UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55711 / May 7, 2007

INVESTMENT COMPANY ACT OF 1940
Release No. 27819 / May 7, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12628

In the Matter of **ZURICH CAPITAL MARKETS INC.,** Respondent.	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (the "Exchange Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Zurich Capital Markets Inc. ("ZCM" and "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities

Exchange Act of 1934 and Section 9(b) of the Investment Company Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. Summary

1. ZCM, an entity that provided financing, aided and abetted four hedge funds that were carrying out schemes to defraud mutual funds that prohibited market timing. Specifically, ZCM provided financing to four market-timing hedge funds that employed various deceptive tactics to invest in mutual funds. ZCM and these hedge funds knew that many mutual funds in which they invested imposed restrictions on market timing activity. In order to buy, exchange and redeem shares in these mutual funds, these hedge funds employed deceptive techniques designed to avoid detection by these mutual funds. ZCM came to learn that the hedge funds were utilizing deceptive practices to market time mutual funds**,** and nonetheless ZCM provided financing to them and took administrative steps that substantially assisted them. By providing assistance to the hedge funds, ZCM aided and abetted the hedge funds' violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent

2. ZCM is a New York-based company, incorporated in Delaware, that is not registered with the Commission as a broker-dealer. During the relevant period, ZCM was an affiliate of Zurich Global Assets LLC (subsequently reorganized and re-named Crown Management Services Limited), and an indirect subsidiary of Zurich Financial Services ("ZFS"), a Swiss holding company. At all relevant times, ZCM wholly owned Zurich Capital Markets Securities Inc. ("ZCMSI"), a registered broker-dealer. As such, ZCM was a "person… directly controlling… [a] broker-dealer," making it "at the time of the alleged misconduct, . . . a person associated with a broker-dealer' subject to the Commission's jurisdiction under Section 15(b)(6) of the Exchange Act." *See* Section 3(a)(18) of the Exchange Act. ZCM was in the business of providing financing to hedge funds and funds of funds. Since mid-2003, ZCM effectively ceased its business operations, having sold its major assets to a third-party and shifted its remaining operations into wind-down mode.

C. Facts

Market Timing

3. Market timing of mutual funds includes (a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal per se, can harm other mutual fund shareholders because it can dilute the value of their shares. Market timing can also disrupt the management of the mutual fund's investment portfolio, and frequent buying and selling of shares by market timers can cause the targeted mutual fund to incur costs it would not incur in the absence of the market timing.

4. Some hedge funds trade through variable annuities to market time the underlying mutual funds. Variable annuities are securities that are insurance contracts that provide for tax-deferred accumulation of investment proceeds during the accumulation period and various payout options, including a series of payments to be made to a person named as the "annuitant" in the contract or another beneficiary whom the owner of the policy designates. The payments typically are scheduled to support the annuitant's retirement. Hedge funds and others that engage in market timing through variable annuities, however, do not purchase the products in order to obtain the retirement income for themselves or family members or others dependent upon them. Rather, they purchase variable annuities to be able to market time the underlying mutual fund portfolios. Because issuers of variable annuities typically aggregate trades in their contracted fund complexes and transmit the trades on a net basis, trading through variable annuity contracts can make it more difficult for mutual funds that prohibit market timing to detect market timing activity or identify investors who are known market timers.

<u>ZCM Aided and Abetted its Hedge Fund Clients' Violations of Federal Securities Laws</u>

5. From 1999-2003, ZCM provided financing to various hedge funds, including some that utilized a market timing strategy. ZCM provided this financing through derivative structures known originally as "call options" and subsequently as "accreting strike basket transactions." They were structured and operated in a manner similar to total return swaps.

