

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 1741 / August 12, 1998

ADMINISTRATIVE PROCEEDING File No. 3-9673

In the Matter of NICHOLAS-APPELGATE CAPITAL MANAGEMENT, A CALIFORNIA LIMITED PARTNERSHIP, Respondent

ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDING, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that a public administrative and cease-and-desist proceeding be instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Nicholas-Applegate Capital Management, a California Limited Partnership ("NACM").

Accordingly, IT IS HEREBY ORDERED that an administrative and cease-and-desist proceeding against NACM be, and hereby is, instituted.

II.

In anticipation of the institution of this proceeding, NACM has submitted an offer of settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the Commission's findings contained herein except that NACM admits the jurisdiction of the Commission over it and over the subject matter of this proceeding, NACM consents to the issuance of this Order Instituting Public Administrative and Cease-and-Desist Proceeding, Making Findings and Imposing Remedial Sanctions ("Order").

III.

On the basis of this Order and the Offer, the Commission makes the following findings[1]:

A. Nicholas-Applegate Capital Management, a California Limited Partnership ("NACM"), whose principal place of business is in San Diego, California, is registered with the Commission as an investment adviser (File No. 801-21442). In 1985, NACM established, for the benefit of all its employees, a defined contribution profit sharing retirement plan (the "NACM Employee Plan"), under the Employment Retirement Income Security Act. NACM acted as the NACM Employee Plan's adviser. From 1991 through July 1993, the assets of the NACM Employee Plan grew in value from \$1.7 million in January 1991 to \$4.2 million in July 1993, and the major beneficiaries of the Plan were NACM's senior management.

B. NACM's head trader (hereinafter referred to as the "Senior Trader") was an associated person of NACM from approximately 1985 through July 1993, when he left NACM's employment. From 1991 through July 1993, the Senior Trader was the portfolio manager, as well as the trader, for the NACM Employee Plan. The Senior Trader had no portfolio manager responsibilities for any other NACM client account.

C. From 1991 through July 1993, the Senior Trader violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act by failing to disclose his conflict of interest in fraudulently allocating profitable equity day

trades[2] to his personal accounts rather than to the NACM Employee Plan, which is described more fully in D-G below. Moreover, the Senior Trader aided and abetted NACM's violations of Section 204 of the Advisers Act and Rule 204-2(a)(12) thereunder (described more fully in M & O below), by failing to report completely and accurately his personal trading to NACM.

The Senior Trader's Investment Strategy

D. The Senior Trader invested the NACM Employee Plan's portfolio primarily in investment grade fixed income securities, and to some extent engaged in a day trading investment strategy. From January 1991 through July 1993, while managing the NACM Employee Plan, the Senior Trader also actively day traded in several personal securities trading accounts held in his or his wife's name[3] (collectively referred to as the Senior Trader's "personal accounts").

The Senior Trader's Allocation of Trades

E. While the Senior Trader was at NACM, it was NACM's practice to report buys and sells of the same security within the same day after the buy and sell were executed and the prices received by the trading desk. As the trader and portfolio manager for the NACM Employee Plan, the Senior Trader was in a position to know whether a security bought and sold within the same day was profitable or unprofitable before reporting it to NACM's back office. Notwithstanding NACM's policies and procedures then in effect (Section I below), NACM had no other employee review the Senior Trader's investment decisions prior to his executing an order for the NACM Employee Plan or for his personal accounts. NACM's procedures for reporting trades gave the Senior Trader the opportunity to allocate a buy and sell of the same security within the same day to the NACM Employee Plan or to one of his personal accounts without anyone's consent or knowledge at NACM.[4]

F. NACM's allocation procedures with respect to the NACM Employee Plan allowed the Senior Trader to use the intervening market movement between placing an order and allocating such order to the NACM Employee Plan to assess whether the trade was profitable. If a trade was profitable, he could allocate it to his personal account and never report it to NACM's back office. Conversely, if a trade was unprofitable, he could allocate it to the NACM Employee Plan and report it to NACM's back office. The Senior Trader's practices resulted in day trades in his personal accounts being significantly more profitable than day trades in the NACM Employee Plan. The Senior Trader never disclosed the conflict of interest these trading practices presented to his client, the NACM Employee Plan.

