

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 5083 / December 20, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18946

In the Matter of

AMERICAN PORTFOLIOS
ADVISORS, INC.,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTIONS 203(e) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), against American Portfolios Advisors, Inc. (“APA” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purposes of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Advisers Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. These proceedings arise out of improper mutual fund share class selection practices by APA, a registered investment adviser. From July 2012 to March 2016 (the "Relevant Period"), APA invested advisory clients in mutual fund share classes that charged 12b-1 fees instead of less expensive share classes of the same funds that were available without 12b-1 fees in many instances. As a result, APA received \$850,000 of avoidable 12b-1 fees during the Relevant Period. However, APA's disclosures failed to adequately inform its clients of the conflict of interest presented by its share class selection practices. In particular, APA failed to disclose that it and its investment adviser representatives ("IARs") had a conflict of interest as a result of the additional compensation received for investing advisory clients in a fund's 12b-1 fee paying share class when a less expensive share class was available for the same fund. Furthermore, the practice of investing advisory clients in mutual fund share classes that charged 12b-1 fees rather than less expensive share classes of the same funds was inconsistent with APA's duty to seek best execution for those transactions. Additionally, APA failed to implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder in connection with its mutual fund share class selection practices.

2. As a result of the conduct described above, APA willfully² violated Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder.

Respondent

3. **American Portfolios Advisors, Inc.**, a Delaware corporation based in Holbrook, New York, has been registered with the Commission as an investment adviser since 2002. APA provides advisory services through over 200 IARs. In its Form ADV filed April 4, 2018, APA reported regulatory assets under management of approximately \$6.2 billion.

Background

4. During the Relevant Period, APA offered asset management services to its advisory clients ("Advisory Clients") through a wrap fee advisory program called Advisor's Choice ("Wrap Fee Program"). The Wrap Fee Program enabled APA's IARs to invest client assets in various mutual funds across numerous fund complexes.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Mutual Fund Share Class Selection

5. Mutual funds typically offer investors different types of shares or “share classes.” Each share class represents an interest in the same portfolio of securities with the same investment objective. The primary difference among the share classes is their fee structure.

6. For example, “Class A” shares³ generally are sold with sales charges or “loads” based on the dollar amount of the investment. The sales charges are waived for Class A shares purchased in wrap fee or fee-based advisory accounts. Class A shares, including “load-waived” Class A shares purchased in advisory accounts, charge 12b-1 fees to cover fund distribution and shareholder services. These recurring fees are deducted from the mutual fund assets on an ongoing basis and paid to the fund’s distributor or principal underwriter, which, in turn, generally remits the fees to the broker-dealer that distributed or sold the shares. The 12b-1 fee for this type of share class is typically 25 basis points per year.

7. Many mutual funds also offer other share classes such as Institutional class shares or Class I shares that do not charge 12b-1 fees.⁴ These share classes are generally available only to investors who meet certain criteria (e.g., minimum investment amount or eligible investment program), which vary from fund to fund. While many Class I shares have higher initial investment minimums as compared to Class A shares, many funds waive or substantially reduce these thresholds for client purchases, particularly in advisory accounts such as the Wrap Fee Program offered by APA during the Relevant Period. A client who holds Class I shares of a mutual fund will pay lower fees over time – and earn higher returns – than a client who holds Class A shares of the same fund.

8. During the Relevant Period, APA’s IARs in many instances purchased, recommended, or held, on behalf of certain Advisory Clients, mutual fund share classes that charged 12b-1 fees (primarily Class A shares) when those clients were otherwise eligible to invest in less expensive share classes of those same funds (primarily Class I shares). As a result, APA’s IARs received 12b-1 fees that they would not have collected had Advisory Clients been invested in less expensive share classes. APA’s affiliated broker-dealer collected 12b-1 fees and paid a portion of the fees to its registered representatives, who acted as IARs for the Advisory Clients.

Disclosure and Best Execution Deficiencies

9. As an investment adviser, APA was obligated to fully disclose all material facts to its Advisory Clients, including any conflicts of interest between itself and its Advisory Clients that could affect the advisory relationship. To accomplish this disclosure obligation, APA was required

³ Share classes sold with sales charges or “loads” go by a variety of names in the mutual fund industry. As used in this Order, the term “Class A shares” refers generically to share classes that charge 12b-1 fees.

