

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4749 / August 21, 2017**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-18120**

**In the Matter of**

**DEERFIELD MANAGEMENT  
COMPANY, L. P.,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTIONS 203(e) AND 203(k) OF THE  
INVESTMENT ADVISERS 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”), against Deerfield Management Company, L.P. (“Deerfield” or “Respondent”).

**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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist (“Order”), as set forth below.

**III.**

On the basis of this Order and Respondent’s Offer, the Commission finds<sup>1</sup> that:

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<sup>1</sup> 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.

## SUMMARY

1. This case involves the failures of Deerfield Management Company, L.P. (“Deerfield”), a registered investment adviser, from 2012 through 2014 (the “Relevant Period”) to establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of material, nonpublic information, particularly taking into consideration the nature of Deerfield’s business. Deerfield conducted extensive research in the healthcare sector, which helped inform the firm’s investment decisions on behalf of hedge funds it advised. As part of this research, Deerfield engaged third party consultants and research firms, including firms that specialized in providing “political intelligence” regarding upcoming regulatory and legislative decisions.

2. During the Relevant Period, Deerfield failed to establish, maintain, and enforce policies and procedures reasonably designed to address the risk that its employees could misuse material, nonpublic information from research firms that Deerfield retained, particularly those specializing in political intelligence. Deerfield’s policies and procedures concerning research firms required only an initial review, to be refreshed “from time to time” (according to its Compliance Manual) to ensure that the research firms observed their own policies and procedures to prevent the disclosure of material, nonpublic information. Deerfield also relied on its own employees to self-evaluate and self-report potential receipt of material, nonpublic information, but failed to adopt policies and procedures to ensure that its employees did so. For example, as explained below, Deerfield distinguished expert network firms from research firms. Deerfield imposed compliance requirements when its employees interacted with experts and expert network firms, but did not adopt similar safeguards for dealings with research firms.

3. The risk posed by Deerfield’s use of research firms manifested when Deerfield analysts received material, nonpublic information from a political intelligence analyst whose research firms Deerfield retained. Until early 2013, contrary to its own policies and procedures, Deerfield failed to review the policies and procedures at one of the political intelligence analyst’s research firms. In addition, the political intelligence analyst provided Deerfield’s analysts with material nonpublic information from sources at the Centers for Medicare and Medicaid Services (“CMS”). However, Deerfield failed to enforce its policies and procedures requiring employees to self-report receipt of this information to certain members of the firm’s senior management.

4. From at least May 2012 through November 2013, the political intelligence analyst conveyed to Deerfield analysts material, nonpublic information regarding three confidential CMS decisions before those decisions were publicly announced. The Deerfield analysts based trading recommendations on that information, and Deerfield made timely trades that resulted in profits of more than \$3.9 million for certain of its hedge funds once CMS announced its decisions.

5. Despite red flags that the political intelligence analyst was conveying material, nonpublic information to Deerfield analysts, Deerfield continued to retain the political intelligence analyst’s firms and did not address the weaknesses in its policies and procedures.

## RESPONDENT

6. **Deerfield Management Company, L.P.** is a Delaware limited partnership headquartered in New York, New York. Deerfield is an investment adviser that provides advisory services in the healthcare sector exclusively to its associated funds. As of December 31, 2014, Deerfield had approximately \$6.4 billion in assets under management. Deerfield has been registered with the Commission as an investment adviser since March 30, 2012. Deerfield has a significant financial interest in the assets and performance of the hedge funds it advises due to advisory fees it receives (traditionally 1.75% per year of the net assets of the applicable funds) and performance-based compensation (traditionally 20% per year of net appreciation of funds' assets).

## FACTS

### **A. Deerfield's Policies and Procedures to Prevent the Misuse of Material, Nonpublic Information**

7. Deerfield first adopted a Compliance Manual in 2012, and revised it in 2013. The 2013 version remained in effect through 2014. The versions did not differ in material respects concerning prevention of the misuse of material, nonpublic information. The Compliance Manual provided employees with a list of types of information they should consider material, including, but not limited to: "dividend changes, earnings estimates, changes in previously released earnings estimates, significant merger, acquisition or other major transaction proposals or agreements, major litigation, liquidation problems, knowledge of an impending default on debt obligations, knowledge of an impending change in debt rating by a statistical rating organization, and extraordinary management developments." The Compliance Manual added that "[m]aterial information does not have to relate to the issuer's business. For example, in one case the Supreme Court considered as material certain information about the contents of a forthcoming newspaper column that was expected to affect the market price of a security."

