

**UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION**

In the Matter of:

Jeff Thomas Allen,

Respondent.

)
) CFTC Docket No. 05- 08
)
) ORDER INSTITUTING PROCEEDINGS
) PURSUANT TO SECTION 6(c) AND
) 6(d) OF THE COMMODITY EXCHANGE
) ACT, MAKING FINDINGS AND IMPOSING
) REMEDIAL SANCTIONS
)

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COMMODOITY FUTURES TRADING COMMISSION
WASHINGTON DC

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that Jeff Thomas Allen (“Allen”) has violated Sections 4b(a)(2)(i) and (iii) and 4o(1)(A) and (B) of the Commodity Exchange Act, as amended (“Act”), 7 U.S.C. §§ 6b(a)(2)(i) and (iii) and 6o(1)(A) and (B)(2002). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and they hereby are, instituted to determine whether Allen engaged in the violations set forth herein, and to determine whether an order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, Allen has submitted an Offer of Settlement (the “Offer”), which the Commission has determined to accept. Without admitting or denying the findings of fact in this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions (“Order”), and prior to any adjudication on the merits, Allen acknowledges service of this Order. Allen consents to the use of the findings in this Order in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party.¹

¹ Respondent does not consent to the use of the Offer or this Order, or the findings consented to in the Offer or this Order, as the sole basis for any other proceeding brought by the Commission other than a proceeding in bankruptcy, or to enforce the terms of the Order. Nor does Respondent consent to the use of the Offer or this Order, or the findings consented to in the Offer or this Order, by any other party in any other proceeding.

III.

The Commission finds the following:

A. SUMMARY

Since the early 1990s, Allen, the Chairman, President, Chief Executive Officer, Chief Investment Officer and principal shareholder of Advanced Investment Management, Inc. (“AIM”), itself formerly a commodity pool operator and commodity trading advisor registered with the Commission, had advised and directed the trading of AIM’s clients, many of which were private and public pension funds. In 2002, with the assistance of others, Allen implemented an aggressive strategy of trading highly leveraged commodity futures contracts and options, including S&P 500 futures contracts and S&P E-mini futures, among other derivatives, on behalf of certain AIM clients. That highly leveraged trading strategy significantly exceeded the risk parameters set forth in the various trading agreements with the AIM clients, was concealed from the clients, and, over several months, primarily from March through July 2002, resulted in losses exceeding \$400 million. Such unauthorized trading violates Sections 4b(a)(2)(i) and (iii) and 4o(1)(A) and (B) of the Act.

B. RESPONDENT

Jeff Thomas Allen, age 48, is a resident of Pittsburgh, Pennsylvania. He was AIM’s Chairman, President, Chief Executive Officer and Chief Investment Officer from 1992 until his resignation in July 2002, and was registered as a principal and associated person of AIM from September 1993 through July 2002. Allen owned 78 percent of AIM’s outstanding shares and directed all activities of the firm. Allen is currently the President of Palomino Capital Management (“Palomino”), a commodity pool operator that has been registered with the Commission since September 25, 2003. Allen has been registered as an Associated Person and listed as a principal of Palomino since the entity was registered.

C. RELATED ENTITY

Advanced Investment Management, Inc. was incorporated in Delaware on July 17, 1992 and maintained its offices in Pittsburgh, Pennsylvania. AIM was registered as commodity pool operator and a commodity trading advisor with the Commission from September 1993 to September 2002, and ceased operations by December 2002.

IV.

FACTS

AIM offered to its clients an investment product called “Enhanced Indexing,” which consistently outperformed the S&P 500 Index during the 1990s and attracted the investment of several private and public pension funds. Allen oversaw the management and implementation of the Enhanced Index trading strategy and exercised complete discretion in his trading and

management of client funds, subject only to his fiduciary duty to comply with the various trading agreements with AIM clients who had committed funds to the Enhanced Indexing strategy.

The Enhanced Indexing strategy sought to outperform the S&P 500 Index by using derivatives, including commodity futures contracts, such as the S&P 500 futures contracts and S&P 500 E-mini futures, to mirror the S&P 500 Index, but at only five percent of the 100 percent cost of purchasing the same S&P 500 equities outright. AIM then invested the cash saved from purchasing the derivatives in short term, high quality debt instruments, or cash equivalents. By March 2002, AIM's assets under management had reached a high of \$8.3 billion.

Many of AIM's institutional clients, such as the private and public pension funds, wanted to limit the amount of risk associated with their investments and the potential for substantial losses if AIM did not follow a controlled and disciplined investment strategy. Accordingly, AIM and its clients entered into trading agreements which set forth the scope of AIM's trading authority. These agreements specifically prescribed the amount of risk AIM could employ in trading their portfolios, including commodity futures and options contracts, as part of the Enhanced Indexing investment.

