Morgan Lewis

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# Investment Adviser Considerations for Retail (TA:7)


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**SIFMA Compliance and Legal Society Annual Seminar**
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**March 21, 2017**

Steven W. Stone*

I. Overview of the Changing SEC Staff Landscape

A. During 2016, and in the period following the presidential election, there have been significant personnel changes at the SEC. The Commission's composition was stable during the fiscal year, but Chair Mary Jo White announced her departure with the end of President Obama's term, leaving the Commission down three members, as of this writing, awaiting the confirmation of President Trump's nominee for Chair. Further, significant transitions are underway in multiple senior staff positions, with acting directors in place in various divisions and offices.

1. Division of Enforcement

On December 8, 2016, the SEC announced that Enforcement Director Andrew J. Ceresney would leave the agency by the end of 2016. In light of Director Ceresney's departure, Stephanie Avakian, Deputy Director of Enforcement, has been named Acting Director. Ms. Avakian joined the Commission in 2014, after previously serving as a partner and vice-chair of the securities practice at Wilmer Cutler Pickering Hale and Dorr LLP (WilmerHale). Earlier in her career, Ms. Avakian worked in the Enforcement Division as branch chief in the New York Regional Office. She also served as counsel to former SEC Commissioner Paul Carey.

On March 10, 2016, Anthony S. Kelly was named Co-Chief of the Division of Enforcement's Asset Management Unit, succeeding Julie Riewe after her departure in February 2016. Mr. Kelly began his career with the SEC in 2000 as a securities compliance examiner in OCIE's Broker-Dealer Group, during which time he attended law school, and he joined the Enforcement Division upon graduation.

On June 28, 2016, C. Dabney O'Riordan was appointed Co-Chief of the Division of Enforcement's Asset Management Unit, joining Anthony S. Kelly, and succeeding Marshall Sprung after his departure in April 2016. Ms. O'Riordan joined the SEC in 2005 as a staff attorney in the Division of Enforcement, and was most recently appointed Associate Regional Director for the Los Angeles Regional Office. Before

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*  Portions of this outline are drawn in part from our publications, *2016 Year in Review: Select SEC and FINRA Developments and Enforcement Cases",* available at https://www.morganlewis.com/~/media/files/publication/morgan%20lewis%20title/white%20paper/2017/lpg_2016-year-in-review_feb2017.ashx?la=en, and *"SEC Weighs In on Robo-Advisers: Disclosure, Suitability, and Compliance Obligations,"* available at https://www.morganlewis.com/pubs/sec-weighs-in-on-robo-advisers-disclosure-suitability-and-compliance-obligations.

coming to the SEC, Ms. O'Riordan practiced as a litigation associate with Munger, Tolles & Olson.

2. Division of Investment Management

On September 7, 2016, Sarah G. ten Siethoff was named Deputy Associate Director in the Division of Investment Management's Rulemaking Office. Ms. ten Siethoff joined the Division of Investment Management in 2008 and served as Assistant Director, Senior Special Counsel and Senior Counsel. Prior to joining the SEC, Ms. ten Siethoff was an associate at Cleary Gottlieb Steen & Hamilton LLP.

On December 22, 2016, Sara P. Crovitz was appointed Deputy Chief Counsel and Associate Director in the Division of Investment Management's Chief Counsel's Office. Ms. Crovitz joined the SEC in 1996 as an attorney in the Office of General Counsel. She joined the Division of Investment Management in 1999, and has since held the position of Senior Counsel in the Office of Investment Company Regulation, as well as several positions in the Chief Counsel's Office. Prior to joining the Commission, Ms. Crovitz was an associate with Steptoe & Johnson.

Also on December 22, 2016, Dr. Timothy Husson was named Associate Director in the Division of Investment Management's Risk and Examinations Office. Dr. Husson joined the Division of Investment Management in 2014, and has served as Branch Chief, Quantitative Research Analyst (Financial Engineer), and Financial Analyst Fellow in the division's Risk and Examinations Office. Prior to his Commission service, Dr. Husson was a Senior Financial Economist at Securities Litigation & Consulting Group.

3. Office of Compliance Inspections and Examinations

a. National Examination Program

On November 12, 2015, Marc Wyatt was appointed Director of OCIE and leader of its National Exam Program. On January 30, 2017, Mr. Wyatt announced that he would leave the SEC in February to return to the private sector. Following the departure of Mr. Wyatt in February 2017, Pete Driscoll, OCIE's Chief Risk and Strategy Officer, will be named Acting Director. Mr. Driscoll previously served as OCIE's Managing Executive from 2013 through 2016. Mr. Driscoll began his career with the Commission in 2001 as a staff attorney in the Enforcement Division in the Chicago Regional Office, and as a Branch Chief and Assistant Regional Director in OCIE. Before that, Mr. Driscoll held several accounting positions in the private sector.

On February 3, 2016, Jane Jarcho was named Deputy Director of OCIE. Ms. Jarcho was previously appointed National Director of OCIE's Investment Adviser/Investment Company examination program on August 20, 2013, and she will continue in that role moving forward. Ms. Jarcho joined the SEC in 1990 in the Division of Enforcement, and has held several positions, including Associate Regional Director of the program in the Chicago Regional Office.

On August 10, 2016, Kristin Snyder was appointed Co-National Associate Director of OCIE's Investment Adviser/Investment Company examination program. Together with Ms. Jericho, Ms. Snyder will oversee more than 520 lawyers, accountants, and examiners responsible for inspections of investment advisers and investment companies that are registered with the SEC. Ms. Snyder joined the SEC in 2003, and spent eight years in the San Francisco office's enforcement program, after which she assumed the role of Associate Regional Director for Examinations in the San Francisco office, a position she will maintain in conjunction with her new leadership role.

On February 17, 2016, Daniel S. Kahl was named Chief Counsel of OCIE, where he oversees a staff of 15 lawyers and advises OCIE leadership on various matters related to the National Exam Program. Since joining the SEC in 2001, Mr. Kahl has held several positions in the Division of Investment Management, and has been Assistant Director of the division's Investment Adviser Regulation Office for the last five years. Prior to joining the Commission, Mr. Kahl was an attorney for the Investment Adviser Association, FINRA, and the North American Securities Administrators Association.

On March 8, 2016, Dr. Robert M. Fisher was appointed Managing Executive of OCIE, succeeding Peter B. Driscoll, who was appointed Chief Risk and Strategy Officer of the new Office of Risk and Strategy (ORS). As Managing Executive, Dr. Fisher will oversee the business operations, technology services, examiner training, and Tips, Complaints and Referrals programs. In 2002, Dr. Fisher joined the SEC in the Office of Economic Analysis (now DERA). Since 2005, Dr. Fisher has held several positions in the Office of International Affairs (OIA), including Acting Director. Dr. Fisher came to OCIE in 2014 as an Associate Director within the Office of the Director. Before joining the Commission, Dr. Fisher worked in private practice in Washington, DC.

II. SEC 2017 Priorities Letter –

Based upon our review of currently available information, we believe that the following list reflects some of the SEC's top enforcement and examination priorities:[1]

A. Electronic Investment Advice

1. Investment Advisers/Broker-Dealers offering "Robo-Advice"

2. Compliance programs

3. Marketing

4. Algorithms that generate recommendations

B. Wrap Fee Programs

[1] *See id.* at 30-32; *see also* OCIE National Exam Program 2017 Examination Priorities (Jan. 12, 2017), https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf.

1. Investment Advisers/Broker-Dealers
2. Suitability
3. Disclosure
4. Conflicts of interest
5. Brokerage practices
6. Trading away
7. Best execution

C. Investment Advisers
1. Never-before-examined firms
2. Multi-branch firms

D. Mutual Fund Share Class Selection
1. Conflicts of Interest
2. Recommendations to invest
3. Recommendations to remain invested

E. Senior Investors and Investors Saving for Retirement
1. Sales and Marketing Practices
2. Suitability
3. Promotion of new, high-risk, and/or complex or structured products, including alternative investments
4. Supervision and controls related to products and services directed to senior investors
5. Suitability and disclosures around variable annuity sales
6. Suitability and disclosures around target date funds

F. Cross-transactions, especially in regard to fixed-income securities

III. Other Enforcement and Examination Priorities

A. Private Fund Advisers

1. Conflicts of interest and disclosures

B. Municipal advisors: compliance, policies and procedures

C. Public Pension Advisers – pay to play

IV. Trends and "Tea Leaves" in SEC Enforcement

A. Enforcement Statistics[2]

In fiscal year 2016, the SEC brought a record 868 enforcement cases, including 548 independent actions for securities laws violations, 125 actions against issuers who were delinquent in making required filings, and 195 "follow on" administrative proceedings seeking associational bars against individuals. Within these matters, a total of 1,700 defendants and respondents were named as parties.

This last year's totals represent an increase from 807 enforcement actions in 2015, of which 507 were independent actions, and from 755 enforcement actions in 2014, of which 413 were independent actions.

The chart below reflects the number of cases brought by the SEC over the last decade:

| Fiscal Year | Number of Enforcement Actions |
|---|---|
| 2007 | 656 |
| 2008 | 671 |
| 2009 | 664 |
| 2010 | 681 |
| 2011 | 735 |
| 2012 | 734 |
| 2013 | 686 |
| 2014 | 755 |
| 2015 | 807 |
| 2016 | 868 |

B. Categories of Cases

The major categories of cases and the number of actions for fiscal year 2016 within each category are as follows; the totals below include civil actions filed in federal court, SEC administrative proceedings, and follow-on administrative proceedings

2 Unless otherwise noted, the information in this section is drawn from the Commission's Press Release titled "SEC Announces Enforcement Results for FY 2016," https://www.sec.gov/news/pressrelease/2016-212.html. The SEC's fiscal year 2016 ended on September 30, 2016.

(where applicable):[3]

| Type of Case | Number of Actions | Percentage of Total Actions |
|---|---|---|
| Broker-Dealer | 173 | 19.9% |
| Investment Advisers/Investment Companies | 159 | 18.3% |
| Delinquent Filings | 121 | 14.4% |
| Issuer Reporting and Disclosure | 103 | 11.9% |
| Securities Offering Cases | 97 | 11.2% |
| Public Finance Abuse | 97 | 11.2% |
| Insider Trading | 45 | 5.2% |
| Market Manipulation | 33 | 3.8% |
| FCPA | 21 | 2.4% |
| Miscellaneous | 11 | 1.3% |
| National Recognized Statistical Ratings Organization (NRSRO) | 2 | 0.2% |
| Transfer Agent | 2 | 0.2% |

Last year the SEC brought its most cases ever against investment advisers and investment companies, at 159 matters, in which 254 individuals and entities were named as parties. In addition, the Commission brought 173 cases against broker-dealer defendants, naming 201 individuals and entities, after what had been a down year for broker-dealer cases in 2015. These increases do not appear to reflect a "surge" but rather a continued focus on regulated entities, the impact of data-driven regulation and enforcement, and continued referrals from OCIE. Together, these regulated entity categories of cases approach 40% of the Enforcement docket, and that does not take into account other categories of matters that likely also involve such entities—for example, the Public Finance Abuse and Insider Trading case types.

C. Areas of Focus

1. Investment Advisers Generally

After several years of the Enforcement Division's talking about its increased focus on investment advisers and investment companies, the division's 2016 statistics demonstrate that focus in real numbers, as the division brought its most ever cases against these registrants. Overall, the 2016 Enforcement docket revealed charges against regulated entities for violations that, at bottom, largely could be classified as disclosure violations, misrepresentations, conflicts of interests, and controls failures. Although the SEC annually makes some effort to sell these matters as "new" and "first," most of this last year's matters would be difficult to categorize as any extension of the

[3] Unless otherwise noted, the information in this section is drawn from the Commission's Report titled "Select SEC and Market Data Fiscal 2016," https://www.sec.gov/reportspubs/select-sec-and-market-data/secstats2016.pdf.

securities laws. Perhaps the continued reliance on data and the Enforcement Division's access to information obtained through the examination process make this result inevitable, and the cases developed as a result somewhat less controversial, which was a necessity this last fiscal year, since they were presented for authorization to a Commission of only three members.

In the Investment Adviser/Investment Company area, the Enforcement Division's investigations of private equity fund advisers resulted in numerous matters, mostly related to failure to disclose allocations of fees and expenses and conflicts of interests.[4] And in what was largely a cautionary tale for investment advisers that offer the products of others, after a sweep investigation the division brought[5] cases against investment advisers for negligently repeating to their own clients false performance data received from F-Squared Investments.[6] In matters that resulted from another OCIE sweep, two wrap fee program sponsors were charged with compliance failures for failing to establish policies and procedures related to commissions incurred when sub-advisers "traded away" from the program.[7] Finally, the Enforcement Division charged that failure to fully disclose 12b-1 fee paying mutual fund share classes presents a conflict of interest and the potential for a breach of fiduciary duty by investment advisers, which was quickly followed by an OCIE Risk Alert advising of the Commission's Share Class Initiative.[8] We can expect, as a result, to see more of these types of matters in fiscal year 2017.

D. Key Cases and Themes

1. Allocation of Investment Opportunities

a. *In re Bruce A. Hartshorn*, Investment Advisers Act Release No. 4371, 2016 SEC LEXIS 1550 (Apr. 19, 2016).

The Commission accepted an offer of settlement from Hartshorn, the founder, president, CEO, and sole employee of an investment adviser formerly registered in

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4 *See, e.g., In the Matter of First Reserve Management, L.P*., IA Rel. No. 4529 (Sept. 14, 2016); *see also* SEC Press Release No. 2016-212, SEC Announces Enforcement Results for FY 2016 (Oct. 11, 2016), https://www.sec.gov/news/pressrelease/2016-212.html (citing seven other private equity–related matters).

5 SEC Press Release No. 2016-167, Investment Advisers Paying Penalties for Advertising False Performance Claims (Aug. 25, 2016), https://www.sec.gov/news/pressrelease/2016-167.html (linking to the matters).

