

**MEMO# 4960**

July 9, 1993

## **SEC SANCTION WITH RESPECT TO PRICING ERROR**

July 9, 1993 TO: ACCOUNTING/TREASURERS COMMITTEE NO. 24-93 COMPLIANCE  
COMMITTEE NO. 14-93 MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 8-93 SEC RULES  
MEMBERS NO. 56-93 RE: SEC SANCTION WITH RESPECT TO PRICING ERROR

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The Securities and Exchange Commission recently sanctioned a bank, acting as fund accountant and adviser, in connection with the alleged miscalculation of the net asset value per share of a tax-free money market fund. The Commission found that in 1990 the fund purchased a tax-exempt bond, the principal and interest of which were guaranteed by an insurance company. In 1991, a state insurance commission seized the insurance company, which was no longer permitted to honor the bond guarantee. The state's action resulted in a significant drop in the bond's market price in mid-July 1991. The Commission found that in July 1991, the bank's fund accounting department received a market price less than par for the bond. According to the Commission, because the price was significantly lower than the previously reported price of par it was improperly treated as a "transmission error" although there was no evidence of such an error. The market price was manually overridden and par value for the bond was allegedly entered on the pricing worksheet. The pricing problem was uncovered in late August 1991. The bank informed the fund's board and purchased the bond from the fund at par value plus interest. The Commission found that the repeated mispricing of the bond: was caused by the Bank's failure to have a system of internal controls sufficient to reasonably prevent one employee's actions from having such significant consequences and to alert management in a timely fashion to the existence of a problem. The Bank's system allowed the same individual who received the market values of Fund securities to price the portfolio and resolve any price deviations. There was no oversight or review of deviations and their resolution by senior Bank management. The Commission also found that the bank's investment advisory records did not adequately "flag" portfolio securities with credit enhancement features. Without admitting or denying the allegations, the bank consented to an order requiring it to permanently cease and desist from committing or causing any violation of Sections 22(c) and 31(a) of the Investment Company Act and Rules 22c-1 and 31a-1 thereunder. A copy of the SEC's order is attached. Thomas M. Selman Assistant General Counsel Attachment