UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 5629 / November 13, 2020

ADMINISTRATIVE PROCEEDING
File No. 3-20152

In the Matter of **ROYAL ALLIANCE ASSOCIATES, 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 Royal Alliance Associates, Inc. ("Respondent" or "Royal Alliance").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement of Royal Alliance Associates, Inc. ("Offer"), which the Commission has determined to accept. Solely for the purpose 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 Investment Advisers Act of 1940, 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 finds[1] that

Summary

1. This matter concerns Royal Alliance's failure to adopt and implement policies and procedures reasonably designed to prevent unsuitable investments in volatility-linked exchange-traded products ("ETPs"). As a result, the investment adviser representatives of Royal Alliance ("IARs") used their discretionary authority over client accounts to buy and hold a complex ETP for time periods that were inconsistent with the purpose of the product as described in its offering materials.

2. During the period from January 2016 through April 2020 (the "Relevant Period"), certain Royal Alliance IARs on behalf of advisory accounts bought and held for extended periods a security called iPath S&P 500 VIX Short–Term Futures ETN ("VXX"). VXX attempts to track the implied volatility of the S&P 500 Index (the "S&P 500") through the use of short-term futures contracts. As disclosed in the VXX prospectus, the constant buying and selling of these contracts by the issuer creates roll costs in most instances. As the roll costs are deducted from VXX's returns, its value was likely to—and, in fact did—decrease when held longer than very short periods, even if the futures index that VXX tracks was flat or positive from the start to end of that period.

3. During the Relevant Period, approximately 108 accounts of Royal Alliance's advisory clients held VXX for periods extending to several months and, in some cases, years. The increased risk from the extended holding periods resulted in significant losses in the affected accounts.

4. During the Relevant Period, while Royal Alliance had policies and procedures that cautioned against holding other similarly risky complex and structured products for extended periods, Royal Alliance had no policies or procedures concerning products designed to track the implied volatility of the S&P 500. Likewise, while Royal Alliance trained its representatives concerning the risks of these other products, it provided no training on volatility ETPs like VXX, even though it knew that certain of its IARs were trading these products for their clients.

5. Under the circumstances described above, Royal Alliance violated Section 206(4) of the Advisers Act and Advisers Act Rule 206(4)-7.

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

Respondent

6. Royal Alliance, a Delaware corporation, is a dual-registered broker-dealer and investment adviser. Royal Alliance has been registered with the Commission as an investment adviser since 1997 and as a broker-dealer since 1998. Royal Alliance has its main offices in Jersey City, New Jersey. It has over 3,178 financial advisors across the United States. Royal Alliance is a subsidiary of Advisors Group, Inc., a wholly-owned subsidiary of Advisor Group Holdings, Inc., which is owned primarily by a consortium of investors through RCP Artemis Co-Invest, L.P., an investment fund affiliated with Reverence Capital Partners LLC.

Background

The VXX Product

7. VXX, which was listed on the NYSE Arca, Inc. exchange during the Relevant Period, is a volatility-linked, complex exchange-traded note ("ETN") that offers exposure to futures contracts of specified maturities on the CBOE volatility index (the "VIX"). The VIX attempts to track the expected volatility of the S&P 500, not the price level of the S&P 500 itself. Futures contracts on the VIX allow investors to invest in forward volatility based on their view of the near-future direction of the VIX. The performance of VXX is, therefore, not linked directly to the VIX but to a separate index that tracks the price of futures contracts on the VIX, the S&P 500 VIX Short-Term Futures Index Total Return (TR) ("Futures Index"). The performance of the Futures Index is based on a rolling portfolio of one-month and two-month futures contracts to target a constant weighted average of one month maturity. Thus, the Futures Index does not purport to track or measure implied volatility in the medium or long term, as its name—"Short-Term"—implies. The Futures Index, on a hypothetical basis, daily sells futures contracts closest to expiration and buys the next month out. When the longer-term contract costs less than the nearer-term contract, the market is in "backwardation," and the VXX benefits from "roll yield," which is a positive return. However, when the longer-term contract costs more, the market is in "contango," resulting in negative roll yield.

