UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 1848 / December 22, 1999

INVESTMENT COMPANY ACT OF 1940
Release No. 24218 / December 22, 1999

ADMINISTRATIVE PROCEEDING
File No. 3-10121

In the Matter of SCUDDER KEMPER INVESTMENTS, INC., and GARY PAUL JOHNSON, Respondents.

ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, IMPOSING REMEDIAL SANCTIONS AND CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (the "Advisers Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (the "Investment Company Act") against Scudder Kemper Investments, Inc. (the "registrant"), and pursuant to Section 203(f) of the Advisers Act against Gary Paul Johnson ("Johnson") (collectively, the "Respondents").

II.

In anticipation of the institution of these administrative proceedings, the Respondents have submitted Offers of Settlement ("Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. Section 201.100 et seq., and without admitting or denying the findings contained herein, except those findings pertaining to the jurisdiction of the Commission over them and over the subject matter of these proceedings, which they admit, the Respondents each consent to the entry of this Order Instituting Proceedings, Making Findings, Imposing Remedial Sanctions and Cease-and-Desist Order ("Order").

III.

On the basis of this Order and the Offers submitted by the Respondents, the Commission finds that:1

A. Relevant Person and Entities

1. The registrant is registered with the Commission as an investment adviser pursuant to Section 203(c) of the Advisers Act (File No. 801-252). The registrant is headquartered in New York, N.Y., and operates principally from offices in Boston, New York, N.Y., and Chicago. The registrant manages more than $280 billion in assets for mutual fund investors, retirement and pension plans, institutional and corporate clients, insurance companies, and private family and individual accounts. 2

2. Johnson, 50, was employed by the registrant from December 1987 to January 1999 and, at all relevant times, was responsible for supervising the registrant's derivatives trading desk in Boston.

3. Scudder Short Term Bond Fund, a diversified series of Scudder Funds Trust (File No. 811-3229), is an open-end management investment company that commenced operations on April 2, 1984. The Short Term Bond Fund's assets totaled approximately $1.17 billion on January 1, 1998.

B. Facts

1. Summary

This matter arises from unauthorized trading by a former trader at the registrant's Boston derivatives trading desk (the "trader") who violated applicable trading limits in a number of institutional accounts managed by the registrant. The registrant and Johnson, the trader's direct supervisor, failed reasonably to supervise the trader and the registrant failed accurately to keep and maintain required books and records. From at least July 1997 through October 9, 1998, the trader initiated over one hundred unauthorized derivatives transactions in twelve institutional accounts, including the accounts of several participating registered investment companies. Although the trader had been given limited discretion to execute a derivatives trading strategy in those accounts, he repeatedly ignored loss limits and other limits on that discretion established by the portfolio managers.3 The trader concealed his activities by miscoding order tickets, forging the signatures of the portfolio managers on order tickets and, in many instances, by not submitting any order ticket at all. The trader's misconduct resulted in losses of more than $16 million and rendered inaccurate and incomplete the registrant's books and records. The trader's unauthorized trading was not consistent with portfolio manager presentations to several participating investment companies regarding risk levels associated with the registrant's derivatives trading, because it caused the investment companies to be exposed to a higher level of risk than that regarded by the portfolio managers as appropriate, as reflected by the trading limits they established. In addition, the registrant, through Johnson, failed reasonably to supervise the trader because Johnson failed to detect or prevent the trader's failure to submit order tickets, his forgery of portfolio managers' signatures on order tickets, and his continued trading after he had exceeded the portfolio managers' loss limits. Moreover, the registrant's controls and procedures were not designed reasonably to prevent and detect the trader's activities.

2. The Trading Program

In September 1996, Johnson, the head of derivatives trading, was principally responsible for implementing a formal derivatives trading strategy referred to at the registrant as the "fixed income derivatives overlay" program (the "overlay program"). The overlay program was a hedging strategy, designed to improve the risk-return profiles of fixed-income portfolios by taking advantage of short-term movements in the U.S. Treasury futures market. As designed, the overlay program was consistent with portfolio manager presentations to several registered investment companies that derivatives were not used to expand the total risk characteristics of the investment companies beyond those regarded as appropriate. As it developed, the overlay program came to involve, almost exclusively, short sales of 30-year Treasury Bond futures traded on the Chicago Board of Trade, mostly in intraday transactions (i.e., transactions in which the positions were closed out at the end of the day on which they were opened). This trading program was different from other derivatives trading at the registrant in that portfolio managers who chose to participate did not initiate trades themselves, but gave limited discretion to the derivatives trading desk to initiate the trades, subject to certain limitations imposed by the portfolio managers. Johnson gave the trader, who had been at the registrant's Boston office for over a decade, responsibility for exercising that limited discretion. The registrant's compliance department did not review the policies and procedures relating to the overlay program before it was implemented.

