

MEMO# 4334

December 16, 1992

SEC CLARIFIES ROLE OF SUPERVISORS IN ADMINISTRATIVE ORDER AGAINST SENIOR MANAGEMENT OF SECURITIES FIRM

December 16, 1992 TO: BOARD OF GOVERNORS NO. 91-92 SEC RULES MEMBERS NO. 71-92
COMPLIANCE COMMITTEE NO. 25-92 RE: SEC CLARIFIES ROLE OF SUPERVISORS IN
ADMINISTRATIVE ORDER AGAINST SENIOR MANAGEMENT OF SECURITIES FIRM

In recent administrative proceedings against three senior officials of a major broker-dealer firm, the SEC amplified its views on who is a supervisor for purposes of the Securities Exchange Act of 1934 and the responsibilities that this role entails. The proceedings were brought as a result of the officials' alleged failure to supervise the former head of the firm's government securities trading desk, who was found to have submitted false bids in certain auctions of U.S. Treasury securities. In connection with the proceedings, the SEC also issued a report of investigation pursuant to Section 21(a) of the 1934 Act with respect to the supervisory responsibilities of brokerage firm employees under certain circumstances. Copies of the SEC's administrative order and report of investigation, as well as related excerpts from remarks made by SEC Chairman Breeden at a December 3 meeting of the Securities Industry Association, are attached. According to the attached order, the three officials (the firm's Chairman and Chief Executive Officer, its President, and a Vice Chairman who was the direct supervisor of the head of the government securities trading desk) breached their supervisory duties by failing to take prompt action to investigate fully what had occurred, or to limit the activities of the individual who committed the alleged violation(s), after they learned that a false bid had been submitted and were advised by the firm's chief legal officer that this appeared to be a criminal act. As a result of this failure, subsequent violations that perhaps could have been prevented took place. The order discusses in detail the response of each of the three individuals to the news of the improper conduct, and how those responses fell short of meeting the supervisory responsibilities imposed by the 1934 Act. In addition to describing what is expected of senior management in response to indications of wrongdoing, the SEC issued a report of investigation delineating its position on the supervisory responsibilities of legal and compliance officers of brokerage firms under the circumstances of this case. The SEC's report of investigation notes that a determination of whether a particular person is a "supervisor" for purposes of Sections 15(b)(4)(E) and 15(b)(6) of the 1934 Act "depends on whether . . . that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue." The absence of any previous direct supervisory responsibility over an employee's activities is not relevant to the analysis. In this case, the chief legal officer of the broker-

dealer firm (who was not named as a respondent) was informed by the other members of senior management of the misconduct that had occurred, and they looked to him for advice and guidance in responding to the problem (as they had in past instances of misconduct). As a result of his role and influence within the firm and the particular facts of the case, the SEC found, the chief legal officer became a supervisor for 1934 Act purposes. Thus, he shared the responsibility to take appropriate action to respond to the misconduct and, once involved in responding, was obligated to take affirmative steps to ensure that appropriate action was taken to address the misconduct. In settlement of the SEC proceeding, the Chairman and Chief Executive Officer of the brokerage firm agreed not to associate in the future in those capacities with any broker, dealer, municipal securities dealer, investment company or investment adviser regulated by the SEC, and to pay a civil penalty of \$100,000. The firm's President agreed to a six-month suspension from the securities industry and was ordered to pay a \$75,000 penalty. The Vice Chairman received a three-month suspension and was assessed a \$50,000 penalty. Craig S. Tyle Vice President- Securities Attachments

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