

SEC BRINGS MONEY MARKET FUND ENFORCEMENT ACTION

On May 5, 2006, the Securities and Exchange Commission (“SEC”) issued an order accepting settlement offers and making findings, imposing sanctions and implementing a cease-and-desist order against Unified Fund Services, Inc. (“Unified”) and its former Vice President, Michael Durham (“Durham”), for willful violations of the Securities Exchange Act of 1934 (“Exchange Act”) and the Investment Company Act of 1940 (“1940 Act”). The violations were in connection with fund administration and accounting services provided by Unified to Liquid Green Money Market Fund and its predecessor (collectively, “Liquid Green”), Florida Street Bond Fund (“Florida Street”) and other fund clients between 1999 and 2002. Liquid Green was a money market fund regulated by Rule 2a-7 under the 1940 Act, and Florida Street was a high-yield bond fund. This action is worthy of note because of the relatively severe penalties and consequences for essentially technical violations of securities laws and SEC rules.

The Findings and Violations

Unified provided fund administration services to Liquid Green and fund administration and accounting services to Florida Street. These services included net asset value calculations, preparation and filing of regulatory reports, and compliance testing. The SEC’s key findings in connection with violations are summarized below.

Rule 2a-7 and Related Issues. The SEC found that portfolio managers for Liquid Green had purchased callable bonds with maturities ranging from two-and-one-half to 12 years. These purchases resulted in the fund’s portfolio having an average maturity of 730 to 1,825 days. Unified, in performing its fund administration duties, inappropriately substituted the call dates of these bonds for their maturity dates.

Rule 22c-1 under the 1940 Act requires that open-end investment companies value their portfolio securities at current market value. However, the SEC has created an exemption under Rule 2a-7 for qualifying money market funds, which may use the amortized cost valuation method. In order for a money market fund to avail itself of the Rule 2a-7 exemption, it must adhere to certain investment requirements, including those stating that each security must have a remaining maturity of 397 days or less and that the dollar-weighted average portfolio maturity must not exceed 90 days. The SEC found that Liquid Green violated the 1940 Act because the fund continued to use the Rule 2a-7 valuation methodology even though it had purchased bonds that substantially exceeded the maturity limits and caused the portfolio’s average maturity to exceed Rule 2a-7’s limits. Unified and Durham were found liable for aiding and abetting Liquid Green’s violation.

In addition, with respect to both Liquid Green and Florida Street, Unified and Durham were cited for violations of Sections 31(a) and 34(b) of the 1940 Act and Rule 2a-7(b)(1) thereunder for material misstatements or omissions in records and reports required by the SEC, including

holding out Liquid Green as a money market fund. The SEC also found that the use of the term “money market fund” was materially misleading and deceptive pursuant to Section 35(d) of the 1940 Act and that there were incorrect shareholder reports in violation of Section 30 of the 1940 Act and Rule 30e-1 thereunder.

Uncollectible Interest. Florida Street carried unsubstantiated interest on its books, approximately \$200,000 of which was uncollectible. Although Durham knew of possible inaccuracies in Florida Street’s books, neither he nor Unified made efforts to verify or correct the records or write off any uncollectible interest, despite requests by the fund’s independent auditor. In addition, Unified neglected to write off uncollectible interest from bonds in default or bonds that the fund no longer owned. The correction of these incorrect entries resulted in a reduction in the fund’s net asset value of approximately 4.7%. The SEC found that this conduct caused Florida Street to violate Section 30(e) of the 1940 Act and Rule 30e-1 thereunder by transmitting misleading financial statements, as well as Section 30(b)(1) of the 1940 Act and Rule 30b1-1 thereunder, and Rule 12b-5 under the Exchange Act.

Late Filings. Finally, between 2000 and 2002, Unified caused, at least in part, the late filings of required reports by a number of portfolios managed by its fund clients in violation of Section 30(b)(1) of the 1940 Act and Rule 30b1-1 thereunder. The SEC found that the late filings were due to Unified’s failure to maintain adequate procedures to ensure timely filings with the SEC. Unified was found to have aiding and abetting liability for violations with respect to the late filings of its clients’ portfolios.

Remedial Efforts and Settlement Conditions

The SEC imposed sanctions and considered Unified’s firing or demotion of personnel when imposing sanctions. In its order, the SEC noted the remedial efforts undertaken by Unified directed at replacing personnel connected with the violations. In particular, the SEC favorably considered the hiring of a new Chief Executive Officer, Compliance Officer and Vice President in charge of mutual fund administration, and the firing or demoting of four other individuals. Also, the SEC took into consideration the hiring of consulting firms by Unified to improve and update its fund accounting, administration and compliance procedures.

In addition to the remedial efforts, Unified voluntarily paid restitution to Liquid Green and Florida State to compensate the funds for any loss incurred from its actions. Although these efforts likely reduced the severity of the penalty prescribed for Unified, under the settlement offer, the firm agreed to:

- pay a civil monetary fine of \$125,000;
- hire an independent compliance consultant to review and submit a report to the SEC regarding its accounting and compliance procedures in connection with the violations mentioned above; and
- adopt all the recommendations of the independent consultant.

The hiring of an independent compliance consultant is notable because of the expense that is generally involved in such undertakings, particularly in light of the expenses already incurred in the remedial efforts of Unified.

Conclusion

This enforcement action can be seen in light of the SEC's focus on mutual fund compliance, which was renewed in 2003 in the wake of industry-wide compliance and trading scandals. The SEC appears to be continuing to institute enforcement actions that have significant consequences for the firms involved, even in cases that involve compliance violations rather than substantial allegations of fraud. Fund service providers may continue to expect to receive a level of scrutiny and, possibly, sanctions that are much greater than before the 2003 scandals.

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June 6, 2006

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