6. With respect to the financing arrangements, ZCM generally placed the "leverage" it contributed as well as the "premium" or "principal" that its hedge-fund client contributed in accounts at one or more broker-dealers ("the managed accounts"). The financing arrangements permitted the hedge fund to contribute additional premium and increase the leverage provided by ZCM subject to a total dollar cap for the transaction and a maximum ZCM contribution of 75% (in one instance 80%) of the total assets in the managed accounts. ZCM opened managed accounts at brokerage firms in the names of special purpose vehicles ("SPVs") that ZCM formed. Pursuant to a limited power of attorney, ZCM granted trading authority within the accounts to its hedge-fund client or the client's investment adviser. The hedge fund or its adviser made all trading decisions with respect to purchases and sales of shares of mutual funds in the managed accounts. The hedge fund or its adviser communicated those decisions directly to the brokers. ZCM, as the owner of the managed accounts, routinely received account statements. ZCM would then track the leverage ratio of the financing arrangement to ensure that it did not exceed the maximum percentage allowed under the applicable derivative agreements. To ensure against diversion or dissipation of the premium and leverage in the managed accounts, ZCM also retained authority over all transfers of funds into and out of these brokerage accounts. To transfer funds among SPVs or accounts, the hedge funds would need to request that ZCM's employees authorize wire transfers or journaling of funds between brokerage accounts.

7. The hedge-fund client was entitled to receive all gains, if any, resulting from its trading in the managed accounts, and bore any losses, while ZCM received only a financing charge on the leverage it provided of LIBOR plus a fixed amount ranging from 115 to 169 basis points, depending on the deal.

8. ZCM's hedge-fund clients knew that numerous mutual funds did not like market timing and that many of these mutual funds prohibited market timing. In an effort to avoid being detected and potentially blocked from making market-timing trades in these funds, each of these hedge funds submitted trades in ways designed to avoid detection by disguising their and ZCM's identities or masking the trades in omnibus transactions.

9. For example, ZCM and the hedge funds used SPVs to mask their identities and execute market timing trades. ZCM first used SPVs in connection with its market timing business in May 2000 when it opened eight SPVs for one hedge fund client ("Hedge Fund A").

10. In or around October, 2000, another hedge fund client ("Hedge Fund B") requested that ZCM create an SPV owned by ZCM but under a different name. In an email, a former ZCM managing director noted that Hedge Fund B had advised him that it would "cause problems if ZCM is viewed as being the direct investor." The managing director wrote that Hedge Fund B suggested setting up an SPV under a different name because a different name was needed to "intermediate" the purchase of mutual funds. When asked what would be problematic about ZCM being viewed as the direct investor, the ZCM managing director wrote that "[t]his is the familiar problem that mutual funds dislike mutual fund timers that arb their redemption policies." Another former ZCM managing director responded that ZCM had previously "set up subsidiaries of [ZCM] (with non-ZCM) names" in connection with its financing arrangement with Hedge Fund A and asked whether that would "solve the problem." ZCM proceeded to create for Hedge Fund B an SPV, to which it assigned a name not recognizable as connected to ZCM.

11. In addition, ZCM set up SPVs for use by two other hedge fund clients at the time the financing transactions were initiated in 2000 and 2001.

12. Further, in 1999, Hedge Fund B requested that ZCM purchase annuity policies with ZCM as owner and one of several ZCM employees named as annuitant on each policy. In December, 2000, a ZCM managing director wrote in an e-mail that Hedge Fund B was doing so because mutual funds were "constantly prohibiting" it from trading, and the variable annuity structure provided a "screen" that made it harder for the underlying mutual funds to detect its market timing activity. From 1999 to 2001, at the request of this counterparty, ZCM purchased at least nine variable annuity contracts. The annuitants named on these policies were ZCM employees, though ZCM was designated as the owner and beneficiary of the policies. Any profits or losses accrued for the benefit of Hedge Fund B. Hedge Fund B then engaged in market timing in the underlying mutual fund portfolios with financing provided by ZCM.

13. In or around February, 2002, a ZCM risk management employee cautioned ZCM's senior management by email that ZCM's hedge funds clients' market timing transactions exposed the company to potential "reputational" risk because some might view the practice of market timing as harmful to other mutual fund shareholders. ZCM management imposed a freeze on any new financing transactions with mutual fund market timers pending ZCM's review of and further inquiry into the business. In addition, internal auditors at Zurich Global Assets, acting at the request and direction of in-house counsel, were conducting a review of operational deficiencies with regard to ZCM's financing of Hedge

Fund B that had come to light in the fall of 2001, after Hedge Fund B's election to terminate its financing arrangement with ZCM. In March 2002, the auditors made a number of comments and recommendations, including the suggestion, with regard to potential reputational risks, that ZCM assess ZCM's continued participation in market timing deals given the prohibitions by some mutual fund companies. A new management team that was installed in April 2002 maintained the freeze on any new financing transactions with hedge funds engaged in market timing of mutual funds, and ZCM did not thereafter enter into such financing transactions. However, while the financing transaction with Hedge Fund B had already been terminated in August 2001, ZCM continued to finance its three other existing market timing clients until the fall of 2003.

