

MEMO# 5029

August 4, 1993

SECOND CIRCUIT UPHOLDS CRIMINAL CONVICTION OF PORTFOLIO MANAGER FOR INVESTMENT COMPANY ACT VIOLATIONS

August 4, 1993 TO: COMPLIANCE COMMITTEE NO. 17-93 SEC RULES MEMBERS NO. 60-93
TASK FORCE ON INSIDER TRADING RE: SECOND CIRCUIT UPHOLDS CRIMINAL CONVICTION
OF PORTFOLIO MANAGER FOR INVESTMENT COMPANY ACT VIOLATIONS

The Second Circuit Court of Appeals recently upheld the criminal conviction of a former mutual fund portfolio manager for violating Sections 17(e) and 17(j) of the Investment Company Act of 1940 and Rule 17j-1 thereunder, and 18 U.S.C. 1954. The conviction was based on the portfolio manager's improper receipt of "compensation" or a "thing of value" when she was given the opportunity to purchase certain warrants for her own account, and her failure to disclose the transaction to her employer. A copy of the appellate court's decision is attached. The court rejected the portfolio manager's argument that the charges against her under Section 17(e) and 18 U.S.C. 1954 required proof that she received "compensation" or a "thing of value" at a price less than market value. According to the court, under these provisions, "it is enough if the item received was regarded as a benefit by the recipient, whether or not others might have taken a different view of its value." The court further found that based on the evidence presented, the jury reasonably could conclude that the portfolio manager viewed the opportunity to purchase the warrants as a benefit. The portfolio manager also argued on appeal that she did not violate Section 17(j) by failing to report her investment in the warrants to the investment adviser that employed her. She contended that Section 17(j) applied only to securities "held or to be acquired" by the investment company (or companies) that she managed. However, the court disagreed with this interpretation of Section 17(j), stating that "any payment to a portfolio manager intended to induce the purchase of a firm's securities on behalf of an investment company easily qualifies as a 'fraudulent, deceptive or manipulative' act 'in connection with' the investment company's acquisition of securities [in violation of Section 17(j)], whether or not the payment consists of an opportunity to purchase securities in a different firm." The court also found that Rule 17j-1, which requires portfolio managers to report personal securities transactions to their employers, "is a prophylactic measure reasonably related to the enforcement of Section 17(j)." Thus, the appellate court affirmed the lower court's decision. Frances M. Stadler
Assistant Counsel Attachment

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