

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 6040 / June 3, 2022

INVESTMENT COMPANY ACT OF 1940
Release No. 34608 / June 3, 2022

ADMINISTRATIVE PROCEEDING
File No. 3-20877

In the Matter of

ALPHACENTRIC
ADVISORS LLC,

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 9(b) OF THE
INVESTMENT COMPANY 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”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against AlphaCentric Advisors LLC (“AlphaCentric” 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 Respondent 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 9(b) of the Investment Company 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 proceedings arise from the failures of AlphaCentric, the investment adviser to the AlphaCentric Income Opportunities Fund (the “Fund”), to implement its policies and procedures relating to the valuation of securities held by the Fund, and also to adopt and implement policies and procedures reasonably designed to oversee the role of the portfolio manager and sub-adviser to the Fund (the “Sub-Adviser”) in valuing the Fund’s securities.

2. From May 2015 through July 2015, the Sub-Adviser purchased for the Fund 42 small “odd-lot” bonds at a discount from the higher prices quoted by the Fund’s third-party pricing vendor (“Pricing Vendor”) for larger institutional-sized “round-lot” bonds. Even though these positions often traded at discounts due to their size, immediately after purchasing the odd-lot bonds, the Fund valued those positions at the higher prices provided by the Pricing Vendor (“Pricing Vendor Marks”), which were intended for round-lot positions, not odd lots. With respect to these odd-lot positions, AlphaCentric failed reasonably to implement its valuation policies and procedures, which required it to assist with the fair value of Fund holdings in accordance with the Fund’s valuation procedures, and to review daily the pricing of the Fund’s holdings for reasonableness.

3. From January 2017 to February 2019, AlphaCentric also failed to implement its compliance policies and procedures concerning its role in valuing Fund securities, which required it to follow the Fund’s valuation procedures. During that period, when the Sub-Adviser believed a Pricing Vendor Mark for bonds held by the Fund was too low, the Sub-Adviser placed bids with certain broker-dealers expressing an interest in purchasing those bonds at prices higher than the Pricing Vendor Marks, reflecting the Sub-Adviser’s view of the bonds’ value. The Sub-Adviser then provided those bids, which it disclosed as its own bids (“Pricing Bids”), to the Pricing Vendor, to persuade the vendor to increase its marks on the bonds. In response, the Pricing Vendor increased its marks for those bonds and the Fund priced its securities based on the increased marks.

4. Although AlphaCentric had delegated pricing responsibilities for the Fund to the Sub-Adviser in the sub-advisory agreement, AlphaCentric did not adopt policies and procedures to provide oversight of the Sub-Adviser’s performance of these duties, including with respect to the Sub-Adviser’s direct interactions with the Pricing Vendor.

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.

Respondent

5. AlphaCentric, a Delaware limited liability company, is an investment adviser registered with the Commission. AlphaCentric has represented that, as of April 29, 2022, it has approximately \$2.501 billion in assets under management, with the assets held exclusively by registered investment companies advised by AlphaCentric. AlphaCentric has been registered with the Commission as an investment adviser since April 2014. AlphaCentric provides investment advisory services to the Fund. AlphaCentric's principal place of business is San Juan, Puerto Rico.

Other Relevant Entities

6. AlphaCentric Income Opportunities Fund (the "Fund"), which was launched on May 28, 2015, is an actively managed open-end investment company registered with the Commission. AlphaCentric has represented that, as of April 29, 2022, the fund had total net assets of \$2.176 billion. The Fund's A-share class trades under the ticker IOFAX.

FACTS

THE FUND'S FORMATION AND VALUATION POLICIES AND PROCEDURES

7. The Fund was launched in May 2015 and was advised by AlphaCentric. Under the terms of a sub-advisory agreement between AlphaCentric and the Sub-Adviser, the Sub-Adviser was responsible for portfolio management. The Fund's investments focused primarily on sub-prime non-agency residential mortgage-backed securities ("Non-Agency RMBS").

8. The Board of Trustees of the Trust ("Fund Board") adopted written valuation policies and procedures ("Fund Valuation Procedures") to value the Fund's portfolio securities and calculate the Fund's net asset value ("NAV") in a manner consistent with Section 2(a)(41) and Rule 2a-4 under the Investment Company Act of 1940 ("Investment Company Act"). The Fund Valuation Procedures in place during all relevant periods provided that the Fund Board was responsible for valuing securities for which market quotations are not readily available at their "fair value," and defined "fair value" as "the amount that the owner might reasonably expect to receive for the security upon its current sale." The Fund used these valuations to calculate its net asset value and the prices at which it sold and redeemed its shares.

9. At the time the Fund launched, the Fund Valuation Procedures and related disclosures to investors stated that fixed income securities were to be valued by a pricing service "when the adviser believes such prices are accurate and reflect the fair market value of such securities" and that "[i]f the adviser decides that a price provided by a pricing service does not accurately reflect the fair market value of the securities . . . then the Fund's adviser should advise the Trust's administrator and request that the Fair Value Committee needs to consider that the security should be considered as one required to be valued using Fair Value Pricing."

