

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4577 /December 1, 2016

INVESTMENT COMPANY ACT OF 1940
Release No. 32376 / December 1, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-17701

In the Matter of

**PACIFIC INVESTMENT
MANAGEMENT COMPANY
LLC,**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 203(e) AND
203(k) 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 Sections 203(e) and 203(k) 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 Pacific Investment Management Company LLC (“PIMCO”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “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 Sections 203(e) and 203(k) 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

1. Launched on February 29, 2012, the PIMCO Total Return-Exchange-Traded Fund (“BOND”) was one of PIMCO’s first actively managed exchange-traded funds, and its early performance attracted substantial media and investor attention. According to BOND’s reported returns, from inception through June 30, 2012 (the “Relevant Period”), BOND greatly outperformed PIMCO’s flagship mutual fund, the PIMCO Total Return Fund (“TRF”), and its benchmark index.

2. To help increase BOND’s initial performance, PIMCO used a strategy that involved purchasing odd lot positions (*i.e.*, small-sized pieces) of non-agency mortgage-backed securities (“NA MBS”) that traded at discounts to round lot positions (*i.e.*, institutional, larger-sized pieces) and then marking those positions at the evaluated prices that were for institutional round lots (“Pricing Vendor Marks”) provided by a third-party pricing vendor used by PIMCO (“Pricing Vendor”). The Pricing Vendor considered an institutional round lot size for bonds as having at least \$1 million current face value. As part of this strategy, PIMCO purchased approximately 156 NA MBS positions for BOND during the Relevant Period that were less than \$1 million in size. At the end of each trading day, BOND received a performance increase reflected by the difference between the purchase price for the odd lot position and the higher Pricing Vendor Mark used to value the position in BOND (generally referred to within PIMCO as gains due to “execution”).

3. PIMCO did not accurately value 43 of the NA MBS positions it purchased for BOND that were less than \$1 million in size.² For these 43 positions, PIMCO did not have a reasonable basis to believe that the Pricing Vendor Mark accurately reflected the exit price BOND would receive for those positions. Nevertheless, consistent with its historical practice, PIMCO still valued these 43 positions at the Pricing Vendor Mark. PIMCO therefore overstated the value of these securities, which caused BOND to overstate its net asset value (“NAV”) throughout the Relevant Period.

4. Immediately after BOND’s launch, there were numerous indications at PIMCO

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 The Commission is not making any findings as to PIMCO’s valuation of the other 113 NA MBS positions in BOND.

that the Pricing Vendor Marks PIMCO used to value BOND's NA MBS positions under \$1 million may not have reflected fair value under Section 2(a)(41) of the Investment Company Act and that using Pricing Vendor Marks to value these positions was positively impacting BOND's NAV. PIMCO's pricing policies and procedures, however, were not reasonably designed to consider these issues or odd lot pricing in general. Further, PIMCO's pricing policy vested the responsibility with PIMCO's traders for determining when to report to PIMCO's Pricing Committee any price that did not reasonably reflect market value, but failed to provide for sufficient oversight of the traders' determinations or any guidance regarding when to elevate significant pricing issues, such as odd lot pricing, to PIMCO's Pricing Committee or the Valuation Committee of BOND's Board of Trustees. As a result, the facts indicating that PIMCO may have been, and in some cases was, overvaluing NA MBS odd lots were never addressed by the Pricing Committee or Valuation Committee. Further, even though many individuals at PIMCO beyond the NA MBS traders—such as the PIMCO ETF Trust's Treasurer and Principal Financial Officer ("ETF Treasurer") and PIMCO's Pricing Group and Compliance Department—knew about odd lot pricing for BOND and its potential impact on BOND's NAV, PIMCO did not perform any contemporaneous analyses to determine whether the use of round lot prices for BOND's NA MBS odd lots appropriately reflected fair value for these smaller positions. PIMCO's pricing policy therefore was not reasonably designed to ensure that the NA MBS odd lots purchased for BOND were accurately priced and the accurate calculation of BOND's NAV.

5. During the Relevant Period, PIMCO communicated with investors and BOND's Board of Trustees about BOND's performance. In monthly and annual reports to investors, PIMCO negligently provided disclosures that were misleading regarding the reasons for BOND's performance by failing to disclose the impact of the "odd lot" strategy and that the performance resulting from this strategy was not sustainable as the fund grew in size. Instead, PIMCO attributed BOND's exceptional performance to the non-agency sector in general and prices for NA MBS that "rose." These disclosures implied that BOND's performance resulted from price appreciation in the non-agency sector, yet internal PIMCO reports indicated – and many of the drafters and reviewers of these disclosures understood – that a significant portion of BOND's favorable performance was attributable to initial gains from valuing odd lots at the Pricing Vendor Mark. PIMCO also negligently failed to disclose the existence or impact of the "odd lot" strategy to BOND's Board of Trustees, which had specifically inquired about why BOND outperformed the TRF.

