

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3960 / October 29, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16223

In the Matter of

**SANDS BROTHERS ASSET
MANAGEMENT, LLC, STEVEN
SANDS, MARTIN SANDS AND
CHRISTOPHER KELLY,**

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**

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 (the “Advisers Act”) against Sands Brothers Asset Management, LLC (“SBAM”), Steven Sands (“S. Sands”), Martin Sands (“M. Sands”) and Christopher Kelly (“Kelly”) (collectively, “Respondents”).

II.

A. SUMMARY

After an investigation, the Division of Enforcement alleges that:

1. For the fiscal years 2010, 2011 and 2012, SBAM failed to timely distribute audited financial statements to the investors of the pooled investment vehicles managed by SBAM in violation of the “custody rule” – Rule 206(4)-2 under Section 206(4) of the Advisers Act – and without regard to an Order issued by the Commission in October 2010 requiring SBAM, S. Sands and M. Sands to cease and desist from violating or causing any future violations of that rule.

2. S. Sands, M. Sands and Kelly – respectively, the two co-chairmen, and the Chief Compliance/Chief Operating Officer of SBAM – aided, abetted and caused SBAM’s custody rule violations, and ignored the Commission’s 2010 Cease-And-Desist Order by failing to implement any procedures or safeguards to ensure compliance. In fact, none of the Respondents made adequate efforts to ensure that SBAM met its custody rule obligations, either by disseminating the audited financial statements that investors in SBAM’s-managed funds were entitled to receive, or alternatively by submitting to a surprise examination to verify client assets.

B. RESPONDENTS

3. **SBAM** is a New York limited liability company formed in June 1998, which has been registered with the Commission as an investment adviser since July of that same year. SBAM maintains offices in New York, Connecticut and California, and provides investment advisory services to various pooled investment vehicles. As of July 2014, SBAM had approximately \$64 million under management.¹ SBAM is owned by the Julios and Targhee Trusts, which are set up for the benefit of the families of M. Sands and S. Sands, SBAM’s principals. In 2010, SBAM was the subject of a settled administrative proceeding, *In re Sands Brothers Asset Management LLC, et al.*, Release No. 3099 (Oct. 22, 2010) (“*In re SBAM*”), by which the Commission censured SBAM, ordered it to cease and desist from violating the Advisers Act, including Rule 206(4)-2, and ordered it to pay a \$60,000 civil money penalty. SBAM has consented to sanctions by the Connecticut Department of Banking for violations of Section 36b-23 of the Connecticut Uniform Securities Act and a prior consent order entered into with that agency. See Stipulation and Agreement, *In the Matter of Sands Brothers Asset Management LLC*, Docket No. RCF-2007-7093-S (September 9, 2009).

4. **S. Sands**, age 55, resides in Locust Valley, New York. He is a principal, co-founder, and controlling person of SBAM, and acts as a senior portfolio manager. He is also a controlling person or director of the managing members / general partners for the pooled investment vehicles that SBAM advises. S. Sands held Series 7, 24 and 63 licenses while previously employed at a number of broker dealers, including Lane Capital Markets, LLC, Laidlaw & Company, Ltd. and Sands Brothers & Co. In 2010, in *In re SBAM*, the Commission censured S. Sands and imposed a cease-and-desist order against him for, among other things, violating Rule 206(4)-2. S. Sands has been sanctioned by the securities authorities in Wisconsin (Consent Order of Prohibition, Case No. X-91034(L) (May 21, 1991)), had his license suspended and been fined by the NASD (Decision & Order of Offer of Settlement, NASD Case No. E102004106801 (July 25, 2006)), and had his broker-dealer registration subject to a number of conditions by Connecticut (Stipulated Agreement Conditioning Registration, No. ST-09-7655-S (July 31, 2009)). S. Sands has also been the subject of a number of customer complaints concerning misappropriation of assets, at least one of which resulted in an NASD arbitration award of \$2.15 million. See *Ramberg v. Sands Brothers & Co.*, No. 03-09201, 2004 WL 2093154 (Sept. 3, 2004).

¹ SBAM is appropriately registered with the Commission under the Advisers Act, because its principal office and place of business is in New York State, which does not subject state-registered advisers to routine examinations. See 15 U.S.C. § 80b-3a(a)(2)(B)(i).

