Mass., Cr.A. No. 07-10127-WGY); *United States of America v. Frank J. Russo, et al.* (U.S. Dist. Ct. Mass., C.A. No. 06-10984-RGS).) Mr. Russo also was ordered to pay a fine of \$500,000 and restitution to clients in the amount of \$20 million.

Mr. Russo, an investment adviser, admitted that from 1982 through 2006, he misrepresented to his clients that their investments would be safe with him and they would receive above-average returns. However, he did not invest their funds as he had promised and lost more than \$20 million of his clients' money. To conceal the losses from his clients and induce them to invest more money with him, Mr. Russo sent them account statements showing inflated balances and gains they never received.