When the overlay program was introduced, Johnson recommended that each portfolio manager establish the following categories of limits on discretion for each participating account: (1) a limit on types of derivatives traded; (2) a limit on the risk measured in duration years or Value-at-Risk percentage of the portfolio; and (3) a monthly basis point loss limit. The portfolio managers for all of the participating accounts imposed a monthly basis point loss limit on overlay trades, which varied from 3 to 15 basis points. In any month when the trader lost an amount equal to the basis point limit, measured against the total net asset value of the account as of the prior month's end, the trader was to cease overlay trading for the month unless expressly authorized by the portfolio manager to continue. Restrictions

imposed by some participating portfolio managers also included restrictions on the maximum effect that the transactions could have on account duration (effectively a restriction on the number of futures contracts that could be purchased or sold) and on the losses that could be incurred on any individual transaction. Johnson, not the portfolio managers, was responsible for supervising the trader's overlay trading and ensuring that the limits placed on the trading were followed.

3. Trading in Excess of Applicable Limits

On numerous occasions during the period from July 1997 through October 9, 1998, the trader disregarded overlay program limits for a number of participating accounts. The trader concealed his unauthorized trading by making it appear that many of the overlay transactions were not overlay transactions, but rather regular derivatives trades that were not subject to the overlay program limits. The trader accomplished this by forging portfolio managers' signatures on order tickets, miscoding overlay trades on order tickets as non-overlay trades and, for a substantial number of trades, failing to submit order tickets.4 The Short Term Bond Fund, which began participating in the overlay program in the fall of 1997, suffered the greatest losses as a result of the trader's unauthorized activities. The trader exceeded loss limits and other overlay trading limits established by the portfolio manager for the Short Term Bond Fund, resulting in losses in excess of those limits totaling more than $12.9 million. During a one year period, the trader executed over 1,100 derivatives trades in the Short Term Bond Fund account. The order tickets for most of those trades were forged, miscoded or not submitted. By the time the registrant discovered the trader's misconduct in October 1998, the trader also had caused more than $3.3 million in losses in eleven other accounts. Upon discovering the trader's conduct, the registrant halted the overlay program and subsequently agreed to reimburse the losses in all affected accounts.

The trader's unauthorized trading was not consistent with portfolio manager presentations to several participating investment companies regarding risk levels associated with the registrant's derivatives trading, because it caused the investment companies to be exposed to a higher level of risk than that regarded by the portfolio managers as appropriate, as reflected by the trading limits they established. The trader therefore caused the portfolio managers' presentations to the investment companies to be false and misleading as to a material fact. By virtue of his conduct, the trader willfully violated Section 34(b) of the Investment Company Act, and willfully aided and abetted and caused violations of Sections 204, 206(1) and 206(2) of the Advisers Act and Rule 204-2(a)(3) thereunder, and Section 31(a) of the Investment Company Act and Rule 31a-1(b)(6) thereunder.

4. Johnson's Supervision of the Trader's Conduct

Johnson was responsible for supervising both the trader and the overlay program through, among other things, the daily review and reconciliation of order tickets and the review of daily derivatives summary reports ("Summary Reports"). Based on his review of the order tickets, which were to be signed by the portfolio managers for non-overlay trades and by Johnson for overlay trades, and the Summary Reports, which reflected all derivatives transactions (both overlay and non-overlay) executed during the day, Johnson knew or should have known of certain significant irregularities in the overlay trading. For example, on numerous occasions, the Summary Reports reflected transactions coded as overlay trades that appeared to violate duration limits in the affected accounts because they showed that the trader had bought or sold more than the maximum number of contracts allowed by the portfolio managers of the participating accounts. Johnson did not detect those irregularities. Moreover, despite his responsibility for reconciling the Summary Reports with the order tickets, Johnson also failed to detect or follow up on the trader's failure to turn in order tickets for a majority of the trades in the participating accounts.

