

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 81274 / August 1, 2017

INVESTMENT ADVISERS ACT OF 1940
Release No. 4736 / August 1, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-18087

In the Matter of

Cadaret, Grant & Co., Inc.,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND 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 Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”) and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), against Cadaret Grant & Co., Inc. (“Cadaret” 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 Section 15(b) of the Exchange Act and 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 from a series of failures by registered investment adviser Cadaret. First, from at least 2011 to 2016, Cadaret invested advisory clients in mutual fund share classes with 12b-1 fees instead of lower-fee share classes of the same funds that were available without 12b-1 fees. In its capacity as a broker-dealer, Cadaret received at least \$1.93 million in 12b-1 fees for investing clients in the higher-fee share classes. Cadaret failed to disclose in its Forms ADV or otherwise that it had a conflict of interest concerning mutual fund share classes. The practice of investing clients in mutual fund share classes with 12b-1 fees rather than lower-fee share classes was also inconsistent with Cadaret's duty to seek best execution for its clients. Although Cadaret represented in its Forms ADV that it would comply with its duty to provide best execution for its clients, Cadaret's representations were misleading in light of its failure to purchase lower-fee share classes and its failure to conduct any analysis of which share class would be most appropriate for advisory clients.

2. Second, during the same period, Cadaret received marketing support payments from two mutual fund complexes. The mutual fund complexes paid marketing support fees to Cadaret when Cadaret invested its advisory clients in mutual fund share classes that charged 12b-1 fees but would not pay such fees when Cadaret invested them in lower-fee share classes. In total, Cadaret received at least \$235,000 in marketing support payments. Cadaret failed to disclose this conflict of interest related to its advisory clients in its Forms ADV or otherwise. In addition, Respondent failed to adopt any written compliance policies and procedures governing mutual fund share class selection.

3. Third, during the same period, Cadaret failed to refund prepaid advisory fees to clients who terminated their relationship with Cadaret before Cadaret earned all of the prepaid fees. Cadaret failed to disclose in its Forms ADV or otherwise that it would retain unearned prepaid fees.

4. As a result of this conduct, Cadaret willfully violated Sections 206(2), 206(4) and 207 of the Advisers Act and Rule 206(4)-7 thereunder.

RESPONDENT

5. **Cadaret, Grant & Co., Inc. ("Cadaret")**, a Delaware corporation, is a dual-registered broker-dealer and investment adviser. Cadaret has been registered with the Commission as an investment adviser since 1992 and as a broker-dealer since 1982. Cadaret's main offices are in Syracuse, New York. Cadaret has 350 affiliated independent investment

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.

advisor representatives (“IARs”) providing advisory services in 189 offices or branch offices. As of December 2016, Cadaret and its affiliated IARs managed approximately 13,000 advisory clients with approximately \$2.9 billion in assets.

FACTS

Background

6. Cadaret offers both brokerage and investment advisory services through financial advisors who are independent contractors. Respondent has responsibility for the regulatory compliance and supervision of 350 IARs in 189 offices or branch offices across the U.S.

7. Cadaret provides advisory services through two programs: The Investment Management System (“TIMS”) program and the Advisors Edge program. Cadaret and its IARs primarily provide advisory services through TIMS. With TIMS, IARs apply Cadaret’s management guidelines to investment advisory accounts. These guidelines include concentration limits on individual stock positions in advisory accounts and restrictions on the types of mutual fund share classes that IARs purchase on behalf of advisory clients. Advisors Edge is a wrap account program for which Cadaret is the program sponsor.

Mutual Fund Share Class Selection

8. Cadaret and its IARs offer TIMS and Advisors Edge clients (“Advisory Clients”) the opportunity to invest in a broad selection of mutual funds across numerous mutual fund complexes. Mutual funds typically offer investors different types of shares or “classes.” Each share class represents an interest in the same portfolio of securities with the same investment objective. The primary difference among the various share classes is their fee structure.

