

MEMO# 13846

August 16, 2001

SEC SANCTIONS INVESTMENT ADVISER, PORTFOLIO MANAGER AND OTHERS IN CONNECTION WITH ALLEGEDLY FRAUDULENT TRADING STRATEGY

[13846] August 16, 2001 TO: COMPLIANCE ADVISORY COMMITTEE No. 35-01 INVESTMENT ADVISER ASSOCIATE MEMBERS No. 10-01 INVESTMENT ADVISER MEMBERS No. 17-01 SEC RULES MEMBERS No. 59-01 RE: SEC SANCTIONS INVESTMENT ADVISER, PORTFOLIO MANAGER AND OTHERS IN CONNECTION WITH ALLEGEDLY FRAUDULENT TRADING STRATEGY The Securities and Exchange Commission recently instituted and settled four separate but related administrative proceedings against (1) a registered investment adviser, (2) a principal and portfolio manager formerly employed by the adviser ("portfolio manager"), (3) a registered broker-dealer, and (4) the former head of the broker-dealer's international equity trading desk ("trader").¹ According to the SEC orders, these proceedings resulted from a trading strategy in which the portfolio manager and the trader placed purchase orders in five securities heavily owned by the portfolio manager's advisory clients shortly before the close of the market with the purpose of increasing the closing price of those securities. (This practice is referred to as "marking the close.") Based in part upon trading records and tapes of contemporaneous telephone conversations (excerpts of which are cited in the SEC orders), the SEC found that the portfolio manager and the trader attempted to mark or marked the close of several securities in violation of the federal securities laws. The SEC orders state that the portfolio manager and the trader discussed which stocks to purchase, focusing on stocks in which the portfolio manager held large positions, and chose target closing prices for these stocks. In some cases, this trading caused a short-term increase in the overall value of certain securities held in accounts managed by the portfolio manager when performance results were reported to advisory clients at the end of fiscal quarters.² The SEC found that this trading strategy was not disclosed to these clients and was not authorized under investment guidelines that applied to their accounts. 1 See In the Matter of Oechsle International Advisors, L.L.C., SEC Release No. IA-1966 (Aug. 10, 2001); In the Matter of Andrew S. Parlin, SEC Release Nos. 34-44679, IA-1967 (Aug. 10, 2001); In the Matter of ABN AMRO Incorporated, SEC Release No. 34-44677 (Aug. 10, 2001); and In the Matter of Angelo Iannone, SEC Release No. 44678 (Aug. 10, 2001) ("SEC orders"). Copies of the SEC orders are available on the SEC's website at www.sec.gov/litigation/admin. 2 The SEC orders note that that portfolio manager did not sell these securities based on the short-term price increases. As a result of his conduct, the SEC found, the portfolio manager willfully violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and willfully aided and abetted violations of Sections 206(1) and (2) of the Advisers Act. He was ordered to cease and desist from committing or causing

any violations of these laws, suspended from association with any investment adviser for a 12-month period, and ordered to pay a \$75,000 civil money penalty. Similarly, the trader was found to have willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. He was ordered to cease and desist from committing or causing any violations of these laws, suspended from association with any broker or dealer for a 12-month period, and ordered to pay a \$75,000 civil money penalty. The SEC found that the investment adviser failed reasonably to supervise the portfolio manager with a view to preventing his above-cited securities law violations. According to the SEC, although the adviser had in place written policies and procedures regarding trade processing, portfolio compliance and other issues, the adviser failed to adequately implement its policies that prohibited manipulative trading. In particular, while the adviser reviewed the portfolio manager's trades on a daily basis, his trading methods were not effectively reviewed for compliance with this aspect of the adviser's policies. The SEC stated that "[i]t is essential that advisers implement policies reasonably designed, under the circumstances of the particular investment strategies employed by the firms, to detect and prevent violations of the federal securities laws by even their most experienced employees." The adviser was censured and ordered to pay a civil money penalty of \$200,000. Similarly, the SEC found that the broker-dealer failed reasonably to supervise the trader, noting that the trader's activities were not effectively reviewed for compliance with the firm's policies and procedures which would have prohibited the trading at issue. The SEC stated that the trader's "position as a supervisor should not have insulated his own sales trading conduct from effective oversight." The broker-dealer was censured and ordered to pay a \$200,000 civil money penalty. The SEC orders in the proceedings against the adviser and the broker-dealer note that the SEC, in accepting each firm's Offer of Settlement, took into account the firm's remedial acts and its cooperation with the SEC staff. For example, the adviser undertook an internal investigation of the portfolio manager's trading after receiving an inquiry from a foreign exchange, and the investigation led to the portfolio manager being placed on administrative leave and subsequently resigning. In addition, the adviser voluntarily compensated clients for any possible adverse effects of the portfolio manager's trading. Finally, the adviser implemented a series of reforms, including enhancing its segregation of functions and requiring that all equity trades be initiated and monitored by the trading department and not by portfolio managers. The broker-dealer likewise (1) conducted an internal investigation in response to a foreign exchange inquiry, (2) placed the trader on administrative leave and eventually terminated him for cause, and (3) enhanced its compliance procedures by requiring review and approval by a supervisor, other than the sales trader, of any significant size order received for execution in the final 30 minutes of a trading day and review of any such order taken directly by the head trader by his or her supervisor. Frances M. Stadler Deputy Senior Counsel