INVESTMENT COMPANY INSTITUTE

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MEMO# 2982

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SEC CENSURES FUND ADVISER FOR "INTERPOSITIONING"

August 1, 1991 TO: SEC RULES MEMBERS NO. 40-91 RE: SEC CENSURES FUND ADVISER FOR "INTERPOSITIONING" ____ The SEC recently censured an investment adviser to a fund and an affiliated broker of the adviser for "interpositioning", which is defined in the SEC's Order as "the practice whereby an investment company, at the direction of an investment adviser, uses a broker to effect a transaction as its agent, instead of dealing directly with a market maker on a principal basis, to purchase a security." The SEC found that the adviser had, in violation of the antifraud provisions of the federal securities laws, interpositioned the broker between the fund and dealers making primary markets in over-the-counter securities that the fund purchased, thereby causing the fund to incur unnecessary expenses (i.e., the commissions that the broker charged the fund for those securities transactions). In addition, the SEC found that the adviser caused the fund to violate Section 18(f)(1) of the Investment Company Act by engaging in short sales without maintaining the required collateral in a segregated account in compliance with the guidelines of Investment Company Act Release No. 10666. The SEC also found that the adviser willfully caused the fund to violate Section 17(g) of the Act and Rule 17g-1(d) thereunder by failing to ensure that the amount of the fund's fidelity bond was at least equal to an amount computed in accordance with the schedule contained in the Rule. The SEC censured the adviser and required that it comply with a number of conditions concerning the purchase of OTC securities on behalf of the fund, including hiring an outside consultant to prepare a report for the SEC on the adviser's practices with respect to the purchase of such securities. The affiliated broker involved with the interpositioning was suspended for one year. A copy of the SEC's Order is attached. Amy B.R. Lancellotta Assistant General Counsel Attachment

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