Allen divided the Enhanced Indexing investment into two categories: "Core" and "Non-Core." The unauthorized trading that led to the tremendous trading losses sustained by the AIM clients primarily occurred in the Non-Core trading. The small group of AIM clients that were part of the Non-Core Trading authorized AIM to increase their market exposure to levels as high as 120 percent, such that the portfolio's value would move disproportionately to the S&P 500 Index depending on the extent of market exposure; the agreements explicitly provided that AIM could not exceed those risk parameters unless approved by the clients.²

Despite the express limitations on the amount of risk to which these clients wanted to be exposed, between March 2002 and July 2002, Allen aggressively conducted the Non-Core trading, purchasing highly leveraged commodity futures contracts, options and other derivatives, and thus increased the clients' risk exposure beyond the authorized levels without their authorization, knowledge or consent. In some instances, the value of the clients' portfolios was exposed by as much as 350 percent or more of their value.

Allen carefully bought and then sold Non-Core positions in excess of authorized amounts on or near the last day of the month to ensure that the monthly statements did not reveal that he was maintaining excessive exposure levels in contravention of the trading agreements. After reporting the month-end exposure levels, Allen increased client exposure levels again by reestablishing the positions he sold only days earlier. Although AIM clients or their trustees received daily reports listing the trades executed for their accounts, the daily reports did not explicitly state the clients' risk exposure as the monthly reports did. Moreover, clients typically relied on the monthly reports. Allen's "window dressing" of the monthly reports prevented the clients from discovering the unauthorized trading.

² Most of AIM's clients were in the Core category and had required AIM to limit their exposure to 100 percent, such that any market movement in the S&P 500 Index would cause equal percentage movements in the market value of the portfolio. The trading responsibilities for the Core trading were shared by Allen and others. There were only limited instances of unauthorized trading in the Core category where Allen was responsible for the trading.

By early spring 2002, Allen's unauthorized trading began to have a negative impact on performance. As the market steadily declined through the spring and early summer 2002 and the portfolios began underperforming the S&P 500, Allen dramatically escalated his use of leverage in a failed attempt to recover lost performance, causing more than \$415 million in losses by July 2002. At that point, Allen finally acknowledged the trading losses and resigned from AIM.³

V.

LEGAL DISCUSSION

Section 4b(a)(2)(i) of the Act prohibits any person from cheating or defrauding or attempting to cheat or defraud other persons in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made, or to be made, for or on behalf of any other person. Section 4b(a)(iii) prohibits any person from willfully deceiving or attempting to deceive other persons in connection with commodity futures contracts.

Section 4o(1) of the Act broadly prohibits fraudulent transactions by a commodity pool operator and/or a commodity trading advisor. Section 4o(1)(A) of the Act makes it unlawful for an associated person of a commodity pool operator or of a commodity trading advisor to employ any device, scheme or artifice to defraud any participant or prospective participant. Section 4o(1)(B) of the Act makes it unlawful to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant. The same conduct that violates Section 4b violates 4o of the Act. *CFTC ex rel. Kelley v. Skorupskas*, 605 F.Supp. 923, 932-33 (E.D.Mich. 1985); *In re R&W Technical Services, Ltd.*, [1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,582 at 47,744 (CFTC March 16, 1999), *aff'd in relevant part*, 205 F.3d 165 (5th Cir. 2000).

Unauthorized trading falls within the Act's anti-fraud prohibitions and occurs when trades are executed without the customer's permission or contrary to the customers' trading instructions. *In re Interstate Securities Corp.*, [1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,295 June 1, 1992, *citing Cange v. Stotler Inc.*, 826 F.2d 581, 589 (7th Cir. 1987); *Haltmier v. CFTC*, 554 F.2d 556, 560 (2^d Cir. 1977).

As set forth above, Allen knowingly violated the clients' trading agreements by purchasing commodity futures contracts and other derivatives that caused excessive leverage without the clients' knowledge, authorization or consent, and then selling the unauthorized positions before month-end so the monthly statements did not reflect the unauthorized positions, actions which resulted in the clients losing hundreds of millions of dollars.

³ Within months of discovering that their losses stemmed from unauthorized trading, several of the AIM clients commenced litigation against AIM, Allen, and AIM's other principals. Eventually, AIM and its four principals, including Allen, settled the litigation with all the former clients affected by the unauthorized trading for \$14.7 million. Allen's contribution to that settlement substantially exceeded his compensation during the relevant time period.

