

MEMO# 8854

May 5, 1997

SEC SANCTIONS INVESTMENT ADVISER FOR FAILING TO SUPERVISE PORTFOLIO MANGER WITH RESPECT TO PERSONAL TRADING ACTIVITIES

1 Release No. IA-1630; Administrative Proceeding File No. 3-9301 (April 28, 1997). 2 In an earlier related proceeding, the Commission found that the portfolio manager's personal trading activities violated Section 17(j) of the Investment Company Act of 1940 and Rules 17j-1(a) and (c) thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940. See Release No. IC-21385; Administrative Proceeding File No. 3-8851 (Sept. 29, 1995). 3 See *id.* The Commission found that during the period in issue the portfolio manager engaged in 24 transactions involving securities that he was also trading in on behalf of the clients he advised. This trading activity constituted a conflict of interest because of the proximity of his personal trades and client trades, and the low volume of the security he was trading in comparison to the size of his clients' trades. 4 See Report of the Advisory Group on Personal Investing (May 9, 1994). The Advisory Group Report recommended that all investment companies adopt certain specific measures designed to obviate conflicts, prevent and detect abusive practices, and preserve investor confidence.

May 5, 1997 TO: COMPLIANCE ADVISORY COMMITTEE No. 17-97 INVESTMENT ADVISER ASSOCIATE MEMBERS No. 15-97 INVESTMENT ADVISER MEMBERS No. 17-97 SEC RULES MEMBERS No. 34-97 RE: SEC SANCTIONS INVESTMENT ADVISER FOR FAILING TO SUPERVISE PORTFOLIO MANAGER WITH RESPECT TO PERSONAL TRADING ACTIVITIES

The Securities and Exchange Commission recently sanctioned an investment adviser for failing reasonably to supervise a portfolio manager to two of its sector funds with respect to his personal trading activities.¹ The Commission's order instituting the proceedings is summarized below, a copy of which is attached. The Commission found deficiencies in the advisers supervisory procedures, which allowed its portfolio manager over a two-year period to engage in a pattern of personal trading in direct conflict with the interests of its clients.² According to the order, the adviser's oversight procedures failed to ensure that the portfolio manager's personal trades received the appropriate level of review. In fact, the Commission found that the adviser failed to conduct the limited review procedures mandated by its own written code of ethics, which procedures were designed to limit and monitor personal trading by employees. Consequently, the Commission determined that the adviser's procedures at the time were either not established or insufficiently implemented, and thus were not reasonably designed to prevent and detect the portfolio manager's personal trading activities during the relevant period.³ Without admitting or denying the Commission's findings, the adviser agreed to a censure and a penalty of

\$100,000, and agreed to retain an independent consultant to, among other things, (1) review and revise its personal trading policies and oversight procedures; (2) submit a written report to its Board of Directors and to the Commission; and (3) submit to the Commission a written affidavit sworn to by its General Counsel and Chairman of the Board of Directors explaining and attesting to the modifications made pursuant to the consultant's findings. * * * The Institute notes that the conduct complained of in this proceeding pre-dates the release of the report on personal investing prepared by a special Advisory Group formed by the Institute to review the standards applicable to personal investing by investment company personnel.⁴ After release of the Advisory Group Report, the Institute conducted a survey and found, among other things, that the overwhelming majority of member fund ⁵ See Report to the Division of Investment Management U.S. Securities and Exchange Commission, Implementation of the Institute's Recommendations on Personal Investing, at 1 (April 21, 1995). complexes have voluntarily implemented the Institute's recommendations and have devoted substantial attention to the question of how the Institute's recommendations can be implemented most effectively in light of each fund complex's specific business activities, structure, and operations.⁵ Barry E. Simmons 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 Information Resource Center at (202)326-8304, and ask for this memo's attachment number: 8854.