

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 79757 / January 9, 2017

INVESTMENT ADVISERS ACT OF 1940
Release No. 4603 / January 9, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-17762

In the Matter of

**ESSEX FINANCIAL
SERVICES, 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 Essex Financial Services, Inc. (“Essex” 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 finds¹ that:

A. SUMMARY

Essex Financial Services (“Essex”) is a Connecticut-based registered investment adviser and broker-dealer. From early 2011 to at least April 2013, John Rafal, Essex’s then President and CEO, and Peter Hershman, a Connecticut attorney, fraudulently schemed to circumvent the rule regarding payments for client solicitations. Rafal agreed to pay Hershman for the referral of Hershman’s wealthy client. Essex did not disclose the solicitation arrangement, and the resulting conflict of interest, to this client—an elderly widow with accounts valued in excess of \$100 million. The two associated solicitation payments were disguised as the payment of fake legal invoices from Hershman for legal services he supposedly provided to joint clients of Essex and Hershman.

B. RESPONDENT

1. **Essex Financial Services, Inc.** (“Essex”) is a Connecticut corporation founded in 2003. Essex is dually registered with the Commission as an investment adviser and broker-dealer with its principal place of business in Essex, Connecticut. Essex is required to be registered with the Securities and Exchange Commission pursuant to Section 203(a) of the Advisers Act and Section 15(b) of the Exchange Act. Essex has been a wholly-owned subsidiary of Essex Savings Bank (“ESB”) since July 2013. During the relevant time period, Essex was majority owned by ESB and partially owned by Rafal.

C. OTHER RELEVANT PARTIES

2. **John W. Rafal**, age 66, is a resident of Old Lyme, Connecticut. He founded Essex, and served as its President from April 2003 until July 2013, when he assumed the role of Vice Chair. From April 2003 until October 2012, Rafal owned 40% of Essex. In October 2012, Rafal sold half of his ownership interest in Essex, becoming a 20% owner until July 2013, when he sold his remaining interest. He was discharged from Essex in November 2015.

3. **Peter D. Hershman**, age 69, is a resident of Branford, Connecticut. Hershman is licensed to practice law in the State of Connecticut and has been an active member of the

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.

Connecticut bar since 1972, engaged in business and estate planning and tax law. Since 2010, he has practiced law at a New Haven, Connecticut law firm. Hershman has never been registered with the Commission in any capacity and does not hold any securities licenses. Hershman has referred several clients of his law firm to Rafal at Essex.

D. FACTS

Essex's Then-CEO and President Made an Undisclosed Referral Fee Arrangement

4. In 2010, Essex, Rafal, and Hershman began to discuss the referral of one of Hershman's clients, an elderly widow with total combined assets in her accounts in excess of \$100 million. As part of this solicitation process, Rafal selected himself and two other Essex Financial Advisors² jointly to manage and supervise that client's accounts (the "Referred Accounts").

5. In the early Spring of 2011, before that client had moved any money to be managed by Essex, Hershman and Rafal discussed Hershman receiving part of the asset management fee Essex expected to receive for managing the client's accounts. Rafal and Hershman subsequently agreed that Hershman would receive an annual fee of \$50,000, paid quarterly, from the advisory fees paid by that client on the Referred Accounts.³ As part of that arrangement, Hershman agreed to become registered as an investment adviser agent.⁴

6. The client decided to retain Essex to manage some of her money and to supervise money that was to remain in an account she owned at another adviser. The client executed an Essex Investment Management Agreement on May 4, 2011. The first of the Referred Accounts held at Essex was opened in May 2011 and additional Referred Accounts were opened at Essex in June 2011, August 2012, and November 2012. No disclosure concerning the solicitation fee was made to the client at those times or at any time while that client was served by Essex.

7. Although Essex made arrangements for Hershman to take the necessary test to become registered as an investment adviser representative, Hershman never took the exam and never became registered as an investment adviser representative. Rafal knew that Hershman had not taken the test or been registered as an investment adviser representative.

