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

12 In the Matter of:) CRD NO.: 139923
)
13 THE COMMISSIONER OF BUSINESS) ORDER REVOKING INVESTMENT
OVERSIGHT,) ADVISER CERTIFICATE PURSUANT TO
14) CORPORATIONS CODE SECTION 25232.3
15 Complainant,)
)
16 v.)
)
17 HIGHLAND CAPITAL GROUP, INC. AND)
18 JOHN MCPHAIL,)
)
19 Respondents.)
20)

21 Manuel P. Alvarez, the Commissioner of Business Oversight (Commissioner), alleges and
22 charges as follows:

23 I.

24 INTRODUCTION

- 25 1. The Commissioner issues this order to revoke the investment adviser certificate of Highland
26 Capital Group, Inc. pursuant to Corporations Code section 25232.3.
27 2. Highland Capital Group, Inc. (Highland) is an investment adviser licensed by the
28 Commissioner (CRD No. 139923), pursuant to the Corporate Securities Law of 1968 (CSL) as set

1 forth in Corporations Code section 25000 et seq., and accompanying regulations in California Code of
2 Regulations, title 10, section 260.000 et seq.¹

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

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

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

9 **II.**

10 **VIOLATIONS OF CSL**

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

16 **Failing to Submit to a Reasonable Examination**

17 7. Section 25241, subdivision (c), provides that all records of an investment adviser are subject to
18 reasonable examination by the Commissioner. Highland and McPhail failed to provide information
19 from books and records during the examination, thereby not submitting to a reasonable examination by
20 the Commissioner. Despite receiving four separate regulatory letters from the Department, Highland
21 and McPhail failed to respond to at least seventeen (17) requests in these regulatory letters.

22 8. Moreover, from the date of the Department's first regulatory letter (March 25, 2016) to the date
23 of the last regulatory letter (August 25, 2016), the Department gave Highland and McPhail at least four
24 (4) extensions to reply. While extensions of time were given to Highland and McPhail to provide
25 requested information, they failed to fully comply by submitting only partial information.

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

4 **Failing to Comply With Books and Records Requirements**

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

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

14 Accordingly, Highland and McPhail violated Rule 260.241.3.

15 **Failing to Comply With Custody Requirements**

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

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

23 Consequently, Highland and McPhail violated Rule 260.237.

24 **Failing to Comply With Minimum Financial Requirements**

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

1 following to the Department:

2 (a) Financial statements in accordance with GAAP demonstrating a minimum net worth as
3 required by Rule 260.237.2(a) and (d).

4 (b) Notification that the net worth of Highland was less than the minimum required by Rule
5 260.237.2(c) and (j).

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

7 **Failing to Comply With Reporting Requirements**

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

13 (a) Annual reports for the most recent fiscal years as required by Rule 260.241.2(a)(2) and (4).

14 (b) Financial statements audited by an independent accountant as required by Rule
15 260.241.2(a)(3).

16 (c) Interim reports of net worth as required by Rule 260.241.2(d)(2), (3) and (4).

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

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

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

24 (a) Current and accurate suitability information to determine suitability for clients CS, DP, HH, J
25 &GF, KB, L&GB, L&DM, MC, N Family Trust, S&RB, SF, and WG, as required by Rule
26 260.238(a).

27 (b) Evidence showing client fees were paid quarterly in accordance with contracts of clients
28 D&RP, HH, JF, CS, KB, GB, D&LM, SF, WG, and S&RB, as required by Rule 260.238(h).

1 (c) Copies of written advisory contracts for clients DP, SF, and WG as required by Rule
2 260.238(n).

3 Accordingly, Highland and McPhail violated Rule 260.238.

4 **Failing to Advertise Accurately and Completely**

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

12 **Failing to Comply With Investment Adviser Representative Report Requirements**

13 16. Rule 260.236.1(a)(3) requires an investment adviser representative to update Form U-4 within
14 30 days of any changes. The Department's examination revealed that Highland and McPhail reported
15 outside business activities that no longer exist. McPhail failed to update the Form U-4. Thus,
16 Highland and McPhail violated Rule 260.236.1(a)(3).

17 **Failing to Provide Notice of Changes**

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

22 **III.**

23 **VIOLATIONS OF ORDERS**

24 18. On December 6, 2018, the Department served an Order to Discontinue Violations on Highland
25 and McPhail pursuant to section 25249. Highland and McPhail failed to request a hearing by January
26 5, 2019, so that order became final and effective. On February 21, 2019, the Department confirmed
27 that Highland and McPhail continued to violate that Order by not complying with the above-referenced
28 laws. This Order was necessary for the protection of investors to ensure that Highland and McPhail

1 were complying with these laws that are designed to guard against mismanagement, misappropriation,
2 and misrepresentation.

3 19. On December 6, 2019, the Department served a Notice of Intent to Levy Administrative
4 Penalties of \$270,000.00 pursuant to section 25252. Highland and McPhail failed to request a hearing
5 by January 5, 2019. On April 11, 12 and 15, 2019, the Department served a final and effective Order
6 Levying Administrative Penalties of \$270,000.00 on Highland and McPhail, giving them 30 days and
7 until May 15, 2019 to pay the penalty to the Department. Highland and McPhail failed to pay that
8 administrative penalty. This Order was necessary for the protection of investors to further ensure that
9 Highland and McPhail complied with the above-referenced laws which they both continue to violate.

10 **IV.**

11 **ORDER REVOKING INVESTMENT ADVISER CERTIFICATE**

12 Corporations Code section 25232.3 provides that the Commissioner may immediately revoke
13 the certificate of any investment adviser if the investment adviser fails to comply with any currently
14 effective order of the Commissioner which is necessary for the protection of any investor, unless the
15 investment adviser secures a court order restraining the enforcement of the Commissioner’s revocation
16 order within 10 days of the date the order is issued.

17 WHEREFORE, good cause showing, based on violations of an Order to Discontinue
18 Violations and an Order Levying Administrative Penalties, given that these orders are for the
19 protection of investors, and pursuant to Corporations Code section 25232.3, the Commissioner hereby
20 revokes the investment adviser certificate of Highland Capital Group (CRD No. 139923).

21 Dated: June 3, 2019
22 Sacramento, CA

MANUEL P. ALVAREZ
Commissioner of Business Oversight

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24 By _____
25 MARY ANN SMITH
26 Deputy Commissioner
27 Enforcement Division
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