5. **M. Sands**, age 53, resides in Greenwich, Connecticut. He is a principal, co-founder, and controlling person of SBAM, and acts as a senior portfolio manager. He is also a controlling person or director of the managing members / general partners for the pooled investment vehicles that SBAM advises. M. Sands held Series 3, 7, 8, 24, 63 and 65 licenses while previously employed at a number of broker dealers, including Lane Capital Markets, LLC, Laidlaw & Company, Ltd. and Sands Brothers & Co. In 2010, in *In re SBAM*, the Commission censured M. Sands and imposed a cease-and-desist order against him for, among other things, violating Rule 206(4)-2. M. Sands has been sanctioned by the securities authorities in Wisconsin (Consent Order of Prohibition, Case No. X-91034(L) (May 21, 1991)), twice been temporarily barred from association or suspended from holding supervisory positions, censured and fined by the New York Stock Exchange (*In re Sands Brothers & Co.*, Panel Decision 00-174 (Oct. 5, 2000); *In re Martin Scott Sands*, Panel Decision 03-222 (Dec. 18, 2003)), had his broker-dealer registration and his investment adviser agent registration subject to a number of conditions by Connecticut (Consent Order Conditioning Registration, No. CO-04-7093-S (Nov. 29, 2004)), and consented to withdrawal of his salesperson registration in Illinois (Consent Order of Withdrawal, No. 0400325 (May 16, 2005)). M. Sands has also been the subject of a number of customer complaints concerning misappropriation of assets, at least one of which resulted in an NASD arbitration award of \$2.15 million. *See Ramberg*, 2004 WL 2093154.

6. **Kelly**, age 57, resides in Greenwich, Connecticut. From 2008 through at least May 2014, Kelly was the Chief Compliance Officer, Chief Operating Officer and a partner at SBAM. According to the reports prepared by an independent compliance consultant retained by SBAM as a result of disciplinary proceedings instituted by the Connecticut Department of Banking, Kelly was responsible for all of SBAM's operations other than those that involved investment decision-making. Kelly is a lawyer and is presently licensed to practice in New York. Kelly previously held a Series 7 license.

C. **FACTS**

The Custody Rule

7. Rule 206(4)-2, promulgated under Section 206(4) of the Advisers Act (the "custody rule"), is designed to protect investor assets. The custody rule requires that advisers who have custody of client assets put in place a set of procedural safeguards to prevent loss, misuse or misappropriation of those assets.

8. An adviser has "custody" of client assets if it holds, directly or indirectly, client funds or securities, or if it has the ability to obtain possession of those assets. 17 C.F.R. § 275.206(4)-2(d)(2).

9. An adviser who has custody must, among other things: (i) ensure that a qualified custodian maintains the client assets; (ii) have a reasonable basis for believing that the qualified custodian sends quarterly account statements to clients; and (iii) ensure that client funds and securities are verified by actual examination each year by an independent public accountant. *Id.* § 275.206(4)-2(a)(1), (3), (4).

10. The custody rule provides an alternative for advisers to pooled investment vehicles. In relevant part, the rule prescribes that an adviser “shall be deemed to have complied with” the independent verification requirement if the adviser “distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its fiscal year.” *Id.* § 275.206(4)-2(b)(4)(i). The accountant performing the audit must be an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board. *Id.* § 275.206(4)-2(b)(4)(ii). An adviser that takes this approach is also not required to satisfy the account statements delivery requirement described above. *Id.* § 275.206(4)-2(b)(4).

SBAM’s History of Non-Compliance with the Custody Rule

11. SBAM provides investment advisory services to a number of pooled investment vehicles. At all times relevant hereto, SBAM served as investment adviser to the following pooled investment vehicles: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP, Vantage Point Partners LP, Select Access LLC, Select Access (Institutional) LLC, Select Access III LLC, and SB Opportunity Technology Associates Institution LLC.

