

**MEMO# 34063**

March 7, 2022

# **SEC Sanctions Adviser for Failing to Disclose Conflicts of Interest Relating to Mutual Fund Share Classes**

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TO: ICI Members

Chief Compliance Officer Committee

Compliance Advisory Committee SUBJECTS: Compliance

Investment Advisers RE: SEC Sanctions Adviser for Failing to Disclose Conflicts of Interest Relating to Mutual Fund Share Classes

Last week, the SEC filed a civil action against an SEC-registered investment adviser and its affiliated broker-dealer for the adviser recommending to clients mutual fund shares that generated millions of dollars in revenue-sharing payments to the broker-dealer when lower-cost share options were available.[\[1\]](#) These lower cost options would have yielded less or no revenue sharing payments to the affiliated broker-dealer. The Complaint seeks injunctive relief, disgorgement, and civil penalties based on the Commission's allegations, which are briefly summarized below.

According to the Complaint, on the advice of the investment adviser Defendant, from at least January 2014 and continuing to the present, its clients invested in certain mutual funds and market cash sweep funds (sweep funds) with no transaction fees (NTFs). These funds and sweep funds generated, or had the potential to generate, revenue for the Relief Defendant from clearing brokers. The arrangements the Relief Defendant had with these clearing brokers created financial incentives for the Relief Defendant to select investments that would lead to greater compensation for it, but that were not in the best interest of the adviser's clients. The arrangements with the clearing brokers generated millions of dollars to the Relief Defendant. According to the Complaint, the adviser did not adequately disclose all material facts regarding the conflicts of interest that arose when it invested advisory clients' assets in more expensive NTF funds and sweep funds that would generate revenue for the broker-dealer when other less expensive options that would not generate this revenue were available.

The Complaint also alleges that the adviser recommended NTF funds for its wrap account clients that avoided the adviser having to pay transaction fees while lower cost investment options, which would have required the adviser to pay transaction fees, were available for

clients. Also, in converting traditional accounts to wrap accounts, the Commission alleges the adviser repeatedly violated its fiduciary duty to clients by failing to provide them full and fair disclosure regarding the conversions and providing them false and misleading information about the need for such conversions. In part, the adviser failed to disclose that it had a financial incentive for such conversions because the adviser collected higher advisory fees from the wrap accounts. Also, the Commission alleges that the adviser failed to adequately determine that each conversion was in the client's best interest.

The Complaint also alleges that, from January 2015 to March 2018, the adviser failed to adequately disclose to its clients that it had a program of giving forgivable loans to its investment adviser representatives. In the Commission's view, these forgivable loans presented a conflict of interest for the investment adviser representatives who received them because it provided them a financial incentive to maintain a relationship with the adviser order to have the loans forgiven and advisory clients were not fully informed of the conflicts associated with these loans.

Finally, the Complaint alleges, based on the above conduct, that the Defendant failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Investment Advisers Act of 1940 in connection with its advisory activities.

This case remains pending.

Tamara K. Salmon  
Associate General Counsel

#### **endnotes**

[1] See U.S. SEC v. Cambridge Investment Research Advisors, Inc., Defendant, and Cambridge Investment Research, Inc., Relief Defendant (the Compliant), which is available at: <https://www.sec.gov/litigation/complaints/2022/comp25340.pdf>.

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