

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. EAF0301050002

TO: Department of Enforcement
NASD

RE: Diversified Investors Securities Corp., Respondent
CRD No. 32205

Pursuant to Rule 9216 of NASD Code of Procedure, Respondent Diversified Investors Securities Corp. (DISC or the Firm) submits this Letter of Acceptance, Waiver and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against Respondent alleging violations based on the same factual findings.

DISC understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council (NAC) Review Subcommittee or Office of Disciplinary Affairs (ODA), pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against it; and
3. If accepted:
 - a. this AWC will become part of DISC's permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against it;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about DISC's disciplinary records;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. DISC may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any allegation in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects DISC's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

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DISC also understands that its experience in the securities industry and disciplinary history may be factors that NASD will consider in deciding whether to accept this AWC. That experience and history are as follows:

DISC has been an NASD member since May 20, 1993. The Firm is based in Purchase, New York and has seven active branches and approximately 600 registered personnel. The Firm is a limited purpose broker-dealer that serves as the principal underwriter and distributor of certain registered securities products, including the Diversified Investors Funds family of mutual funds (Diversified Funds). It is a wholly owned subsidiary of Diversified Investment Advisors, Inc. (DIA), the Diversified Funds' advisor. The Firm has no relevant disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

DISC specifically and voluntarily waives the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against it;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission (SEC) and a U.S. Court of Appeals.

Further, DISC specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

DISC further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

II.

ACCEPTANCE AND CONSENT

A. Findings

DISC hereby accepts and consents, without admitting or denying the allegations or findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NASD:

Summary

1. This matter involves violations of NASD rules resulting from DISC's facilitation of market-timing activity that occurred in the Diversified Investors International Equity Fund (International Equity Fund or Fund), notwithstanding language in the Fund's prospectus, DISC's procedures, and representations made by certain DISC registered representatives to shareholders in the Fund.¹ The Diversified Funds are designed for retirement investment. Before June 2003, DIA, with the knowledge and acquiescence of certain DISC registered representatives, entered into agreements that permitted Customers A and B² to market time in the Fund, subject to certain restrictions. Before June 2003, the Fund's prospectus reserved the funds' rights to reject any purchase or exchange and to modify or terminate exchange privileges. Effective June 30, 2003, language was added to the Fund's prospectus, stating that the Fund had established new procedures designed to discourage large volume exchange activity by certain shareholders. The new prospectus language explained that shareholders who sold shares of the Fund through an exchange or redemption may not be permitted to exchange shares back into the Fund for ninety days. To enforce this policy, certain DISC registered representatives participated in the adoption of procedures to identify investors who transferred in and out of the Fund within a certain number of business days and block them from further exchanges into the Fund for ninety days. Despite these procedures, and the new language in the Fund's prospectus, DISC registered representatives permitted Customers A and B to continue to engage in market timing activity from July 1, 2003 through October 24, 2003. This conduct violated NASD Conduct Rule 2110.
2. In connection with the change in prospectus language in June 2003, a DISC registered representative sent letters to approximately eighty investors with exchange activity in the International Equity Fund. The letters stated that the Fund would not permit an investor who sold interests in the Fund to exchange back into the Fund for ninety days. The letters did not disclose that the restrictions were not applied to Customers A and B. In addition,

¹ At all relevant times, DISC was the principal underwriter and distributor for the Fund.

² Customer A refers to a group of 19 accounts managed by the same investment advisor, and Customer B refers to an insurance company that offered variable annuity contracts to a group of partnerships managed by the same general partners.

one DISC registered representative instructed certain DISC registered representatives who processed orders through the Diversified Funds' call center to tell investors that the limit on transfers applied to all investors. These descriptions of the Fund's new procedures were inaccurate. This conduct also violated NASD Conduct Rule 2110.

3. DISC also failed to effectively implement and enforce procedures relating to market timing. As a result, the Firm did not have a supervisory system and procedures reasonably designed to detect and prevent market timing activities, in violation of NASD Conduct Rules 3010 and 2110.
4. From November 2000 through July 2004, DISC did not maintain and preserve all e-mail communications as required, in violation of Section 17(a) of the Securities Exchange Act of 1934, Rule 17a-4 thereunder, and NASD Conduct Rules 3110 and 2110. DISC also failed to effectively implement and enforce a supervisory system and procedures relating to preservation of e-mail, in violation of NASD Conduct Rules 3010 and 2110.