9. Class A shares were one of the more common mutual fund share classes that Cadaret’s IARs purchased for Advisory Clients during 2011 to 2016. Class A shares typically are purchased by retail brokerage customers in brokerage accounts, but also can be purchased by retail advisory clients in advisory accounts. Class A shares are sold with sales charges or sales “loads” in retail brokerage accounts based on the dollar amount of the investment, but the sales charges are generally waived when purchased in fee-based advisory accounts. However, even these “load-waived” Class A shares in fee-based accounts continue to pay what is known as a 12b-1 fee, a fee paid by a mutual fund on an ongoing basis from its assets for shareholder services, distribution and marketing expenses.² The 12b-1 fee for Class A shares is typically 25 basis points. Class A shares also are subject to initial minimum investment requirements that are usually not higher than \$3,000.

² 12b-1 fees are paid to the fund’s distributor or underwriter, which, in turn, generally remits the fees to intermediaries that distribute or “sell” the fund’s shares. In its capacity as a broker-dealer, Cadaret received 12b-1 fees from mutual funds it sold to Advisory Clients and then shared substantially all of these 12b-1 fees with its IARs as compensation.

10. In addition to load-waived Class A shares or equivalent “no load” fund shares,³ many mutual funds in recent years have begun to offer share classes exclusively for fee-based advisory accounts such as “institutional” or “advisory” share classes that do not include 12b-1 fees. Institutional shares, which are sometimes designated as “Class I” shares, have higher initial investment minimums (*e.g.*, \$1 million) than Class A or equivalent no load or load-waived share classes, while advisory shares have similar investment minimums as Class A or equivalent shares. Many mutual funds waive or substantially reduce the minimum investment requirement for institutional shares in fee-based advisory accounts, such as TIMS and Advisors Edge accounts. The terms and eligibility requirements for any particular share class are described in a mutual fund’s prospectus.

11. When an advisory client in a fee-based program like TIMS or Advisors Edge is eligible for advisory shares, institutional shares or any similar lower-fee share class of the same mutual fund, it is generally in the client’s best interest to invest in the lower-fee share class rather than the higher-fee share class because the client’s returns are not reduced by 12b-1 fees. Accordingly, where there is no credit, offset or similar adjustment for 12b-1 fees, an advisory client will benefit from higher investment returns over time by investing in the lower-fee share class.

12. From 2011 to 2016, Cadaret and its IARs invested certain of their Advisory Clients in share classes with 12b-1 fees when lower-fee share classes of those same funds without 12b-1 fees were available in many instances. As a result, Cadaret and its IARs received at least \$1,933,000 in 12b-1 fees that they would not have collected had they invested those Advisory Clients in available lower-fee share classes.

Marketing Support Payments to Cadaret

13. From 2011 to 2016, Cadaret received payments from two mutual fund complexes to support the marketing and distribution of those companies’ funds’ shares to Cadaret’s Advisory Clients.⁴ Cadaret received the marketing support payments pursuant to separate marketing support agreements (“MSAs”) that it entered into with each of the two mutual fund complexes under which Cadaret agreed to provide the mutual fund complexes with fund sales data as well as information about Cadaret’s IARs and their offices. In addition to providing Cadaret with marketing support payments, the MSAs also provided that the mutual fund complexes would pay Cadaret fees so that Cadaret’s IARs could attend educational and training events sponsored by the two complexes.

14. Each of the MSAs specified the method for calculating the fees paid to Cadaret for marketing support. Pursuant to the terms of the MSAs, the fund complexes paid fees to

³ Certain mutual funds known as “no load” funds can be purchased in fee-based accounts but may have 12b-1 fees, typically up to 25 basis points. These “no load” funds are equivalent to “load-waived” Class A shares in fee-based accounts.

⁴ The marketing support agreements at issue here are distinct from 12b-1 distribution plans and revenue sharing agreements that fund companies typically enter into with registered investment advisers and broker-dealers.

