

**MEMO# 5661**

March 9, 1994

## **SEC SANCTIONS INVESTMENT ADVISER FOR CUSTODY VIOLATIONS**

March 9, 1994 TO: COMPLIANCE COMMITTEE NO. 4-94 INVESTMENT ADVISER ASSOCIATE  
MEMBERS NO. 12-94 INVESTMENT ADVISER MEMBERS NO. 11-94 RE: SEC SANCTIONS  
INVESTMENT ADVISER FOR CUSTODY VIOLATIONS

The Securities and Exchange Commission recently sanctioned a registered investment adviser for violating certain provisions of the Investment Advisers Act of 1940. According to the SEC's order, a copy of which is attached, the adviser failed to follow required safeguard procedures with respect to its client assets over which it had constructive, and in some cases direct, custody. Specifically, the SEC found that certain of the adviser's managers served as sole or co-trustees of various trust accounts that were custodied at either banks or broker-dealers. The adviser had received a no-action letter from the Division of Investment Management in 1983 stating that the adviser would not be deemed to have custody, possession or control of the funds or securities of the trusts, provided that it followed certain safeguards. In the attached order, the SEC found that the adviser failed to comply with the conditions of the no-action letter and other required safeguards pertaining to transfers of assets from custodians to the adviser and others. In addition, the SEC found that the adviser maintained direct custody or possession of clients' funds or securities in certain instances because of its employees' signing authority as trustee over four trusts' checking accounts, unilateral authorization to wire funds from one institutional client's custodial account, and assumption of custody or possession of clients' securities certificates. According to the SEC's order, through these activities, the adviser used the mails and means and instrumentalities of interstate commerce to engage in fraudulent, deceptive and manipulative acts, practices and courses of business in violation of Section 206(4) of the Investment Advisers Act and Rule 206(4)- 2(a)(5) thereunder. The adviser also failed to have an independent accountant perform at least once annually a surprise audit of custodied funds and securities and file a certificate with the SEC concerning such audit. Finally, the SEC found that the adviser violated Section 204 of the Advisers Act and Rule 204-1 thereunder by failing to amend its Form ADV to reflect its custody and possession of client funds and securities, failing to file a balance sheet within 90 days of its fiscal year's end for certain years and failing to file annual reports on Form ADV-S for those years. The adviser also violated Section 203 of the Advisers Act and Rule 203-1 thereunder by making untrue statements of material facts and omitting to state material facts required to be stated in Forms ADV and ADV-S regarding its custody of advisory client funds and obligation to file an audited balance sheet. The SEC ordered the adviser, among other things, to pay a civil penalty of \$25,000 and to retain an independent consultant to review the adviser's policies and procedures and monitor its activities for five years. Frances M. Stadler Associate Counsel Attachment

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