6 SEC Press Release No. 2016-167, Investment Advisers Paying Penalties for Advertising False Performance Claims (Aug. 25, 2016), https://www.sec.gov/news/pressrelease/2016-167.html (linking to the matters).

7 SEC Press Release No. 2016-181, Two Firms Charged With Compliance Failures in Wrap Fee Programs (Sept. 8, 2016), https://www.sec.gov/news/pressrelease/2016-181.html.

8 *See In the Matter of Royal Alliance Associates, Inc. et al.*, Exchange Act Rel. No. 77362 (Mar. 14, 2016); *see also* National Exam Program Risk Alert, OCIE's 2016 Share Class Initiative (July 13, 2016), https://www.sec.gov/ocie/announcement/ocie-risk-alert-2016-share-class-initiative.pdf.

California. The Commission alleged that Hartshorn engaged in “cherry-picking” by disproportionately and fraudulently allocating profitable trades to his proprietary accounts and unprofitable trades to client accounts. The Commission further alleged that Hartshorn delayed allocation until the day after purchasing securities through an omnibus trading account in order to determine whether the securities had appreciated. The Commission ordered Hartshorn to cease and desist from further violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and Section 206(1) and 206(2) of the Advisers Act, and barred Hartshorn from association and from serving in any capacity for a registered investment company or affiliated person of an investment adviser, depositor, or principal underwriter. The Commission further ordered Hartshorn to pay disgorgement of $109,516, prejudgment interest of $5,036, and a civil penalty of $75,000.

b. *In re James Caird Asset Management LLP*, Investment Advisers Act Release No. 4413, 2016 SEC LEXIS 3278 (June 2, 2016).

The Commission accepted an offer of settlement from James Caird Asset Management LLP (JCAM) and its principal, Leslie (collectively, Respondents). The Commission alleged that Respondents engaged in fraud and deceit by not accurately disclosing to JCAM’s investors the nature and scope of the overlap in the trading of JCAM’s closed-end private fund, the JCAM Credit Opportunities Fund (CrOp), and their flagship hedge fund client, the JCAM Global Fund (Global) (collectively, the Funds), which was approximately 20 times larger than CrOp. The Commission alleged that Respondents’ disclosures, marketing materials, and offering memoranda regarding the Funds that were furnished to the Funds’ investors and boards provided expectations that the Funds would have little overlap between the trading of the Funds, which had different stated investment strategies. Specifically, CrOp was intended for less-liquid, -stressed, and -distressed assets, whereas Global was a multistrategy fund with different risk and liquidity constraints. The Commission alleged, however, that Leslie allocated all or a portion of certain liquid equity new issues to CrOp, including equity initial public offerings, that fell within Global’s investment strategy. The Commission alleged that in such instances, 33% to 100% of highly profitable new issues were allocated to CrOp. The Commission alleged that primarily due to this activity, most of CrOp’s positions overlapped with Global’s positions. The Commission alleged that the management of these Funds was inconsistent with the prior disclosure that had been made to investors and the board. The Commission censured Respondents and ordered Respondents to cease and desist from further violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder. The Commission ordered Leslie to pay disgorgement of $1,708,957, prejudgment interest of $212,117, and a civil money penalty of $200,000. JCAM was ordered to pay a civil money penalty of $400,000.

c. *In re Simpson Hughes Fin., LLC*, Investment Advisers Act Release No. 4433, SEC LEXIS 2991 (June 22, 2016).

The Commission accepted offers of settlement from Simpson Hughes Financial, LLC, an Idaho limited liability company registered as an investment adviser with the State of Idaho (Simpson Hughes) and Mark C. Simpson, a former registered investment adviser representative associated with Simpson Hughes and its sole owner and control person (collectively, Respondents). The Commission alleged that Respondents engaged in a cherry-picking scheme whereby securities were purchased through an omnibus account and allocated at the end of the day with profitable trades being allocated to proprietary accounts and two favored client accounts and the other trades to disfavored client accounts. As a result of the conduct above, the Commission alleged that Respondents willfully violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder by knowingly or recklessly allocating profitable trades to proprietary accounts at the expense of advisory clients. The Commission also alleged that Respondents willfully violated Section 206(1) and 206(2) of the Advisers Act. The Commission ordered Respondents to cease and desist from further violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 206(1) and 206(2) of the Advisers Act. The Commission censured Simpson Hughes and barred Simpson from association. Simpson was also prohibited from serving in any capacity for a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter. The Commission ordered Respondents to pay, jointly and severally, disgorgement of $130,450, prejudgment interest of $6,669, and a civil penalty of $150,000.

d. *In re Laurence I. Balter d/b/a/ Oracle Investment Research*, Investment Advisers Act Release No. 4545, 2016 SEC LEXIS 3752 (Oct. 4, 2016).

The Commission brought an action against Laurence Balter (Balter), the principal, CCO, and sole owner of Oracle Investment Research (Oracle), formerly a registered investment adviser, for alleged breaches of fiduciary duty and violations of the federal securities laws. Balter, through Oracle, was the investment adviser to the Oracle Mutual Fund (the Fund) and between 100 and 120 separately managed accounts (SMAs). The Commission alleged that Balter engaged a day-trading strategy for himself and certain SMA clients whereby he cherry-picked profitable trades for himself without his clients' knowledge and in contravention of Oracle's Form ADV disclosure regarding trade allocation. The Commission further alleged that Balter materially misrepresented the fees that SMA clients would be charged in connection with an investment in the Fund. Finally, the Commission alleged that Balter caused the Fund to deviate from its fundamental investment limitations. As a result, the Commission alleged that Balter violated Section 17(a) of the Securities Act; Section 10(b) of the Securities Exchange Act; and Sections 206(1), 206(2), 207, and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, as well as aided and abetted and caused the Fund's violations of Sections 34(b) and 13(b) of the Investment Company Act and violated and aided and abetted and caused the Fund's violations of Section 34(b) of the Investment Company Act. The Commission ordered that public administrative and cease-and-desist proceedings be instituted against Balter. Those proceedings are pending.

e. *In re TPG Advisors LLC*, Investment Advisers Act Release No. 4588, 2016 SEC LEXIS 4638 (Dec. 15, 2016).

The Commission accepted offers of settlement from TPG Advisors LLC, a formerly registered investment adviser (TPG), and Phillips, its sole owner and principal. The Commission alleged that TPG and Phillips engaged in “cherry-picking” by unfairly and systematically allocating profitable trades to certain accounts while harming other accounts by allocating unprofitable trades. The Commission alleged that, while TPG’s Form ADV filings and policies and procedures required equitable trade allocation that did not favor any particular client, TPG and Phillips allocated trades in a manner that favored the accounts of a handful of clients with whom Phillips had personal connections. The Commission further alleged that TPG and Phillips ignored express warnings about their allocation process from a third-party broker that maintained custody of TPG client accounts. The Commission ordered TPG and Phillips to cease and desist from further violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 207 of the Advisers Act, and barred Phillips from association, from participating in any penny stock offering, and from serving in any capacity for a registered investment company or affiliated person of an investment adviser, depositor, or principal underwriter. The Commission further ordered TPG and Phillips to jointly and severally pay disgorgement of $25,295, prejudgment interest of $3,143, and a civil penalty of $300,000.

2. Best Execution

a. *In re The Bank of New York Mellon*, Investment Company Act Release No. 32151, 2016 SEC LEXIS 3301 (June 13, 2016).

The Commission accepted an offer of settlement from The Bank of New York Mellon (BNY Mellon), in which it admitted certain facts. The Commission alleged that BNY Mellon misled certain custodial clients with regard to the execution of their Standing Instruction (SI) foreign currency transactions. The Commission alleged that BNY Mellon communicated to customers, including registered investment companies, that its SI program provided foreign exchange execution according to best execution standards, provided “best rates,” priced the transactions at levels that “generally reflected the interbank market at the time the trade was executed,” and was “free of charge.” However, the Commission alleged that BNY Mellon priced its clients’ SI transactions near the end of the trading day or near the worst interbank rates reported during the day, which resulted in substantial revenue to BNY Mellon. The Commission further alleged that the trade confirmations and monthly transaction reports disseminated by BNY Mellon did not specify the time the transactions were executed or provide information to customers about how the specific rates were assigned. The Commission alleged that had such information been included, it would have been revealed that the SI program did not provide execution in the manner represented by BNY Mellon. The Commission ordered BNY Mellon to cease and desist from future violations of Sections 31(a) and 34(b) of the Investment Company Act and Rule 31a-1(b) thereunder. The Commission ordered BNY Mellon to pay disgorgement of $120 million and prejudgment interest of $13,022,207 (the payment of such amount to be deemed satisfied by its payment under the terms of BNY Mellon’s settlements with the US Department of Justice and the New York Attorney General in related civil actions), and pay a civil money penalty in the amount of $30 million.

b. *In re State Street Bank and Trust Company*, Investment Company Act Release No. 32390, 2016 SEC LEXIS 4584 (Dec. 12, 2016).

The Commission accepted an offer of settlement from State Street Bank and Trust Company (State Street), a Massachusetts trust company and bank that is a member of the Federal Reserve System and acts as a custody bank for a wide range of clients, including mutual funds, closed-end funds, and unit investment trusts that are registered with the Commission as investment companies under the Investment Company Act. The Commission alleged that from January 2006 to October 2009 State Street provided certain of its custody clients, including a large number of registered investment companies, with materially misleading statements regarding how it priced a method of foreign currency exchange (FX) it offered, known as Indirect FX. The Commission alleged that State Street represented to its custody clients that, among other things, it provided “best execution” on FX transactions, that its priority was to obtain the best possible prices on FX transactions, that it priced FX transactions at prevailing interbank or market rates, and that its Indirect FX rates were based on the size of the trade, State Street’s inventory of the currency, prevailing market conditions and rates, and/or State Street’s risk management assessment. The Commission alleged that these representations were materially misleading because State Street priced most Indirect FX transactions near the end of each trading day, irrespective of when the orders were received, and applied a predetermined, uniform markup to current interbank market rates to price the Indirect FX transactions. As a result, Indirect FX trades were often executed for custody clients at or near the highest and lowest rates in the interbank market between market open and the time the transactions were priced. The Commission alleged that State Street violated Section 34(b) of the Investment Company Act for providing custody clients with materially misleading statements about how it priced and provided “best execution” for Indirect FX. The Commission enjoined State Street from committing any further violations of Sections 31(a) and 34(b) of the Investment Company Act, and Rule 31a-1(b) thereunder. The Commission further ordered State Street to pay a civil money penalty of $75 million, disgorgement of $75 million and prejudgment interest of $17,369,417.

3. Compensation Payments for Representatives

a. *In re Advantage Investment Management*, LLC, Investment Advisers Act Release No. 4455, 2016 SEC LEXIS 3317 (July 18, 2016).

The Commission accepted an offer of settlement from Advantage Investment Management, LLC, a registered investment adviser (Advantage). The Commission alleged that Advantage failed to disclose a loan of approximately $3 million, forgivable over a five-year period, from a dual registrant (Broker) that it had engaged to provide clearing and custody and other services for its clients. The Commission alleged that Advantage’s representatives each received a portion of the proceeds of the loan based, in part, on its respective assets under management and that the loan proceeds were used, in part, to cover costs associated with transitioning clients from Advantage’s prior broker-dealer to Broker. The associated conflict of interest and the forgivable loan itself was not disclosed in Advantage’s regulatory filings or otherwise to clients. Based on the conduct described, the Commission alleged that Advantage violated Sections 206(2) and 207 of the Advisers Act. The Commission ordered Advantage to cease and desist from committing violations and any future violations of Sections 206(2) and 207 of the Advisers Act and to pay a civil money penalty of $60,000.

b. *In re Washington Wealth Management, LLC*, Investment Advisers Act Release No. 4456, 2016 SEC LEXIS 3287 (July 18, 2016).

The Commission accepted an offer of settlement from Washington Wealth Management, LLC, a registered investment adviser (Washington Wealth). Washington Wealth is a Delaware limited liability company with its principal place of business in San Diego, California. The Commission alleged that Washington Wealth engaged a dually registered broker-dealer and registered investment adviser (Broker) to provide client clearing and custodial services and that Washington Wealth received more than $1.8 million in loans from Broker, of which more than $1.1 million was intended to be forgivable over a five-year period. The Commission alleged that certain of the loans were used to cover costs associated with transitioning Washington Wealth's business from its prior broker-dealer to Broker. In addition, two of the loans, by their terms, would be forgiven over a five-year period provided that Washington Wealth's relationship with Broker continued and that Washington Wealth maintained certain asset levels on Broker's custodial platform. The Commission alleged that for nearly a year Washington Wealth did not disclose to clients its receipt of the loans from Broker. The Commission alleged that Washington Wealth thus failed to timely disclose its receipt of potential revenue from a third party that it had engaged to provide services to its clients. The Commission alleged that by failing to timely disclose its conflicts of interest completely and accurately, Washington Wealth violated Section 206(2) of the Advisers Act. The Commission further alleged that Washington Wealth also violated Section 207 of the Advisers Act by virtue of omissions of material facts from its Commission filings concerning its relationship with Broker. The Commission censured Washington Wealth and ordered it to cease and desist from further violations of Advisers Act Sections 206(2) and 207. In addition, Washington Wealth was ordered to pay a penalty of $50,000.

4. Compliance Policies and Procedures

a. *In re Dupree Financial Group, LLC*, Investment Advisers Act Release No. 4546, 2016 SEC LEXIS 3782 (Oct. 5, 2016).

The Commission accepted an offer of settlement from Dupree Financial Group, LLC (Dupree Financial), a registered investment adviser. The Commission alleged that Dupree Financial failed to conduct annual compliance reviews over a multiyear period. The Commission censured Dupree Financial and ordered it to cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. The Commission also ordered Dupree Financial to pay a civil money penalty in the amount of $25,000.

