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by

Linda Chatman Thomsen [1]

Director, Division of Enforcement
U.S. Securities and Exchange Commission

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Thank you, David. And thanks to all of you in the audience today for attending this important conference. I feel like I am preaching to the choir today because, as compliance professionals, you are in many ways our partners in protecting investors. After I agreed to speak to you today, I happened to glance at the program for this conference, and noticed that my address to you was billed as "the good, bad and ugly of enforcement." Well, I don't know about the good - that's generally not a side of the industry we see in Enforcement - but I can certainly tell you about the bad and the ugly. I was already planning a movie-themed address, and realized the 1966 Clint Eastwood Western fits right into the theme I want to talk to you about today. "The Good, the Bad and the Ugly" tells the story of three men seeking a fortune in buried coins. Each knows only a piece of the secret of where the coins are buried. They repeatedly double-cross one another, and efficiently dispose of anyone who stands in their way, as they seek to learn the secret location and be the first to unearth the money. The movie is all about the lengths to which they go in their ruthless pursuit to follow the money.

Fast forward 30 years to another movie, "Jerry McGuire." Jerry McGuire is a down on his luck sports agent who is fired from his job and sets out on his own. None of his clients follows him, save one - a soon to be over the hill football player who decides to stick by Jerry but, in the most famous line of the movie, demands that he show him the money. Jerry does so admirably and, in the process, realizes that life is about a lot more than just following the money.

What do these two movies have in common? One could view them both as being about the high price of the single-minded pursuit of money. More broadly, they can both be viewed as examples of how money can create incentives to act in certain ways we perhaps wouldn't want to encourage. And what does that theme have to do with our job in Enforcement? Well, that's where the bad and the ugly come in. In Enforcement we keep learning and relearning that we need

to follow the money in order to identify securities law violations before they become widespread problems in the industry. Following the money has become an essential component of our enforcement program and, frankly, there is nothing new about this idea. In fact, I believe that when it comes to money and conflicts of interest in the financial services industry, there is really nothing new under the sun (or in the shadows, as the case may be). Rather, the conflicts that may be uncovered by following the money usually are variations on age-old themes and our, as well as your, challenge is to identify those new variations promptly, and take appropriate action, before they result in harm to clients.

Before I go further, I need to mention that my views on movies, enforcement, and anything else I might discuss today are my own and do not necessarily reflect the views of the Commission or any other member of the staff.

So how do we follow the money? For us, it means looking at those areas of the industry to which investor dollars are flowing. It also means looking at those areas of firms' businesses in which they or their representatives are subject to the greatest potential conflicts of interest between their own financial interests and those of their clients, and in which controls to address those conflicts may be inadequate. We certainly don't take the view that money is the root of all evil, but it does seem to have an uncanny tendency to be followed on its heels by conflicts and incentives that may potentially harm clients. This can be seen by looking at some of our recent cases in which securities violations resulted from situations in which advisers or their personnel acted on incentives to benefit themselves at the expense of clients or others in the market. Before discussing these cases, I'd like to remind you that we are not the only ones who are following the money - many of these cases came to us as referrals from the Commission's examination program, which is always on the lookout for financial conflicts of interest and other areas that present a heightened risk of legal violations.

One area in which the interests of a mutual fund adviser may be at odds with the interests of its clients is distribution. Mutual fund advisers have a powerful financial incentive to increase their assets under management in order to increase advisory fees and other asset-based fees that flow to affiliates. We have seen problems, however, when advisers face conflicts with respect to payments made for distribution and fail to disclose those conflicts to fund boards. Most recently, we brought a case against BISYS Fund Services, Inc. based on its entering into undisclosed side agreements with mutual fund advisers for the payment of distribution expenses.[2] Prior to that, we brought a series of cases against mutual fund advisers that used fund brokerage to satisfy their own revenue sharing obligations with select broker-dealers, without disclosure of that practice to fund boards or shareholders.[3] I expect these cases won't be the last we see in which mutual fund advisers have found ways to receive, or benefit from, distribution payments without the necessary disclosure to fund boards. We will be on the lookout for variations on this theme, and I urge all of you to do the same. Examine your firm's distribution arrangements and look at where the money is coming from and where it's going. Are these flows consistent with how the distribution arrangements are

disclosed to the board and to investors? Are distribution arrangements adequately described and covered by the funds' 12b-1 plans, to the extent required? Also re-examine non-distribution fees paid by the fund and make sure they are being used as intended and as disclosed to the board and shareholders.

