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SEC ADMINISTRATIVE PROCEEDING REGARDING "INCUBATOR" FUND PERFORMANCE DISCLOSURE

* In the Matter of Van Kampen Investment Advisory Corp. and Alan Sachtleben, Admin. Proc. File No. 310002 (September 8, 1999). 1 [11239] September 13, 1999 TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 18-99 COMPLIANCE ADVISORY COMMITTEE No. 34-99 SEC RULES MEMBERS No. 54-99 RE: SEC ADMINISTRATIVE PROCEEDING REGARDING "INCUBATOR" FUND PERFORMANCE DISCLOSURE _____ The Securities and Exchange Commission recently accepted an offer of settlement and imposed sanctions in an administrative proceeding involving an investment adviser and its former chief investment officer for equity investments ("chief investment officer") in connection with the disclosure of an "incubator" fund's performance.* The adviser and the chief investment officer each consented to the entry of an order, without admitting or denying the Commission's findings. A copy of the order is attached and it is summarized below. The order states that from December 1995 to February 1997, the fund was an incubator fund whose shares were generally not available to the public for investment and whose net assets ranged from $200,000 to $380,000 during most of 1996. During this incubation period, the fund achieved a 61.99% one-year total return, without adjusting for the applicable sales load. According to the order, more than 50% of the fund's 1996 return was attributable to securities acquired through 31 hot initial public offerings (IPOs). Although the fund only purchased 100 to 400 shares in each hot IPO, those shares had a magnified impact on the fund's return because of its small asset base. The order further states that in January 1997, the chief investment officer received a copy of an article questioning the gains of the fund and the possible use of hot IPOs to bolster its performance. In response, he directed an employee to conduct a study to determine the impact of IPOs on the fund's 1996 performance. The IPO impact study, which assumed that IPO purchases were made at the higher, post-IPO price, concluded that the impact of IPOs accounted for approximately one-third of the fund's 1996 return. The order also states that the chief investment officer did not inform the fund's trustees of the existence or the results of the study at the January 1997 board meeting at which the public offering of the fund was approved. According to the order, after the fund was opened to the public for investment, the fund's principal underwriter, an affiliate of the adviser, disseminated an advertisement that prominently displayed the fund's 1996 return and its #1 performance ranking for its category, but did not disclose that IPOs had a large impact on the fund's 1996 return. The order indicates that the chief investment officer was responsible for providing information about the fund to the fund's trustees and senior 2officers of the adviser and the principal underwriter, but

did not inform them that he had initiated the study or report to them the results of the study. The advertisement also contained a disclaimer, which was repeated in the fund's December 1996 semi-annual report and prospectus, stating that there was no assurance that the fund's performance would have been the same had the fund been broadly distributed. The order notes, however, that the disclaimer did not mention the specific role of IPO investments, and the semi-annual report gave no other indication that the fund had in any way participated in the IPO market. In addition, the order cites press statements attributed to representatives of the adviser and the principal underwriter that indicated that there were a limited number of IPOs in the fund during 1996 and that they did not greatly affect the fund's performance. The Commission concluded that disclosure that a large portion of the fund's return was attributable to its investment in IPOs would have been material to an investor's decision whether to invest in the fund, particularly because the fund's growth made it questionable whether the fund could continue to experience substantially similar performance by investing in hot IPOs. On this basis, the Commission found that the adviser willfully violated, and the chief investment officer caused and willfully aided and abetted the adviser's violation of, Section 206(2) of the Investment Advisers Act by omitting to state material facts to its client, the fund, the fund's shareholders, and prospective shareholders concerning the impact of hot IPOs on the fund's 1996 performance. In addition, the Commission found that the adviser and the chief investment officer caused and willfully aided and abetted violations of Section 34(b) of the Investment Company Act, which prohibits the filing, transmitting or keeping of certain documents that omit to state facts necessary in order to prevent the statements made in those documents, in the light of the circumstances under which they were made, from being materially misleading. The adviser and the chief investment officer were each censured and ordered to cease and desist from committing or causing any violation and any future violation of Section 206(2) of the Advisers Act and Section 34(b) of the Investment Company Act and to pay civil penalties of $100,000 and $25,000, respectively. Frances M. Stadler Deputy Senior 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 11239. ICI Members may retrieve this Memo and its attachment from ICINet (http://members.ici.org).