5. The Registrant's Lack of Reasonable Controls and Procedures Relating to the Overlay Program

The registrant failed to have in place adequate controls to detect and prevent the trader's misconduct. In particular, the procedures and controls established for the overlay program were deficient in that portfolio managers were not given sufficient information to effectively monitor the trader's activities in

their accounts, such as the Summary Reports, copies of order tickets or any other documents or reports reflecting the trade-by-trade details of the trader's intraday derivatives transactions. The portfolio managers therefore were not in a position to determine that the trader was entering orders under their names by forging their signatures and miscoding transactions on order tickets. 5

Moreover, the registrant's existing supervisory and monitoring structure for derivatives trading in general was inadequate to prevent or detect the trader's activities because it relied too heavily on traders accurately to self-report and code transactions. Like the overlay program, the registrant's general derivatives procedures failed to require that trade-by-trade detail for all trades be distributed to the portfolio managers, who were in the best position to detect trading in excess of the limits they established in their accounts. The registrant further failed to develop any comprehensive report from which the portfolio managers effectively could monitor the intraday derivatives trading in their accounts.6

C. Legal Analysis

1. Sections 203(e)(6) and 203(f) of the Advisers Act

Section 203(e)(6) of the Advisers Act authorizes the Commission to impose sanctions against an investment adviser if that adviser, or any associated person, has failed reasonably to supervise, with a view to preventing violations of the provisions of federal securities laws and rules thereunder, another person who commits such a violation, if that person is subject to the adviser's or associated person's supervision. Section 203(f) of the Advisers Act provides for sanctions against associated persons for the same conduct. "The Commission has repeatedly emphasized that the duty to supervise is a critical component of the federal regulatory scheme." Rhumbline Advisers, Advisers Act Rel. No. 1765, (Sept. 29, 1998) (citing John H. Gutfreund, Exchange Act Rel. No. 31554, 52 SEC Docket 4370, 4386 (Dec. 3, 1992)). Sections 203(e)(6)(A) and 203(e)(6)(B) of the Advisers Act provide an affirmative defense to failure to supervise liability for investment advisers that demonstrate that they have established (and complied with) procedures reasonably designed to prevent and detect the violations at issue.7

a. The Registrant Failed Reasonably to Supervise the Trader

As discussed below, the registrant, through its associated person Johnson, failed reasonably to supervise the trader. See, e.g., RhumbLine Advisers, Advisers Act Rel. No. 1765, 68 SEC Docket 276 (Sept. 29, 1998) (investment adviser and principal both "failed reasonably to supervise [trader], who was subject to their supervision within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing his violations" of the federal securities laws).

Moreover, the registrant cannot avail itself of the statutory defense to a failure to supervise charge, because it failed to have in place procedures reasonably designed to prevent and detect the trader's violations. It is incumbent on firms seeking to assert the statutory defense that they not only have reasonable procedures in place, but also that they have reasonable systems and reporting structures for monitoring the application of those procedures. Moreover, given the number of recent instances of investment advisory firms and their clients suffering significant losses as a result of the actions of long-term senior employees,8 it is essential that the procedures and the system for applying those procedures are reasonably designed, under the circumstances of the investment strategies employed by the firms, to detect and prevent violations of the federal securities laws by even their most experienced employees.

The registrant's controls for both the overlay program, a new derivatives trading strategy, and derivatives trading in general were not reasonably designed to prevent and detect the trader's activities because they relied on the trader to self-report without adequate independent verification, thereby allowing the trader to circumvent the restrictions on the strategy and the supervision and controls in place on his activities. See First Capital Strategists, Advisers Act Rel. No. 1648, (Aug. 13, 1997) (investment adviser that failed to supervise trader who engaged in unauthorized trading also failed to adopt policies and procedures reasonably designed to prevent and detect unauthorized trading in client accounts); Van Kampen Am. Capital Asset Mgt., Inc., Advisers Act Rel. No. 1525, 60 SEC Docket 1045

(Sept. 29, 1995) (investment adviser that failed to supervise portfolio manager who mispriced derivative securities also failed to institute appropriate supervisory controls and procedures).