5. Conflicts of Interest Disclosure

a. *In re Biscayne Capital Int'l, LLC*, Investment Advisers Act Release No. 4399, 2016 SEC LEXIS 3275 (May 27, 2016).

The Commission accepted offers of settlement from Biscayne Capital International, LLC, a former US registered investment adviser (Biscayne); Chatburn, an investment adviser representative for and principal of Biscayne; and Roberto Cortes, Juan Cortes, and Weisson, three Biscayne principals (the Primary Principals) (together with Biscayne, Respondents). The Commission alleged that Biscayne failed to disclose conflicts of interest and other material information relating to the recommendation and sale to non-US clients of securities issued by private offshore investment companies formed by the Primary Principals, which companies were under common beneficial ownership with Biscayne (the Proprietary Products). The Commission further alleged that Biscayne failed to disclose the financial condition of its majority beneficial owner, a Florida-based real estate development entity, which during the relevant period failed to generate enough revenue or cash flow to meet maturing debt obligations or sustain operations absent the additional financing it was obtaining from the sale of the Proprietary Products. The Commission alleged that Chatburn and the Primary Principals willfully aided and abetted and caused Biscayne's violations, and that Chatburn, in recommending and selling approximately $3.49 million in Proprietary Products to Biscayne clients, also failed to analyze the Proprietary Products (in contravention of Biscayne's Form ADV representations), and failed to disclose his personal conflicts of interest, including beneficial ownership interest in Biscayne and receipt of undisclosed compensation. The Commission further alleged that Juan Cortes, as chief compliance officer, failed to adopt and implement policies and procedures reasonably designed to prevent violations of the Advisers Act, that Biscayne made material misstatements in its Form ADV, and that Biscayne and the Primary Principals failed to reasonably supervise Chatburn. The Commission censured Biscayne; ordered Respondents to cease and desist from committing violations of Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder; and barred Chatburn, Roberto Cortes, Juan Cortes, and Weisson from association and from serving in any capacity for a registered investment company or affiliated person of an investment adviser, depositor, or principal underwriter, with the right to reapply after three or, in Chatburn's case, four years. The Commission further ordered Biscayne and Chatburn to pay $30,024 and $78,924 in disgorgement and $3,063 and $8,052 in prejudgment interest, respectively; and imposed civil penalties of $125,000 on Biscayne, $100,000 on Chatburn, and $50,000 on each of Roberto Cortes, Juan Cortes, and Weisson.

b. *In re Lee D. Weiss*, Investment Advisers Act Release No. 4442, 2016 SEC LEXIS 2992 (June 29, 2016).

The Commission accepted an offer of settlement from Lee D. Weiss, the owner of Family Endowment Partners, LP (FEP), a registered investment adviser. The Commission alleged that Weiss urged advisor clients to invest in more than $40 million in illiquid securities issued by several related companies without disclosing that Weiss had an ownership interest in the parent company of the entities and received payments from the entities. The Commission further alleged that FEP urged clients to invest in entities owned and controlled by Weiss where the funds were used primarily to benefit FEP. The Commission barred Weiss from association, ordered Weiss and FEP to pay a civil penalty of $1 million and $500,000, respectively, and ordered Weiss and certain relief defendants to pay disgorgement of $8,436,766.

c. *In re Concert Global Group Ltd.*, Investment Advisers Act Release No. 4459, 2016 SEC LEXIS 3058 (July 21, 2016).

The Commission accepted an offer of settlement from Concert Global Group Limited, a California corporation (Concert Global); its CEO, Felipe Luna; and its subsidiary, Concert Wealth Management Inc. (Concert Wealth), a registered investment adviser (together, Respondents). The Commission alleged that from 2010 through 2013 Concert Global provided investors with materially misleading private placement memoranda that (i) overstated Concert Global subsidiaries' assets under management, (ii) overstated Concert Global's financial results, and (iii) misrepresented or failed to disclose conflicts of interest arising from the potential use of offering proceeds to pay several affiliated entities. The Commission further alleged that Concert Wealth failed to implement adequate policies and procedures to address the disclosure of possible conflicts of interest between the various entities controlled by Luna. The Commission ordered Respondents to cease and desist from further violations of Sections 5(a), 5(c), and 17(a) of the Securities Act and Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder. The Commission censured Concert Wealth and Luna and further ordered Concert Global and Concert Wealth to pay $120,000 and Luna to pay $60,000 in penalties. The Commission also ordered Concert Wealth to retain a compliance consultant for at least three years, keep all records of compliance with the ordered undertakings for the next six years, provide a notice of the order to all its customers, post a summary of the order on its website, and certify compliance with these undertakings. In a related action, In re Navarra, Investment Advisers Act Release No. 4460, 2016 SEC LEXIS 3008 (July 21, 2016), the Commission censured Dennis Navarra, the CFO, COO, and Chief Strategy Officer for Concert Global.

d. *In re Gleisner*, Investment Advisers Act Release No. 4537, 2016 SEC LEXIS 3679 (Sept. 28, 2016).

The Commission accepted an offer of settlement from Jan Gleisner, the president and managing director of Belvedere Asset Management LLC (Belvedere), formerly a registered investment adviser, and Keith D. Pagan, Belvedere's CEO, CIO, CCO, and principal, who was solely responsible for Belvedere's compliance and operations functions. The Commission alleged that the two principals failed to disclose material conflicts of interests to clients whose money Belvedere used to fund an affiliated mutual fund (the Fund). Specifically, the Commission alleged that Gleisner invested approximately one-third of the assets held by Belvedere's individual clients into the new Fund, and that Gleisner and Pagan failed to disclose to clients the material conflicts of interest inherent in such investments due to the adviser's financial incentives to invest clients in the affiliated Fund. The Commission alleged that clients invested in the Fund paid both advisory fees and undisclosed fees and expenses associated with their investment in the Fund. The Commission further alleged that Pagan caused

Belvedere's violations of the Investment Advisers Act relating to compliance rules and Form ADV delivery requirements, which were tasks he was specifically required to perform under Belvedere's written policies and procedures. The Commission ordered Gleisner and Pagan to cease and desist from further violations of Section 206(2) of the Advisers Act and enjoined Pagan from causing any future violations of Sections 204(a) and 206(4) of the Advisers Act and Rules 204-3 and 206(4)-7 promulgated thereunder. Additionally, the Commission censured Gleisner and ordered Gleisner to pay disgorgement of $63,887, prejudgment interest of $4,614, and a civil money penalty in the amount of $40,000. Pagan was ordered to pay disgorgement of $39,702 and prejudgment interest of $2,867.

e. *In re John Leo Valentine*, Investment Advisers Act Release No. 4557, 2016 SEC LEXIS 3946 (Oct. 20, 2016).

The Commission accepted an offer of settlement from John Leo Valentine, the president and owner of Valentine Capital Asset Management, Inc. (VCAM), a formerly registered investment adviser, who was also a registered representative formerly associated with several registered broker-dealers. The Commission alleged that Valentine failed to provide full and fair disclosure to his clients by failing to disclose that he had a conflict of interest when he recommended that his clients sell shares of a fund for which he did not earn commissions and buy shares of another fund for which he would earn a commission. The Commission further alleged that Valentine misrepresented the reasons why VCAM changed custodians by failing to note that the previous custodian terminated the relationship with VCAM due in part to concerns about a prior Commission administrative proceeding against Valentine and VCAM. Instead, Valentine claimed that he terminated the custodian relationship after conducting a year-long independent review and then concluding that the termination would benefit clients. In previous cease-and-desist and administrative proceedings against Valentine, the Commission found that Valentine violated Section 206(2) of the Advisers Act by failing to disclose a financial conflict of interest to clients in connection with his recommendation that clients exchange one series of managed futures fund for another series of the same fund. See In re Valentine Capital Asset Management, Inc., 2010 SEC LEXIS 3210, Investment Advisers Act Release No. 3090 (Sept. 29, 2010). The Commission ordered Valentine to cease and desist from further violations of Section 206(2) of the Advisers Act and ordered him to pay a civil penalty of $140,000. Valentine was also barred from associating with any broker-dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization with the right to apply for reentry after two years. The Commission also barred Valentine from participating in any offering of a penny stock, with the right to apply for reentry after two years.

f. *In re Derik J. Todd*, Investment Advisers Act Release No. 4567, 2016 SEC LEXIS 4200 (Nov. 10, 2016).

The Commission accepted offers of settlement from Todd and Madison Capital Energy Income Fund II GP LLC (the GP), both unregistered investment advisers, and several of their affiliated entities, Madison Capital Investments LLC, Big Horn Minerals

LLC, and Madison Royalty Management LLC (the Affiliates). The Commission alleged that Todd and the GP improperly used the Affiliates, which were controlled by Todd, as intermediaries in numerous purchases and sales of oil and gas royalty interests on behalf of the Madison Capital Energy Income Fund II LP (the Fund), thereby misappropriating $308,638 from the Fund and its investors. The Commission further alleged that Todd and the GP acted in breach of their fiduciary duties and contrary to disclosures in the Fund's offering materials stating that the Fund's assets would be used for the "exclusive benefit" of the Fund to purchase assets at the "best possible price," and that affiliate transactions would be conducted on an "arms-length" basis. The Commission censured the GP and the Affiliates, ordered Respondents to cease and desist from further violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(1) and 206(2) of the Advisers Act, and barred Todd from association and from serving in any capacity for a registered investment company or affiliated person of an investment adviser, depositor, or principal underwriter. The Commission further ordered Respondents to jointly and severally pay $205,673 in disgorgement and $21,581 in prejudgment interest, and imposed a civil penalty of $50,000 on Todd.

g. *In re Harold D. Garrison*, Investment Advisers Act Release No. 4584, 2016 SEC LEXIS 4517 (Dec. 7, 2016).

The Commission accepted an offer of settlement from Garrison, the chief executive officer and a principal of fund manager HDGM Advisory Services (HDGM). Between 2002 and 2013, HDGM served as investment manager for two commercial property investment funds (the Funds). The Commission alleged that during 2012 Garrison caused HDGM to charge $5,800,000 in transactional fees to the Funds without adequately disclosing such fees to their respective boards of directors. The Commission specifically alleged that Garrison, acting on behalf of HDGM, failed to adequately disclose the prepayment of $5,800,000 in transaction fees in its 2012 quarterly reports on the financial condition of the Funds to the Funds' board of directors and Investment Committee. The prepaid fees were charged to the Funds in anticipation of the sale of portfolio holdings of the Funds, the refinancing of certain of the Funds' lending arrangements, and the leasing of the Funds' holdings. The Commission also alleged that Garrison failed to disclose these fees while present at numerous board of directors and Investment Committee meetings, or during email communications and conference calls that he participated in regarding the financial affairs of the Funds. The Commission ordered that Garrison cease and desist from further violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, barred him from association with a right to reapply for reentry, and ordered him to pay disgorgement of $1,350,000.

h. *In re New Silk Route Advisors, L.P.*, Investment Advisers Act Release No. 4587, 2016 SEC LEXIS 4612 (Dec. 14, 2016).

The Commission accepted an offer of settlement from New Silk Route Advisors, L.P. (New Silk Route), the manager of two Cayman Islands–domiciled private equity funds (the Funds). The co-founder and CEO of New Silk Route was also a co-founder and CEO of another Commission-registered investment advisor (the Related Adviser). The Commission alleged that from 2008 through 2014 New Silk Route breached its fiduciary duty by repeatedly failing to obtain required advisory board consents for certain co-investments made by the Funds. In the order, the Commission alleged that New Silk Route caused the Funds to invest more than $250 million in four portfolio companies in which another private equity fund managed by the Related Adviser invested. To address such conflicts, the Funds' Limited Partnership Agreements had required the consent of the Funds' advisory boards in order to co-invest with a fund managed by the Related Adviser. The Commission alleged that New Silk Route negligently failed to obtain the required advisory board consents for the co-investments made by the Funds, thereby violating Section 206(2) and 206(4) of the Advisers Act, and Rules 206(4)-7 and 206(4)-8 thereunder. The Commission censured New Silk Route and enjoined it from further violations of Section 206(2) and 206(4) of the Advisers Act, and Rules 206(4)-7 and 206(4)-8 thereunder, and ordered it to pay a civil money penalty of $275,000.

i. *SEC v. Interinvest Corporation, Inc.*, Litigation Release No. 23713, 2016 SEC LEXIS 4817 (Dec. 28, 2016).

In a civil action brought by the Commission, the US District Court for the District of Massachusetts entered a default judgment against Interinvest Corporation (Interinvest), a registered investment adviser, and Black, its owner (the Defendants). The Commission's complaint, which the Defendants failed to answer, alleged that the Defendants funneled more than $17 million of client assets into four Canadian penny stock companies in which Black had an undisclosed interest, causing investors to lose as much as $12 million. The Commission further alleged that the Defendants failed to disclose to their advisory clients the conflict of interest resulting from the facts that Black served on the companies' boards of directors, and that the companies paid approximately $1.9 million to an entity controlled by Black. The Court enjoined the Defendants from future violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, Section 17(a) of the Securities Act, and Section 206(1) and 206(2) of the Advisers Act, and ordered the Defendants, jointly and severally, to pay $5.4 million in disgorgement and prejudgment interest. The court also imposed civil penalties of $1.5 million on Interinvest and $2 million on Black.

6. Custody Rule

a. *In re Reid S. Johnson*, Investment Advisers Act Release No. 4368, 2016 SEC LEXIS 1486 (Apr. 14, 2016).

