a limited and controlled amount of timing activity will be in Janus' best interests—increased profitability—we will make exceptions." In another document, a Janus official claimed that "I have no interest in building a business around market timers, but at the same time I do not want to turn away $10–20 million."

- What are the responsibilities of mutual fund managers? How should conflicts of interest be decided?
- Late trades and market timing usually have only a small effect on the price of a mutual fund's share. Given the large number of individual investors in a mutual fund, it is unlikely that any individual suffered anything but minuscule financial losses. In what ways, and to what degree, has anyone been hurt by these practices?
- What, if anything, is ethically wrong with market timing and late trading?
- Should the regulation of financial markets be left to the workings of a competitive market, or is there a role for significant government regulation here?

## *Decision Scenario D*
## "SOFT MONEY" IN THE SECURITIES INDUSTRY

Kickbacks are illegal payments that occur when some portion of a payment is paid back, typically to an individual who made the original payment on behalf of some third party, as an incentive for the original payment. For example, a purchasing agent for a firm is responsible for making purchases for that firm at the best available price. An illegal kickback would occur if a purchasing agent enters into an agreement with a supplier by which part of the purchase price was "kicked back" to the purchasing agent. The fiduciary obligation that the purchasing agent owes to her firm is violated when she accepts personal benefits from the supplier because those benefits by right belong to her firm.

In recent years a practice has evolved in the financial industry that, according to some critics, amounts to little more than institutionalized kickbacks. "Soft money" payments occur when financial advisors receive payments from a brokerage firm to pay for research and analyst services that, in theory, should be used to benefit the advisors' clients. Soft money payments are abused when this money is used for the personal benefit of the financial advisors instead.

Consider how financial investments typically work. An investor gives money to a financial advisor to be invested on her behalf. This investment advisor then deals with a brokerage firm to carry out the specific investments that the advisor chooses and pays that brokerage firm commissions on these trades. To make responsible decisions, the financial advisor requires significant information, ranging from stock prices to corporate performance and financial records, and technical support such as computers and software. As it turns out, the brokerage firm is often exactly in the position to supply these services. Thus has developed the practice of soft money. In soft money transactions, the broker uses some of the money paid in commissions to pay for research and information services for the financial advisor. Typically, to do this they must charge higher commissions than they otherwise would to pay for this additional service. Encouraged by this practice, an entire research industry has developed, both within large brokerage houses and independently of them, to supply just these information and analyst services.

Soft money certainly can be a legitimate practice. Assuming the soft money is used for the benefit of the investor, and assuming the investor has understood and consented to paying higher costs for this added benefit, soft dollars appear to be an ethical and legitimate business practice. In 1975, the U.S. Congress legalized soft money payments by protecting financial advisors from charges of a conflict of interest as long as they disclose such payments to their clients. Problems arise when the money for research is used for the personal benefit of the advisor or the broker, or when investors are not informed of the practice.

On September 22, 1998, the Office of Compliance, Inspections and Examinations of the United States Securities and Exchange Commission released a major report on the practice of soft money payments. This report found that most products and services obtained by advisors fell within the legal definition of allowable research. However, they also reported that 35% of broker–dealers and 28% of advisors provided or received nonresearch products and services as part of their soft money payments. Examples included payments used for office rent and equipment, personal travel and automobile expenses, employee salaries, legal expenses, college tuition costs, and even membership at a private beach club. The report also concluded