Investment Management Regulatory Update

September 30, 2014

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SEC Rules and Regulations

SEC Proposes Two-Year Extension of Rule 206(3)-3T

On August 12, 2014, the Securities and Exchange Commission (the "**SEC**") proposed to amend Rule 206(3)-3T (the "**Rule**") under the Investment Advisers Act of 1940 (the "**Advisers Act**") by extending the date on which it will sunset from December 31, 2014 to December 31, 2016. The Rule is a temporary rule that establishes an alternative means for registered investment advisers that are also registered with the SEC as broker-dealers ("**Dual Registrants**") to comply with Section 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain of their non-discretionary advisory clients.

If the proposed amendment is adopted, this will mark the fourth extension of the sunset date of the Rule. The Rule was initially adopted in September 2007 on an interim final basis and was supposed to sunset on December 31, 2009, but it was subsequently adopted as a final rule in December 2009 with a sunset date of December 31, 2010. The sunset date was again extended by two years to December 31, 2012 in order for the SEC to complete a study required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**") and for the SEC to consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers. The sunset date was further extended by two years to December 31, 2014 in order for the SEC to consider the results of the 913 Study.

As previously reported in the ***November 27, 2012 Investment Management Regulatory Update***, the ***September 13, 2010 Investment Management Regulatory Update*** and the ***October 2007 Investment Management Regulatory Update***, the Rule generally allows Dual Registrants to transact on a principal basis with certain non-discretionary advisory accounts if, among other things: (i) the adviser discloses conflicts of interest associated with principal transactions and the manner in which such adviser addresses those conflicts, (ii) the client executes a blanket consent prospectively authorizing principal transactions, (iii) before the execution of each principal transaction, the adviser informs the client of the capacity in which it may act with respect to such transaction and obtains the client's consent (either written or orally), (iv) at or before completion of each such transaction, the adviser sends the client written confirmation of the principal transaction and (v) at least annually, the adviser provides the client reports of principal transactions executed in reliance on the Rule.

If the Rule is allowed to sunset on December 31, 2014, Dual Registrants will need to be in compliance with Section 206(3)'s transaction-by-transaction written disclosure and consent requirements without the benefit of the alternative means of complying with these requirements. This could, according to the SEC, limit the access of non-discretionary advisory clients of Dual Registrants to certain securities and require firms to make substantial changes to disclosure documents, client agreements, procedures and systems.

The SEC has requested comments by September 17, 2014 on a list of questions set forth in the proposed rule release.

- **See a copy of the proposed rule release**

SEC Grants No-Action Relief Permitting Investment Adviser to Offer Advisory Fee Rebate

On August 19, 2014, the Staff of the Division of Investment Management of the SEC issued a no-action letter to Amerivest Investment Management, LLC ("**Amerivest**"). In the letter, the Staff stated that it would not recommend enforcement action under Section 205(a)(1) of the Advisers Act, in the event that Amerivest offers an advisory fee rebate (the "**Rebate**") to eligible clients with underperforming portfolios.

Section 205(a)(1) of the Advisers Act generally prohibits registered investment advisers from entering into any investment advisory contract that "provides for compensation to the investment adviser on the basis of a share of capital gains or capital appreciation in a client's account or any portion thereof." According to the SEC, Section 205(a)(1) is intended to, among other things, discourage investment advisers from speculating and taking "undue risks" with their clients' funds.

According to the no-action letter, Amerivest offers an investment advisory service (the "**Service**") under which Amerivest is responsible for implementing models and recommendations provided by Morningstar Associates, LLC ("**Morningstar**"). According to the no-action letter, Morningstar, serving as an investment adviser and independent consultant to Amerivest with respect to the Service, has no direct contractual relationship with Amerivest's clients and receives compensation from Amerivest based on a fee schedule that does not involve any performance-based compensation. As described in the no-action letter, Amerivest seeks to continue to charge its clients a quarterly asset-based advisory fee, but offer a Rebate to eligible clients investing in a model portfolio if the portfolio experiences two consecutive calendar quarters of negative performance during a twelve-month period. According to Amerivest, such Rebate would be equal to the advisory fee each eligible client paid for the two calendar quarters with respect to such portfolio, and would not be recaptured by Amerivest through future appreciation. According to Amerivest, it would not attempt to influence Morningstar's recommendations for the purpose of avoiding any Rebate.