The Commission accepted an offer of settlement from Johnson, the founder, sole owner, president, managing director, and chief compliance officer of a formerly registered investment adviser (the Adviser). The Commission alleged that the Adviser had custody of certain client funds and securities, including securities of pooled investment vehicles whose managing members were entities owned and controlled by Johnson and operated as a single integrated investment adviser with the Adviser, and that the Adviser violated the Custody Rule under the Advisers Act by failing to adequately determine the securities of which it had custody, to ensure the maintenance of such securities by a qualified custodian, and to obtain adequate surprise examinations. The Commission further alleged that the Adviser violated Advisers Act Rule 206(4)-7, that Johnson willfully aided and abetted these violations, and that the Adviser and Johnson made materially false representations in the Adviser's Form ADV filings. Johnson admitted to the Commission's findings. The Commission ordered Johnson to cease and desist from further violations of Sections 206(4) and 207 of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder, and barred Johnson from association, from participating in any penny stock offering, and from serving in any capacity for a registered investment company or affiliated person of an investment adviser, depositor, or principal underwriter, with the right to reapply after one year. The Commission further ordered Johnson to pay a civil penalty of $45,000 and to complete, and certify to the Commission that he has completed, 30 hours of Advisers Act compliance training.

b. *In re Santos, Postal & Co., P.C.*, Investment Advisers Act Release No. 4380, 2016 SEC LEXIS 1581 (Apr. 29, 2016).

The Commission accepted offers of settlement from Santos, Postal & Company, P.C., an accounting firm (Santos), and Scolaro, one of its partners (together, Respondents). The Commission alleged that Respondents had engaged in improper professional conduct in connection with Santos's examination of client funds and securities of which a certain registered investment adviser had custody, and filed reports on Form ADV-E containing untrue statements of material fact regarding certain examinations. Specifically, the Commission alleged that Respondents failed to exercise due professional care and professional skepticism, failed to obtain sufficient evidence, and failed to prepare and maintain appropriate documentation in the course of their examinations, and that Respondents failed to assign an adequately trained team to the examinations. The Commission further alleged that Santos's reports on the examinations in question contained untrue statements of material fact, including regarding confirmation of the contributions to and withdrawals from the accounts of the adviser's clients, testing procedures (which were not actually followed), and an unqualified opinion regarding the adviser's compliance with the Advisers Act rules relating to custody when in fact Respondents were aware of misappropriation of client funds by the adviser's president. The Commission ordered Respondents to cease and desist from further violations of Section 207 of the Advisers Act, and barred Respondents from practicing before the Commission as accountants, granting Santos the right to reapply after one year and Scolaro the right to reapply after five years. The Commission further ordered Santos to pay $25,800 in disgorgement and $3,277 in prejudgment interest, and imposed a civil penalty of $15,000 on Scolaro.

c. *In re Fortius Financial Advisors*, LLC, Investment Advisers Act Release No. 4483, 2016 SEC LEXIS 3294 (Aug. 15, 2016).

The Commission accepted an offer of settlement from Fortius Financial Advisers, LLC, a formerly registered investment adviser (Fortius), and Gary E. Oliver and Jeff M. Bollinger, each members of the firm (together, Respondents). Respondents managed the assets of certain trust entities for which Oliver served as trustee. The Commission alleged that Respondents invested more than $800,000 of the entities' assets in unsuitable, illiquid investments in which Respondents had an undisclosed financial interest. Second, the Commission alleged that Oliver misappropriated approximately $137,000 from the trust entities' accounts over the course of approximately four years. Third, the Commission alleged that Fortius and Bollinger failed to reasonably supervise Oliver and failed to comply with the requirements of the custody rule under the Advisers Act, in light of Oliver's full signatory authority over the trust entities' accounts, by failing to engage an independent public accountant to conduct a surprise examination of such accounts. Fourth, the Commission alleged that Fortius and Bollinger failed to adopt and implement policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules, particularly as to Oliver's misappropriation of client assets. Finally, the Commission alleged that Oliver caused Fortius to make untrue statements in its Form ADV registration application filed with the Commission. The Commission ordered Respondents to cease and desist from further violations of Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rules 206(4)-2 and 206(4)-7 promulgated thereunder. The Commission censured Fortius and Bollinger. The Commission ordered that Oliver be barred from association and prohibited from serving in any capacity at an investment adviser. Fortius was ordered to pay $21,000 in disgorgement and $70,000 in penalties. Bollinger was ordered to pay $2,000 in disgorgement and $25,000 in penalties.

7. Fees and Allocation of Expenses

a. *In re Equinox Fund Management, LLC*, Investment Advisers Act Release No. 4315, 2016 SEC LEXIS 237 (Jan. 19, 2016).

The Commission accepted an offer of settlement from Equinox Fund Management, LLC (Equinox) for material misstatements and omissions that the Commission alleged Equinox made in connection with the offer and sale of units in a publicly registered managed futures fund with multiple series (the Fund). Equinox was the manager of the Fund. The Commission alleged that from 2004 through March 2011 the Fund's registration statements disclosed that Equinox charged management fees based upon the net asset value (NAV) of each series of the Fund, when in reality the management fees were based upon the notional trading value of the assets (including leverage) in the Fund. This resulted in clients being charged an additional $5.4 million in management fees than would have been charged had the fees been calculated on the basis of NAV. Further, the Commission alleged that during this timeframe the Fund's disclosures (including its Forms 10-K and 10-Q) included a number of material misstatements regarding the methodology for valuation of certain derivatives and options transactions. The Commission alleged that, as a result of this conduct, Equinox violated Sections 17(a)(2) and 17(a)(3) of the Securities Act as well as Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. The Commission censured Equinox, and ordered it to cease and desist from further violations of the federal securities laws and to pay disgorgement of $5,404,004 and prejudgment interest of $596,063, as well as a civil money penalty of $400,000.

b. *In re Marco Investment Management, LLC*, Investment Advisers Act Release No. 4348, 2016 SEC LEXIS 3264 (Mar. 2, 2016).

The Commission accepted an offer of settlement from Marco Investment Management, LLC (MIM) and its principal owner, Steven S. Marco. The Commission alleged that from approximately 2005 through 2014 Marco, through MIM, charged certain clients advisory fees that were calculated differently, and in certain instances were in excess, of what was provided for in those clients' respective written advisory agreements. MIM's investment management agreements with clients provide for an advisory fee calculated as an identified percentage of the portfolio's gross assets, billed quarterly. A quarter of MIM's client base had margin agreements in place for their custodial accounts permitting Marco to utilize margin in managing the portfolio. The Commission alleged that, for those clients with margin accounts, MIM calculated quarterly management fees without adjusting for the sales proceeds or other credits that had been applied against the clients' margin balance by the account's custodial broker-dealer. The Commission alleged that these billing practices were inconsistent with the written billing terms set out in the written advisory agreements, and resulted in MIM's providing incorrect figures for its regulatory assets under management in its Form ADV. The Commission censured MIM and Marco and ordered each to cease and desist from further violations of Sections 204(a), 206(4), and 207 of the Advisers Act, and Rules 204-2 and 206(4)-7 thereunder. The Commission further ordered MIM to retain an independent compliance consultant, and pay disgorgement of $124,750.44 and prejudgment interest of $7,595.94, and, together with Marco, cumulative civil money penalties of $150,000.

c. *SEC v. Momentum Investment Partners LLC*, Litigation Release No. 23549, 2016 SEC LEXIS 1913 (May 31, 2016).

The Commission initiated proceedings against Momentum Investment Partners LLC (d/b/a Avatar Investment Management) (Momentum) and one of its principals, Fernandes (collectively, Respondents). The Commission alleged that Respondents moved some of their clients' assets from individual accounts to newly created mutual funds, which increased management fees, without providing them notice. The Commission further alleged that Respondents deployed the same investment strategy and did not provide any additional services when the assets were moved into the mutual funds, even though clients were charged higher management fees as the result of the asset movement. The Commission alleged that Respondents violated Section 206(1) and 206(2) of the Advisers Act, Momentum violated Sections 206(4) and 207 of the Advisers Act, and Fernandes aided and abetted Momentum's violations of Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act. The Commission is also seeking permanent injunctions, disgorgement of ill-gotten gains plus prejudgment interest, and a civil penalty. This litigation is pending.

d. *In re Blackstreet Capital Management, LLC*, Investment Advisers Act Release No. 4411, 2016 SEC LEXIS 2062 (June 1, 2016).

The Commission accepted an offer of settlement from Blackstreet Capital Management, LLC (BCM) and its principal, Gunty (collectively, Respondents). The Commission alleged that BCM received transaction-based compensation in connection with the acquisition and disposition of portfolio companies, thereby providing brokerage services, while not being registered as a broker. The Commission further alleged that BCM improperly charged operating partner oversight (OPO) fees to the portfolio companies owned by one of the private funds it managed, even though the fund's governing documents did not authorize the OPO fees. The Commission further alleged that BCM improperly used fund assets to make political and charitable contributions and for entertainment expenses, even though it was not expressly authorized by the funds' governing documents to do so. The Commission further alleged that BCM acquired a departing employee's shares in portfolio companies also held by a fund managed by BCM in contravention of the terms of the agreement by which the employee received the shares. Specifically, the shares should have been repurchased by the portfolio companies for the benefit of the fund and its limited partners. In addition, by acquiring the shares the Commission alleged that BCM engaged in a conflicted transaction without disclosing the conflict to investors. Further, the Commission alleged that, through a controlled entity, Gunty acquired interests in a fund advised by BCM from limited partners instead of having the interests forfeited back to each fund as required by each fund's governing document and that Gunty improperly waived his obligation to satisfy future capital calls on new investments, contrary to the funds' governing documents. The Commission further alleged that BCM failed to adopt and implement written policies and procedures to prevent violations of the Advisers Act. The Commission censured BCM and ordered Respondents to cease and desist from further violations of Sections 15(b) and 21C of the Securities Exchange Act and Sections 203(e) and 203(k) of the Advisers Act. The Commission ordered Respondents to pay disgorgement of $2,339,000, prejudgment interest of $283,737, and a civil money penalty of $500,000.

e. *In re Apollo Mgmt. V, L.P.*, Investment Advisers Act Release No. 4493, 2016 SEC LEXIS 3297 (Aug. 23, 2016).

The Commission accepted an offer of settlement from four affiliated registered investment advisers: Apollo Management V, L.P., Apollo Management VI, L.P., Apollo Management VII, L.P., and Apollo Commodities Management, L.P. (together, Respondents or Apollo). Respondents had entered into agreements with certain portfolio companies owned by certain private equity funds managed by Respondents (Funds) whereby Respondents received fees from the portfolio companies for providing certain monitoring and consulting services (Monitoring Fees). The Commission alleged that Respondents failed to adequately disclose to the Funds, and the Funds' limited partners prior to their commitment of capital, that Respondents could accelerate future monitoring fees upon termination of the monitoring agreements. The Commission separately alleged that Apollo Management VI failed to disclose that accrued interest from a lending agreement among several funds would be allocated solely to one fund. In addition, the Commission alleged that from at least January 2010 through June 2013 a former senior partner at Apollo (Partner) improperly charged personal items and services to Apollo-advised Funds and the Funds' portfolio companies. The Commission alleged that Respondents failed to reasonably supervise the Partner to prevent his conduct. Finally, the Commission alleged that Respondents failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act arising from the undisclosed receipt of accelerated monitoring fees and failed to implement its policies and procedures concerning employees' reimbursement of expenses. In determining to accept Respondents' offer of settlement, the Commission considered remedial acts taken by Apollo and cooperation afforded the Commission staff. The Commission ordered Respondents to cease and desist from further violations of Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder and pay $37,527,000 in disgorgement, $2,727,552 in prejudgment interest, and a $12,500,000 civil monetary penalty. Respondents agreed to distribute the disgorgement and interest amounts to affected fund investors and provide a final accounting and certification to the Commission regarding the disgorgement.

f. *In re WL Ross & Co. LLC*, Investment Advisers Act Release No. 4494, 2016 SEC LEXIS 3298 (Aug. 24, 2016).

The Commission accepted an offer of settlement from WL Ross & Co., LLC (WL Ross), a registered investment adviser. The Commission alleged that WL Ross failed to disclose its fee allocation practices to certain private equity funds that it advised (the Funds) and each Fund's underlying investors, resulting in the Funds paying higher management fees than disclosed. The limited partnership agreements for the Funds provided that WL Ross may receive fees from the portfolio companies owned by the Funds from time to time, including break-up, origination, commitment, broken deal, topped bid, cancellation, monitoring, closing, financial advisory, investment banking, director, or other transaction fees (collectively, Transaction Fees). The limited partnership agreements further provided that the quarterly management fees payable by the Funds would be reduced by an amount equal to 50% or 80% of any Transaction Fees received by WL Ross during the prior quarter from portfolio companies of each Fund. Each Fund's governing documents, however, did not disclose how transaction fees would be allocated when multiple Funds and co-investors were invested in the same portfolio company. The Commission alleged that between 2001 and 2011 WL Ross adopted a Transaction Fee allocation methodology that resulted in it retaining a significant amount of fees for itself rather than allocating them to the Funds for the purpose of offsetting the management fee. The Commission alleged that WL Ross did not make appropriate disclosure related to this practice. WL Ross voluntarily reimbursed $11,873,571 to the affected Funds, revised its allocation methodology and self-reported the violation to the Commission. The Commission ordered WL Ross to cease and desist from further violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder and pay a penalty of $2,300,000.

g. *In re First Reserve Mgmt., L.P.*, Investment Advisers Act Release No. 4529, 2016 SEC LEXIS 3446 (Sept. 14, 2016).

