

Press Release

McKinsey Affiliate to Pay \$18 Million for Compliance Failures in Handling of Nonpublic Information

FOR IMMEDIATE RELEASE

2021-241

Washington D.C., Nov. 19, 2021 — The Securities and Exchange Commission today announced that an affiliate of McKinsey & Company that offers investment options exclusively to current and former McKinsey partners and employees has agreed to pay an \$18 million penalty for compliance failures. The SEC's investigation found that the affiliate maintained inadequate policies and procedures to prevent McKinsey partners from misusing material nonpublic information they obtained as consultants to public companies and other McKinsey clients while they were simultaneously overseeing the affiliate's investment decisions.

The SEC's order finds that McKinsey's affiliate MIO Partners Inc. was investing hundreds of millions of dollars in companies that McKinsey was advising. Certain McKinsey partners oversaw MIO's investment choices and also had access to material nonpublic information as a result of their McKinsey consulting work. These partners were routinely privy to confidential information like financial results, planned bankruptcy filings, mergers and acquisitions, product pipelines and funding efforts, and material changes in senior management at those companies.

According to the SEC's order, MIO did not have reasonably designed policies and procedures to address the dual roles for McKinsey consultants who were involved in MIO's investment choices. For example, the order cites an instance where a McKinsey partner's access to confidential information about MIO's investments in a company through a third-party manager created a risk that one of McKinsey's units could influence the company's Chapter 11 reorganization plan in a way that favored MIO's investment.

"Allowing individuals who may possess or have access to material nonpublic information also to have oversight over investment decisions that may benefit them economically presents a heightened risk of misuse," said Gurbir S. Grewal, Director of the SEC's Division of Enforcement. "It is crucial that investment advisers have robust compliance policies and procedures in place to address the risks inherent to their organizational structures."

The SEC's order finds that MIO, which is a registered investment adviser and wholly-owned subsidiary of McKinsey, violated Sections 204A and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7. Without admitting or denying the findings, MIO consented to the entry of a cease-and-desist order and a censure, and agreed to pay the \$18 million penalty.

The SEC's investigation was conducted by Rebecca Reilly, Patricia H. Schrage, William Uptegrove, Neal Jacobson, Richard Hong, Christopher C. Mele, Alistaire Bambach, Andrew B. Dean, and Thomas P. Smith Jr. of the New York Regional Office. The case was supervised by Sanjay Wadhwa and Richard R. Best.

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 5912 / November 19, 2021

ADMINISTRATIVE PROCEEDING
File No. 3-20656

In the Matter of

MIO PARTNERS, INC.

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 MIO Partners, Inc. (“MIO” 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 (“Order”), as set forth below.

III.

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

Summary

1. These proceedings arise out of the failures of MIO, a registered investment adviser, from at least 2015 through 2020 (the "Relevant Period"), to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of its business, to prevent the misuse of material non-public information ("MNPI").

2. MIO, a subsidiary of management consulting firm McKinsey & Company ("McKinsey"), provides investment options exclusively to current and former McKinsey partners and employees.

3. Active McKinsey partners who were members of the Investments Committee of MIO's Board of Directors (the "Board") (i) obtained material non-public information concerning issuers as a result of their consulting work on behalf of clients ("McKinsey Client MNPI"), and (ii) had access to material non-public information concerning the investments made by MIO funds as a result of their participation on the MIO Investments Committee ("MIO MNPI").

4. Allowing active McKinsey partners, individuals who had access to MNPI about issuers in which MIO funds were invested, to oversee and monitor MIO's investment decisions presented an ongoing risk of misuse of MNPI. MIO did not have policies and procedures reasonably designed to address the risks associated with its organizational structure.

Respondent

5. MIO, also known as McKinsey Investment Office, is a Delaware corporation headquartered in New York, New York. MIO is a subsidiary of McKinsey and has been registered with the Commission as an investment adviser since 1992. MIO reported total regulatory assets under management of \$31 billion as of December 31, 2020.

Other Relevant Entities

6. McKinsey is a global management consulting firm headquartered in New York, New York. McKinsey provides consulting and other services to public companies and other entities that issue securities, as well as broker-dealers, investment advisers, and other registrants and self-regulatory organizations.

7. McKinsey Recovery & Transformation Services U.S., LLC. ("McKinsey RTS") is McKinsey's wholly-owned turnaround advisory and crisis management unit.

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.

Background

A. The Business, Operational Structure, and Oversight of MIO

8. MIO provides investment options exclusively to current and former partners and employees of McKinsey. During the Relevant Period, MIO invested approximately 90% of MIO client assets indirectly, through third-party managers who exercise their own investment discretion (i.e., a so-called “fund-of-funds” strategy), and the remaining approximately 10% directly, by purchasing and selling securities.

9. For MIO’s direct investments, MIO had investment discretion (i.e., MIO made the decision regarding whether to buy or sell each security subject to a direct trading policy which prohibited, except in specified circumstances, direct investment in the debt or equity of corporations) and had full knowledge of all securities held, including the number of shares of each security.

