The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

**MEMO# 11309**

October 14, 1999

# SEC SANCTIONS INVESTMENT ADVISER, BROKER-DEALER, AND EIGHT INDIVIDUALS FOR FRAUD STEMMING FROM DIRECTED BROKERAGE

1 In the matter of Fleet Investment Advisor Inc.(as successor to Shawmut Investment Advisers, Inc.) SEC Admin. Proc. File No. 3-10005 (September 9, 1999); In the matter of Karen Michalski and Christopher D. Sargent SEC Admin. Proc. File No. 3-10006 (September 9, 1999); and In the matter of Michael J. Rothmeier, Clark T. Blizzard, Rudolph Abel, Donald C. Berry, Christopher P. Roach, Craig Janutol, and East West Institutional Services, Inc. SEC Admin. Proc. File No. 3-10007 (September 9, 1999). Of the individuals named in these actions: Michalski and Sargent were fixed income traders employed by the investment adviser; Rothmeier was the adviser's former president and CEO, Blizard was its former vice president for sales, and Abel and Berry were its former chief investment officers; Roach was the registered representative for the broker- dealer (i.e., East-West Institutional Services) and Janutol was the broker-dealer's former president. 2 The SEC alleges that, although the adviser was not the adviser to the mutual funds, through its traders it directed certain transactions for the funds to generate further commissions to compensate the broker selected by the salesman for client referrals. [11309] October 14, 1999 TO: COMPLIANCE ADVISORY COMMITTEE No. 40-99 INVESTMENT ADVISER ASSOCIATE MEMBERS No. 22-99 INVESTMENT ADVISER MEMBERS No. 19-99 SEC RULES MEMBERS No. 61-99 RE: SEC SANCTIONS INVESTMENT ADVISER, BROKER-DEALER, AND EIGHT INDIVIDUALS FOR FRAUD STEMMING FROM DIRECTED BROKERAGE

_____ In three related enforcement actions, the Securities and Exchange Commission ("SEC") charged an investment adviser, a broker-dealer, and eight individuals with fraud in connection with the use OF advisory clients' brokerage commissions to pay for client referrals.1 In particular, these proceedings were based upon the adviser's undisclosed use of approximately $1.9 million of advisory client commissions and mark-ups and mark-downs to compensate certain broker-dealers. The individuals connected with the investment adviser that were charged in these actions include its former president and CEO, former vice president for sales, two chief investment officers, and two fixed income traders. According to the SEC, from mid-1993 through December 1995, the adviser represented to its clients that it directed brokerage commissions to brokers on the basis of research they provided. However, certain brokers were selected by a salesman for the adviser on the basis of their ability to refer clients to the adviser. The adviser did not disclose this arrangement to its clients in its Form ADV or otherwise. In addition, the SEC alleged that two fixed income

traders for the adviser altered several trade tickets in order to conceal that they did not seek the best price on certain transactions directed to a broker selected by the salesman. The SEC also alleged that certain of the brokerage commissions that the adviser directed to brokers on the basis of client referrals resulted from transactions in the account of a registered investment company with which the adviser was affiliated.2 As a result, the SEC alleged 3 The proceeding notes that "Even if [the adviser] had adequately disclosed its receipt of client referrals in exchange for brokerage commissions, the disclosure would not have cured the violation of Section 17(e)(1) because that provision reflects the Congressional determination that disclosure alone is not adequate protection in the investment company field." See In the matter of Fleet Investment Advisors, Inc. at footnote 16. that the adviser and the named respondents violated Sections 204, 206(1), 206(2), and 207 of the Investment Advisers Act of 1940 and Rules 204-1(b)(1) and 204-2(a)(3) thereunder, and Section 17(e)(1) of the Investment Company Act of 1940.3 With respect to the broker-dealer and its registered representative, the SEC alleged that these respondents had an agreement with the adviser's former vice president of sales whereby the adviser agreed to direct $1000 in brokerage commissions to the broker-dealer for every $1 million of client assets the broker-dealer steered to the adviser and to conceal this arrangement from a union pension account worth $600 million that was referred to the adviser by the broker-dealer. Because this arrangement was not disclosed, these persons were charged with violating the antifraud provisions of the Advisers Act and the broker-dealer's former president was charged with violating Section 15(b)(4)(E) of the Securities Exchange Act of 1934 for failing to supervise the firm's registered representative. Without admitting or denying the charges, the adviser and its fixed income traders settled the SEC's action. The adviser agreed to a cease and desist order and to pay more than $1.9 million to clients whose accounts were used to pay brokers for client referrals. The fixed income traders agreed to a cease and desist order, a $5000 civil monetary penalty, and a bar from association with an investment adviser with a right to reapply after 15 months. The remaining respondents have contested the charges and the matter has been referred to an administrative law judge for a hearing. A copy of the Order Instituting Proceedings against the adviser is attached. Copies of the Orders against the other respondents can be obtained from the SEC's website at www.sec.gov. Tamara K. Reed Associate Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11309. ICI Members may retrieve this Memo and its attachment from ICINet (http://members.ici.org).

---