

MEMO# 31442

October 17, 2018

SEC Sanctions an Adviser for Failing to Disclose a Conflict of Interest Involving Its Own Business Interest

[31442]

October 17, 2018 TO: ICI Members
Investment Company Directors
Chief Compliance Officer Committee
Compliance Advisory Committee
Investment Advisers Committee SUBJECTS: Compliance
Investment Advisers
Litigation & Enforcement RE: SEC Sanctions an Adviser for Failing to Disclose a Conflict of Interest Involving Its Own Business Interest

The Securities and Exchange Commission has announced the settlement of an enforcement proceeding against an adviser (the Respondent) that violated the Advisers Act by failing to disclose a conflict relating to its product offerings.^[1] The Respondent's failure to disclose its conflict resulted in it violating Sections 206(2) and (4) of the Investment Advisers Act, which are the antifraud provisions, and Rule 206(4)-7, which is the compliance rule. Based on these violations, the Respondent was censured, ordered to cease and desist, and ordered to pay a civil penalty, disgorgement, and interest of approximately \$8.9 million. The facts of this case as detailed in the SEC's Order are briefly summarized below.

According to the Order, the Respondent is an investment adviser that offers advisory products on its investment advisory platform. In offering the products on its platform, it represented to clients that the products were reviewed based on their investment merits. Pursuant to its standard review process, the Respondent's due diligence staff recommended terminating certain products on the platform that were offered by a US investment advisory subsidiary of a foreign multinational banking and financial services corporation (the "Subsidiary"). Prior to the decision being made, the Subsidiary found out about the recommendation and contacted a senior executive of the Respondent to encourage the Respondent to reconsider. As part of the Subsidiary's appeal to the senior executive, the Subsidiary "included an appeal to the broader business relationship" between the Respondent and the Subsidiary. As explained in the Order:

The Senior Executive informed the officer of the [Subsidiary] on the same day as the pitch, six days prior to the [meeting of the Respondent's committee that

would make the final determination], that the products would not be terminated and the [Subsidiary] would have additional time to make its case After additional communications between and among the [Subsidiary] and [the Respondent's senior management], the [Respondent's committee] deferred the proposed termination.

At no time were the Respondent's full committee or the Respondent's clients informed of the communications between the Subsidiary and the Respondent's senior management. As a result of this conduct, the Order found that "this undisclosed conflict of interest in [the Respondent's] decision-making process" violated the antifraud provisions of the Advisers Act and the SEC's compliance rule and imposed the sanctions discussed above.

Tamara K. Salmon
Associate General Counsel

endnotes

[1] See *In the Matter of Merrill Lynch, Pierce, Fenner & Smith, Inc., Respondent*, SEC Release No. 34-83886 (Aug. 20, 2018) (the "Order"), which is available at: <https://www.sec.gov/litigation/admin/2018/34-83886.pdf>.

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