

MEMO# 16526

September 11, 2003

SEC SANCTIONS INVESTMENT ADVISER FOR INADEQUATE POLICIES RELATING TO PREVENTION OF MISUSE OF NON- PUBLIC INFORMATION

[16526] September 11, 2003 TO: COMPLIANCE ADVISORY COMMITTEE No. 74-03 INVESTMENT ADVISER ASSOCIATE MEMBERS No. 20-03 INVESTMENT ADVISER MEMBERS No. 33-03 SEC RULES MEMBERS No. 121-03 RE: SEC SANCTIONS INVESTMENT ADVISER FOR INADEQUATE POLICIES RELATING TO PREVENTION OF MISUSE OF NON-PUBLIC INFORMATION The Securities and Exchange Commission recently issued an order instituting and settling an administrative proceeding against a registered investment adviser in connection with violations of Section 204A of the Investment Advisers Act of 1940.¹ Based upon the Commission's finding that the adviser had violated Section 204A, as discussed in more detail below, the adviser was censured and ordered to: cease and desist from further violations of Section 204A; pay a civil penalty of \$200,000; have the adviser's General Counsel office complete a comprehensive review of the policies, procedures, and practices maintained and implemented by the adviser pursuant to Section 204A; adopt, implement, and maintain procedures and practices pursuant to Section 204A that are consistent with the Commission's Order; and provide a report to the Commission detailing the adviser's compliance with the required review and any new policies, procedures, and practices adopted pursuant to Section 204A. In imposing these sanctions, the Commission's Order noted the cooperation the adviser extended to the Commission in this matter and the fact that the adviser brought this matter to the Commission's attention. In addition, the Order states that the adviser neither admitted nor denied the findings set forth therein. According to the Commission's Order, the adviser that was the respondent in this matter (the "Respondent") retained numerous consultants to provide a wide range of information and analysis concerning the financial markets and political, budgetary, and 1 See In the Matter of Massachusetts Financial Services Company, Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 203(e) and 203(k) of the Investment Advisers Act of 1940, SEC Release No. IA-2165 (Sept. 4, 2003) (the "Commission's Order"). A copy of the Commission's Order is available on the SEC's website at: <http://www.sec.gov/litigation/admin/ia-2165.htm>. Section 204A of the Advisers Act requires every federally-registered investment adviser to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the adviser's business, to prevent the misuse, in violation of the Advisers Act or the Securities Exchange Act of 1934 or the rules thereunder, of material, non-public information by such adviser or any person associated with the investment adviser. 2 regulatory developments in

Washington, D.C. In October 2001, one of these consultants provided to a senior portfolio manager in the Respondent's fixed income department material, non-public information. While this information was still non-public, portfolio managers of the adviser traded on it.² Though the Commission's Order found that the adviser had policies and procedures to prevent the misuse of non-public information, these policies and procedures only discussed inside information received from company insiders or their agents – not information received from paid consultants. As such, they failed to describe the potential that the adviser's consultants could obtain and provide material, non-public information to the adviser. Indeed, according to the Commission's Order, no written guidelines expressly discussed the use of consultants by the adviser or the handling of information obtained from consultants. Nor, according to the Commission's Order, did they expressly address the potential for misuse of material, non-public information relative to debt securities – and in particular Government- issued securities, even though the adviser's fixed income department primarily invested in debt securities. Based upon these inadequacies, the Commission found that the adviser violated Section 204A and imposed the above discussed sanctions. Tamara K. Salmon Senior Associate Counsel 2 According to the Commission's Order, the inside information provided to the adviser's portfolio manager was that the U.S. Treasury Department was going to announce the suspension of the 30-year bond.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.