8. The VXX prospectus supplement in effect during the Relevant Period made clear that, as a historical matter, the VIX futures market typically resides in contango. The supplement disclosed that "VIX futures have frequently exhibited very high contango in the past, resulting in a significant cost to 'roll' the futures." As a result, the levels of the Futures Index may experience significant declines as a result of these roll costs, especially over a longer period. The VIX index will perform differently than the Futures Index and in certain cases may have positive performance during periods while the Futures Index is experiencing poor performance. In turn, an investment in VXX may experience a significant decline in value over time, the risk of which increases the longer that VXX is held.

9. The VXX prospectus supplement in effect during the Relevant Period also warned of the limited upside potential of VXX. Specifically, it stated: "VIX Index has typically reverted

over the longer term to a historical mean, and its absolute level has been constrained within a band. It is likely that spot level of the VIX Index will continue to do so in the future, especially when the current economic uncertainty recedes. If this happens, the value of futures contracts on the VIX Index will likely decrease, reflecting the market expectation of reduced volatility in the future, and the potential upside of your investment in your ETNs will correspondingly be limited as a result."

Royal Alliance Failed to Adopt and Implement Reasonably Designed Policies and Procedures Concerning Volatility-Linked ETPs

10. Throughout the Relevant Period, Royal Alliance maintained a written supervisory policy (the "WSP") and a sales practice manual (the "SPM") for all of its representatives, including its IARs. The SPM stated that the "[f]irm has a duty to ensure that all IARs act in a manner consistent with the fiduciary duty owed to their Clients."

11. The SPM stated that Royal Alliance's registered representatives and IARs had to make suitable recommendations and investments on behalf of all Royal Alliance customers and advisory clients. Royal Alliance's SPM told IARs that they were obligated to "make only suitable recommendations" to advisory clients. The SPM stated that IARs must make a "reasonable investigation," explained in the SPM as the obligation to conduct "due diligence" into products recommended to or acquired for clients and that "[t]he nature and extent of the due diligence that the IAR must conduct will depend upon the nature of [a product], including, among other things, its complexity and uniqueness."

12. The SPM further stated that, "[f]or those Clients for whom the IAR has agreed to provide on-going investment management services, the IAR has an obligation to determine if its recommendations continue to be suitable."

13. VXX was intended for a very short investment horizon, not for a "buy and hold" strategy. The Futures Index underlying VXX seeks to track price movements in futures contracts with a weighted average of one month maturity, and the relationship between the level of the VIX and the Futures Index begins to break down as the length of an investor's holding period increases, even within the course of a single index business day. The relationship between the level of the Futures Index and the value of VXX will also break down as the length of an investor's holding period increases due to the effect of accrued fees, leading eventually to an expected value of VXX of zero. Indeed, the costs of "rolling" the relevant futures contracts could drive down the value of VXX over time, even if the Futures Index was flat or positive from the start to end of that period. As such if an investor holds VXX as a long term investment, the investor will likely lose all or a substantial portion of their investment.

14. During the Relevant Period, Royal Alliance had specific policies and procedures for certain complex products, including leveraged and inverse exchange-traded funds ("LETFs"). Royal Alliance also provided training to all its IARs concerning the risks of LETFs. Since at least 2016, Royal Alliance required IARs and their first line supervisors to be

trained on the risks of investing in LETFs before investing on behalf of their clients, advised IARs to monitor any positions in the products and limited holding periods to 32 days without a customer attestation and to 90 days without an exception granted from the broker-dealer. Ultimately, in February 2018, Royal Alliance banned IARs from investing in LETFs on behalf of retail investors. The 2019 SPM noted that LETFs were designed to achieve their results on a daily basis, were subject to a "compounding" effect that caused them to deviate from the underlying index over the long term, and were typically "unsuitable for retail investors who plan to hold them longer than one trading session."

15. Despite similar risks of a buy-and-hold strategy for both VXX and LETFs, during the Relevant Period, Royal Alliance did not apply these policies to VXX because VXX was not identified as inverse (because it followed the Futures Index) or leveraged. Rather, Royal Alliance inappropriately categorized VXX as an equity security rather than a complex or, more specifically, volatility-linked product and included VXX on its limited list of approved products for purchase in all client accounts.

16. During the Relevant Period, Royal Alliance failed to adopt written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules regarding the suitability of recommending investments in volatility-linked ETPs, such as VXX, for retail advisory clients. Royal Alliance also failed to implement and reasonably design existing written policies and procedures that would safeguard against unsuitable investments in such products. For example, Royal Alliance did not dedicate resources to training IARs and their supervisors concerning volatility-linked ETPs even though it was aware that certain advisers were investing their clients in VXX, including for extended periods, in spite of the statements in the product's offering material about the risks of an extended holding due to contango and negative roll yield.

