

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4747 / August 16, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-18114

In the Matter of

**INSTITUTIONAL
INVESTORS ADVISORY
COMPANY**

Respondent.

**ORDER INSTITUTING CEASE-AND-DESIST
PROCEEDINGS PURSUANT TO SECTION
203(k) OF THE INVESTMENT ADVISERS
ACT OF 1940, MAKING FINDINGS, AND
IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Institutional Investors Advisory Company (“IIAC” 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 Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing 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. IIAC's business consists solely of advising Institutional Investors Investment Fund ("IIIF"), an investment fund controlled by IIAC owner and president William L. Zielinski ("Zielinski") that serves tax-exempt charitable, religious and educational institutions. From the inception of IIAC in 1970 to approximately April 2014, IIAC also served as the investment adviser to certain institutions that invested in IIIF vis-à-vis advisory agreements that IIAC entered into with these particular institutions. The agreements were titled Managing Agency Agreements ("MAAs") and provided that investors that entered into an MAA ("MAA Investors") would receive a distribution of all income less expenses earned on investments in IIIF. These proceedings arise out of IIAC's breach of fiduciary duty and failure to make adequate disclosures regarding the distribution of investor profits and its conflict of interest regarding a portion of its advisory fees.

2. IIIF, under Mr. Zielinski's direction, created a reserve fund ("Reserve Fund" or "Reserve") in 1993 to smooth investment earnings by either transferring "excess" investor profits into the Reserve when investment profits exceeded a fixed rate of return established by IIIF's board of directors (the "Stated Return") or by distributing funds from the Reserve to IIIF's investors if profits fell below the Stated Return to ensure investor earnings met the Stated Return. According to IIAC and IIIF, the primary purposes of the Reserve were to: (i) maintain consistency of IIIF's distributions and (ii) provide liquidity for IIIF investors who expected immediate return of their capital. Contrary to a representation made in the MAAs, however, Mr. Zielinski authorized IIIF to retain withdrawing investors' pro rata share of undistributed earnings in the Reserve. Although Mr. Zielinski, who was responsible for IIAC's and IIIF's disclosures to investors, made disclosures to the MAA Investors regarding the existence, purpose and operation of the Reserve, neither Mr. Zielinski nor IIAC sufficiently disclosed to the MAA Investors until 2014 that upon withdrawing from IIIF they would not receive all of their profits.

3. Further, starting in 2001, IIAC's advisory fee was applied to all of IIIF's assets, including the investor profits that IIIF retained in the Reserve Fund. Earning advisory fees on the assets in the Reserve created a conflict of interest for IIAC – the more of IIIF's income that IIIF retained in the Reserve (as opposed to distributing it to investors), the more fees IIAC earned. IIAC failed to adequately disclose this conflict to the MAA Investors.

RESPONDENT

4. IIAC, based in St. Louis, Missouri, has been registered with the Commission as an investment adviser since July 2012 and, previously, with the state of Missouri. IIAC was founded

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.

in 1970 by William L. Zielinski, who is the sole owner and president. As of March 22, 2017, IIAC had approximately \$350 million in assets under management.

OTHER RELEVANT PARTIES

5. Institutional Investors Investment Fund, incorporated in Missouri in 1970, was created by religious institutes of the Catholic Church as an investment vehicle for not-for-profit religious, charitable and educational organizations and operates as a tax-exempt entity pursuant to Section 501(c)(2) of the Internal Revenue Code (“501(c)(2”). IIIF is not registered as an investment company under the Investment Company Act of 1940 pursuant to the exemption from the definition of “investment company” in Section 3(c)(10) of the Investment Company Act. Respondent has served as IIIF’s only investment adviser.

6. William L. Zielinski, age 90, is registered as an investment adviser representative with the state of Missouri. As a means to provide investment advice to IIIF and to ensure compliance with the terms of IIIF’s 501(c)(2) tax exemption, Mr. Zielinski founded IIAC, which has served as IIIF’s investment adviser for the past 46 years. In addition to serving as IIAC’s president, he also serves as the president of IIIF and sits on the board of directors of IIAC and IIIF along with certain other members of his family who are associated with IIAC. Mr. Zielinski is a resident of St. Louis, Missouri.

