

MEMO# 17531

May 17, 2004

SEC FILES CIVIL FRAUD CHARGES AGAINST FUND ADVISERS, DISTRIBUTOR, CEO AND CHAIRMAN OF THE BOARD OF TRUSTEES AND A PORTFOLIO MANAGER RELATING TO MARKET TIMING

1 See SEC v. PIMCO Advisors Fund Management LLC, PEA Capital LLC f/k/a PIMCO Equity Advisors LLC, PIMCO Advisors Distributors LLC, Stephen J. Treadway, and Kenneth W. Corba, Civil Action No. 04 Civ. 3464 (VM) (S.D.N.Y. May 6, 2004). A copy of the litigation release and complaint are available on the SEC's website at <http://www.sec.gov/litigation/litreleases/lr18697.htm>. [17531] May 17, 2004 TO: COMPLIANCE ADVISORY COMMITTEE No. 51-04 INVESTMENT COMPANY DIRECTORS No. 25-04 SEC RULES MEMBERS No. 74-04 SMALL FUNDS MEMBERS No. 54-04 RE: SEC FILES CIVIL FRAUD CHARGES AGAINST FUND ADVISERS, DISTRIBUTOR, CEO AND CHAIRMAN OF THE BOARD OF TRUSTEES AND A PORTFOLIO MANAGER RELATING TO MARKET TIMING The Securities and Exchange Commission announced the filing of civil charges against two-federally registered investment advisers, an affiliated distributor, the advisers' chief executive officers, the chairman of the board of trustees of the group of mutual funds managed by the advisers, and a portfolio manager for the funds.¹ The complaint alleges that from February 2002 to April 2003, the defendants entered into an undisclosed arrangement with a hedge fund, which permitted the hedge fund and its affiliates to engage in market timing activity in certain mutual funds in return for long-term investments (referred to as "sticky assets") in a mutual fund and a hedge fund from which the advisers earned management fees. The agreement allegedly allowed the hedge fund to engage in several round-trip transactions per month even though: (1) the funds' prospectuses created the impression that the funds' managers discouraged market timing and worked to prevent market timing, including by limiting an investor to six round-trip transactions per year; (2) during the same period, the distributor was issuing warning letters, freezing accounts, or blocking trades relating to market timing activity by other fund investors; and (3) the funds' prospectuses did not disclose to investors that an agreement had been made to permit timing in the funds in exchange for sticky assets. The complaint further alleges that the advisers did not establish, maintain, or enforce written policies and procedures designed to prevent disclosure of the funds' nonpublic ²portfolio holdings and that one of the advisers disclosed nonpublic information about the funds'

portfolio holdings to the hedge fund's brokers and others. The complaint charges the defendants with violations of the antifraud provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisers Act of 1940. The advisers and the executives are further charged with violations of Section 34(b) of the Investment Company Act of 1940, which prohibits material misstatements or omissions in any registration statement filed with the SEC. The advisers and the distributor are also charged with violating Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder, which prohibit a fund affiliate from participating in a joint transaction with the fund without an SEC order. Finally, the advisers are charged with violations of Section 204A of the Advisers Act, which requires an adviser to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information by the adviser or any person associated with the adviser. The SEC's complaint seeks: (1) injunctive relief; (2) disgorgement of all ill-gotten gains; (3) monetary penalties; (4) an order pursuant to Section 36(a) of the Investment Company Act preventing the defendants from serving as investment advisers, principal underwriters, officers, directors, or members of any advisory boards to any registered investment company; and (5) such other relief as the court may determine to be just and necessary. Jane G. Heinrichs
Assistant Counsel

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