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Ex-Putnam Exec Settles With SEC Over 401(k) Foul

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After hitting six former Putnam employees with charges stemming from a 401(k) gaffe in 2001 that cost investors $4 million, the SEC settled with a seventh ex-**Putnam** exec last week.

Michele Knowlton, former vice president at Putnam Fiduciary Trust Company (PFTC), has agreed to a six-month ban from the fund and brokerage industries. She will also provide testimony in any future hearings or court proceedings that address the issue.

Knowlton was unavailable for comment by deadline.

Earlier this month the agency charged six former Putnam Fiduciary Trust Company (PFTC) executives with trying to hide losses incurred by Cardinal Health Inc.'s 401(k) plan and other retirement plans. The losses were due to a Putnam mistake.

The six former PFTC employees charged earlier are Karnig Durgarian, Donald McCracken, Virginia Papa, Sandra Childs, Kevin Crain and Ronald Hogan.

Industry attorneys say the Knowlton settlement illustrates that the regulator, while continuing to crack down on the fund industry, is also providing leniency toward employees that cooperate with investigations.

The SEC charges that PFTC processed a **Cardinal Health** retirement plan mutual fund purchase order one day late. PFTC had agreed to process the trades at fund NAVs for January 2, 2001. Yet, the firm didn't invest the assets until the following day, when the NAV of the funds had increased. The delay resulted in a $4 million loss because the plan assets missed out on upward market appreciation.

At the time, Putnam policy dictated it would compensate clients if it processed a trade late and the fund's NAV increased by more than one penny a share. PFTC also had a policy of processing "as of" trades, which basically means the firm would sell investors the shares at the price they were supposed to get.

The SEC maintains that rather than pony up the cash to make up for the loss, PFTC managers manipulated share prices by reversing prior transactions and by instructing Knowlton to find additional expenses that could be used to lower the funds' NAVs.

Knowlton said she was originally unable to find such expenses, but was told by a senior manager that that was the "wrong answer."

The SEC says the managers wanted to find enough expenses to narrow the differences in NAVs on the trading date and the date the trade was expected to be processed to less than one penny. That way the firms wouldn't have to compensate investors.

According to the settlement, Knowlton went to her superiors a second time with a list of expenses that were used to lower the funds' NAVs. She later informed her superiors that using the expenses she had identified for that purpose was inappropriate.

Observers add that Knowlton's settlement is somewhat mild, especially considering that the SEC is seeking to have civil penalties imposed against the other six execs allegedly involved.

The SEC has entered into a lenient settlement with Knowlton because the prior PFTC vice president cooperated fully with the regulator's investigation of the trading issue, says Walter G. Ricciardi. He is the deputy director and district

administrator at the SEC.

Observers point out that the SEC has been encouraging firms and individuals to cooperate with investigations. Indeed, the SEC has previously said it isn't seeking penalties against Putnam in the Cardinal Health incident because the fund shop took "extraordinary measures" to cooperate with the regulator's investigation into the problem.

Attorneys add that the practice of providing leniency for individuals who cooperate with investigations isn't that uncommon.

"It's not that unusual a tactic in the world of litigation to have your attorney bargain [with cooperation] on your behalf," says Tom Westle, an attorney with **Blank Rome**. "I don't think it's much different from the standpoint of what you hear in criminal cases."

He adds that the SEC complaint against other prior PFTC employees is focusing on more senior-level managers. The SEC may have decided to grant the leniency after considering that Knowlton's supervisors and other senior level managers were allegedly involved in the problem.

"Maybe this shows that if you are a lower-level employee that the SEC is willing to be lenient if you cooperate," Westle says.

The SEC hasn't always offered leniency to individuals who cooperate with investigations, adds Terrance O'Malley, a partner with **Schulte Roth & Zabel**.

Terrance O'Malley
Partner
Schulte Roth & Zabel

"It just seems to be part of an ebb and flow," he says. At other times, for example, the SEC was less willing to grant leniency.

At the same time, the SEC is being stretched thin with the task of monitoring a large number of registered firms and high volumes of transactions, points out Neils Holch, executive director of the Coalition of Mutual Fund Investors.

With that in mind, the SEC has little choice but to try and encourage employees at firms to cooperate with investigations. That is a more efficient approach than conducting investigations without the help of employees at firms that are being scrutinized, he says.

In a written statement, Putnam has pointed out that it promptly reported the matter to regulators in 2004 after discovering the problem. Its swift efforts to address the problem included making complete restitution and taking appropriate actions against employees who were involved in the incident.

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