We also remain concerned about advisers using their influence to structure or recommend mutual fund service arrangements in a way that financially benefits the adviser at the expense of the funds. You need only remember our May 2005 case against Citigroup for a troubling example of an adviser structuring a service arrangement to benefit itself, rather than the funds to which it owed a fiduciary duty.[4] I am not suggesting that there is anything wrong with an advisory affiliate profiting from providing services to funds managed by the adviser. It is critical, however, for fund advisers to remain focused on their fiduciary obligations in order to make sure the arrangements they recommend to the fund's board are in the best interests of the fund. When an adviser has a material conflict of interest in recommending a particular arrangement to a fund's board, it has an obligation to make full disclosure of that conflict to the board so that the board can evaluate the arrangement and the implications, if any, of the conflict. There are many ways an adviser or its affiliates could structure service arrangements to benefit themselves at the expense of the funds to which they owe a fiduciary duty. It is important, therefore, to be vigilant in looking for such examples of overreaching and, more importantly, to seek to ensure that your firm has adequate controls in place to seek to ensure such overreaching doesn't occur to begin with.

We have been following the money (and there has been a lot of money to follow) to hedge funds. We continue to see too many examples of fraud by hedge fund managers involving the funds they manage and investors in those funds. These frauds run the gamut - we've seen theft of assets, fraudulent valuations of securities held by the fund, and false information provided to investors about performance and other important matters. While in some cases we find that managers intend from the beginning to pull one over on investors, it appears more common that managers get in over their heads when trading losses mount and try to cover their tracks with lies and deceit in order to keep the money coming in and stem mass redemptions.

We are seeing more and more hedge fund managers engaged in trading violations. These violations include market manipulation,[5] deceptive market timing and late trading,[6] illegal short selling[7] and, of course, insider trading.[8] At the beginning of this month, we filed an insider trading case alleging wide-ranging violations by numerous Wall Street professionals, including two hedge fund managers.[9] Our complaint alleged two overlapping insider trading schemes: one involved trading ahead of upcoming UBS analyst upgrades and downgrades, where the center of the scheme was an executive director in UBS's research department who served on a powerful internal committee dedicated to reviewing and approving the firm's proposed analyst recommendations. The other scheme involved trading ahead of corporate acquisition announcements using information stolen from Morgan Stanley. At the center of that scheme was a lawyer in Morgan Stanley's global compliance department, whose duties included

safeguarding confidential information. We alleged illegal conduct that occurred over five years and involved hundreds of tips, thousands of trades and millions of dollars in illegal profits.

In addition to focusing on frauds committed by hedge fund managers against the funds they manage or their investors, or against others in the market, we remain concerned about the conflicts that may exist when an advisory firm manages hedge funds, or other highly profitable accounts, as well as other client accounts. The manager may have a powerful financial incentive to benefit the hedge fund, and other accounts expected to be especially profitable, over other clients through its trading strategies and allocation practices. In the absence of strong controls, these conflicts may result in cherry-picking, front-running, and similar abuses. Recently, we brought a proceeding against a registered investment adviser, Melhado, Flynn & Associates, Inc., and two of its officers for allegedly engaging in fraudulent trade allocations that benefited a proprietary trading account and a hedge fund client at the expense of other clients, without disclosure to clients of these practices.[10]

Let's talk a little bit about brokerage. Brokerage is a client asset and, under the federal securities laws, must be treated that way. Advisers and their personnel, however, face many temptations to utilize the value of client brokerage in a manner that benefits themselves or their affiliates, at the potential expense of clients. This can take many forms. I mentioned advisers' use of mutual fund brokerage to satisfy revenue sharing obligations. Another way in which the value of client brokerage may be misused is when advisory firm traders accept personal benefits from brokers they use to trade the funds' securities. In our recent case against a broker-dealer representative of Jeffries & Co., Inc., we charged the representative with aiding and abetting and causing certain mutual fund traders' violations of one of the Investment Company Act's conflict of interest provisions.[11] We alleged that the broker-dealer representative provided traders from whom he received substantial brokerage business with extensive travel, and lavish entertainment and gifts.

Similar concerns may be raised in the soft dollar area. Fiduciary principles require investment advisers to seek to obtain best execution for client trades, and limit advisers from using client assets for their own benefit. Investment advisers may, however, legitimately use soft dollars generated by client transactions to obtain research and brokerage services or, under some circumstances, other services. In some of our cases, however, we have uncovered aggressive undisclosed soft dollar practices that violate the law. In our case against the managers of the Fountainhead Fund, LP, a hedge fund, and their investment advisory firm, for example, we alleged that the defendants excessively traded several of the hedge fund's securities accounts for the sole purpose of generating soft dollar credits, which they then withdrew as cash and used for, among other things, their own personal living expenses.[12] Needless to say, they didn't disclose this practice to the fund's investors.

