

**MEMO# 6455**

December 12, 1994

## **SEC SANCTIONS INVESTMENT ADVISER WITH RESPECT TO PROCEDURES AGAINST INSIDER TRADING**

December 12, 1994 TO: COMPLIANCE COMMITTEE No. 23-94 INVESTMENT ADVISER  
MEMBERS No. 57-94 SEC RULES MEMBERS No. 88-94 RE: SEC SANCTIONS INVESTMENT  
ADVISED WITH RESPECT TO PROCEDURES AGAINST INSIDER TRADING

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Securities and Exchange Commission recently sanctioned an investment adviser and its affiliated broker-dealer with respect to their procedures to prevent insider trading. The Commission found that the de facto chief investment officer of the adviser and broker-dealer also served as chairman of the board of directors and chief executive officer of a public holding company. The Commission found that the procedures of the broker-dealer and investment adviser did not address the special circumstances that arose from his dual roles as CIO of the investment adviser and broker-dealer and chairman and CEO of a public holding company with routine access to potentially material, nonpublic information. Consequently, the Commission found that the entities violated Section 15(f) of the Securities Exchange Act of 1934 and Section 204A of the Investment Advisers Act of 1940 (requiring insider trading procedures). In particular, the Commission found that the entities' policies required each employee, prior to trading securities for himself or a client, to determine if he had material, nonpublic information. If the employee believed that he did have such information, or had questions as to whether the information was material and nonpublic, he had to report the matter to the general counsel, refrain from trading the securities for himself or others, and not communicate the information to anyone other than the general counsel. The Commission found that the reliance on "self-reporting" was inadequate as applied to the CIO, because it "provided for insufficient objective, third-party review to determine whether [the CIO] possessed material, nonpublic information when he bought or sold" the public holding company's securities. The broker-dealer also maintained a restricted list that would restrict trading in several situations, such as when anyone associated with the entities possessed material, nonpublic information. A person who believed that he received material, nonpublic information was responsible for reporting that fact to the general counsel who then, if necessary, placed the security on the restricted list. The Commission's order states, "This reliance on self-reporting [was] inadequate under the specific circumstances raised by the CIO's dual roles." The Commission found that the public holding company was not placed on the restricted list prior to the February 1992 public release of the company's year-end financial results. The broker-dealer and investment adviser also had a "three-day rule," under which trading of the personal holding company's securities was to be prohibited on the day prior, the day of, and the day after its issuance of press releases or board meetings. The public holding company was to notify the

entities when it was to issue a press release or hold board meetings. The Commission found this rule to be "ineffective" because "there was no correlation to when the CIO received material, nonpublic information [and] there were no written procedures governing when and how the three-day rule was to be invoked. Furthermore, [the broker-dealer] failed to maintain records concerning when it was notified of an upcoming . . . board meeting or press release, or who at [the public holding company] made the notification . . . ." Moreover, the Commission found that the broker-dealer rarely placed the public holding company on the restricted list prior to issuance of its press releases because the company rarely gave advance notice of the releases. Without admitting or denying the Commission's allegations, the broker-dealer and investment adviser consented to a cease-and-desist order, civil penalties of \$50,000 each, and the appointment of an independent consultant to review their trading policies and procedures, make recommendations, and take appropriate steps to bring the entities into compliance with the law. A copy of the Commission's order is attached. Thomas M. Selman Associate Counsel Attachment

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