



COMMONWEALTH OF KENTUCKY
PUBLIC PROTECTION CABINET
DIVISION OF SECURITIES
ADMINISTRATIVE ACTION NO. 2019—AH—00073

DEPARTMENT OF FINANCIAL INSTITUTIONS

COMPLAINANT

vs.

AGREED ORDER

J.P. MORGAN SECURITIES, LLC

RESPONDENT

PARTIES

1. The Kentucky Department of Financial Institutions (DFI, or the “Department”) is responsible for administering the provisions of Kentucky Revised Statutes (KRS) Chapter 292, the Securities Act of Kentucky (the “Act”), as well as the rules and regulations enacted thereunder.

2. Respondent J.P. Morgan Securities, LLC (JPMS, or “Respondent”), a wholly-owned subsidiary of JPMorgan Chase & Co. (“JPMorgan”), is a Delaware company headquartered in New York, New York. JPMS has been registered with the Securities and Exchange Commission as an investment adviser since 1965 and as a broker-dealer since 1985.

FACTUAL BACKGROUND

Summary

3. This matter concerns the negligent failure of JPMS to disclose conflicts of interest arising from, preferences for JPMorgan-managed mutual funds (“Proprietary Mutual Funds”).

4. From May 2008 to 2013, JPMS failed to disclose that it designed and operated Chase Strategic Portfolio (“CSP”), a retail unified managed account program, with a preference for Proprietary Mutual Funds. JPMS also failed to disclose that there was an economic incentive to invest CSP Assets in Proprietary Mutual Funds as a result of discounted pricing for services provided to JPMS for CSP by a JPMS affiliate. The discounts were based on the amount of CSP assets that JPMS invested in Proprietary Mutual Funds. Finally, until November 2013, JPMS

failed to disclose to CSP clients the availability of certain less expensive Proprietary Mutual Fund share classes. As a result, Respondent JPMS breached its fiduciary duty to CSP clients by failing to adequately disclose conflicts of interest.

5. During the relevant period, JPMS violated the Act when it failed to adequately disclose to its clients, the specific conflicts of interest set forth below.

Failure to Disclose Preference for Proprietary Funds

6. As a unified managed account program, CSP comprised a set of standardized, risk-weighted portfolios of predominantly registered funds. JPMS (or, beginning in September 2013, an affiliate of JPMS engaged to serve as sub-adviser) selected the constituent holdings for each CSP portfolio and set the percentage of assets invested in each holding in the various CSP portfolios.

7. JPMS launched CSP in May 2008 and, consistent with an expectation that a majority of CSP's assets would be in Proprietary Mutual Funds, as well as JPMorgan Asset Management ("JPMAM")-managed money market funds and separately managed accounts (together with Proprietary Mutual Funds, "Proprietary CSP Assets"), JPMS invested approximately 60% of CSP client assets in Proprietary CSP Assets. Since that time, JPMS has continuously operated CSP with a preference for Proprietary Mutual Funds.

8. From 2008 to 2013, CSP grew rapidly, and by December 2013 JPMS had invested approximately \$10 billion, out of a total of \$32.6 billion of CSP client mutual fund assets, in Proprietary Mutual Funds. From early 2009 until early 2012, JPMS invested approximately 47% to 51% of CSP client mutual fund assets in Proprietary Mutual Funds. Thereafter, the percentage began to decrease, falling to 45% by mid-2012, approximately 31% by year-end 2013, and 27% by year-end 2014.

9. From 2008 through August 5, 2013, neither CSP's Schedule H or its successor Form ADV Part 2A (collectively "CSP ADV"), nor CSP marketing materials disclosed that JPMS preferred Proprietary Mutual Funds. JPMS also failed to disclose that JPMS had designed CSP to feature Proprietary Mutual Funds, and that JPMS had an expectation that it would invest a majority of CSP client assets in Proprietary CSP Assets at the beginning of the program.

Failure to Disclose Service Discounts

10. JPMS contracted with another JPMorgan affiliate, which was part of JPMAM, to provide various services to CSP, including "overlay services" (i.e., trading and reporting services related to the management of CSP portfolios) and, later, asset allocation, portfolio construction, and tactical trading advice.

