



## Valuation

# Manager Accused of “Cooking the Books” Facing Civil and Criminal Fraud Charges From SEC and DOJ

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Valuation remains a critical fault line for fund managers and the subject of unrelenting regulatory scrutiny. The SEC recently filed a civil **complaint** (Complaint) against hedge fund manager Premium Point Investments L.P. (Premium Point) and three of its principals, alleging that, as the performance of Premium Point’s funds faltered, the defendants used inflated marks from a friendly broker and unauthorized valuation mechanisms to increase the value of the bonds in the funds’ portfolios. On the same day, the DOJ unsealed an **indictment** (Indictment) charging the three individual Premium Point defendants with four counts of securities fraud, wire fraud and conspiracy to commit those offenses. This article details the civil and criminal charges and the circumstances giving rise to them.

See “[Three Approaches to Valuing Fund Assets and How Auditors Review Those Valuations](#)” (May 11, 2017).

## Masking Performance Affects Investors

In the SEC **press release** announcing the filing of the Complaint, Daniel Michael, Chief of the Complex Financial Instruments Unit of the SEC Division of Enforcement, observed, “Investors rely on their investment advisers to fairly and accurately value securities, and that is especially true when the securities trade in opaque markets. As we allege, Premium Point masked its true performance, which denied investors the opportunity to make informed investment decisions.”

In the DOJ **press release**, Audrey Strauss, Senior Counsel to the U.S. Attorney for the Southern District of New York, remarked, “By allegedly cooking the books, [the individual defendants] made the fund appear more attractive to would-be investors and dissuaded current investors from withdrawing their investments.”

## Defendants and Relevant Non-Parties

The defendants in the SEC action are Premium Point; Anilesh Ahuja a/k/a Neil Ahuja, Premium Point’s founder, majority owner and CEO; Amin Majidi, the firm’s chief risk officer and portfolio manager; and Jeremy Shor, a director and trader. Ahuja founded Premium Point in 2008.

Premium Point managed two master-feeder hedge fund complexes that invested in mortgage securities:

1. Premium Point Master Mortgage Credit Fund, Ltd., Premium Point Mortgage Credit Fund LP and Premium Point Offshore Mortgage Credit Fund, Ltd. (collectively, the Mortgage Credit Fund); and
2. Premium Point Master New Issue Opportunity Fund, Ltd., Premium Point New Issue Opportunity Fund LP and Premium Point Offshore New Issue Opportunity Fund, Ltd. (collectively, the New Issue Fund and, together with the Mortgage Credit Fund, the Funds).

As is customary, Premium Point received a management fee based on a percentage of the value of the Funds' assets under management.

## Valuation Policies

The Funds' offering and organizational documents represented that the Funds' assets would be valued at "fair value," determined in accordance with U.S. generally accepted accounting principles.

See "[Three Pillars of an Effective Hedge Fund Valuation Process](#)" (Jun. 19, 2014).

Specifically, Premium Point represented that:

securities which are not [ ] listed . . . shall be valued at the mean between the "bid" and "asked" price on the date of determination based on quotations obtained by the Fund or its delegate from one or more brokers or dealers regularly making markets in and issuing quotations for such securities.

The Complaint indicates that, in practice, Premium Point "typically used at least one third-party vendor and at least one broker-dealer that Premium Point traders selected to provide month-end price quotes."

See "[Steps Advisers Can Take to Minimize the Risk That a Routine SEC Examination Ends With a Referral to Enforcement: Five Key Priorities for OCIE \(Part One of Two\)](#)" (Jan. 4, 2018); and "[WilmerHale and Deloitte Identify Best Legal and Accounting Practices for Hedge Fund Valuation, Fees and Expenses](#)" (Jul. 18, 2013).

## Alleged Valuation Fraud

As more fully described below, the Complaint alleges that the defendants manipulated the values of the mortgage securities held by the Funds from at least September 2015 through March 2016. The SEC asserted that the Funds' performance had begun to deteriorate and certain of the Funds' "major investors" began to request "large redemptions," thereby compounding the Funds' troubles.

Ahuja and Majidi allegedly recognized that, if the Funds' performance did not improve, redemptions would continue and the Funds would fail. The SEC charged that, as a result, they "created estimates of the performance they desired for the Funds for the *preceding* month and used those to set aggressive performance 'targets' for the *preceding* month" (emphasis added).

They pressured their traders to come up with valuations for Fund holdings to meet those targets.

The Indictment indicates that the defendants first challenged broker-supplied marks, making the case that the marks should be higher. When that failed, they allegedly “reverse-engineered” performance using sham broker quotes and using “imputed” midpoint prices.

