



**FOR IMMEDIATE RELEASE**

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## TARP INVESTMENT FUND ADVISER CHARGED WITH ILLEGALLY TRADING SECURITIES

WASHINGTON, DC – The Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) today announced that, on Monday, the Securities and Exchange Commission (SEC) sanctioned Western Asset Management Co. (Western Asset), a California-based investment adviser for engaging in cross trading that favored some clients over others and for concealing investor losses that resulted from a coding error.

Western Asset, which is a subsidiary of Legg Mason, agreed to pay more than \$21 million to settle the SEC's charges as well as a related matter announced by the U.S. Department of Labor on Monday.

The SEC finds that Western Asset engaged in a type of cross trading that was illegal. Cross trading is the practice of moving a security from one client account to another without exposing the transaction to the market, and when done appropriately, it can benefit both clients by avoiding market and execution costs. However, cross trading can also pose substantial risks to clients due to the adviser's inherent conflict of interest in obtaining best execution for both the buying and the selling client.

The SEC's order finds that during the financial crisis, Western Asset was required to sell mortgage-backed securities and similar assets into a sharply declining market as registered investment companies and other clients sought account liquidations or were no longer eligible to hold these securities after rating agency downgrades. Instead of selling the securities at prices that Western Asset believed did not represent their long-term value, it arranged for certain broker-dealers to purchase the securities from the Western Asset selling clients and sell the same security back to different Western Asset clients with greater risk tolerance in prearranged sale-and-repurchase cross trades. Because Western Asset arranged to cross these securities at the bid price rather than a price representing an average between the bid and the ask price, the firm improperly allocated the full benefit of the market savings on the trades to buying clients and denied the selling clients approximately \$6.2 million in savings.

"SIGTARP's proactive investigatory efforts led to the initial discovery of cross trades by Western Asset which violated federal securities laws and the PPIP fund manager's TARP contract with Treasury," said Christy Romero, Special Inspector General for TARP (SIGTARP). "As a PPIP fund manager participating in TARP, Western Asset was prohibited from engaging in cross trades involving RLJ Western, the PPIP fund it managed. However, Western Asset violated this prohibition, illegally using the PPIP fund to defraud its clients out of \$6.2 million. SIGTARP and its law enforcement partners will ensure that those who defraud, abuse, or exploit taxpayers' TARP investments will be held accountable."

Western Asset provided advisory services to RLJ Western Asset Public/Private Master Fund, L.P., and its affiliated funds (RLJ Western). Western Asset was one of nine fund management firms selected to establish a Public-Private Investment Fund (PPIF), in this case RLJ Western, as part the Public-Private Investment Program (PPIP), a subpart of the U.S. Department of the Treasury Troubled Asset Relief Program (TARP). Western Asset was chosen to participate in PPIP in June 2009, and RLJ Western was launched in November 2009 with combined public/private investments of \$2.5 billion. Pursuant to Western Asset's agreement with Treasury to participate in PPIP, the firm was prohibited from engaging in cross trades involving RLJ Western.

The purpose of PPIP was to purchase legacy securities from banks, insurance companies, mutual funds, pension funds, and other eligible financial institutions through PPIFs. PPIFs were partnerships, formed specifically for this program, that invested in mortgage-backed securities using equity capital from private-sector investors combined with TARP equity and debt. According to Treasury, the aim of PPIP was to "restart the market for legacy securities, allowing banks and other financial institutions to free up capital and stimulate the extension of new credit."<sup>1</sup>

In a separate order involving a different set of client accounts, according to an SEC order instituting settled administrative proceedings, Western Asset serves as an investment manager primarily to institutional clients, many of which are Employee Retirement Income Security Act (ERISA) plans. Western Asset breached its fiduciary duty by failing to disclose and promptly correct a coding error that caused the improper allocation of a restricted private investment to the accounts of nearly 100 ERISA clients. The private investment that was off-limits to ERISA plans had plummeted in value by the time the coding error was discovered, and Western Asset had an obligation to reimburse clients for such losses under the terms of its error correction policy. Instead, Western Asset failed to notify its ERISA clients until nearly two years later, long after the firm had liquidated the prohibited securities out of those client accounts.

The SEC's orders find that Western Asset violated Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7, and aided and abetted and caused violations of Sections 17(a)(1) and 17(a)(2) of the Investment Company Act of 1940. Without admitting or denying the findings, the firm agreed to be censured and must cease and desist from committing or causing any further such violations. For the disclosure violations related to the coding error, Western Asset must distribute more than \$10 million to harmed clients and pay a \$1 million penalty in the SEC settlement and a \$1 million penalty in the Labor Department settlement. For the cross trading violations, Western Asset must distribute more than \$7.4 million to harmed clients and pay a \$1 million penalty in the SEC settlement and a \$607,717 penalty in the Labor Department settlement. An independent compliance consultant must be retained to internally address both sets of violations.

### **About SIGTARP**

The Office of the Special Inspector General for the Troubled Asset Relief Program investigates fraud, waste, and abuse in connection with TARP.

To report suspected illicit activity involving TARP, dial the **SIGTARP Hotline**: 1-877-SIG-2009 (1-877-744-2009).

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<sup>1</sup> Treasury Press Release, "Treasury Department Provides Updated Guidance," 4/6/2009, [www.treasury.gov/press-center/press-releases/Pages/tg82.aspx](http://www.treasury.gov/press-center/press-releases/Pages/tg82.aspx), accessed 1/6/2014.

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