ZCM Profited While Its Clients' Short-Term Trading Harmed Mutual Funds and Their Shareholders

14. ZCM profited from the fees it received from the business of providing derivative financing to hedge funds engaging in a mutual-fund market timing strategy. From 1999 through September, 2003, ZCM's revenue from providing financing to the four hedge fund clients was approximately $11 million. Numerous mutual funds and their shareholders suffered dilutive harm caused by short-term market timing trading done by these hedge funds with financing provided by ZCM.

D. ZCM Aided and Abetted and Caused Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

15. As a result of the conduct described above, ZCM willfully aided and abetted and caused violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit, in connection with the purchase or sale of securities, the use of any manipulative or deceptive device, including any device, scheme or artifice to defraud; making any untrue statement of material fact or omitting to state a material fact when doing so makes the statement made misleading; or engaging in any act, practice or course of business which operates or would operate as a fraud. ZCM's market timing hedge fund clients engaged in a scheme to defraud mutual funds. Specifically, these clients utilized numerous deceptive practices to market time mutual funds. ZCM knowingly provided substantial assistance to these hedge funds. For example, ZCM created seemingly unaffiliated SPVs in whose name multiple brokerage accounts were opened, and this enabled its hedge fund clients to disguise their identities (and ZCM's identity) to market time mutual funds. Accordingly, ZCM willfully aided and abetted and caused violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

E. Respondent's Remedial Efforts

16. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff by Respondent during its investigation.

F. Undertakings

17. Ongoing Cooperation. Respondent shall cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, Respondent has undertaken:

a. To use its best efforts to cause employees to be interviewed by the Commission's staff at such times as the staff reasonably may direct;

b. To use its best efforts to cause employees to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's Staff; and

c. To use its best efforts to facilitate access to its former employees.

18. Respondent undertakes pursuant to Rule 1101 of the Commission's Rules on Fair Fund and Disgorgement Plans [17 C.F.R. § 201.1101], and in consultation with the Staff of the Commission, to develop, with the assistance of an expert consultant, a plan to distribute the $16,809,354.42 in disgorgement, civil penalties, and interest as provided for in the Order ("Distribution Plan"), which will be submitted to the Commission within 180 days for notice in accordance with Rule 1103 [17 C.F.R. § 201.1103]. Following a Commission order approving a Distribution Plan, as provided in Rule 1104 [17 C.F.R. § 201.1104], Respondent shall take all necessary and appropriate steps to assist the Commission-appointed Administrator of the final Distribution Plan. Respondents shall bear the costs of administering and implementing the final Distribution Plan.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 15(b) and Section 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent shall pay disgorgement in the amount of $11 million, pre-judgment interest in the amount of $1,809,354.42, and a civil money penalty in the amount of $4 million, for a total payment of $16,809,354.42.

B. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

C. Respondent is hereby censured; and

D. Respondent shall, within 30 days of the entry of this Order, pay disgorgement of $11 million, pre-judgment interest in the amount of $1,809,354.42, and a civil money penalty in the amount of $4 million to the Securities and Exchange Commission: Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) wired, hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies ZCM as Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Kay L. Lackey, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Northeast Regional Office, 3 World Financial Center, New York, NY, 10281.

E. There shall be, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund established for the funds described in Section IV.A and D ("Fair Fund Distribution"), which shall be distributed to the affected mutual funds. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that it shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that it is entitled to, nor shall it further benefit by offset or reduction of any part of ZCM's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors or mutual funds based on substantially the same facts as alleged in this Order instituted by the Commission in this proceeding.

F. Respondents shall comply with the undertakings enumerated in Section III.F.18.

By the Commission.

Nancy M. Morris
Secretary