Desperately Seeking Alpha (and Getting Caught)

By Kerry Pechter *Thu, May 19, 2022*

Low rates, demand for yield, financial alchemy, gaudy incentives and a black swan event provided the ingredients for the cataclysm at AGI US. Pictured: SEC chief Gary Gensler.

A major asset manager has admitted that for five years its fund advisers hid the flaws of their complex options strategies—flaws that would cost pension funds, family offices and other institutional investors an estimated $5 billion.

The Securities & Exchange Commission (SEC) has ordered Allianz Global Investors US (AGI US), a subsidiary of Munich-based Allianz SE, and three then-advisers of AGI US's Structured Alpha funds, to "disgorge" over $100 million in bonuses that the SEC's May 17 civil **complaint** called "ill-gotten." The Structured Alpha funds held as much as $11 billion in assets, on which AGI earned some $550 million in fees, the complaint said.

No institutional investors were identified in the SEC complaint. There were 17 Structured Alpha funds, with 114 institutional investors in the US and other countries. The funds took in almost $3 billion more than their pre-established $9 billion capacity. As of December 31, 2020, AGI US managed $148.8 billion.

AGI US—which Allianz SE sold this week to Voya Investment Management (see below)—admitted that its conduct from 2016 to 2020 violated federal securities laws. It agreed to a cease-and-desist order, a censure and payment of $315.2 million in disgorgement, $34 million in prejudgment interest, and a $675 million civil penalty, a portion of which will be distributed to certain investors, the SEC release said.

In addition, the US Attorney's Office for the Southern District of New York this week announced related criminal charges against AGI US and the three advisers: Gregoire P. Tournant, Trevor L. Taylor, and Stephen G. Bond-Nelson. AGI US, Taylor and Bond-Nelson have agreed to guilty pleas.

In an apparent response to the negative news, Allianz SE separated itself from AGI. The German firm has already arranged to sell AGI to Voya Investment Management (Voya IM).

After its guilty plea, AGI US was automatically and immediately disqualified from providing advisory services to US registered investment funds for the next ten years. AGI US will transfer teams managing about $120 billion in “income and growth, fundamental equities and private placements” assets to Voya IM, whose assets under management will grow to about $370 billion. Allianz will own 24% of Voya IM. It was not immediately clear if the service ban will follow the AGI US teams or affect the disposition of their AUM after they transition to Voya IM.

In its release this week, the SEC emphasized that the crime was not victimless. “The victims of this misconduct include teachers, clergy, bus drivers, and engineers, whose pensions are invested in institutional funds to support their retirement. This case once again demonstrates that even the most sophisticated institutional investors, like pension funds, can become victims of wrongdoing,” said SEC Commissioner Gary Gensler, in a release.

The AGI advisers admitted to deceiving institutional investors about the risk management techniques in the fund and then trying to cover up its activity by lying to its customers and, later, to the SEC.

The complaint painted a picture in which low interest rates and investor demand for yield, plus high-tech financial engineering, plus immense financial incentives to hide bad news from clients, plus a black swan event in the financial markets in March 2020 (when the Structured Alpha funds suffered massive losses), provided the ingredients for a multi-level disaster.

According to the complaint, the fund advisers saved money by buying less expensive but riskier options, using less effective hedging strategies than they led their clients to believe, and accepting investor money in excess of the capacity of the fund.

“Structured Alpha was a complex options trading strategy designed to generate profits by using a portfolio of debt or equity securities as collateral to purchase and sell options, primarily on the S&P 500 Index,” the complaint said.

“Structured Alpha’s options trading strategy had three components: range-bound spreads, directional spreads, and hedging positions,” the complaint continued. “Range-bound spreads and directional spreads were designed to generate profits by collecting premiums from selling put and call options that expired out-of-the-money. Hedging positions were designed to protect against short-term market crashes.”

Judging by their bonuses, disclosed in the SEC complaint, the AGI advisers were highly incentivized to grow the Structured Alpha business, to retain clients and attract new investments, and to hide difficulties.

Over five years, Tournant and Taylor each received almost $50 million in bonuses on top of $300,000 annual base salaries. Bond-Nelson received $10.775 million in bonuses on top of a $250,000 base salary. Together, they received just under $114.66 million across the five-year period relevant to the complaint.

Year	Tournant Base	Tournant Bonus	Taylor Base	Taylor Bonus	Bond-Nelson Base	Bond-Nelson Bonus
2016	$300,000	$11,857,971	$300,000	$11,857,970	$250,000	$2,650,000
2017	$300,000	$14,776,007	$300,000	$14,776,007	$250,000	$3,250,000
2018	$300,000	$9,780,204	$300,000	$9,780,204	$250,000	$2,150,000
2019	$300,000	$13,403,104	$300,000	$13,403,105	$250,000	$2,725,000
2020	$300,000	N/A	$300,000	N/A	$250,000	N/A
Total	**$1,500,000**	**$49,817,286**	**$1,500,000**	**$49,817,286**	**$1,250,000**	**$10,775,000**

From 5/17/2022 SEC complaint against AGI US, p. 46.

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The SEC's investigation was conducted by Jonathan C. Shapiro and James F. Murtha, and supervised by Reid A. Muoio of the Complex Financial Instruments Unit. The litigation will be led by Timothy K. Halloran under the supervision of Melissa J. Armstrong.