

SEC Enforcement Case Summary Principal & Affiliated Transactions & Other Violations

On October 31, 2024, the SEC charged dually registered broker-dealer/investment adviser, J.P. Morgan Securities LLC (**JPMS**), and investment adviser, J.P. Morgan Investment Management Inc. (**JPMIM**), in five separate enforcement actions for failures including misleading disclosures to investors, breach of fiduciary duty, prohibited joint transactions and principal trades, and failures to make recommendations in the best interest of customers. The firm agreed to pay a combined \$151 million in voluntary disgorgement and civil penalties for the settled actions.

One action against JPMS involved misleading disclosures to brokerage customers that invested in affiliated "**Conduit**" private fund-of-fund products. The Conduit funds pooled customer money and invested in private equity or hedge funds that customers might not be able to access directly. On occasion, the third-party fund in which a Conduit was invested would distribute shares of companies that had recently undertaken an initial public offering ("**IPO**") or another liquidity event to the fund's limited partners, including the Conduit. A JPMS affiliate administered the Conduit and an affiliated "Distribution Management" team at JPMIM utilized its discretion to determine when to sell the shares for distribution to brokerage customers. In the offering documents for the Conduits, customers were told, among other things, that such sales "may not immediately follow the distribution" but would occur "as promptly as practicable under reasonable commercial terms." Contrary to these disclosures, however, the Distribution Management team actively managed the Shares, exercising complete discretion as to when to sell and the number of shares to be sold, and at times holding the Shares for several months before selling them. JPMS failed to disclose that the Distribution Team would exercise complete investment discretion of such sales and the extent of market risks due to the timing of the sales.

The other violations by JPMS involved the failure to disclose financial incentives by its financial advisers for recommending a proprietary discretionary wrap fee program over third-party managed advisory programs and recommending certain mutual fund products to retail brokerage customers when less expensive clone ETF products that offered the same investment portfolio to investors were also available on JPMS's platform for recommendation to these customers. The SEC noted that JPMS violated Regulation Best Interest as well as anti-fraud provisions under the Investment Advisers Act.

JPMIM managed U.S. money market funds registered under the Investment Company Act (the "**Domestic Funds**") and an affiliated foreign money market fund ("**Foreign Fund**"). One of the enforcement actions against JPMIM involved prohibited transactions between the Domestic Funds and Foreign Fund. At the onset of the COVID-19 pandemic, the Federal Reserve Board ("**Fed**") established a liquidity facility to address severe liquidity constraints in the market called the Money Market Mutual Fund Liquidity Facility ("**MMLF**"). The MMLF was available only for certain qualifying U.S. funds and assets. While the Domestic Funds had access to the MMLF, the Foreign Fund and many of its assets were not eligible for the program. Both the Domestic Funds and the Foreign Fund experienced significant investor redemptions in early 2020. In anticipation of possible additional redemptions and to avoid the need to charge investors a fee for redeeming shares ("**liquidity fees**") or limiting or halting redemptions altogether ("**gates**"), and to slow or discourage redemptions in the Foreign Fund, JPMIM structured transactions involving the Domestic Funds to provide the Foreign Fund with liquidity from the MMLF. The SEC order noted that while the Foreign Fund recognized a net realized gain and received sales proceeds from the transactions that enhanced its liquidity, the Domestic Funds earned one-tenth of this amount and bore certain associated risks. Those risks included the chance that the Fed might reject the structured transaction between the Domestic Funds and Foreign Fund for placement into the MMLF,

which could have affected the Domestic Funds' liquidity position, and the risk that the SEC could determine these were joint transactions that violated the affiliated transaction prohibitions under Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder. These provisions require registered investment companies ("**RICs**") to obtain an exemption from the SEC for joint transactions, which JPMIM did not seek or obtain.

In the final action, JPMIM was charged with engaging in principal transactions when a portfolio manager directed an unaffiliated broker-dealer to buy commercial paper or similar short-term fixed income securities from JPMS. JPMIM then purchased the paper from the broker-dealer on behalf of one of its clients. Such transactions consisted of principal transactions, which require specific disclosure and consent under Section 206(3) of the Investment Advisers Act. However, JPMIM did not provide required disclosures nor obtain client consent for these trades. Certain of the transactions involved RICs managed by JPMIM and therefore were further subject to the affiliated transaction provisions under Section 17 of the Investment Company Act. The case noted that although the SEC granted JPMIM exemptive relief years before the relevant period that permits JPMIM to trade with JPMS provided that certain conditions were met, JPMIM did not comply with those conditions for any of these trades involving RICs. JPMIM was further charged with failing to adopt and implement policies and procedures to prevent unlawful principal transactions.

The SEC noted that upon learning of the principal transactions, JPMIM notified SEC staff and promptly provided documents, communications and other information on a voluntary basis, provided additional training to its investment professionals and updated its policies and procedures. These affiliated transaction cases do not appear to have involved actions intended at enriching JPMIM at the expense of clients or investors, and in fact on their face appear to have been intended to benefit clients and investors. However, the defendants violated the affiliated and principal transaction provisions of Section 17 of the Investment Company Act and Section 206(3) and failed to comply with the technical requirements under such regulations. Investment advisers and private fund managers must be diligent in identifying affiliated and principal transactions and ensuring relevant disclosure, consent and other applicable requirements are satisfied prior to engaging in such transactions.

See Summary - <https://www.sec.gov/newsroom/press-releases/2024-178>