

MEMO# 1289

July 26, 1989

SEC SANCTIONS ADVISER FOR VIOLATIONS OF ADVERTISING, RECORDKEEPING AND DISCLOSURE RULES

July 26, 1989 TO: INVESTMENT ADVISER MEMBERS NO. 40-89 INVESTMENT ADVISER
ASSOCIATE MEMBERS NO. 39-89 RE: SEC SANCTIONS ADVISER FOR VIOLATIONS OF
ADVERTISING, RECORDKEEPING AND DISCLOSURE RULES

On July 3, 1989, the SEC filed an order imposing sanctions against an adviser for violations of the advertising, recordkeeping and disclosure rules under the Investment Advisers Act of 1940. A copy of the order is attached. In the advertising area, the SEC sanctioned the adviser under Rule 206-4(a)(5) for: (i) implying that equity portfolios could be structured to provide a profit, at a particular rate per year, without disclosing the risks of investment; (ii) implying that the adviser's accounts increased in value from 400% to 500% over the last ten years, when such increases were not supportable; and (iii) failing to disclose the effect the deduction of advisory fees had on the performance of the adviser's managed accounts. The SEC also sanctioned the adviser for failure to maintain required books and records. The Commission sanctioned the adviser for failure to maintain an unearned income account for advisory fees paid quarterly or semi-annually in advance, as required under Rule 204-2(a)(2). That rule requires that an adviser make and keep "general and auxiliary ledgers (or other comparable records) reflecting asset, liability, reserve, capital, income, and expense accounts." The adviser was also sanctioned under the recordkeeping rule for failure to keep (i) a memorandum of each purchase and sale order; (ii) a trial balance; and (iii) a record of every transaction in which the adviser had acquired a direct or indirect beneficial ownership. Additionally, the adviser was sanctioned for failure to amend its Form ADV to disclose that: (i) the adviser's business was conducted at a location other than its principle place of business; (ii) the adviser had an arrangement with a brokerage firm whereby the adviser received a "portfolio status report" for each account domiciled with the firm which enabled the adviser to track the performance of those accounts; and (iii) the adviser frequently required payment of fees six or more months in advance. Finally, the adviser was sanctioned for failure to furnish each advisory client and each prospective advisory client with a written disclosure statement as defined in Rule 204-3(a). Please note the extensive undertakings required of the adviser as a result of the violations. Robert L. Bunn, Jr. Assistant General Counsel Attachment

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