

SEC Settles Charges Against Hedge Fund Adviser for Conducting Prohibited Transactions and Retaliating Against Whistleblower

Article By:

Investment Services Group

On June 16, 2014, the **SEC settled charges** against a hedge fund advisory firm, **Paradigm Capital Management, Inc.**, for engaging in principal transactions with an affiliated broker-dealer without providing effective disclosure to, or obtaining effective consent from, a hedge fund client. The SEC also settled charges against the firm's owner, Candace Weir, for causing the improper principal transactions.

According to the SEC's order, Paradigm's former head trader **made a whistleblower submission** to the SEC that revealed the principal transactions between Paradigm and the affiliated broker-dealer. The SEC found that, after learning that its head trader had reported potential violations to the SEC, Paradigm engaged in a series of retaliatory actions that ultimately resulted in the head trader's resignation. This is the first time the SEC has filed a case under its new authority to bring anti-retaliation enforcement actions. According to the SEC, Ms. Weir conducted transactions between Paradigm and an affiliated broker-dealer while trading on behalf of a hedge fund client. The SEC's order also found that Paradigm failed to provide effective written disclosure to the hedge fund and did not obtain its consent as required prior to the completion of each principal transaction. The SEC's order stated that Paradigm attempted to satisfy the written disclosure and consent requirements by establishing a conflicts committee to review and approve each of the principal transactions on behalf of the hedge fund. The SEC's order found that the conflicts committee itself, however, was conflicted, because its two members, Paradigm's chief financial officer and chief compliance officer, each reported to Ms. Weir and Paradigm's CFO also served as CFO of the affiliated broker-dealer. The SEC also found that Paradigm's Form ADV was materially misleading for failing to disclose its CFO's conflict as a member of the conflicts committee.

The SEC's order found that Paradigm violated, among other things, Sections 206(3) and 207 of the Advisers Act. The SEC's order also found that Ms. Weir caused Paradigm's violations of Section 206(3) of the Advisers Act. Paradigm and Ms. Weir agreed to jointly and severally pay disgorgement of \$1.7 million for distribution to current and former investors in the hedge fund, and pay prejudgment interest of \$181,771 and a penalty of \$300,000. Paradigm also agreed to retain an independent compliance consultant.

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