VAN KAMPEN AMERICAN CAPITAL ASSET MANAGEMENT, INC. Respondent

Admin. Proc. File No. 3-8846

SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISORS ACT OF 1940, Release No. 1525

September 29, 1995

TEXT:

ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest to institute public administrative proceedings pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Van Kampen American Capital Asset Management, Inc. ("American Capital"). n1

> n1 Van Kampen American Capital Asset Management, Inc. was formerly known as American Capital Asset Management, Inc.; as discussed below, the firm's parent company was purchased by and merged into The Van Kampen Merritt Companies, Inc. in late 1994.

II.

In anticipation of the institution of this proceeding, American Capital has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of this proceeding, and any other proceeding brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the matters set forth herein, except that American Capital admits the jurisdiction of the Commission over it and over the subject matter of this proceeding and paragraphs III A. and III B., American Capital consents to the issuance of this Order Instituting Proceedings, Making Findings and Imposing Remedial Sanctions ("Order"), and to the entry of the findings and the order set forth below.

Accordingly, IT IS ORDERED that an administrative proceeding pursuant to Section 203(e) of the Advisers Act be, and hereby is, instituted.

III.

On the basis of this Order and the Offer submitted by American Capital, the Commission finds that: n2

> n2 The findings herein are made pursuant to American Capital's Offer of Settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

Respondent

A. American Capital is a Delaware corporation located in Houston, Texas, and has been registered with the Commission as an investment adviser pursuant to Section 203(c) of the Advisers Act since April 6, 1958. American Capital is now a subsidiary of Van Kampen American Capital, Inc. In December 1994, the adviser's parent company was purchased by and merged into The Van Kampen Merritt Companies, Inc.; the surviving entity changed its name to Van Kampen American Capital, Inc.

Other Relevant Entity and Individual

B. American Capital Federal Mortgage Trust ("ACFMT" or the "Fund") located in Houston, Texas, has been registered with the Commission as an investment company pursuant to Section 8 of the Investment Company Act of 1940 ("ICA") since November 21, 1985. American Capital has served as the investment advisor to ACFMT from May 1986 to the present.

C. Thomas M. Rogge ("Rogge") was employed by American Capital as a vice president and the portfolio manager for ACFMT from January 1991 until September 2, 1993.

Summary

D. This proceeding involves the intentional mispricing of certain derivative securities held in the portfolio of ACFMT, known as Planned Amortization Class Interest Only ("PAC IO") securities, by the Fund's portfolio manager, Rogge. During the period from August 4 to August 26, 1993, Rogge deliberately mispriced as many as five of the PAC IOs in an attempt to conceal their declining value in violation of the federal securities laws. By the time American Capital discovered the scheme on August 27, 1993, the PAC IOs were overvalued by as much as $ 6.88 million and the Fund was calculating an inflated net asset value by as much as 76 cents per share. American Capital had inadequate policies and procedures in place to detect and prevent Rogge's violations. As a result, American Capital failed reasonably to supervise Rogge with a view to preventing his violations of Section 34(b) of the ICA and willful aiding and abetting violations of Section 31(a) of the ICA and Rules 22c-1(a) and 31a-1 thereunder and Sections 206(1) and (2) of the Advisers Act.

Background

E. After consulting with his supervisors in general about the appropriateness of PAC IO securities for the Fund, during the period from September 1992 through August 1993, Rogge purchased PAC IOs for the Fund's portfolio. As of August 4, 1993, the Fund held seven PAC IOs in its portfolio constituting 21.4 percent of the Fund's total net assets. n3

> n3 The following seven PAC IOs were held in the Fund's portfolio as of August 4, 1993: FH 1393 K, FN 92-187 JA, FN 92-193 JB, FN 93-15 L, FN 92-23 PL, FN 92-156 G, and FH 1385 K.

F. According to ACFMT's policies and procedures, as stated in its prospectus and Statement of Additional Information ("SAI"), the Fund was required to determine the market value of its PAC IO holdings, as well as certain other portfolio securities, by obtaining daily bid side market prices from broker-dealers. Prices for the PAC IOs were recorded on daily derivative pricing sheets and were submitted to American Capital's accounting department, which used this information to calculate the Fund's daily net asset value. The responsibility for oversight of the daily security pricing process for ACFMT's portfolio securities, including the manual pricing of PAC IOs, was shared by ACFMT's portfolio manager and his investment assistants. Either Rogge or one of his investment assistants obtained daily prices for the Fund's PAC IOs from approximately five broker-dealers.