11. JPMAM tied both its willingness to provide services to JPMS, and the pricing for those services, to the amount of CSP's assets that JPMS invested in Proprietary CSP Assets. Between 2008 and 2013, JPMS failed to disclose that the discounted pricing of services provided to JPMS by a JPMAM affiliate was tied to the amount of CSP assets that JPMS invested in Proprietary CSP Assets. JPMS also did not disclose for a period of time that JPMAM's provision of services to CSP was tied to JPMS's investment of the majority of CSP assets in Proprietary CSP Assets.

Failure to Disclose Availability of Lower-Cost Share Classes

12. JPMS's CSP ADV described the share classes available in the program as follows: "Fund shares sold in [CSP] are generally investor or institutional class shares, or no load or load-waived Class A shares that are sold at net asset value." CSP clients were informed in writing prior to account opening of the share class they would be receiving and the fees associated with that share class.

13. Certain of the Proprietary Mutual Funds used in CSP offered, in addition to retail share classes, two different institutional share classes: (a) a “Select” share class (with an investment minimum of \$1 million) and (b) an “Institutional” share class (with an investment minimum of \$3 million). For a majority of the Proprietary Mutual Funds used in CSP, the “Select” share class was the only institutional share class offered by the fund.

14. From 2008 to 2013, a minority of the Proprietary Mutual Funds used in CSP offered both Select and Institutional classes. In certain of these funds, JPMS invested CSP client assets in the Select share class even though the lower-cost Institutional class was available. The Select share class typically had a shareholder servicing fee that was 15 basis points higher than the Institutional share class offered by those Proprietary Mutual Funds. As a result, JPMAM earned higher fees when JPMS invested CSP client assets in the Select share class. In November 2013, JPMS converted all CSP client investments in Select shares to Institutional shares where the Proprietary Mutual Funds offered Institutional shares.

15. Between 2008 and 2013, JPMS failed to disclose that certain of the Proprietary Mutual Funds purchased for CSP clients offered Institutional shares that were less expensive, and would generate less revenue for a JPMS affiliate, than the Select shares JPMS chose for CSP clients.

Failure to Disclose Conflicts of Interest on Form ADV

16. From 2008 through 2013, JPMS filed nine CSP ADVs with the Department. These forms included the following descriptions of potential conflicts of interest in CSP investments:

A. September 2008- “To the extent that JPMorgan Funds are recommended and sold, [JPMS] will receive an indirect benefit due to the increased fee revenue of its parent company.”

B. September 2009- “Certain funds in the Program may be affiliated with [JPMS] ... and [JPMS] and/or its affiliates may receive compensation in connection with the operations and/or sale of affiliated or unaffiliated Funds.”

C. August 2010- “[JPMS] may recommend Funds that are sponsored or managed by its affiliates in which a related person may have a financial interest.”

D. October 2012- “[JPMS] has retained J.P. Morgan Investment Management, an affiliate, as the Program’s overlay manager (“Overlay Manager”).”

E. October 2012 and June 2013- “JPMS may have a conflict of interest by including JPMorgan Funds because JPMS and/or its affiliates will receive more overall compensation when JPMorgan Funds are included in an investment strategy that in JPMS used non-JPMorgan Funds.”

17. In advance of account opening, CSP clients were informed which funds were proposed for their CSP portfolios, and how much of the portfolios’ assets were to be allocated to each Proprietary Mutual Fund and each third-party mutual fund. Once the accounts were open, CSP clients were informed of which funds were in their accounts and the amount of assets allocated to those funds through, for example, periodic account statements and client reviews. Marketing materials used with potential CSP clients also disclosed which funds were to comprise a portfolio and the amount of portfolio assets allocated to each fund.

18. However, in its CSP ADV filings, JPMS did not disclose that it had exercised a preference for Proprietary Mutual Funds in CSP. JPMS also failed to disclose that the discounted pricing of services provided to JPMS for CSP by a JPMAM affiliate was tied to the amount of CSP assets that JPMS invested in Proprietary CSP Assets. Finally, JPMS’s CSP ADV filings did

not disclose that, for certain of the Proprietary Mutual Funds in which it invested CSP clients, less expensive share classes were available.

19. On August 5, 2013, JPMS filed an amended CSP ADV that disclosed there “may” be a preference for Proprietary Mutual Funds in CSP. On December 31, 2013, JPMS further amended the CSP ADV to disclose that “[a]s a general matter, we prefer” Proprietary Mutual Funds.

