

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 87100 / September 25, 2019

INVESTMENT ADVISERS ACT OF 1940
Release No. 5369 / September 25, 2019

ADMINISTRATIVE PROCEEDING
File No. 3-19514

In the Matter of

Hefren-Tillotson, 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 AND SECTION 15(b)(4) OF THE SECURITIES EXCHANGE ACT OF 1934, 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”) and Section 15(b)(4) of the Securities Exchange Act of 1934 (“Exchange Act”) against Hefren-Tillotson, Inc. (“Hefren” 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 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, 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 and Section 15(b)(4) of the Securities Exchange Act of 1934, 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. Hefren is a registered investment adviser and broker-dealer and from 2014 to 2017 received undisclosed financial compensation of \$1.95 per client trade from its unaffiliated clearing broker (the "Clearing Broker"). The Clearing Broker charged Hefren clients a \$7.95 "Service Charge" that Hefren originally designed to equal the Clearing Broker's charges for clearing and executing trades. Over time, however, the Clearing Broker's fee to Hefren for clearing and execution decreased to \$6.00 per transaction, yet the Service Charge stayed the same. This resulted in Hefren receiving the difference (*i.e.*, \$1.95). Although Hefren told clients that they would pay \$7.95 to trade individual stocks, exchange-traded funds, and closed end funds, Hefren did not inform advisory clients that it received any compensation for acting as introducing broker for client trades or that this compensation created a conflict of interest. The undisclosed compensation also caused Hefren to breach its fiduciary duty to seek best execution for its advisory clients and as a result, Hefren violated Section 206(2) of the Advisers Act.

Respondent

2. Hefren is a Pennsylvania corporation with its principal place of business in Pittsburgh, Pennsylvania. Hefren has been registered with the Commission as a broker-dealer since 1962 and as an investment adviser since 1997. As of January 24, 2018, Hefren reported over \$7.5 billion of regulatory assets under management.

Undisclosed Brokerage Compensation Paid by Hefren Advisory Clients

3. Since 2002, Hefren has used the Clearing Broker – an unaffiliated broker-dealer – as its preferred clearing broker and custodian for advisory clients. Hefren disclosed that it would use the Clearing Broker and that clients would pay a \$7.95 transaction fee for clearing and executing a trade. Hefren, however, never told clients that it would receive compensation from the Clearing Broker on client trades.

4. Hefren negotiated a Fully Disclosed Clearing Agreement ("FDCA") with the Clearing Broker in 1992, which was amended several times, most recently in 2017. The FDCA, among other things, sets forth the amounts Hefren pays the Clearing Broker for providing execution, clearing, and custody for Hefren's clients. While the FDCA required Hefren to pay the Clearing Broker for clearing and execution, Hefren's Forms ADV disclosed that clients would pay these fees. To accomplish this, starting in 2002, the Clearing Broker charged Hefren clients a

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.

\$7.95 fee (called a “Service Charge” on client confirmations) on each trade, which at the time equaled what the Clearing Broker charged Hefren for clearing and execution.

5. Hefren’s clearing and execution costs declined over time, reaching \$6.00 per trade by 2012. The Service Charge, however, remained unchanged, with Hefren receiving the difference. As a result, by 2012, Hefren was receiving \$1.95 on each client trade and from 2014 through 2017, Hefren kept \$254,060 in excess fees.

6. Hefren’s receipt of the excess fees was a conflict of interest that should have been disclosed to its clients. First, an adviser who receives compensation from its clearing broker on advisory client trades has an incentive to enter into more transactions for clients. Second, it creates an incentive for an adviser to use a clearing broker that pays it a portion of its Service Charge over another broker that does not allow these payments.

Hefren’s Disclosure Failures Related to the Service Charge

7. Hefren did not adequately disclose in its Form ADV Part 2A (“Brochure”) that it received transaction-based compensation or the associated conflicts of interest. In particular, Hefren’s Form ADV explained that the firm recommends clients “use [Hefren’s] broker-dealer services” and the Clearing Broker for executing and clearing trades. Since Hefren is dually registered as a broker-dealer and adviser, clients “have flexibility in how they pay for professional services” which include “commissions, fees, or a combination of both.” For advisory clients, Hefren’s compensation was “primarily through an advisory fee” and pursuant to an Investment Advisory Agreement (“IAA”), Hefren charged clients a management fee based on a percentage of a client’s assets under management. Both the Brochure and IAA informed clients that in addition to the advisory fee, clients would pay the Clearing Broker’s transaction expenses. For example, Hefren’s 2016 Brochure explains that “common stock and exchange traded funds are subject to a \$7.95 flat fee on buy and sell transactions.” Hefren, however, did not tell clients that it would receive a portion of the Service Charge.