The Commission accepted an offer of settlement from First Reserve Management, L.P. (First Reserve), a registered investment adviser. Firstly, the

Commission alleged that First Reserve did not adequately disclose certain financial conflicts of interest to private equity funds it managed (the Funds) or to the underlying investors in the Funds. Between 2010 and 2015 First Reserve allocated certain expenses to the Funds without making appropriate disclosures or receiving effective consent, including certain fees and expenses of two entities formed as advisers to a Fund portfolio company that was a pooled investment vehicle, which the Commission alleged enabled First Reserve to avoid incurring certain expenses in connection with providing advisory services to the Funds. Secondly, the Commission alleged that First Reserve allocated certain liability insurance premiums associated with an insurance policy covering it for risks not entirely arising from its management of the Funds to the Funds, while the relevant fund-governing documents provided that the Funds would only pay insurance expenses relating to the affairs of the Funds. Thirdly, the Commission alleged that First Reserve negotiated a legal fee discount for itself for certain legal services based on the large volume of work the law firm performed for the Funds, while the Funds did not receive a discount on the same services. The Commission ordered First Reserve to cease and desist from further violations of Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder and pay a penalty of $3,500,000.

8. Front Running

a. *In re Christopher M. Gibson*, Investment Advisers Act Release No. 4359, 2016 SEC LEXIS 1200 (Mar. 29, 2016).

The Commission instituted public administrative and cease-and-desist proceedings against Gibson for alleged fraudulent and deceptive conduct while he acted as an investment adviser to a private investment fund (the Fund). The Commission alleged that Gibson engaged in a number of transactions that caused him to breach his fiduciary duties to the Fund. Specifically, the Commission alleged that Gibson “front-ran” the Fund by selling personal shares, and shares in other accounts that he controlled, in advance of liquidating the Fund’s substantial position in the same security, resulting in the Fund receiving a price that was more than $0.50 per share lower than the price obtained for the personal accounts. The Commission also alleged that Gibson favored other investors over the Fund by causing the Fund to purchase more than 680,00 shares from another investor in a private transaction, enabling that investor to sell his entire position in the security at a favorable price and without the price-depressing impact of a publicly executed sale. The Commission alleged that during the course of this transaction the other investor paid Gibson an annual salary of $150,000 through a commercial real estate business, creating a conflict of interest that was not disclosed to the Fund. As a result of this transaction, the Fund suffered a total loss of approximately $1.1 million when its position in the security was liquidated. The Commission alleged that Gibson willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(1), (2), and (4) of the Advisers Act and Rule 206(4)-8 thereunder. Gibson was ordered to file an answer to the allegations in the Commission’s Order.

9. Gatekeepers

a. *In re Apex Fund Serv. (US), Inc.*, Investment Advisers Act Release Nos. 4428 and 4429, 2016 SEC LEXIS 3282 and 2016 SEC LEXIS 3283 (June 16, 2016).

Apex Fund Services (US), Inc. (Apex), a private fund administrator, was charged with failing to identify red flags for two private fund complexes, ClearPath Wealth Management, LLC (ClearPath) and EquityStar Capital Management LLC (EquityStar), for which it had been engaged to serve as administrator. Specifically, in two separate actions the Commission alleged that Apex ignored a series of red flags in both cases. With respect to ClearPath, the Commission alleged that Apex failed to act appropriately after detecting undisclosed brokerage and bank accounts, undisclosed margin and loan agreements, and inter-series and inter-fund transfers made in violation of fund offering documents and failed to correct previously issued accounting reports and capital statements and continued to provide materially false reports and statements to ClearPath and the funds' independent auditor that resulted in incorrect information being provided to the funds' investors. With respect to EquityStar, the Commission alleged that Apex accounted for more than $1 million in undisclosed withdrawals by EquityStar's owner from the EquityStar funds as receivables owed to the funds, despite no evidence that the owner was able or willing to repay the withdrawals; confronted the owner about the withdrawals; and concluded that he was unlikely to repay the funds, yet Apex failed to properly account for the withdrawals—which grew to more than half of the NAV of one fund, and more than one quarter of the other. Finally, the Commission alleged that Apex sent monthly account statements to investors in the EquityStar funds that it knew or should have known materially overstated the investors' true holdings in the funds. Each of ClearPath and EquityStar was separately charged by the Commission. The Commission charged Apex with causing both ClearPath's and EquityStar's violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Without admitting or denying the Commission's findings, Apex agreed to retain an independent consultant and pay a total of $352,449, including disgorgement of $96,800 plus interest of $8,813 and a penalty of $75,000 for its role in the ClearPath fraud, as well as disgorgement of $89,050 plus interest of $7,786 and a penalty of $75,000 for its role in the EquityStar fraud.

b. *In re Grassi & Co., CPAs, P.C.*, Investment Advisers Act Release No. 4572, 2016 SEC LEXIS 4329 (Nov. 21, 2016); In re Gary R. Purwin, CPA, Investment Advisers Act Release No. 4573, 2016 SEC LEXIS 4330 (Nov. 21, 2016).

The Commission accepted offers of settlement from Grassi & Co., CPAs, P.C. (Grassi), a public accounting firm registered with the Public Company Accounting Oversight Board, and Purwin, one of its partners. The Commission alleged that during Grassi's engagement as independent auditor for several private funds, the funds were being defrauded by their adviser and its principal, who were misappropriating fund assets and making repeated misstatements to investors about the value and existence of fund investments. The Commission further alleged that Grassi repeatedly violated professional standards in failing to heed indications of the fraud, and thus negligently issued multiple materially false audit reports, thereby enabling the adviser and principal to continue to report materially inflated valuations, to conceal use of fund assets for their own benefit, and to continue their scheme to defraud the funds and their investors. The Commission also alleged that Purwin authorized Grassi to issue the materially false audit reports and failed to fulfill his role as the engagement partner for the funds' audits by failing to appropriately assess audit risks, establish audit plans to effectively address those risks, properly supervise the audit engagement, and exercise professional skepticism in light of the indicia of the fraud apparent from the accounting records. The Commission further alleged that Purwin also failed to sufficiently review certain audit paperwork due to health reasons, but nonetheless authorized the release of the relevant audit upon Grassi's instructions. The Commission censured Grassi, ordered Grassi and Purwin to cease and desist from further violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, ordered Grassi to pay $130,000 in disgorgement and $11,510 in prejudgment interest, and imposed civil penalties of $260,000 on Grassi and $20,000 on Purwin. The Commission further barred Purwin from practicing before the Commission as an accountant, with the right to reapply after one year, and ordered Grassi to require additional training for its audit professionals and to hire an independent compliance consultant to review and improve its quality controls.

10. Material Nonpublic Information

a. *In re Federated Global Inv. Mgmt. Corp.*, Investment Advisers Act Release No. 4401, 2016 SEC LEXIS 3276 (May 27, 2016).

The Commission accepted an offer of settlement from Federated Global Investment Management Corp., a registered investment adviser (Federated). The Commission alleged that Federated maintained inadequate policies and procedures for preventing the misuse of material, nonpublic information in connection with its use of outside consultants. Specifically, the Commission alleged that while Federated had written policies and procedures regarding both material nonpublic information and personal trading activities of individuals with access to confidential information, Federated did not establish policies and procedures for identifying outside consultants who should be subject to compliance oversight due to their access to confidential information. The Commission alleged that due to this lack of policies and procedures, a particular consultant was not made subject to the firm's Code of Ethics, and consequently Federated was unaware that the consultant was a member of the boards of four public companies of which the funds sub-advised by Federated were shareholders, and that the consultant purchased and sold for his personal account, at times in close proximity to trades by the funds, the securities of certain companies held by the funds. The Commission, noting that Federated took remedial actions promptly upon becoming aware of the situation in 2010, censured it and ordered it to cease and desist from further violations of Section 204A of the Advisers Act and to pay a $1,500,000 civil penalty.

b. *In re Artis Capital Management, L.P.*, Investment Advisers Act Release No. 4550, 2016 SEC LEXIS 3868 (Oct. 13, 2016).

The Commission accepted offers of settlement from Artis Capital Management L.P. (Artis), formerly a registered investment adviser, and Michael W. Harden, formerly employed as a senior analyst at Artis. The Commission alleged that Artis and Harden failed to reasonably supervise an Artis employee (Employee) who procured material nonpublic information from a public company insider and then provided such information to Artis, which subsequently executed profitable trades based on such information. The Commission noted that the Employee had shared information with Harden that should have caused a reasonable supervisor to question whether the Employee had improperly obtained material nonpublic information. The Commission further alleged that Artis failed to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information consistent with the nature of its business. Although Artis had written policies and procedures that prohibited the receipt and use of material nonpublic information, the Commission alleged that Artis failed to adopt policies and procedures to address the particular risk presented by the Employee's frequent interaction with contacts at public companies whose securities Artis traded. The Commission censured Artis and ordered it to pay disgorgement of $5,165,862, prejudgment interest of $1,129,222, and a civil money penalty in the amount of $2,582,991. The Commission suspended Harden from association with any broker-dealer, investment adviser, municipal securities dealer, or other transfer agent for 12 months and ordered Harden to pay a civil money penalty in the amount of $130,000.

11. Investment Adviser Registration

a. *In re Saving2Retire, LLC*, Investment Advisers Act Release No. 4457, 2016 SEC LEXIS 3319 (July 19, 2016).

The Commission instituted proceedings against Saving2Retire, LLC (Saving2Retire), which is an investment adviser located in Sugar Land, Texas, and its sole owner, Marian P. Young (collectively, Respondents). The Commission alleged that Saving2Retire was improperly registered as an investment adviser with the SEC, failed to produce documents to the examination staff, and failed to keep required books and records. Saving2Retire registered under the internet investment adviser exemption despite not qualifying for the exemption, as it did not advise any clients through an interactive website but did advise clients outside of the website. Further, during an examination by the SEC's examination staff, Saving2Retire refused to produce or retain certain client account documents and firm financial records as required by the Advisers Act. As a result of said conduct, the Commission alleged that Respondents willfully violated Section 203A of the Advisers Act and has ordered a public cease-and-desist hearing on the alleged violations.

b. *In re Bank Leumi le-Israel B.M.*, Investment Advisers Act Release No. 4555, 2016 SEC LEXIS 3911 (Oct. 18, 2016).

The Commission accepted offers of settlement from Bank Leumi le-Israel B.M., an Israeli corporation holding an Israeli banking license; Leumi Private Bank; and Bank Leumi (Luxembourg) S.A., wholly owned subsidiaries of Bank Leumi le-Israel B.M (collectively, Respondents). The Commission alleged that from 2002 to 2013 Respondents provided cross-border investment advisory and brokerage services to customers in the United States without registering with the Commission as either an investment adviser or a broker-dealer. Specifically, the Commission alleged that among other actions certain employees of Respondents traveled to the United States to solicit new and/or service existing US customers, in part by soliciting or attempting to solicit securities transactions and/or through the provision of investment advice for compensation. The Commission censured Respondents and ordered each of Respondents to cease and desist from further violations of Section 15(a) of the Exchange Act and Section 203(A) of the Advisers Act. The Commission also ordered Respondents to pay disgorgement of $65,700, representing the outstanding unpaid balance from a total disgorgement figure of $3,372,700, less $3,307,000 already disgorged to the US Department of Justice for related conduct, and pay prejudgment interest of $8,713 and a civil money penalty in the amount of $1,517,715.

12. Misappropriation

a. *In re Markusen*, Investment Advisers Act Release No. 4406, 2016 SEC LEXIS 3277 (May 31, 2016).

The Commission initiated administrative proceedings against Markusen, the former CEO of Archer Advisors LLC (Archer), an unregistered investment adviser to private funds (the Funds), and Cope, a former employee of Archer's. The Commission alleged that Markusen and Cope engaged in a scheme to defraud the Funds of illegitimately claimed research expenses by misrepresenting Cope as an independent research consultant so that he could be paid with investor money. The Commission further alleged that Markusen misappropriated improper research expenses from the Funds and failed to disclose conflicts of interest associated with Cope, an Archer insider, receiving fees and soft dollars from the Funds. The Commission further alleged that Markusen and Cope inflated monthly returns reported to existing and prospective investors by marking the close in the Funds' largest holding, which resulted in Archer collecting additional management fees. The Commission ordered a public hearing before an administrative law judge to make findings on their allegations.

In a related civil action filed by the Commission, the US District Court for the District of Minnesota entered a final judgment against (i) Markusen permanently enjoining him from future violations of Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and Section 206(1) and 206(2) of the Advisers Act and (ii) Cope permanently enjoining him from future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and from aiding and abetting any violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 206(1) and 206(2) of the Advisers Act. The court ordered Markusen and Archer to pay disgorgement of $630,830, plus prejudgment interest, and a civil penalty of $100,000. The court also ordered Cope to pay disgorgement of $549,285, prejudgment interest of $81,037, and a civil penalty of $100,000. See also SEC v. Markusen, No. 14-cv-3395, 2016 U.S. Dist. LEXIS 55419, at *1 (D. Minn. Apr. 25, 2016).

b. *SEC v. Davis, Jr.*, Litigation Release No. 23554, 2016 SEC LEXIS 1965 (June 2, 2016).

The Commission accepted a partial offer of settlement from Davis, the owner and operator of an unregistered investment adviser. The Commission's allegations relate to Davis's management of two unregistered pooled investment vehicles (the Funds). The Commission alleged that there was no exemption from registration available for the Funds' securities and yet no registration statement was filed or in effect for such securities. The Commission further alleged that Davis communicated to investors that he planned to invest their money in "hard assets," such as real estate or mineral rights, but instead entered into business transactions with unregistered pooled investment vehicles that he owned and/or controlled, and failed to disclose this conflict of interest to all investors. The Commission further alleged that Davis transferred money he raised from investors into bank accounts he controlled to satisfy business expenses that were not related to the investment strategy of the Funds, without disclosing it to investors. Finally, the Commission alleged that Davis falsely reported to investors that their investments were growing based on speculative valuations and, as a result, he received management fees that were in excess of what he was entitled to under the Funds' offering materials. The Commission alleged that Davis violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as Sections 5 and 17(a) of the Securities Act and Section 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. The Commission ordered Davis to pay disgorgement plus interest and civil penalties, subject to the approval and determination by the court at a later date. Further, without admitting or denying the allegations, Davis agreed to a partial settlement that barred him from any further sale of securities in a pooled investment vehicle as well as from future violations of antifraud and securities registration provisions of the federal securities laws. The Commission also ordered Davis to cooperate with a court-appointed receiver.

c. *In re Augustine Capital Management, LLC*, Investment Advisers Act Release No. 4591, 2016 SEC LEXIS 4709 (Dec. 20, 2016).