10. The Fund Board approved the use of the Pricing Vendor for all the Fund's sub-prime Non-Agency RMBS. As disclosed by the Fund, the Pricing Vendor published evaluated prices ("Pricing Vendor Marks") for the bonds representing its opinion as to what the holder would

receive in an orderly transaction for an institutional round-lot position under current market conditions. The Pricing Vendor considered relevant observable inputs in its evaluation process, including transaction activity, such as trades and bids, as well as reference data (such as credit ratings and cash flows) and other market inputs. This daily activity allowed the Pricing Vendor to maintain evaluated prices for specific bonds even without any observed market information for those bonds on a particular day.

11. Under the Fund Valuation Procedures, AlphaCentric was responsible for reviewing daily the pricing of the Fund's portfolio holdings for reasonableness and for determining whether the Pricing Vendor Marks reflected fair value for the securities held by the Fund. AlphaCentric's Compliance Policies and Procedures Manual, dated June 2015, further provided that AlphaCentric would assist with the fair value of Fund holdings in accordance with the Fund Valuation Procedures. The Fund Valuation Procedures also created a Fair Valuation Committee ("Fair Valuation Committee"), a committee of the Fund Board designated to provide oversight of Fund valuations that included the Trust's Treasurer and Chief Compliance Officer. The Fund Valuation Procedures directed the Fair Valuation Committee and AlphaCentric to oversee the implementation of the procedures so as to ascertain "fair value" when a market price for a security was unavailable or did not otherwise reflect fair value of the security.

12. The Fund Valuation Procedures further provided that, in performing its valuation responsibilities, AlphaCentric may "utilize the information and support services" of the Sub-Adviser. In the sub-advisory agreement with AlphaCentric, the Sub-Adviser also agreed, subject to the general oversight of AlphaCentric, to provide valuation services to the Fund, including promptly advising the Fund's administrator and accountant ("Fund Administrator") if any security price used for determining the Fund's NAV appeared to be incorrect.

13. The Fund's Valuation Procedures provided that, following a review for reasonableness, the Fund Administrator could challenge "initial valuations" from the Pricing Vendor. In practice, the Sub-Adviser and portfolio manager also sent messages directly to the Pricing Vendor on behalf of the Fund seeking price adjustments based, for example, on the Sub-Adviser's view of market color or bond reference data. The Sub-Adviser generally informed or copied the Fund Administrator and, at times, certain members of the Fair Valuation Committee, when making these submissions. The Fund's Valuation Policies required the Sub-Adviser or the Adviser to notify the Fair Valuation Committee if they reasonably believed that the Pricing Vendor's methodology for valuing securities held by the Fund was not producing reliable valuations or if there was uncertainty about whether that methodology continued to be appropriate.

14. The Fund Administrator submitted NAV calculations, along with the daily prices from the Pricing Vendor, to the Sub-Adviser and AlphaCentric for review. Starting in February 2018, the Fund Board formally included a representative of the Sub-Adviser on the Fair Valuation Committee as a voting member.

**ALPHACENTRIC’S FAILURE TO ADOPT AND IMPLEMENT POLICIES AND PROCEDURES
REGARDING SUB-ADVISER OVERSIGHT AND VALUATION**

Odd-Lot Valuations
(May 28, 2015 – July 31, 2015)

15. From the Fund’s inception on May 28, 2015, through July 31, 2015, when the Fund’s total assets were less than \$13 million, between 91% and 100% of the Fund’s holdings consisted of “odd-lot” positions. As the Sub-Adviser explained to the Fund Board in February 2015, it “focused solely on small odd-lot sized bonds that typically trade cheaper to the broader market...” “Odd-lot” Non-Agency RMBS are bonds typically sold in sizes less than \$1 million in current face value, and tend to trade at a discount to bonds sold in larger quantities.² By March 31, 2016, when the Fund published its first annual shareholder report, the Fund had grown to over \$100 million due to inflows from investors and it stopped purchasing as many odd-lot Non-Agency RMBS positions.

16. In accordance with the Fund Valuation Procedures, the Fund Administrator obtained Pricing Vendor Marks to value the Fund’s Non-Agency RMBS portfolio holdings prior to calculating and publishing the daily NAV. The Pricing Vendor disclosed to the Fund Trust, and the Fund disclosed to its shareholders, that its marks were reference prices based on prices for institutional round lots, which the Pricing Vendor generally defined as those bonds with at least \$1 million current face value. As the Sub-Adviser purchased odd-lot bonds for the Fund, the Fund routinely valued those securities at the higher marks provided by the Pricing Vendor.

Valuing RMBS
(January 2017 – February 2019)

17. The Fund’s Valuation Procedures provided that the Fund Administrator, when appropriate, could challenge a published price provided by the Pricing Vendor for reasonableness, including for pricing errors. From the inception of the Fund through January 2017, when the Sub-Adviser believed that the Pricing Vendor Mark on bonds held by the Fund were too low, it provided the Pricing Vendor with its analysis of the bond’s fundamental characteristics (*e.g.*, maturity, callability, conditional default rates, prepayment risks, or delinquency rates), and sought an upward price adjustment based on this “market color”. The Pricing Vendor generally did not adjust its marks upward in response to these submissions, which carried less weight with the Pricing Vendor than submissions supported by new market information, such as bids and trades.