8. Item 5 of the Brochure requires advisers to disclose if clients will incur brokerage and other transaction costs. In response to Item 5, Hefren stated that in addition to its advisory fee, “[s]mall transaction fees may be incurred.” There is no discussion that Hefren would receive a portion of the Clearing Broker’s Service Charge on client trades.

9. Item 12.A of the Brochure requires advisers that “routinely recommend, request or require” clients to execute transactions through a specified broker-dealer, to describe the factors that the adviser considers in recommending a broker-dealer for client transactions, to describe “any economic relationship” with the broker-dealer “that creates a material conflict of interest,” and to

discuss that conflict of interest.² In response to Item 12.A, Hefren disclosed that the firm is both an investment adviser and broker dealer and when the firm buys or sells securities, it will use Hefren to introduce trades to the Clearing Broker for execution and clearing. Hefren disclosed that its “registered representatives earn commissions for executing trades for some of the firm’s investment adviser clients” and commissions may be kept by the firm. Hefren acknowledged that “[t]hese conditions ... [are a] permissible conflict of interest as long as [Hefren] disclose[s] these arrangements” to clients. The Brochures, however, did not identify any other conflicts of interest from using the Clearing Broker to execute and clear client trades. For example, Hefren never disclosed that selecting the Clearing Broker allowed Hefren to receive additional compensation on each client trade or that the Service Charge was not based on the Clearing Broker’s actual execution and clearing fees for the particular transaction or that it received the excess fees. Hefren also did not disclose, either in the IAA – which all advisory clients must sign – or elsewhere that Hefren received undisclosed compensation from its clearing broker.

10. During the Commission’s investigation, Hefren conducted an analysis regarding the firm’s receipt of undisclosed financial compensation from the Clearing Broker during the relevant period, which it shared with Commission staff. Hefren also updated its Form ADV disclosures after deciding to discontinue its practice of receiving a portion of the Clearing Broker’s Service Charge.

Hefren’s Failure to Provide Best Execution

11. Hefren did not fulfill its obligation to provide best execution. In its Forms ADV, Hefren did not discuss the firm’s best execution policies. The Brochures only inform clients that they “are not required to use [Hefren’s] brokerage services, however most of our advisory Clients choose to do so. If a Client directs [the firm] to use a broker-dealer other than our own to execute” trades, clients “may pay higher transaction prices and commissions than those paid by Clients who use [Hefren] brokerage services. Nonetheless, we work closely with our Clients to help select a brokerage partner to meet your unique investment needs.” The Brochures fail to mention that Hefren had advisory clients pay \$7.95 to buy and sell securities irrespective of the actual transaction costs for those trades. This amount was usually more than the Clearing Broker’s actual charges and the \$7.95 Service Charge had no correlation to the brokerage services Hefren provided for the client.

VIOLATIONS OF THE LAW

12. Section 206(2) of the Advisers Act makes it unlawful for any investment adviser to use any means or instrumentality of interstate commerce to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. Scierter is

² Hefren should have also disclosed this compensation in response to Item 14.A of the Brochure which requires advisers to disclose compensation received from third parties in connection with providing investment advisory services to clients.

not required to establish a violation of Section 206(2), but rather such violation may be based on a finding of 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, 194-95 (1963)). As a result of the conduct described above, Hefren willfully³ violated Section 206(2).

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 Sections 203(e) and 203(k) of the Advisers Act and Section 15(b)(4) of the Exchange Act, it is hereby ORDERED that:

- A. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act.
- B. Respondent is censured.
- C. Respondent shall pay disgorgement, prejudgment interest, and a civil penalty as follows:
 - (i) Respondent shall pay disgorgement of \$254,060; prejudgment interest of \$45,905.29; and a \$80,000 civil penalty, for a total of \$379,965.29 consistent with the provisions of this Subsection C;
 - (ii) Within ten (10) days of the entry of this Order, Respondent shall deposit \$254,060 in disgorgement; \$45,905.29 in prejudgment interest; and \$80,000 civil penalty, for a total of \$379,965.29 (the "Fair Fund") into an escrow account at a financial institution not unacceptable 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 of disgorgement and prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 [17

³ "Willfully," for purposes of imposing relief under Section 203(e) of the Advisers Act and Section 15(b)(4) of the Exchange 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).