Cadaret based either on the total assets invested by Cadaret's advisory clients or the total sales of the mutual fund shares sold to Cadaret's advisory clients. The MSAs specified that fees would be paid only on the share classes that charged 12b-1 fees. No MSA fees would be paid on shares that did not pay 12b-1 fees.

15. Both MSAs presented a conflict of interest for Cadaret because they gave Cadaret an additional economic incentive to sell Advisory Clients more expensive share classes so that Cadaret could receive marketing support payments. From 2011 to 2016, Cadaret received \$235,000 in marketing support payments under the terms of these two MSAs as a result of the share classes purchased or owned by its Advisory Clients.

Unearned Prepaid Advisory Fees

16. In its Forms ADV, among other places, Cadaret informed Advisory Clients that they would pay an advisory fee for services such as portfolio management, trade execution, trade and performance reporting, and account servicing. Typically, Cadaret charged between 0.75% and 2.2% of the Advisory Clients' assets under management invested with Cadaret and its IARs. Cadaret's Forms ADV stated that Advisory Clients' fees are billed in advance of each calendar quarter based on the value of the account on the last business day of the ending quarter. With respect to the TIMS program, Cadaret's Forms ADV during the relevant period stated that if an advisory contract was terminated, any prepaid advisory fees for the quarter would not be refunded, "[s]ince the significant portions of the functions conducted by the IAR and Cadaret, Grant are provided at the beginning of each quarter." This disclosure was inaccurate, however, because a significant portion of the fees in the TIMS program was not earned at the beginning of the quarter, even though Cadaret retained these unearned prepaid fees. The Forms ADV also did not disclose that Cadaret would retain unearned prepaid fees in the Advisor's Edge program.

17. From 2011 to 2016, Cadaret failed to refund unearned fees to Advisory Clients who had prepaid the fees but terminated their relationship with Cadaret before the end of the quarter. In total, Cadaret overcharged Advisory Clients by \$423,000 of unearned fees.

Inadequate Disclosures and Related Compliance Deficiencies

18. During the relevant period, Cadaret disclosed in its Forms ADV that it received 12b-1 fees from mutual fund investments of its Advisory Clients. However, Cadaret did not disclose in its Forms ADV or otherwise that it had a conflict of interest concerning mutual fund share classes and would select share classes that carried 12b-1 fees even when its clients were eligible for lower-cost share classes of the same fund.

19. Cadaret also failed to disclose in its Forms ADV or otherwise that it had a conflict of interest due to a financial incentive to invest Advisory Client assets in higher-fee share classes of the mutual funds purchased under the MSAs. Finally, Cadaret failed to disclose in its Forms ADV or otherwise that it would retain unearned prepaid advisory fees.

20. In addition, from the period beginning 2011 through 2016, Cadaret failed to adopt and implement written compliance policies and procedures governing mutual fund share class selection.

Violation of Duty to Seek Best Execution

21. By failing to invest certain Advisory Clients in lower-fee share classes, Cadaret and its IARs also violated their duty to seek best execution for advisory client transactions. 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 – *i.e.*, “to seek the most favorable terms reasonably available under the circumstances.” *In the Matter of Fidelity Management Research Company*, Investment Advisers Act Rel. No. 2713 (Mar. 5, 2008) (citing Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Rel. No. 23170, (Apr. 23, 1986)). The Commission has repeatedly stated in settled enforcement actions that when an investment adviser causes a client to purchase a more expensive share class when a less expensive share class is available, it has failed to seek best execution.⁵

22. Although Cadaret’s Advisory Clients were in many cases eligible to purchase advisory shares, institutional shares, or any similar lower-fee share class of the same mutual fund, Cadaret routinely invested those clients in a more expensive mutual fund share class that charged a 12b-1 fee. In addition, Cadaret represented in its Forms ADV that it would comply with its duty to provide best execution for its clients. Cadaret’s representations were misleading in light of its failure to purchase lower-fee share classes and its failure to conduct any analysis of which share class would be most appropriate for clients. By not choosing mutual fund share classes with a view to minimizing transactional and ongoing costs, and by failing to disclose that best execution would not be sought for mutual funds with multiple share classes available, while also disclosing that it would comply with a duty to seek best execution, Cadaret violated its duty to seek best execution on behalf of its Advisory Clients.

