Securities Regulation Daily Wrap Up, ENFORCEMENT—Advisers' 'belt-and-suspenders' compliance approach shows lack of intent to conceal conflicts, (Jun. 5, 2015)

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By Anne Sherry, J.D.

An investment adviser and its co-owners were let off the hook for receiving undisclosed servicing fee payments tied to particular mutual funds. An administrative law judge held that although the payments were material, the SEC failed to show that the respondents acted with the requisite state of mind, and even assuming it had met that threshold burden, the respondents relied in good faith on the advice of compliance professionals (*In the Matter of The Robare Group, Ltd.*, June 4, 2015, Grimes, J.).

Background. Last September, the SEC charged Houston-based investment advisory firm Robare Group Ltd. and its co-owners with fraud for failing to disclose to clients a servicing fee agreement with Fidelity under which Robare Group received a percentage of investments in certain mutual funds. The Commission alleged that the respondents violated (or aided and abetted violations of) Investment Advisers Act Sections 206(1), 206(2), and 207 by failing to disclose the arrangement and the resulting conflicts of interest.

Disclosures. The ALJ found that from 2005 onwards, the disclosure in Fidelity's own brokerage agreement adequately disclosed the fee program to Robare Group's clients. Given that the instructions for Form ADV itself permit advisers to disclose conflicts "by some other means," the ALJ determined that the SEC tacitly conceded adequate disclosure by its failure to dispute that point. However, approximately 150 of the firm's clients had signed on before 2005 and thus received a version of the Fidelity brokerage agreement that did not reference the program. By 2011, Robare Group included a disclosure in its Form ADV that the law judge found "plainly adequate." As a result of these findings, the focus of the case narrowed to Robare Group's disclosures prior to December 2011 to its first 150 clients.

Scienter. The law judge held that even if the disclosure to that group of clients was inadequate, the SEC could not prevail on its Section 206(1) claim because it cannot show scienter. The evidence of scienter consisted of nothing more than asserting that Robare Group's co-owner was knowledgeable about the program and possessed ultimate authority over the Form ADV filings. On the contrary, the law judge found the individual respondents to be honest and credible, remarking that "it is difficult to imagine them trying to defraud anyone, let alone their investment clients." Their testimony that they did not know which mutual funds paid fees under the program was supported by evidence that the percentage of client assets in non-paying funds always exceeded the percentage of available non-paying funds. Even assuming that the SEC had carried its threshold burden on the scienter element, the respondents relied in good faith on the advice of its compliance firms.

Negligence. As to the alleged Section 206(2) violations, the ALJ held that the SEC failed to present evidence of the applicable standard of reasonable care. Although in some cases it may be readily apparent that a person failed to act with reasonable care, here Robare Group relied on multiple firms to guide its compliance efforts, so some evidence as to the applicable standard was necessary.

Willful violation of Section 207. Finally, the law judge determined that no respondent willfully violated Section 207 by making untrue statements or omissions in a Form ADV. Given the respondents' diligence and the SEC's failure to show a failure to act with reasonable care, it could not be said that the respondents acted willfully.

The release is No. ID-806.

Companies: The Robare Group, Ltd.

LitigationEnforcement: Enforcement InvestmentAdvisers