An adviser's best execution duty means that the adviser must seek to execute client transactions so that the client's "total cost or proceeds in each transaction is the most favorable under the circumstances,"

although the adviser may consider a variety of factors in making this determination.[13] Because of the significant value represented by client brokerage, an adviser or its employees may face conflicts of interest in directing how client trades are executed. In the past, we have seen best execution violations by advisers based on, among other things, use of full service brokers when lower cost alternatives were available, unnecessarily interpositioning a broker-dealer between clients and a market maker on OTC trades, and engaging in cross trades in a manner that caused certain clients to pay higher execution costs than other clients.[14] Execution-related conflicts may also result in an adviser's disclosure about its brokerage practices being false or misleading. We have brought many cases against advisers involving situations in which advisers used client brokerage in a manner that benefited themselves without accurate disclosure to clients of their practices.[15]

Still another area in which following the money may lead to potential conflicts of interest is financial incentives to advisory and brokerage representatives to sell certain products or services over others. There is nothing inherently wrong with compensating employees differently for the sale of different products or services, and we understand such practices are common in the industry. Differential compensation practices do, however, have the potential to create incentives for advisory and brokerage employees to sell certain products or services to clients over others in a manner inconsistent with their duties to clients. We have seen examples of this conflict in our revenue sharing cases against broker-dealers in which the firms, and oftentimes the representatives, had an undisclosed financial incentive to sell "preferred" mutual funds over others.[16] We are also concerned about situations in which representatives of a dual registrant sell to clients, in the course of providing advisory services, broker-dealer services and products for which the representative is compensated, without disclosing that conflict clearly to the client. The Commission has stated that "[t]he receipt of commissions by [an] Adviser's principals goes to the core of the delicate relationship between the Adviser's fiduciary relationship to its clients and its own self-interest in obtaining compensation for its services." [17]

We have also brought numerous cases in which an advisory firm or its representative sought proprietary or personal trading profits at the expense of clients.[18] As a fiduciary, an investment adviser has an obligation to place the interests of its clients above its own. This obligation includes not taking an investment opportunity that belongs to a client, or trading for a personal or proprietary account in a way that advantages the adviser or its personnel at the expense of the client without disclosure to, and consent from, the client.

While we are on this topic, I want to mention one of my pet peeves -- firms that turn a blind eye to how big producers are making money. We are seeing too many situations in which a firm's big producers got that way by engaging in conduct that violates the federal securities laws. Sometimes we find the firm turned a blind eye, perhaps not wanting to question the cash cow too closely; other times we find the firm condoned or was actively complicit in its representatives' misconduct. In our recent case against two broker-dealer

representatives of CIBC World Markets and their supervisors, for example, we alleged that the supervisors had extensive knowledge of the representatives' fraudulent market timing activities, yet failed to take action to halt those activities and, in many instances, actively supported them.[19] We alleged that, because the representatives' market timing business was highly profitable, World Markets supported their business and even provided them with the exclusive right to engage in market timing at the firm. Let's be clear: firm management is responsible for seeking to ensure that all firm employees, including its top producers, are complying with the federal securities laws. If we find, in the course of our investigations, that firm management turned a blind eye, or worse, to signs of misconduct by its most lucrative employees, we will seek to hold senior management of the firm, as well as the firm itself, accountable.[20]

I have shared with you today a number of examples of how following the money has led us to violations of the federal securities laws. Greed and money are powerful motivators and, as far as I can tell, they aren't going away any time soon. That being the case, we're not going away any time soon either. I expect variations on the financial conflicts of interest I have described to you today will continue to keep us busy far into the future. As compliance professionals, you have an important role to play in developing and maintaining a compliance program that, among other things, proactively identifies and addresses conflicts of interest. While one reason to do this, of course, is to avoid a possible enforcement action, the other reason, and the one that should be most important to you, is to avoid the harm to your client relationships and reputation that may well result if these conflicts are not adequately identified and addressed -- harm that will inevitably affect your bottom line. As Jerry McGuire, early on in the movie, remembers his mentor advising him and takes to heart by the end, "the key to this business is personal relationships." The same could be said of the investment management business.

Thank you.

Endnotes

[1]The Securities and Exchange Commission disclaims responsibility for any private publication or statement of any SEC employee or Commissioner. This speech expresses the author's views and does not necessarily reflect those of the Commission, the Commissioners, or other members of the staff

[2]*In re BISYS Fund Services, Inc.*, Advisers Act Release No. 2554 (Sept. 26, 2006).

