

MEMO# 31142

March 22, 2018

SEC Charges Insurance Fund Advisers in Connection with Securities Lending Practices

[31142]

March 22, 2018 TO: ICI Members

Investment Company Directors

Investment Advisers Committee

Tax Committee

Variable Insurance Products Advisory Committee SUBJECTS: Disclosure

Fees and Expenses

Fund Governance

Investment Advisers

Litigation & Enforcement

Portfolio Oversight

Tax

Variable Insurance Products RE: SEC Charges Insurance Fund Advisers in Connection with Securities Lending Practices

The Securities and Exchange Commission (SEC) recently entered into a settled enforcement action with two registered investment advisers to insurance-dedicated mutual funds in connection with the funds' securities lending practices.[\[1\]](#) The SEC alleged that the advisers engaged in the practice of recalling, in advance of the dividend record date, portfolio securities of mutual funds they advised. This practice enabled insurance companies affiliated with the advisers, which were the record shareholders of the funds' securities, to take a tax deduction for the dividends received on the securities. Because mutual funds are not eligible to take this "dividends received" deduction (DRD), the tax benefit accrued to the insurance companies. The SEC explained that this practice created a conflict of interest because the affiliated insurance companies benefited from the DRD, while the funds and contract holders, who invested in the funds through variable life annuity and variable life insurance contracts, lost securities lending income during the period when the securities were recalled.

The SEC alleged that the advisers knew that this securities recall practice benefitted the affiliated insurance companies, but failed to identify and sufficiently disclose the conflict of interest to the funds' board of directors. Nor did they disclose the conflict in the funds' prospectuses, which the SEC alleged made the prospectuses materially misleading. The

SEC found that, for the relevant period, the securities recall practice resulted in a tax benefit to the affiliated insurance companies of over \$2.6 million, while the funds lost over \$2 million in securities lending income.

The SEC found that the advisers violated section 206(2) of the Investment Advisers Act of 1940 (“Advisers Act”), as well as Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. The SEC ordered the advisers to cease and desist, and to pay disgorgement and prejudgment interest of \$3,147,469.14, along with a \$500,000 penalty.

Sarah A. Bessin
Associate General Counsel

endnotes

[1] *In re Voya Investments, LLC and Directed Services LLC*, Investment Advisers Act Release No. 4868 (March 8, 2018), available at <https://www.sec.gov/litigation/admin/2018/34-82837.pdf>.

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