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9
10 BEFORE THE DEPARTMENT OF BUSINESS OVERSIGHT
11 OF THE STATE OF CALIFORNIA

12 In the Matter of:) CRD NOS.: 139923 and 2592183
)
13 THE COMMISSIONER OF BUSINESS) STATEMENT IN SUPPORT OF ORDER TO
OVERSIGHT,) DISCONTINUE VIOLATIONS PURSUANT
14) TO CORPORATIONS CODE SECTION 25249
)
15 Complainant,)
)
16 v.)
)
17 HIGHLAND CAPITAL GROUP, INC. AND)
18 JOHN MCPHAIL,)
)
19 Respondents.)
)
20

21 Jan Lynn Owen, the Commissioner of Business Oversight (Commissioner), alleges and charges
22 as follows:

23 **I.**

24 **Introduction**

25 1. Highland Capital Group, Inc. (Highland) is an investment adviser licensed by the
26 Commissioner (CRD No. 139923), pursuant to the Corporate Securities Law of 1968 (CSL) as set
27 forth in Corporations Code section 25000 et seq., and accompanying regulations in California Code of
28

1 Regulations, title 10, section 260.000 et seq.¹

2 2. Highland has its principal place of business located at 1875 Century Park East, Suite 700, Los
3 Angeles, California 90067.

4 3. John McPhail (McPhail) is, and was at all times relevant, herein, the owner and chief executive
5 officer of Highland, licensed as an investment adviser representative (CRD No. 2592183).

6 4. The Commissioner is authorized to administer and enforce the provisions of the CSL and rules
7 adopted thereunder.

8 5. The Commissioner brings this action to order Highland and McPhail to discontinue violations
9 of law pursuant to section 25249.

10 **II.**

11 **Violations of the CSL**

12 6. On February 22, 2016, the Department of Business Oversight (Department) examined the
13 books and records of Highland. During this examination, the Department found that Highland
14 maintains custody of client accounts and detected several violations of the CSL and rules adopted
15 thereunder. The Department communicated its findings to Highland in four regulatory letters dated
16 March 25, 2016; June 6, 2016; July 5, 2016; and August 25, 2016.

17 **Failing to Submit to a Reasonable Examination**

18 7. Section 25241, subdivision (c), provides that all records of an investment adviser are subject to
19 reasonable examination by the Commissioner. Highland and McPhail failed to provide information
20 from books and records during the examination, thereby not submitting to a reasonable examination by
21 the Commissioner. Despite receiving four separate regulatory letters from the Department, Highland
22 and McPhail failed to respond to at least seventeen requests in these regulatory letters.

23 8. Moreover, from the date of the Department's first regulatory letter (March 25, 2016) to the date
24 of the last regulatory letter (August 25, 2016), the Department gave Highland and McPhail at least four
25 extensions to reply. While extensions of time were given to Highland and McPhail to provide
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27 ¹ All further section and rule references are to the California Corporations Code and title
28 10 of the California Code of Regulations.

1 requested information, they failed to fully comply by submitting only partial information.

2 9. To date, Highland and McPhail failed to respond to the Department's last regulatory letter
3 dated August 25, 2016. Based on the foregoing, they failed to submit to a reasonable examination of
4 records in violation of section 25241, subdivision (c).

5 **Failing to Comply with Books and Records Requirements**

6 10. Rule 260.241.3 requires every licensed investment adviser to keep true, accurate and current
7 books and records. Despite four regulatory letters requesting information from the books and records
8 of Highland, Highland and McPhail failed to provide the following to the Department:

- 9 (a) General ledger as required by Rule 260.241.3(a)(2);
- 10 (b) Account reconciliations for the Charles Schwab account number xxxx2071 and Fidelity
11 account number xxxx8970 as required by Rule 260.241.3(a)(4);
- 12 (c) Financial statements and worksheets as required by Rule 260.241.3(a)(6);
- 13 (d) Copies of third-party manager contracts as required by Rule 260.241.3(a)(10), and;
- 14 (e) Monthly computations of net worth as required by Rule 260.241.3(j);

15 Accordingly, Highland and McPhail violated Rule 260.241.3.

16 **Failing to Comply with Custody Requirements**

17 11. Rule 260.237 provides that it is unlawful and deemed to be a fraudulent, deceptive and
18 manipulative practice or course of business for a licensed investment adviser to have custody of client
19 funds, unless the investment adviser complies with certain requirements. Highland and McPhail
20 engaged in fraudulent, deceptive and manipulative practices, because they failed to provide the
21 following to the Department:

- 22 (a) Notification of custody on Form ADV as required by Rule 260.237(a)(1), and;
- 23 (b) Independent verification of client funds and securities as required by Rule 260.237(a)(6).

