

MEMO# 28737

February 13, 2015

SEC Charges Adviser to Alternative Mutual Funds with Violations of Custody and Other Provisions of Investment Company Act

[28737]

February 13, 2015

TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 9-15
REGISTERED FUND CPO ADVISORY COMMITTEE
INVESTMENT ADVISER MEMBERS No. 5-15
SEC RULES MEMBERS No. 11-15
COMPLIANCE MEMBERS No. 7-15
SMALL FUNDS MEMBERS No. 6-15 RE: SEC CHARGES ADVISER TO ALTERNATIVE MUTUAL FUNDS WITH VIOLATIONS OF CUSTODY AND OTHER PROVISIONS OF INVESTMENT COMPANY ACT

The Securities and Exchange Commission (“SEC”) recently brought a settled administrative proceeding against an investment adviser to several registered open-end investment companies (“Funds”) that engage in an “alternative” trading strategy. [\[1\]](#) According to the SEC’s press release, [\[2\]](#) the alleged violations were uncovered during an SEC examination of the investment adviser and the Funds. The Order is summarized briefly below.

The Order charges the investment adviser with causing the Funds’ violations of the custody requirements of Section 17(f)(5) of the Investment Company Act of 1940 (“1940 Act”) by maintaining the cash collateral from the Funds’ total return and portfolio return swaps with broker-dealer counterparties, rather than with bank custodians, as generally required by Section 17(f)(5) and as required by the Funds’ policies and procedures. The Order also charges the investment adviser with causing the Funds’ violations of Section 12(b) of, and Rule 12b-1(h) under, the 1940 Act by failing to create and maintain an approved list of executing brokers for the Funds as required by the Funds’ policies and procedures, and failing to maintain documentation reflecting monitoring of the Funds’ compliance with the Rule 12b-1(h) policies and procedures, as required by the Funds’ policies and procedures themselves. Finally, the Order charges the investment adviser with causing the Funds’ violations of Rule 38a-1 under the 1940 Act based on these failures to implement the Funds’ policies and procedures.

The adviser was ordered to cease and desist from committing or causing any violations and any future violations of these provisions, and was ordered to pay a \$50,000 penalty.

Sarah A. Bessin
Associate General Counsel

endnotes

[1] In the Matter of Water Island Capital LLC, Investment Company Act Release No. 31445 (Feb. 12, 2015), available at <http://www.sec.gov/litigation/admin/2015/ic-31455.pdf> (“Order”). According to the Order, the adviser trades equities and derivatives, including swaps, to carry out its alternative trading strategies.

[2] See SEC Charges Mutual Fund Adviser in Connection With Improper Handling of Fund Assets (Feb. 12, 2015), available at http://www.sec.gov/news/pressrelease/2015-31.html#.VN4zg_nF884.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.