STATUTORY AUTHORITY

20. KRS 292.320 states in relevant part:

(2) It is unlawful for any person who receives any consideration from another person primarily for advising the other person as to the value of securities or their purchase or sale, whether through the issuance of analyses or reports or otherwise:

- (a) To employ any device, scheme, or artifice to defraud the other person; or
- (b) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon the other person.

21. 808 KAR 10:450§2, which was enacted by the Department to further describe the requirements of KRS 292.320, states as follows:

[A]n investment adviser or an investment adviser representative shall be a fiduciary and shall have a duty to act primarily for the benefit of its clients. An investment adviser or investment adviser representative shall not engage, either directly or indirectly, in unethical or dishonest practices. The following acts and practices shall be considered either a breach of fiduciary duty or a dishonest and unethical practice...

(8)(c) Omitting to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they were made, not misleading;

...

(11) Failing to disclose to clients in writing before any advice is rendered any material conflict of interest relating to the adviser, or any of its employees...

22. The authority of the DFI's Commissioner to enforce the Act is set forth in KRS

292.470 (3) which states, in relevant part:

Whenever it appears to the commissioner that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule or order under this chapter, the commissioner may in his or her discretion bring any or all of the following remedies:

3. Issue a final order, after notice and an opportunity for a hearing, containing findings of fact and conclusions of law, directing any person or persons found to have engaged in, or about to be engaged in, activity that constitutes a violation of this chapter or any rule or order under this chapter:
 - (a) To cease and desist from the activity;
 - (b) To perform any other reasonable mandates directed by the commissioner pursuant to an appropriate remedy fashioned by the commissioner and reasonably calculated to carry out the provisions of this chapter; or
 - (c) To pay fines assessed under KRS 292.500(14) and costs assessed under KRS 292.500(15).

VIOLATIONS

23. In failing to disclose its internal preference for investing CSP assets in Proprietary Funds, JPMS violated KRS 292.320 and 808 KAR 10:450§2(8)(c).

24. In failing to disclose that it was receiving discounted services from affiliated companies, and that these discounts were based on the amount of CSP assets invested in Proprietary Funds, JPMS violated KRS 292.320 and 808 KAR 10:450§2(11)(a).

25. In failing to disclose the availability of lower-cost share classes than those purchased for CSP investments, and that higher-cost share classes were selected because they generated higher fees for JPMorgan affiliates, JPMS violated KRS 292.320 and 808 KAR 10:450§2(11)(a).

26. In failing to adequately disclose these conflicts of interest on any of the Form ADVs filed with the Department between 2008 and 2013, JPMS violated KRS 292.320 and 808 KAR 10:450§2(11)(a).

AGREEMENT AND ORDER

27. To resolve this matter without litigation or other adversarial proceedings, DFI and Respondent agree to compromise and settle all claims arising from the above-referenced factual background in accordance with the terms set forth herein.

28. This Agreed Order is not intended by the DFI to subject Respondent or any of its affiliates and their current or former officers, directors, employees, or other persons to any disqualifications contained in the laws of the United States, any state, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, the federal securities laws or the Commodity Exchange Act, the rules and regulations thereunder (including, without limitation, Regulation A and Rules 504 and 506(d) of Regulation D, and Regulation CF under the Securities Act of 1933), or the rules and regulations of self-regulatory organizations, or various states' securities laws, including any disqualifications from relying upon registration exemptions or safe harbor provisions. In addition, this Agreed Order is not intended to form the basis for any such disqualifications.

29. This Agreed Order is not intended to disqualify Respondent and those referenced in the above paragraph from any business that they otherwise are qualified, licensed or permitted to perform under applicable securities laws or regulations of Kentucky and any disqualifications from relying upon this state's administration exemptions or safe harbor provisions that arise from the Agreed Order are hereby waived.

30. In the interest of economically and efficiently resolving the violations described herein, DFI and Respondent hereby agree as follows:

- a. Respondent does not admit the facts, findings, and conclusions set forth above;
- b. Respondent agrees to pay a civil fine in the amount of **three hundred and twenty-five thousand dollars (\$325,000)** for the violations described herein, which shall be due and payable within fifteen (15) days of the entry of this Agreed Order;
- c. Respondent shall transmit payment electronically to the Department, which will provide detailed ACH transfer instructions upon request; and
- d. Respondent shall cease and desist from any further violations of the Act.

