

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 87177 / September 30, 2019

INVESTMENT ADVISERS ACT OF 1940
Release No. 5397 / September 30, 2019

ADMINISTRATIVE PROCEEDING
File No. 3-19570

In the Matter of

**FOUNDERS FINANCIAL
SECURITIES, LLC**

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 Founders Financial Securities, LLC (“Founders” 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 him 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 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 (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

1. These proceedings arise out of breaches of fiduciary duty and inadequate disclosures by Founders, a dually-registered investment adviser and broker-dealer, in connection with its mutual fund share class selection practices and the fees it and its associated persons received or benefited from pursuant to Rule 12b-1 under the Investment Company Act of 1940 ("12b-1 fees"). At times during the relevant period of January 1, 2014 to February 1, 2017 (the "Relevant Period"), Respondent purchased, recommended or held for advisory clients mutual fund share classes that charged 12b-1 fees instead of lower-cost share classes of the same funds for which the clients were eligible. Respondent and its associated persons received or benefited from 12b-1 fees in connection with these investments. Respondent failed to adequately disclose the conflicts of interest related to its receipt of 12b-1 fees and its selection of mutual fund share classes that pay such fees. In addition, Respondent breached its duty to seek best execution for its clients by investing them in mutual fund share classes with 12b-1 fees rather than available lower-cost share classes of the same funds. During the Relevant Period, Respondent and its associated persons received, or benefited from, over \$1.24 million in 12b-1 fees for advising clients to invest in or hold such mutual fund share classes.

2. Founders also failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder in connection with its mutual fund share class selection practices.

3. As a result of this conduct, Founders willfully violated Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.¹

Respondent

4. **Founders Financial Securities LLC ("Founders")**, a Maryland limited liability company, is a dual-registered broker-dealer and investment adviser based in Towson, Maryland. Founders has been registered with the Commission as a broker-dealer and investment adviser since 2006. Founders is a wholly-owned subsidiary of Founders Financial, Inc. On its Form ADV dated March 29, 2019, Founders reported that it had approximately \$1 billion in regulatory assets under management and provided investment advisory services to over 10,000 client accounts through approximately 90 investment adviser representatives ("IARs"), most of whom are also registered representatives of the firm. Founders has no relevant disciplinary history.

¹ Founders was not eligible to self-report pursuant to the Division of Enforcement's Share Class Selection Disclosure Initiative announced in February 2018 because the Division contacted it about the disclosure violations before the initiative was announced.

Background

5. Founders provides advisory services through certain programs, including Independence Advisory Accounts (“IAA”) and Freedom Capital Management Strategies (“FCMS”). These programs enabled Founders’ IARs to invest client assets in various mutual funds across numerous fund complexes. Founders used two third-party broker dealers (“Clearing Brokers”) for clearing, custody and execution services for clients in the IAA and FCMS programs (“Custody Services”).

Mutual Fund Share Class Selection

6. Mutual funds typically offer investors different types of shares or “share classes.” Each share class represents an interest in the same portfolio of securities with the same investment objective. The primary difference among the share classes is the fee structure.

7. For example, some mutual fund share classes charge 12b-1 fees to cover fund distribution and sometimes shareholder service expenses. These recurring fees, which are included in a mutual fund’s total annual fund operating expenses, vary by share class, but typically range from 25 to 100 basis points. They are deducted from the mutual fund’s assets on an ongoing basis and paid to the fund’s distributor or principal underwriter, which generally remits the 12b-1 fees to the broker-dealer that distributed or sold the shares. Here, the 12b-1 fees were paid to the Clearing Brokers, who either passed them on to Founders or used them to offset amounts due from Founders for the cost of client Custody Services.

8. Many mutual funds also offer share classes that do not charge 12b-1 fees (e.g., “Institutional Class” or “Class I” shares (collectively, “Class I shares”)).² An investor who holds Class I shares of a mutual fund will usually pay lower total annual fund operating expenses over time – and thus will almost always earn higher returns – than one who holds a share class of the same fund that charges 12b-1 fees. Therefore, if a mutual fund offers a Class I share, and an investor is eligible to own it, it is often, though not always, better for the investor to purchase or hold the Class I share.

9. During the Relevant Period, Founders’ IARs purchased, recommended or held, on behalf of certain advisory clients, mutual fund share classes that charged 12b-1 fees when those clients were otherwise eligible to invest in lower-cost share classes of those same funds. The Clearing Brokers received 12b-1 fees from the mutual funds in which these advisory clients were invested, and either passed those 12b-1 fees on to Founders directly, or, as to one of the Clearing Brokers, used those fees to offset amounts due from Founders to the Clearing Brokers for Custody Services. Founders therefore received a financial benefit that it would not have had its advisory clients been invested in the lower-cost share classes. Founders paid a portion of the 12b-1 fees received from the Clearing Broker in the IAA program to its IARs.

