SEC Charges Multiple Hedge Fund Managers with Fraud in Inquiry Targeting Suspicious Investment Returns

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Washington, D.C., Dec. 1, 2011 — As part of an initiative to combat hedge fund fraud by identifying abnormal investment performance, the Securities and Exchange Commission today announced enforcement actions against three separate advisory firms and six individuals for various misconduct including improper use of fund assets, fraudulent valuations, and misrepresenting fund returns.

Additional Materials

- SEC Complaint

Under the initiative — the Aberrational Performance Inquiry — the SEC Enforcement Division's Asset Management Unit uses proprietary risk analytics to evaluate hedge fund returns. Performance that appears inconsistent with a fund's investment strategy or other benchmarks forms a basis for further scrutiny.

In particular, the SEC alleges that the firms and managers engaged in a wide variety of illegal practices in the management of hedge funds or private pooled investment vehicles, including fraudulent valuation of portfolio holdings, misuse of fund assets, and misrepresentations to investors about critical attributes such as performance, assets, liquidity, investment strategy, valuation procedures, and conflicts of interest.

"We're using risk analytics and unconventional methods to help achieve the holy grail of securities law enforcement — earlier detection and prevention," said Robert Khuzami, Director of the SEC's Division of Enforcement. "This approach, especially in the absence of a tip or complaint, minimizes both the number of victims and the amount of loss while increasing the chance of recovering funds and charging the perpetrators."

Robert Kaplan and Bruce Karpati, Co-Chiefs of the SEC Enforcement Division's Asset Management Unit, added, "The extraordinary returns reported by these advisers and portfolio managers were, in most cases, too good to be true. In other cases, outlier returns were a telltale sign that something else was amiss. We are applying analytics across the investment adviser space — beyond performance and beyond hedge funds."

The SEC has filed several enforcement actions to date stemming from this initiative. Of the four actions announced today, three were filed in federal court and one was brought as an administrative proceeding.

Michael Balboa and Gilles De Charsonville

The SEC today charged two individuals for engaging in a fraudulent scheme to overvalue the reported returns and net asset value of the Millennium Global Emerging Credit Fund. At its peak in October 2008, the hedge fund's reported assets were $844 million.

The SEC's complaint alleges that Michael Balboa, the fund's former portfolio manager, schemed with two European-based brokers including Gilles De Charsonville of BCP Securities LLC to inflate the fund's reported monthly returns and net asset value by manipulating its supposedly independent valuation process.

Separately, the U.S. Attorney's Office for the Southern District of New York announced the arrest of Balboa and simultaneous filing of a criminal action against him.

According to the SEC complaint, from at least January to October 2008, Balboa surreptitiously provided De Charsonville and another broker with fictional prices for two of the fund's illiquid securities holdings for them to pass on to the fund's outside valuation agent and its auditor. The scheme caused the fund to drastically overvalue these securities holdings by as much as $163 million in August 2008, which in turn allowed the fund to report inflated and falsely-positive monthly returns. By overstating the fund's returns and overall net asset value, Balboa was able to attract at least $410 million in new investments, deter about $230 million in eligible redemptions, and generate millions of dollars in inflated management and performance fees.

The SEC's investigation, which continues, was conducted by Bill Conway, Brian Fitzpatrick, and Alison Conn of the New York Regional Office. Nancy Brown is leading the SEC's litigation effort.

The SEC acknowledges the assistance and cooperation of the U.S. Attorney, U.S. Postal Inspection Service, U.K. Financial Services Authority, Bermuda Monetary Authority, Comisión Nacional del Mercado de Valores, Guernsey Financial Services Authority, and Nigeria Securities and Exchange Commission.

ThinkStrategy Capital Management and Chetan Kapur

The SEC charged New York-based hedge fund firm ThinkStrategy Capital Management LLC and its sole managing director Chetan Kapur with fraud in connection with two separate hedge funds they managed (ThinkStrategy Capital Fund and TS Multi-Strategy Fund). At its peak in 2008, ThinkStrategy managed approximately $520 million in assets.