Respondent

6. **Pacific Investment Management Company LLC**, a Delaware limited liability company, is an investment adviser registered with the Commission, with approximately \$1.5 trillion in assets under management. PIMCO's principal place of business is in Newport Beach, California. PIMCO is a majority-owned subsidiary of Allianz Asset Management of America L.P. ("Allianz Asset Management"). Through various holding company structures, Allianz Asset Management is indirectly wholly owned by Allianz SE. PIMCO provides investment advisory services to the PIMCO ETF Trust. BOND is one in a series of exchange-traded funds offered by the PIMCO ETF Trust.

Other Relevant Entities

7. **PIMCO ETF Trust**, incorporated as a Delaware Statutory Trust, is an open-end management investment company registered with the Commission since November 14, 2008. The PIMCO ETF Trust's principal place of business is in Newport Beach, California.

8. **PIMCO Total Return Exchange-Traded Fund**, is an actively managed exchange-traded fund that commenced trading on February 29, 2012. BOND's listing exchange is NYSE Arca (ticker: "BOND"). PIMCO changed BOND's ticker symbol from "TRXT" to "BOND" on April 4, 2012.

Background

9. BOND is an exchange-traded fund ("ETF") that was designed to be very similar to TRF, PIMCO's flagship mutual fund. A video PIMCO made available on its website on March 1, 2012, provided statements from BOND's portfolio manager that BOND:

has the same overarching investment strategy and objectives as our flagship Total Return strategy. It will rely on the same investment process and have the same portfolio manager. It will have much the same flexibility. But, there will be some difference in terms of portfolio holdings. For example, [BOND] has distinct guidelines and implementation parameters. Otherwise, we'll be running it nearly the same way that we run the Total Return strategy. So, basically, these two approaches are twins.

10. From its inception on February 29, 2012 through June 30, 2012, BOND's net assets grew from \$102 million to over \$1.7 billion due to substantial investor interest in the fund. For its management of BOND during this period, PIMCO earned advisory fees of approximately \$1.33 million.

11. As set forth in the table below, BOND significantly outperformed both PIMCO's flagship fund, TRF, and its benchmark index, Barclay's Capital U.S. Aggregate Index, during the Relevant Period.

| | March 2012 | April 2012 | May 2012 | June 2012 | Since BOND's Inception through June 30, 2012 |
|---|-----------------------|-----------------------|---------------------|----------------------|---|
| BOND | 1.64% | 1.99% | 1.76% | 0.74% | 6.27% |
| TRF | 0.04% | 1.46% | 0.85% | 0.46% | 2.83% |
| Barclay's Capital U.S. Aggregate Index | -0.55% | 1.11% | 0.90% | 0.04% | 1.50% |

PIMCO Pursues an “Odd Lot” Strategy to Increase BOND’s Performance “Out of the Gate”

12. NA MBS are asset-backed securities issued by private institutions that are backed by mortgages that are not guaranteed by a government-sponsored entity. During the Relevant Period, NA MBS odd lots typically traded at a significant discount from round lot positions in NA MBS. There is no standard definition regarding what constitutes an odd lot. However, the Pricing Vendor PIMCO used to value all of its NA MBS positions considered an institutional round lot size for bonds as having at least \$1 million current face value.³

13. To increase BOND’s early performance, PIMCO employed an “odd lot” strategy using NA MBS. This strategy involved (1) purchasing odd lot positions that traded at a discount to the round lot prices; (2) valuing those positions in BOND at the higher Pricing Vendor Marks, which were for institutional round lots; and (3) obtaining immediate positive returns for BOND. As part of this strategy, PIMCO purchased approximately 156 NA MBS positions for BOND that were less than \$1 million in size.

14. For example, on March 9, 2012, PIMCO purchased an NA MBS odd lot at \$64.9999 with a current face of \$0.2 million. PIMCO then valued the position at the Pricing Vendor’s institutional round lot mark of \$82.74585 (a 27% increase). This trade alone increased BOND’s NAV by nearly \$0.02 per share in one day.

15. PIMCO calculated and published a daily NAV for BOND based on its valuations of the NA MBS odd lots at the Pricing Vendor Marks. For 43 of these positions, however, PIMCO did not have a reasonable basis to believe that the Pricing Vendor Mark reflected what PIMCO could obtain when exiting the position.

The “Odd Lot” Strategy

16. Immediately prior to BOND’s launch, the head of PIMCO’s Structured Products desk sent a note to BOND’s portfolio manager proposing purchasing discounted odd lots that PIMCO would price at the higher Pricing Vendor Mark. The note clearly focused on increasing BOND’s performance by taking advantage of the discrepancy between the purchase price and the Pricing Vendor Mark. The note stated:

We are probably not able to 17a7 or arms length FHA projects from 700 [TRF] to new ETF. Because they are very illiquid, physical settle bonds we typically can’t get dealers to bid unless they line up buyer on other side (without signaling which is prohibited by Compliance). Compliance especially sensitive given visibility of this ETF launch and likely focus by bloggers and/or regulators. *Instead, we can find you several odd lot positions in the coming days that trade well below round lot levels and therefore pricing marks which will help with performance out of the gate.* (Emphasis added.)