Buy-And-Hold Investments Made in VXX On Behalf Of Clients

17. During the Relevant Period, certain Royal Alliance IARs bought and held VXX on behalf of their clients; in most cases, the VXX position constituted between five and ten percent of the clients' overall portfolios. Many of these purchases were made on behalf of clients participating in Royal Alliance's Advisory Managed Program ("AMP"), which the firm described as "designed for investors with a long-term investment horizon." Many purchases were made in retirement accounts.

18. Contrary to the warnings in the prospectus about the effect of contango and negative roll yield, these IARs bought and held VXX for their client accounts for periods some of which spanned months to years. At least 108 accounts holding VXX for extended periods lost money on their investment. The VXX positions in some of these accounts went to zero.

19. Without the benefit of firm training or guidance from policies and procedures, certain of these Royal Alliance IARs had a flawed understanding of VXX's operation and risks. For example, although VXX's performance was tied to an index tracking the daily performance of

futures contracts and did not provide highly correlated inverse exposure to the S&P 500 (as made clear in the VXX prospectus), several IARs stated in communications with clients that they viewed the product as a hedge against an anticipated period of volatility or market downturn. Some of these communications were in response to clients who were unfamiliar with VXX and asked the reason for its purchase. Supervisors, who also lacked training, accepted this flawed rationale from IARs when suitability questions occasionally arose on VXX trades and approved the trades.

20. As a result, these Royal Alliance IARs could not make a reasonable determination as to whether VXX was suitable in light of their clients' buy-and-hold investment objectives, as Royal Alliance's suitability policy required them to do. In particular, these IARs could not determine whether it would be reasonable for Royal Alliance IARs to hold VXX for extended periods as a hedge against a potential market downturn or other potential unpredictable or long-term future events.

Royal Alliance's Violations

21. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations, by the investment adviser and its supervised persons, of the Advisers Act and its rules. In failing to adopt written policies and procedures directed at volatility-linked products, and in failing to implement its existing policies and procedures, Royal Alliance willfully[2] violated Section 206(4) of the Advisers Act and Advisers Act Rule 206(4)-7.

Remedial Efforts

22. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Royal Alliance and cooperation afforded the Commission staff. In particular, in April 2020, Royal Alliance adopted policies and procedures relating to volatility-linked ETPs such as VXX and imposing restrictions on holding them in all client accounts maintained at the firm.

[2] "Willfully," for purposes of imposing relief under Section, 203(e) of the Advisers Act, "'means no more than 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." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). The decision in *The Robare Group, Ltd. v. SEC*, which construed the term "willfully" for purposes of a differently structured statutory provision, does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has "willfully omit[ted]" material information from a required disclosure in violation of 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 Royal Alliance's Offer.

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

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Advisers Act Rule 206(4)-7;

B. Respondent is censured;

C. Respondent shall pay disgorgement, prejudgment interest, and a civil money penalty totaling $502,400.29 as follows:

1. Respondent shall pay disgorgement of $1,953.00 and prejudgment interest of $447.29, consistent with the provisions of Subsection C;

2. Respondent shall pay a civil monetary penalty in the amount of $500,000, consistent with the provisions of this Subsection C;

3. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalty described above for distribution to affected client accounts. Amounts ordered to be paid as a civil money penalty pursuant to this Order shall be treated as a penalty 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.

4. Within 10 days of the issuance of this Order, Respondent shall deposit $502,400.29 (the "Distribution Fund" or "Fair Fund") into an escrow account at a financial institution not unacceptable to Commission staff and Respondent shall provide

Commission staff with evidence of such deposit in a form acceptable to Commission staff. If timely payment into the escrow account is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 -17 C.F.R. § 201.600.

5. 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.

