

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2666 / September 28, 2007

INVESTMENT COMPANY ACT OF 1940
Release No. 28005 / September 28, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12855

In the Matter of

**SMITH BARNEY FUND
MANAGEMENT LLC,**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 203(e) OF THE
INVESTMENT ADVISERS ACT OF 1940
AND SECTIONS 9(b) AND 9(f) OF THE
INVESTMENT COMPANY ACT OF 1940,
MAKING FINDINGS AND IMPOSING
REMEDIAL SANCTIONS AND A 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 Section 203(e) of the Investment Advisers Act of 1940 (“Advisers Act”) and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against Smith Barney Fund Management LLC (“Respondent” or “Smith Barney”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”) 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 to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 203(e) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

This matter concerns violations of Section 19(a) of the Investment Company Act and Rule 19a-1 thereunder by three closed-end funds: the High Income Opportunity Fund, the Zenix Income Fund, and the Managed High Income Portfolio (collectively, the "Funds"). Section 19(a) of the Investment Company Act and Rule 19a-1 thereunder require funds to provide shareholders with contemporaneous written statements identifying the source of distributions to shareholders if any portion of the distributions is from a source other than the fund's net income. The purpose of Section 19(a) and Rule 19a-1 is to provide shareholders adequate disclosure of the sources from which distributions are made.

This matter also concerns violations of Section 34(b) of the Investment Company Act, which makes it unlawful for any person to make an untrue statement in a report filed with the Commission, or to omit to state material facts necessary in order to prevent the statements made therein from being materially misleading.

During the period from March 1, 2001 through September 30, 2004 (the "relevant period"), the High Income Opportunity Fund made thirty-six distributions to shareholders from shareholder capital, the Zenix Income Fund made twenty-nine distributions to shareholders from shareholder capital, and the Managed High Income Portfolio made twenty-four distributions to shareholders from shareholder capital. None of the distributions was accompanied by a notice that contained the information required by Rule 19a-1. The Funds therefore violated Section 19(a) and Rule 19a-1 thereunder. Pursuant to advisory and administrative agreements with the Funds, Smith Barney was responsible for providing Section 19(a) notices to shareholders of the Funds. Although Smith Barney, which regularly tracked the sources of distributions for the Funds, knew or was reckless in not knowing that the Funds' distributions were partly funded from shareholder capital during the relevant period, it failed to provide contemporaneous notices containing the information required by Rule 19a-1 to the Funds' shareholders. Smith Barney thus caused and willfully² aided and abetted the Funds' violations of Section 19(a) and Rule 19a-1 thereunder.

Smith Barney was also responsible for filing annual reports with the Commission for the Funds during the relevant period. Although the Financial Highlights section of the Funds' annual reports disclosed that during the relevant period the Funds' distributions included returns of shareholder capital, the Management Discussion of Fund Performance ("MDFP") section of the 2002 annual reports for the High Income Opportunity Fund and the Zenix Income Fund reported

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² "Willfully," as used in this paragraph and in paragraph 10 of this Order, means intentionally committing the act that constitutes the violation. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

an annual dividend without disclosing that a portion thereof included a return of shareholder capital. Likewise, the MDFP section of the 2002 annual reports for the High Income Opportunity Fund and the Zenix High Income Fund and the 2002 and 2003 annual reports for the Managed High Income Portfolio provided annualized yield figures that assumed a dividend paid entirely from net income, although actual distributions were partly from shareholder capital. By failing to disclose that a portion of the reported dividends came from shareholder capital, the statements were untrue in that they implied that distributions were entirely from net investment income and thus that investments in the Funds reflected greater returns than was the case. By filing annual reports that contained material omissions or misstatements regarding these two measures of fund performance, Smith Barney violated Section 34(b).

Respondent

1. **Smith Barney**, an investment adviser registered with the Commission under Section 203(c) of the Advisers Act, provided investment management and administrative services to a number of closed-end investment companies registered under the Investment Company Act, including the High Income Opportunity Fund, the Zenix Income Fund, and the Managed High Income Portfolio. Smith Barney's principal place of business is New York, New York. From 2001 through 2004, Smith Barney was part of Citigroup's Asset Management group ("CAM"), a subsidiary of Citigroup Inc., a publicly traded company. Legg Mason, Inc. acquired CAM on December 1, 2005, and is currently in the process of winding down the activities of Smith Barney. The Funds are currently managed by Legg Mason Partners Fund Adviser, LLC, a wholly-owned subsidiary of Legg Mason, Inc.