³ Accordingly, for purposes of the findings in this Order only, positions of less than \$1 million in current face value shall be considered odd lots.

17. BOND's portfolio manager approved and implemented this as a strategy with NA MBS, along with other strategies, to generate early positive returns for BOND.

18. On or about March 2, 2012, BOND's portfolio manager sent a handwritten note to PIMCO's trading desks, including NA MBS traders, giving instructions to purchase positions below Pricing Vendor Marks. This note stated:

Today – ASAP – within the next 2 hours – find 1-2 million bonds in your area that are 2 points or more cheap to how they would be marked by pricing services at close tonight.

19. The trading desks complied with this directive. In particular, PIMCO's non-agency mortgage traders began to purchase NA MBS odd lots of less than \$1 million for BOND.

20. On or about March 23, 2012, BOND's portfolio manager sent another handwritten note instructing the non-agency mortgage traders to buy NA MBS for BOND with "cheap odd lots preferred." At that time, BOND's net assets had grown to \$256 million primarily through inflows of new investor money.

21. Executing on these notes and instructions from BOND's portfolio manager, PIMCO's traders found and purchased NA MBS odd lots. During the Relevant Period, PIMCO purchased approximately 156 NA MBS odd lots for BOND for a total amount of \$37 million.

22. For NA MBS purchases or prospective purchases, PIMCO's traders prepared a write-up for BOND's portfolio manager that included specific information and inputs about each individual security. BOND's portfolio manager approved the NA MBS positions for BOND after analyzing these write-ups that often contrasted the purchase price to the Pricing Vendor Mark.

23. At the time, PIMCO employed a "gold star" program to incentivize traders to maximize performance. Gold stars were financial rewards given to PIMCO traders at \$1,000 per award. BOND's portfolio manager used these gold stars to reward, among others, traders who purchased NA MBS odd lots for BOND that were significantly below the Pricing Vendor Mark.

PIMCO Received Immediate Warnings of the Impact of Odd Lot Pricing on BOND

24. PIMCO's Pricing Group, in conjunction with its custodian and back-office administrator (collectively, the "Administrator"), employed daily variance checks regarding price and NAV impact to ensure that Pricing Vendor Marks were accurate. These variance checks, which were included in PIMCO's procedures, sought to identify potential pricing issues for the traders. If a variance was breached, the Administrator notified PIMCO. After notification of a breach, the Pricing Group alerted the trader responsible for the trade, who then determined whether to challenge the Pricing Vendor Mark. If the trader failed to respond to such an inquiry, the Pricing Vendor Mark was automatically challenged.

25. Almost immediately after BOND's launch, PIMCO's Pricing Group began receiving notifications from the Administrator indicating that the difference between the purchase price and Pricing Vendor Mark for the NA MBS odd lots in BOND was exceeding variance thresholds or having a potential impact on BOND's NAV.

26. After receiving these notifications, PIMCO's Pricing Group notified the appropriate PIMCO trader and inquired whether to challenge the Pricing Vendor Mark. For example, on March 12, 2012, a member of the Pricing Group sent an email to an NA MBS trader regarding one of the NA MBS odd lots purchased for BOND, stating "[y]ou traded the below on Friday 3/9, which is potentially impacting the NAV for account 4700 [BOND]. Despite your previous conversation that these small lot trades do not need a challenge, per the new SEC findings of UBS, we have to make sure we follow procedures. Please confirm if you would like to challenge." PIMCO had purchased this NA MBS odd lot position at \$64.9999 and then marked it to \$82.74585 using the Pricing Vendor Mark, which had positively impacted BOND's NAV by \$0.02. The NA MBS trader replied that there was "[n]o need to challenge" because "the bigger piece of the same cusip is likely to trade at low 80s."

27. The NA MBS traders routinely made similar determinations not to challenge Pricing Vendor Marks. Because these repeated variance notices created an administrative burden for the traders, in May 2012 PIMCO's Pricing Group shut down the automatic challenge process at PIMCO for mortgage securities, such as NA MBS. As a result, there would be no automatic challenge if the trader did not respond to a variance notice.

28. Despite receiving numerous notifications of significant pricing variances related to NA MBS odd lots during BOND's initial weeks, PIMCO continued to value these odd lots at the Pricing Vendor Mark.

29. Other individuals and groups at PIMCO also knew that PIMCO's purchase of NA MBS odd lots for BOND was having a significant positive impact on the fund's performance. For example, the Compliance Department reviewed BOND's performance for the period of February 29, 2012 through April 30, 2012 and determined that the odd lots were significant performance contributors. In particular, a June 2012 memorandum prepared by the Compliance Department noted that PIMCO's Pricing Group had "confirmed that smaller [sic] odd-lot CMO positions can trade at a relative discount versus institutional size lots. Generally, smaller, odd-lot sizes [sic] CMO positions are priced at a discount compared to larger institutional lot sizes due to dealers' preference to not hold such odd-lot sizes in their inventories." Further, during the three months after BOND's launch, the ETF Treasurer knew that odd lot/round lot pricing differences for NA MBS were positively impacting BOND's NAV and contributing to its impressive performance.