Falsification of the Fund's Books and Records and Aiding and Abetting the Fund's Pricing Violation

G. On or about March 31, 1993, two registered broker-dealers ceased providing daily prices to the Fund for four PAC IOs in the Fund's portfolio. Instead of obtaining bid side market prices from other broker-dealers as required by the Fund's prospectus and SAI, Rogge began pricing the four PAC IOs himself on a daily basis. n4 During that time, he falsified the Fund's daily pricing sheets by indicating that the prices had been obtained from the two formerly participating broker-dealers rather than indicating that he was the source of the prices. Moreover, from August 4 through August 26, 1993, Rogge provided the Fund with prices for the 93-15 L PAC IO that were materially higher than bid side market prices and recorded or caused these inflated prices to be recorded on the Fund's daily pricing sheets. Accordingly, Rogge willfully violated Section 34(b) of the ICA.

n4 Specifically, Rogge priced the FN 92-15 L PAC IO from at least March 31, 1993 until August 26, 1993, the 92-187 JA PAC IO from at least March 31, 1993 until August 4, 1993, and the FN 92-193 JB and FN 92-156 G PAC IOs from at least March 31, 1993 until August 17, 1993.

H. At various times during the period from August 4 to August 26, 1993, Rogge supplied a registered representative at a broker-dealer with pricing assumptions (i.e., spreads to U.S. Treasury securities and mortgage prepayment rates) for between one and three of the PAC IOs held in the Fund's portfolio. n5 At Rogge's request, the registered representative utilized the assumptions Rogge provided, rather than consulting with the broker-dealer's trading desk, to price the PAC IOs.

n5 Rogge provided pricing assumptions for the FH 1385 K PAC IO during the period from August 4 to August 26, 1993. Similarly, during the period from August 17 to August 26, 1993, Rogge supplied the registered representative with pricing assumptions for the FN 92-193 JB and FN 92-156 G PAC IOs held in the Fund's portfolio.

I. Similarly, during the period from August 4 to August 10, 1993, Rogge convinced a registered representative at another broker-dealer to provide him with prices for two PAC IOs in the Fund's portfolio based upon assumptions he provided, rather than consulting with the broker-dealer's trading desk. n6 Beginning on August 10, 1993, and continuing until August 26, 1993, Rogge obtained offered, rather than bid side, daily market prices for these two PAC IOs from the registered representative, based upon pricing assumptions he provided.

n6 Specifically, the FN 93-23 PL and FN 92-187 JA PAC IOs.

J. As a result of Rogge's actions, the prices obtained from the two broker-dealers, as calculated based on assumptions which he provided, or offered side market prices, were materially higher than the actual bid side market prices for these securities. By obtaining offered, rather than daily bid side market prices, Rogge violated the Fund's policies and procedures, as set forth in its prospectus and SAI, which required the PAC IOs to be priced at bid side market prices. Rogge caused the inflated prices for these five PAC IOs to be recorded on the Fund's daily pricing sheets. These inflated prices, as obtained by Rogge, in addition to the inflated prices provided by Rogge for the FN 93-15 L PAC IO, were then utilized for calculating a materially inaccurate and inflated daily net asset value for the Fund.

K. By causing the Fund to use inflated prices for the PAC IOs, securities for which market quotations were readily available, Rogge caused the Fund to calculate its net asset value on inflated values rather than the current market value of the Fund's portfolio securities as required by Section 2(a)(41) of the ICA and Rule 2a-4 thereunder. As a result of the aforementioned conduct, Rogge caused the Fund to calculate an incorrect daily net asset value resulting in the Fund's sale and redemption of 290,000 and 562,000 shares, respectively, at an inflated price and caused the Fund to improperly maintain its books and records in support of its financial statements from August 4 through August 26, 1993. Accordingly, Rogge willfully violated Section 34(b) of the ICA and aided and abetted the Fund's violations of Section 31(a) of the ICA and Rules 22c-1 and 31a-1 thereunder. Rogge's actions also defrauded the Funds and its shareholders. As a result, Rogge willfully aided and abetted violations of Sections 206(1) and 206(2) of the Advisers Act.

