

**MEMO# 7574**

January 22, 1996

## **FUND ADVISER SETTLES SEC PROCEEDINGS FOR ALLEGEDLY FALSE ADVERTISEMENTS**

1 See Memorandum to Compliance Committee No. 20-95, Investment Adviser Members No. 22-95, SEC Rules Members No. 32-95 and Subcommittee on Advertising No. 6-95, dated May 4, 1995. 2 Release Nos. 33-7255, 34-36712, IC-21671, IA-1545; Administrative Proceeding File No. 3-8682, dated January 16, 1996. January 22, 1996 TO: COMPLIANCE COMMITTEE No. 1-96 INVESTMENT ADVISER MEMBERS No. 4-96 SEC RULES MEMBERS No. 5-96 SUBCOMMITTEE ON ADVERTISING No. 1-96 RE: FUND ADVISER SETTLES SEC PROCEEDINGS FOR ALLEGEDLY FALSE ADVERTISEMENTS

A mutual fund adviser and its principals, among others, agreed to settle an SEC administrative action brought last May concerning an allegedly fraudulent marketing strategy.<sup>1</sup> A copy of the Commissions order is attached.<sup>2</sup> Specifically, administrative proceedings were instituted against a mutual fund investment adviser (the "Adviser"); the two principals of the Adviser, who control it through various entities owned by each of them and who were the president and chairman of the board of the fund (the "Principals"); the company that performs the fund's marketing services, which is controlled by one of the Principals and is a general partner of the Adviser (the "Marketing Partner"); the publisher of several investment letters, which is controlled by one of the Principals and for which the other Principal edits two of the newsletters (the "Publisher"); and the fund's marketing manager. In the settlement order, the Commission found that false and misleading statements had been disseminated regarding the market-timing model developed by one of the Principals, which was a regular feature in one of the newsletters he edited. These statements, which were included in advertisements for the newsletter, claimed that an investor using the model could have turned an investment of \$10,000 made in 1980 into \$39,160,394 by 1992. The Commission concluded that in fact an investor could not have used the model to achieve such returns because the model had been constantly adjusted and revised since its inception. Therefore, the claimed earnings could only have been obtained, if at all, by retroactively applying the then-current updated version of the model and by using trading strategies that were not available as early as 1980. The newsletter advertisements failed to disclose these facts. The Commission further found that investments in the fund were solicited from many of the same individuals who had received the misleading newsletter advertisements. In addition, certain fund advertisements implied that the results touted in the newsletter advertisements would be obtained by the fund, suggesting that the model would be used in making investment decisions for the fund. The Commission found, however, that the fund did not and could not follow the model because the fund's stated investment objectives and policies were inconsistent with the model's short-term, aggressive investment

strategies. Based on its involvement in the marketing scheme, the Commission found that the Marketing Partner had violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, Section 17(a) of the Securities Act of 1933 and Section 34(b) of the Investment Company Act of 1940, and that the Principal who controlled the Marketing Partner and the Publisher willfully aided and abetted those violations. The Commission also found that the Adviser, the Principal who edited the newsletters (and who was the president and portfolio manager of the fund) and the marketing manager each failed to adequately review such advertisements or to take other appropriate action to prevent false and misleading statements from being disseminated to actual and potential fund investors. Accordingly, they were found to have aided and abetted and were a cause of the Marketing Partner's violations of Section 17(a) of the Securities Act and Section 34(b) of the Investment Company Act. Without admitting or denying the matters set forth in the Commission's order, each of the respondents agreed to pay civil penalties of \$60,000, except for the marketing manager who was not subject to a monetary penalty, and was censured and ordered to cease and desist from committing or causing further violations. In addition, the Adviser was ordered to comply with certain undertakings designed to ensure that future advertisements for the fund comply with the federal securities laws. Amy B.R. Lancellotta 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 (202)326-8305 or (202)326-5903, and ask for this memo's attachment number: 7574.

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