² Share Classes that do not charge 12b-1 fees also go by a variety of other names in the mutual fund industry, such as “Class F2,” “Class Y” and “Class Z” shares. As used in this Order, the term “Class I shares” refers generically to share classes that do not charge 12b-1 fees.

Disclosure and Best Execution Failures

10. As an investment adviser, Founders was obligated to fully and fairly disclose all material facts to its advisory clients, including any conflicts of interest between itself and its advisory clients that could affect the advisory relationship and how those conflicts could impact advice Founders provided its clients. To meet this obligation, Founders was required to provide its advisory clients with sufficient information so that they could understand Founders' conflicts of interest concerning the firm's advice about investing in the different classes of mutual funds and have a basis on which they could consent to or reject such conflicted transactions.

11. During the Relevant Period, Founders did not disclose in its Forms ADV that advisory clients in the IAA and FCMS programs would be invested in mutual fund share classes that charge 12b-1 fees, and that Founders would receive or benefit from those 12b-1 fees. The client agreements for the IAA and FCMS programs signed by all affected investors stated that mutual funds charge 12b-1 fees and that Founders may receive a portion of those fees. However, Founders did not adequately disclose that it had a conflict of interest as a result of the additional compensation it received or benefited from for investing advisory clients in a fund's 12b-1 fee paying share class when a cheaper share class was available for the same fund. Founders also failed to adequately disclose that it would and did select share classes paying 12b-1 fees when less expensive share classes were available for the same fund.

12. Furthermore, 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. *See, e.g.*, Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, Exchange Act Rel. No. 23170 (Apr. 28, 1986). The Commission has brought several settled enforcement proceedings against investment advisers for failing to seek best execution when the advisers caused clients to purchase a more expensive share class when a less expensive share class of the same fund was available.³ By causing certain advisory clients to invest in fund share classes that charged 12b-1 fees when such clients were otherwise eligible for lower-cost share classes, Founders violated its duty to seek best execution for those transactions.

Compliance Deficiencies

13. During the Relevant Period, Founders failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder in connection with its mutual fund share class selection practices. Founders did not adopt policies and procedures reasonably designed to ensure that advisory clients would be invested in the lowest-cost available share class of mutual funds when doing so would be in the clients' best interests.

³ *See, e.g., In the Matter of SunTrust Investment Services, Inc.*, Advisers Act Rel. No. 4769 (Sept. 14, 2017) (settled order) (collecting cases).

Violations

14. As a result of the conduct described above, Founders willfully⁴ violated Section 206(2) of the Advisers Act, which makes it unlawful for any investment adviser, directly or indirectly, to “engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client.” Scierter is not required to establish a violation of Section 206(2), but rather may rest 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)).

15. As a result of the conduct described above, Founders 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.

Undertakings

16. Founders has undertaken to:

- a. Within 45 days of the entry of this Order, notify affected investors (*i.e.*, those former and current clients who, during the Relevant Period of inadequate disclosure, purchased or held 12b-1 fee paying share class mutual funds when a lower-cost share class of the same fund was available to the client) (hereinafter, “affected investors”) of the settlement terms of this Order in a clear and conspicuous fashion.
- b. Within 60 days of the entry of this Order, certify, in writing, compliance with the undertakings ordered pursuant to Section IV.F., below. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The certification and supporting material shall be submitted to Assunta Vivolo, Assistant Director, Securities and Exchange Commission, Division of Enforcement, 1617 John F. Kennedy Blvd, Ste. 520, Philadelphia, Pennsylvania, 19103, or such other address as the Commission staff may provide,

⁴ “Willfully,” for purposes of imposing relief under Section 15(b) of the Exchange Act and Section 203(e) of the Advisers 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[ed]” material information from a required disclosure in violation of Section 207 of the Advisers Act).

with a copy to the Office of Chief Counsel of the Division of Enforcement, Securities and Exchange Commission, 100 F. Street, NE, Washington, DC 20549.

Remedial Efforts

17. In determining to accept the Offer, the Commission considered remedial acts taken by Respondent, including ending the practice of receiving or benefiting from 12b-1 fees in February 2017, and revising its disclosures and compliance policies and procedures.