8. Deerfield's Compliance Manual stated that concerns about the misuse of material, nonpublic information by the firm or its employees could arise primarily in two ways: (1) "the Firm conducts extensive fundamental research on the entire healthcare sector in order to develop and implement investment theses. Despite efforts to avoid receiving non-public information, such research may sometimes result in the Firm receiving non-public information about the companies it researches"; and (2) the Firm may possess "material, non-public information relating to its own business and the investment activities of the Funds."

### **B. Deerfield Did Not Establish or Maintain Policies and Procedures Reasonably Designed to Address the Risks Created by Its Practice of Using Research Firms**

9. Deerfield engaged research firms and their political intelligence analysts to provide information regarding government decision-making. This business practice exposed Deerfield's employees to the risk of receiving material, nonpublic information from such research firms. Deerfield's policies and procedures were not reasonably designed to guard against this risk during the Relevant Period.

10. Deerfield's Compliance Manual established certain procedures for its use of "experts" and "expert networks." However, as explained below, Deerfield did not apply these procedures to a broad category of "research firms," including those that employed political intelligence analysts.

11. The Compliance Manual noted that Deerfield "may from time to time consult with experts in scientific, medical, commercial, business, regulatory, and legal fields, among others, and the Firm or a third party expert network may pay such persons for providing their time and expertise." Under Deerfield's policies and procedures, all expert and expert networks engaged by Deerfield must first undergo "due diligence" to evaluate their compliance controls. In addition, at the beginning of any expert consultation, the Deerfield employee consulting with the expert was required to provide an oral reminder to the expert not to disclose information that would constitute material, nonpublic information. After the conclusion of the consultation, the employee was required to enter a report of the discussion into Deerfield's "Matrix" system (a database created by Deerfield to retain and organize investment research). The head of Deerfield's internal research department (the Deerfield Institute) was responsible for monitoring compliance with these requirements.

12. In 2012, Deerfield provided training to its employees that specifically *excluded* research firms from the requirements for expert consultations. Deerfield distinguished research firms from expert consultants by defining research firms as firms that provided "a finished product" based upon the research firm's "internal expertise and research." The training materials stated that the Deerfield Institute would conduct "diligence" on research firms, but Deerfield would rely upon the research firms to police their own conduct. Further, it was "not necessary to give a cautionary statement or make a Matrix entry following a "consult" with a research firm.

13. In 2013, Deerfield adopted a new version of its Compliance Manual, which remained in effect through 2014. This version incorporated the exception for research firms that had been explained in the 2012 training. Research firms were required only to demonstrate that they "observe policies and procedures to prevent the disclosure of material non-public information or any information in breach of a duty." That demonstration was to be "refreshed from time to time." However, the policies and procedures did not explain what these reviews should entail, such as verification that the research firm had adopted such policies and procedures and was actually following them or how Deerfield personnel should go about doing so. In addition, the Compliance Manual explained that it was "not necessary for Deerfield analysts to obtain fresh terms and conditions, or to provide fresh warnings regarding the disclosure of confidential information with each interaction" or take any other steps such as to document their interactions in the firm's Matrix system for monitoring by the head of the Deerfield Institute.

14. Apart from this review described in the 2012 training and added in the 2013 Compliance Manual, Deerfield did not have any policies or procedures that applied to "research firms," including those that employed political intelligence analysts. Deerfield's policies and procedures otherwise placed the burden on Deerfield's employees to police themselves by requiring that they identify their potential receipt of material, nonpublic information and raise concerns with superiors, including the Chief Compliance Officer, Chief Financial Officer, or Head Trader.

### C. Deerfield Did Not Enforce its Policies and Procedures

15. As discussed above, Deerfield's policies and procedures required the Deerfield Institute to determine that research firms observed policies and procedures designed to prevent the disclosure of material, nonpublic information or any other information in breach of a duty. Deerfield's review of whether a research firm observed its own policies and procedures was critical because it was Deerfield's sole procedure in place to prevent the receipt and misuse of material, nonpublic information from research firms. However, Deerfield did not enforce this requirement.

16. For example, Deerfield did not review the policies and procedures of at least one research firm it retained from at least 2009 until early 2013. When Deerfield received this research firm's policies and procedures in 2013, Deerfield continued to retain the firm's services despite red flags. One red flag was that the research firm's Form ADV<sup>2</sup> indicated that the political intelligence analyst also served as the research firm's Chief Compliance Officer. Deerfield continued to retain the services of the political intelligence analyst and his research firm despite the conflict of interest posed by a Chief Compliance Officer overseeing his own work, which involved a risk of obtaining material, nonpublic information and providing such information to his investment adviser clients.