Accordingly, the registrant failed reasonably to supervise the trader, who was subject to its supervision within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing the trader from willfully violating Section 34(b) of the Investment Company Act, and willfully aiding and abetting and causing violations of Sections 204, 206(1) and 206(2) of the Advisers Act and Rule 204-2(a)(3) thereunder, and Section 31(a) of the Investment Company Act and Rule 31a-1(b)(6) thereunder.

b. Johnson Failed Reasonably to Supervise the Trader

Johnson failed reasonably to supervise the trader. Liability for failure to supervise may be imposed when a supervisor "[fails] to learn of improprieties when diligent application of supervisory procedures would have uncovered them." Blinder, Robinson & Co., Inc., Exchange Act Rel. No. 19057, 26 SEC Docket 238, 240 (September 17, 1982) (supervisors failed to supervise because they failed properly to review order tickets which would have alerted them to possible violations). Johnson failed adequately to fulfill his responsibilities for reviewing order tickets and Summary Reports, thereby failing to detect a number of significant trading irregularities that would have been revealed by such reviews. He further failed on a consistent basis to reconcile order tickets to the Summary Reports, rendering him unable to determine whether the trades had been authorized or whether the trader even had submitted order tickets. Accordingly, Johnson failed reasonably to supervise the trader, who was subject to his supervision within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing the trader from willfully violating Section 34(b) of the Investment Company Act, and willfully aiding and abetting and causing violations of Sections 204, 206(1) and 206(2) of the Advisers Act and Rule 204-2(a)(3) thereunder, and Section 31(a) of the Investment Company Act and Rule 31a-1(b)(6) thereunder.

2. The Registrant Failed to Keep and Maintain Appropriate Books and Records Relating to the Overlay Program

a. Investment Company Act

Rule 31a-1(b)(6), promulgated under Section 31(a) of the Investment Company Act, requires registered investment companies to maintain and keep current a record of all portfolio purchases or sales, other than purchases and sales of securities, showing details comparable to those prescribed by Rule 31a-1(b)(5). In turn, Rule 31a-1(b)(5) requires registered investment companies to maintain and keep current:

A record of each brokerage order given by or in behalf of the investment company for, or in connection with, the purchase or sale of securities, whether executed or unexecuted. Such record shall include the name of the broker, the terms and conditions of the order and of any modification or cancellation thereof, the time of entry or cancellation, the price at which executed, and the time of receipt of report of execution. The record shall indicate the name of the person who placed the order [on] behalf of the investment company.

As described above, the trader failed to submit numerous order tickets for the Short Term Bond Fund and other registered investment companies affected by his trading, and also forged and miscoded tickets, causing violations of Section 31(a) and Rule 31a-1(b)(6) thereunder. When he engaged in this conduct, the trader knew or was reckless in not knowing that his actions would substantially assist and contribute to those violations. Because the trader had been given discretion to execute the overlay program on behalf of the registrant, his scienter and conduct may be imputed to the registrant. See SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1089 n.3 (2d Cir. 1972) (individual's awareness of securities violations was imputed to two companies where individual exercised "blanket authority" in connection with certain securities transactions on behalf of those companies). Accordingly, by virtue of the trader's conduct, the registrant willfully aided and abetted and caused violations of Section 31(a) and Rule 31a-1(b)(6).

b. Investment Advisers Act

Section 204 of the Advisers Act and Rule 204-2 thereunder require every registered investment adviser to make and keep true, accurate and current certain specified books and records relating to its investment adviser business. Rule 204-2(a)(3) requires a registered investment adviser to maintain, among other things, a memorandum of each order given by the adviser for the purchase or sale of a security, showing the terms and conditions of the order.

The trader's failure to submit many order tickets and his forgery and miscoding of many others caused the registrant to fail to maintain an accurate memorandum of each brokerage order. Accordingly, the registrant willfully violated Section 204 and Rule 204-2(a)(3) thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offers and to impose the sanctions set forth therein. 9

V.

