Ruling may tie SEC's hands on fining advisers who aid and abet fraud

Commission lacks that authority under the Advisers Act, judge concludes

By Sara Hansard

The Securities and Exchange Commission may have a tougher time fining financial advisers who are found guilty of aiding and abetting securities fraud under a recent ruling by the U.S. District Court in Washington.

On May 6, U.S. District Judge Colleen Kollar-Kotelly barred Robert Radano, 52, of Bethesda, Md., from the investment advisory business for aiding and abetting fraud. But the judge said in her opinion that the SEC lacks the authority to fine him under the Investment Advisers Act of 1940 and threw out a $15,000 fine against him.

Mr. Radano, who in the early 1980s was a staff aide to then-Rep. John Breaux, D-La., before Mr. Breaux was elected to the Senate, was charged in 2002 with helping investment adviser Steven Bolla hide from clients the fact that Mr. Bolla had been barred from the industry.

Mr. Radano and Mr. Bolla operated advisory firm Washington Investment Network Inc. of Bethesda.

Mr. Bolla served a year in prison in 2003 for lying to the SEC in connection with an earlier case involv-

SEC will have a tough time getting around the May 6 ruling.

"What the judge is saying is that the statutory language to fine adviser aiders and abettors is not in the Advisers Act," said Jane Stafford, managing member of Stafford & Associates LLC in Kansas City, Mo. She has defended advisers in enforcement cases, but said that most of her law firm's work relates to providing compliance consulting for advisory firms.

Asked whether the ruling will hinder the SEC's ability to fine advisers in such cases, Ms. Stafford replied, "Heavens, yes. It essentially stops it."

According to the ruling, the Investment Advisers Act doesn't cover fines against advisers found guilty of aiding and abetting securities fraud, Ms. Stafford said.

"The problem is, no one pays

Continued on Page 36

Ruling may constrain the SEC

Continued from Page 3
attention to the Advisers Act," she said.

"That's going to be changing. As people are changing their business models, we're going to have more advisers, and we're going to have more stuff like this," Ms. Stafford said.

"A lot of registered [representatives] are starting their own advisory firms," she said. "They can't make any money any more as registered reps, and the broker-dealer firms are consolidating."

But SEC officials, who declined to speak for attribution, said that, even with the ruling throwing out Mr. Radano's fine, they still will be able to continue fining advisers found to have aided and abetted fraud through administrative proceedings that are conducted internally.

The SEC hasn't said whether it will appeal the district court ruling.

If the court decision stands, however, "it certainly is a factor we would have to take into account," an SEC official said.

NAMING LOCKWOOD

For his part, Mr. Radano maintains that he did nothing wrong, and that the SEC should have charged Lockwood Financial Services Inc., which managed the $55 million in wrap-fee-account assets that he and Mr. Bolla referred to the Malvern, Pa., broker-dealer and registered investment advisory firm.

Mr. Radano is continuing to challenge his punishment in court and at the SEC, where he defended himself in an emotional appeal to the full commission on May 5.

Investors whom he referred to Lockwood did well financially, Mr. Radano said, a fact not disputed by the SEC.

Lockwood Financial held the contract for managing the assets, he said.

"The SEC is elevating me to the level of Lockwood, but I had none of the abilities to act on behalf of investors," Mr. Radano said. "There's a double standard for regulatory enforcement."

Indeed, at the May 5 hearing, SEC assistant chief litigation counsel James Kidney acknowledged that Lockwood may also have been culpable in the case.

"It was Radano's duty — perhaps Lockwood owed one too, but certainly Radano owed a fiduciary duty" to inform Washington Investment Network clients about Mr. Bolla's exclusion from the advisory business, Mr. Kidney charged at the hearing.

"Radano tried to shift blame and hide behind corporate structures," Mr. Kidney said, quoting earlier court findings. "Radano tried to blame Lockwood Financial, the agent for wrap investments, for not informing clients about Bolla."

Ken Lench, assistant SEC enforcement division director, declined to comment on Lockwood's involvement in the case.

"The investigation pertaining to Washington Investment Network was related to their adviser activity," Michael Geller, a spokesman for Pershing LLC of Jersey City, N.J., wrote in an e-mail.

Pershing, a subsidiary of The Bank of New York Mellon Corp. of New York, is an affiliate of Lockwood.

"Lockwood fully cooperated with the Securities and Exchange Commission's investigation of Mr. Bolla in 2002, and we terminated our business relationship with Washington Investment Network that year," Mr. Geller wrote in an e-mail. "Lockwood was not a party to these regulatory proceedings."

Mr. Radano hid from clients the fact that Mr. Bolla had been barred because Mr. Radano wanted to get his advisory fees, Mr. Kidney said at the May 5 hearing.

Most of the clients at Washington Investment Network belonged to Mr. Bolla, who was receiving about $150,000 a year in advisory fees, compared with just $10,000 a year in fees that Mr. Radano was receiving, according to court documents filed by the SEC in the case.

'MORE LEVERAGE'

Although the SEC will still be able to pursue monetary penalties for aiding and abetting fraud administratively, the ruling may make it easier to defend advisers who face enforcement proceedings.

"It will make it a bit more difficult for the SEC to bring cases," said David Chase, an attorney who operates under his own name in Fort Lauderdale, Fla. He is a white-collar defense attorney who has defended investment advisers and who was a senior counsel in the SEC's enforcement division from 1995 to 1999.

If the ruling stands, the SEC may resort to trying to impose fines through administrative proceedings while asking courts to issue injunctions to stop defendants from committing securities fraud, Mr. Chase said.

"Their arsenal is not being eliminated. It's just being limited to a particular forum," he said.

"It will perhaps give defense lawyers like myself potentially more leverage in negotiating with the SEC on these types of charges," Mr. Chase added.

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Citigroup

Continued from Page 6
on managers they're already doing," she added.

Another potential speed bump could be the matter of introducing a performance record for Citi's research department, according to Sam Jones, president of All Season Financial Advisors Inc. in Denver.

"I think it's great in theory, but how will they know what's going to do well in the future?" he said. "I guess we'll know in three to five years if their tactical opportunities list is worth anything."

Mr. Tracy acknowledged much of the criticism, including the association to market timing, but said he doesn't believe providing advance notice on which managers are likely to outperform over the next one to three years will lead to increased turnover of client portfolios.

"Advisers will continue to consider things like the tax implications of turning over a client's portfolio," he said. "Let's just assume it works; that would be a tremendous resource for our clients. Nobody's demanding this right now because they didn't know it could exist, but there is demand for resources to help clients."

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