

Investment Management

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Former CIO Indicted for \$600M Fraud in Parallel DOJ, SEC Actions

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On November 25, 2024, the U.S. Department of Justice (DOJ) and the U.S. Securities and Exchange Commission (SEC, and collectively with DOJ, the Government) brought parallel criminal and civil enforcement actions against the former Chief Investment Officer (the ex-CIO) of Western Asset Management Company, LLC (Western Asset). The Government alleges that the ex-CIO engaged in an illegal investment allocation scheme to favor certain advisory clients at the expense of other advisory clients by allocating investment transactions with approximately \$600 million in first-day gains to favored advisory clients and allocating investment transactions with approximately \$600 million in first-day losses to disfavored advisory clients in violation of Section 10(b) of the Exchange Act, Section 17(a)(1) and 17(a)(3) of the Securities Act, Sections 206(1) and 206(2) of the Advisers Act, and Sections 36(a) and 37 of the Investment Company Act.

Specifically, the Government alleges that the ex-CIO placed trades using omnibus accounts and routinely waited until late in the trading day to allocate the trades among the advisory client portfolios. Allegedly, the ex-CIO allocated the first-day winning trades to favored advisory clients, whose fee structures were substantially higher than the fee structures of the disfavored advisory clients to whom the first-day losing trades were allocated. The Government further alleges that the ex-CIO personally benefited because his compensation was tied to the performance of the favored advisory client portfolios. Furthermore, the Government alleges that it was not disclosed to investors (in offering documents, on Form ADV, in response to client diligence questionnaires, or otherwise) that first-day performance was a factor being used to determine how to allocate trades among advisory clients. The ex-CIO has denied liability with respect to the allegations.

This matter serves as an important reminder to investment advisers that investment allocations must at all times be fair and equitable and will be judged in light of the adviser's fiduciary duty to not place its own economic interests ahead of the interests of its clients. Investment allocations and the disclosure of related conflicts of interest remain hot topics and are among the SEC's 2025 Examination Priorities.¹

As an immediate lesson learned from this matter, advisers should review their investment allocation policies and procedures to ensure that they are timely making trade allocations when transacting for multiple clients and should conduct compliance testing to confirm that all investment allocations are fair and equitable.

The DOJ and the SEC have not filed charges against Western Asset. Indeed, in its complaint, the SEC noted that Western Asset launched an internal investigation in October 2023, placed the ex-CIO on leave in August 2024, and closed and liquidated a strategy managed by the ex-CIO for the benefit of the favored clients in October 2024. This matter serves as another reminder of the importance of taking proactive remedial actions, such as monitoring compliance with fair and equitable trade allocation policies and procedures, conducting internal reviews, taking appropriate action against wrongdoers, potentially reimbursing affected investors if wrongdoing in fact occurred, and timely self-disclosing misconduct to the regulators, in order to avoid prosecution.

For further information, guidance, and clarity on how investment advisers can approach and tailor their policies and procedures (and testing thereof) and associated trainings related to the fair and equitable allocations of investments among advisory clients, please reach out to the authors of this article or to your regular Lowenstein Sandler contact directly.

¹ See SEC Division of Examinations, "Fiscal Year 2025 Examination Priorities" (Oct. 21, 2024) at page 7, <https://www.sec.gov/files/2025-exam-priorities.pdf>. Our prior client alert on the SEC's 2025 Examination Priorities can be found [here](#).

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