The Commission instituted administrative and cease-and-desist proceedings against Augustine Capital Management, LLC, an unregistered investment adviser owned by three principals (together, Respondents). Respondents advise a private fund (the Fund). Following an investigation, the Division of Enforcement (the Division) alleged that Respondents caused the Fund to engage in conflicted transactions without providing disclosure to, or obtaining the consent of, the Fund's investors. Specifically, the Division alleged that Respondents invested in and lent money on behalf of the Fund to two entities in which they had an interest. Respondents also lent themselves money from the Fund in order to finance an investment in a business venture; when the venture failed and the loan went into default, the Fund internalized the resulting losses. The Division alleged that Respondents actively concealed these investments and loans from investors, which investments and loans were not authorized under the Fund's offering documents. Further, the Division alleged that Respondents collected nearly $1 million in investor funds by charging the Fund for all of the manager's expenses (including personal salaries), in contravention of the Fund's offering documents, and even though the principal Respondents were themselves investors in the Fund, they exempted themselves and certain of their relatives who were investors in the Fund from paying their pro rata shares of employee salaries. The Division also alleged that Respondents did not form separate partnership interest classes for the Fund, as provided in the private placement memorandum; actively concealed and misrepresented the Funds' losses in communications to investors; and denied investor redemption requests. The Division alleged that these actions violated the anti-fraud provisions of the Advisers Act. The Commission ordered that an evidentiary hearing be convened, and required that Respondents file an answer to the Division's allegations.

13. Mutual Fund Share Class Selection

a. *In re Everhart Financial Group, Inc.*, Investment Advisers Act Release No. 4314, 2016 SEC LEXIS 185 (Jan. 14, 2016).

The Commission accepted an offer of settlement by the Everhart Financial Group and its principals (together, Respondents) for violations of the anti-fraud provisions of the Investment Advisers Act in connection with investments Everhart Financial Group made on behalf of advisory clients into a single family of mutual funds. The Commission alleged that Respondents nearly always had clients invest in a share class offered by the fund complex that charged 12b-1 fees, which were paid back to Respondents' principal owners, who were also registered representatives of a broker-dealer firm registered with the Commission. In doing so, the Commission alleged that Respondents violated Advisers Act Section 206(2) and 206(4) by creating a conflict of interest that they did not adequately disclose to clients, and failing to fulfill their duty to seek best execution for client transactions by favoring share classes that charged 12b-1 fees. The Commission also alleged that Respondents caused several other compliance failures, including failure to conduct an annual compliance review for a number of years pursuant to Advisers Act Rule 206(4)-7, and issuing insufficient disclosures regarding the receipt of 12b-1 fees. The Commission censured Respondents and ordered them to cease and desist from committing or causing any violations of Sections 204, 206(2), 206(4), and 207 of the Advisers Act and Rules 204-3(a), 204-3(b)(1) and (2), and 206(4)-7 thereunder. The Commission ordered Respondents to pay disgorgement of $201,986 and prejudgment interest of $23,423 as well as cumulative civil money penalties of $140,000, and to retain the services of an independent compliance consultant.

b. *In re Royal Alliance Associates, Inc.*, Investment Advisers Act Release No. 4351, 2016 SEC LEXIS 1027 (Mar. 14, 2016).

The Commission accepted an offer of settlement from Royal Alliance Associates, Inc., SagePoint Financial, Inc., and FSC Securities Corporation (together, Respondents), each indirectly owned by American International Group, Inc. (AIG). The Commission alleged that Respondents breached their fiduciary duty under Section 206 of the Advisers Act by having advisory clients invest in mutual fund share classes with 12b-1 fees when a lower-fee share class of the same fund was otherwise available. Respondents, in their capacity as broker-dealers, each received the 12b-1 fees paid by the funds in which such clients were invested. The Commission alleged that Respondents did not adopt any compliance policies and procedures governing mutual fund share class selection, and failed to disclose in their Forms ADV or otherwise that they had a conflict of interest due to the financial incentive to place advisory clients in share classes that resulted in higher fees for Respondents. The Commission also alleged that Respondents failed to monitor advisory accounts for inactivity or "reverse churning," as required under their compliance policies and procedures, to ensure that a wrap fee program (e.g., one with a single fee inclusive of trading and advisory costs) was appropriate for those clients who traded infrequently. The Commission censured Respondents and ordered each to cease and desist from further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder. Respondents were further ordered to retain an independent compliance consultant, and to jointly and severally pay disgorgement of $1,956,460 and prejudgment interest of $93,399, and a civil money penalty of $7,500,000.

c. *In re Alison, LLC*, Investment Advisers Act Release No. 4468, 2016 SEC LEXIS 2946 (Aug. 2, 2016).

The Commission instituted proceedings against Alison, LLC, a registered investment adviser, and Stephen D. Alison, its sole owner and control person (together, Respondents), alleging violations of Sections 206(2), 207, and 204(a) of the Advisers Act. The Commission alleged that for more than three years, during a time when they had escalating financial difficulties, Respondents generated approximately 8.3% to 11.2% of the revenue produced from Alison LLC's advisory clients from 12b-1 fee payments that were charged to clients by third parties. These fees were ultimately paid to Stephen Alison out of client assets. The Commission alleged that Alison LLC failed to disclose to clients that cheaper share classes, which did not pay the 12b-1 fees but had identical holdings, were available. The Commission alleged that Respondents did not disclose this conflict of interest and misrepresented in Alison LLC's Forms ADV and updating amendments that Alison LLC did not receive 12b-1 fee payments. In addition, the Commission alleged that Respondents repeatedly failed to produce required books and records to the Commission's examination staff. The Commission also alleged that Respondents failed to include disclosure in Alison LLC's Form ADV regarding its distressed financial condition, which was reasonably likely to impair its ability to meet contractual commitments to clients. The Commission ordered that public administrative and cease-and-desist proceedings be instituted. Such proceedings are pending.

14. Performance Advertising

a. *In re Peter Kuperman, L.L.C.*, Investment Advisers Act Release No. 4323, 2016 SEC LEXIS 353 (Jan. 28, 2016).

The Commission accepted an offer of settlement from QED Benchmark Management, L.L.C. (QED) and its founder and principal Kuperman. The Commission alleged that Kuperman, acting on behalf of QED, fraudulently marketed and offered interests in a private investment fund (the Fund) based on promises to follow a scientific stock selection strategy, while in practice repeatedly deviating from that strategy. When deviations from this strategy resulted in heavy losses, the Commission alleged that Kuperman misled current and prospective investors about those losses by marketing the fund using purported historical results that contained hypothetical performance figures. Kuperman also failed to disclose to investors that he had invested most of the Fund's assets in a single penny stock for which he had a conflict of interest. The Commission further alleged that Kuperman marketed the Fund using unsupported valuations of portfolio assets, and made a number of misleading statements to current investors about the health and liquidity of the Fund. The Commission censured and enjoined Kuperman and QED from further violations of Section 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder; Section 17(a) of the Securities Act; and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The Commission ordered that Kuperman be barred from association, with the right to reapply. The Commission additionally ordered Kuperman to pay disgorgement of $2,877,000 and a civil penalty of $75,000.

b. *In re Cantella & Co.*, Investment Advisers Act Release No. 4338, 2016 SEC LEXIS 3262 (Feb. 23, 2016).

The Commission accepted an offer of settlement from Cantella & Co. (Cantella) for alleged misstatements made to certain of its clients who were invested in a model investment strategy developed by F-Squared Investments, Inc. (F-Squared). As model manager for the investment strategy, F-Squared was alleged to have provided Cantella with inaccurate performance information on the strategy, including hypothetical and back-tested performance figures that were materially inflated. The Commission alleged that Cantella took insufficient steps to confirm the accuracy of the historical data and other information provided by F-Squared, and failed to obtain sufficient documentation that substantiated F-Squared's claims. As a result, the Commission alleged that Cantella violated Rule 206(4)-1(a)(5) under the Advisers Act for publishing, circulating, and distributing advertisements that contained the misleading performance information provided by F-Squared. The Commission also alleged that Cantella violated Section 204(a) of the Advisers Act and Rule 204-2(a)(16) thereunder by not making and keeping records necessary to form the basis for, or demonstrate the calculation of, advertised performance figures. The Commission ordered Cantella to cease and desist from further violations of the federal securities laws, and ordered it to pay a civil money penalty of $100,000.

c. *In re Shamrock Asset Mgmt. LLC*, Investment Advisers Act Release No. 4496, 2016 SEC LEXIS 3020 (Aug. 25, 2016); *In re Schneider Downs Wealth Mgmt. Advisors, LP*, Investment Advisers Act Release No. 4497, 2016 SEC LEXIS 3021 (Aug. 25, 2016); *In re Prospera Fin. Serv., Inc.*, Investment Advisers Act Release No. 4498, 2016 SEC LEXIS 3022 (Aug. 25, 2016); *In re Banyan Partners LLC*, Investment Advisers Act Release No. 4499, 2016 SEC LEXIS 3023 (Aug. 25, 2016); *In re HT Partners*, Investment Advisers Act Release No. 4500, 2016 SEC LEXIS 3024 (Aug. 25, 2016); *In re Ladenburg Thalmann Asset Mgmt. Inc.*, Investment Advisers Act Release No. 4501, 2016 SEC LEXIS 3025 (Aug. 25, 2016); *In re J.J.B. Hilliard, W.L. Lyons, LLC*, Investment Advisers Act Release No. 4502, 2016 SEC LEXIS 3026 (Aug. 25, 2016); *In re Executive Monetary Mgmt., LLC*, Investment Advisers Act Release No.

4503, 2016 SEC LEXIS 3027 (Aug. 25, 2016); *In re Risk Paradigm Grp., LLC*, Investment Advisers Act Release No. 4504, 2016 SEC LEXIS 3028 (Aug. 25, 2016); *In re Constellation Wealth Advisors LLC*, Investment Advisers Act Release No. 4505, 2016 SEC LEXIS 3029 (Aug. 25, 2016); *In re BB&T Secs., LLC*, Investment Advisers Act Release No. 4506, 2016 SEC LEXIS 3030 (Aug. 25, 2016); *In re Congress Wealth Mgmt. LLC*, Investment Advisers Act Release No. 4507, 2016 SEC LEXIS 3031 (Aug. 25, 2016); *In re Assetmark, Inc.*, Investment Advisers Act Release No. 4508, 2016 SEC LEXIS 3032 (Aug. 25, 2016).

The Commission accepted offers of settlement from 13 registered investment advisers (each, a Respondent and together, Respondents). The Commission alleged that Respondents had made misstatements to certain clients, including clients with separately managed accounts invested in a strategy offered by an unaffiliated investment management firm, F-Squared, in negligent reliance on F-Squared's false claims about the strategy's exceptional performance over the 2001-2008 period. Specifically, the Commission alleged that Respondents' advertisements of the strategy failed to disclose that the performance figures were hypothetical and back tested, and contained performance figures that had been miscalculated by F-Squared, resulting in substantially inflated performance figures. The Commission alleged that Respondents failed to have a reasonable basis to believe the accuracy of F-Squared's statements regarding the strategy's performance and performance-related claims, having taken insufficient steps to confirm the accuracy of the performance data and not having obtained adequate documentation that would have substantiated F-Squared's assertions. Furthermore, Respondents allegedly failed to maintain adequate books and records necessary to substantiate the calculation of the strategy's advertised performance. Without admitting or denying the findings, Respondents consented to the Commission's order to cease and desist from further violations of Sections 204(a) and 206(4) of the Advisers Act and Rules 204-2(a)(16) and 206(4)-1(a)(5) thereunder, and to each pay a civil penalty in an amount based upon the fees each Respondent earned from the relevant strategy. The penalties assessed against Respondents ranged from $100,000 (against seven of the Respondents) to $500,000 (against Assetmark, Inc.) with a penalty of $200,000 assessed against each of the remaining five Respondents (BB&T Securities, Banyan Partners, Hilliard Lyons, Ladenburg Thalmann Asset Management, and Shamrock Asset Management).

After Respondents had stopped, at F-Squared's instruction, advertising the strategy's 2001-2008 performance, the Commission instituted a settled fraud action against F-Squared in which F-Squared admitted, among other things, to making the materially false claims regarding the performance of the strategy in question. See In re F-Squared Inv., Inc., Investment Advisers Act Release No. 3988 (Dec. 22, 2014).

15. Principal Trades

a. *In re Moloney Securities Co., Inc.*, Investment Advisers Act Release No. 4542, 2016 SEC LEXIS 3722 (Sept. 30, 2016).

The Commission accepted an offer of settlement from Moloney Securities Co. Inc. (Moloney), formerly a registered investment adviser and a registered broker-dealer, and Joseph Ronald Medley, Jr. (Medley), the CIO and President of Moloney who has been associated with Moloney as both a registered representative and as an investment advisory representative. The Commission alleged that, despite receiving two prior deficiency letters from the Commission's Office of Compliance Inspections and Examination regarding failures relating to its written compliance policies and procedures, the implementation of such policies and procedures and the manner in which Moloney conducted principal transactions, the issues were ongoing, which resulted in a third deficiency letter alleging that Moloney failed to (i) properly conduct principal transactions, (ii) accurately disclose its practices regarding principal transactions in its Form ADV, and (iii) implement compliance policies and procedures regarding principal transactions and best execution. In determining to accept the settlement offer, the Commission considered Moloney's remedial acts, including the fact that Moloney reimbursed certain clients for noncompliant principal transactions, segregated brokerage and advisory accounts, and hired a compliance consultant to revise and enhance its compliance policies and procedures and also hired an experienced CCO. Moloney also undertook to hire an independent compliance consultant. The Commission censured Moloney and ordered it to cease and desist from committing or causing any violations and future violation of Sections 206(2), 206(3), 207, and 206(4) of the Advisers Act and Rule 204-4(7) promulgated thereunder. The Commission further ordered Moloney to pay a civil money penalty in the amount of $34,000. Medley was ordered to pay a civil money penalty in the amount of $7,500.