PIMCO's "Odd Lot" Strategy Caused BOND to Overvalue Its Portfolio and Thus Fail to Price Fund Shares on the Basis of Their Net Asset Value

30. Rule 22c-1 under the Investment Company Act prohibits registered investment companies, among others, from selling, redeeming, or repurchasing any redeemable security except at a price based on the current NAV of such security. Under Section 2(a)(41)(B) of the Investment Company Act, registered investment companies must value their portfolio assets by using: (1) market values for securities with readily available market quotations; and (2) fair value for all other portfolio assets, as determined in good faith by the board of directors. The fair value of securities for which market quotations are not readily available is the exit price the fund would reasonably expect to receive for the securities.

31. PIMCO did not properly value 43 NA MBS odd lots that BOND purchased, repeatedly causing BOND to overstate its NAV. PIMCO did not have a reasonable basis to believe that it could exit these 43 positions at round lot prices. PIMCO, however, valued those 43 NA MBS at the Pricing Vendor Marks.

32. Commission guidance provides that there are many relevant factors to consider when valuing securities. *See* Accounting Series Release No. 118 ("ASR 118").⁴ While, depending on the circumstances, it is not necessarily improper to value an odd lot at a pricing vendor mark,⁵ PIMCO did not conduct any contemporaneous review or analysis to determine if BOND's NA MBS odd lots could in fact be sold at or near the Pricing Vendor Marks. This was despite the fact that (1) the purchase prices for these 43 positions were, on average, approximately 9% lower than the Pricing Vendor Mark, (2) PIMCO did not have a reasonable basis to believe BOND could exit these NA MBS positions as part of a round lot, and (3) during the Relevant Period, PIMCO sold NA MBS for which it did not otherwise have a round lot position for amounts that were on average 3.81% less than the Pricing Vendor Mark.

33. By using the Pricing Vendor Marks to value these 43 NA MBS odd lots in BOND, PIMCO overstated the value of these positions. This practice impacted BOND's daily NAV throughout the Relevant Period. Thus, PIMCO caused BOND to overvalue its portfolio and, consequently, to sell its shares at prices that were not based on their current NAV.

34. Using the Pricing Vendor Mark to value these 43 positions positively impacted BOND's NAV up to \$0.31 per share during the Relevant Period, when BOND's daily reported NAV ranged from approximately \$100 to \$105.55 per share.

⁴ *See also* FASB Accounting Standards Codification "ASC" 820-10-30-2. The Commission has provided interpretive guidance related to financial reporting in the Accounting Series Releases, which is included in the Codification of Financial Reporting Policies. Thus, conformity with the ASR 118 is required by Commission rules and complies with Generally Accepted Accounting Principles ("GAAP"). *See also* Articles 1-01(a) and 6.03 of Regulation S-X.

⁵ *Money Market Fund Reform; Amendments to Form PF*, Securities Act Rel. No. 9616 (July 23, 2014) at 285-88 (providing guidance regarding the use of pricing services).

Odd Lot Pricing Was Not Addressed by PIMCO's Pricing Policy, Nor Was the Issue Elevated According to the Provisions of that Policy

35. The Board of Trustees of the PIMCO ETF Trust adopted valuation procedures to be followed by each series of the Trust, including BOND, for the stated purpose of determining the value of the funds' portfolio securities and ensuring that NAV was calculated on a timely and accurate basis. The Trustees also established a Valuation Committee for each series of the Trust to oversee implementation of the valuation procedures and make fair value determinations on behalf of the Board, which would subsequently ratify any actions taken by the Valuation Committee. According to the valuation procedures, the Trustees delegated primary responsibility for determining fair value to PIMCO, with ultimate responsibility for oversight of valuation residing with the Board. The Trustees also approved PIMCO's compliance policies and procedures, which included the pricing policy discussed below.

36. PIMCO's Executive Committee adopted a pricing policy for purposes of valuing client securities. The Executive Committee delegated to PIMCO's Pricing Committee responsibility for overseeing the implementation of the pricing policy, making fair value determinations, and resolving valuation issues. PIMCO's Pricing Group implemented the pricing policy on a daily basis.

37. The stated purpose of PIMCO's pricing policy was to ensure that prices reasonably reflected fair value. The policy, as well as BOND's prospectus, stated that "[m]arket value is generally determined on the basis of last reported sales prices, or if no sales are reported, based on quotes obtained from a quotation reporting system, established market makers, or pricing services."

38. Under the pricing source hierarchy in the pricing policy, the primary vendor that PIMCO used for determining the value of NA MBS positions was the Pricing Vendor. PIMCO used this pricing service to value all of the NA MBS positions in BOND during the Relevant Period. According to the Pricing Vendor, its marks represented its good faith opinion as to "what a buyer in the marketplace would pay for a security (typically in an institutional round lot position) in a current sale." Although PIMCO knew that the Pricing Vendor provided it with institutional round lot marks, PIMCO nevertheless used the Pricing Vendor's round lot marks to value all of the NA MBS positions in BOND, including the 43 positions discussed above that were all less than \$1 million in size.