10. For MIO’s indirect investments via third-party managers, a little less than half were invested in separately managed accounts (“SMAs”), which were accounts within a MIO owned and operated special purpose fund. In the SMA structure, MIO contracted with a third-party manager to manage the SMAs; however, because MIO maintained in its records information reflecting all of the securities held by the SMAs, as well as all transactions executed by the SMAs, MIO had full knowledge of all securities held by the SMAs, including the number of shares of each security. For the remaining third-party managed funds, MIO’s investments were held in a third-party manager’s fund. MIO did not typically possess information reflecting all securities holdings and transactions in these accounts, but MIO frequently had access to securities holdings by way of public filings and communications with the third-party manager, including investor updates.

11. During the Relevant Period, MIO’s team of portfolio managers, led by MIO’s Chief Investment Officer (“CIO”), maintained day-to-day responsibility over MIO’s investments. MIO’s CIO reported to the Board, which oversaw MIO’s operations. Prior to September 2020, the Board primarily comprised active McKinsey partners.

12. MIO’s Board Charter (the “Charter”) set forth the Board’s roles and responsibilities and outlined the mandates of various Board committees, including, for example, the Investments Committee. According to the Charter in place since November 2018, the Investments Committee shall, *inter alia*, “[o]versee and monitor investments to be made by each Fund including direct investments, commitments to managers, additions to or withdrawals from existing managers, or material changes in circumstances or arrangements with existing managers.”

13. Prior to November 2017, the Charter further empowered the Investments Committee to formally ratify MIO investment decisions, meaning that the Investments Committee was authorized to approve investment decisions, which could pertain to both actual and planned allocations to third-party managers and direct investments.

14. Throughout the Relevant Period, MIO's investment decisions remained "subject to review and monitoring" by the Investments Committee.

15. Investments Committee members had a fiduciary duty to MIO's clients and, as such, were required to oversee and monitor MIO's investment decisions consistent with that fiduciary duty.

B. MIO's Access to MNPI

16. Throughout the Relevant Period, MIO had access to substantial MNPI.

17. Active McKinsey partners serving on the Investments Committee, including, through June 2017, the President of McKinsey RTS, possessed and had access to McKinsey Client MNPI by way of their various roles at McKinsey. As McKinsey consultants, Investments Committee members were routinely privy to MNPI relating to, for example, financial results, planned bankruptcy filings, mergers and acquisitions, product pipelines and funding efforts, and material changes in senior management.

18. Investments Committee members also possessed and had access to MIO MNPI as a result of their participation on the Board and its committees. For example, Investments Committee members were aware of MNPI regarding MIO's investment strategies, concentration limits, risk limits, and third-party manager allocations, and had access to MIO's holdings (both direct holdings and holdings in SMAs).

C. MIO Was Directly and Indirectly Invested in Issuers About Which Board Members Had Access to McKinsey Client MNPI

19. MIO directly and indirectly invested hundreds of millions of dollars in the securities of issuers about which Investments Committee members who were active McKinsey partners had access to substantial McKinsey Client MNPI.

20. For example, between October 2015 and June 2017, MIO's third-party managed funds, including certain of its SMAs, bought and sold securities of Alpha Natural Resources, Inc. ("ANR"), SunEdison, Inc. ("SunEdison"), and The Commonwealth of Puerto Rico ("Puerto Rico"). At the time of these transactions, certain Investments Committee members had access to MNPI concerning these issuers.

21. In February 2016, the Investments Committee reviewed and ratified a \$70 million allocation change to a third-party fund manager that was heavily invested in ANR senior secured debt. At that time, and in November 2015, when the Investments Committee had preliminarily ratified the allocation, McKinsey RTS was providing restructuring advice to ANR and the President of McKinsey RTS was on the Investments Committee. By June 2016, MIO had increased its total investment in the third-party manager's funds to approximately \$272 million and those funds, in turn, had obtained approximately \$80 million of ANR's senior secured debt.

22. Between October 2015 and December 2016, MIO's SMAs also invested (via six third-party managers) in another client of McKinsey RTS, SunEdison, while an Investments Committee member led McKinsey RTS.

23. Finally, in January and February of 2017, MIO was directly invested in the municipal bonds of Puerto Rico at the same time McKinsey was providing restructuring advice to the Puerto Rico Financial Oversight & Management Board (“FOMB”), the entity charged with spearheading Puerto Rico’s financial turnaround. During this time frame, the Investments Committee, which included active McKinsey partners with access to McKinsey Client MNPI, was empowered under the Investments Committee Charter to oversee MIO’s direct investments, including MIO’s sale of nearly \$1 million worth of Puerto Rican bonds. Further, in addition to MIO’s direct investments in Puerto Rico, through at least June 2017, MIO was also invested in Puerto Rico’s debt via its SMAs and other third-party managed funds.