[3]*See, e.g., In re Massachusetts Financial Services Company*, Advisers Act Release No. 2224 (Mar. 31, 2004).

[4]*In re Smith Barney Fund Management LLC and Citigroup Global Markets, Inc.*, Advisers Act Release No. 2390 (May 31, 2005).

[5]*See, e.g., SEC v. Scott R. Sacane, et al.*, Litigation Release No. 19424 (Oct. 12, 2005).

[6]*See, e.g., In re Millennium Partners, L.P., et al.*, Investment Advisers Act release No. 2453 (Dec. 1, 2005); *SEC v. Brent William Federighi and Michael Carl Hoffman*, Litigation Release No. 19510 (Dec. 22, 2005)

[7]*See, e.g., In re Imperium Advisors, LLC*, Advisers Act Release No. 2597 (Mar. 15, 2007); *In re DB Investment Managers, Inc.*, Exchange Act Release No. 51707 (May 19, 2005); *In re Galleon Management, L.P.*, Exchange Act Release No. 51708 (May 19, 2005); *In re Oaktree Capital Management, LLC*, Exchange Act Release No. 51709 (May 19, 2005).

[8]*See, e.g., SEC v. Joseph J. Spiegel*, Litigation Release No. 19956 (Jan. 4, 2007); *Spinner Asset Management, LLC and Spinner Global Technology Fund, Ltd.*, Advisers Act Release No. 2573 (Dec. 20, 2006); *SEC v. Edwin Buchanan Lyon, IV, et al.*, Litigation Release No. 19942 (Dec. 12, 2006) (insider trading violations related to PIPE offerings); *SEC v. Aragon Capital Management LLC, et al.*, Litigation Release No. 19995A (Feb. 13, 2007) (traditional insider trading); *SEC v. Nelson J. Obus, et al.*, Litigation Release No. 19667 (Apr. 25, 2006) (traditional insider trading).

[9]*SEC v. Guttenberg, et al.*, Litigation Release No. 20022 (March 1, 2007).

[10]*In re Melhado, Flynn & Associates, Inc., George M. Motz and Jeanne McCarthy*, Advisers Act Release No. 2593 (Administrative Proceeding File No. 3-12574, Feb. 26, 2007).

[11]*In re Kevin W. Quinn*, Exchange Act Release No. 54862 (Dec. 1, 2006). We also charged the firm and the representative's supervisor with failing reasonably to supervise the representative. *In re Jefferies & Co., Inc. and Scott Jones*, Exchange Act Release No. 54861 (Dec. 1, 2006).

[12]*In re Anthony P. Postiglione, Jr.*, Investment Advisers Act Release No. 2432 (Sept. 21, 2005); *In re William J. Lennon*, Investment Advisers Act Release No. 2433 (Sept. 21, 2005); *SEC v. Anthony P. Postiglione, Jr., et al*, Civil Action No. 04-CV-3604 (E.D. Pa., Sept. 20, 2005) (final judgment as to defendant Fountainhead Asset Management, L.L.C.).

[13]Exchange Act Release No. 23170 (Apr. 23, 1986).

[14]*See, e.g., In re Jamison, Eaton & Wood, Inc.*, Advisers Act Release No. 2129 (May 15, 2003); *In re Portfolio Advisory Services, LLC, and Cedd L. Moses*, Advisers Act Release No. 2038 (June 20, 2002); *In re Renberg Capital Management, Inc. and Daniel H. Renberg*, Advisers Act Release No. 2064 (Oct. 1, 2002).

[15]*See, e.g., In re Fleet Investment Advisors Inc.*, Advisers Act Release No. 1821 (Sept. 9, 1999).

[16]*See, e.g., In re Morgan Stanley DW Inc.*, Securities Act Release No. 8339 (Nov. 17, 2003).

[17]*In re Heine Securities Corporation*, Advisers Act Release No. 1150 (Dec. 28, 1988).

[18]*See, e.g., In re Gerson Asset Management, Inc. and Seth Gerson*, Advisers Act Release No. 2457 (Dec. 2, 2005).

[19]*In re Michael Sassano, Dogan Baruh, Robert Okin, and R. Scott Abry*, Exchange Act Release No. 55208 (Administrative Proceeding File No. 3-12554, Jan. 31, 2007); see also In re Marshall Dornfeld, Exchange Act Release No. 55209 (Jan. 31, 2007).

[20]*See In re Canadian Imperial Holdings Inc. and CIBC World Markets Corp.*, Advisers Act Release No. 2407 (July 20, 2005).

http://www.sec.gov/news/speech/2007/spch032207lct.htm