39. The pricing policy also vested PIMCO's traders with the responsibility for determining when to report to PIMCO's Pricing Committee any price that does not reasonably reflect market value. Specifically, the policy stated that "[i]t is the responsibility of the respective [trading] Desk to bring to the attention of the [Pricing] Committee any price that does not reasonably reflect market value and/or initiate a pricing source change." The policy did not, however, provide the traders with any guidance regarding when to raise or elevate significant pricing issues, such as odd lot pricing.

40. Despite the indications PIMCO had that it may be inaccurately pricing NA MBS in BOND, the odd lot pricing issue was never discussed at any PIMCO Pricing Committee or

ETF Board Valuation Committee meetings during the Relevant Period. The issue was never even elevated to the committee level.

PIMCO Negligently Made Misleading Disclosures to Investors about BOND's Initial Performance

41. At PIMCO, fund disclosures were prepared largely by Product Management (“PdM”), an internal group responsible for understanding a certain product area and interfacing between Portfolio Management and the client-facing groups who interact with either (1) the financial intermediaries that represent individual investors or (2) institutional investors. For BOND, ETF PdM was the sub-group responsible for the product area.

42. Early on, ETF PdM became aware of the impact of the pricing of NA MBS odd lots on BOND's performance. Within the first few weeks of BOND's launch, PIMCO's internal performance attribution system, known as PICASO, reported strong returns for BOND. ETF PdM noted that the “execution” category in PICASO for the NA MBS market—which captured the difference between the trade price and the end-of-day vendor mark—was a large contributor to returns. ETF PdM also learned that NA MBS odd lots can trade at different prices from round lots and that those differences were reflected as “execution” in PICASO. By March 5, 2012, ETF PdM knew that execution was causing an “alpha boost” to BOND.

43. Indeed, BOND's initial performance was largely attributable to PIMCO's use of the “odd lot” strategy involving the 156 NA MBS positions of less than \$1 million in size. Specifically, this strategy contributed 54% to BOND's cumulative performance returns in March 2012; 30% in April 2012; 20% in May 2012; and 18% in June 2012.

44. In late March 2012, PdM began fielding questions from the media and internal client-facing groups about the significant differences in performance between BOND and TRF. In contrast to BOND, PICASO showed virtually no performance for TRF attributable to the difference between the trade price and the end-of-day Pricing Vendor Mark. The head of ETF PdM emailed his supervisors about how to address execution and these types of questions, recognizing that the Portfolio Management team might be sensitive about performance attribution. In one email he wrote: “Question to discuss on if/how we address these types of questions in the press” so as to “balance [Portfolio Management] preferences on how alpha is characterized.” He also noted “[t]he new Picaso attribution system ... shows that 101 [basis points] of alpha is coming from Execution in the Securitized sector.” In another email he wrote: “May ask for your input on this as attribution reporting may have [Portfolio Management] sensitivities. We may also consider different levels of detail for different audiences ([Institutional], [Global Wealth Management], media). The Picaso system is very clear about sources of alpha, [another employee] confirmed that the ‘Execution’ bucket specifically captures intra-day changes in price between purchase price and end-of-day mark. I’m not sure how much people use or understand it though.”

45. On or about March 29, 2012, the head of ETF PdM met with his supervisor and another individual in Mortgage PdM to get input on attribution reporting. That same day, the head of ETF PdM and others worked to draft bullet points to describe the execution gains for

internal client-facing groups. In early April 2012, “internal only” updates were provided to client-facing groups that gave a limited and ambiguous explanation of execution: “The Total Return ETF has benefited from the overweight to mortgages that were executed at particularly favorable levels. Well-publicized inefficiencies in the non-agency market offer opportunities for an active manager to add value.”

Monthly Commentaries

46. For each month from March to June 2012, PIMCO posted “Monthly Commentaries” for BOND on its public website (within a week or so of the month end) and provided copies of the documents to investors. According to PIMCO, “the Monthly Fund Commentary is the only standardized report that offers fund information, key performance data, and comprehensive portfolio characteristics; combined with direct market insight and outlook from PIMCO’s product team.” During the same time, PIMCO also posted Monthly Commentaries for TRF.

47. PIMCO negligently made materially misleading statements about BOND’s performance in the Monthly Commentaries under the heading “Performance summary,” which listed “Contributors” and “Detractors,” as well as under the heading “Performance commentary.”

