

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 5387 / September 30, 2019

ADMINISTRATIVE PROCEEDING
File No. 3-19554

In the Matter of

**MID ATLANTIC FINANCIAL
MANAGEMENT, 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, 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”) against Mid Atlantic Financial Management, Inc. (“MAFM” 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 it 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, 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 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.

1. These proceedings arise out of breaches of fiduciary duty and inadequate disclosures by registered investment adviser Mid Atlantic Financial Management, Inc. in connection with its mutual fund share class selection practices and the fees its affiliated broker and the broker's registered representatives ("associated persons"), who were also acting in their capacity as MAFM's investment adviser representatives ("IARs"), received pursuant to Rule 12b-1 under the Investment Company Act of 1940 ("12b-1 fees"). At times during the period from October 2013 through April 2018 (the "Relevant Period"), MAFM 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. MAFM's affiliated broker and associated persons received 12b-1 fees in connection with these investments. MAFM did not adequately disclose this conflict of interest in its Forms ADV or otherwise. MAFM also breached its duty to seek best execution for its clients by investing them in mutual fund share classes with 12b-1 fees rather than lower-cost share classes.

2. Furthermore, MAFM 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. MAFM, although eligible to do so, did not self-report to the Commission pursuant to the Division of Enforcement's (the "Division") Share Class Selection Disclosure Initiative ("SCSD Initiative").²

Respondent

4. Respondent Mid Atlantic Financial Management, Inc., incorporated in Pennsylvania and headquartered in Pittsburgh, Pennsylvania, has been registered with the Commission as an investment adviser since 1984. In its Form ADV dated March 29, 2019, MAFM reported that it had approximately \$2.4 billion in regulatory assets under management. MAFM is a wholly-owned subsidiary of Mid Atlantic Capital Group, Inc., a Delaware corporation. MAFM provides advisory services through investment adviser representatives, most of whom are registered representatives of MAFM's affiliated broker, Mid Atlantic Capital Corporation.

Related Party

5. Mid Atlantic Capital Corporation ("MACC"), a Pennsylvania corporation based in Pittsburgh, Pennsylvania, has been registered with the Commission as a broker-dealer since 1982. MACC also is a wholly-owned subsidiary of Mid Atlantic Capital Group, Inc., and is affiliated with MAFM through common ownership and control. Throughout the Relevant Period, MACC acted as an introducing broker-dealer for MAFM's advisory clients.

² See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, *Share Class Selection Disclosure Initiative*, <https://www.sec.gov/enforce/announcement/scsd-initiative> (last modified Feb. 12, 2018).

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.

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”)).³ 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 generally 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, MAFM’s IARs advised clients to purchase or hold⁴ mutual fund share classes that charged 12b-1 fees when lower-cost share classes of those same funds were available to those clients. MAFM’s affiliated broker and associated persons received \$900,069 in 12b-1 fees that they would not have collected had MAFM’s advisory clients been invested in the available lower-cost share classes.

Disclosure and Best Execution Deficiencies

10. As an investment adviser, MAFM was obligated to disclose all material facts to its clients, including any conflicts of interest between itself and/or its associated persons and its clients that could affect the advisory relationship and how those conflicts could impact advice MAFM provided its clients. Relevant to the issue herein, MAFM was required to give its clients sufficient information so that they could understand the conflicts of interest of MAFM and its associated persons concerning their 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, MAFM disclosed that “[m]anagement personnel and other related persons of [MAFM] are licensed as registered representatives of a broker-dealer” and

³ 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.

⁴ In many cases, mutual funds permit certain advisory clients who hold shares in classes charging 12b-1 fees to convert those shares to Class I shares without cost or tax consequences to the client.

that such “individuals are able to implement investment recommendations for advisory clients for separate and typical compensation (i.e., commissions, 12b-1 fees or other sales-related forms of compensation).” MAFM also disclosed that a “client that invests in mutual funds is subject to the payment of 12b-1 and/or shareholder servicing fees for distribution to the broker as set forth in the prospectuses of those mutual funds. When [MACC] is used as the broker/dealer to effect the transaction in mutual funds, it may receive the 12b-1 and/or shareholder servicing fees.” However, MAFM failed to adequately disclose that it had a conflict of interest as a result of the additional compensation its affiliated broker and associated persons received when MAFM invested advisory clients in a fund’s 12b-1 fee paying share class when a lower-cost share class of the same fund without 12b-1 fees was available.

