

SEC Enforcement Case Summary Cherry-Picking by Former Investment Advisory Representative

On December 12, 2024, the SEC charged Eric Cobb, a former investment advisory representative of SeaCrest Wealth Management, Inc., with engaging in a fraudulent scheme where he allocated profitable securities trades to favored accounts and unprofitable trades to disfavored clients, a practice known as cherry-picking. The case against Cobb is being litigated in U.S. District Court for the Southern District of New York, while related charges against SeaCrest were settled with the firm agreeing to pay a \$375,000 penalty.

According to the SEC's complaint against Cobb, from at least June 2019 to mid-April 2022, Cobb allegedly disproportionately allocated profitable trades to his personal and wife's accounts, and unprofitable trades to the accounts of his other clients. Cobb allegedly executed the scheme by buying securities as part of a "block trade" in an omnibus account and then often waiting a day or longer to allocate the trades, which allowed him to see whether the securities had increased in price. Based on the SEC's analysis, the average return measured at time of allocation for the favored accounts was approximately 4.7%, while the average return at time of allocation for the disfavored accounts was approximately 0.1%.

The SEC's complaint also alleged that Cobb routinely placed clients in highly volatile and risky investments that were inconsistent with their investment profiles. These clients identified their investment objectives to Cobb as either preserving capital or moderate capital appreciation. Despite this, Cobb, who had discretionary trading authority over his client's accounts, routinely placed these clients in highly speculative and risky securities designed for day trading. Cobb regularly placed these clients in highly-leveraged exchange traded funds ("**ETFs**") despite warnings in fund prospectuses regarding the risks of such products. The SEC noted that Cobb, who had discretionary authority over his clients' accounts, had a duty to conduct a suitability analysis and provide suitable investment advice for each client based on each client's investment profile. Cobb, however, did not conduct sufficient, if any, analysis to determine that these leveraged ETF investments were in the best interest of his advisory clients, nor did he conduct sufficient, if any, periodic or ongoing analysis to make sure the recommendations were consistent with clients' current objectives.

Investment adviser, SeaCrest, was charged with failing to implement policies and procedures designed to prevent violations of the federal securities laws and failing to reasonably supervise Cobb. During the relevant period, SeaCrest's compliance manual included a policy for "Trade Aggregation and Allocation." This policy required that block trades be allocated in a fair and equitable manner, including that investment adviser representatives not favor certain accounts over other accounts, and that investment adviser representatives must give individual investment advice to each participating account. The policy further required that the allocation method be specified in writing before entering an aggregated order. The policy required SeaCrest's CCO to review the adequacy of the firm's trading practices, including asset allocation strategies and trade allocations. Despite these requirements in the policy, in practice, Cobb routinely waited to allocate block trades until the day following block trades and there was no record of Cobb's written allocation method prior to the trade. Cobb's allocations were not reviewed by the CCO or a designee, as required by SeaCrest's policies and procedures. According to the SEC order, SeaCrest's custodian sent SeaCrest at least twelve alerts about possible unallocated block trading by Cobb. The employee receiving the alerts never elevated the issue to the firm's CCO. Further, SeaCrest never conducted its own independent compliance review of Cobb's trade allocations, as required by

SeaCrest's policies and procedures, until after SeaCrest's custodian brought the issue of potential cherry-picking directly to SeaCrest's CCO.

SeaCrest's compliance manual further included a policy entitled "Suitability" stating that SeaCrest "has a fiduciary duty to provide investment advice to each Client that is suitable to that particular Client" and is responsible for making "a reasonable inquiry into the Client's investment objectives, financial situation, investment experience, and tolerance for risk." The policy required investment adviser representatives to ensure that suitability determinations remained current to the clients' current needs and objectives and that trades were placed consistent with those objectives. The policy also required the compliance department to review these suitability decisions made by investment adviser representatives. Notwithstanding these requirements, the SEC alleged that at the time that Cobb made the unsuitable recommendations, he failed to take into consideration his clients' age, investment objectives, risk tolerance, investment time horizons, financial needs, and financial condition. At no time during the period did SeaCrest conduct reviews to identify trades in products inconsistent with the clients' stated risk tolerance and investment objectives, as required by the firm's policies and procedures.

The SEC noted that SeaCrest's Form ADV Part 2 negligently included statements about its practices. Specifically, the firm described its policy for aggregating and allocating trades as follows: "SeaCrest will execute its transactions through the Custodian as authorized by the Client. SeaCrest may aggregate orders in a block trade or trades when securities are purchased or sold through Custodian for multiple (discretionary) accounts. If a block trade cannot be executed in full at the same price or time, the securities actually purchased or sold by the close of each business day must be allocated in a manner that is consistent with the initial pre-allocation or other written statement. This must be done in a way that does not consistently advantage or disadvantage particular Clients' accounts." With respect to suitability, the firm's Form ADV Part 2 stated: "[investment adviser representatives] will work with each client to determine their tolerance for risk as part of the portfolio construction process" and further highlighted the risks associated with investing in leveraged ETFs.

This case highlights the SEC's ongoing focus on cherry-picking violations. The SEC also highlighted in the press release its intent to enforce compliance with subpoenas and noted that it obtained a court order from the U.S. District Court for the Southern District of New York compelling Cobb to comply with the production of documents and testimony in the case. Moreover, the case emphasizes the need for investment advisers to adopt and enforce robust controls with respect to trade allocations and suitability to avoid and promptly detect potential cherry-picking and unsuitable investments.

See Summary - <https://www.sec.gov/newsroom/press-releases/2024-198>