- a. In the BOND Monthly Commentary for the period ended March 31, 2012, PIMCO listed as a Contributor: “Exposure to non-Agency mortgages, as the sector outperformed Treasuries.” PIMCO also noted in the commentary: “exposure to non-Agency mortgages added to returns as prices on these securities rose.”
- b. In the BOND Monthly Commentary for the period ended April 30, 2012, PIMCO listed as a Contributor: “Modest exposure to non-Agency mortgage-backed securities, as prices on these securities rose,” and further explained “modest exposure to non-Agency mortgages added to returns as prices on these securities rose.”
- c. In the BOND Monthly Commentary for the period ended May 31, 2012, PIMCO listed as a Contributor: “exposure to non-Agency MBS,” and noted “exposure to non-Agency MBS [was] positive for returns.”
- d. In the BOND Monthly Commentary for the period ended June 30, 2012, PIMCO listed as a Contributor, “exposure to non-agency MBS, as these securities outperformed,” and explained “exposure to non-Agency MBS was positive for returns.”

48. These were misleading statements because, by stating that the “prices on these securities rose,” or that they “outperformed,” or were “positive for returns,” PIMCO negligently implied that the performance was due to price appreciation in the non-agency sector or the realization of inherent value in the NA MBS purchased for BOND. In reality, however, a significant portion of the returns resulted from the immediate gains attributable to pricing NA

MBS odd lots at Pricing Vendor round lot marks. Moreover, despite PIMCO's understanding that "execution" from NA MBS odd lots was a significant contributor to BOND's performance, PIMCO identified other contributors of lesser significance to BOND's performance. Specifically, PIMCO failed to mention (1) the returns attributable to the one-day pricing gains from NA MBS odd lots, (2) that such returns were not sustainable as BOND grew larger, and (3) that such returns were the direct result of a strategy to increase BOND's performance out of the gate by buying odd lots that traded at a discount to the Pricing Vendor's round lot marks. The description of BOND's performance from NA MBS was similar, and often identical, to the description of TRF's performance described in the TRF Monthly Commentaries for the same period, despite TRF having virtually no performance coming from execution.

49. The first substantive draft of the BOND Monthly Commentaries was prepared by Total Return ("TR") PdM, a task force that was loosely structured with a shifting membership. TR PdM had no supervisor of its PdM responsibilities and its members did not receive any formal training or written instructions on how to draft the Monthly Commentaries.

50. The TR PdM task force knew that execution from NA MBS in BOND was a cause of BOND's performance dispersion with the TRF (*i.e.*, the variance by which BOND outperformed the TRF). The TR PdM member who primarily drafted the Monthly Commentaries for BOND questioned whether BOND's performance was a result of "[g]ood execution or good pricing..." Members of ETF PdM reviewed and provided comments on the draft of BOND's Monthly Commentaries prepared by TR PdM.

51. PIMCO's disclosure policies and procedures were not reasonably designed to prevent misleading statements like these from being made about the sources of fund performance in the Monthly Commentaries. PIMCO's policies and procedures did not provide for the adequate training and supervision of the TR PdM task force. Neither the TR PdM task force nor the ETF PdM team considered whether execution from odd lot NA MBS—a significant and unusual source of BOND's performance—should have been disclosed in the Monthly Commentaries. Nothing in PIMCO's policies or procedures required them to do so. In addition, although many other individuals within PIMCO had some role in reviewing drafts of the Monthly Commentaries, none of them had any responsibility for confirming the substance of the sources of performance reported by PdM.

Annual Report

52. PIMCO also negligently made materially misleading statements about the sources of BOND's performance (and failed to comply with reporting obligations) in the Form N-CSR it prepared for the PIMCO ETF Trust dated June 30, 2012 and filed August 31, 2012. Like the Monthly Commentaries, the Annual Report disclosed under the heading "Portfolio Insights" that "Non-Agency positions added to returns as prices on these securities rose." This statement implied that the returns resulted from price appreciation in the non-agency sector or the realization of inherent value in the NA MBS purchased for BOND when in reality a significant portion of the returns resulted from the immediate gains attributable to pricing NA MBS odd lots at Pricing Vendor Marks.

53. The Annual Report also did not disclose, as required, that BOND's performance resulted from a strategy to increase BOND's performance out of the gate by buying odd lots that traded at a discount to the round lot prices and marking them up to the Pricing Vendor Mark. Item 27(b) of Form N-1A requires every annual report to shareholders to include financial statements containing Management's Discussion of Fund Performance. The Form N-1A instructions, under Management's Discussion of Fund Performance, require disclosure of "the factors that materially affected the [fund's] performance during the most recent completed fiscal year, including the relevant market conditions and the investment strategies and techniques used by the [fund's] investment adviser."⁶ A "strategy" is defined as including "any policy, practice or technique used by the [fund] to achieve its investment objectives." BOND's investment objective is to seek "maximum total return, consistent with preservation of capital and prudent investment management." PIMCO failed to disclose in the Annual Report its "odd lot" strategy, which significantly impacted BOND's ability to achieve total return during the Relevant Period.

54. The drafting and review of the portfolio commentary for BOND that was included in the Annual Report was similar to the drafting and review of the Monthly Commentaries. The TR PdM task force prepared the first substantive draft of the portfolio commentary for BOND, which was reviewed by ETF PdM. The head of ETF PdM suggested adding the reference to NA MBS that appeared in the final version.