Discovery of the Scheme

L. Based upon their review of the PAC-IO securities held by the Fund in July 1993, Rogge's supervisors instructed him to immediately begin to systematically reduce the PAC-IO position in the Fund and, if certain market conditions developed, to expedite the sale of the PAC IOs. Three PAC IOs were sold between July 16 and August 2, 1993 at prices approximating their market value. On August 24, 1993, the pre-defined market conditions occurred but Rogge took no action to reduce the Fund's position in the PAC IOs at that time. When Rogge failed to act, his immediate supervisor ordered him to sell at least one of the PAC IOs by the end of the day on August 26, 1993. As instructed, Rogge liquidated one PAC IO at approximately 4:00 p.m. that day. The selling price for this PAC IO was approximately 30 percent less than the previous day's price that had been used in the Fund's net asset value calculation. Rogge's

immediate supervisor discovered the scheme on August 27, 1993 after conferring with the registered representatives that had supposedly been pricing the Fund's PAC IOs.

M. On Monday, August 30, 1993, American Capital notified the Fund's Board of Trustees and the Commission staff of the PAC IO pricing situation. American Capital elected to sell the remaining PAC IOs and reimburse the Fund. As a result of the sale of the PAC IOs, the Fund suffered a loss of $ 6.88 million, which was reimbursed by American Capital out of its own assets. A further consequence of the scheme was that the Fund incorrectly calculated its net asset value by as much as 76 cents per share from at least between August 4 through August 26, 1993. American Capital fired Rogge on September 2, 1993.

American Capital's Failure to Supervise Rogge

N. American Capital did not establish procedures, or a system for applying such procedures, which could reasonably have been expected to prevent or detect Rogge's violations. Specifically, American Capital had no written procedures to implement the Fund's policy to use bid side market prices for valuing securities with current market quotations available, such as the PAC IOs. n7 The firm's practices concerning the daily pricing of the portfolio were insufficient in that they, among other things, gave Rogge too much control over the pricing process with little or no oversight by anyone in a supervisory capacity. In addition, there was no procedure in place to alert American Capital when bid side market prices for securities were not available. American Capital did not independently verify the daily prices provided to American Capital's accounting department with the pricing source or any secondary sources.

> n7 According to American Capital's internal policy, the Fund's prospectus and SAI were considered to be the primary compliance documents for portfolio managers. Although the prospectus and SAI do provide guidelines and restrictions applicable to the Fund, these documents do not specify internal controls and procedures necessary to ensure compliance with those requirements.

O. American Capital's failure to have written procedures, or a system for applying such procedures, enabled Rogge to choose broker-dealers for daily pricing purposes, to change pricing sources without approval from his supervisors, to directly obtain daily prices from broker-dealers, and to record prices on the Fund's daily derivative pricing sheets without any verification by a third party.

P. Pursuant to Section 203(e)(5) of the Advisers Act, the Commission can impose sanctions on any investment adviser for failure reasonably to supervise, with a view to preventing violations, any person who commits a violation of the federal securities laws or any rules and regulations thereunder if that person is subject to the adviser's supervision. The aforementioned policies and procedures of American Capital were inadequate reasonably to detect and prevent Rogge's violations. For this reason, American Capital failed reasonably to supervise Rogge with a view to preventing his violations of the federal securities laws.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions which are set forth in the Offer submitted by American Capital. In determining to accept the Offer, the Commission has considered remedial acts undertaken by American Capital and cooperation afforded the Commission staff.

Accordingly, IT IS HEREBY ORDERED THAT:

A. American Capital shall be, and hereby is, censured;

B. American Capital shall certify, contemporaneously with the entry of this Order, that it has previously adopted and implemented comprehensive written policies and procedures reasonably

designed to ensure compliance with Section 2(a)(41) of the ICA and Rule 22c-1 thereunder, and that it will undertake to maintain and comply with such policies and procedures; and

C. American Capital shall pay a civil penalty, in the amount of $ 50,000, within five days of the issuance of this Order to the United States Treasury, pursuant to Section 203(i) of the Advisers Act. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check, or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered to the Comptroller, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549; and (D) submitted under cover letter which identifies American Capital as Respondent in these proceedings, the file number of these proceedings, and the Commission's case number (FW-1978), a copy of which cover letter and money order or check shall be sent to T. Christopher Browne, District Administrator, Fort Worth District Office, Securities and Exchange Commission, 801 Cherry Street, 19th Floor, Fort Worth, Texas 76102.

By the Commission.