Amerivest claimed that, although the Rebate may be a performance-contingent fee arrangement prohibited by Section 205(a)(1) under the Advisers Act, it would be unlikely that Amerivest would attempt to avoid having to offer the Rebate by "taking undue risks, timing transactions in a client's account or over-trading."

According to the no-action letter, the Division would not recommend enforcement action against Amerivest in the event that Amerivest institutes the Rebate based on the facts and representations described above and in the letter and particularly on Amerivest's representations that:

- Amerivest will provide full disclosure of the rules governing the eligibility of the Rebate and the methodology for evaluation of portfolio performance (the "**Rebate Terms**") to all clients participating in the Service and apply the Rebate Terms in a fair and consistent manner;

- If Amerivest decides to change any of the Rebate Terms, it will notify participating clients before making any such changes that may negatively influence such clients (provided that any such changes will not be effective until the start of the next 12-month period);
- The Rebate Terms will not allow recapture of any Rebate through future appreciation of the portfolio;
- Amerivest will not deviate from or attempt to influence Morningstar's recommendations to avoid making any Rebate payment;
- Amerivest may only deviate from Morningstar's recommendations for non-investment and non-performance-related reasons, such as tax considerations, or in order to avoid breaching its fiduciary duty;
- Amerivest will maintain accurate and current records of each deviation from Morningstar's recommendations and provide detailed explanations for each deviation;
- Amerivest's deviation from or failure to implement a recommendation of Morningstar will not, by itself, disqualify any clients from receiving the Rebate;
- There will be no understanding, explicit or tacit, between Morningstar and Amerivest that Morningstar's compensation or continued engagement will be influenced by whether Amerivest is required to pay the Rebate under the proposed arrangement; and
- Amerivest will not take any action solely for the purposes of disqualifying a client for the Rebate, subject to enforcing certain eligibility requirements.

▸ **See a copy of the no-action letter**

Industry Update

CFTC Grants Exemptive Relief to Permit Certain CPOs to Engage in General Solicitation

On September 9, 2014, the Division of Swap Dealer and Intermediary Oversight (the "**Division**") of the U.S. Commodity Futures Trading Commission (the "**CFTC**") issued CFTC Staff Letter No. 14-116 (the "**Letter**") providing exemptive relief to commodity pool operators ("**CPOs**") from certain provisions of CFTC Regulations 4.7(b) and 4.13(a)(3), which exempt CPOs from specific compliance obligations in Part 4 of the CFTC's regulations and from CPO registration, respectively. The CFTC issued this Letter in response to the recent amendments to Rules 506 and 144A under the Securities Act of 1933 (the "**Securities Act**") pursuant to the Jumpstart Our Business Startups Act (the "**JOBS Act**"). The exemptive relief granted in the Letter permits CPOs of certain private funds to engage in public solicitation to the extent such activities are consistent with amended Rules 506 and 144A.

To implement Section 201(a)(1) of the JOBS Act directive, the SEC amended Rule 506 under the Securities Act to permit a company or fund to engage in general solicitation or advertising while offering and selling securities on a non-SEC-registered basis, as long as all purchasers of the securities are accredited investors and the company or fund takes reasonable steps to verify that the purchasers are accredited investors. Similarly, to implement Section 201(a)(2) of the JOBS Act directive, the SEC amended Rule 144A under the Securities Act to permit resellers of securities pursuant to Rule 144A to offer such securities to persons other than Qualified Institutional Buyers ("**QIBs**") (i.e., engage in general solicitation or advertising in making such offers) as long as the securities are only sold to QIBs or to purchasers reasonably believed by the reseller or any person acting on the reseller's behalf to be QIBs.

CFTC Regulations 4.7(b) and 4.13(a)(3) provide exemptions for a number of compliance obligations specified in CFTC regulations if CPOs satisfy certain conditions, including not engaging in public marketing or solicitation. According to the Letter, without any exemptive relief, certain qualified CPOs that wish to rely on the amended Rules 506(c) and 144A to engage in general solicitation may not be able to do so because they are subject to CFTC Regulation 4.7(b) or 4.13(a)(3). To address this issue, according to the Letter, the Division determined that it is appropriate to grant exemptive relief to such dually regulated CPOs to permit them to engage in general solicitation pursuant to Rules 506(c) and 144A. Specifically, the CFTC is granting relief from the Regulation 4.7(b) requirements that an offering be exempt pursuant to Section 4(a)(2) of the Securities Act and be offered solely to "qualified eligible persons," as defined under CFTC Regulation 4.7(a), and from the requirement in Regulation 4.13(a)(3) that securities be "offered and sold without marketing to the public."

