

MEMO# 7332

October 10, 1995

SEC SANCTIONS INVESTMENT ADVISER IN CONNECTION WITH ALLEGED MISPRICING OF FUND PORTFOLIO SECURITIES

1 See Memorandum to Accounting/Treasurers Members No. 14-95, Compliance Committee No. 15-95 and SEC Rules Members No. 17-95, dated March 9, 1995. 2 Investment Advisers Act Release No. 1525 (September 29, 1995); Administrative Proceeding File No. 3-8846. October 10, 1995 TO: ACCOUNTING/TREASURERS MEMBERS No. 46-95 COMPLIANCE COMMITTEE No. 39-95 SEC RULES MEMBERS No. 71-95 RE: SEC SANCTIONS INVESTMENT ADVISER IN CONNECTION WITH ALLEGED MISPRICING OF FUND PORTFOLIO SECURITIES

The Securities and Exchange Commission recently sanctioned an investment adviser under Section 203(e)(5) of the Investment Advisers Act of 1940 with respect to the alleged mispricing of fund portfolio securities. The Commission found that the adviser failed reasonably to supervise a portfolio manager who had intentionally mispriced certain derivative securities held by the fund that he managed.¹ A copy of the Commission's order² is attached. In its order, the Commission found that: C the investment adviser had no written procedures to implement the fund's policy of using bid side prices for the securities in question; C the investment adviser's daily pricing practices gave the portfolio manager too much control over pricing with little or no oversight by a supervisor; C there was no procedure in place to alert the investment adviser when bid side prices were not used; and C the investment adviser did not independently verify the prices provided to its accounting department with the pricing source or any secondary sources. Thus, according to the order, the portfolio manager could select broker-dealers for pricing purposes, change pricing sources without approval, directly obtain daily prices from broker-dealers and record the prices on the fund's daily derivative pricing sheets without verification by a third party. On this basis, the Commission found that the investment adviser's policies and procedures were inadequate to prevent or detect the portfolio manager's violations of the federal securities laws and, as a result, the investment adviser failed reasonably to supervise the portfolio manager. The investment adviser, without admitting or denying the Commission's allegations, agreed to: (1) a censure; (2) certify that it had adopted and implemented comprehensive written policies and procedures reasonably designed to ensure compliance with Section 2(a)(41) of the Investment Company Act and Rule 22c-1 thereunder, and to undertake to maintain and comply with such policies and procedures; and (3) pay a civil fine of \$50,000. Frances M. Stadler Associate Counsel Attachment Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Information Resource Center at

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