⁴ Share classes that do not charge 12b-1 fees also go by a variety of names in the mutual fund industry. As used in this Order, the term “Class I shares” refers generically to share classes that do not charge 12b-1 fees.

to provide its Advisory Clients with sufficient information so that they could understand the conflicts of interest that APA had, enabling clients to give informed consent to such conflicts or practices or reject them.

10. During the Relevant Period, APA disclosed in its Forms ADV Part 2A that its IARs may receive 12b-1 fees from the sale of mutual funds. However, APA failed to adequately disclose that its IARs had a conflict of interest as a result of the additional compensation they received for selecting share classes paying 12b-1 fees even when less expensive share classes of the same fund were available.

11. During the Relevant Period, APA was required to prepare disclosures specific to each of its IARs on Form ADV Part 2B and distribute these disclosures to clients. In response to Item 4 of that form, APA was required to disclose that certain IARs received 12b-1 fees from the sale of mutual funds, and that the receipt of those fees created an incentive to recommend Class A shares rather than less costly share classes available to eligible clients. APA incorrectly stated that its IARs did not receive 12b-1 fees or that IARs selected Class A shares only where less costly shares were unavailable to eligible clients. In fact, its IARs received 12b-1 fees and selected more expensive mutual fund share classes where less expensive share classes of the same fund were available to Advisory Clients.

12. Section 206 of the Advisers Act imposes on investment advisers a fiduciary duty to act for the benefit of their clients. That duty includes, among other things, an obligation to seek best execution for client transactions. *See, e.g.*, Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, Exchange Act Rel. No. 23170 (Apr. 28, 1986) (stating that money managers, as fiduciaries to their clients, have an obligation to “execute securities transactions for clients in such a manner that the client’s total cost or proceeds in each transaction is the most favorable under the circumstances”). By causing certain Advisory Clients to invest in fund share classes that charged 12b-1 fees when such clients were otherwise eligible for less expensive share classes, APA violated its duty to seek best execution for those transactions.

Compliance Deficiencies

13. During the Relevant Period, APA’s written policies and procedures instructed its IARs to review 12b-1 fees and other sales charges for each mutual fund share class and to select the share class with the lowest sales charge and/or asset-based fee, without regard to the IAR’s compensation. However, APA failed to implement its policies and procedures concerning 12b-1 fees or its IARs’ mutual fund share class selection practices.

Violations

14. Section 206(2) of the Advisers Act makes it unlawful for any investment adviser, directly or indirectly, to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. Scienter is not required to establish a violation of Section 206(2), but may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194-95 (1963)). As a result of the conduct described above, APA willfully violated Section 206(2).

15. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require a registered investment adviser to, among other things, “[a]dopt and implement written policies and procedures reasonably designed to prevent violation” of the Advisers Act and its rules. As a result of the conduct described above, APA willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

16. Section 207 of the Advisers Act makes it “unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein.” As a result of the conduct described above, APA willfully violated Section 207 of the Advisers Act.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent’s Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder.

B. Respondent is censured.

C. Respondent shall pay disgorgement, prejudgment interest, and a civil monetary penalty totaling \$1,145,353 to compensate Advisory Clients that were affected by the conduct detailed in this Order, as follows:

- (i) Respondent shall pay disgorgement of \$850,000 and prejudgment interest of \$45,353, consistent with the provisions of this Subsection C.
- (ii) Respondent shall pay a civil money penalty in the amount of \$250,000 consistent with the provisions of this Subsection C.