Other Relevant Entities

2. The High Income Opportunity Fund, a closed-end, diversified management investment company registered under the Investment Company Act, was incorporated under the laws of Maryland on July 30, 1993. Its shares trade on the New York Stock Exchange under the symbol HIO. The High Income Opportunity Fund, which seeks a high current income with capital appreciation as a second objective, pays distributions monthly. Its fiscal year ends on September 30.

3. The Zenix Income Fund, a closed-end, diversified management investment company registered under the Investment Company Act, was incorporated under the laws of Maryland on February 11, 1988. Its shares trade on the New York Stock Exchange under the symbol ZIF. The Zenix Income Fund, which seeks high current income with capital appreciation as a second objective, pays distributions monthly. Its fiscal year ends on March 31.

4. The Managed High Income Portfolio, a closed-end, diversified management investment company registered under the Investment Company Act, was incorporated under the laws of Maryland on December 24, 1992. Its shares trade on the New York Stock Exchange under the symbol MHY. The Managed High Income Portfolio, which seeks high current income with capital appreciation as a second objective, pays distributions monthly. Its fiscal year ends on February 28.

Section 19(a) Violations

5. Section 19(a) of the Investment Company Act prohibits investment companies such as closed-end funds from paying distributions from any source other than net income unless the payments are accompanied by contemporaneous written statements to shareholders disclosing the sources of the distributions. Rule 19a-1 specifies that the written statement must be on a separate paper and clearly indicate what portion of the payment is from: 1) net income (not including capital gains); 2) capital gains; and 3) paid-in surplus or other capital source. The purpose of Section 19(a) and Rule 19a-1 is to afford shareholders adequate disclosure of the sources from which the payments are made so shareholders will not believe that a fund portfolio is generating investment income when, in fact, distributions are paid from other sources, such as shareholder capital or capital gains.³

6. Smith Barney provided investment advisory and administrative services to the High Income Opportunity Fund, the Zenix Income Fund, and the Managed High Income Portfolio. Pursuant to agreements with the Funds, Smith Barney was responsible for the Funds' administrative operations and was required to perform its duties consistent with the requirements of the Investment Company Act, including Section 19(a).

7. During the relevant period, the High Income Opportunity Fund, the Zenix Income Fund, and the Managed High Income Portfolio each made distributions to shareholders from shareholder capital, as shown below on a per share basis.

High Income Opportunity	2002		2003		2004	
	%	\$	%	\$	%	\$
Net Investment Income	95%	\$.71	93%	\$.63	93%	\$.56
Shareholder Capital ⁴	5%	\$.04	7%	\$.05	7%	\$.04

Zenix Income Fund	2002		2003		2004	
	%	\$	%	\$	%	\$
Net Investment Income	95%	\$.53	93%	\$.42	93%	\$.39
Shareholder Capital ⁵	5%	\$.03	7%	\$.03	7%	\$.03

³ Rule 19a-1(g) states: “[t]he purpose of this section, in the light of which it shall be construed, is to afford security holders adequate disclosure of the sources from which dividend payments are made.” See SEC Release No. 71, 1941 WL 37715 (Feb. 21, 1941) (“An important feature of the rule is the extent to which it requires explicit and affirmative disclosure whenever a dividend is being paid from a capital source.”).

⁴ During fiscal years 2002, 2003, and 2004, a portion of all thirty-six of the High Income Opportunity Fund's monthly distributions came from shareholder capital.

⁵ During fiscal years 2002, 2003, and 2004, a portion of twenty-nine of the Zenix Income Fund's thirty-six monthly distributions came from shareholder capital.

Managed High Income	2002		2004	
	%	\$	%	\$
Net Investment Income	94%	\$.81	92%	\$.59
Shareholder Capital ⁶	6%	\$.05	8%	\$.05

8. During the relevant period, Smith Barney failed to provide notices containing the information required by Rule 19a-1 to the Funds' shareholders, even though the Funds repeatedly made distributions from shareholder capital. Between 2002 and 2004, Smith Barney sent written notices with distributions for the High Income Opportunity Fund and the Zenix Income Fund, but the notices did not inform shareholders that the distributions were partly from shareholder capital. Likewise, in 2002 and 2004, Smith Barney sent written notices with distributions for the Managed High Income Portfolio, but the notices also failed to inform shareholders that the distributions were partly from shareholder capital.

9. By paying distributions to shareholders from sources other than net income without disclosing the source of those distributions in a notice that accompanied the distributions, the High Income Opportunity Fund, the Zenix Income Fund, and the Managed High Income Portfolio violated Section 19(a) of the Investment Company Act and Rule 19a-1 thereunder.

