

MEMO# 6311

October 19, 1994

SEC SANCTIONS PORTFOLIO MANAGER FOR PERSONAL TRADING ACTIVITIES

October 19, 1994 TO: COMPLIANCE COMMITTEE NO. 19-94 INVESTMENT ADVISER MEMBERS
NO. 48-94 SEC RULES MEMBERS NO. 72-94 INVESTMENT ADVISER ASSOCIATE MEMBERS
NO. 41-94 RE: SEC ISSUES TWO ORDERS SANCTIONING PORTFOLIO MANAGERS FOR
PERSONAL TRADING ACTIVITIES

The Securities and Exchange Commission recently issued two orders sanctioning portfolio managers with respect to their personal trading activities. A copy of both orders is attached.

1. Portfolio Manager to Unregistered Investment Funds In the first case, the Commission found that the portfolio manager to unregistered investment funds purchased subordinated notes for the funds and shortly thereafter purchased warrants of the same issuer for herself. Had the portfolio manager purchased the warrants for the funds, they would have enhanced the value of the notes, due to the nature of the warrants. The Commission found that the portfolio manager violated the antifraud provisions of the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940. According to the order: Where, as here, in the course of performing investment advisory duties, a portfolio manager learns of an investment opportunity of limited availability that would be appropriate for a client and in which the client would be financially and legally able to invest, the portfolio manager commits fraud if the portfolio manager invests in that opportunity without disclosing that opportunity to the client (or a disinterested representative) and obtaining the client's prior or subsequent consent. The Commission also found that the portfolio manager concealed her purchase of the warrants from the investment adviser, thereby causing the adviser to violate the books and records provisions of the Investment Advisers Act. Without admitting or denying the Commission's allegations, the portfolio manager consented to an order barring her from the business and requiring her to cease and desist from future violations of the antifraud and books and records provisions.

2. Sanctions Against Portfolio Manager, General Counsel and Investment Adviser In the second case, the Commission sanctioned an investment adviser and its portfolio manager and general counsel for actions related to the portfolio manager's personal trading. The Commission found that the adviser had failed to disclose to its clients certain potential conflicts of interest, arising from the fact that the portfolio manager provided advice to the organizers of various companies, for which he received nonpublic securities of those companies for nominal consideration. The adviser subsequently purchased for its clients public securities of these companies or their affiliates. The Commission found that the portfolio manager had precleared his purchase of the nonpublic securities with the adviser's general counsel. Subsequently, and "without determining whether [the adviser] had purchased securities of the same issuers for clients," the general counsel executed amendments to the adviser's Form ADV that did not disclose the potential conflict at issue. The Commission's order states, "Personal investments and personal business relationships

with issuers or persons related to issuers . . . require particularly careful scrutiny and disclosure by an investment adviser." The order further states: The Commission takes seriously the obligation of investment advisers and related persons to identify potential conflicts of interest and make complete and accurate disclosure of such conflicts, and in appropriate cases, will not hesitate to bring enforcement actions in circumstances where information concerning a potential conflict is not disclosed at the relevant time. Without admitting or denying the Commission's findings, the adviser, portfolio manger, and general counsel agreed to cease and desist from violations of certain provisions of the Investment Advisers Act and to a censure by the Commission. The adviser also agreed to employ outside counsel to review its policies and procedures and to pay a penalty of \$500,000, and the portfolio manager agreed to a penalty of \$250,000. Thomas M. Selman Associate Counsel Attachment

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