VIOLATIONS

23. As a result of the conduct described above, Cadaret willfully⁶ violated Section 206(2) of the Advisers Act, which prohibits an investment adviser, directly or indirectly, from engaging “in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.” A violation of Section 206(2) may rest on a finding of

⁵ See *In the Matter of Credit Suisse Securities (USA) LLC*, Investment Advisers Act Rel. No. 4678 (Apr. 4, 2016) (settled matter); *In the Matter of Everhart Financial Group, Inc.*, Investment Advisers Act Rel. No. 4314 (Jan. 14, 2016) (settled matter); *In the Matter of Pekin Singer Strauss Asset Management Inc.*, Investment Advisers Act Rel. No. 4126 (June 23, 2015) (settled matter); and *In the Matter of Manarin Investment Counsel, Ltd.*, Investment Advisers Act Rel. No. 3686 (Oct. 2, 2013) (settled matter).

⁶ 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)).

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, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.*

24. As a result of the conduct described above, Cadaret willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require a registered investment adviser to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder.

25. As a result of the conduct described above, Cadaret willfully violated Section 207 of the Advisers Act, which 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.”

REMEDIAL EFFORTS

26. In determining to accept the Offer, the Commission considered remedial acts taken by Respondent and cooperation afforded by it to the Commission staff.

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 Section 15(b) of the Exchange Act and 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 of \$3,048,000 to compensate advisory clients that were affected by the conduct detailed in this Order, as follows:
 - (i) Respondent shall pay disgorgement of \$2,591,000 and prejudgment interest of \$177,000, consistent with the provisions of this Subsection C.
 - (ii) Respondent shall pay a civil money penalty in the amount of \$280,000 consistent with the provisions of this Subsection C.
 - (iii) Within ten (10) days of the entry of this Order, Respondent shall deposit \$3,048,000 (the “Distribution Fund”) into an escrow account acceptable to the Commission staff and shall provide the Commission staff with evidence of such

deposit in a form acceptable to the Commission staff. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 [17 C.F.R. § 201.600] or 31 U.S.C. § 3717.

- (iv) Respondent shall be responsible for administering 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 minimus* threshold, as described in paragraph (v) below. No portion of the Distribution Fund shall be paid to Respondent or its past or present officers or directors.
- (v) Respondent shall, within 60 days of the entry of this Order, submit a proposed Calculation to the staff for its review and approval that identifies, at a minimum, (1) the name of each affected past or present Advisory Client account, (2) the exact amount of the payment to be made from the Distribution Fund to each affected past or present Advisory Client account, and (3) the amount of any *de minimus* 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 the purpose of 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 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.
- (vi) The distribution of the Distribution Fund shall be made in the next fiscal quarter immediately following the staff’s approval of the Calculation but no later than within 90 days of the 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.
- (vii) 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 any of Respondent’s past or present clients.
- (viii) Within 120 days after Respondent completes the disbursement of all amounts payable to affected past and present Advisory Clients and has received notification of any returned payments, 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 amount paid to each past or present Advisory Client account; (2) the date of each payment; (3) the check number or other identifier of money transferred to each account; (4) the amount of any returned payment and the date received; (5) a description of any effort 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 past and present Advisory Clients in accordance with the distribution plan 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 Commission staff, under a cover letter that identifies Cadaret 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.

- (ix) 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.
- (x) 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.
- (xi) 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 Exchange Act Section 21F(g)(3), after the final accounting provided for in Paragraph viii 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 Cadaret 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 Anthony S. Kelly, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street NE, Washington, D.C., 20549.

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