The exemptive relief is only granted to CPOs relying on amended Rule 506(c) or amended Rule 144A. CPOs are required to file a notice with the Division in order to claim this exemptive relief. Such claim will be effective upon filing if the claim is materially complete and accurate. According to the Letter, this exemptive relief will remain in effect until the effective date of any final CFTC actions in response to the JOBS Act-related amendments.

- **See a copy of the Press Release**
- **See a copy of the Letter**

IRS Memorandum Concludes That Members of an Investment Management Firm Organized as an LLC Owed Self-Employment Tax on Their Shares of the Firm's Income

The Internal Revenue Service (the "**IRS**") recently released a Chief Counsel Advice memorandum (the "**CCA**") concluding that income allocated to the members of a limited liability company (an "**LLC**") that served as the manager of a family of investment funds was subject to federal self-employment tax.[1] The LLC, which was treated as a partnership for U.S. federal income tax purposes, took the position that its members qualified for the exemption from self-employment tax that applies to limited partners' shares of a partnership's net income. According to the CCA, the members of the LLC were not "limited partners" for this purpose because of their active involvement in the conduct of the LLC's business. The unredacted portions of the CCA that have been released leave unanswered the question whether the IRS would take the same position if the entity in question were organized as a limited partnership under applicable state law. The CCA is a legal memorandum from the IRS Chief Counsel's office to IRS personnel, which does not constitute binding legal authority. It does, however, indicate the position that the IRS is likely to take on audit (at least with respect to entities that are not organized as limited partnerships) and may signal that there will be more audit activity on this issue.

The self-employment tax, which is imposed on "net earnings from self-employment" of self-employed individuals, is the analog of the Social Security and Medicare taxes that are imposed on the wages of employees. It has two components: an old-age, survivors and disability insurance tax (commonly known as the Social Security tax) and a hospital insurance tax (commonly known as the Medicare tax).[2] Since 2013, the "net investment income" of any individual with income over a specified threshold amount has also been subject to a Medicare tax.[3] For this purpose, "net investment income" includes net income from a "passive activity" – that is, a business activity in which the individual does not substantially participate, including a business activity conducted by a partnership in which the individual is a partner if the individual does not substantially participate in that business.

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[1] I.R.S. Chief Couns. Adv. 201436049 (May 5, 2014). The CCA was released on September 5, 2014.

[2] The amount of earnings subject to the Social Security tax is capped (for 2014, at $117,000), while all "net earnings from self-employment" are subject to the Medicare tax. The rate of the Social Security tax is 12.4%; the rate of the Medicare tax is 2.9%, but for earnings over a specified threshold amount, the rate increases to 3.8%.

[3] The rate of this tax is 3.8%.

If an individual conducts a business through a general partnership, his or her share of the partnership's net operating income will be subject to self-employment tax. Internal Revenue Code Section 1402(a)(13) provides, however, that a *limited partner*'s share of a partnership's income will not constitute "net earnings from self-employment." On its face, this provision exempts a limited partner's share of a partnership's income from self-employment tax without regard to how actively the limited partner participates in the partnership's business, but there is uncertainty as to whether a limited partner who is active in the partnership's business is properly treated as a "limited partner" for this purpose. At the time Section 1402(a)(13) was enacted, state partnership laws required limited partners to be almost completely passive in order to retain their limited liability. Since that time, states have revised their limited partnership acts in a manner that permits limited partners to be active to some extent and have also enacted statutes providing for various limited liability entities, such as LLCs and limited liability partnerships ("**LLPs**"), the members of which will not lose their limited liability without regard to how active they are in the underlying business. Under the "check-the-box" regulations that Treasury promulgated in 1996, LLCs, LLPs and other similar entities are generally treated as partnerships for U.S. federal income tax purposes (and their members are therefore treated as partners for such purposes) unless they elect otherwise. In 1997, Treasury issued proposed regulations that would have defined the term "limited partner" for purposes of Section 1402(a)(13) generally to exclude persons who are actively engaged in the partnership's business.[4] These regulations are still only in proposed form. Legislation similar to the proposed regulations has also been proposed, but not enacted.