18. From January 2017 into February 2019, the Sub-Adviser submitted bids to broker-dealers, offering to purchase certain bonds held by the Fund at prices higher than the Pricing

² While there is no absolute definition of “odd lots”, institutional investors generally consider bond positions of less than \$1 million in current face value to be “odd lots,” while larger positions are considered “round lots.” The Pricing Vendor based its pricing evaluations for these bonds on transactions in round lots, which it typically considered those of \$1 million or greater current value.

Vendor Marks when it believed the Pricing Vendor Marks undervalued those bonds. The Sub-Adviser then submitted these Pricing Bids to the Pricing Vendor, noting that it was submitting bids on bonds it owned, in support of higher prices for those bonds. In response, the Pricing Vendor consistently raised its marks to the levels reflected in the Sub-Adviser's Pricing Bids.

19. Between January 2017 and February 2019, on a total of 30 trading days, the Sub-Adviser submitted a total of 88 Pricing Bids to the Pricing Vendor on bonds the Fund held. One of the Sub-Adviser's purposes in bidding higher prices on bonds the Fund already owned was to provide new market information to the Pricing Vendor to persuade the Pricing Vendor to increase its marks. In several instances, the Sub-Adviser submitted Pricing Bids on bonds for which the Fund already owned the entire tranche and thus could not purchase additional bonds in the market. In these situations, the Sub-Adviser noted in its bids that it owned the whole tranche but would be interested in other bonds with similar profiles. From at least February 2018, the Sub-Adviser forwarded its Pricing Bid submissions to AlphaCentric in addition to the Fund Administrator. AlphaCentric generally did not respond to or analyze these submissions. In February 2019, the Pricing Vendor informed the Sub-Adviser that "[i]n general, going forward we will not be able to accept bids from a party who already owns these bonds."

20. While the Fund Valuation Procedures provided that the Fund Administrator could challenge initial valuations with the Pricing Vendor, those procedures also required AlphaCentric or the Sub-Adviser to notify the Fund Administrator if they believed that the Pricing Vendor Marks for bonds held by the Fund were unreliable and request that the Fair Valuation Committee consider the appropriateness of the Pricing Vendor's pricing methodology and whether the bonds should be fair valued. Instead, when its pricing challenges based on "market color" were not effective, the Sub-Adviser submitted Pricing Bids to the Pricing Vendor on bonds the Fund owned to persuade the Pricing Vendor to increase its marks for those bonds to levels that reflected the Sub-Adviser's own view of the value of those bonds. This process was inconsistent with the Fund Valuation Procedures. AlphaCentric did not adopt policies and procedures reasonably designed to oversee the Sub-Adviser's responsibilities with respect to the valuation of securities held by the Fund, including with respect to the Sub-Adviser's direct communications with the Pricing Vendor.

AlphaCentric's Compliance Failures

21. Under its compliance policies and procedures, AlphaCentric was responsible for monitoring the Sub-Adviser's compliance with the Fund's investment guidelines and determining that the Sub-Adviser maintained sufficient controls in light of the Fund's investment activities. AlphaCentric failed to adopt and implement policies and procedures reasonably designed to oversee the Sub-Adviser's role in valuing securities held by the Fund and failed to implement its policies and procedures relating to the valuation of securities held by the Fund.

22. Under AlphaCentric's Compliance Policies and Procedures Manual, dated June 2015, which provides that AlphaCentric will assist with fair valuation of Fund holdings in accordance with the Fund Valuation Procedures, AlphaCentric was responsible for reviewing daily the pricing of the Fund's holdings for reasonableness. AlphaCentric did not reasonably implement these procedures to determine whether the Pricing Vendor Marks represented the fair value or "exit

price” for odd-lot securities that traded at a discount to institutional round-lot securities when the Pricing Vendor Marks were based upon the prices for institutional round-lots of similar bonds.

23. Although AlphaCentric had delegated pricing responsibilities for the Fund to the Sub-Adviser in the sub-advisory agreement, AlphaCentric did not adopt policies and procedures that would provide for oversight of the Sub-Adviser’s performance of these duties or its related communications with the Pricing Vendor. AlphaCentric thus did not have procedures in place to oversee the Sub-Adviser’s use of Pricing Bids.

Violation

24. As a result of the conduct described above, AlphaCentric willfully³ violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and rules thereunder.

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 9(b) of the Investment Company Act, it is hereby ORDERED that:

- A. AlphaCentric shall cease and desist from committing or causing any violations and any future violations of Sections 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.
- B. AlphaCentric is censured.
- C. AlphaCentric shall, within 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:

³ “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[ted]” material information from a required disclosure in violation of Section 207 of the Advisers Act).

(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 AlphaCentric as 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 C. Dabney O'Riordan, Co-Chief, Asset Management Unit, Division of Enforcement, U.S. Securities and Exchange Commission, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071.

D. 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.

By the Commission.

Vanessa A. Countryman
Secretary