

MEMO# 21800

October 9, 2007

Fund Administrators Settle With SEC Over Alleged Violations Of Section 19(a), Rule 19a-1, And Section 34(b)

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TO: ACCOUNTING/TREASURERS MEMBERS No. 33-07
BROKER/DEALER ADVISORY COMMITTEE No. 64-07
CLOSED-END INVESTMENT COMPANY MEMBERS No. 63-07
SEC RULES MEMBERS No. 135-07
SMALL FUNDS MEMBERS No. 95-07
TRANSFER AGENT ADVISORY COMMITTEE No. 70-07 RE: FUND ADMINISTRATORS SETTLE
WITH SEC OVER ALLEGED VIOLATIONS OF SECTION 19(A), RULE 19A-1, AND SECTION 34(B)

The Securities and Exchange Commission recently issued four orders instituting administrative and cease-and-desist proceedings, making findings, and imposing sanctions against particular advisers and/or administrators for certain closed-end investment companies ("Respondents"). [\[1\]](#) All four Orders were based on allegations that the Respondents aided and abetted their respective funds' violations of Section 19(a) of the Investment Company Act and Rule 19(a)(1) there under. Two of the orders additionally were based on allegations that the Respondents aided and abetted their respective funds' violations of Section 34(b) under the Investment Company Act. [\[2\]](#) The Respondents neither admitted nor denied the allegations. The Orders share many of the same elements and are collectively summarized below.

Section 19(a) and Rule 19a-1

According to the Orders:

- Each of the funds paid a number of monthly or quarterly distributions to shareholders from sources other than net investment income (e.g., return of capital and/or capital gain).
- By paying distributions from these sources without disclosing the source of the distributions in a notice accompanying the distributions, the funds violated Section 19(a) and Rule 19a-1 there under.[3]
- The Respondents knew, or were reckless in not knowing, at the time the distributions were made that each included a return of shareholders' capital or capital gain as of the end of the period during which the distribution was made.
- The Respondents therefore willfully aided and abetted and caused the funds' violations of Section 19(a) and Rule 19a-1.

Section 34(b)

According to the two Orders with these additional findings:

- The Management Discussion of Fund Performance section of the annual reports of some of the funds disclosed an annual dividend without indicating that the figure included returns of shareholder capital. Annualized yield or distribution rates were disclosed based on the assumption that dividends were paid entirely from net income, although actual distributions were partly from shareholder capital.
- By failing to disclose that a portion of the reported dividends and yield or distribution rate came from shareholder capital, the statements implied that distributions were entirely from fund net income and that investment in the funds reflected greater returns than was the case.
- Respondents willfully violated Section 34(b) by filing annual reports that contained

material omissions or misstatements regarding fund performance.

Under the Orders, the Respondents were required to: (1) cease and desist from causing any violations and any future violations of Section 19(a) and Rule 19a-1 (and Section 34(b), as applicable); and (2) pay a civil money penalty that ranged from \$350,000 to \$450,000.

[4]

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endnotes

[1] See In the Matter of AllianceBernstein, L.P., SEC Release No. IC-28002, Admin. Proc. File No. 3-12852 (Sept. 28, 2007); In the Matter of Putnam Investment Management, LLC, SEC Release No. IC-28003, Admin. Proc. File No. 3-12853 (Sept. 28, 2007); In the Matter of Salomon Brothers Asset Management Inc., SEC Release No. IC-28004, Admin. Proc. File No. 3-12854 (Sept. 28, 2007); In the Matter of Smith Barney Fund Management LLC, SEC Release No. IC-28005, Admin. Proc. File No. 3-12855 (Sept. 28, 2007) (“Orders”). The Respondents provided accounting and administrative services to each of their respective funds. The Orders are available on the SEC’s website at <http://www.sec.gov/litigation/admin.shtml>.

[2] See Salomon Brothers Asset Management and Smith Barney Fund Management, *supra* at note 1.

[3] Section 19(a) of the Investment Company Act of 1940 prohibits investment companies from paying dividends from any source other than accumulated undistributed net income, unless the payment is accompanied by a written statement to shareholders disclosing the source of the payment. Rule 19a-1 specifies that the written statement must be made on a separate paper and clearly indicate what portion of the payment is from: (1) net income; (2) capital gains; or (3) paid-in surplus or other capital source. The Orders note that, while Respondents provided shareholders with a Form 1099-DIV disclosing the nature of all distributions on a tax basis, this notice did not comply with Section 19(a) or Rule 19a-1 because it was not made contemporaneously with each dividend.

[4] In determining to accept each of the Respondents’ settlement offers, the SEC considered the remedial acts undertaken and cooperation afforded.

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