The application of the Section 1402(a)(13) exemption to limited partners who are actively engaged in the partnership's business has become particularly anomalous following the enactment of the Medicare tax on "net investment income." If a limited partner participates in the partnership's business to a sufficient extent that his or her share of the partnership's income does not constitute "passive activity" income, that income will be exempt from the Medicare tax on "net investment income." Therefore, assuming that Section 1402(a)(13) applies without regard to whether the relevant limited partner is engaged in the partnership's business, an active limited partner's share of a partnership's net operating income is one of the only types of income that is not subject to the Medicare tax.

The LLC addressed in the CCA derived fees from the funds for which it served as investment manager. In the years in question, this fee income constituted its only gross income. The LLC was treated as a partnership for U.S. federal income tax purposes, and all of its members were individuals that were actively engaged in its business. It treated each of these individuals as an employee, paying each of them an amount of wages, which it reported on IRS Form W-2. Its net income, determined after deduction of these wages and other expenses, was allocated to the individuals in their capacities as LLC members. The LLC took the position that, under Section 1402(a)(13), the members' shares of this net income were not subject to self-employment tax.

The CCA reasons that, because the members of the LLC actively participated in the LLC's business, they were not "limited partners" within the meaning of Section 1403(a)(13). In reaching this conclusion, the CCA relies on the reasoning of two recent opinions in each of which the court held that active members of a limited liability entity that was treated as a partnership for U.S. federal income tax purposes (an LLP and an LLC, respectively) were not "limited partners" for purposes of Section 1402(a)(13). Noting that the legislative history of Section 1403(a)(13) refers to the interest of a limited partner as "basically of an investment nature," the CCA agrees with the Tax Court that this legislative history "does not support a holding that Congress contemplated excluding partners who performed services for a partnership in their capacity as partners (i.e., acting in the manner of self-employed persons), from liability for self-

[4] In response to taxpayer complaints, Congress imposed a one-year moratorium on the finalization of these regulations. The moratorium ended in 1998.

employment taxes."[5] The CCA also rejects the argument that, because the LLC members provided services to the LLC in their capacities as LLC employees, they were not self-employed. It cites Revenue Ruling 69-184,[6] which concludes that, under common law rules applicable to determining employer-employee relationships, partners who provide services to their partnership cannot be employees of the partnership, but instead are self-employed. As noted in the CCA, a federal district court has reached the same conclusion in holding that members of an LLC were subject to the self-employment tax.[7] The CCA did not focus on whether the LLC members had made capital contributions to the LLC, and thus it appears that the IRS viewed did not view the existence of capital contributions as relevant to its analysis.

Many investment managers are organized as tiered limited partnerships, in which the individuals are employees of the lower-tier partnership and limited partners of the upper-tier partnership. By contrast, both the CCA and the cases it cites address members of entities that are treated as partnerships for U.S. federal income tax purposes, but are not organized as limited partnerships under applicable state law. While the reasoning in the CCA and the relevant cases could apply to disqualify a limited partner who materially participates in the partnership's business from treatment as a "limited partner" for purposes of Section 1402(a)(13), the CCA does not indicate whether the IRS would challenge the position that an active limited partner's share of the partnership's net income is exempt from self-employment tax.

SEC Summarizes Use of Form PF Data in Annual Staff Report

On August 15, 2014, the SEC's Division of Investment Management (the "**Division**") published its annual report on the SEC's use of the data obtained from Form PF filings (the "**Report**"). As directed by the Dodd-Frank Act, the SEC adopted Form PF requiring certain registered investment advisers to maintain records and file reports regarding certain private funds they advise. Please see the ***November 18, 2011 Investment Management Regulatory Update*** for a discussion of the final rule requiring advisers to file Form PF. According to the Report, the SEC is using the data to buttress its regulatory programs, including to examine and investigate private fund advisers, to monitor risks, to provide information for guidance updates and to cooperate with other regulators and organizations regarding issues relating to private fund advisers.

1. Examinations and Investigations

According to the Report, the SEC staff utilizes data obtained from Form PF in its examination and enforcement programs. In particular, the Office of Compliance Inspections and Examinations ("**OCIE**") staff routinely reviews a private fund adviser's Form PF filings before an examination as background information on the adviser. According to OCIE, the OCIE staff may review to make sure the investment strategies implemented by an adviser are accurately disclosed by the Form PF and to ensure that disclosures on an adviser's Form PF are consistent with other documents of the adviser that are reviewed by the SEC.