Accordingly, it is hereby ordered, pursuant Sections 203(e), 203(f), 203(i) and 203(k) of the Advisers Act and Sections 9(b), 9(d) and 9(f) of the Investment Company Act, that:

A. Johnson be, and hereby is, suspended from association with any investment adviser for a period of three months, effective on the second Monday following the entry of this Order;

B. Johnson be, and hereby is, suspended from acting in any supervisory capacity with any investment adviser for a period of nine months immediately following the period of his suspension from association;

C. Johnson shall, within 30 days of the entry of this Order, pay a civil money penalty of $10,000 to the United States Treasury. 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, VA 22312; and (d) submitted under cover of a letter that identifies Johnson as a Respondent in these proceedings, the file number of these proceedings and the Commission's case number. A copy of the cover letter and money order or check shall be sent to Juan Marcel Marcelino, District Administrator, Securities and Exchange Commission, Boston District Office, 73 Tremont Street, Suite 600, Boston, Massachusetts 02108;

D. Johnson shall comply with his undertaking to provide, within 30 days after the expiration of the suspensions described in paragraphs V.A. and B., above, an affidavit via certified mail to Juan Marcel Marcelino, District Administrator, Securities and Exchange Commission, Boston District Office, 73 Tremont Street, Suite 600, Boston, Massachusetts 02108, setting forth with particularity the details of his compliance with the suspensions;

E. The registrant be, and hereby is, censured;

F. The registrant shall cease and desist from committing or causing any violation or future violation of Section 204 of the Advisers Act and Rule 204-2(a)(3) thereunder, and shall cease and desist from causing any violation or future violation of Section 31(a) of the Investment Company Act and Rule 31a-1(b)(6) thereunder;

G. The registrant shall, within 10 days of the entry of this Order, pay a civil money penalty of $250,000 to the United States Treasury. 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, VA 22312; and (d)

submitted under cover of a letter that identifies the registrant as a Respondent in these proceedings, the file number of these proceedings and the Commission's case number. A copy of the cover letter and money order or check shall be sent to Juan Marcel Marcelino, District Administrator, Securities and Exchange Commission, Boston District Office, 73 Tremont Street, Suite 600, Boston, Massachusetts 02108;

H. The registrant shall comply with its undertaking to maintain the enhanced supervisory policies and procedures referenced in footnote 6 above, and implemented prior to the date of this Order; and

I. The registrant shall comply with its undertaking to:

1. mail a copy of this Order, together with a cover letter in a form acceptable to the staff of the Commission's Boston District Office, to each board of directors or trustees of each registered investment company, unregistered investment company, and institutional investor whose accounts participated in the overlay program during the period September 1, 1996, through October 13, 1998, by certified mail, return receipt requested, within 30 days from the date of this Order; and

2. provide, within 30 days from the entry of this Order, an affidavit via certified mail to Juan Marcel Marcelino, District Administrator, Securities and Exchange Commission, Boston District Office, 73 Tremont Street, Suite 600, Boston, Massachusetts 02108, certifying that it has complied with its undertaking set forth in subparagraph V.I.1, above, and identifying the persons to whom it provided a copy of this order pursuant to such undertaking.

By the Commission.

Jonathan G. Katz
Secretary

Footnotes

1 The findings herein are made pursuant to the Offers of Settlement of the registrant and Johnson and are not binding on any other person or entity in this or any other proceeding.

2 Prior to a December 31, 1997, combination with Zurich Kemper Investments, Inc., the registrant was known as Scudder, Stevens & Clark.

3 Overall, the portfolio managers for twenty institutional accounts, including ten registered investment companies, gave the trader limited discretion to execute the trading strategy in those accounts to varying degrees during some or all of the time the strategy was available.

4 The registrant and its registered investment company clients were required accurately to maintain the order tickets pursuant to the books and records provisions of the Advisers Act and the Investment Company Act.

5 The overlay program developed without a review by the firm's compliance specialists to ensure that the proper supervisory and monitoring procedures were in place prior to the program's implementation.

6 Prior to the date of this Order, the registrant adopted enhanced supervisory controls and procedures relating to the types of violations that gave rise to these proceedings and which are described in this Order.

7 Sections 203(e)(6)(A) and (B) specifically provide that "no person shall be deemed to have failed reasonably to supervise any person, if:

(A) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and

(B) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

8 See, e.g. Rhumbline, Advisers Act Rel. No. 1765, (Sept. 29, 1998); First Capital Strategists, Advisers Act Rel. No. 1648, (August 13, 1997); see also Gutfreund, Exchange Act Rel. No. 31554 (Dec. 3, 1992), 52 SEC Docket 4370.

9 In determining to accept the Offers, the Commission considered remedial acts promptly undertaken by the Respondents and cooperation afforded the Commission staff.