

MEMO# 10221

August 21, 1998

SEC FILES COMPLAINT AGAINST PORTFOLIO MANAGER FOR PERSONAL TRADING VIOLATIONS; SANCTIONS INVESTMENT ADVISER FOR FAILURE TO SUPERVISE

1 SEC v. Lyons, Lit. Rel. No. 15842A; S.D. Calif. No. 98 CV 1471J RBB (August 12, 1998) (the "Complaint"); and In Re Nicholas-Applegate Capital Management, Release No. IA-1741; File No. 3-9673; Admin. Proc. File No. 3-9673 (August 12, 1998) (the "Order"). [10221] August 21, 1998 TO: COMPLIANCE ADVISORY COMMITTEE No. 23-98 INVESTMENT ADVISER ASSOCIATE MEMBERS No. 22-98 INVESTMENT ADVISER MEMBERS No. 23-98 RE: SEC FILES COMPLAINT AGAINST PORTFOLIO MANAGER FOR PERSONAL TRADING VIOLATIONS; SANCTIONS INVESTMENT ADVISER FOR FAILURE TO SUPERVISE

The SEC recently filed a complaint against a former portfolio manager at two registered investment adviser firms for personal trading violations and also settled an administrative action with one of the firms for failing to supervise his trading activities.¹ A copy of the SEC's administrative actions are attached and are summarized below. The SEC's Complaint charged the portfolio manager with violating the antifraud provisions of the federal securities laws by failing to disclose his conflict of interest in allocating profitable equity "day" trades (i.e., buying and selling the same security within the same day) to his personal accounts and unprofitable trades to his client accounts. The day trades purportedly generated profits of approximately one million dollars in the portfolio manager's personal accounts. The Complaint alleges that these violations occurred: (1) from at least 1991 through July 1993 at an investment adviser firm, which had employed him as the trader and portfolio manager for its employee profit-sharing retirement plan; and (2) from August 1993 through August 1995 at another investment adviser firm formerly registered with the SEC, of which he was a 70% owner, and where he had served in the same capacity for all of the adviser's client accounts. The SEC charged the portfolio manager with: (1) perpetrating the allocation scheme during his employment with the two adviser firms in violation of Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 thereunder; (2) breaching his fiduciary duty to his clients in violation of Sections 206(1) and (2) of the Investment Advisers Act of 1940 by failing to disclose his conflict of interest in favoring his personal accounts to the detriment of client accounts in allocating day trades; and (3) aiding and abetting the adviser's recordkeeping violations of Section 204 of the Advisers Act and Rule 204-2(a)(12) thereunder by failing to report completely and accurately to the adviser his personal trading activities. The SEC seeks a permanent injunction, disgorgement of illicit

profits, and civil monetary penalties. 2In a related matter, the SEC settled an administrative proceeding with the registered investment adviser that had employed the portfolio manager to manage and trade the firm's employee profit-sharing retirement plan. According to the Order, the adviser: (1) failed reasonably to supervise the portfolio manager and placed him in a conflict of interest position when it appointed him to manage and trade the retirement plan without establishing adequate procedures, or an adequate system for implementing such procedures, to ensure that potential conflicts of interest were properly monitored; (2) failed to institute adequate procedures to review and supervise the portfolio manager's personal trading; (3) willfully violated the recordkeeping provisions of the Advisers Act by failing to maintain accurate and complete records of the portfolio manager's personal trading for a substantial number of months from February 1991 through July 1993; (4) maintained procedures that were inadequate to promote compliance by the portfolio manager with its reporting requirements; and (5) failed to use reasonable diligence to address the repeated deficiencies in the portfolio manager's reporting. In its settlement agreement, the adviser, without admitting or denying the findings, agreed to the following: (1) a censure; (2) cease and desist from committing or causing violations and any future violations of Section 204 of the Advisers Act and Rule 204-2(a)(12) thereunder; (3) pay a civil money penalty of \$250,000; and (4) maintain and implement procedures reasonably designed to supervise its employees with a view toward preventing and detecting the violations noted above. Barry E. Simmons Assistant Counsel

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