55. The Annual Report was signed and certified by the ETF Treasurer, who knew that execution was a significant contributor to performance through June 30, 2012, but did not take any action to address this information in the disclosure.

56. PIMCO's disclosure policies and procedures were not reasonably designed to prevent misleading statements like this from being made about the sources of fund performance in the Annual Report. Like the Monthly Commentaries, neither the TR PdM task force nor the ETF PdM team considered whether execution from NA MBS odd lots should have been disclosed in the Annual Report. Nothing in PIMCO's policies or procedures required them to do so. PIMCO's policies and procedures also did not ensure that the drafters and reviewers of the Annual Report were made aware of investment strategies like the strategy to increase performance by buying NA MBS odd lots at a discount and valuing them at Pricing Vendor Marks.

PIMCO Failed to Disclose the Existence and Impact of the "Odd Lot" Strategy to BOND's Board of Trustees

57. On or about May 21, 2012, the head of ETF PdM gave an update to the ETF Trust Board of Trustees about BOND. In response to a question from a Trustee about BOND's performance, the head of ETF PdM responded by "focusing on the potential reasons it has significantly outperformed [TRF] since BOND's inception." He pointed to the fact that BOND was a new fund with sizeable weekly inflows that enabled it to implement its best ideas, and another PIMCO representative cited a "market anomaly that BOND was uniquely positioned to

⁶ The Form N-1A instructions do not require the disclosure of any reasons for performance for a fund that is less than six months old. The PIMCO ETF Trust nonetheless made this disclosure.

exploit because of the timing of its launch.” However, the Board was not told that (1) PIMCO had employed an “odd lot” strategy to increase performance out of the gate in which odd lot NA MBS were valued at the Pricing Vendor Mark, (2) execution resulting from this strategy significantly impacted BOND’s performance in its initial months and largely explained the dispersion from TRF, and (3) the “odd lot” strategy was unsustainable as BOND grew.

58. PIMCO’s policies and procedures were not reasonably designed to prevent misleading statements from being made about the sources of fund performance to the ETF Trust Board. Nothing in PIMCO’s policies or procedures required those making disclosures to fund boards to explain significant and unusual sources of performance, like execution from NA MBS odd lots.

Violations

59. As a result of the conduct described above, PIMCO willfully⁷ violated Section 206(2) of the Advisers Act, which prohibits investment advisers from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon a client or prospective client. A violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* Specifically, PIMCO made materially misleading statements to the ETF Trust Board by failing to inform it about the “odd lot” strategy and execution as a significant source of BOND’s performance.

60. As a result of the conduct described above, PIMCO willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and Rules thereunder. By vesting the responsibility with its traders for determining when to report to PIMCO’s Pricing Committee any price that did not reasonably reflect market value without sufficient objective checks or guidance for elevating pricing issues to the Pricing Committee or Valuation Committee, PIMCO’s pricing policy was not reasonably designed to prevent valuation-related violations. Further, PIMCO’s policies and procedures did not require those making disclosures to investors or the ETF Trust Board to consider whether significant and unusual sources of performance like execution should be disclosed. Nor did they ensure that those making the disclosures were made aware of investment strategies like the “odd lot” strategy. As such, PIMCO’s disclosures policies and procedures were not reasonably designed to prevent misleading statements from being made about the sources of fund performance.

61. As a result of the conduct described above, PIMCO willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which make it unlawful for any investment adviser to a pooled investment vehicle to make any untrue statement of material fact

⁷ A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

or omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle, or otherwise engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle. Specifically, in preparing, posting on its website, and providing to investors copies of each of the Monthly Commentaries for the period March through June 2012, and distributing to shareholders of BOND the Annual Report filed with the Commission by the ETF Trust for the period ended June 30, 2012, PIMCO negligently made untrue or misleading statements of material fact about the sources of BOND's performance to investors and prospective investors in a pooled investment vehicle.

62. As a result of the conduct described above, PIMCO willfully violated Section 34(b) of the Investment Company Act, because it was responsible for the inclusion of untrue statements of material fact in a registration statement, application, report, account, record or other document filed or transmitted pursuant to the Investment Company Act, or omitted to state therein, facts necessary in order to prevent the statements made therein, in light of the circumstances under which they were made, from being materially misleading. Specifically, in preparing the Annual Report filed with the Commission by the ETF Trust for the period ended June 30, 2012, PIMCO negligently made untrue or misleading statements of material fact about the factors that materially affected BOND's performance.

63. As a result of the conduct described above, BOND violated Rule 22c-1 under the Investment Company Act which prohibits registered investment companies, among others, from the sale, redemption, or repurchase of any redeemable security except at a price based on the current net asset value of such security. Specifically, BOND overstated its NAV and executed transactions in redeemable securities at prices not based on current net asset values throughout the Relevant Period. PIMCO caused these violations.