12. 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) (stating that money managers, as fiduciaries to their clients, have an obligation to “execute securities transactions for clients in such a manner that the client’s total cost or proceeds in each transaction is the most favorable under the circumstances”). 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 of the same funds, MAFM violated its duty to seek best execution for those transactions.

Compliance Deficiencies

13. During the Relevant Period, MAFM 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 disclosure of conflicts of interest presented by its mutual fund share class selection practices.

Violations

14. As a result of the conduct described above, Respondent willfully⁵ 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.” Scienter is not required to establish a violation of Section 206(2), but rather a violation may rest on a finding of negligence. *SEC v. Steadman*, 967

⁵ “Willfully,” for purposes of imposing relief under 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).

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, Respondent 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.

MAFM's Remedial Efforts

16. While MAFM did not self-report pursuant to the SCSO Initiative even though it was eligible to do so, in determining to accept the Offer, the Commission considered other remedial acts promptly undertaken by MAFM and cooperation afforded the Commission staff.

Undertakings

17. Respondent has undertaken to:

- a. Within 30 days of the entry of this Order, review and correct as necessary all relevant disclosure documents concerning mutual fund share class selection and 12b-1 fees.
- b. Within 30 days of the entry of this Order, evaluate whether existing clients should be moved to a lower-cost share class and move clients as necessary.
- c. Within 30 days of the entry of this Order, evaluate, update (if necessary), and review for the effectiveness of their implementation, Respondent's policies and procedures so that they are reasonably designed to prevent violations of the Advisers Act in connection with disclosures regarding mutual fund share class selection.
- d. Within 30 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.
- e. Within 40 days of the entry of this Order, certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), 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 Brendan P. McGlynn, Assistant Regional Director, Asset Management Unit, Philadelphia Regional Office, Securities and Exchange Commission, 1617 JFK Blvd., Suite 520, Philadelphia, PA 19103, or such other address as the Commission staff may provide, 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.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these undertakings. Deadlines for procedural dates 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 the last day.

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, 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, totaling \$1,027,002 as follows:

(i) Respondent shall pay disgorgement of \$900,069 and prejudgment interest of \$126,933, consistent with the provisions of this Subsection C.

(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 not unacceptable to the staff of 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 of 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, 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. 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 ninety (90) days of the date the Commission staff accepts the Payment File unless such time period is extended as provided in Paragraph (xi) of this Subsection C. If, after reasonable efforts to distribute the Distribution Fund pursuant to the approved Payment File, Respondent is unable to distribute any portion of the Distribution 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 the Commission staff. Any such payment shall be made in accordance with Paragraph (xii) 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 one hundred fifty (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, but not be limited to: (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 or credited 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 Mid Atlantic Financial Management, Inc. as the Respondent in these proceedings and the file number of these proceedings to Brendan P. McGlynn, Assistant Regional Director, Asset Management Unit, Philadelphia Regional Office, Securities and Exchange Commission, 1617 JFK Blvd., Suite 520, Philadelphia, PA 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) After Respondent has submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval and shall request Commission approval to send any undistributed amount to the United States Treasury.

(xi) 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.

(xii) Respondent's transfer of any undistributed funds to the Commission for transmittal to the United States Treasury 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 Brendan P. McGlynn, Assistant Regional Director, Asset Management Unit, Philadelphia Regional Office, Securities and Exchange Commission, 1617 JFK Blvd., Suite 520, Philadelphia, PA 19103, or such other address as the Commission staff may provide.

D. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$300,000 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:

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
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HQ Bldg., Room 181, AMZ-341
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Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Mid Atlantic Financial Management, Inc. as the 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 Brendan P. McGlynn, Assistant Regional Director, Asset Management Unit, Philadelphia Regional Office, Securities and Exchange Commission, 1617 JFK Blvd., Suite 520, Philadelphia, PA 19103.

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 17.a through 17.e above.

By the Commission.

Vanessa A. Countryman
Secretary