The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Sections 203(f) 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 Michael R. Donnell (“Donnell” or “Respondent”).

In anticipation of the institution of these public administrative proceedings, Donnell has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purposes 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 himself and the subject matter of these proceedings, which are admitted, Donnell consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940 as to Michael R. Donnell (“Order”).
III.

On the basis of this Order and Donnell’s Offer, the Commission finds¹ that:

Summary

This matter concerns the failure of Michael Donnell to disclose the conflict of interest arising from a sub-adviser’s payment of substantial “referral fees” to his mother. Donnell was a vice president of Mercantile Capital Advisors, Inc. (“Mercantile Advisors”), a registered investment adviser. Mercantile Advisors manages a “fund of hedge funds” investment company (the “Mercantile Fund”) that is registered with the Commission, and Donnell was also a vice president of the Mercantile Fund. Donnell and his supervisor were responsible for finding a sub-adviser to manage the Mercantile Fund’s portfolio. Donnell recommended hiring a sub-adviser which, he knew, had promised to pay a substantial portion of any sub-advisory fees to his mother as a “referral fee,” if it was retained by the Mercantile Fund. The proposed payments created a conflict of interest, but Donnell did not disclose the conflict or the proposed payments to anyone at Mercantile Advisors or to the board of directors of the Mercantile Fund. Eventually, Donnell’s mother received payments of about $78,000, which was over one-third of the fees received by the sub-adviser. The arrangement ended when Mercantile Advisor’s parent company, Mercantile Bankshares Corp. (“Mercantile Bank”), and the Commission received an anonymous letter disclosing the payments.

Respondent

1. Michael R. Donnell, age 37, is a resident of Miami, Florida. Donnell was a vice president at Mercantile Advisors from March 2002 until his termination in March 2004, and he was a vice-president of the Mercantile Fund.

Other Relevant Entity

2. Mercantile Capital Advisors, Inc. is a Maryland corporation and a wholly-owned subsidiary of Mercantile Safe Deposit & Trust Co., which was the largest affiliate of Mercantile Bank. Mercantile Advisors is registered with the Commission as an investment adviser under the Advisers Act (File No. 801-60093). On March 2, 2007, Mercantile Bank merged with and into the PNC Financial Services Group, Inc. (“PNC”), with PNC as the surviving entity. PNC is a diversified financial services company headquartered in Pittsburgh, Pennsylvania; its common stock is registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934.

¹ The findings herein are made pursuant to the Offer and are not binding on any other person or entity in this or any other proceeding.
Background

Mercantile Bank Enters Hedge Fund Business

3. In 2001, Mercantile Bank began to develop in-house hedge fund products for sale to its customers. In 2002, Mercantile Bank hired Donnell as a consultant to the hedge funds project. In March 2002, Mercantile Advisors hired Donnell as a Managing Director with the title Vice President – Alternative Investments Distribution. In this capacity, Donnell’s chief responsibility was to organize the creation of three “fund of hedge funds” investment companies and to market the new product line to Mercantile Bank’s customers. The three investment companies each appointed Donnell vice-president as well.

4. Mercantile Advisors planned to manage, administer and advise the three investment companies, which would register with the Commission under the Investment Company Act. Each of the three registered investment companies would invest in unregistered hedge funds engaged in a variety of investments. Mercantile Bank invested $25 million in seed capital in each of the three investment companies.

Mercantile Advisors Hires a Sub-Adviser on Donnell’s Recommendation

5. With his supervisor, Donnell undertook the task of locating appropriate candidates to serve as sub-advisers to the funds. The sub-advisers would be responsible for carrying out the funds’ investment strategies; specifically, they would research and identify appropriate investments, and thereafter review, supervise and administer the investments. A friend of Donnell’s family worked at an investment advisory firm and had experience with investing in hedge funds. On Donnell’s recommendation, Mercantile Bank officials met with the friend and another official of the friend’s firm. Thereafter, Donnell conducted due diligence on the friend’s firm in anticipation of selecting the firm as sub-adviser to the Mercantile Fund. Donnell prepared a due diligence memorandum for his superiors at Mercantile Bank, recommending that Mercantile Advisors and the Mercantile Fund hire his friend’s firm as sub-adviser. On October 28, 2002, following a presentation by Donnell and his supervisor recommending the hiring of the friend’s firm, the Mercantile Fund’s board of directors approved hiring the sub-adviser.

6. At the time that Donnell made the presentation, he was also helping his mother negotiate with the proposed sub-adviser an agreement to pay her a fee or fees for referring the sub-adviser to the Mercantile Fund. In these negotiations, Donnell learned the amounts and terms of the proposed payments to his mother. However, Donnell did not disclose to anyone at Mercantile Advisors or the Mercantile Fund the proposed agreement between his mother and the sub-adviser, or his role in their negotiations. Outside of a brief telephone call to the sub-adviser alerting it to the possible business, Donnell’s mother performed no services for the sub-adviser, the Mercantile Fund or Mercantile Advisors.

8. On January 1, 2003, the sub-adviser, Mercantile Advisors and the Mercantile Fund signed an Investment Advisory Agreement (the “Advisory Agreement”). Pursuant to the Advisory Agreement, Mercantile Advisors agreed to pay the sub-adviser 50% of the management fee that it received from the Mercantile Fund. The management fee was a quarterly payment of 0.3125% of the fund’s net assets (1.25% per year); therefore, the fee was based on the amount of money invested by the public in the fund. Mercantile Bank began offering the Mercantile Fund to its clients after the second post-effective amendment was filed, in July 2003. By March 31, 2004, Mercantile Bank’s customers had invested approximately $21 million in the fund.

