INVESTMENT COMPANY INSTITUTE

**MEMO# 10704**

February 5, 1999

# SEC SETTLES WITH FUND DIRECTORS AND PORTFOLIO MANAGERS OF MONEY MARKET FUND THAT ""BROKE THE DOLLAR""

1 In the Matter of John E. Backlund, John H. Hankins, Howard L. Peterson, and John G. Guffey, Securities Act Release No. 7626 (January 11, 1999). [10704] February 5, 1999 TO: DIRECTOR SERVICES COMMITTEE No. 6-99 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 2-99 SEC RULES MEMBERS No. 16-99 RE: SEC SETTLES WITH FUND DIRECTORS AND PORTFOLIO MANAGERS OF MONEY MARKET FUND THAT "BROKE THE DOLLAR" ____________________________________________________________ The Securities and Exchange Commission ("SEC") recently settled separate administrative proceedings (attached) with former directors and portfolio managers of a now defunct money market fund that "broke the dollar" (i.e., failed to maintain a $1.00 per share NAV). The fund "broke the dollar" as a result of having a substantial percentage of its assets invested in adjustable-rate derivative securities that declined in value due to rising interest rates. In the first proceeding,1 the SEC sanctioned several directors of the fund. The SEC found that the directors should have known that the continued use of the fund's valuation method was inappropriate and, in particular, that the use of amortized cost to calculate the fund's NAV per share did not fairly reflect the fund's market-based NAV per share. The SEC also found that the directors knew that a substantial percentage of the fund's assets had been invested in the derivative securities that were quickly losing value and that the board had no reasonable basis for believing that the valuation problem could be resolved over time or that the adverse market conditions were temporary. The SEC further found that, as a result of the significant decrease in the market value of the securities and the fund's portfolio value, the fund's prospectus and SAI were materially misleading regarding the liquidity of the fund's portfolio and the value of shares being sold. Nevertheless, after the securities dropped in value, the fund's investment adviser, with the knowledge and approval of the fund's board, continued to market fund shares to prospective and existing shareholders, representing to them that each fund share continued to be worth $1.00. At the direction of the board, the fund also filed with the SEC a registration statement which included material misrepresentations. The SEC therefore charged the directors with violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 34(b) and Rule 22c-1 of the Investment Company Act. All the directors were ordered to cease and desist from committing or causing any violation and any future violation of the federal securities laws in which they were charged. In addition, the directors were ordered to pay civil money penalties and one director was suspended from association with any investment company or investment adviser for a period of twelve months. 2 In the Matter of Craig S. Vanucci and

Brian K. Andrew, Securities Act Release No. 7625 (January 11, 1999). - 2 - In the second proceeding,2 the SEC sanctioned two portfolio managers of the fund who caused the fund to purchase the derivative securities for the fund's portfolio. The SEC charged that the portfolio managers violated Section 206(2) of the Investment Advisers Act by causing the fund to purchase the securities without adequately assessing the risks associated with holding these securities at a time when interest rates were increasing. The SEC also charged that the portfolio managers violated Section 17(a)(2) and 17(a)(3) of the Securities Act by causing the fund's representations regarding its portfolio to be untrue as a result of the fund’s investment in the derivative securities. The portfolio managers were ordered to cease and desist from committing or causing any violation and any future violation of the federal securities laws in which they were charged and were ordered to pay a civil money penalty. In addition, the portfolio managers were prohibited, with certain conditions attached, from becoming an associated person of any investment adviser or affiliated person of any investment company. Ari Burstein Assistant Counsel Attachment Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Library Services Division at (202)326- 8304, and ask for this memo's attachment number: 10704.

---