17. Additional red flags were communications with the political intelligence analyst that contained potential material, nonpublic information. These communications continued for several years, including several received by members of senior management responsible for enforcing Deerfield's policies and procedures. Nevertheless, these emails did not result in any actions by Deerfield to prevent the potential misuse of material, nonpublic information. Examples of these communications include:

- A. In July 2010, the political intelligence analyst emailed several Deerfield analysts about a forthcoming regulation by CMS, writing: "Timing for regs are crazy but I just heard from a reliable cms source the reg is likely coming out today after 4pm. All issues have been resolved and all outstanding edits have been completed." One of the analysts forwarded the email to other Deerfield personnel, including traders, portfolio managers, the Chief Compliance Officer/general counsel.
- B. In September 2010, a Deerfield analyst sent the same group of Deerfield personnel a summary of a conversation he had with the political intelligence analyst concerning an upcoming regulation and what to expect from CMS. The analyst wrote: "[t]here is a closed-door meeting next week and [the political intelligence analyst] has a guy there . . . regulation would be announced in 2011, effective 2012."
- C. In September 2011, a Deerfield analyst emailed the political intelligence analyst regarding an anticipated coverage decision by a Medicare

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<sup>2</sup> The research firm was a registered investment adviser that filed a Form ADV with the Securities and Exchange Commission and was registered with the District of Columbia.

Administrative Contractor, asking, “Is it already public or did you just hear about it from CMS guys? Any sense of how strong an endorsement it is?” The analyst forwarded the email string to the other Deerfield personnel, enabling others at the firm to see his questions to the political intelligence analyst.

18. Other communications that contained material, nonpublic information resulted in trading by Deerfield. Between at least May 2012 and November 2013, the political intelligence analyst transmitted material, nonpublic information regarding CMS decisions to Deerfield analysts, which the Deerfield analysts then used as the basis for trading recommendations. These communications were not reported to senior management as required by the firm’s policies and procedures, and Deerfield did not have reasonably designed procedures in place to enforce this requirement. Instead, Deerfield traded in advance of several CMS announcements:

- A. In May and June 2012, the political intelligence analyst provided Deerfield analysts with specific information regarding confidential CMS deliberations regarding cuts to Medicare reimbursement rates for certain radiation oncology treatments. The Deerfield analysts recommended trades based on this information, and Deerfield then traded on behalf of certain of its hedge funds to sell short shares of two companies who offered products and services related to radiation oncology. The hedge funds that Deerfield advised then profited when CMS announced the rate cuts.
- B. In May and June 2013, the political intelligence analyst provided a Deerfield analyst with specific information regarding confidential CMS deliberations regarding a proposed 12% reduction to the Medicare reimbursement rate for certain kidney dialysis treatments, services, and drugs. The Deerfield analyst recommended trades based on this information and Deerfield then sold short the shares of a company that offered products and services related to kidney dialysis. The hedge funds that Deerfield advised then profited when CMS publicly announced the cuts, which were in the exact amount the political intelligence analyst had conveyed to the Deerfield analyst.
- C. In November 2013, the political intelligence analyst provided a Deerfield analyst with specific information regarding confidential CMS deliberations regarding a final decision to phase in, over a four-year period, a 12% reduction to the Medicare reimbursement rate for certain kidney dialysis treatments, services, and drugs. The analyst recommended trades based on this information and Deerfield then purchased shares of a company that offered products and services related to kidney dialysis. The hedge funds that Deerfield advised then profited when CMS publicly released its decision to phase-in the 12% cuts over a three- to four-year period, which was perceived as a positive development for the affected company.

19. As a result of these trades, hedge funds advised by Deerfield received profits totaling approximately \$3,946,267. Through its management agreements with the hedge funds, including performance-based compensation, Deerfield received approximately \$714,110 due to these trades.

### **VIOLATIONS**

20. As a result of the conduct described above, Deerfield willfully<sup>3</sup> violated Section 204A of the Advisers Act, which requires investment advisers subject to Section 204 of the Advisers Act, such as Deerfield, to “establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser’s business, to prevent the misuse in violation of this Act, or the Securities Exchange Act of 1934, or the rules or regulations thereunder, of material nonpublic information by such investment adviser or any person associated with such investment adviser.”

### **REMEDIAL EFFORTS**

21. In determining to accept the Offer, the Commission considered remedial acts undertaken by Deerfield.

## **IV.**

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

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

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 204A of the Advisers Act.

B. Respondent is censured.

C. Respondent shall, within 14 days of the entry of this Order, pay disgorgement of \$714,110, prejudgment interest of \$97,585 and a civil money penalty of \$3,946,267 to the United States 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 the 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:

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<sup>3</sup> 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)).

- (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 Deerfield 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 Robert A. Cohen, Co-Chief, Market Abuse Unit, Division of Enforcement, United States Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

By the Commission.

Brent J. Fields

Secretary