24. Considering the nature of MIO’s business, including the Investments Committee’s oversight of MIO’s investment decisions, the risk of misuse of MNPI was real and significant.

D. McKinsey Provided Consulting Services to Clients About Which It Had Access to MIO MNPI

25. In numerous instances, McKinsey provided consulting services to clients in which MIO funds were invested and about which MIO MNPI was potentially relevant.

26. For example, McKinsey RTS had been retained in August 2015 as ANR’s turnaround adviser, worked very closely with ANR management including by being embedded in part of its operations, and prepared a comprehensive business plan that formed the basis for the financial projections underpinning ANR’s Chapter 11 plan that helped to establish the value of the securities that were exchanged for ANR’s senior secured debt held by MIO. During the course of that consulting work, the President of McKinsey RTS sat on the Investments Committee and had access to MIO MNPI, including that MIO was invested with a third-party manager. The third-party manager had invested in ANR’s senior secured debt. In this context, MIO’s investments through the third-party manager in ANR’s senior secured debt overlapped with McKinsey RTS’s consulting work and, as such, there was a risk that McKinsey RTS could influence the reorganization plan in a way that favored MIO’s investments.

27. Before confirming ANR’s Chapter 11 plan, the Bankruptcy Court, which needed to rely on McKinsey RTS’s testimony in order to confirm the plan, ordered McKinsey RTS to disclose MIO’s connections to interested parties in the ANR bankruptcy case because of both the relationship between MIO and McKinsey RTS and the presence of McKinsey RTS’s President on the MIO Board. In a Bankruptcy Court-ordered in camera submission filed on July 6, 2016, however, McKinsey RTS did not disclose MIO’s connection to the third-party manager that was invested in ANR senior secured debt. After reviewing the in camera submission, the Bankruptcy Court confirmed the ANR Chapter 11 plan without disclosure in the bankruptcy proceedings of MIO’s interest in ANR senior secured debt via the third-party manager. Pursuant to the confirmed plan, because of their priority, the holders of ANR’s senior secured debt received 87.5% of the stock of ANR’s successor under the plan, and all other investors and creditors received a de minimis distribution.

28. Subsequently, the United States Trustee reached settlements with McKinsey and McKinsey RTS regarding, among other things, the adequacy and completeness of their

disclosures of their connections to MIO in certain bankruptcy cases, *see* Alpha Natural Resources, Case No. 19-00302 (Bankr. E.D. Va.); SunEdison, Case No. 16-10992 (Bankr. S.D.N.Y); Westmoreland Coal Company, Case No. 18-35672 (Bankr. S.D. Tex.), and released claims in 11 other bankruptcy cases.

E. MIO’s Policies and Procedures Were Not Reasonably Designed to Prevent the Misuse of MNPI

29. MIO’s policies and procedures were not reasonably designed, taking into consideration the nature of its business, to prevent the misuse of McKinsey Client MNPI or MIO MNPI. MIO’s written policies and procedures did not address the fact that McKinsey personnel on the Investments Committee brought MNPI obtained in their jobs as consultants to public issuers to their roles on the MIO Board. In addition, prior to September 2020, none of MIO’s written policies or procedures (i) effectively sought to identify whether Investments Committee members may have MNPI that was relevant to their involvement in MIO’s investment decisions, or (ii) set forth a recusal procedure reasonably designed to guard against the misuse of McKinsey Client and MIO MNPI.

30. The MIO Collaboration Policy (the “Collaboration Policy”), in effect since at least 2015, was MIO’s chief policy governing information sharing between McKinsey and MIO personnel. The Collaboration Policy included a specific carve out for Board and Investments Committee members that situated them above the protective wall and did not prohibit access to MIO portfolio investments.

31. MIO’s policies and procedures were likewise not reasonably designed to prevent the misuse of MIO MNPI. The Collaboration Policy did not prohibit Board and Investments Committee members from accessing MIO’s investment information and did not contemplate the ways that MIO MNPI could be misused by Investments Committee members in the course of their consulting work for McKinsey clients.

Violations

32. As a result of the conduct described above, Respondent willfully² violated Section 204A of the Advisers Act. Section 204A requires investment advisers subject to Section 204 of the Advisers Act 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 of material, nonpublic information by such investment adviser or any person associated with such investment adviser in violation of the Advisers Act or the Securities Exchange Act of 1934 (the “Exchange Act”) or the rules or regulations thereunder.

33. As a result of the conduct above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require registered investment advisers to

² “Willfully,” for purposes of imposing relief under Section 203(e) of the Advisers Act “means no more than 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.” *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent'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 Sections 204A and 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

B. Respondent is censured.

C. Respondent shall, within 10 days of the entry of this Order, pay a civil monetary penalty in the amount of \$18,000,000 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 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 MIO 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 Thomas P. Smith, Jr., Assistant Regional Director, Enforcement Division, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281.

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, MIO agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, off set 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, 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 the 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.

By the Commission.

Vanessa A. Countryman
Secretary