UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 92095 / June 2, 2021

INVESTMENT ADVISERS ACT OF 1940
Release No. 5744 / June 2, 2021

ADMINISTRATIVE PROCEEDING
File No. 3-20357

In the Matter of **Centaurus Financial, Inc.** **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 Centaurus Financial, Inc. ("CFI" 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 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[1] that:

Summary

1. These proceedings arise out of breaches of fiduciary duty by CFI, a dually-registered investment adviser and broker-dealer, in connection with its receipt of third-party compensation from client investments without fully and fairly disclosing its conflicts of interest. In particular, since at least 2014 CFI invested clients in: (1) mutual fund share classes that paid CFI fees pursuant to Rule 12b-1 under the Investment Company Act of 1940 ("12b-1 fees"); (2) certain mutual funds that also generated no-transaction fee ("NTF") revenue for the firm; and (3) cash sweep products that likewise resulted in CFI receiving revenue sharing. In spite of these financial arrangements, CFI provided no disclosure or inadequate disclosure of the multiple conflicts of interest arising from the firm's receipt of this compensation. CFI, 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] At all relevant times, CFI 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, cash sweep revenue sharing, and NTF revenue sharing. As a result of the conduct described above, CFI willfully[3] violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

Respondent

2. Respondent Centaurus Financial, Inc. ("CFI"), incorporated in California and headquartered in Anaheim, California, has been registered with the Commission as an investment

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[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.

[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).

[3] "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).

adviser since 1999 and as a broker-dealer since 1993. In its Form ADV dated July 2020, CFI reported that it had approximately $2.7 billion in regulatory assets under management.

Background

3. CFI provides investment advisory services to individuals, pension and profit sharing plans, charitable organizations, corporations and other businesses. CFI offers investment advisory services to clients on both a non-discretionary and discretionary basis. CFI also provides financial planning and consulting services.

4. As an investment adviser, CFI was obligated to disclose all material facts to its advisory clients, including any conflicts of interest between itself and/or its associated persons and its clients, which could affect the advisory relationship. CFI was also obligated to disclose all material facts relating to how those conflicts could affect the advice CFI and/or its associated persons provided its clients. To meet this fiduciary obligation, CFI was required to provide its advisory clients with full and fair disclosure that was sufficiently specific so that clients could understand the conflicts of interest concerning CFI's investment advice and have an informed basis on which they could consent to or reject the conflicts.

Mutual Fund Share Class Selection

5. 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.

6. For example, some mutual fund share classes charge 12b-1 fees to cover certain costs of fund distribution and sometimes shareholder services. 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.

7. 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")).[4] 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

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[4] 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.

eligible to own it, it is often, though not always, better for the investor to purchase or hold the Class I share.

8. During the relevant period, CFI advised clients to purchase or hold[5] mutual fund share classes that charged 12b-1 fees when lower-cost share classes of those same funds were available to those clients. As a result, CFI received 12b-1 fees that it would not have collected had its advisory clients been invested in the available lower-cost share classes of those funds.

9. In the relevant period, however, CFI's Form ADV stated that:

> Costs excluded from [Centaurus's advisory fees] can include certain . . . internal mutual fund [] expenses . . . The Firm and its IARs may receive all or a portion of these additional fees, the receipt of which may create a conflict of interest given that the IAR may have an incentive to sell a product with upfront or trail commissions over one without any commission.

10. CFI did not adequately disclose all material facts regarding the conflict of interest that arose when it invested advisory clients in a share class that would generate 12b-1 fee revenue for CFI while a share class of the same fund was available that would not provide CFI with that additional compensation.

<u>Revenue Sharing From Certain Mutual Funds</u>

11. In the relevant period, the unaffiliated clearing broker ("Clearing Broker") that CFI contracted with to provide securities transaction clearing services used for client accounts offered a no-transaction fee ("NTF") program, which provided CFI access to certain mutual funds. When CFI's advisory clients invested in mutual funds on the NTF platform, the Clearing Broker shared with CFI a certain percentage of the NTF revenue that the Clearing Broker received from those mutual funds. The NTF revenue were expenses of the mutual funds, and thus, advisory clients invested in those funds indirectly paid the NTF revenue.