The Market Timing Agreements

5. Market timing is the practice of short-term buying and selling of mutual fund shares to take advantage of inefficiencies in mutual fund pricing. Unlike securities listed on an exchange, the "net asset value" or NAV of mutual funds currently is usually calculated only once per day, generally based upon closing prices at 4:00 p.m. Eastern Time. This regimen for determining NAV provides market timers the opportunity to engage in arbitrage based on market information not reflected in that day's NAV. To accomplish this, market timers typically buy and sell shares in mutual funds on a short-term basis, realizing quick gains and then retreating to the previous market position. Market timing is not illegal *per se*. However, it can harm mutual fund shareholders because it can dilute the value of their shares, by, among other things, causing a fund to redeem shares at a price that does not reflect the fund's true NAV per share due to portfolio pricing inefficiencies, requiring the fund to keep a larger percentage of highly liquid assets to cover redemptions, or increasing transaction costs for a fund. Long-term fund investors may ultimately bear the burden of paying these costs.
6. Before the prospectus language change on June 30, 2003 that restricted market timing, Customers A and B, with the knowledge and acquiescence of certain DISC registered representatives, had opened accounts for the purpose of market timing in Diversified Funds, including the International Equity Fund. Market timing agreements with Customers A and B imposed quantitative limits intended to protect the funds against harm.
7. Specifically, an investment adviser was permitted to enter market timing orders on behalf of twenty-three accounts managed by the investment advisor. The agreement permitted market timing in several Diversified Funds, including the International Equity Fund.

Nineteen of those accounts (referred to collectively as Customer A) traded in the International Equity Fund.³

8. Separately, an insurance company and a group of partnerships managed by the same general partners (referred to collectively as Customer B) were permitted to market time in Diversified Funds, including the International Equity Fund, through separate accounts held under variable annuity contracts.
9. DISC's policies and procedures were not adequate to ensure that the two market timers complied with the quantitative limits on market timing and there was inadequate monitoring of trading by Customers A and B to ensure that their trading stayed within the limits. Between June 30 and October 24, 2003, Customers A and B exceeded the dollar limits imposed on their trading in the Fund on 9 occasions, with total trading over the limits of almost \$7.5 million.

New Restrictions on Market Timing

10. In early 2003, unusually high levels of cash flows in the International Equity Fund were detected and analyzed. Certain DISC registered representatives identified approximately 80 investors (other than Customers A and B) who appeared to be market timing the Fund and whose cumulative cash flow activity was potentially harmful to the Fund. Certain DISC registered representatives knew that Customers A and B were also market timing, and assumed that Customer A's and Customer B's trading was within the limits set in the agreements, but did not specifically evaluate the potential effect of Customer A's and Customer B's frequent trading on the Fund. Certain DISC registered representatives participated in the decision to exclude Customer A and Customer B from the new restrictions on trading.
11. Effective June 30, 2003, the Fund added the following language to its prospectus:

Effective June 30, 2003, the Diversified . . . International Equity Fund has established new procedures concerning sales and purchases of shares of that Fund. These new procedures are designed to discourage large volume exchange activity by certain shareholders which has the potential to affect negatively the Fund and its other shareholders. Specifically, if a shareholder sells International Equity Fund shares (either through an exchange or a redemption), that shareholder may not be permitted to exchange shares back into the International Equity Fund for 90 days. This restriction on exchanges will not affect purchases of International Equity Fund shares through regular retirement plan contributions during any such 90 day period. In addition, The Diversified Investors Funds Group

³ The remaining four accounts, which were collective trust accounts, invested in the Diversified Investors International Equity Portfolio. DISC did not handle transactions in those accounts.

continues to reserve the right to modify or terminate the exchange privilege at any time with respect to any or all Funds.

12. As principal underwriter and distributor of the Fund, DISC distributed the prospectus containing language describing the market timing policies and procedures of the Fund. The prospectus did not disclose the existing agreements with Customer A and Customer B relating to market timing and did not disclose that the new market timing procedures were not being applied to these customers.
13. In June 2003, a DISC registered representative sent letters to approximately 80 identified market timers in the International Equity Fund, including those who purchased and sold as little as \$5000 per trade, telling them to stop market timing. The letters explained the Fund's policy as follows:

[T]he Diversified Funds are designed for long-term retirement investment. Therefore, we discourage the use of our Funds by investors who wish to "time" the market because of the negative effect on other shareholders and the Funds. . . . [E]ffective June 30, 2003 . . . an investor who sells interests in the International Equity Fund will not be permitted to exchange back into the Fund for ninety days.
14. The letters failed to disclose that there were existing agreements with Customers A and B that allowed them to market time in the Fund, and that the new policies and procedures would not be applied to them.
15. Following amendment of the International Equity Fund's prospectus, certain DISC registered representatives participated in the adoption of internal procedures to monitor and stop certain market timing. Certain DISC registered representatives monitored trading in the Fund. If an investor transferred in and then out of the Fund within a certain number of business days, new purchases or transfers into the Fund were blocked for ninety days. These DISC registered representatives exempted exchanges by Customer A and Customer B from these procedures and the limits on trading. Following the prospectus amendment, Customer A made an average of more than 20 "round trip" exchanges in and out of the Fund in each of its 19 accounts, and Customer B made 13 "round trip" exchanges in and out of the Fund. Together, Customers A and B executed approximately 400 market timing "round trip" exchanges in their accounts, purchasing shares valued at approximately \$162 million in the aggregate, and selling shares valued at approximately \$163 million in the aggregate.
16. An internal e-mail to DISC registered representatives at the Diversified Funds' call center explained that the Fund's manager was limiting transfers into and out of the Fund because market timing was having a negative impact on the Fund's performance. The e-mail explained that the transfer restrictions applied to all investors, not just market timers. The e-mail instructed these DISC registered representatives to explain to investors that once they transferred in and then out of the Fund within a certain number of business days they would not be permitted to transfer back for ninety days. The e-mail directed

these DISC registered representatives to refer to draft letters to explain the Fund's policy to investors. These letters stated "an investor who sells interests in the International Equity Fund will not be permitted to exchange back into the Fund for ninety days." The e-mail and the draft letters did not disclose that the two market timers, Customer A and Customer B, were exempt from the restriction.

**DISC Facilitated Market Timing Activity from July 1, 2003 through October 24, 2003
in Violation of NASD Conduct Rule 2110**

17. Despite the prospectus language, the internal procedures, and the letters sent to other investors, DISC facilitated Customer A's and Customer B's continued market timing in the International Equity Fund from July 1, 2003 through September 3, 2003 for Customer B and through October 24, 2003 for Customer A. During this period, Customer A and Customer B made a total of approximately 400 "round trip" exchanges in the Fund that were inconsistent with the restrictions described in the Fund's prospectus.⁴
18. Customer A's and Customer B's trading in the International Equity Fund can have a detrimental effect on the performance of the Fund and DISC should not have facilitated the trading under the policies and procedures described above.
19. By facilitating market timing activity from July 1, 2003 to October 24, 2003, DISC failed to adhere to high standards of commercial honor and just and equitable principles of trade, in violation of NASD Conduct Rule 2110.

**DISC's Communications with the Public were Inaccurate in Violation of NASD
Conduct Rule 2110**

20. As described above, DISC, through certain registered representatives, made inaccurate statements with respect to the International Equity Fund's restrictions on market timing. In so doing, DISC failed to adhere to high standards of commercial honor and just and equitable principles of trade, in violation of NASD Conduct Rule 2110.

**DISC Failed to Implement and Enforce a Supervisory System and Procedures
Reasonably Designed to Identify and Prevent Market Timing in Violation of
NASD Conduct Rules 3010 and 2110**

21. NASD Conduct Rule 3010 requires a member firm to establish, maintain, and enforce a supervisory system and procedures that are reasonably designed to achieve compliance with NASD Rules and the federal securities laws and regulations thereunder.
22. As described above, in July 2003, procedures were adopted to identify and prevent potentially harmful market timing that were consistent with the new language contained

⁴ In seven instances, the total transfers in Customer A's accounts exceeded the \$7 million limit contained in its market timing agreement. In two instances, Customer B exceeded the \$5 million maximum in its market timing agreement.

in the International Equity Fund's prospectus. These procedures required that investors, who made exchanges in and out of the Fund within a certain number of business days, be identified and prevented from exchanging back into the Fund for the next ninety days. However, the procedures exempted transactions by Customer A and Customer B.

23. Because these procedures exempted trading by Customer A and Customer B, the Firm did not have a supervisory system and procedures that were reasonably designed to detect and prevent market timing in accordance with the International Equity Fund's prospectus and procedures during the relevant period. In addition, on occasion DISC registered representatives facilitated market timing transactions by Customer A and Customer B in excess of limits contained in earlier market timing agreements. As a result, DISC violated NASD Conduct Rules 3010 and 2110.

