

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 5452 / February 27, 2020

INVESTMENT COMPANY ACT OF 1940
Release No. 33807 / February 27, 2020

ADMINISTRATIVE PROCEEDING
File No. 3-19715

In the Matter of

**FORTRESS INVESTMENT
MANAGEMENT, LLC and
WILLIAM M. MALLOY, III**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 203(e), 203(f)
AND 203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940 AND SECTION
9(b) OF THE INVESTMENT COMPANY
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), 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against William M. Malloy, III and Fortress Investment Management, LLC (collectively “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the “Offers”) 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 them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent

to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company 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 Respondents’ Offers, the Commission finds¹ that:

Summary

These proceedings arise from improper Commission registration and failure to disclose a conflict of interest involving William M. Malloy, III (“Malloy”) and two investment adviser firms under his control, MWM 1835, LLC (“MWM”) and Fortress Investment Management, LLC (“Fortress”).

In January 2014, MWM registered with the Commission as an investment adviser at Malloy’s direction. MWM registered based on the premise that it would reach \$100 million in regulatory assets under management (“RAUM”) within 120 days and therefore be eligible to remain registered. As the 120-day mark approached, MWM staff reported to Malloy that they believed the firm had no more than \$10 million in RAUM. Nonetheless, MWM remained improperly registered for months while Malloy maintained that the firm’s RAUM included more than \$100 million in assets in which he held a personal interest. Yet as Malloy knew or was reckless in not knowing, his occasional discussions with an MWM investment adviser representative regarding general investment strategies or investment ideas for these assets were not a sufficient basis to include them in MWM’s RAUM.

During 2014 and 2015, advisory clients of MWM and Malloy held approximately \$2.6 million in investments in a private fund called Income Opportunity Capital, LLC (“IOC”). IOC was managed by Fortress, which Malloy controlled. At Malloy’s direction, IOC invested heavily in securities issued by an entity in the Oregon-based Aequitas enterprise (“Aequitas”).² At the same time, Aequitas was paying Fortress a monthly fee for consulting and business development services that included introducing prospective investors to Aequitas. These payments created a conflict of interest that Malloy did not disclose to the MWM clients who invested in IOC. Clients did receive information broadly identifying a potential conflict of interest, but it was insufficient to allow them to provide informed consent to the actual conflict that existed.

¹ The findings herein are made pursuant to Respondents’ Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

² In March 2016, the Commission commenced an action charging several Aequitas companies and officers with fraudulent sales of more than \$300 million in securities. See *SEC v. Aequitas Management, LLC, et al.*, No. 3:16-cv-00438-PK (D. Or. filed March 10, 2016).

Respondents

1. **William M. Malloy, III**, age 43, resides in La Jolla, California. Malloy's marital trust owned 95 percent of MWM and 100 percent of Fortress. Malloy was a Manager of both entities and controlled them. Through his control of Fortress, Malloy controlled IOC.
2. **Fortress Investment Management, LLC** is a Delaware limited liability company formed by Malloy in April 2011 and owned by Malloy's marital trust. Fortress served as manager and investment adviser to IOC and also conducted non-advisory business operations.³

Other Relevant Entities

3. **MWM 1835, LLC** is a Delaware limited liability company formed by Malloy in October 2013. Malloy's marital trust owns 95 percent of MWM. MWM became registered with the Commission as an investment adviser in January 2014 and withdrew its registration in June 2015. MWM currently conducts no investment advisory or other operations.
4. **Income Opportunity Capital, LLC** was a Delaware limited liability company formed by Malloy in January 2010 that invested in private credit strategies, including Aequitas securities. IOC was liquidated in September 2015. At its peak, it had approximately \$5.4 million in assets.

Facts

Malloy Aided and Abetted MWM's Improper Registration with the Commission

5. Malloy formed MWM in October 2013 for the purpose of conducting an investment advisory business. At all times, MWM had no more than ten employees. Malloy used the title "Chairman" of MWM and controlled the firm.
6. In January 2014, at Malloy's direction, MWM became registered with the Commission as an investment adviser. The registration was based on the premise that MWM would reach \$100 million in regulatory assets under management ("RAUM") within 120 days and therefore be eligible to remain registered.
7. As the 120-day deadline approached, Malloy knew that MWM's outside compliance consultant had advised that if MWM did not reach \$100 million in RAUM by the deadline, it would be required to withdraw its Commission registration and register with the state of California instead. Also as the deadline approached, MWM staff provided reports to Malloy indicating they believed the firm had no more than \$10 million in RAUM.

³ From January to May 2015, Fortress was designated a relying adviser on MWM's Form ADV filed with the Commission.

8. The \$10 million figure did not count certain closely held assets in which Malloy had a personal interest (“the closely held assets”). Malloy had occasional discussions with an MWM investment adviser representative regarding general investment strategies or investment ideas for the closely held assets. But MWM did not provide continuous and regular supervisory or management services for the closely held assets, as the Commission’s Form ADV required for those assets to be included in MWM’s RAUM figure.

9. On May 9, 2014, MWM filed a Form ADV with the Commission stating that MWM had approximately \$104 million in RAUM and continuing the firm’s registration with the Commission. Malloy learned of this filing within a week.