24 Consequently, Highland and McPhail violated Rule 260.237.

25 **Failing to Comply with Minimum Financial Requirements**

26 12. Rule 260.237.2(a), (c), (d), and (j) require an investment adviser who has custody or
27 discretionary authority of client funds or securities to maintain a minimum net worth in accordance
28 with generally accepted accounting principles (GAAP); and to notify the Commissioner when its net

1 worth is less than the minimum required by rule. Highland and McPhail failed to provide the
2 following to the Department:

- 3 (a) Financial statements in accordance with GAAP demonstrating a minimum net worth as
4 required by Rule 260.237.2(a) and (d).
- 5 (b) Notification that the net worth of Highland was less than the minimum required by Rule
6 260.237.2(c) and (j).

7 For these reasons, Highland and McPhail violated Rule 260.237.2.

8 **Failing to Comply with Reporting Requirements**

9 13. Rule 260.241.2(a) and (d) require every licensed investment adviser subject to Rule 260.237.2
10 (custody and discretionary authority) to file an annual financial report; to have the financial statements
11 in the annual report prepared by an independent accountant; and to file interim reports when its net
12 worth fails to meet the minimum required by law. Highland and McPhail failed to provide the
13 following to the Department:

- 14 (a) Annual reports for the most recent fiscal years as required by Rule 260.241.2(a)(2) and (4);
- 15 (b) Financial statements audited by an independent accountant as required by Rule
16 260.241.2(a)(3), and;
- 17 (c) Interim reports of net worth as required by Rule 260.241.2(d)(2), (3) and (4).

18 For these reasons, Highland and McPhail violated Rule 260.241.2.

19 **Failing to Follow Fair, Equitable and Ethical Principles**

20 14. For purposes of section 25238, Rule 260.238(a), (h) and (n) prohibit an investment adviser
21 from making investment recommendations without reasonable inquiry concerning a client's
22 investment objectives, financial situation, needs, and client records; prohibit misrepresenting the nature
23 of the fees charged to clients; and prohibit investment adviser contracts that are not in writing. During
24 the examination, Highland and McPhail failed to provide the following to the Department:

- 25 (a) Current and accurate suitability information to determine suitability for clients CS, DP, HH, J
26 &GF, KB, L&GB, L&DM, MC, N Family Trust, S&RB, SF, and WG, as required by Rule
27 260.238(a);
- 28 (b) Evidence showing client fees were paid quarterly in accordance with contracts of clients

1 D&RP, HH, JF, CS, KB, GB, D&LM, SF, WG, and S&RB, as required by Rule 260.238(h),
2 and;

3 (c) Copies of written advisory contracts for clients DP, SF, and WG as required by Rule
4 260.238(n).

5 Accordingly, Highland and McPhail violated Rule 260.238.

6 **Failing to Advertise Accurately and Completely**

7 15. Rule 260.235(a)(5), for purposes of section 25235, makes it unlawful to advertise misleading
8 statements. During the examination, examiners requested revisions to Highland's website so as not to
9 mislead the public concerning the years of experience held by Highland or its founder McPhail.
10 Highland and McPhail failed to update the website to clarify that Highland commenced business as a
11 registered investment adviser in 2007 (not in 2005 as implied). Also, Highland and McPhail failed to
12 update the website to clarify that McPhail (rather than Highland) has more than 20 years of investment
13 experience. As a result, Highland and McPhail violated Rule 260.235(a)(5).

14 **Failing to Comply with Investment Adviser Representative Report Requirements**

15 16. Rule 260.236.1(a)(3) requires an investment adviser representative to update Form U-4 within
16 30 days of any changes. The Department's examination revealed that Highland and McPhail reported
17 outside business activities that no longer exist. McPhail failed to update the Form U-4. Thus,
18 Highland and McPhail violated Rule 260.236.1(a)(3).

19 **Failing to Provide Notice of Changes**

20 17. Rule 260.241.4(a) requires each licensed investment adviser to promptly make changes to an
21 application. Highland and McPhail failed to update Form ADV Part 1, Item 9.A(1), of Highland's
22 application to indicate it has custody of client accounts. Therefore, Highland and McPhail violated
23 Rule 260.241.4(a).

24 **III.**

25 **Order to Discontinue Violations**

26 Corporations Code section 25249 provides that if, after examination and investigation, the
27 Commissioner has reasonable grounds to believe that any investment adviser has violated any law or
28 rule binding upon it, the Commissioner shall, by written order addressed to the investment adviser,

1 direct the discontinuance of the violation.

2 WHEREFORE, good cause showing, and pursuant to section 25249, the Commissioner prays
3 for an order directing Highland Capital Group, Inc. and John McPhail to discontinue violating
4 Corporations Code section 25241, subdivision (c), and the following sections of title 10, California
5 Code of Regulations:

6 260.241.3(a)(2), (4), (6), (10), and (j)

7 260.237(a)(1), (6)

8 260.237.2(a), (c), (d), (j)

9 260.241.2(a)(2), (3), (4) and (d)(2), (3), (4)

10 260.238(a), (h), (n)

11 260.235(a)(5)

12 260.236.1(a)(3)

13 260.241.4(a)

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15 Dated: June 8, 2018
16 Sacramento, CA

JAN LYNN OWEN
Commissioner of Business Oversight

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By _____
TIMOTHY L. Le BAS
Senior Counsel
Enforcement Division

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