2. Risk Monitoring

The SEC additionally uses Form PF data in its risk monitoring activities, according to the Report. For example, the Division of Economic and Risk Analysis has been developing its proprietary analytical tools partly using data obtained from Form PF filings. According to the Report, such data has been used to identify advisers engaging in activities implicating certain areas of examination focus, such as exposures

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[5] *Renkemeyer, Campbell, and Weaver LLP v. Comm'r*, 136 T.C. 137, 150 (2011).

[6] 1969-1 C.B. 256.

[7] *See Riether v. United States*, 919 F. Supp. 2d 1140 (D.N.M. 2012).

and high-frequency trading. Other divisions and offices have used Form PF data to discover trends and possible emerging risks in the private fund industry, as well as to identify, through aberrational returns reported in Form PF filings, advisers that may be engaged in fraud or other improper conduct.

3. Guidance

The Division staff assesses data obtained from the Form PF filings to provide guidance and to communicate with Form PF filers.

4. Consultation

According to the Report, the SEC also uses Form PF data to cooperate with other federal regulators such as the FSOC, as well as international organizations, in efforts to better regulate and improve the private funds industry. For example, in 2013 and 2014, the SEC provided certain non-proprietary data from Form PF filings with the International Organization of Securities Commissions for a report shared with the Financial Stability Board.

- **See a copy of the Report**

SEC Investor Advocate Promotes User Fees

On August 19, 2014, Rick A. Fleming, the first head of the SEC's Office of the Investor Advocate, addressed the Southwest Securities Conference in Dallas, Texas. The SEC's press release in early 2014 announcing Fleming's appointment as the first Investor Advocate described the Office's mandate as including "assisting retail investors in interactions with the [SEC] and with self-regulatory organizations (SROs), identifying areas where investors would benefit from changes in, and analyzing the impact of, the rules and regulations of the [SEC] and SROs, identifying problems that investors have with financial service providers and investment products and proposing related changes to promote the interests of investors." In his speech, Fleming advocated for Congress to authorize the SEC to collect "user fees" from registered investment advisers in order to, among other things, assist the SEC in carrying out more frequent SEC examinations.

In his speech, Fleming noted that the expansion, in number and complexity, of SEC-registered advisers in the past decade has outpaced the growth of the budget of OCIE. Fleming emphasized that in fiscal year 2013, the SEC examined only roughly 9% of registered investment advisers, meaning that, at that rate, an investment adviser could potentially only be examined once every eleven years. The SEC has previously discussed, and indicated its support for, the imposition of user fees on investment advisers, including in a January 2011 study that considered various options for increased investment adviser oversight. This study is discussed in further detail in the ***February 14, 2011 Investment Management Regulatory Update***. Legislation introduced in the House of Representatives to require that investment advisers pay such fees, discussed in the ***August 22, 2012 Investment Management Regulatory Update***, was ultimately unsuccessful. According to Fleming, critics are concerned about budget deficits and inefficient use of funds by the SEC. However, according to Fleming, the user fee proposal is deficit-neutral. In addition, Fleming stated that while the SEC budget has increased in recent years, OCIE has been overwhelmed by the volume and complexity of registered advisers. Moreover, according to Fleming, several industry associations representing investment advisers have already endorsed the idea of user fees to empower the SEC to weed out rogue investment advisers who harm the advisory industry.

- **See a copy of Fleming's speech**
- **See the Press Release naming Fleming as Investor Advocate**

Litigation

SEC Charges Texas Investment Adviser for Failure to Disclose Conflict of Interest

On September 2, 2014, the SEC announced charges against a Houston-based investment advisory firm, The Robare Group, Ltd. ("**Robare Group**"), and its co-owners Mark L. Robare and Jack L. Jones, Jr. (the "**Owners**"), for failure to disclose to their clients a compensation arrangement with a broker-dealer and the resulting conflicts of interest. According to the SEC, the case against Robare Group and the Owners is part of an initiative developed by the SEC's Asset Management Unit aimed at uncovering undisclosed revenue-sharing arrangements between investment advisers and brokers. For more information about this initiative and a previous enforcement action arising out of the initiative, please see the ***October 17, 2012 Investment Management Regulatory Update***.