Based upon these actions, Allen violated Section 4b(a)(2)(i) and (iii) of the Act. Each act of unauthorized trading also violates Section 4o because each was committed while Allen was acting as a registered AP of a registered commodity pool and of a registered commodity trading advisor.

VI.

OFFER OF SETTLEMENT

Allen has submitted an Offer of Settlement in which, without admitting or denying the findings herein, and prior to any adjudication on the merits, he acknowledges service of the Order; admits jurisdiction of the Commission with respect to the matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based upon violations or for enforcement of the Order; and waives service of a complaint and notice of hearing, a hearing, all post-hearing procedures, judicial review by any court, any objection to the staff's participation in the Commission's consideration of the Offer, any claim of double jeopardy based on the institution of this proceeding or the entry of any order imposing a civil monetary penalty or other relief, and all claims which they may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2000) and 28 U.S.C. § 2412 (2000), and part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1, *et seq.* (2002), relating to, or rising from, this action.

Allen stipulates that the record basis upon which this Order is entered consists solely of this Order. Allen consents to the Commission's issuance of this Order, which makes findings, as set forth herein, including findings that Allen violated Sections 4b(a)(2)(i) and (iii) and 4o(1)(A) and (B) of the Act, and orders that Allen cease and desist from violating the provisions of the Act he has been found to have violated, revokes his registration, imposes a permanent trading ban, prohibits personal trading for a period of five years, and requires him to comply with the undertakings set forth below.

VII.

FINDING OF VIOLATIONS

Based solely upon the consent of Allen as evidenced by his Offer, and prior to any adjudication upon the merits, the Commission finds that Allen violated Section 4b(a)(2)(i) and (iii) and 4o (1)(A) and (B) of the Act, 7 U.S.C. §§ 6b(a)(2)(i) and (iii) and 6o(1)(A) and (B)(2002).

VIII.

ORDER

Based upon the consent of Allen to the entry of this Order and the findings herein that Allen violated Sections 4b(a)(2)(i) and (iii) and 4o(1)(A) and (B) of the Act, the Commission deems it appropriate and in the public interest to impose remedial sanctions against Allen, and accordingly:

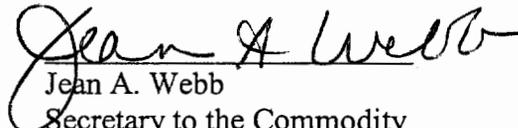
- A. **IT IS HEREBY ORDERED** that Allen shall cease and desist from violating Sections 4b(a)(2)(i) and (iii) and 4o(1)(A) and (B) of the Act, 7 U.S.C. §§ 6b(a)(2)(i) and (iii) and 6o(1)(A) and (B).
- B. **IT IS HEREBY FURTHER ORDERED** that Allen's registration with the Commission as an associated person is revoked;
- C. **IT IS HEREBY FURTHER ORDERED** that Allen is permanently prohibited from trading for others on or subject to the rules of any registered entity and all registered entities shall refuse Allen all privileges thereon;
- D. **IT IS HEREBY FURTHER ORDERED** that Allen is prohibited for a period of five years following the date of this order from trading for himself on or subject to the rules of any registered entity and all registered entities shall refuse Allen all privileges thereon;
- E. **IT IS HEREBY FURTHER ORDERED** that Allen shall comply with the following undertakings:
 - 1. Allen shall never apply for registration or claim exemption from registration with the Commission in any capacity, except as provided for in Regulation 4.14 (a)(9), 17 C.F.R. § 4.14(a)(9) (2004), and shall never engage in any activity requiring such registration or exemption from registration, or act as a principal, agent or officer of any person registered or exempted from registration, except as provided for in Regulation 4.14 (a)(9), 17 C.F.R. § 4.14(a)(9) (2004) and
 - 2. Allen agrees that neither he nor any of his agents or employees acting under his authority or control shall take any action or make any public statement denying, directly or indirectly, any findings in the Order or creating, or tending to create, the impression that the Order is without a factual basis; provided, however, that nothing in this provision affects Allen's (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party.

IX.

The Commission notes that an order imposing a substantial civil monetary penalty reflecting the egregiousness of Allen's fraud and the losses sustained by the AIM clients would be appropriate in this case, but is not imposing one based on the fact that only limited restitution was available to, and obtained by, AIM's clients.

The provisions of this Order shall be effective on this date. A copy of this Order shall be served on all contract markets, and on the National Futures Association.

By the Commission:


Jean A. Webb
Secretary to the Commodity
Futures Trading Commission

Date: April 6, 2005