

MEMO# 5109

August 30, 1993

SEC SANCTIONS INVESTMENT ADVISER FOR UNDISCLOSED COMPENSATION ARRANGEMENTS

August 30, 1993 TO: COMPLIANCE COMMITTEE NO. 19-93 INVESTMENT ADVISER ASSOCIATE MEMBERS NO. 32-93 INVESTMENT ADVISER MEMBERS NO. 44-93 RE: SEC SANCTIONS INVESTMENT ADVISER FOR UNDISCLOSED COMPENSATION ARRANGEMENTS

The Securities and Exchange Commission recently sanctioned a registered investment adviser for violations of the Investment Advisers Act in connection with undisclosed compensation arrangements between the adviser and a broker. The Commission found that a life insurance company affiliated with the adviser entered into compensation arrangements with a broker who was widely regarded as an expert on public employee retirement board investments. Under these arrangements the broker consulted the adviser on the public pension market, introduced the adviser to the broker's retirement board clients, and recommended to those clients the adviser's investment advisory services and the life insurance company's group annuity contracts. The life insurance company paid approximately \$1 million to the broker in consulting fees and approximately \$800,000 to insurance agencies designated by the broker. The Commission found that the adviser failed to disclose to investors the fees paid to the broker. At various times according to the Commission, members of retirement boards asked whether there was any economic relationship between the adviser and the broker. Employees of either the adviser or its affiliates gave inaccurate or incomplete responses, which were not corrected by the employees' superiors or by inside counsel. The Commission found that the adviser thus violated Sections 206(2) and (4) of the Investment Advisers Act and Rule 206(4)-3 thereunder (the "cash solicitation" rule). The Commission also found that while Part II of the adviser's Form ADV generally indicated that the adviser had referral arrangements, it did not disclose the arrangements with the broker in particular. The Commission found that the adviser thus violated Sections 204 and 207 of the Investment Advisers Act and Rules 204-1 and 204-3 thereunder. Finally, the Commission found that a broker-dealer affiliated with the adviser offered and sold one of the life insurance company's securities products without disclosing the compensation arrangement to investors. The Commission found that the broker-dealer violated Sections 17(a)(2) and (3) of the Securities Act and that the adviser was a cause of those violations. Without admitting or denying the allegations, the adviser consented to a penalty of \$500,000 and an order that it cease and desist from violating Sections 204, 206(2), 206(4), and 207 of the Investment Advisers Act, Rules 204-1, 204-3, and 206(4)-3 thereunder, and Sections 17(a)(2) and (3) of the Securities Act. Without admitting or denying the allegations, the affiliated broker-dealer consented to an order that it cease and desist from violating Sections 17(a)(2) and (3) of the Securities Act. Attached is a copy of the Commission's

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