10. MWM’s chief compliance officer (“CCO”) learned of the RAUM figure in the Form ADV after it was filed, and starting on June 1, 2014, the CCO made several requests to Malloy to identify the basis for the \$104 million. The CCO framed the issue as one requiring immediate attention. Malloy responded by referring the CCO to other MWM staff and telling the CCO that he would address the issue only after the CCO completed certain unrelated tasks.

11. Then, in early July 2014, Malloy directed the CCO to documents purporting to show that in March 2014, MWM had entered a written investment management agreement with four entities that controlled the closely held assets. The purported agreement covered approximately \$101 million in assets of the four entities. These documents were misleading because, as Malloy knew, or was reckless in not knowing, MWM was not providing continuous and regular supervisory or management services for the assets.

12. Over the next few months, the CCO, Malloy, and others on MWM’s staff worked to determine MWM’s RAUM figure in accordance with the instructions to Form ADV. After conferring with outside counsel, the outside compliance consultant, and Malloy, the CCO concluded in November 2014 that MWM then had approximately \$13 million in RAUM (having added approximately 50 new clients since May 2014). With Malloy’s agreement, the CCO then notified Commission staff that MWM had begun the process of withdrawing from Commission registration and registering with the state of California.

Malloy Failed to Disclose an Aequitas-Related Conflict of Interest

13. Some of Malloy and MWM’s advisory clients were invested in IOC, which Malloy managed through IOC’s investment adviser, Fortress, which was wholly owned by Malloy’s marital trust. IOC’s stated investment strategy was to invest primarily in private credit strategies, with an emphasis on investing in Aequitas securities. From 2013 to 2015, Malloy, through Fortress, directed IOC to invest in multiple promissory notes issued by Aequitas Commercial Finance, LLC (“ACF”), an Aequitas entity. At all times from 2014 through IOC’s liquidation in September 2015, ACF promissory notes made up more than 95 percent of the investment assets held by IOC.

14. In February 2014, Malloy caused Fortress to enter into a consulting services agreement with Aequitas Capital Management, Inc. (“ACM”), the Aequitas entity that served as the manager of ACF. Under the agreement, ACM paid Fortress a flat fee of approximately \$15,000 per month for performing consulting and business development services that included introducing prospective investors to Aequitas. While the agreement was in effect during 2014 and 2015, IOC purchased approximately \$1 million of ACF promissory notes at the direction of Malloy and Fortress, and thirteen advisory clients of MWM and Malloy were invested in IOC.

15. As an investment adviser, Malloy was obligated to fully disclose all material facts to advisory clients, including any conflicts of interest with advisory clients. To meet this obligation, Malloy was required to provide advisory clients with information sufficiently specific so that the clients could understand any conflict of interest and make an informed decision whether to provide consent to the conflict.

16. The Fortress-ACM agreement incentivized Malloy, through his control of Fortress, to invest IOC in Aequitas, rather than other investments, using the assets that MWM clients invested in IOC. The agreement therefore created a conflict of interest between Malloy and MWM clients. Yet Malloy took no steps to disclose the agreement to clients, and it was not disclosed.

17. Clients did receive information broadly identifying a potential conflict of interest, but it was not sufficient to allow them to provide informed consent to the actual conflict that existed. IOC investors were provided with IOC’s limited liability company agreement and an IOC private placement memorandum approved by Malloy. These documents included statements that Fortress or its personnel “may” work for and receive compensation from companies in which IOC invested. But clients were not informed that Aequitas, in which IOC was heavily invested, in fact was compensating Fortress for the services described above.

18. While the Fortress-ACM agreement was in effect, IOC paid Fortress approximately \$45,040 in management fees that were assessed on capital of MWM clients which was invested in IOC, and, in turn, invested in ACF promissory notes by IOC.

Violations

19. As a result of the conduct described above, MWM willfully violated Section 203A of the Advisers Act by improperly registering with the Commission. Malloy willfully aided and abetted and caused MWM’s violation of Section 203A.

20. As a result of the conduct described above, Malloy willfully violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from “engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.” Proof of scienter is not required to establish a violation of Section 206(2). *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)). Fortress was a cause of Malloy’s violations of Section 206(2).

Undertaking

21. Malloy has undertaken to provide to the Commission, within 30 days after the end of the 12-month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV.B below.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Malloy cease and desist from committing or causing any violations and any future violations of Sections 203A and 206(2) of the Advisers Act; and Fortress cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act.

B. Malloy be, and hereby is:

suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, for a period of 12 months, effective on the second Monday following the entry of this Order; and

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, for a period of 12 months, effective on the second Monday following the entry of this Order.

C. Malloy shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$50,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

D. Fortress shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$50,000, disgorgement in the amount of \$45,040, and prejudgment interest in the amount of \$9,057 to the Securities and Exchange Commission. If timely payment of disgorgement and prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600, and if timely payment of the civil money penalty is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

E. Payment of the above disgorgement, prejudgment interest, and civil money penalty amounts must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondents 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) Respondents 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 Malloy and Fortress as Respondents 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 Steven D. Buchholz, Assistant Regional Director, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, California, 94104.

F. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement, prejudgment interest and penalties referenced in paragraphs IV.C and IV.D 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, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they 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 one or both Respondents 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.

G. Malloy shall comply with the undertaking enumerated in Section III.21 above.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Malloy, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Malloy under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Malloy of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Vanessa A. Countryman
Secretary