According to the SEC, Robare Group provides portfolio management services primarily to retail clients. The SEC alleged that Robare Group entered into revenue-sharing agreements in 2004 and 2012 with a registered broker-dealer (the "**Broker**") whereby the Broker agreed to pay Robare Group a percentage of every dollar that Robare Group's clients invested in certain mutual funds offered on the Broker's platform. According to the Order, Robare Group failed to disclose the revenue-sharing arrangement to its clients and also failed to disclose that it had an incentive to recommend the Broker's mutual funds over other investments since such recommendations would generate additional revenue for Robare Group under the revenue-sharing agreement. According to the SEC, Robare Group received $441,000 from the Broker pursuant to this revenue-sharing arrangement.

According to the Order, Robare Group did not disclose the compensation arrangement on its Form ADV until 2011 and failed to disclose the conflict of interest until June 2013. According to the SEC, these disclosures were inadequate because they falsely claimed that Robare Group did not receive economic benefit from the Broker for providing investment advice and were falsely equivocal about whether payments were being made. Therefore, according to the SEC, Robare Group and the Owners willfully violated Section 207 of the Advisers Act, which generally prohibits advisers from making misstatements or omissions in SEC reports or registration applications.

Based on this conduct, the SEC alleged that Robare Group and Robare willfully violated Sections 206(1), 206(2) and 207 of the Advisers Act. In addition, the SEC alleged that Jones willfully violated Section 207 of the Advisers Act and aided and abetted and caused Robare Group's and Robare's violations of Sections 206(1) and 206(2) of the Advisers Act.

- **See a copy of the SEC's press release**
- **See a copy of the SEC's order**

Jury Rules Against Adviser in SEC Fraud Case

On August 13, 2014, the SEC announced that a federal court jury returned a verdict against Sage Advisory Group, LLC ("**Sage**") and its sole owner (collectively, the "**Defendants**") for material misrepresentations and omissions to customers, in a case first filed in September 2010 by the SEC.

According to the SEC's 2010 complaint (the "**Complaint**"), prior to October 2005, the sole owner of Sage was a registered representative at Wedbush Morgan Securities ("**Wedbush**"), a full-service broker-dealer, where he had more than 300 customer accounts, most of which were managed by First Wilshire Securities Management, Inc. ("**First Wilshire**"), a registered investment adviser. According to the Complaint, the owner resigned from Wedbush on September 30, 2005 to operate Sage. The SEC further claimed that the owner communicated to his former clients at Wedbush that: (1) they needed to establish Sage as their investment adviser and an unaffiliated discount broker-dealer as the custodian of their brokerage accounts in order to avoid disruption in First Wilshire's management of their assets and (2) the charge for their accounts would now be a 2% "wrap fee," and that such fee was historically less expensive than fees paid under the prior arrangement with Wedbush (under which customers paid a 1% management fee plus Wedbush's brokerage commissions). Furthermore, according to the Complaint, the owner also told certain clients that First Wilshire refused to continue to manage their accounts at Wedbush, and that such clients were required to transfer their accounts to Sage if they wished to retain First Wilshire as their money manager.

According to the Complaint, the communications regarding First Wilshire's service were not authorized or required by First Wilshire and the communications regarding the wrap fee were not supported by facts, and therefore were materially false and misleading. Furthermore, the SEC alleged that the Defendants failed to disclose that the transfer of client accounts from Wedbush to the discount broker-dealer would result in the Defendants receiving the benefit of the cost savings. In addition, the Complaint alleged that Sage's Form ADV also contained materially false and misleading statements, including due to statements that Sage engaged in periodic discussions with its advisory clients about their financial needs and that it recommended money managers based on such clients' needs, when in fact, according to the SEC, Sage did not engage in such discussions and recommended that all of its clients have their assets managed by First Wilshire, provided the clients met First Wilshire's minimum asset requirement.

Based on these alleged fraudulent communications with their clients, the SEC charged the Defendants with violations of several rules and regulations, including Sections 204A and 206(1), (2) and (4) of the Advisers Act and Rules 204A-1 and 206(4)-7 thereunder. After a trial on August 4, 2014, the jury returned a verdict of liability against the Defendants under Sections 204A and 206(1), (2) and (4) of the Advisers Act and Rules 204A-1 and 206(4)-7 thereunder. According to the Press Release, the United States District Court for the District of Massachusetts will determine at a later date whether and what relief to impose against the Defendants.

- **See a copy of the SEC Complaint**
- **See a copy of the Press Release**

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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