16. Privacy and Data Security

a. *In re Morgan Stanley Smith Barney LLC*, Investment Advisers Act Release No. 4415, 2016 SEC LEXIS 2142 (June 8, 2016).

The Commission accepted an offer of settlement from Morgan Stanley Smith Barney LLC (MSSB). The Commission alleged that MSSB failed to adopt written policies and procedures reasonably designed to protect customer records and information. The Commission alleged that Marsh, an MSSB employee, misappropriated data of approximately 730,000 customer accounts by downloading and transferring it to a personal server at his home. Portions of this stolen data were posted to internet sites with an offer to sell additional data in exchange for digital currency. The Commission further alleged that although MSSB had adopted written policies and procedures to protect customer data, they were not reasonably designed to safeguard the data as required by Rule 30(a) of Regulation S-P. The Commission alleged that MSSB failed to (i) adequately restrict and monitor employee access to confidential customer data and (ii) effectively audit or test its authorization models. In determining to accept MSSB's offer of settlement, the Commission considered the remedial efforts promptly undertaken by MSSB, as well as its cooperation provided to the Commission staff. The Commission censured MSSB and ordered it to cease and desist from further violations of Rule 30(a) of Regulation S-P. The Commission further ordered MSSB to pay a civil money penalty of $1 million.

17. Senior Investors

a. *SEC v. Joseph Andrew Paul*, Litigation Release No. 23510, 2016 SEC LEXIS 1223 (Apr. 4, 2016).

The Commission filed a complaint in the US District Court for the Eastern District of Pennsylvania against Paul and Ellis, co-founders of a formerly registered investment advisory firm; Ellison, a formerly registered representative associated with numerous securities firms; and Quay (a/k/a Jameson), a disbarred attorney previously convicted of securities fraud. The Commission's complaint alleged that Paul and Ellis lied about the investment track record of their advisory firm, including by cutting and pasting performance numbers from another firm's website, and that Quay and Ellison used these materials to mislead and solicit investors, including senior citizens who responded to a mass-mailing offer of a free dinner. The Commission's complaint further alleged that Paul and Ellis stole investors' money, and that Quay and Ellison concealed Quay's real name, instead using a fictitious name to prevent prospective investors from researching his history of tax fraud conviction and disbarment. The Commission requested that the court permanently enjoin the defendants from further violations of Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, and sought disgorgement and civil penalties.

b. *SEC v. Cody*, Litigation Release Nos. 23702 and 23710, 2016 SEC LEXIS 4771 (Dec. 22, 2016).

The Commission filed a complaint in federal court in Boston charging investment adviser and broker representative Richard G. Cody and his firm Boston Investment Partners, LLC, through which he provides investment advisory and brokerage services (collectively, Respondents). The Commission alleged that Respondents made misrepresentations to three clients regarding the true value of their retirement accounts. Cody allegedly took various steps to conceal a substantial decline in the value of the retired clients' accounts over a 12-year period, for example, by transferring in funds from other sources when there were insufficient funds for distribution and fabricating tax forms. The Commission alleged that Respondents' deceptive acts caused the retirees to believe that their accounts were secure when they were not. The Commission alleges violations of Section 10(b) of the Exchange Act and Section 206(1) and 206(2) of the Advisers Act and seeks disgorgement of ill-gotten gains plus interest and penalties as well as permanent injunctive relief. The matter is pending.

18. Valuation

a. *In re Calvert Investment Management, Inc.*, Investment Advisers Act Release No. 4554, 2016 SEC LEXIS 3910 (Oct. 18, 2016).

The Commission accepted an offer of settlement from Calvert Investment Management, Inc. (Calvert), a registered investment adviser, for alleged improper fair valuation of the securities held by certain registered investment companies managed by

Calvert (the Funds), which led the Funds to be priced at an incorrect NAV. The Commission alleged that this resulted in the Funds executing shareholder transactions at the wrong NAV and stating inaccurate performance figures. The Commission further alleged that Calvert failed to accurately remedy the harm to Fund investors in accordance with Calvert's NAV error correction procedures and failed to disclose this procedural deviation to investors. The Commission also alleged that Calvert caused a violation of Section 17(a) of the Investment Company Act when a Calvert-advised Fund engaged in a prohibited transaction with another Calvert sub-advised fund and where Calvert did not timely report the transaction to the Fund's board. In determining whether to accept the settlement offer, the Commission considered Calvert's remedial efforts, including the fact that Calvert enhanced its compliance and fair valuation policies and procedures, revised the fair value for each of the securities in question, thereby updating the affected Funds' portfolios with the newly calculated prices during the relevant period, and adjusting the NAVs for the relevant period for each affected Fund. The Commission censured Calvert and ordered Calvert to cease and desist from further violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, and Sections 17(a) and 34(b) of the Investment Company Act and Rules 22c-1 and 38a-1 thereunder. Calvert was also ordered to pay a civil money penalty in the amount of $3,900,000.

b. *In re Pacific Investment Management Company LLC*, Investment Advisers Act Release No. 4577, 2016 SEC LEXIS 4453 (Dec. 1, 2016).

The Commission accepted an offer of settlement from Pacific Investment Management Company LLC (PIMCO), a registered investment adviser. The Commission alleged that PIMCO pursued a strategy that caused the PIMCO Total Return Exchange-Traded Fund, an actively managed exchange-traded fund (the Fund), to overvalue its portfolio and thus fail to price Fund shares at their NAV. The Commission alleged that PIMCO systematically purchased "odd lots" of nonagency mortgage-backed securities, which traded at a discount to "round lots," for the Fund, and then used a third-party pricing vendor's valuations of the odd lot positions at the higher round lot price. The Commission further alleged that, based on this pricing process, PIMCO lacked a reasonable basis to believe that it could obtain the higher price upon exit for 43 positions. The Commission further alleged that PIMCO failed to address odd lot pricing in its pricing policy, failed to elevate the issue in accordance with that policy, negligently made misleading disclosures regarding Fund performance to investors that did not discuss the odd lot strategy, and failed to disclose the odd lot strategy and its impact to the Fund's board of trustees. The Commission censured PIMCO and ordered it to cease and desist from further violations of Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder, and Section 34(b) of the Investment Company Act and Rule 22c-1 thereunder. The Commission further ordered PIMCO to pay $1,331,629 in disgorgement, $198,179 in prejudgment interest, and a civil penalty of $18,300,000, and to hire an independent compliance consultant to review and improve PIMCO's policies and procedures with respect to the pricing and valuation of odd lots and the elevation of pricing issues.

19. Wrap Fee Programs

a. *In re WFG Advisors, L.P.*, Investment Advisers Act Release No. 4441, 2016 SEC LEXIS 2996 (June 28, 2016).

The Commission accepted an offer of settlement from WFG Advisors, L.P., a registered investment adviser based in Dallas with branch offices throughout the United States (WFG). The Commission alleged that WFG represented that clients participating in its wrap account program would not be charged commissions in connection with alternative investments. Nevertheless, from January 2011 through August 2013 clients were in fact charged a commission in addition to an advisory fee. During approximately the same period, WFG also engaged in securities transactions with advisory clients on a principal basis through its broker-dealer without providing prior written disclosures or obtaining consent from the clients. The Commission alleged that WFG failed to adopt policies and procedures reasonably designed to ensure that advisory fees were calculated as represented. The Commission alleged that WFG violated Sections 206(2), 206(3), 206(4), and 207 of the Advisers Act, and Rule 204(4)-7 thereunder. The Commission ordered WFG to cease and desist from further violations of Sections 206(2), 206(3), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder. The Commission also censured WFG and ordered it to pay a civil penalty of $100,000.

b. *In re RiverFront Investment Group, LLC*, Investment Advisers Act Release No. 4453, 2016 SEC LEXIS 3285 (July 14, 2016).

The Commission accepted an offer of settlement from RiverFront Investment Group, LLC (RiverFront), which is a registered investment adviser that served as a subadviser to clients in various wrap fee programs created by a number of different sponsors. The Commission alleged that RiverFront made materially misleading disclosures in its Forms ADV concerning the frequency that it traded in a manner that resulted in additional, insufficiently disclosed transaction costs to advisory clients in wrap fee programs that were not covered by the annual wrap fee. Specifically, when RiverFront first began serving as a subadviser to advisory clients in wrap fee programs, it disclosed that it may trade away from the wrap free program's designated broker-dealer in an effort to obtain best execution on behalf of its clients, but that it would "generally" execute trades through the designated broker-dealers, which it did. However, the Commission alleged that beginning in late 2009 RiverFront substantially increased the amount it was trading away. RiverFront claimed that trading away resulted in improved execution prices. However, the Commission alleged that by trading away, RiverFront caused its clients to pay millions of dollars' worth of transaction costs that were not covered by the annual wrap fee, and not adequately disclosed to clients. The Commission alleged that RiverFront violated Sections 204(a) and 207 of the Advisers Act and Rule 204-1(a) thereunder. The Commission ordered RiverFront to cease and desist from further violations of Sections 207 and 204(a) of the Advisers Act and Rule 204-1 promulgated thereunder. The Commission also censured RiverFront and ordered it to pay a civil money penalty of $300,000.

c. *In re Raymond James & Assoc., Inc.*, Investment Advisers Act Release No. 4525, 2016 SEC LEXIS 3369 (Sept. 8, 2016).

The Commission accepted an offer of settlement from Raymond James & Associates, Inc. (Raymond James), a registered investment adviser, relating to allegations regarding compliance failures associated with its wrap fee program. Specifically, the Commission alleged that Raymond James failed to adopt and implement policies and procedures reasonably designed to determine the amount of commissions its clients were being charged when subadvisers "traded away" with a broker-dealer outside the wrap fee program. Within Raymond James's wrap fee program, clients selected a participating subadviser to develop a model portfolio and pay a negotiable wrap fee as well as any commissions on equity transactions executed by unaffiliated broker-dealers. Although Raymond James's ADV did disclose that subadvisers may "trade away" with broker-dealers other than the broker-dealer associated with the program, resulting in commission charges in addition to the wrap fee, the Commission alleged that Raymond James did not obtain information regarding the amount of commissions charged for such transactions or whether that amount was material. Consequently, the Commission alleged that Raymond James (i) failed to adopt and implement policies and procedures reasonably designed to allow Raymond James to determine whether the wrap fee program or particular subadvisers were suitable for its prospective and existing advisory clients (such as collecting, tracking, and disclosing information regarding commissions associated with trading away), and (ii) failed to adopt and implement procedures to communicate the subadvisers' trading away practices and associated costs to wrap fee program clients, resulting in clients not having adequate information to negotiate meaningfully the wrap fee with Raymond James, assess the total cost of the wrap fee program, and determine which subadviser(s) to select. Raymond James undertook to properly disclose trading away practices and all associated costs as well as update its policies and procedures, conduct periodic reviews, and report and certify all these undertakings. The Commission ordered Raymond James to cease and desist from further violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and pay a penalty of $600,000.

d. *In re Robert W. Baird & Co., Inc.*, Investment Advisers Act Release No. 4526, 2016 SEC LEXIS 3370 (Sept. 8, 2016).

The Commission accepted an offer of settlement from Robert W. Baird & Co., Inc. (Baird), a registered investment adviser, relating to allegations regarding compliance failures associated with its wrap fee program. Specifically, the Commission alleged that Baird did not track or monitor which subadvisers were trading away from the broker-dealer associated with the wrap fee program, how often those subadvisers were trading away, or the specific costs associated with such trade-aways. The Commission alleged that Baird began collecting cost information from subadvisers who were trading away in August 2013, but failed to adopt or implement any policies and procedures designed to provide information to Baird's clients and financial advisors about the amount of the additional costs of trading away. Without the availability of such information, Baird's financial advisors could not separately consider the costs associated with trading away practices when conducting their initial and periodic suitability analyses for advisory clients in wrap fee programs whose funds were managed by certain subadvisors. The Commission ordered Baird to cease and desist from further violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and pay a penalty of $250,000.

## V. Robo-Advisers

On February 23, 2017, the U.S. Securities and Exchange Commission's ("SEC") Division of Investment Management ("IM") released IM Guidance Update 2017-02 ("Guidance"),[9] which focuses on "robo-advisers," or investment advisers that use technology to provide discretionary asset management services to clients through online algorithmic-based programs. The Guidance focuses on three key areas: disclosure, suitability, and compliance programs. It provides various considerations that robo-advisers should keep in mind as they seek to meet their legal obligations under the Advisers Act.

The Guidance focuses on robo-advisers that provide services directly to clients online, but notes that it may be helpful for other types of robo-advisers, as well as other registered investment advisers that use algorithms or digital tools when formulating advice or monitoring client accounts. The Guidance was released simultaneously with an Investor Bulletin by the SEC's Office of Investor Education and Advocacy, which aims to educate individual investors about robo-advisers and help them decide whether to use robo-advisers to meet their investment goals.[10]

The Guidance follows on the heels of increased SEC activity around Fintech and electronic investment advice. On November 14, 2016, the SEC held a Fintech Forum that included a panel discussion about digital investment advice. More recently, on January 12, 2017, the SEC's Office of Compliance Inspections and Examinations ("OCIE") released its Examination Priorities for 2017 (the "Examination Priorities"). The Examination Priorities noted that this year OCIE will examine both robo-advisers that primarily interact with their clients online, as well as advisers and broker-dealers that leverage automated investing functions as one component of a service model that provides access to human financial professionals.[11]

### A. Our perspective

1. The Guidance confirms that robo-advisers registered with the SEC are subject to both the substantive requirements and the fiduciary obligations of the Advisers Act, even in the case of robo-advisers with more limited business models. This should eliminate any uncertainty, raised by some critics, as to whether robo-

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[9] U.S. Securities and Exchange Commission, Division of Investment Management, "Robo-Advisers," IM Guidance Update No. 2017-02 (February 2017).

