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SEC Charges Mutual Fund Directors for Inadequate Valuation Oversight

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On December 10, 2012, the Securities and Exchange Commission (the “SEC”) charged eight former directors (the “Directors”) of five Morgan Asset Management (“MAM”) registered investment companies (“RICs”) with securities laws violations for their role in valuing the RICs’ securities from March 2007 through August 2007. Section 2(a)(41)(B) of the Investment Company Act of 1940, as amended, requires that when market quotations are not readily available in respect of securities held by RICs, the securities must be given a fair value as determined in good faith by the RICs’ boards of directors. Pursuant to SEC guidance, boards of directors are permitted to delegate their responsibility for calculating fair values, pursuant to board-approved policies and procedures. According to the SEC’s Order Instituting Public Administrative and Cease-And-Desist Proceedings (the “Order”), RICs managed by MAM, which included one open-end RIC that had three series and four closed-end RICs, had approximately $3.85 billion in assets under management. The RICs’ assets included mortgage-backed securities and other types of structured products. According to the Order, the Directors delegated their asset pricing duties to MAM and, pursuant to the RICs’ policies and procedures (the “Valuation Procedures”), the MAM valuation committee (the “Valuation Committee”) determined the fair value of securities that did not have available quotations. According to the Order, fair-valued securities made up more than 60 percent of the net asset value for most of the RICs.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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