- (iii) Within ten (10) days of the entry of this Order, Respondent shall deposit \$1,145,353 (the “Distribution Fund”) into an escrow account at a financial institution acceptable to the Commission staff and shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff.
- (iv) If any payment is not made timely into the escrow account by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 and/or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application.
- (v) Respondent shall be responsible for administering the Distribution Fund and may hire a professional to assist it in the administration of the distribution. The costs and expenses of administering the Distribution Fund, including any such professional services, shall be borne by Respondent and shall not be paid out of the Distribution Fund. Respondent shall distribute the amount of the Distribution Fund to the applicable past and present Advisory Clients affected by the above conduct described herein, pursuant to a disbursement calculation (the “Calculation”) that will be submitted to, reviewed and approved by the Commission staff in accordance with this Subsection C. Such calculation shall be subject to a de minimis threshold, as described in Paragraph (vi) below. No portion of the Distribution Fund shall be paid to Respondent, any of its past or present officers or directors, nor to any affected account in which Respondent, or any of its past or present officers or directors, have a financial interest.
- (vi) Respondent shall, within sixty (60) days of the entry of this Order, submit the Calculation to the Commission staff for review and approval. The Calculation shall identify, at a minimum: (1) the name of each affected past or present Advisory Client account and Advisory Client; (2) the exact amount of the payment to be made from the Distribution Fund to each affected past or present Advisory Client account and Advisory Client; and (3) the amount of any de minimis threshold to be applied. Respondent shall also provide to the Commission staff such additional information and supporting documentation as the Commission staff may request for its review. In the event of one or more objections by the Commission staff to Respondent’s proposed Calculation or any of its information or supporting documentation, Respondent shall submit a revised Calculation for the review and approval of the Commission staff or additional information or supporting documentation within ten (10) days of the date that Respondent is notified of the objection, which revised Calculation shall be subject to all of the provisions of this Subsection C.
- (vii) Respondent shall complete the disbursement of amounts from the Distribution Fund to affected Advisory Client accounts and Advisory Clients within ninety (90) days of the Commission staff’s approval of the Calculation. If Respondent does not distribute any portion of the Distribution Fund for any reason, including factors

beyond Respondent's control, Respondent shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury. Any such payment shall be made in accordance with Paragraph (xi) of this Subsection C, below.

- (viii) Respondent agrees to be responsible for all tax compliance responsibilities associated with distribution of the Distribution Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondent and shall not be paid by the Distribution Fund, nor any of Respondent's affected past or present Advisory Clients.
- (ix) Within ninety (90) days after Respondent completes the disbursement of all amounts payable to affected past and present Advisory Clients, Respondent shall submit to the Commission staff a final accounting and certification of the disposition of the Distribution Fund not unacceptable to the staff, which shall be in a format to be provided by the Commission staff. The final accounting and certification shall include: (1) the name of each affected past or present Advisory Client account and Advisory Client who received payment; (2) the amount paid to each affected past or present Advisory Client account and Advisory Client; (3) the date of each payment; (4) the check number or other identifier of money transferred to each account; (5) the amount of any returned payment and the date received; (6) a description of any effort to locate a prospective payee whose payment was returned or to whom payment was not made for any reason; (7) the total amount, if any, to be forwarded to the Commission for transfer to the United States Treasury; and (8) an affirmation that Respondent has made payments from the Distribution Fund to affected past and present Advisory Clients in accordance with this Order and the Calculation approved by the Commission staff. Respondent shall submit the final accounting and certification, together with proof and supporting documentation of such payment in a form acceptable to the Commission staff, under a cover letter that identifies APA as the Respondent in these proceedings and the file number of these proceedings to Panayiota K. Bougiamas, Assistant Regional Director, Asset Management Unit, New York Regional Office, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, New York, 10281, or such other address the Commission staff may provide. Any and all supporting documentation for the accounting and certification shall be provided to the Commission staff upon request, and Respondent shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.
- (x) After Respondent has submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval and shall request Commission approval to send any undistributed amount to the United States Treasury.

- (xi) The Commission staff may extend any of the procedural dates set forth in this Subsection C for good cause shown. Deadlines for dates relating to the Distribution Fund shall be counted in calendar days, except if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.
- (xii) If Respondent is unable to distribute or return any portion of the Distribution Fund for any reason, Respondent shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury, in accordance with Section 21F(g)(3) of the Securities Exchange Act of 1934, after the final accounting provided for in Paragraph (ix) of this Subsection C is submitted to the Commission staff. Payment must be made in one of the following ways:
 1. Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
 2. Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
 3. Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying APA as Respondent in this proceeding, and the file number of this proceeding; a copy of the cover letter and check or money order must be sent to Panayiota K. Bougiamas, Assistant Regional Director, Asset Management Unit, New York Regional Office, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, New York, 10281.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalty, disgorgement, and prejudgment interest described above. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and

Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a “Related Investor Action” means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary