

SEC Bars Former CCO from the Compliance Industry and Sanctions Investment Adviser and Him for Failure to Adopt Appropriate Compliance Procedures and Code of Ethics

The Securities and Exchange Commission (the "SEC") has barred the former chief compliance officer ("CCO") of Consulting Services Group ("CSG") "from association in a compliance capacity with any broker, dealer, or investment adviser." An order ("Order") issued in an October 2007 administrative proceeding states that CSG and its former CCO had willfully violated sections of the Investment Advisers Act of 1940 (the "Act") that required CSG to (1) adopt adequate compliance policies and procedures and (2) timely adopt and accurately document a code of ethics.¹

CSG is a registered investment adviser that provides investment-related consulting services to individual and institutional clients, including public and private pension funds. CSG assists its clients in developing investment strategies and selecting investment firms to serve as discretionary money managers. The CCO, a founding partner and shareholder of CSG, served as its CCO for 16 years before being removed from this position in the wake of the SEC's investigation.

Inadequacy of CSG's Compliance Policies and Procedures

The SEC found that CSG's compliance policies and procedures did not satisfy Section 206(4) of the Act and Rule 206(4)-7 thereunder, which requires investment advisers to adopt written

policies and procedures "reasonably designed to prevent violations" of the Act by the adviser and its supervised persons. In adopting Rule 206(4)-7, the SEC noted that there was no single set of universally acceptable policies and procedures, and instead endorsed a flexible approach to adopting policies and procedures that allowed advisers to consider their specific operations. The SEC stressed that firms should identify the conflicts and other factors that create risk exposure and design policies and procedures that address those specific risks.

In preparing CSG's compliance materials, the CCO had purchased a prepackaged manual from a compliance outsourcing firm and adopted the manual with few modifications as CSG's written policies and procedures. The SEC noted that many of the provisions in the prepackaged manual were "completely inapplicable and irrelevant to CSG's provision of advisory services" and determined that those materials, which had been designed for use by advisers offering discretionary money management services, "failed to address adequately the conflicts of interest unique to CSG's operations as a pension consultant."

Specifically, the SEC noted that CSG's compliance program did not address potential conflicts of interest arising out of the relationship between CSG and its wholly-owned broker-dealer subsidiary, Trading Services Group, Inc.

¹ See *In the matter of Consulting Services Group, LLC and Joe D. Meals*, Rel. IA-2669 (October 4, 2007).

(“TSG”), which had been created to provide a commission recapture plan to clients. Under this plan, clients whose trades were executed through TSG could use a portion of the trading commissions to offset their CSG consulting fees. The SEC stated that CSG’s compliance materials “gave no specific consideration” to the “multiple potential conflicts of interest” that arose from this arrangement. The SEC concluded that the compliance policies and procedures therefore did not satisfy the requirements of Rule 206(4)-7, and the CCO, through his actions, had aided and abetted and caused CSG’s violation.

Failure to Adopt and Accurately Document a Code of Ethics

The SEC also determined that CSG had failed to timely adopt and accurately document a code of ethics pursuant to Section 204A of the Act and Rule 204A-1 thereunder. In late 2004, the SEC released Rule 204A-1 and established a compliance date of February 1, 2005. Rule 204A-1 requires investment advisers to adopt a written code of ethics for supervised persons and sets forth minimum criteria including, among other requirements, that supervised persons provide the adviser with written acknowledgment of their receipt of the code.

At the time of the rule’s adoption, CSG’s code of ethics did not include such a provision, and CSG did not amend its code of ethics to add the provision prior to the February 1 compliance date. In March 2005, the SEC staff issued a deficiency letter to CSG reminding CSG of the rule and its current effectiveness. In response to the letter, the CCO revised CSG’s code of ethics and prepared written acknowledgement forms for CSG’s supervised persons. The CCO then instructed these supervised persons to backdate their written acknowledgments to January 2005—even though they had not received copies of the code prior to March 2005—and sent these documents to the SEC staff as evidence that CSG had complied timely with Rule 204A-1. The SEC determined that these actions constituted a willful violation of Section 204 and Rules 204-2 and 204A-1, and that the CCO had aided and abetted and caused this violation.

Sanctions

For his role in the events leading up to the investigation, the SEC:

- censured the CCO;
- ordered him to cease and desist from current and future violations;
- fined him \$10,000;
- barred him from associating in a compliance capacity with any broker, dealer, or investment adviser; and
- outlined several non-exclusive factors the SEC would consider if he ever reapplied to serve in a compliance capacity.

Pursuant to a settlement agreement, the SEC also:

- censured CSG;
- ordered it to cease and desist from current and future violations; and
- fined the company \$20,000.

The Order also states that in accepting the settlement, the SEC had considered the fact that CSG had voluntarily retained an independent compliance consultant to review and revise its policies, procedures, and disclosure statements and that, upon discovering the CCO’s conduct, had placed him on administrative leave and removed him from all compliance and supervisory roles.

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