For an enforcement action involving fraudulent overrides of broker marks, see “[SEC Continues to Focus on Insider Trading and Fund Valuation](#)” (Jun. 30, 2016).

## Sham Broker Quotes

The Complaint alleges that, during each monthly valuation process, if the defendants were dissatisfied with the marks they received from broker-dealers and [independent pricing sources](#), defendant Shor and an unnamed Premium Point trader (Trader) would seek “friendly” quotes from a representative (Representative) of an unnamed “small regional broker-dealer” (Broker).<sup>[1]</sup>

Shor and the Trader would send trades to the Representative in exchange for favorable quotes they requested. The SEC asserted that the Broker “essentially gave Shor and the Trader whatever marks they wanted for those bonds.” As evidence of this quid-pro-quo arrangement, the Complaint quotes a text message from the Representative to Shor that stated, “[The Trader] gonna have to show me/[Brokerage Firm] some more love [by sending trades] if he thinks I’m gonna just mark all those bonds where he wants them.”

Ahuja and Majidi allegedly understood that Shor and the Trader were able to obtain inflated marks and encouraged them to do so. The Indictment alleges that, when one partner of the firm refused to participate in the mismarking scheme, Ahuja demoted that individual, who then resigned.

For discussion of another SEC and DOJ action involving a similar valuation scheme, see “[SEC Accuses Former Portfolio Manager of Hedge Fund Millennium Global Emerging Credit Fund and Broker-Dealer Accomplice of Fraud in Conspiring to Inflate the Fund’s NAV](#)” (Dec. 8, 2011).

## Use of Imputed Mid-Point Prices

According to the Complaint, in 2011, Majidi provided a potential investor with a draft pricing policy that stated: “Pricing will correspond to 3pm mid-market levels on the last business day of each month. . . . In cases where we are given only a bid side price, the Investment Manager may add one half of bid/offer spreads to the bid price to establish a mid-market price.” When the investor objected to this provision, Majidi allegedly removed it from the policy. The investor subsequently invested \$100 million with Premium Point. See “[Operational Due Diligence From the Hedge Fund Investor Perspective: Deal Breakers, Liquidity, Valuation, Consultants and On-Site Visits](#)” (Apr. 25, 2014).

Despite what it told that investor, Premium Point allegedly continued to use imputed mid-point pricing. Certain pricing services used by Premium Point provided only bid-side marks for the Funds’ bonds. In those instances, “Premium Point solicited data from various sources regarding the bid/ask spread in particular bond sectors or categories . . . rather than individual bonds.” It then added half of that spread to the pricing service’s bid mark.

See “[Recent SEC Settlement Reminds Fund Managers to Strictly Adhere to Disclosed Fee and Expense Calculation Methodologies and Fully Disclose Conflicts of Interest](#)” (Nov. 16, 2017); and

## **“Adhering to Disclosed Fee and Valuation Methodologies Is Crucial for Hedge Fund Managers to Avert Enforcement Action” (Jan. 28, 2016).**

The Complaint details one instance where, even though one broker-dealer had provided an actual mid-point price of \$2.63 for a bond, Shor instead used (1) the bid price provided by a pricing service; (2) a significantly inflated bid price provided by the Broker; and (3) sector spreads provided by the pricing service and the Broker to arrive at an imputed midpoint price of \$4.22. That valuation was “60% higher than the mid-point price from the small broker-dealer and over 78% higher than the bid-side price from the independent pricing service,” the SEC asserted.

In another instance, Shor asked the Broker and another broker-dealer to “re-label the mid-point price marks they had been providing to Premium Point on specific bonds as bid-side price marks,” which enabled him to generate a much higher imputed mid-point price for those bonds.

Even after Premium Point’s primary pricing service began providing both bid- and mid-point marks, Premium Point continued to use imputed mid-point marks to boost the value of its portfolio. In one instance, this dubious methodology resulted in an imputed mid-point price of \$6.57 for a bond for which the independent pricing service had provided a mid-point mark of \$2.61. Moreover, Premium Point showed month-over-month increases in the values of certain bonds, even though the bid prices it received for the bonds in those months had actually declined.

Finally, the Indictment indicates that, in some instances, when the Funds sold a portion of a bond, they continued to mark their remaining positions in the bond at a price significantly higher than the recent actual sale price.