9. Pursuant to the Advisory Agreement, Mercantile Advisors made the following payments to the sub-adviser for its work on the fund:

<table>
<thead>
<tr>
<th>Month</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 2003</td>
<td>$39,712</td>
</tr>
<tr>
<td>August 2003</td>
<td>$48,275</td>
</tr>
<tr>
<td>November 2003</td>
<td>$30,700</td>
</tr>
<tr>
<td>December 2003</td>
<td>$23,600</td>
</tr>
<tr>
<td>February 2004</td>
<td>$66,462</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$208,749</strong></td>
</tr>
</tbody>
</table>

The Sub-Adviser Pays Over One-Third of Its Fees to Michael Donnell’s Mother

10. On January 15, 2003, the sub-adviser sent a letter to Donnell’s supervisor, disclosing that the sub-adviser planned to pay a “referral fee” to Donnell’s mother in connection with the sub-advisory engagement, absent any objection from Mercantile Advisers. Donnell’s supervisor discussed the letter with Donnell. Donnell falsely claimed that he had no prior knowledge of the proposed payment. Donnell knew, but did not disclose to his supervisor, the material terms of the agreement between his mother and the sub-adviser or his role in assisting his mother in negotiating the terms of her agreement with the sub-adviser. Donnell also knew, but did not disclose, that the payments to his mother would be continuous and would increase if the assets in the Mercantile Fund exceeded $60 million.

11. On March 10, 2003, the sub-adviser and Donnell’s mother executed a written agreement in which the sub-adviser agreed to pay Donnell’s mother 50% of the management fee it received from Mercantile Advisors on the first $25 million of assets in the Mercantile Fund, and 20% of any fee it received on fund assets in excess of $60 million.
12. The sub-adviser made the following payments to Donnell’s mother:

<table>
<thead>
<tr>
<th>Month</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 2003</td>
<td>$19,531</td>
</tr>
<tr>
<td>August 2003</td>
<td>$19,531</td>
</tr>
<tr>
<td>December 2003</td>
<td>$9,765</td>
</tr>
<tr>
<td>January 2004</td>
<td>$9,765</td>
</tr>
<tr>
<td>February 2004</td>
<td>$19,530</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>$78,122</strong></td>
</tr>
</tbody>
</table>

13. Beyond the conversation with his immediate supervisor, Donnell did not disclose the existence of the agreement between his mother and the sub-adviser or the payments made thereunder to anyone else at Mercantile Advisors or the Mercantile Fund. Neither the Mercantile Fund’s filings with the Commission nor its offering documents disclosed the agreement or the payments.

14. In March 2004, Mercantile Advisors’ parent company received an anonymous letter disclosing the payments to Donnell’s mother by the sub-adviser to the Mercantile Fund. Soon thereafter Mercantile Advisors terminated both Donnell and the agreement with the sub-adviser.

**Donnell Willfully Aided and Abetted and Caused Mercantile Advisors’ Violations of Sections 206(1) and 206(2) of the Advisers Act**

15. As a result of the conduct described above, Mercantile Advisors violated Sections 206(1) and 206(2) of the Advisers Act, and Donnell willfully aided and abetted and caused Mercantile Advisors’ violations. Sections 206(1) and 206(2) of the Advisers Act make it unlawful for any investment adviser to employ any device, scheme, or artifice to defraud, or to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client. The arrangement between the sub-adviser and Donnell’s mother created a material conflict between the interests of Mercantile Advisors (and its associated person, Donnell) and those of the Mercantile Fund. The knowledge that Donnell’s mother stood to benefit financially would have been material to the decision of the Mercantile Fund to accept Donnell’s recommendation of the friend’s firm as sub-adviser. Mercantile Advisors violated Sections 206(1) and 206(2) of the Advisers Act when it failed to disclose that conflict to the Mercantile Fund’s board of directors. Donnell failed to disclose this conflict of interest to the Mercantile Fund, even though he played a major role in the selection of the sub-adviser to the Mercantile Fund and he was directly involved in the ongoing evaluation of the sub-adviser’s performance after the fund became operational. Donnell therefore willfully aided and abetted and caused Mercantile Advisors’ violations.

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2 In August 2003, the family friend and an investment partnership formed a new corporation, which purchased the Mercantile Fund’s sub-adviser. The Mercantile Fund and Mercantile Advisors agreed to retain the new corporation as sub-adviser, and the new sub-adviser agreed to continue the payment of fees to Donnell’s mother. Both entities are referred to in this Order as “sub-adviser.”
IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Donnell’s Offer.

Accordingly, pursuant to Sections 203(f) and 203(k) of the Advisers Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Donnell cease and desist from committing or causing any violation of and any future violations of Sections 206(1) and 206(2) of the Advisers Act;

B. Donnell be, and hereby is, barred from association with any investment adviser, and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, with the right to reapply for association after three years to the appropriate self-regulatory organization, or if there is none, to the Commission;

C. Any reapplication for association by Donnell will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Donnell, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order;
D. It is further ordered that Donnell shall pay a civil money penalty in the amount of $50,000. Such payment shall be made as follows: $20,000 within 10 days of the entry of the Order and 11 payments of $1,000 each every 30 days thereafter with one final twelfth payment of $19,000 to be made on the first year anniversary of the entry of the Order. All payments shall be made to the United States Treasury. Such payments shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Donnell as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Kara N. Brockmeyer, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549-8549.

Donnell agrees that if the full amount of any payment described above is not made by the date the payment is required by this Order, the entire amount of the civil penalty plus any interest accrued pursuant to 31 U.S.C. Section 3717, minus payments made, if any, is due and payable immediately without further application.

By the Commission.

Nancy M. Morris
Secretary