INVESTMENT COMPANY INSTITUTE

MEMO# 5438

December 30, 1993

SEC SANCTIONS FOR FAILURE TO SUPERVISE IN CONNECTION WITH MUTUAL FUND SALES

December 30, 1993 TO: BROKER/DEALER ASSOCIATE MEMBERS NO. 29-93 COMPLIANCE COMMITTEE NO. 31-93 SEC RULES MEMBERS NO. 104-93 RE: SEC SANCTIONS FOR FAILURE TO SUPERVISE IN CONNECTION WITH MUTUAL FUND SALES

____ The Securities and Exchange Commission recently sanctioned several senior and other officers of a registered broker-dealer in connection with alleged deficiencies with respect to supervising the sale of shares of two high yield bond funds. The broker-dealer is the underwriter of these funds, as well as other affiliated funds. Specifically, the SEC alleged that the broker-dealer had violated the anti-fraud provisions under the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with the sale of shares in two high yield bond funds. The SEC alleged that the broker-dealer's sales representatives had made misleading statements regarding the risk of loss of principal invested in the funds and the return on an investment in the funds, omitted to state material facts necessary to make certain statements made not misleading, and sold shares of the funds to certain investors for whom such shares were unsuitable investments. The broker-dealer previously had agreed to settle SEC charges based on this alleged misconduct. In this proceeding, the SEC asserted that with respect to the alleged misconduct described above, the broker-dealer's sales training, supervisory, and compliance programs regarding the sales presentations for the funds were inadequate in several respects. The SEC found that the broker-dealer failed to: (1) adopt and maintain uniform standards of sales training company-wide; (2) adopt adequate procedures to ensure the suitability of customer's investments; and (3) adopt and implement an adequate system of monitoring sales training to ensure that sales presentations complied with applicable state and federal securities laws and rules and regulations of national securities exchanges. The SEC alleged that the respondents failed reasonably to supervise certain of the broker-dealer's sales representatives under their direct or indirect supervision by failing to establish procedures reasonably designed to prevent and detect the violative conduct and by failing to respond reasonably to indications that the broker-dealer's sales training, supervisory, and compliance systems might not reasonably be expected to prevent and detect, insofar as practicable, violative sales practices. In addition, the SEC alleged that as part of their failures to supervise, the respondents failed adequately to investigate, or cause an adequate investigation to be made into, allegations suggesting that some of the broker-dealer's sales representatives were inadequately trained and that some sales presentations for the funds contained misrepresentations regarding the return on investment in the funds and the risk of loss of principal in the funds. The respondents, without admitting or denying the SEC's allegations, agreed to settle the charges and to the imposition of the sanctions set forth in the SEC's order. A copy of the SEC's order is attached. Amy B.R. Lancellotta Associate Counsel Attachment