The SEC's complaint filed on Nov. 9, 2011 alleges that ThinkStrategy and Kapur engaged in a pattern of deceptive conduct designed to bolster their track record, size, and credentials. In particular, they materially overstated the performance of the Capital Fund and gave investors the false impression that the fund's returns were consistently positive and minimally volatile. ThinkStrategy and Kapur also repeatedly inflated the firm's assets, exaggerated the firm's longevity and performance history, and misrepresented the size and credentials of firm's management team.

ThinkStrategy and Kapur consented to the entry of judgments permanently enjoining them from violating the antifraud provisions of the securities laws, and have agreed to pay financial penalties and disgorgement in an amount to be determined by a federal court. Kapur consented to the entry of an SEC order, instituted Nov. 30, 2011, barring him from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

The SEC's investigation was conducted by Darren Long, Jeffrey Anderson, and Scott Weisman. Michael Semler is leading the remaining litigation effort.

Patrick Rooney and Solaris Management

The SEC charged Oakbrook, Ill. resident Patrick G. Rooney and his company Solaris Management LLC for fraudulently misusing the assets of the Solaris Opportunity Fund LP, to which it was the investment adviser.

According to the SEC's complaint filed on Nov. 16, 2011 in federal court in Chicago, Rooney and Solaris made a radical change in the fund's investment strategy, contrary to the fund's offering documents and marketing materials, by becoming wholly invested in Positron Corp., a financially troubled microcap company.

The SEC alleges that Rooney, who has been Chairman of Positron since 2004 and received salary and stock options from Positron since September 2005, misused the Solaris Fund's money by investing more than $3.6 million in Positron through both private transactions and market purchases. Many of the private transactions were undocumented while other investments were interest-free loans to Positron. Rooney and Solaris hid the Positron investments and Rooney's relationship with the company from the fund's investors for over four years. Although Rooney finally told investors about the Positron investments in a March 2009 newsletter, he allegedly lied by telling them he became Chairman to safeguard the fund's investments. These investments benefited Positron and Rooney while providing the fund with a concentrated, undiversified, and illiquid position in a cash-poor company with a lengthy track record of losses.

The SEC's investigation was conducted by Andrew Shoenthal, Malinda Grish, Ann Tushaus, Linda Gerstman, and Paul Montoya of the Chicago Regional Office. Timothy Leiman is leading the litigation effort.

LeadDog Capital Markets, Chris Messalas and Joseph LaRocco

The SEC instituted administrative proceedings against unregistered investment adviser LeadDog Capital Markets LLC and its general partners and owners Chris Messalas and Joseph LaRocco for misrepresenting or failing to disclose material information to investors in the LeadDog Capital LP fund.

In proceedings instituted on Nov. 15, 2011, the SEC Division of Enforcement alleges that LeadDog, Messalas, and LaRocco induced investors to invest in a hedge fund they controlled through material misrepresentations and omissions concerning among other things Messalas's negative regulatory history as a securities professional, compensation received by Messalas and LaRocco in connection with the fund's investments, and Messalas's substantial ownership interest in, and control of, some of the same companies to which he directed fund investments.

In addition, LeadDog, Messalas, and LaRocco allegedly misrepresented to, and concealed from, existing and prospective investors the substantial conflicts of interests and related party transactions that characterized the fund's illiquid investments. For example, to induce one elderly investor to invest $500,000 in the fund, LeadDog, Messalas, and LaRocco represented falsely that at least half of the fund's assets were liquid and could be marked to market each day, and that the investor could exit the fund at any time.

The SEC's investigation was conducted by Luke Fitzgerald, Lisa Knoop, James Flynn, and Ken C. Joseph of the New York Regional Office. Richard Primoff is leading the litigation.

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Significant coordination and assistance for the Aberrational Performance Inquiry has been provided by: Harvey Westbrook and Yongping Zheng of the SEC's Division of Risk, Strategy, and Financial Innovation; James Reese and Brian Snively of the SEC's Office of Compliance Inspections and Examinations; Alberto Arevalo, Marianne Olson, and Michael Moore of the SEC's Office of International Affairs; and Scott Weisman, Luke Fitzgerald, and Stephen Holden of the Division of Enforcement's Asset Management Unit.

Additional investigations stemming from this initiative are continuing.

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Home | Previous Page Modified: 12/1/2011