6. Respondent shall pay from the Distribution Fund an amount representing a portion of the respective loss incurred from investments in VXX to each client of Royal Alliance who incurred a loss as a result of investments made in VXX between January 1, 2016, and April 13, 2020 plus reasonable interest at the Internal Revenue Service's rate to calculate underpayment penalties compounded quarterly from the date of the purchase to April 13, 2020, pursuant to a disbursement calculation (the "Calculation") that will be submitted to, reviewed, and approved by Commission staff in accordance with this Subsection C. No portion of the Distribution Fund shall be paid to any affected client account in which Respondent, or any of its current or former officers or directors, or any of its IARs who recommended buy-and-hold investments in volatility-linked ETPs has a financial interest. If the amount deposited into the Distribution Fund is not sufficient to pay the full amount of the losses determined to be payable to the affected clients, then each eligible affected client will receive an amount that the client's losses bears in proportion to the aggregate losses of all eligible affected clients.

7. Respondent shall, within 90 days from the date of this Order, submit a proposed Calculation to Commission staff for review and approval. At or around the time of submission of the proposed Calculation to the staff, Respondent shall make itself available, and shall require any third-parties or professionals retained by Respondent to assist in formulating the methodology for its Calculation and/or administration of the Distribution to be available, for a conference call with Commission staff to explain the methodology used in preparing the proposed Calculations and its implementation, and to provide the staff with an opportunity to ask questions. Respondent also shall provide Commission staff such additional information and supporting documentation as Commission staff may request for the purpose of its review. In the event one or more objections by 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 Commission staff or additional information or supporting documentation with 10 days of the date that Commission staff notifies Respondent of the objection. The revised Calculation shall be subject to all of the provisions of this Subsection C.

8. After the Calculation has been approved by Commission staff, Respondent shall submit a payment file (the "Payment File") within thirty (30) days for review and acceptance by Commission staff demonstrating the application of the methodology to each harmed client. The Payment File should identify, at a minimum, (1) the name of each affected harmed client; (2) the exact amount of the payment to be made; (3) the amount of any *de minimis* threshold to be applied; and (4) the amount of reasonable interest paid.

9. Respondent shall complete the disbursement of all amounts payable to affected client accounts within 90 days of the date that Commission staff accepts the Payment File, unless such time period is extended as provided in Paragraph 13 of this Subsection C. Respondent shall notify Commission staff of the dates and the amount paid in the initial distribution.

10. If Respondent is unable to distribute or return any portion of the Distribution Fund for any reason, including an inability to locate an affected client or a beneficial owner of an affected client or any factors beyond Respondents' control, 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 when the distribution of funds is complete and before the final accounting provided for in Paragraph 12 of this Subsection C is submitted to Commission staff. Payment must be made in one of the following ways:

    a. Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request.

    b. Respondent may make direct payment from a bank account via Pay.gov through the SEC website at https://www.sec.gov/paymentoptions; or

    c. 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 Royal Alliance as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money

order must be sent to Osman Nawaz, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281.

11. A Distribution Fund is a Qualified Settlement Fund ("QSF") under Section 468B(g) of the Internal Revenue Code ("IRC"), 26 U.S.C. §§ 1.468B.1-1.468B.5. Respondent shall be responsible for any and all tax compliance responsibilities associated with the Distribution Fund, including but not limited to tax obligations resulting from the Distribution Fund's status as a QSF and the Foreign Account Tax Compliance Act ("FATCA"), and may retain any professional services necessary. The costs and expenses of tax compliance, including any such professional services shall be borne by Respondent and shall not be paid out of the Distribution Fund.

12. Within 150 days after Respondent completes the disbursement of all amounts payable to affected clients, Respondent shall return all undisbursed funds to the Commission pursuant to the instructions set forth in this Subsection C. Respondent shall then submit to Commission staff a final accounting and certification of the disposition of the Distribution Fund for Commission approval, which final accounting and certification shall include, but not be limited to (1) the amount paid to each payee, with the reasonable interest amount, if any, reported separately; (2) the date of each payment; (3) the check number or other identifier of the money transferred; (4) the amount of any returned payment and the date received; (5) a description of the efforts to locate a prospective payee whose payment was returned or to whom payment was not made for any reason; (6) the total amount, if any, to be forwarded to the Commission for transfer to the United States Treasury; and (7) an affirmation that Respondent has made payments from the Distribution Fund to affected clients in accordance with the Calculation approved by Commission staff. The final accounting and certification shall be submitted under a cover letter that identifies Respondent and the file number of these proceedings to Osman Nawaz, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281. Respondent shall provide any and all supporting documentation for the accounting and certification to Commission staff upon its request and shall cooperate with any additional requests by Commission staff in connection with the accounting and certification.

13. 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 that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

By the Commission.

Vanessa A. Countryman
Secretary