12. CFI did not disclose that it was receiving NTF revenue from client investments in advisory accounts or otherwise put clients on notice regarding the conflicts of interest inherent in this arrangement. None of CFI's disclosures to its advisory clients advised them of this revenue sharing arrangement.

<u>Revenue Sharing from Cash Sweep Money Market Funds</u>

13. Since at least 2014, CFI recommended that clients choose certain money market funds to hold uninvested cash ("Sweep Account Options"). A sweep account a money market

[5] 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.

mutual fund or bank account used by brokerages to hold uninvested cash (*e.g.*, incoming cash deposits, dividends, or certain investment returns) until the investor or its adviser decides how to invest the money ("Sweep Account"). A money market fund is a type of mutual fund registered under the Investment Company Act of 1940 and regulated pursuant to Rule 2a-7 under that Act. Money market funds generally invest in short term, highly liquid securities with limited credit risk, and are frequently used as cash sweep account options. The investment yields and expense ratio of a money market fund will differ from fund to fund.

14. Clearing Broker agreed to share with CFI a portion of the revenue the Clearing Broker received in connection with certain money market funds offered to Sweep Accounts. Under this arrangement, the Clearing Broker provided CFI with a list of many money market funds as Sweep Account Options for CFI's advisory clients. The amount of revenue sharing CFI receives varies depending on the money market fund CFI selects for advisory clients.

15. CFI has a conflict of interest when it recommends Sweep Account Options to its clients. In particular, the money market funds available on the Clearing Broker's platform wherein CFI receives the most revenue sharing generally charge higher fees and have at times returned lower investment yields to clients. Conversely, the money market funds available on Clearing Broker's platform that pay no or lower revenue sharing generally charge lower fees and have at times returned higher investment yields to clients.

16. CFI predominantly recommends and invests advisory clients' uninvested cash in a money market funds tier for which the Clearing Broker has agreed to pay CFI the highest revenue sharing even though the Clearing Broker makes several money market funds available to CFI's advisory clients that at times would pay CFI's clients higher yields, but for which CFI would have received less or no revenue sharing. When CFI recommends Sweep Account Options to its clients, the firm's interests are in conflict with its advisory clients' interests because CFI has an incentive to recommend cash sweep products that paid the greatest amount of revenue sharing to CFI.

17. In the relevant period, CFI did not disclose its receipt of revenue sharing from cash sweep products in which CFI had invested its clients' assets, or otherwise put clients on notice regarding the conflicts of interest inherent in this arrangement. None of CFI's disclosures to its advisory clients advised them of this revenue sharing arrangement, or explained how the firm may be incentivized to recommend cash sweep products to advisory clients that paid CFI revenue sharing, instead of other investment alternatives.

Best Execution Failures

18. An investment adviser's fiduciary duties include, among other things, an obligation to seek best execution for client transactions.[6]

19. In the relevant period, by causing certain advisory clients to invest in certain mutual fund share classes when share classes of the same funds were available to the clients that presented a more favorable value under the particular circumstances in place at the time of the transactions, CFI violated its duty to seek best execution for those transactions.

Compliance Deficiencies

20. In the relevant period, CFI 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, making recommendations of mutual fund share classes that were in the best interests of its advisory clients, receipt of cash sweep revenue, and receipt of service fee revenue.

Violations

21. As a result of the conduct described above, CFI willfully violated Section 206(2) of the Advisers Act, which prohibits an investment adviser, directly or indirectly, from engaging "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 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

22. As a result of the conduct described above, CFI 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.

Remedial Efforts

23. While CFI did not self-report pursuant to the SCSD Initiative even though it was eligible to do so, in determining to accept the Offer, the Commission considered other remedial acts promptly undertaken by CFI, including efforts to address the share class issues in September 2018, and cooperation afforded the Commission staff.

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[6] *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).

Disgorgement and Civil Penalties

24. The disgorgement and prejudgment interest ordered in paragraph IV.C. is consistent with equitable principles, does not exceed Respondent's net profits from its violations, and is awarded for the benefit of and will be distributed to harmed investors to the extent feasible. Upon approval of the distribution final accounting by the Commission, any amounts remaining that are infeasible to return to investors, and any amounts returned to the Commission in the future that are infeasible to return to investors, may be transferred to the general fund of the U.S. Treasury, subject to Section 21F(g)(3) of the Exchange Act.