For other SEC actions in which the respondent failed to take into account actual market conditions in valuing an important asset, see “[Failure to Consider Relevant Market Inputs When Valuing Assets May Draw SEC Enforcement Action Against Fund Managers](#)” (Apr. 20, 2017); and “[Hedge Fund Platinum Partners and Principals Face Civil and Criminal Proceedings From SEC and DOJ Over Alleged Fraudulent Valuation Practices and Liquidity Misrepresentations](#)” (Jan. 12, 2017). For an action involving abuse of discretion in valuing illiquid assets, see “[SEC Fraud Charges Against Lynn Tilton, So-Called ‘Diva of Distressed,’ Confirms the Agency’s Focus on Valuation and Conflicts of Interest](#)” (Apr. 9, 2015).

## **Inflated Fees and Misleading Marketing**

The SEC and DOJ alleged that the valuation scheme had three primary effects:

1. Premium Point received inflated management fees based on the Funds’ improperly inflated net asset values (NAV);
2. the inflated valuations induced investors not to redeem their interests in the Funds; and
3. the respondents tried (unsuccessfully) to use the inflated valuation of the New Issue Fund as a selling point to raise capital for a new version of that Fund.

The Indictment alleges that, when selling bonds to meet investor redemption requests, in order to mask the valuation scheme, the defendants sold bonds whose actual values were closer to the value reported by the Funds. As a result, the defendants had to continue inflating the value of the remaining bonds to sustain the bogus NAV and performance. The SEC pointed to internal communications among the individual defendants to establish that those defendants understood

“the extent of Premium Point’s overvaluation of securities and its impact on Premium Point’s performance.”

## Audit and Restated NAV

During its audit of the Funds’ 2015 financial statements, the Funds’ auditor discovered the overvaluation of securities and advised Premium Point that it might have to restate their NAVs. Premium Point revalued the securities, revealing that from September 2015 through March 2016, the valuations had been overstated, on average, by 14 percent per month. The Indictment alleges that, at its peak, the mismarking across the Premium Point funds exceeded \$200 million. Premium Point never completed its 2015 or 2016 audits.

## SEC Charges and Relief Requested

The Complaint contains three classes of claims for relief:

- *Securities Fraud*: All defendants allegedly violated [Section 10\(b\)](#) and [Rule 10b-5](#) under the Securities Exchange Act of 1934 (Exchange Act) and [Sections 17\(a\)\(1\) and 17\(a\)\(3\)](#) of the Securities Act of 1933, which make it unlawful to “employ any device, scheme, or artifice to defraud” or to “engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit” upon a securities purchaser.
- *Investment Adviser Fraud*: Premium Point, Ahuja and Majidi allegedly violated [Sections 206\(1\), 206\(2\) and 206\(4\)](#) of the Investment Advisers Act of 1940 (Advisers Act) and [Rule 206\(4\)-8\(a\)\(2\)](#) thereunder, which prohibit an adviser from engaging in any act, practice or course of business that is fraudulent, deceptive or manipulative with respect to any investor or prospective investor in a pooled investment vehicle. The three individual defendants allegedly aided and abetted Premium Point’s violations of those provisions.
- *Custody Rule Violation*: Premium Point allegedly violated [Section 206\(4\)](#) and [Rule 206\(4\)-2](#) under the Advisers Act, which require advisers with custody of client securities to undergo an annual surprise examination by an independent auditor or, in lieu of that examination, to undergo an annual audit by an independent public accountant and to deliver the audited financial statements to investors. For fiscal years 2015 and 2016, Premium Point failed to obtain either a surprise examination or an annual audit. See our two-part series on avoiding common pitfalls under the custody rule: “[Inadvertent Custody, Delivery Failures and GAAP Compliance](#)” (Mar. 23, 2017); and “[Custody Determination, Auditor Independence and Liquidation Audits](#)” (Apr. 6, 2017).

Against each defendant, the SEC is seeking:

- a permanent injunction against future violation of each of the federal securities laws allegedly violated;
- disgorgement of ill-gotten gains, plus prejudgment interest; and
- civil penalties.

## DOJ Indictment of Individual Defendants

The four-count Indictment against Ahuja, Majidi and Shor parallels the Complaint and charges each with securities fraud (*i.e.*, violation of Section 10(b) and Rule 10b-5 under the Exchange Act); conspiracy to commit securities fraud; wire fraud; and conspiracy to commit wire fraud. In addition to other criminal sanctions, the DOJ intends to seek forfeiture by the defendants of the proceeds of their alleged criminal conduct.

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[1] The Indictment identifies the Representative as Frank Dinucci and the Trader as Ashish Dole (who served as Premium Point's chief risk officer and as a junior trader assisting Shor). Both Dinucci and Dole have pleaded guilty to various counts of conspiracy, wire fraud and securities fraud and are cooperating with the government.

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