The Senior Trader's Performance in the NACM Employee Plan and His Personal Accounts

G. From January 1991 through July 1993, while both the Senior Trader's personal accounts and the NACM Employee Plan engaged in day trading, day trades in the same securities in the Senior Trader's personal accounts were significantly more profitable than day trades in the NACM Employee Plan. For day trades in the account of the NACM Employee Plan within 21 days of day trades in the same securities in the Senior Trader's personal accounts: 1) the Senior Trader had 212 profitable trades (approximately 94%) and 14 unprofitable trades (approximately 6%), which resulted in a net profit of approximately \$1.5 million[5]; and 2) the NACM Employee Plan had 111 profitable trades (approximately 41%) and 159 unprofitable trades (approximately 59%), which resulted in a net loss of over \$232,000.

NACM Failed Reasonably to Supervise the Senior Trader

H. NACM, by appointing the Senior Trader to manage and trade the NACM Employee Plan, placed the Senior Trader in a conflict of interest position. NACM did not establish adequate procedures, or an adequate system for implementing such procedures, to ensure that potential conflicts of interest were properly monitored. For instance, NACM had no procedures for someone other than the Senior Trader to review the Senior Trader's investment and allocation decisions to ensure that he did not improperly allocate trades to his personal accounts to the detriment of the NACM Employee Plan.

I. NACM's policies and procedures required portfolio managers, traders, and the Senior Trader to work in a single room within close proximity of each other. NACM's policies and procedures further required employees, prior to personally trading, to obtain pre-clearance from someone at the trading desk to determine whether a personal trade created a conflict with an existing client trade. These policies, however, did not adequately address the review of personal trades by the Senior Trader. From January 1991 through the Senior Trader's departure from NACM in July 1993, the Senior Trader, an assistant senior trader, and a trading assistant comprised the trading desk. The assistant senior trader did not recall the Senior Trader ever asking him for approval. NACM, by not having any procedures requiring someone other than the Senior Trader to pre-approve his own requests to personally trade, placed the Senior Trader in a conflict of interest position.

J. From January 1991 through July 1993, the Senior Trader, at times, day traded in the same securities as the NACM Employee Plan. Due to NACM's lack of an effective review of the Senior Trader's personal trading, the Senior Trader was able to trade in the same securities as the NACM Employee Plan without NACM's knowledge, and then allocate the profitable trades to his personal accounts.

K. NACM's policies prohibited employees from trading in the same securities in conflict with client accounts. In December 1992, NACM, as a result of its review of employee personal trading, changed its policies to prohibit day trading (which it then defined as buying and selling the same security within seven days) in employee personal accounts. Notwithstanding this prohibition, the Senior Trader continued to day trade through his undisclosed wife's account.

L. From January 1991 through the Senior Trader's departure in July 1993, NACM had no written procedures or guidelines specifically for comparing the Senior Trader's personal trades to trades in the NACM Employee Plan or for identifying conflicts of interest between his trades and the trades in the NACM Employee Plan. NACM's Compliance Officer never identified any conflicts of interest or other violations of NACM's policies by the Senior Trader. Specifically, NACM's Compliance Officer never discovered that from January 1991 through July 1993, the Senior Trader placed a substantial number of trades in the same securities on the same day in the NACM Employee Plan and in his personal accounts.

M. Furthermore, a substantial number of the Senior Trader's Personal Securities Transaction Reports (which NACM required its employees to complete regarding their monthly personal trading) from January 1991 through July 1993 were incomplete and/or lacked some of the information required by NACM. NACM's consistent failure to obtain the Senior Trader's completed monthly trading reports resulted in NACM's maintaining incomplete books and records of its employees' personal trading.

N. In mid-1992, NACM requested that its Compliance Officer review the Senior Trader's personal trading activity for "conflicts." NACM's Compliance Officer performed a review in mid-1992 and found no conflicts. As discussed above, from 1991 through July 1993, the Senior Trader placed trades in the same securities on the same day in the NACM Employee Plan and in his personal accounts, which represented a repeated conflict of interest between his personal trading and the NACM Employee Plan's trading.

O. As discussed above, as a result of NACM's review of employee personal trading, in December 1992, NACM banned day trading for all its employees. Despite this ban, and without NACM's knowledge, the Senior Trader continued his personal day trading in his wife's name after December 1992. Additionally, several of the Senior Trader's Personal Securities Transaction Reports were incomplete from December 1992 until he left NACM's employment in July 1993.