[10] U.S. Securities and Exchange Commission, Office of Investor Education and Advocacy, Investor Bulletin: Robo-Advisers (February 23, 2017).

[11] According to the Examination Priorities, examinations of such entities will focus on their compliance programs (including compliance practices for overseeing algorithms that generate investment advisory recommendations), marketing, the formulation of investment recommendations, data protection, and disclosures relating to conflicts of interest.

advisers are able to meet fiduciary standards and whether the existing regulatory framework is flexible enough to accommodate the robo-adviser business model.

2. The SEC staff takes a flexible, rather than one-size-fits-all approach, emphasizing that robo-advisers have a wide variety of business models and offer a range of advisory services, and consequently may have a “variety of means” to meet their regulatory obligations. In doing so, the SEC staff validates the concept that robo-advisers may define and limit the scope of the advisory services they provide.

3. In the area of suitability and client profiling, the Guidance clarifies that there is no quantitative test as to the minimum number of questions or list of factors that a robo-adviser must consider in order to build an appropriate client profile and provide and investment recommendation. Rather, the robo-adviser must collect sufficient information to conclude that its initial recommendations and ongoing advice are suitable and appropriate for a particular client based on the client’s financial situation and investment objectives, presumably as such concepts are applied in the context of the robo-adviser’s business.

4. The Guidance does not substantively address how robo-advisers may meet their obligations under Investment Company Act Rule 3a-4, which provides discretionary investment advisory programs with a non-exclusive safe harbor from the definition of an “investment company” (e.g., a mutual fund). However, the SEC staff did remind robo-advisers to consider their obligations under Rule 3a-4 and other federal securities laws, and it encouraged robo-advisers to contact the SEC staff for further guidance if they believe that their organization and operations raises unique facts or circumstances “not addressed” by Rule 3a-4.

5. A number of the SEC staff’s disclosure recommendations relate to the use of algorithms by robo-advisers. The concept of an “algorithm” is very broad, and disclosure regarding the use of technology has not historically been a topic of SEC guidance. Consequently, the use of algorithms is arguably not any more significant for digital advisers than for traditional advisers, given their long-standing reliance on technology in formulating and delivering investment advice. One could just as well question whether the failure to use technology to deliver investment advice should be disclosed as a material risk in today’s world. Disclosure regarding the use and limitations of algorithms should, in any event, depend upon the materiality of the use of such algorithms in the investment adviser’s decision-making process.

6. We expect that the recommendations in the Guidance will be incorporated into OCIE’s exam module for robo-advisers. Because the SEC staff’s views are offered in the form of recommendations or other matters that firms might consider, we would hope that the OCIE exam staff will not apply each of the recommendations to all robo-advisers, and cite for deficiencies any advisers who do not follow all of the SEC staff’s recommendations. In this regard, firms may wish to consider the SEC staff’s recommendations and, as part of their annual Rule 206(4)-7 review or Form ADV annual updating amendment, document which of the recommendations in

the Guidance they adopt and the rationale for why the other recommendations were determined to be inapplicable to their business.

7. While the SEC staff's recommendations are thoughtful and provide useful suggestions for robo-advisers, the SEC staff's recommendations are not legal obligations, and do not represent the views of the Commission. It is important to recognize that the SEC staff's disclosure recommendations do not have the force of law and do not necessarily give rise to disclosure obligations under Advisers Act Section 206 and Form ADV. For instance, a number of the disclosure areas referenced by the SEC staff relate to business practices that are not required to be disclosed by Form ADV or Section 206 unless they present material conflicts of interest. Consequently, while it is certainly a matter of best practices for robo-advisers and other advisers that use automated investment tools to consider these topics when formulating disclosure, a failure to address any of the SEC staff's points should not be viewed as a per se breach of fiduciary duty under Advisers Act Section 206.

B. Substance of disclosures

The SEC staff observes that because client relationships with robo-advisers may occur with limited, if any, human interaction, a client's decision about whether to enter into or continue an investment advisory relationship may depend solely on disclosures that are delivered through electronic media. This, combined with the prominent role that technology plays in determining and delivering investment advice, lead the SEC staff to suggest that robo-advisers should be thoughtful about the most effective way to explain their business models and the scope of advisory services they provide, as well as the associated risks and limitations. Below is a list of the SEC staff's recommendations with respect to disclosure, accompanied by our observations:

<table>
<tr><td>Methodology and Services</td><td>
➢ That an algorithm is used to manage individual client accounts.<br><br>
Most every investment adviser relies on technology to some degree to manage individual client accounts. Accordingly, we believe the SEC staff's recommendations were likely designed to address situations where algorithms actually generate investment decisions.<br><br>
➢ How algorithmic functions are used to manage client accounts.<br><br>
It seems reasonable that advisers who use hundreds of algorithmic and other technology functions to manage accounts would not be expected to disclose each algorithm and its use in managing client accounts, unless it is material to the adviser's investment recommendations.<br><br>
➢ The assumptions and limitations the algorithm used to manage client accounts.<br><br>
Note that robo-advisers should only be required to disclose to clients the material assumptions and limitations of an algorithm. Many if not all of these assumptions and limitations may already be disclosed through the robo-adviser's website and user interface, to the extent they include a discussion of the firm's investment methodology.<br><br>
➢ The degree of human involvement in the oversight and management of
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| | individual client accounts.<br>➢ How and when a client should update information they have provided to the robo-adviser. |
| **Risks and Limitations** | ➢ The particular risks inherent in the use of an algorithm to manage client accounts (*e.g.*, that the algorithm might rebalance client accounts without regard to market conditions or more frequently than the client might expect).<br>*Note that robo-advisers routinely rebalance client portfolios based on a "glide path" or other triggers that are unrelated to market conditions. The parameters and management authority used to rebalance accounts are generally established by the adviser, and should be referenced clearly in disclosure.*<br>➢ The particular circumstances that might cause the robo-adviser to override the algorithm used to manage client accounts (*e.g.*, that the robo-adviser might halt trading or take other temporary defensive measures in stressed market conditions).<br>*Although there has been substantial confusion in the robo-adviser space over this point, robo-advisers do not "halt trading" in securities. Rather, they exercise their discretion as to when to place orders on behalf of client accounts. Robo-advisers should consider whether their disclosures clearly explain their brokerage practices, including in the context of stressed market conditions), but robo-advisers are no different from any other discretionary investment adviser that has the ability to determine when to trade on behalf of client accounts.*<br>➢ How the robo-adviser uses information gathered from a client to generate a recommended portfolio, and any limitations.<br>*Traditional and robo-advisers both rely on static questionnaires that form the primary, if not sole, basis for the adviser's investment recommendations. From a suitability perspective, we continue to recommend that robo-advisers document the basis on which they have made the determination to select particular factors or questions that they incorporate into their online questionnaires, particularly if such questionnaires are very limited in nature. Ideally, the use of particular factors or questions is tied to a particular investment rationale.* |
| **Conflicts** | ➢ Any involvement by a third party in the development, management, or ownership of the algorithm used to manage client accounts, including an explanation of any conflicts of interest that such an arrangement may create.<br>*In addressing this disclosure point, firms that are relying on private-label solutions should consider the extent to which the robo-adviser is involved in their offering. If the robo-adviser is actively involved in providing investment advisory services and dictating the investment options for client accounts (which may include their own proprietary products), firms should consider the conflicts of interest that this presents.* |

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| **Costs** | ➢ Any fees that the client will be charged directly by the robo-adviser and any other costs that the client may bear either directly or indirectly.<br>*This disclosure is already expressly required under Form ADV.* |

The SEC staff further observes that robo-advisers should take care to avoid creating a "false implication" about the scope of the services that they provide. The SEC staff notes that robo-advisers could mislead clients by implying, for example, that: (i) they are offering a comprehensive financial plan, where the robo-adviser's advice is only targeted to meet a specific financial goal; (ii) a tax-loss harvesting service also provides comprehensive tax advice; or (iii) the algorithm considers information outside of a questionnaire when generating investment recommendations, if such information is not actually considered.

C. Presentation of disclosures

The Guidance also takes a pragmatic approach of reminding robo-advisers to consider whether their disclosures are "effective" – meaning that they are not buried or incomprehensible. In particular, the SEC staff recommends that robo-advisers consider whether:

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| **Timely** | Key disclosures are presented prior to the sign-up process, so that information necessary to make an informed investment decision is available to clients before they engage or make an investment with the robo-adviser. |
| **Prominent** | Key disclosures are specially emphasized (through design features such as pop-up boxes). |
| **Comprehensive** | Disclosures are accompanied by interactive text or other means to provide additional details to clients who are seeking more information (e.g., through tool-tips or an FAQ) |
| **Adapted** | Alternate channels are considered in presenting and formatting disclosure (e.g., disclosure made on a mobile platform is appropriately adapted). |

Given the emphasis on the content and placement of disclosure, we would recommend that robo-advisers revisit the disclosure contained in their Form ADV and user interfaces.

D. Providing suitable advice

The Guidance also reinforces the principle that as fiduciaries, robo-advisers have an obligation to make a reasonable determination that the investment advice they provide is suitable for a client based on the client's financial situation and investment objectives.[12]

[12] Suitability of Investment Advice Provided by Investment Advisers, Investment Advisers Act Release No. 1406 (Mar. 16, 1994); *see also* Status of Investment Advisory Programs under the Investment Company Act of 1940, Investment Company Act Release No. 22579 (Mar. 24, 1997), text accompanying n.32; Study on Investment Advisers and Broker Dealers as Required by Section 913 of the Dodd-Frank Wall

The SEC staff observes that many robo-advisers provide investment advice based primarily, if not solely, on client responses to online questionnaires. The SEC staff notes that, in addition to varying in length and the types of information sought, many of the questionnaires do not provide clients with the opportunity to give additional information or context about their responses. Consequently, the SEC staff recommends that robo-advisers take their suitability obligations into account when designing questionnaires, and consider whether:

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| **Sufficiency** | The questions elicit sufficient information to allow the robo-adviser to conclude that its initial recommendations and ongoing investment advice are suitable and appropriate for that client based on his or her financial situation and investment objectives.<br>*We note that we assume the SEC staff is interpreting the concept of "financial situation and investment objectives" within the context of a robo-adviser business. For example, most robo-advisers rely on goals-based wealth management, which does not require a client to define an investment objective for each account, and information about a client's financial situation may be limited to retirement savings or annual income.* |
| **Clarity** | The questions are sufficiently clear, and the questionnaire is designed to provide additional clarification or examples to clients when necessary (e.g., through interactive text, pop-up boxes, or FAQs). |
| **Consistency** | Steps have been taken to address inconsistent client responses, such as design features that alert a client when their responses appear internally inconsistent, and suggest that the client may wish to reconsider their responses; and systems that automatically flag apparently inconsistent information provided by a client for review or follow-up by the robo-adviser. |

E. Implementation of an effective compliance program

The Guidance also emphasizes that a robo-adviser's internal compliance program, as required by Advisers Act Rule 206(4)-7, should address the unique aspects of the robo business model. These include the robo-adviser's reliance on algorithms, limited human interaction with clients and provision of online advisory services. As a result, robo-advisers should consider whether to adopt and implement written policies and procedures that address the following:

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| **Testing** | The development, testing, and back testing of the algorithm, and post-implementation monitoring of the algorithm's performance, in order to ensure that:<br>• the algorithm is adequately tested before, and periodically after, it is integrated into the robo-advisers' platform;<br>• the algorithm performs as represented; and<br>• any modifications to the code would not adversely affect client |

Street Reform and Consumer Protect Act, n.12 (Jan. 2011), *available at* www.sec.gov/news/studies/2011/913studyfinal.pdf.

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| | accounts. |
| **Suitability** | The design and content of questionnaires and consideration of how the information the robo-adviser obtains from clients supports the suitability of initial recommendations and ongoing investment advice. |
| **Algorithm Modifications** | Disclosure to clients of changes to the algorithmic code that may materially affect their portfolios.<br>*We note that the materiality threshold is critical here. There may be a whole range of "changes," including those resulting from routine maintenance, testing and system enhancements that might not materially affect the management of client portfolios. Disclosure should not be viewed as an impediment to enhancing or correcting code.* |
| **Oversight** | Appropriate oversight of any third party that develops, owns, or manages the algorithm or software modules.<br>*This concept should be incorporated into the adviser's vendor management and, depending on the relationship with the third party, supervisory procedures.* |
| **Cybersecurity and Privacy** | Prevention and detection of, and response to, cybersecurity threats, and protection of client accounts and key advisory systems. |
| **Marketing** | Use of social and other forms of electronic media in connection with the marketing of advisory services (e.g., websites, Twitter, compensation of bloggers to publicize services, and "refer-a-friend" programs). |

F. Investor bulletin

The Investor Bulletin concentrates on a number of considerations retail investors should take into account when deciding whether to invest with a robo-adviser. These include the following:

- The level of interaction that an investor will have with a robo-adviser, and how the form and amount of this interaction will differ from what the investor would experience with a traditional adviser;
- The extent of a robo-adviser's consideration of an investor's personal financial circumstances, and whether the investor's investment objectives are goal-specific;
- How the robo-adviser develops portfolio and investment recommendations, and the limitations associated with the robo-adviser's approach to investing;
- The use of tax-loss harvesting, its value and application to the investor's particular tax circumstances; and
- The total fees and costs associated with investing through the robo-adviser.