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BLOCK, J.

POHORELSKY, M.J.

UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, :  
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 Plaintiff, :  
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 -against- :  
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 RALPH R. CIOFFI and :  
 MATTHEW M. TANNIN, :  
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 :  
 Defendants. :  
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08 Civ. \_\_\_\_\_ ( )

JURY TRIAL  
DEMANDED

COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission"), alleges the following against defendants Ralph R. Cioffi ("Cioffi") and Matthew M. Tannin ("Tannin"):

SUMMARY OF ALLEGATIONS

1. This action concerns fraudulent acts and misrepresentations made by Cioffi and Tannin in connection with the high-profile collapse of two now-defunct hedge funds which they managed, the Bear Stearns High-Grade Structured Credit Strategies

misrepresented to Bank No. 1 – or failed to report to Bank No. 1 as required by the total return swap agreement – the Enhanced Leverage Fund’s performance, portfolio composition, and true condition.

75. By the middle of May, Cioffi had concluded that the Enhanced Leverage Fund would not survive at all. On May 13, 2007, he admitted to Tannin and the Third Manager: “I think...the [Enhanced Leverage Fund] has to be liquidated which seems to be somewhat certain given the redemption activity.” (emphasis added). However, Cioffi and Tannin never disclosed this conclusion to Bank No. 1, despite a duty under the total return swap agreement to inform Bank No. 1 of material events.

**2. Cioffi and Tannin Misrepresented the Funds’ Net Asset Value**

76. Most of the funds’ short positions had readily obtainable market prices and were marked to market daily. However, most of the funds’ long portfolio consisted of highly illiquid securities that lacked a market quotation.

77. Pursuant to BSAM’s pricing policy, the funds sought to obtain multiple “marks” (i.e., price quotations) for their long securities on a monthly basis, either from the dealers that had sold them securities or from other dealers who had become familiar with the funds’ holdings. The funds sent their positions to dealers on the street at the end of each month and typically averaged the marks that they received to determine a month-end valuation for each security. When the funds could not obtain sufficient marks, or when Cioffi thought the marks were incorrect, the funds relied on so-called “fair market” valuations, which Cioffi determined. Any fair market valuations had to be approved by BSAM’s pricing committee.

78. BSAM and the funds, with input from the defendants, computed a daily net asset value (“NAV”) and month-to-date return for the High Grade and Enhanced Leverage Funds. However, these figures only took into account month-to-date changes to the funds’ hedges and their few exchange-traded long securities and assumed that the rest of the long portfolio had remained at the same valuation as the prior month-end marks. As a result, the funds and the defendants historically did not provide intra-month estimates to most of their investors because such estimates were unreliable. Instead, they provided “preliminary estimates” within a couple of weeks after each month’s end, followed by a final NAV about six weeks later. Preliminary estimates were issued after most dealer marks had been received. The final NAV came out once all of the marks were available. By early 2007, many subprime securities were rapidly declining in value, and thus BSAM and the defendants could no longer reasonably rely on stale, prior month-end marks as an indication of current values.

79. As late as mid-March 2007, Cioffi was adamant that intra-month estimates not be released to investors, castigating a BSAM sales person, internally, that the figures were unreliable: “You should also know better [than to release intra-month figures] in that our hedges are marked real time [and] our assets at the end of each month. We’ve said that 1000 times!!”

80. By April 2007, however, Cioffi was anxious to present the funds’ April performance in a positive light. Thus, he not only took the unusual step of providing an intra-month estimate on the April 25, 2007 investor conference call, but also did so without any notice to the call participants of the severe limitations inherent in the estimate. The only information that Cioffi provided was as follows: “The estimated

returns for April are -0.6 basis points for High Grade and -0.7 for Enhanced [i.e., -0.06% and -0.07%, respectively].” These “estimated returns” were disastrously off the mark, as the final NAVs for April were -5.09% for the High Grade Fund and -18.97% for the Enhanced Leverage Fund, stunningly large monthly losses for funds that Cioffi and Tannin had marketed as operating “like a bank.”

81. Tannin actively participated in the April 25, 2007 call. Although he constantly interjected his opinions to reinforce and explain Cioffi’s claims, in this instance, he said nothing to explain the estimates’ limitations.