8. Hershman did, however, remain in frequent contact with Rafal throughout 2012 regarding their mutual client. For instance, in June 2012, Hershman informed Rafal of his efforts

² Essex's term for its investment adviser representatives is "Financial Advisor."

³ The annual amount for future years was subject to change based on the value of assets in the Referred Accounts.

⁴ Section 36b-6(c)(3) of the Connecticut Uniform Securities Act prohibits an investment adviser from paying a referral fee to a person who is not registered as an investment adviser agent under the Connecticut Uniform Securities Act. Essex's internal policies also prohibit Essex from paying a referral fee to an individual if the individual is not registered as an investment adviser agent.

to have a new \$4 million trust account, which was being established by the client, become an Essex-managed account.

9. Shortly thereafter, in July 2012, Hershman telephoned Rafal requesting his first payment pursuant to the referral arrangement. Rafal knew that Hershman was not a registered investment adviser representative and that the referral arrangement had not been disclosed to their mutual client. Nevertheless, Rafal agreed that Essex would make the first payment. As Rafal knew that under the circumstances it would be improper for Essex to pay a referral fee to Hershman, Rafal and Hershman agreed that Hershman would send Essex an invoice in the form of a false bill for legal services.

10. In late July 2012, Hershman emailed Essex a \$25,000 invoice for “legal services,” representing the first two quarterly payments of 2012 pursuant to the referral arrangement. Rafal asked Hershman to break the bill into two separate \$12,500 invoices, and to send quarterly invoices going forward, explaining that the large amount would look bad on Essex’s cash flow. Hershman sent a revised invoice to Essex in the amount of \$12,500.

11. Rafal forwarded the revised invoice to Essex’s bookkeeper, directing her to pay it. On August 20, 2012, Essex sent Hershman a check in the amount of \$12,500.

12. In or around November 2012, Rafal asked Hershman to send a more detailed invoice for the first quarter of 2012 stating that Essex “needed something to put in the file for [the] auditors.” Hershman complied, sending Rafal a detailed, itemized bill for the first quarter of 2012 that purported to reflect time spent working on matters for various Essex clients.

13. Hershman also sent Essex an itemized bill in the amount of \$12,690 for the second quarter of 2012, purporting to reflect time spent doing legal work for Essex related to various clients. Rafal forwarded the second quarterly bill to Essex’s bookkeeper, directing her to pay it. Essex paid the invoice for the second quarter of 2012 on November 26, 2012.

14. On March 21, 2013, Hershman sent an invoice to Rafal in the amount of \$24,570, representing the last two quarters of 2012, once again purporting to reflect legal work for Essex, itemized by client.

15. On April 1, 2013, Hershman emailed Rafal requesting the status of his invoice for the last two quarters of 2012. Rafal directed Essex’s bookkeeper to mail the check to Hershman and replied to Hershman that the check had been cut and would be sent out later that week.

16. Based on internal complaints at Essex concerning the undisclosed solicitation payments, Essex stopped the process to pay Hershman’s invoice for the last two quarters of 2012, and required Rafal to arrange for the return of the previous payments from Hershman.

17. On April 5, 2013, after being directed by Essex not to pay Hershman’s invoice for the last two quarters of 2012, Rafal used an account owned by an entity that he controlled to pay

Hershman \$24,570 – the balance due to Hershman on the invoice Hershman submitted to Essex for the last two quarters of 2012. Rafal concealed the \$24,570 payment from Essex.

18. On or about April 17, 2013, at the direction of Essex, Rafal asked Hershman to return the previous payments made to Essex for the first two quarters of 2012—totaling \$25,190. Hershman complied. Unbeknownst to Essex, Rafal subsequently paid Hershman \$25,190 from an account owned by an entity that Rafal controlled.

19. On or about April 19, 2013, Hershman received a letter from Essex stating that the referral fee payments Essex previously paid to Hershman were prohibited by law, and asking Hershman to return all of the referral fees which he had received to Essex as soon as possible. The letter acknowledged that Hershman had already returned the \$25,190.