12. In 1999, the staff of the Commission’s Office of Compliance Inspection and Examinations (“OCIE”) performed an examination of SBAM. As a result of that examination, a deficiency letter was issued that concluded, among other things, that SBAM wrongly stated in its Form ADV that it does not have custody of client assets. To the contrary, by virtue of the relationship of the Adviser to its pooled investment vehicles, and the relationship between S. Sands and M. Sands and the managing members / general partners of those vehicles, SBAM did in fact appear to have custody of client assets.²

13. The deficiency letter, addressed to M. Sands, went on to spell out some of the requirements that SBAM had to meet as a custodian of investor assets.

14. In 2010, as a result of subsequent OCIE examinations in 2004 and 2009 and an investigation by the Division of Enforcement, SBAM, M. Sands and S. Sands consented, without

² All but one of the funds at issue in the 1999 deficiency letter were different from the funds that SBAM advises today. Nonetheless, the arrangements cited in 1999 leading the staff to conclude that SBAM had custody over client assets exist with respect to SBAM’s current funds. As to the one fund that SBAM still advises that was addressed in the 1999 deficiency letter – Katie and Adam Bridge Partners, L.P. – the exam staff concluded that SBAM appeared to have custody of investor assets because a provision in the Limited Partnership Agreement provided that the General Partner, controlled by S. Sands and M. Sands, had authority to “open, maintain, and close bank accounts and draw checks or other orders for the payment of monies....” That arrangement remained the same.

admitting or denying the findings therein, to the entry of an Order Instituting Settled Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act (the “2010 Order”).

15. Among other findings, the Commission’s 2010 Order found that SBAM willfully violated the custody rule by improperly relying on the pooled investment vehicle alternative, which allowed for the distribution of audited financial statements in lieu of submitting to a surprise examination by an independent public accountant to verify custody of assets, among other requirements. In particular, SBAM: (i) failed to submit to an adequate audit performed in accordance with generally accepted standards; and (ii) did not timely distribute audited financial statements. The Commission’s 2010 Order further found that SBAM continued to state in its Forms ADV that it did not have custody over client funds when, in fact, it did.³ (2010 Order ¶¶ 7-11.)

16. The Commission’s 2010 Order concluded that, as the lead principals primarily responsible for the relevant SBAM actions, S. Sands and M. Sands willfully aided, abetted and caused SBAM’s violations of the custody rule. (*Id.* ¶¶ 4, 13(e).)

17. In light of these and other violations of the Advisers Act, the Commission’s 2010 Order ordered that: (i) SBAM, S. Sands and M. Sands cease and desist from committing or causing violations or future violations of, among other things, the custody rule; (ii) SBAM, S. Sands and M. Sands be censured; and (iii) SBAM pay a civil money penalty of \$60,000. (*Id.* § IV(A)-(C).)

SBAM Continued to Violate the Custody Rule After the 2010 Order

18. The 2010 Order notwithstanding, SBAM failed to comply with the custody rule in the years that followed. SBAM neither submitted to a surprise examination, nor distributed its audited financials in the 120-day window imposed by the rule. Indeed, SBAM took no remedial action in response to the 2010 Order to implement policies or procedures aimed at ensuring compliance with the custody rule.

19. For the period 2010 through 2012, SBAM had custody of client assets within the meaning of Rule 206(4)-2(d)(2). At no time from 2010 through the present has SBAM submitted to a surprise examination by an independent public accountant.

³ In addition to the custody rule deficiencies, the 2010 Order found violations of Advisers Act Section 204 and Rule 204-2 for failing to make, keep and furnish copies of certain books and records to the Commission, and Sections 204 and 207 and Rule 204-1 for making inaccurate statements in, and failing to properly file, its Form ADV.

20. SBAM distributed its funds' audited financial statements for the fiscal years 2010 – 2012 after the 120-day custody rule deadline.⁴

- a. Audited financial statements for the fiscal year 2010 were distributed at least 40 days late for the following funds: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP and Vantage Point Partners LP (collectively, the "Ten Funds");
- b. Audited financial statements for the fiscal year 2011 were distributed at least 191 days (over 6 months) late and up to 242 days (nearly 8 months) late for the Ten Funds; and
- c. Audited financial statements for the fiscal year 2012 were distributed at least 84 days and up to 93 days (approximately 3 months) late for the Ten Funds.