FACTS

A. Advisory Relationship between IIAC and the MAA Investors

7. The MAAs constituted an advisory agreement with the MAA Investors. From its inception until approximately 2002, IIAC required each tax-exempt organization that wanted to invest in IIIF to execute an MAA, which were signed by Mr. Zielinski on behalf of IIAC. IIAC and IIIF utilized the MAAs in an attempt to ensure compliance with the terms of its 501(c)(2) tax exemption, which required among other things that IIIF operate “within [its] stated purposes to hold title to property, collect income therefrom and turn over the entire amount thereof, less expenses, to [investors]....”

8. The MAAs provided that IIAC was ultimately responsible for distributing net income to the MAA Investors and that “[t]he entire amount of income collected by [IIIF], less expenses of [IIIF], will be distributed to the [MAA Investors] on a pro-rata basis.” The MAAs set forth the advisory fees that these investors were expected to pay IIAC for its advisory services.

9. Accordingly, the MAAs served as the basis for the advisory relationship between IIAC and the MAA Investors. IIAC served as the investment adviser to the MAA Investors from the time these investors joined IIIF until their MAA agreements were terminated in April 2014. Consequently, IIAC owed a fiduciary duty to the MAA Investors.

B. Disclosures Regarding the Reserve Fund

10. In approximately November 1993, IIF's board of directors, which included Mr. Zielinski who was also IIF's president, began using the Reserve Fund to provide investors with liquidity, a steady rate of return and protection from potential investment losses in any given month. IIF's Reserve consists of IIF's investment profits in excess of the Stated Return that IIF's board determines will be distributed to investors. Accordingly, on a monthly basis, IIF either transfers its investment profits in excess of the Stated Return established by the board into the Reserve or pays investors with funds from the Reserve if profits fall below the Stated Return to ensure investor earnings meet the return. During the operation of the Reserve, IIF has maintained the Stated Return between 5% and 6.7%.

11. MAA Investors that withdrew from IIF as investors did not receive their pro rata profit that was remaining in the Reserve Fund at the time of their withdrawal.

12. Neither Mr. Zielinski nor IAC disclosed the existence of the Reserve to the MAA Investors when the Reserve was first established. Subsequent disclosures provided to the MAA Investors between 2002 and 2013 mentioned the Reserve Fund in varying degrees of specificity, but none adequately disclosed that the MAA Investors would not receive any of their interests in the Reserve upon their withdrawal from IIF. Specifically, in 2002, Mr. Zielinski first made general disclosures to the MAA Investors about the Reserve and its goal to maintain current income and provide consistent investment returns in IIF's brochures ("Fund Brochures") distributed to the MAA Investors. However, these disclosures did not provide the MAA Investors with sufficient notice that they would not receive any of their pro rata interest in the Reserve upon withdrawing from IIF. Further, IAC did not take any measures to revise the MAAs to describe the operation of the Reserve and its impact on the amount of income that the MAA Investors would (or would not) receive. Such disclosures would have been significant given that, based on their MAAs, the MAA Investors would have expected to receive all net income as investors in IIF.

13. Not until April 2014 were the MAA investors more fully informed about their rights in the Reserve Fund. Specifically, in an effort to address the concerns regarding insufficient disclosures raised by the Chicago Regional Office's staff in the Commission's Office of Compliance Inspections and Examinations ("OCIE"), Mr. Zielinski authorized IIF to revise the disclosure documents as follows:

Member understands the Fund utilizes a reserve for purposes of funding redemptions and normalizing distributions to members. By reserving a portion of the Fund's assets, the Fund is able to have cash on hand to fund member withdrawals and to pay higher returns in periods when its actual return on investment may be lower. Member understands and acknowledges that a portion of the income earned on Member's participation in the Fund will become part of the Fund's reserve, which Member will not have a right to upon withdrawal from the Fund...

14. From at least January 2011 to April 2014, certain MAA Investors did not receive their portion of the Reserve upon departing IIIF. These MAA Investors unknowingly left \$1,268,536 remaining in the Reserve, i.e., IIIF did not distribute these funds to them upon their withdrawal.

C. Disclosures Regarding Advisory Fees Imposed on the Reserve Fund

15. In 2001, several years after IIIF established the Reserve Fund, IIAC began charging advisory fees on the investor profits that IIIF retained in the Reserve among other of IIIF's assets. The MAAs and other disclosure documents disseminated by IIIF to the MAA Investors generally provided that IIAC's advisory fees for managing IIIF would be a percentage of "the average net asset value of the property held hereunder."

16. This disclosure did not adequately disclose that the assets in the Reserve were included in the assets upon which IIAC's advisory fees were based. Also, the disclosure was deficient because it did not address the inherent conflict of interest that was created when IIAC began generating fees from the Reserve. Specifically, earning advisory fees on the assets in the Reserve created a conflict of interest for IIAC – the more of IIIF's income IIIF transferred to the Reserve (as opposed to distributing it to investors), the more fees IIAC earned. IIAC failed to adequately disclose this conflict to the MAA Investors.

17. In April 2014, in light of OCIE's concerns about the adequacy of the disclosures regarding IIAC's advisory fees on the Reserve Fund, IIIF revised its disclosures to the MAA Investors to explain that IIAC would charge advisory fees to manage the assets in the Reserve. The revised disclosure provided that IIIF would "pay its investment adviser ... a monthly fee of 1/12th of 0.89% of the Fund's asset value, which includes the assets transferred by Members to the Fund and earnings thereon (including the reserve)...." Thus, in April 2014, the first disclosure was made to the MAA Investors clearly stating that the Reserve was included in the assets upon which IIIF would pay advisory fees.

18. From January 2011 to April 2014, IIAC received a total of \$531,680 in advisory fees on the Reserve Fund from the MAA Investors.

VIOLATION

19. As a result of the conduct described above, IIAC violated Section 206(2) of the Advisers Act, which prohibits investment advisers from engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Investment advisers have a duty to disclose potential conflicts of interest. *See Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003) (affirming that "petitioners had a duty to disclose potential conflicts of interest accurately . . ."). A violation of Section 206(2) may rest on a finding of simple 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)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.*

IIAC'S REMEDIAL EFFORTS

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

UNDERTAKINGS

21. Respondent undertakes to pay \$1,268,536, which represents the amount of profits that the MAA Investors left remaining in the Reserve Fund upon their withdrawal from IIF, and prejudgment interest thereon of \$146,750 to the Securities and Exchange Commission for the Fair Fund established in Section IV.C. of this Order to compensate the MAA Investors for harm caused by the conduct set forth in this Order. Payment shall be made in the following installments: \$283,057.20 within 10 days of the entry of the Order; \$424,585.80 on or before 180 days of the entry of the Order; and \$707,643 on or before 364 days of the entry of the Order. Pursuant to Section 308(b) of the Sarbanes-Oxley Act of 2002, as amended, this amount shall be accepted by the Commission as an additional payment to the Fair Fund and distributed as set forth in Paragraph IV.D. of this Order.

22. The payment described in Paragraph 21 may 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 IIAC 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 Robert Burson, Associate Director, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 1450, Chicago, IL 60604.

23. Respondent shall cooperate fully with the Commission staff and shall provide the Commission staff with access to files, books, records, and personnel as reasonably requested, until

the Fair Fund distribution as described in paragraph IV.D. below has been fulfilled as determined by the Commission staff.

24. In determining whether to accept the Offer, the Commission has considered these undertakings. Respondent agrees that if the Division of Enforcement (“Division”) believes that Respondent has not satisfied these undertakings, the Division may petition the Commission to reopen this matter to determine whether additional sanctions are appropriate.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in IIAC’s Offer.

Accordingly, pursuant to Section 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 Section 206(2) of the Advisers Act.

B. Respondent shall pay to the Securities and Exchange Commission: (i) disgorgement of \$531,680; (ii) prejudgment interest thereon of \$61,507; and (iii) a civil money penalty in the amount of \$250,000. Payment shall be made in the following installments: \$168,637.40 within 10 days of the entry of the Order; \$252,956.10 on or before 180 days of the entry of the Order; and \$421,593.50 on or before 364 days of the entry of the Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 and/or 31 U.S.C. §3717, shall be due and payable immediately, without further application.

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 IIAC 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 Robert Burson, Associate Director, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 1450, Chicago, IL 60604.

C. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the payment referenced in paragraph III.21 above and the disgorgement, prejudgment interest and penalties referenced in paragraph IV.B. above. 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.

D. After receipt of Respondent IIAC's payments of the civil penalty and the payments described in paragraphs III.21 and IV.B. above, the Commission shall make payments from the Fair Fund described in paragraph IV.C. to the investors described as Clients 1 through 107 in Exhibit 1 hereto, in the amounts set forth in Exhibit 1. The amount of each of these payments represents the dollar amount by which each client was affected by the conduct described above, as calculated by the Commission staff and agreed upon by Respondent IIAC. Commission staff shall seek the appointment of a tax administrator for the above payments to harmed investors as they constitute payments from a qualified settlement fund under section 468B(g) of the Internal Revenue Code (IRC), 26 U.S.C. §468B(g), and related regulations, 26 C.F.R. §§1.468B-1 through 1.468B-5. Taxes, if any, and related administrative expenses shall be paid from the Fair Fund. After the Commission makes the foregoing payments, any remaining funds shall be remitted to the United States Treasury.

By the Commission.

Brent J. Fields
Secretary

EXHIBIT 1

Client 1	\$ 39,036.68	Client 45	\$ 2,847.23	Client 89	\$ 63,711.66
Client 2	\$ 36,745.06	Client 46	\$ 2,737.89	Client 90	\$ 302.35
Client 3	\$ 35,878.17	Client 47	\$ 2,654.21	Client 91	\$ 292.31
Client 4	\$ 31,731.18	Client 48	\$ 2,593.97	Client 92	\$ 284.50
Client 5	\$ 28,985.48	Client 49	\$ 371.52	Client 93	\$ 282.27
Client 6	\$ 27,934.50	Client 50	\$ 2,557.15	Client 94	\$ 213.10
Client 7	\$ 22,112.86	Client 51	\$ 2,341.82	Client 95	\$ 197.48
Client 8	\$ 20,955.90	Client 52	\$ 2,316.16	Client 96	\$ 187.43
Client 9	\$ 19,079.32	Client 53	\$ 2,224.67	Client 97	\$ 176.28
Client 10	\$ 18,117.60	Client 54	\$ 2,074.06	Client 98	\$ 174.05
Client 11	\$ 17,046.54	Client 55	\$ 1,782.86	Client 99	\$ 142.81
Client 12	\$ 16,004.49	Client 56	\$ 1,661.25	Client 100	\$ 137.23
Client 13	\$ 15,742.30	Client 57	\$ 1,661.25	Client 101	\$ 82.56
Client 14	\$724,267.14	Client 58	\$ 1,653.44	Client 102	\$ 46.86
Client 15	\$ 12,980.99	Client 59	\$ 1,502.83	Client 103	\$ 5,570.86
Client 16	\$ 12,847.10	Client 60	\$ 1,461.55	Client 104	\$ 23.43
Client 17	\$ 10,210.74	Client 61	\$ 1,460.43	Client 105	\$ 16.74
Client 18	\$ 10,052.32	Client 62	\$ 1,401.30	Client 106	\$ 8.93
Client 19	\$ 9,939.63	Client 63	\$ 1,261.84	Client 107	\$ 83,637.35
Client 20	\$185,023.07	Client 64	\$ 1,203.82		
Client 21	\$ 9,785.67	Client 65	\$ 1,199.36		
Client 22	\$ 9,687.49	Client 66	\$ 1,085.56		
Client 23	\$ 9,087.25	Client 67	\$ 1,081.10		
Client 24	\$ 8,914.32	Client 68	\$ 1,053.21		
Client 25	\$ 7,856.65	Client 69	\$ 961.72		
Client 26	\$ 7,591.12	Client 70	\$ 936.06		
Client 27	\$ 1,345.52	Client 71	\$ 899.24		
Client 28	\$ 6,212.13	Client 72	\$378,541.30		
Client 29	\$ 5,926.51	Client 73	\$ 785.44		
Client 30	\$ 5,377.60	Client 74	\$ 739.70		
Client 31	\$ 5,289.46	Client 75	\$ 651.56		
Client 32	\$ 4,640.13	Client 76	\$ 637.06		
Client 33	\$ 4,482.82	Client 77	\$ 594.66		
Client 34	\$ 4,070.02	Client 78	\$ 585.73		
Client 35	\$ 4,054.40	Client 79	\$ 524.37		
Client 36	\$ 3,922.75	Client 80	\$ 513.21		
Client 37	\$ 3,913.82	Client 81	\$ 510.98		
Client 38	\$ 3,901.55	Client 82	\$ 498.71		
Client 39	\$ 3,711.88	Client 83	\$ 463.01		
Client 40	\$ 3,612.59	Client 84	\$ 451.85		
Client 41	\$ 3,487.63	Client 85	\$ 384.91		
Client 42	\$ 3,470.89	Client 86	\$ 383.80		
Client 43	\$ 3,085.98	Client 87	\$ 352.56		
Client 44	\$ 2,925.32	Client 88	\$ 335.82		