C.F.R. § 201.600] and if timely payment of a civil money penalty is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

- (iii) Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the distribution of the disgorgement, prejudgment interest, and civil penalty paid by Respondent pursuant to this Order to Affected Clients, as that term is defined below in Paragraph (v) of this Subsection C. 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 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 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 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 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.
- (iv) Respondent shall be responsible for administering the Fair Fund and may hire a professional to assist it in the administration of the distribution. The costs and expenses of administering the Fair Fund, including any such professional services, shall be borne by Respondent and shall not be paid out of the Fair Fund.
- (v) Respondent shall pay from the Fair Fund to each current or former advisory client who paid a Service Charge that was greater than Hefren's actual clearing and execution charges ("Affected Clients") during the time period January 1, 2014 through June 9, 2017 (the "Relevant Period") the difference between the Service Charge and what Respondent paid the Clearing Broker for clearing and executing the trade 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. No portion of the Fair Fund shall be paid to any Affected Clients in which Respondent or any of its current or former officers, directors, Investment Adviser Representatives, or registered representatives has a financial interest.
- (vi) Respondent shall, within thirty (30) days of the entry of this Order, submit a proposed Calculation to the Commission staff for review and approval by the Commission staff. At or around the time of submission of the proposed Calculation

to the staff, Respondent, along with any third-parties or professionals retained by Respondent to assist in formulating the methodology for its Calculation and/or administration of the Distribution, will make themselves available for a conference call with the Commission staff to explain the methodology used in preparing the proposed Calculation and its implementation, and to provide the staff with an opportunity to ask questions. Respondent shall also provide to the Commission staff such additional information and supporting documentation as the Commission staff may reasonably 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 ten (10) days of the date that Respondent is notified of the objection. The revised Calculation shall be subject to all of the provisions of this Subsection C.

- (vii) After the Calculation has been approved by the Commission staff, Respondent shall submit a payment file (the "Payment File") for review and acceptance by the Commission staff demonstrating the application of the methodology to each Affected Client. The Payment File should identify, at a minimum: (1) the name of each Affected Client, and (2) the exact amount of the payment to be made from the Fair Fund to each affected investor; and (3) the amount of any *de minimis* threshold to be applied.
- (viii) Respondent shall complete the disbursement of all amounts payable to Affected Clients within ninety (90) days of the date of receipt of the Commission staff approval of the Payment File, unless such time period is extended as provided in Paragraph (xii) of this Subsection C.
- (ix) If Respondent is unable to distribute or return any portion of the Fair Fund for any reason, including an inability to locate an affected investor or a beneficial owner of an affected investor account or any factors beyond Respondent's control, Respondent shall transfer any such undistributed funds to the Commission for eventual transmittal to the United States Treasury in accordance with Section 21F(g)(3) of the Exchange Act, when the distribution is complete and before the final accounting provided for in Paragraph (xi) of this Subsection C is submitted to 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 Hefren-Tillotson, Inc. as a 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 Paul Montoya, Assistant Regional Director, Asset Management Unit, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 1450, Chicago, IL, 60604.

- (x) A Fair 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 Fair Fund, including but not limited to tax obligations resulting from the Fair Fund's status as a QSF and the Foreign Account Tax Compliance Act, 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 Fair Fund
- (xi) Within one hundred fifty (150) days after Respondent completes the distribution of the Fair Fund as described in Paragraph (viii) of this Subsection C, Respondent shall return all undisbursed funds to the Commission pursuant to the instruction set forth in Paragraph (ix) of this Subsection C. Respondent shall then submit to the Commission staff for its approval a final accounting and certification of the disposition of the Fair Fund for Commission approval, which shall be in a format to be provided by the Commission staff. The final accounting and certification shall include, but not be limited to: (1) the amount paid to each Affected Client; (2) the date of each payment; (3) the check number or other identifier of money transferred; (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 Fair Fund to Affected Clients in accordance with the Calculation 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 the Commission staff under a cover letter that identifies Hefren-Tillotson, Inc. as a Respondent and the file number of these proceedings to Paul Montoya, Assistant Regional Director, Asset Management Unit, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 1450, Chicago, IL, 60604, or such other address the Commission staff may provide. Respondent shall provide any supporting documentation for the accounting and certification to the Commission staff upon its request and shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.

- (xii) 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 Fair 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