DISC Failed to Retain E-Mail as Required in Violation of Section 17(a)(1) of the Securities Exchange Act of 1934, SEC Rule 17a-4 thereunder, and NASD Conduct Rules 3110 and 2110

24. NASD Conduct Rule 3110 requires members to preserve books, accounts, records, memoranda, and correspondence in a format, medium, and for the time prescribed in SEC Rule 17a-4. SEC Rule 17a-4(b)(4) requires every broker and dealer to preserve originals of all communications received and copies of all communications sent by such member, broker or dealer (including inter-office memoranda and communications) relating to its business as such for a period of not less than three years, the first two in an easily accessible place.
25. While DISC intended its e-mail retention policy to provide a means to manage e-mails that had no retention requirements, such as a regulatory or legal purpose, the Firm relied on its registered representatives and associated persons to preserve e-mails in paper files, off-line storage or public e-mail folders. DISC's written policies and procedures failed to require its registered representatives and associated persons to preserve originals of all internal e-mail (including inter-office memoranda) relating to its business as such.
26. Beginning in about April 2001, all e-mails older than ninety days were automatically purged from DISC registered representatives' and in associated persons' Inbox, Sent Items, and Deleted Items folders, on a monthly basis. Beginning in about June 2001, all e-mails older than one year were automatically purged from DISC registered representatives' and associated persons' Outlook personal folders on a monthly basis.
27. From November 2000 to December 2003, DISC did not preserve and maintain all internal e-mail communications as required by SEC Rule 17a-4. As a result, DISC violated Section 17(a)(1) of the Securities Exchange Act of 1934, SEC Rule 17a-4 thereunder, and NASD Conduct Rules 3110 and 2110.

DISC Failed to Implement and Enforce Supervisory Procedures Reasonably Designed to Preserve E-Mail in Violation of NASD Conduct Rules 3010 and 2110.

28. From November 2000 to December 2003, DISC failed to establish, maintain, and enforce a supervisory system and procedures that were reasonably designed to preserve originals of all internal e-mail (including inter-office memoranda) relating to its business as such for a period of not less than three years. As a result, DISC violated NASD Conduct Rules 3010 and 2110.

B. Sanctions

DISC also consents to the imposition, at a maximum, of the following sanctions:

1. Censure;
2. Fine of \$1,300,000;
3. Restitution of \$949,011.96 to the Diversified International Equity Fund. Within 60 days of issuance of this AWC, DISC shall pay this amount to compensate the Fund for losses attributable to the market timing described in this AWC. Within 90 days of issuance of this AWC, an officer of DISC shall certify to NASD that the payments to the Fund have been made and shall provide NASD with copies of cancelled checks or other documents evidencing such payments;
4. Within 30 days of the issuance of this AWC, an officer of DISC shall certify to NASD that the Firm has reviewed its procedures regarding market timing and has systems and procedures in place that are reasonably designed to ensure that the Fund's policies and procedures are enforced; and
5. Within 30 days of the issuance of this AWC, an officer of DISC shall certify to NASD that the Firm has reviewed its procedures regarding e-mail retention and has established systems and procedures reasonably designed to achieve compliance with the laws, regulations, and rules concerning the retention of electronic mail communications.

The fine imposed herein shall be payable within ten days of notice that this AWC has been accepted. The other sanctions imposed herein shall be effective on a date set by NASD staff.

III.

OTHER MATTERS

DISC understands that it may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future violations. DISC also understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.

DISC agrees to pay any monetary sanctions imposed on them upon notice that this AWC has been accepted and that such payments are due and payable and has attached an Election of Payment form showing the method by which DISC proposes to pay any fine imposed.

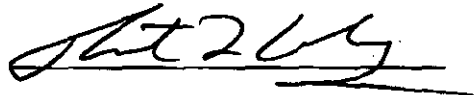
DISC specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

The undersigned representative of DISC certifies that he has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, have been made to induce DISC to submit it.

Diversified Investors Securities Corp.

December 6, 2005
Date

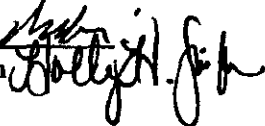
By:



Name: Robert F. Colby

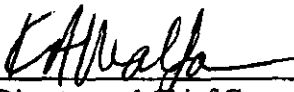
Title: Vice President

Reviewed by:

Brian L. Kelly
Counsel for Firm 

Accepted by NASD:

2/14/06
Date


Director and Chief Counsel
Department of Enforcement
NASD

Signed on behalf of the Director of ODA,
by delegated authority