Undertakings

Respondent has undertaken to complete the following actions:

64. PIMCO shall retain, within thirty (30) days of the issuance of this Order, an Independent Compliance Consultant ("Consultant") not unacceptable to the staff of the Commission, and provide a copy of this Order to the Consultant. The Consultant's compensation and expenses shall be borne exclusively by PIMCO. PIMCO shall require the Consultant to conduct a comprehensive review of PIMCO's written compliance policies and procedures to address (1) the pricing and valuation of odd lots noted in paragraphs 30-34 of the Order, including (but not limited to) what constitutes an odd lot, how to value those odd lots, and the frequency with which they should evaluate odd lot pricing, and (2) the procedures noted in paragraphs 39-40 of the Order. Although the Order addresses the valuation of NA MBS odd lots, PIMCO shall require the Consultant to include as part of its review the pricing and valuation of odd lots as noted above as it pertains to all asset classes of securities.

65. PIMCO shall provide to the Commission staff, within thirty (30) days of retaining the Consultant, a copy of an engagement letter detailing the Consultant's responsibilities, which

shall include the review described above in paragraph 64.

66. At the end of the review, which in no event shall be more than one hundred twenty (120) days after the date of the entry of this Order, PIMCO shall require the Consultant to submit a Report to PIMCO and the staff of the Commission (“Report”). The Report shall address the issues described above in paragraph 64, and shall include a description of the review performed, the conclusions reached, the Consultant’s recommendations for changes in or improvements to PIMCO’s policies and procedures, and a procedure for implementing the recommended changes in or improvements to those policies and procedures.

67. PIMCO shall adopt all recommendations contained in the Report within ninety (90) days of receipt; provided, however, that within thirty (30) days of PIMCO’s receipt of the Report, PIMCO shall, in writing, advise the Consultant and the Commission staff of any recommendations that it considers unnecessary, unduly burdensome, impractical, or inappropriate. With respect to any such recommendation, PIMCO need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose. As to any recommendation on which PIMCO and the Consultant do not agree, such parties shall attempt in good faith to reach an agreement within thirty (30) days after PIMCO provides the written notice described above. In the event that PIMCO and the Consultant are unable to agree on an alternative proposal, PIMCO and the Consultant shall jointly confer with the Commission staff to resolve the matter. In the event that, after conferring with the Commission staff, PIMCO and the Consultant are unable to agree on an alternative proposal, PIMCO will abide by the recommendations of the Consultant.

68. Within thirty (30) days of PIMCO’s adoption of all of the recommendations in the Consultant’s Report, as determined pursuant to the procedures set forth herein, PIMCO shall certify in writing to the Consultant and the Commission staff that it has adopted and implemented all of the Consultant’s recommendations in the Report. Unless otherwise directed by the Commission staff, all Reports, certifications, and other documents required to be provided to the Commission staff shall be sent to C. Dabney O’Riordan, Co-Chief, Asset Management Unit, Division of Enforcement, U.S. Securities and Exchange Commission, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071, or such other address as the Commission’s staff may provide.

69. PIMCO shall cooperate fully with the Consultant and shall provide the Consultant with access to files, books, records, and personnel as are reasonably requested by the Consultant for review.

70. To ensure the independence of the Consultant, PIMCO (i) shall not have the authority to terminate the Consultant or substitute another independent compliance consultant for the initial Consultant, without the prior written approval of the Commission’s staff; (ii) shall compensate the Consultant and persons engaged to assist the Consultant for services rendered pursuant to this Order at their reasonable and customary rates; and (iii) shall not invoke the attorney-client or any other doctrine or privilege to prevent the Consultant from communicating with or transmitting any information, reports, or documents to the Commission’s staff.

71. PIMCO shall require the Consultant to enter into an agreement providing that for the period of the engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing, or other professional relationship with PIMCO, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Consultant in the performance of his/her duties under this Order shall not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with PIMCO, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

72. For good cause shown, the Commission staff may extend any of the procedural dates relating to undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

73. PIMCO shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance with the undertakings in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and PIMCO agrees to provide such evidence. The certification and supporting material shall be submitted to C. Dabney O’Riordan, Co-Chief, Asset Management Unit, Division of Enforcement, U.S. Securities and Exchange Commission, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in Respondent PIMCO’s Offer.

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

A. Respondent PIMCO cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 promulgated thereunder, and Section 34(b) of the Investment Company Act and Rule 22c-1 under the Investment Company Act.

B. Respondent PIMCO is censured.

C. PIMCO shall, within 14 days of the entry of this Order, pay disgorgement of \$1,331,628.74, prejudgment interest of \$198,179.04, and a civil money penalty in the amount of

\$18,300,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment of disgorgement and prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and if timely payment of a civil money penalty is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying PIMCO as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to C. Dabney O'Riordan, Co-Chief, Asset Management Unit, Division of Enforcement, U.S. Securities and Exchange Commission, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

E. Respondent shall comply with the undertakings enumerated in paragraphs 64-73 above.

By the Commission.

Brent J. Fields
Secretary