82. Throughout May, Cioffi became increasingly desperate to fair value his funds’ portfolios and bring the final April numbers as much in line with earlier estimates as possible, thereby avoiding the need to report a huge disparity and prompt a likely flood of additional redemptions. Cioffi’s efforts, however, ultimately ran into resistance from BSAM’s pricing committee.

83. At a May 31, 2007 meeting, the pricing committee rejected every one of Cioffi’s requests to set aside a dealer mark and use his own valuation. When challenged, Cioffi had virtually no evidence to support his desired valuations, and conceded in a contemporaneous e-mail to a committee member, “There is no market... its [sic] all academic anyway [because] -19% [i.e., the Enhanced Leverage Fund’s anticipated final April NAV] is doomsday.”

84. Later in the day on May 31<sup>st</sup>, after the pricing committee had already met, Tannin e-mailed Cioffi to ask whether investors should still be given “the [preliminary]

-6.5 april or the larger down april?” Rather than simply telling Tannin to use the most recent and accurate number, Cioffi even then continued to equivocate, responding, “Ah that’s correct[.] I think that one deserves a phone call [to discuss].”

85. Cioffi and Tannin failed to disclose to the funds’ investors the significant limitations on the April 25<sup>th</sup> “estimated returns,” rendering the figures misleading under the circumstances. The estimates were material to investors.

86. Tannin also independently misrepresented the funds’ April NAV. On or about May 3, 2007, he falsely represented to a significant institutional counterparty that the funds’ performance had been flat to slightly positive in March and April and that the NAVs continued to increase.

87. Furthermore, by the middle of May, at the latest, Cioffi and Tannin were aware that the Enhanced Leverage Fund’s final April NAV would reflect losses of more than 10%. Even though the total return swap agreement with Bank No. 1 required Cioffi and Tannin to notify Bank No. 1 of any actual or anticipated losses greater than 10%, they failed to make the required disclosure.

88. On June 7, 2007, BSAM announced the Enhanced Leverage Fund’s final April NAV and froze redemptions. The following day, it announced the High Grade Fund’s final returns. Margin calls subsequently could no longer be met, and creditors began seizing the funds’ assets.

**3. Cioffi Misrepresented an Upcoming CDO<sup>2</sup> Issuance as a Guaranteed Source of Liquidity**

89. From 2005 through December 31, 2006, BSAM and the funds issued approximately seven of their own CDOs or CDO<sup>2</sup>s into the marketplace. On the April 25, 2007 investor call, Cioffi claimed that the funds had “significant amounts of

liquidity,” in part because of what he variously called a “trade,” “transaction,” “facility,” or “funding vehicle” – actually a CDO<sup>2</sup> issuance – to be undertaken by Cioffi’s team and BSAM with a domestic bank (“Bank No. 2”). Cioffi asserted that this transaction “should be done this month and will close in May.” According to Cioffi, this was a “significant transaction to get done.” Cioffi also had touted the transaction on the March 12, 2007 conference call.

90. Although Cioffi continually presented the Bank No. 2 CDO<sup>2</sup> issuance as imminent throughout the spring, he knew, or was reckless in not knowing, that the deal would not actually be available to the funds until late May or early June, at the earliest. Moreover, he knew, or was reckless in not knowing, that the issuance would not solve the funds’ current and/or prospective liquidity problems because there were essentially no buyers for new CDOs in the market, which severely limited the amount of money that could be raised in an offering. In mid-April, Cioffi admitted to a broker that there was no “buy interest on anything anywhere in this world or universe[.] [I] think we need to go into outer space to find new buyers of cdo’s.”

91. When the deal was ultimately done, in late May 2007, it failed to impart benefits to the funds sufficient to solve their liquidity problems.

92. Cioffi misrepresented to investors the timing of the Bank No. 2 CDO<sup>2</sup> issuance and its impact on the funds’ liquidity. These misrepresentations were material to investors.

**D. CIOFFI AND TANNIN MATERIALLY MISREPRESENTED THE  
LEVEL OF INVESTOR REDEMPTIONS**

93. As April 2007 progressed, the defendants knew that many investors in the funds were either submitting redemption requests or considering doing so. The