31. Respondent waives its right to demand a hearing at which it would be entitled to legal representation, to confront and cross-examine witnesses, and to present evidence on its own behalf, or to otherwise appeal or set aside this Agreed Order.

32. Respondent consents to and acknowledges the jurisdiction of DFI over this matter, and that this Agreed Order is a matter of public record and may be disseminated as such.

33. In consideration of execution of this Agreed Order, Respondent for itself, and for its successors and assigns, hereby releases and forever discharges the Commonwealth of Kentucky, DFI, Office of Legal Services, and each of their members, agents, and employees in their individual capacities, from any and all manner of actions, causes of action, suits, debts, judgments, executions, claims and demands whatsoever, known and unknown, in law or equity, that Respondent ever had, now has, may have or claim to have against any or all of the persons or entities named in this paragraph arising out of or by reason of this investigation, this disciplinary action, this settlement or its administration.

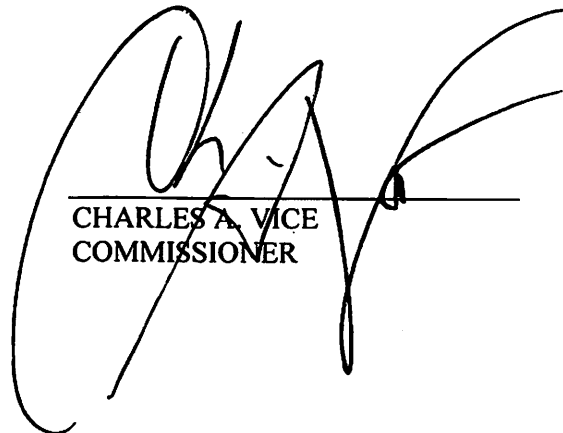
34. Execution of this Agreed Order and the full payment of the amount specified above concludes the investigation by the DFI and any other action the DFI could commence under

applicable Kentucky law on behalf of the Commonwealth of Kentucky in connection with the conduct and practices of the Respondent detailed in the Agreed Order, and the DFI fully and finally releases the Respondent from any civil or administrative claim for Respondent's conduct that the DFI has the authority to bring.

35. By signing below, the parties acknowledge they have read the foregoing Agreed Order, know and fully understand its contents, and that they are authorized to enter into and execute this Agreed Order and legally bind their respective parties.

36. This Agreed Order shall constitute the Final Order in this matter.

IT IS SO ORDERED on this the 9th day of March, 2020.

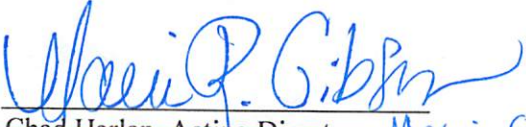


CHARLES A. VICE
COMMISSIONER

Consented to:

On behalf of the Department of Financial Institutions,

This 9th day of March, 20 20.

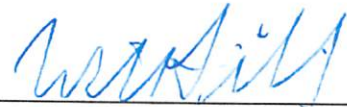


~~Chad Harlan, Acting Director~~ Marni Gibson, Division Director
Division of Securities
Department of Financial
Institutions

AND

On behalf of J.P. Morgan Securities, LLC,

This 5th day of March, 20 20.



Authorized Representative
J.P. Morgan Securities, LLC
Respondent

ACKNOWLEDGEMENT

STATE OF New York)

COUNTY OF New York)

On this the 5 day of MARCH, 20 20, William Freilich,

personally appeared before me and acknowledged himself/herself to be a duly authorized representative of J.P. Morgan Securities, LLC, and acknowledged that he/she entered into and executed the foregoing instrument for the purposes therein contained.

My Commission Expires: _____





Notary Public

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **Agreed Order** was sent on this the 10th day of March, 2020, by certified mail, return receipt requested, to:

Simpson Thatcher & Bartlett LLP
Attn: Joshua Levine
425 Lexington Avenue
New York, New York 10017-3954
COUNSEL FOR RESPONDENT

And by Hand-Delivery to:

Stuart Michael
Department of Financial Institutions
500 Mero Street 2SW19
Frankfort, KY 40601
COUNSEL FOR COMPLAINANT



Kentucky Department of Financial Institutions