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 cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

B. Respondent is censured.

C. Respondent shall pay disgorgement and prejudgment interest to affected investors, totaling \$1,475,465.88 as follows:

(i.) Respondent shall pay disgorgement of \$1,246,133.60 and prejudgment interest of \$229,332.28, consistent with the provisions of this Subsection C and subject to the offset provisions of Subsection C.(vii) below.

(ii.) Within ten (10) days of the entry of this Order, Respondent shall deposit the full amount of the disgorgement and prejudgment interest (the "Distribution Fund") into an escrow account at a financial institution not unacceptable to the Commission staff and Respondent shall provide evidence of such deposit in a form acceptable to the Commission staff. If timely deposit is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 [17 C.F.R. § 201.600].

(iii.) Respondent shall be responsible for administering the Distribution Fund and may hire a professional acceptable to the Commission, at its own cost, to assist it in the administration of the distribution. The costs and expenses of administering the Distribution Fund, including any such professional services, shall be borne by Respondent and shall not be paid out of the Distribution Fund.

(iv.) Respondent shall distribute the amount from the Distribution Fund to each affected investor an amount representing: (a) the 12b-1 fees attributable to the

affected investor during the Relevant Period; and (b) reasonable interest paid on such fees,⁵ 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. The Calculation shall be subject to a de minimis threshold. No portion of the Distribution Fund shall be paid to any affected investor account in which Respondent or its past or present officers or directors have a financial interest.

(v.) Respondent shall, within ninety (90) days of the entry of this Order, submit a Calculation to the Commission staff for review and approval. 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, shall 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 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.

(vi.) Respondent shall, within thirty (30) days of the written approval of the Calculation by the Commission staff, submit a payment file (the “Payment File”) for review and acceptance by the Commission staff demonstrating the application of the methodology to each affected investor. The Payment File should identify, at a minimum: (1) the name of each affected investor, (2) the exact amount of the payment to be made from the Distribution Fund to each affected investor, and (3) the application of a de minimis threshold.

(vii.) Respondent shall disburse all amounts payable to affected investors within 90 days of the date the Commission staff accepts the Payment File unless such time period is extended as provided in Paragraph (x.) of this Subsection C. The amount Respondent pays to affected investors pursuant to this Subsection C will dollar for dollar offset the disgorgement payable to the Commission pursuant to this Subsection C, subject to approval by Commission staff. If, after Respondent’s reasonable efforts to distribute the Distribution Fund pursuant to the approved Payment File, Respondent is unable to distribute any portion of the Distribution

⁵ Reasonable interest will be calculated at the Short-Term Applicable Federal Rate plus three percent (3%), compounded quarterly from the end of the year when Respondent and its associated persons received the 12b-1 fees to June 13, 2019.

Fund for good cause, including factors beyond Respondent's control, Respondent shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury in accordance with Section 21F(g)(3) of the Securities Exchange Act of 1934 when the distribution of the funds is complete and before the final accounting provided for in Paragraph (ix.) below is submitted to Commission staff. Any such payment shall be made in accordance with Section IV.D. below.

(viii.) A Distribution 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 agrees to be responsible for all tax compliance responsibilities associated with distribution of the Distribution Fund, including but not limited to tax obligations resulting from the Distribution Fund's status as a QSF and the Foreign Account Tax Compliance Act ("FATCA"), 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 the Distribution Fund.

(ix.) Within 150 days after Respondent completes the distribution of all amounts payable to the affected investors, Respondent shall submit to the Commission staff a final accounting and certification of the disposition of the Distribution Fund for Commission approval. The final accounting 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 affected investor, with reasonable interest; (2) the date of each payment; (3) the check number or other identifier of money transferred to each affected investor; (4) the amount of any returned payment and the date received; (5) a description of any effort to locate an affected investor 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 investors in accordance with the Payment File 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 Founders Financial Securities, LLC as the Respondent in these proceedings and the file number of these proceedings to Assunta Vivolo, Assistant Director, Securities and Exchange Commission, Division of Enforcement, 1617 John F. Kennedy Blvd, Ste. 520, Philadelphia, Pennsylvania, 19103, or such other address as 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.

(x.) The Commission staff may extend any of the procedural dates set forth in Paragraphs (ii.) through (ix.) of 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 the last day.

D. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$140,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (a) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (b) 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
- (c) 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 Respondent 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 Assunta Vivolo, Assistant Director, Securities and Exchange Commission, Division of Enforcement, 1617 John F. Kennedy Blvd, Ste. 520, Philadelphia, Pennsylvania, 19103, or such other address as the Commission staff may provide.

E. 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.

F. Respondent shall comply with the undertakings enumerated in Section III, paragraphs 16.a and 16.b above.

By the Commission.

Vanessa A. Countryman
Secretary