NACM Failed Reasonably to Supervise the Senior Trader with a View Toward Preventing His Violations of the Federal Securities Laws

P. Section 203(e)(6) of the Advisers Act authorizes the Commission to sanction an investment adviser for failing reasonably to supervise a person under his or her supervision who has committed a violation of the federal securities laws or rules thereunder. In the Matter of Alliance Capital Management, L.P., Advisers Act Release No. 1360, (Apr. 28, 1997); In the Matter of Ronald V. Speaker and Janus Capital Corp., Advisers Act Release No. 1605, (Jan. 13, 1997); In the Matter of Van Kampen American Capital

Asset Management, Inc., Advisers Act Release No. 1525, (Sept. 29, 1995); In the Matter of Kemper Financial Services, Inc., Advisers Act Release No. 1387, (Oct. 20, 1993).

Q. As described in §§ D-O, NACM failed reasonably to supervise the Senior Trader with a view toward preventing his violations of the federal securities laws by placing the Senior Trader in a conflict of interest position with respect to the NACM Employee Plan without establishing adequate procedures to ensure these conflicts of interest were properly monitored and failing to institute adequate procedures to review and supervise the Senior Trader's personal trading.

NACM Violated Section 204 of the Advisers Act and Rule 204-2(a)(12) Thereunder

R. Section 204 of the Advisers Act and Rule 204-2(a)(12) thereunder require an investment adviser to make and keep true, accurate, and current a record of every transaction in a security which the investment adviser or any advisory representative of the investment adviser has any "direct or indirect beneficial ownership." These reporting requirements were enacted primarily to expose improper trading practices that might give rise to conflicts of interest. In the Matter of Chancellor Capital Management, Inc., Advisers Act Release No. 1447, (Oct. 18, 1994); In the Matter of Joan Conan, Advisers Act Release No. 1446, (Sept. 30, 1994); American Syndicate Advisers, SEC No-Action Letter, (Oct. 29, 1986).

S. NACM willfully violated Section 204 and Rule 204-2(a)(12) thereunder by failing to maintain accurate and complete records of the Senior Trader's personal trading for a substantial number of the months from February 1991 through July 1993, as described in §§ M & O. Moreover, NACM's procedures were inadequate to promote compliance by the Senior Trader with its reporting requirements and the firm failed to use reasonable diligence to address the repeated deficiencies in the Senior Trader's reporting, as described in §§ M & O.

IV.

Based on the foregoing, the Commission finds that:

A. NACM failed reasonably to supervise the Senior Trader, within the meaning of Section 203(e)(6) of the Advisers Act, with a view toward preventing his violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act, and his aiding and abetting violations of Section 204 of the Advisers Act and Rule 204-2(a)(12) thereunder; and

B. NACM willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(12) thereunder.

Accordingly, the Commission deems it appropriate and in the public interest to impose the remedial sanctions specified in NACM's Offer. Therefore, effective immediately, IT IS HEREBY ORDERED that:

(1) NACM be censured;

(2) NACM cease and desist from committing or causing violations and any future violations of Section 204 of the Advisers Act and Rule 204-2(a)(12) thereunder;

(3) NACM pay a civil money penalty in the amount of \$250,000 to the United States Treasury pursuant to Section 203(i)(2)(C) of the Advisers Act within 30 days from the date of entry of the Order. 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 or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA22312; and (d) submitted under cover letter that identifies NACM as a respondent in this proceeding (a copy of the cover letter and money order or check shall be sent to Lisa A. Gok, Assistant Regional Director, in the Commission's Pacific Regional Office); and

(4) NACM maintain and implement procedures reasonably designed to supervise its employees with a view toward preventing and detecting the violations noted in III.C.

By the Commission.

Jonathan G. Katz
Secretary

FOOTNOTES

[1]: The findings herein are made pursuant to NACM's Offer of Settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

[2]: The term "day trading," in this context, refers to the investment strategy of buying and selling the same security on the same day (and, in a few limited instances, within a few days).

[3]: The Senior Trader never disclosed to NACM the existence of his wife's account.

[4]: The Senior Trader was able to allocate the equity day trades between his personal accounts and the NACM Employee Plan because of: 1) the type of brokerage accounts he established for his personal accounts; 2) the manner in which he placed incoming orders at various brokerage firms for his personal accounts and the NACM Employee Plan; and 3) the manner in which various brokerage firms he placed orders with recorded incoming orders.

[5]: Of this amount, at least \$800,000 of profits were never reported to NACM by the Senior Trader in his monthly transaction reports.