20. Neither Rafal nor Essex ever informed the owner of the Referred Accounts that the referral fee payments had occurred, or that there had been an agreement to pay Hershman a fee for the referral of the client's accounts.

21. In or around August 2013, after some former representatives of Essex contacted a representative of the owner of the Referred Accounts to report that Rafal was under investigation, Hershman disclosed to the owner of the Referred Accounts that he had received payments from Essex related to her accounts. At that point, Hershman told the owner of the Referred Accounts that he had received payments from Essex for “legal fees” and that he had subsequently returned those payments. Hershman did not disclose that the true nature of the payments was for his referral of her account to Essex, nor did he disclose that he had received replacement payment from Rafal for the returned payments.

22. During the existence of the fee arrangement between Rafal and Hershman, Hershman also referred several other clients to Essex. Rafal did not notify these prospective clients of the fee arrangement. There do not appear to have been referral fee agreements regarding these accounts.

Essex Takes Further Corrective Measures and Reports Misconduct to the Commission

23. In July 2013, Essex reported the undisclosed referral arrangement and payments to Commission staff. Essex also informed Commission staff that Rafal was the subject of an internal investigation, and had been removed as President and CEO of Essex and would no longer have any managerial, compliance, supervisory, or oversight duties.

24. From May 2013 through March 2014, Rafal sent numerous emails to Essex clients and others that falsely stated, among other things, that the SEC had “fully investigated all matters” and “issued a ‘no action’ letter completely exonerating [Essex] and [Rafal] from the so called ‘securities violation.’”

25. Essex discovered Rafal's false and misleading emails to clients shortly after he sent the bulk of them in March 2014. Essex promptly informed Commission staff of Rafal's misrepresentations. Essex also compelled Rafal to send retractions to recipients of his misleading emails.

26. Essex took further corrective measures by increasing staffing in its compliance department, transferring operations responsibilities away from its Chief Compliance Officer to provide greater compliance focus, improving its account monitoring software, revising its policies relating to employee complaint procedures, and revising its reporting structure so that the Chief Compliance Officer reports directly to the Chair of the Audit Committee of the Board, instead of to the CEO.

27. Essex discharged Rafal in November 2015.

E. VIOLATIONS

28. As a result of the conduct described above, Essex willfully⁵ violated Section 206(4) of the Advisers Act and Rule 206(4)-3 thereunder, which makes unlawful the payment, directly or indirectly, of a cash fee by an investment adviser required to be registered pursuant to Section 203 of the Advisers Act to a solicitor with respect to solicitation activities unless the disclosure and other requirements of the Rule are met.

Essex's Remedial Efforts

29. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

Undertakings

30. Respondent has undertaken to:

a) Notice to Advisory Clients: Within thirty (30) days of the entry of this Order, Respondent Essex shall provide a copy of this Order via mail, e-mail, or other such method not unacceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff, to each of Essex's existing advisory clients as of the entry of this Order and to any client referred by Hershman during the period of the referral arrangement.

b) Certification of Compliance by Respondent: Certify, in writing, compliance with the undertaking 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

⁵ A willful violation of the securities laws means merely "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)).

to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Associate Regional Director John T. Dugan, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in Respondent Essex'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 Essex cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-3 promulgated thereunder.

B. Respondent Essex shall, within 14 days of the entry of this Order, pay disgorgement of \$170,000 and prejudgment interest of \$13,181.31 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 SEC Rule of Practice 600.

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
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 Essex Financial Services, Inc. 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 John T. Dugan, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 33 Arch Street, 24th Floor, Boston, MA 02110.

C. Respondent acknowledges that the Commission is not imposing a civil penalty based upon its cooperation in a Commission investigation. If at any time following the entry of the Order, the Division of Enforcement (“Division”) obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission, or in a related proceeding, the Division may, at its sole discretion and with prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay a civil penalty. Respondent may contest by way of defense in any resulting administrative proceeding whether it knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

D. Respondent shall comply with the undertakings enumerated in Section III above.

By the Commission.

Brent J. Fields
Secretary