

MEMO# 11289

October 5, 1999

SEC SANCTIONS CHIEF INVESTMENT OFFICER FOR FAILURE TO SUPERVISE PORTFOLIO MANAGER CONCERNING FUND INVESTMENTS

* In the Matter of Ellen Griggs, Admin. Proc. File No. 3-9703 (September 27, 1999). The fund's investment adviser and its former portfolio manager were sanctioned in prior proceedings. See Memoranda to Compliance Advisory Committee No. 28- 98 and SEC Rules Members No. 73-98, dated September 21, 1998, and SEC Rules Members No. 69-97 and Compliance Advisory Committee No. 25-97, dated September 12, 1997. [11289] October 5, 1999 TO: COMPLIANCE ADVISORY COMMITTEE No. 38-99 SEC RULES MEMBERS No. 59-99 RE: SEC SANCTIONS CHIEF INVESTMENT OFFICER FOR FAILURE TO SUPERVISE PORTFOLIO MANAGER CONCERNING FUND INVESTMENTS

The Securities and Exchange Commission recently accepted an offer of settlement and imposed sanctions in an administrative proceeding against a former chief investment officer ("chief investment officer") for failure to supervise a portfolio manager in connection with a short-term government bond fund's investments in certain stripped mortgage-backed securities.* The chief investment officer consented to the entry of the order, without admitting or denying its findings. A copy of the order is attached and is summarized below. The order states that the fund's stated investment objective was to achieve the highest level of income consistent with the preservation of capital and low volatility of net asset value. In addition, an appendix to the prospectus disclosed that the fund had "no present intention" of investing in interest- only ("IO") and principal-only ("PO") stripped mortgage-backed securities that were not planned amortization class ("PAC") bonds. Notwithstanding these disclosures, the portfolio manager invested in certain non-PAC IOs and POs, as well as in PAC inverse IOs that were more volatile than permitted by the fund's low volatility investment objective. According to the order, the portfolio manager routinely overrode prices provided by the fund custodian for certain of these investments. The portfolio manager generated his own prices that frequently were higher than the custodian-provided prices, but kept no documentation to support his calculations. In addition, the Commission found that he further obscured the volatile effects of these securities by employing a method that materially understated the fund's aggregate duration. The order further states that the chief investment officer did not effectively delegate her supervision of the portfolio manager, and that her efforts to ensure the low volatility of the fund's net asset value were not sufficient to prevent or detect the violations committed by the portfolio manager. For example, although she instructed the portfolio manager that the fund was not permitted to

purchase certain securities, she did not review his purchases of portfolio securities or the contents of the portfolio to ensure his compliance with the fund's disclosures concerning investments. In addition, the order notes that she monitored the fund's volatility on a daily basis by reviewing the fund's net asset value and the portfolio's aggregate duration, but she did not review the portfolio manager's methods of valuing portfolio securities, overriding custodian's prices, or calculating aggregate duration. The Commission found that the chief investment officer's supervision of the portfolio manager was inadequate in that she ceded to the portfolio manager virtually total control over the purchase and valuation of portfolio securities with little or no effective oversight. As a result, the Commission concluded, she failed reasonably to supervise the portfolio manager with a view to preventing, within the meaning of Section 203(e)(6) of the Investment Advisers Act, his violations of the federal securities laws. The SEC suspended the former chief investment officer from association with any investment adviser for one month, suspended her from acting in any supervisory capacity with any investment adviser for four months immediately following her suspension from association, and ordered her to pay a civil penalty of \$10,000. Kathy D. Ireland Associate Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11289. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

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