21. The circumstances that led the audits to be delayed were predictable and not unforeseeable. As SBAM's auditors noted with respect to the audit for the fiscal year 2012, "[t]here was a delay in the timely receipt from [SBAM] management of the information supporting the valuation of non-performing loans . . . which significantly affected the completion of the audit and the timely issuance of the financial statements." The conditions underlying that delay "were known or identifiable before the commencement of the audits," and therefore "a more proactive timely approach by your valuation staff in identifying these situations and obtaining the necessary documentation . . . could alleviate most of the audit issues." Indeed, the auditors had repeated difficulty obtaining the information they needed to value the same portfolio companies year over year. This was so even though for some of those companies, S. Sands and/or M. Sands served on the company's board, and for one such portfolio company, Kelly acted as President and Chief Executive Officer.

22. S. Sands and M. Sands knew or were reckless in not knowing about, and substantially assisted, SBAM's violations of the custody rule. In the wake of the 2010 Order – which specifically found that S. Sands and M. Sands aided, abetted and caused SBAM's custody rule violations – S. Sands and M. Sands were aware of the custody rule requirements; indeed, S. Sands and M. Sands executed a notarized offer of settlement to enter into the 2010 Order. And, they knew about SBAM's failure to timely distribute audited financial statements because they regularly communicated with the auditors during the audit process and signed representation letters immediately prior to the completion of each year's audit. Further, as the principals and founders of SBAM, S. Sands and M. Sands were responsible for ensuring that SBAM's

⁴ Even after SBAM, S. Sands, and M. Sands received Wells notices in April 2009 and engaged in negotiations leading to the 2010 Order (but prior to the Order's issuance), SBAM was two weeks late sending out financials for four funds – Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, and Sands Brothers Venture Capital IV LLC – for the fiscal year 2009.

compliance personnel has the authority to implement whatever procedures and policies are necessary to ensure that SBAM complied with the Advisers Act. Additionally, as subjects of the 2010 Order, they were responsible for ensuring that SBAM did not engage in future violations of the custody rule.

23. Kelly knew or was reckless in not knowing about, and substantially assisted, SBAM's violations of the custody rule. Kelly executed the notarized offer of settlement to enter into the 2010 Order on behalf of SBAM. Further, SBAM's compliance manual tasked Kelly with "ensur[ing] compliance with the restrictions and requirements of Rule 206(4)-2 adopted under the Advisers Act." Kelly engaged the auditors for full audits (but not surprise examinations); he also signed representation letters to, and was a principal contact for, the auditors. He knew that the audited financial statements were not being distributed on time. Despite his responsibility to do so, Kelly, who was responsible for compliance and for all of SBAM's non-investment operations, implemented no policies or procedures to ensure compliance with the custody rule – even after the 2010 Order and after SBAM continued to miss its custody rule deadline year after year. At most, he simply reminded people of the custody rule deadline without taking any more substantial action. Kelly did not make any attempt to notify the staff of the Commission of any difficulties the Adviser was encountering in meeting the custody rule deadlines.

D. VIOLATIONS

24. As a result of the conduct described above, SBAM willfully violated Section 206(4)-2 of the Advisers Act, which prohibits a registered investment adviser from engaging in fraudulent, deceptive or manipulative conduct, and Rule 206(4)-2 thereunder, which requires an adviser to take certain enumerated steps to safeguard client assets over which it has custody.

25. As a result of the conduct described above, S. Sands, M. Sands and Kelly willfully aided and abetted and caused SBAM's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against SBAM, pursuant to Section 203(e) of the Advisers Act, including, but not limited to, censure, limitations on its activities, functions or operations, suspension or revocation of its registration, and civil penalties pursuant to Section 203 of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against S. Sands, M. Sands, and Kelly, pursuant to Section 203(f) of the Advisers Act, including, but not limited

to, censure, limitations on their activities, suspension or bar from association with an investment adviser, broker, dealer, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical ratings organization, and civil penalties pursuant to Section 203 of the Advisers Act;

D. Whether, pursuant to Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of, Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, and whether Respondents should be ordered to pay civil penalties pursuant to Section 203(i) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened *not earlier than 30 days and not later than 60 days from service of this Order* at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that each Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as under Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not “rule making” within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary