

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 5084 / December 20, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18947

In the Matter of

PPS ADVISORS, INC.,

and

LAWRENCE NICHOLAS
PASSARETTI,

Respondents.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
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 Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), against PPS Advisors, Inc. (“PPS”) and Lawrence Nicholas Passaretti (collectively “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have 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 them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Advisers Act, 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 Respondents' Offer, the Commission finds¹ that:

Summary

1. These proceedings arise out of improper mutual fund share class selection practices by registered investment adviser PPS and its majority owner, Lawrence Nicholas Passaretti. From July 2012 to March 2016 (the "Relevant Period"), PPS and Passaretti invested advisory clients in mutual fund share classes that charged 12b-1 fees instead of less expensive share classes of the same funds that were available without 12b-1 fees in many instances. PPS's disclosures failed to adequately inform its clients of the conflict of interest presented by its investment adviser representatives' ("IARs") share class selection practices. In particular, PPS did not disclose that its IARs had a conflict of interest as a result of the additional compensation an IAR received for investing advisory clients in a fund's 12b-1 fee paying share class when a less expensive share class was available for the same fund. Furthermore, the practice of investing advisory clients in mutual fund share classes that charged 12b-1 fees rather than less expensive share classes of the same funds was inconsistent with PPS's duty to seek best execution for those transactions. Additionally, PPS 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 its mutual fund share class selection practices.

2. As a result of the conduct described above, PPS willfully² violated and Passaretti caused PPS's violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder.

Respondents

3. **PPS Advisors, Inc.** is a New York corporation based in Holbrook, New York. It was registered with the Commission as an investment adviser from March 19, 2010 until March 27, 2018. PPS provided advisory services through approximately ten IARs. In its last Form ADV filed March 28, 2017, PPS reported regulatory assets under management of approximately \$362,905,118. PPS filed an ADV-W on March 27, 2018. PPS is no longer registered as an investment adviser and no longer advises clients.

4. **Lawrence Nicholas Passaretti** resides in St. Pete Beach, Florida. During the Relevant Period, he was the co-founder, majority owner, Chief Executive Officer, and Chief Investment Officer of PPS. Passaretti was an investment adviser representative of PPS. Passaretti holds Series 7, 24, 52, 63 and 65 licenses.

¹ The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² 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)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Background

5. During the Relevant Period, PPS offered asset management services to its advisory clients (“Advisory Clients”) through a wrap fee advisory program (“Wrap Fee Program”). The Wrap Fee Program enabled PPS’s IARs to invest client assets in various mutual funds across numerous fund complexes.

Mutual Fund Share Class Selection

6. 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 their fee structure.

7. For example, “Class A” shares³ generally are sold with sales charges or “loads” based on the dollar amount of the investment. The sales charges are waived for Class A shares purchased in wrap fee or fee-based advisory accounts. Class A shares, including “load-waived” Class A shares purchased in advisory accounts, charge 12b-1 fees to cover fund distribution and shareholder services. These recurring fees are deducted from the mutual fund assets on an ongoing basis and paid to the fund’s distributor or principal underwriter, which, in turn, generally remits the fees to the broker-dealer that distributed or sold the shares. The 12b-1 fee for this type of share class is typically 25 basis points per year.

8. Many mutual funds also offer other share classes such as Institutional class shares or Class I shares that do not charge 12b-1 fees.⁴ These share classes are generally available only to investors who meet certain criteria (e.g., minimum investment amount or eligible investment program), which vary from fund to fund. While many Class I shares have higher initial investment minimums as compared to Class A shares, many funds waive or substantially reduce these thresholds for client purchases, particularly in advisory accounts such as the Wrap Fee Program offered by PPS during the Relevant Period. A client who holds Class I shares of a mutual fund will pay lower fees over time – and earn higher returns – than a client who holds Class A shares of the same fund.

9. During the Relevant Period, PPS’s IARs in many instances purchased, recommended, or held, on behalf of certain Advisory Clients, mutual fund share classes that charged 12b-1 fees (primarily Class A shares) when those clients were otherwise eligible to invest in less expensive share classes of those same funds (primarily Class I shares). As a result, PPS’s IARs received 12b-1 fees that they would not have collected had Advisory Clients been invested in less expensive share classes. PPS’s unaffiliated broker-dealer collected the 12b-1 fees and paid a portion of the fees to its registered representatives, who acted as IARs for the Advisory Clients.

³ Share classes sold with sales charges or “loads” go by a variety of names in the mutual fund industry. As used in this Order, the term “Class A shares” refers generically to share classes that charge 12b-1 fees.

⁴ Share classes that do not charge 12b-1 fees also go by a variety of names in the mutual fund industry. As used in this Order, the term “Class I shares” refers generically to share classes that do not charge 12b-1 fees.

10. Passaretti invested his Advisory Clients in mutual fund share classes that charged 12b-1 fees when those clients were eligible to invest in lower-cost share classes of the same funds. Passaretti received a significantly greater portion of 12b-1 fees than PPS's other IARs received.

Disclosure and Best Execution Deficiencies

11. As an investment adviser, PPS was obligated to fully disclose all material facts to its Advisory Clients, including any conflicts of interest between itself and its Advisory Clients that could affect the advisory relationship. To accomplish this disclosure obligation, PPS was required to provide its Advisory Clients with sufficient information so that they could understand the conflicts of interest that PPS had, enabling clients to give informed consent to such conflicts or practices or reject them.

12. During the Relevant Period, PPS failed to disclose in its Form ADV Part 2A or otherwise that its IARs had a conflict of interest as a result of the additional compensation they received for investing Advisory Clients in a fund's 12b-1-fee-paying share class when a less expensive share class was available for the same fund.

13. During the Relevant Period, PPS was required to prepare disclosures specific to each of its IARs on Form ADV Part 2B and distribute these disclosures to clients. In response to Item 4 of that form, PPS was required to disclose that certain IARs received 12b-1 fees from the sale of mutual funds, and that the receipt of those fees created an incentive to recommend Class A shares rather than less expensive share classes available to eligible clients. PPS incorrectly stated that IARs selected Class A shares for the "long-term benefit" of clients and only where less expensive share classes of the same fund were unavailable. In fact, IARs in many instances selected more expensive mutual fund share classes where less expensive share classes of the same fund were available to Advisory Clients.

14. Section 206 of the Advisers Act imposes on investment advisers a fiduciary duty to act for the benefit of their clients. That duty includes, among other things, an obligation to seek best execution for client transactions. *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) (stating that money managers, as fiduciaries to their clients, have an obligation to "execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances"). By causing certain Advisory Clients to invest in fund share classes that charged 12b-1 fees when such clients were otherwise eligible for lower-cost share classes, PPS violated its duty to seek best execution for those transactions.

Compliance Deficiencies

15. During the Relevant Period, PPS 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 its mutual fund share class selection practices. For example, PPS's written policies and procedures did not reference 12b-1 fees and did not include guidance concerning mutual fund share class selection.

Violations

16. Section 206(2) of the Advisers Act makes it unlawful for any investment adviser, directly or indirectly, to engage in any transaction, practice, or course of business that 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 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, 194-95 (1963)). As a result of the conduct described above, PPS willfully violated and Passaretti caused PPS's violations of Section 206(2).

17. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require a registered investment adviser to, among other things, "[a]dopt and implement written policies and procedures reasonably designed to prevent violation" of the Advisers Act and its rules. As a result of the conduct described above, PPS willfully violated and Passaretti caused PPS's violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

18. Section 207 of the Advisers Act makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein." As a result of the conduct described above, PPS willfully violated and Passaretti caused PPS's violations of Section 207 of the Advisers Act.

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondents PPS and Passaretti shall cease and desist from committing or causing any violations and any future violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder.

B. Respondent PPS is censured.

C. Respondents PPS and Passaretti shall pay disgorgement, prejudgment interest, and a civil monetary penalty totaling \$706,746 to compensate Advisory Clients that were affected by the conduct detailed in this Order, as follows:

- (i) Respondents PPS and Passaretti on a joint and several basis shall pay disgorgement of \$600,000 and prejudgment interest of \$31,746, consistent with the provisions of this Subsection C.
- (ii) Respondents PPS and Passaretti on a joint and several basis shall pay a civil money penalty in the amount of \$75,000 consistent with the provisions of this Subsection C.
- (iii) Within ten (10) days of the entry of this Order, Respondents PPS and Passaretti shall deposit \$176,686.50 (“the Distribution Fund”) into an escrow account at a financial institution acceptable to the Commission staff. Within one hundred twenty (120) days of the entry of this Order, Respondents shall deposit \$176,686.50 into the escrow account for the Distribution Fund. Within two hundred forty (240) days of the entry of this Order, Respondents shall deposit \$176,686.50 into the escrow account for the Distribution Fund. Within three hundred sixty (360) days of the entry of this Order, Respondents shall deposit \$176,686.50 into the escrow account for the Distribution Fund. Respondents shall provide the Commission staff with evidence of each deposit in a form acceptable to the Commission staff.
- (iv) If any payment is not made timely into the escrow account 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 pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application.
- (v) Respondents shall be responsible for administering the Distribution Fund and may hire a professional to assist them in the administration of the distribution. The costs and expenses of administering the Distribution Fund, including any such professional services, shall be borne by Respondents and shall not be paid out of the Distribution Fund. Respondents shall distribute the amount of the Distribution Fund to the applicable past and present Advisory Clients affected by the above conduct described herein, 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. Such calculation shall be subject to a de minimis threshold, as described in Paragraph (vi) below. No portion of the Distribution Fund shall be paid to Respondents, any of their past or present officers or directors, nor to any affected account in which Respondents, or any of their past or present officers or directors, have a financial interest.
- (vi) Respondents shall, within sixty (60) days of the entry of this Order, submit the Calculation to the Commission staff for review and approval. The Calculation shall identify, at a minimum: (1) the name of each affected past or present Advisory Client account and Advisory Client; (2) the exact amount of the payment to be made from the Distribution Fund to each affected past or present Advisory Client account and Advisory Client; and (3) the amount of any de minimis threshold to be

applied. Respondents shall also provide to the Commission staff such additional information and supporting documentation as the Commission staff may request for its review. In the event of one or more objections by the Commission staff to Respondents' proposed Calculation or any of their information or supporting documentation, Respondents 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 Respondents are notified of the objection, which revised Calculation shall be subject to all of the provisions of this Subsection C.

- (vii) Respondents shall make four (4) tranches of distribution payments to affected past or present Advisory Client accounts and Advisory Clients, with each distribution payment tranche tracking the Respondents' payments in accordance with the payment plan set forth in Paragraph (iii) above. Such distribution is to be based on the methodology set forth in the Calculation and as reviewed and approved by the Commission staff.
- (viii) Respondents shall complete the disbursement of amounts from the Distribution Fund to affected past or present Advisory Client accounts and Advisory Clients as follows: (a) for the first tranche, within sixty (60) days of the Commission staff's approval of the Calculation, and (b) for the remaining tranches, within sixty (60) days of each date after Respondents complete each of their payments by depositing the amounts into the escrow account for the Distribution Fund as required by Paragraph (iii) above, unless such time period is extended by the Commission staff as provided in Paragraph (xii) of this Subsection C.
- (ix) Respondents agree to be responsible for all tax compliance responsibilities associated with distribution of the Distribution Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondents and shall not be paid by the Distribution Fund, nor any of Respondents' past or present clients.
- (x) Within thirty (30) days after Respondents complete each tranche of distribution payments and disbursed the amounts payable to affected past and present Advisory Clients, Respondents shall submit to the Commission staff evidence that the distribution payments were made. Such evidence of payment should be submitted to the Commission staff and include: (1) the name of each affected past or present Advisory Client account and Advisory Client whom received payment; (2) the amount paid to each affected past or present Advisory Client account and Advisory Client; (3) the date of each payment; (4) the check number or other identifier of money transferred to each account; (5) the amount of any returned payment and the date received; (6) a description of any effort to locate a prospective payee whose payment was returned or to whom payment was not made for any reason; (7) an

affirmation that Respondents have made payments from the Distribution Fund to affected past and present Advisory Clients in accordance with the Calculation approved by the Commission staff.

- (xi) Within ninety (90) days after Respondents complete all tranches of distribution payments in accordance with Paragraph (vii) and Respondents disbursed all amounts payable to affected past and present Advisory Clients, Respondents shall submit to the Commission staff a final accounting and certification of the disposition of the Distribution Fund not unacceptable to the staff, which shall be in a format to be provided by the Commission staff. The final accounting and certification shall include: (1) the name of each affected past or present Advisory Client account and Advisory Client who received payment; (2) the amount paid to each affected past or present Advisory Client account and Advisory Client; (3) the date of each payment; (4) the check number or other identifier of money transferred to each account; (5) the amount of any returned payment and the date received; (6) a description of any effort to locate a prospective payee whose payment was returned or to whom payment was not made for any reason; (7) the total amount, if any, to be forwarded to the Commission for transfer to the United States Treasury; and (8) an affirmation that Respondents have made payments from the Distribution Fund to affected past and present Advisory Clients in accordance with this Order and the Calculation approved by the Commission staff. Respondents shall submit the final accounting and certification, together with proof and supporting documentation of such payment in a form acceptable to the Commission staff, under a cover letter that identifies PPS and Passaretti as the Respondents in these proceedings and the file number of these proceedings to Panayiota K. Bougiamas, Assistant Regional Director, Asset Management Unit, New York Regional Office, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, New York, 10281, or such other address the Commission staff may provide. Any and all supporting documentation for the accounting and certification shall be provided to the Commission staff upon request, and Respondents shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.
- (xii) After Respondents have submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval and shall request Commission approval to send any undistributed amount to the United States Treasury.
- (xiii) The Commission staff may extend any of the procedural dates set forth in this Subsection C for good cause shown. Deadlines for dates relating to the Distribution 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 to be the last day.

- (xiv) If Respondents are unable to distribute or return any portion of the Distribution Fund for any reason, Respondents 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, after the final accounting provided for in Paragraph (x) of this Subsection C is submitted to the Commission staff. Payment must be made in one of the following ways:
1. Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
 2. Respondents 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. Respondents 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 PPS and Passaretti as Respondents in this proceeding, and the file number of this proceeding; a copy of the cover letter and check or money order must be sent to Panayiota K. Bougiamas, Assistant Regional Director, Asset Management Unit, New York Regional Office, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, New York, 10281.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalty, disgorgement, and prejudgment interest described 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, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they 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 Respondents 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.

Brent J. Fields
Secretary