Undertakings

25. Respondent CFI 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, Sweep Account revenue sharing, and NTF revenue sharing.

b. Within 30 days of the entry of this Order, evaluate whether existing clients should be moved to a lower-cost mutual fund share class, alternative cash sweep products, or mutual funds that do not result in CFI receiving NTF revenue, 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, CFI'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, Sweep Account revenue sharing, and NTF revenue sharing

d. Within 30 days of the entry of this Order, notify affected investors (*i.e.*, those former and current clients who were financially harmed during each relevant period by the practices discussed above (hereinafter, "affected investors")) of the settlement terms of this Order by sending a copy of this Order to each affected investor via mail, email, or such other method not unacceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff.

e. Within 45 days of the entry of this Order, certify, in writing, compliance with the undertakings set forth above. 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 Gary Y. Leung, Assistant Regional Director, Asset Management Unit, Los Angeles Regional Office, Securities and Exchange Commission, 444 S. Flower Street, 9th Floor, Los Angeles, CA 90071, 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 CFI'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 shall 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 thereunder.

B. Respondent is censured.

C. Respondent shall pay disgorgement, prejudgment interest, and a civil penalty totaling $1,281,396 as follows:

(i.) Respondent shall pay disgorgement of $907,377 and prejudgment interest of $124,019, consistent with the provisions of this Subsection C.

(ii.) Respondent shall pay a civil monetary penalty in the amount of $250,000, consistent with the provisions of this Subsection C.

(iii.) Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalties, disgorgement, and prejudgment interest described above for distribution to affected investors. 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 thirty (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.) Within ten (10) days of the entry of this Order, Respondent's payment of the Fair Fund shall be made by depositing the full amount of the disgorgement, prejudgment interest, and civil penalty 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], and if timely payment of a civil money penalty is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

(v.) 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.

(vi.) Respondent shall distribute from the Fair Fund to each affected investor an amount representing: (a) the financial harm during each relevant period by the practices discussed above, and (b) reasonable interest paid on such amounts, 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 Fair Fund shall be paid to: (1) any affected investor account in which Respondent, or any of its current or former officers, directors, investment adviser representatives, or associated persons (or any of their spouses or children) have a financial interest; and (2) any affected investor account that was not charged advisory fees by Respondent.

(vii.) 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 shall make themselves available, and shall require any third-parties or professionals retained by Respondent to assist in formulating the methodology for its Calculation and/or administration of the distribution to

be 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.

(viii.) 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 Fair Fund to each affected investor, (3) the application of a *de minimis* threshold, and (4) the amount of reasonable interest paid.

(ix.) Respondent shall complete the disbursement of 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 (xiii.) of this Subsection C. Respondent shall notify the Commission staff of the date[s] and the amount paid for each distribution.

(x.) If Respondent is unable to distribute 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 or any other 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 (xii.) below is submitted to Commission staff. 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 CFI 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 Gary Y. Leung, Assistant Regional Director, Asset Management Unit, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, CA 90071, or such other address as the Commission staff may provide.

(xi.) 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 all tax compliance responsibilities associated with distribution of 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 ("FATCA"), 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 by the Fair Fund.

(xii.) Within 150 days after Respondent completes the distribution of amounts payable to the affected investors, Respondent shall return all undisbursed funds to the Commission pursuant to the instructions set forth in this Subsection C. Respondent shall then submit to the Commission staff a final accounting and certification of the disposition of the Fair 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 and post-order interest if applicable; (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 Fair 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 Centaurus Financial, Inc. as the Respondent in these proceedings and the file number of these proceedings to Assistant Regional Director Gary Y. Leung, 444 South Flower Street, Suite 900, Los Angeles, CA 90071, or such other address as the Commission staff may provide. Respondent shall provide any and all supporting documentation for the accounting and certification 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.

(xiii.) 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 Fair 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 comply with the undertakings enumerated in Section III, paragraph 25, (a) through (e) above.

By the Commission.

Vanessa A. Countryman
Secretary