

MEMO# 31159

April 11, 2018

SEC Sanctions Three Advisers for Violating the Advisers Act by Selling Inappropriate Mutual Fund Classes to Clients

[31159]

April 11, 2018 TO: ICI Members

Broker/Dealer Advisory Committee

Chief Compliance Officer Committee

Operations Committee

SEC Rules Committee SUBJECTS: Investment Advisers

Litigation & Enforcement RE: SEC Sanctions Three Advisers for Violating the Advisers Act by Selling Inappropriate Mutual Fund Classes to Clients

The SEC has announced its settlement of enforcement actions against three investment advisers^[1] for violating the Investment Advisers Act of 1940 (the “Act”) through conduct involving putting clients in inappropriate share classes and failing to disclose related conflicts of interests.^[2] Each of the orders found that the Respondent violated the anti-fraud provisions of the Act (*i.e.*, Sections 206(2) and 207) and the requirements of the compliance rule under the Act (*i.e.*, Section 206(4)-7) by:

- Investing advisory clients in mutual fund share classes with 12b-1 fees instead of in lower-cost share classes of the same funds without 12b-1 fees, thereby creating a conflict of interest that was not disclosed to clients;
- Breaching their fiduciary duty to client to seek best execution for these clients; and
- Failing to have adequate compliance policies and procedures to ensure compliance with the Act.

In addition to these violations, which generally occurred between 2012-2017, the SEC also found that:

- Respondent A failed to disclose on its Form ADV or otherwise the conflict of interest that resulted from the firm receiving over \$497,000 in marketing support payments, which were only paid when the firm invested its advisory clients in mutual fund shares that charged 12b-1 fees. The firm was also found to have improperly charged over \$105,000 in advisory fees to client accounts whose investment adviser has departed the firm and for which a new representative had not been assigned to the account

within 30 days.

- Respondent C failed to disclose to clients its revenue sharing agreements with two broker-dealers and the conflicts of interest from these arrangements, which generated approximately \$400,000 to the Respondent.

The sanctions imposed against each Respondent based on their violations are detailed below.

The SEC's press release announcing these orders encouraged "eligible firms to participate in the recently announced Share Class Selective Disclosure Initiative as part of an effort to stop these violations and return money to harmed investors as quickly as possible."^[3] It additionally notes that the "Share Class Selective Disclosure initiative gives eligible advisers until June 12, 2018, to self-report similar misconduct and take advantage of the Enforcement Division's willingness to recommend more favorable settlement terms, including no civil penalties against the adviser."^[4]

Sanctions Imposed on Respondent A^[5]

Based on Respondent A's violations of the Act, it was: censured; ordered to pay disgorgement and prejudgment interest totaling \$5,847,200 to compensate advisory clients impacted by the firm's violations of the law; pay an additional amount of \$497,144 in disgorgement and \$63,426 in interest to the SEC; pay a civil monetary penalty of \$900,000; and ordered to cease and desist from further violations.

Sanctions Imposed on Respondent B^[6]

Based on its violations, Respondent B was: censured; ordered to pay disgorgement, prejudgment interest of approximately \$5 million to compensate advisory clients impacted by the violations; pay a civil monetary penalty of \$775,000; and cease and desist from further violations. In imposing these sanctions, the SEC noted that the firm had implemented several policies to address concerns with its fund share class selection practices, including requiring its representatives to complete all new purchases of funds in the lowest cost share class; converting higher cost class shares into lower cost shares; and credit back 12b-1 fees to clients where appropriate.

Sanctions Imposed on Respondent C^[7]

Based on its violation, Respondent C was: censured; required to provide a copy of the SEC's order against it to all advisory clients impacted by its unlawful behavior; revise its Form ADV and brochure; pay disgorgements in excess of \$1 million and prejudgment interest of over \$87,500; pay an additional disgorgement/prejudgment interest amount of approximately \$423,000; pay a civil penalty of \$250,000; and cease and desist from committing additional violations.

Tamara K. Salmon
Associate General Counsel

endnotes

^[1] Respondents A and C are dually-registered investment advisers and broker-dealers. Respondent B's violations involved an affiliated broker-dealer.

[2] The SEC's orders against the respondents are as follows:

For Respondent A's Order, see *In the Matter of PNC Investments, LLC., Respondent*, SEC Administrative Proceeding File No. 3-18426 (April 6, 2018) (the "Order against Respondent A"), which is available at: <https://www.sec.gov/litigation/admin/2018/ia-4876.pdf>.

For Respondent B's Order, see *In the Matter of Securities American Advisors, Inc., Respondent*, SEC Administrative Proceeding File No. 3-18424 (April 6, 2018), which is available at: <https://www.sec.gov/litigation/admin/2018/34-83004.pdf>.

For Respondent C's Order, see *Geneos Wealth Management, Inc. Respondent*, SEC Administrative Proceeding File No. 3-18425 (April 6, 2018), which is available at: <https://www.sec.gov/litigation/admin/2018/34-83003.pdf>.

[3] See "SEC Orders Three Investment Advisers to Pay \$12 Million to Harmed Clients," SEC Press Release No. 2018-82 (April 6, 2018), which is available at: <https://www.sec.gov/news/press-release/2018-62>. Based on the press release, it does not appear that these orders were the result of the Respondents self-disclosing their violations through the SEC's Share Class Disclosure Initiative. Instead, it appears they were the result of SEC examinations that led to investigations by the SEC's Asset Management Unit.

[4] For more information about the SEC's Share Class Disclosure Initiative, see <https://www.sec.gov/enforce/announcement/scsd-initiative>.

[5] The Order notes that the firm received over \$5.129 million in 12b-1 fees for investing clients in higher-cost shares.

[6] Unlike the orders against the other Respondents, the order against Respondent B does not appear to indicate how much revenue the firm generated from its violations.

[7] The SEC found that, between 2012 and 2017, Respondent C generated over \$1 million in 12b-1 fees from its advisory clients by putting such clients into more expensive share classes.