10. Smith Barney, which closely monitored the sources of distributions for the Funds throughout the year, knew or was reckless in not knowing at the time the Funds' distributions were paid that such distributions were partly from shareholder capital. Yet Smith Barney failed to provide contemporaneous notices that complied with Section 19(a) in 2002, 2003, and 2004.⁷ As a result of the conduct described above, Smith Barney caused and willfully aided and abetted the Funds' violations of Section 19(a) of the Investment Company Act and Rule 19a-1 thereunder.

Section 34(b) Violations

11. Section 34(b) of the Investment Company Act makes it unlawful for any person to make an untrue statement of material fact, or omit material information necessary to make other statements made not misleading, in any registration statement, application, report, account, record, or other document filed with the Commission pursuant to the Investment Company Act.

12. Smith Barney was responsible for filing annual reports with the Commission for each of the Funds. In 2002, Smith Barney filed annual reports for the High Income Opportunity Fund and the Zenix Income Fund in which the MDFP section of the report disclosed an annual dividend

⁶ During fiscal years 2002 and 2004, a portion of all twenty-four of the High Income Opportunity Fund's monthly distributions came from shareholder capital.

⁷ In response to a 1997 application by Smith Barney for exemption from Section 19(a) and 19(b) of the Investment Company Act, the Division of Investment Management declined to support the request to satisfy Section 19(a)'s disclosure requirements by making annual disclosures in shareholders' Forms 1099-DIV. Although during the relevant period, the Funds provided shareholders with Internal Revenue Service Forms 1099-DIV that identified the source of the shareholder's distributions for the prior calendar year, such notices did not comply with Section 19(a) and Rule 19a-1 because they were not made contemporaneously with each distribution.

without indicating that the figure included returns of shareholder capital. For example, although the Financial Highlights section of the High Income Opportunity Fund's 2002 annual report showed that \$.08, or 11% of the \$.75 per share annual distribution was from shareholder capital on a tax basis, the MDFP section stated only that "[d]uring the year ended September 30, 2002, the Fund distributed dividends to shareholders totaling \$.75 per share." Likewise, the MDFP section of the Zenix Income Fund's 2002 annual report reported a per share annual dividend without disclosing, as the Financial Statements showed, that a portion thereof was from shareholder capital. By failing to disclose that a portion of the reported dividends came from shareholder capital, the statements implied that distributions were entirely from fund net income.

13. Although during the relevant period the Financial Highlights section of the Funds' annual reports disclosed that the Funds' distributions included returns of shareholder capital on a tax basis, the yield figures included in the MDFP sections of the 2002 annual report for the High Income Opportunity Fund and Managed High Income Portfolio and the 2002 and 2003 annual reports for the Zenix Income Fund assumed an annual dividend paid entirely from net income. For example, the High Income Opportunity Fund's 2002 annual report stated that the Fund had an annualized distribution rate of 11.21% of NAV, calculated based on "the Fund's current monthly income dividend rate, annualized, and then divided by the NAV or the market price noted in this report. The annualized distribution rate assumes a current monthly income dividend rate of \$0.0570 [per share] for 12 months." In fact, as the Financial Highlights showed, 11% of the High Income Opportunity Fund's 2002 distributions was a return of shareholder capital on a tax basis. Likewise, although the Financial Highlights section of the Funds' annual reports disclosed that the Funds' distributions included returns of shareholder capital on a tax basis, Smith Barney calculated the annualized distribution rates for the 2002 Managed High Income Portfolio annual report and the 2002 and 2003 Zenix Income Fund annual reports based on the assumption that the dividends were entirely from net income, when those Funds also paid distributions from shareholder capital. By including return of shareholder capital in the calculation of annualized distribution rates, the statements implied that the current monthly distributions were entirely from fund net income, when they were not.

14. As a result of the conduct described above, Smith Barney willfully⁸ violated Section 34(b) of the Investment Company Act.

Respondent's Cooperation and Remedial Efforts

15. In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent and cooperation afforded to the Commission staff.

⁸ "Willfully," as used in paragraph 14 of this Order means intentionally committing the act that constitutes the violation. See *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he or she is violating one of the Rules or Acts.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Smith Barney's Offer.

Accordingly, it is hereby ORDERED pursuant to Sections 9(b) and 9(f) of the Investment Company Act and Section 203(e) of the Advisers Act that:

A. Smith Barney shall cease and desist from causing any violations and any future violations of Section 19(a) of the Investment Company Act and Rule 19a-1 thereunder and from committing or causing any violations and any future violations of Section 34(b) of the Investment Company Act; and

B. Smith Barney shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$450,000 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 Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Smith Barney Fund Management LLC as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Mark Kreitman, Esq., Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-4628.

By the Commission.

Nancy M. Morris
Secretary