

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 2430 / September 15, 2005**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12041**

**In the Matter of**  
  
**CMS FUND ADVISERS, INC.,**  
  
**Respondent**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER PURSUANT TO  
SECTIONS 203(e) AND 203(k) OF THE  
INVESTMENT ADVISERS ACT OF 1940**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against CMS Fund Advisers, Inc. (“Respondent” or “CMS”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e) and 203(k) of the Advisers Act (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### **Nature of Proceedings**

1. This matter involves violations of Section 206(4) and Rule 206(4)-2 of the Advisers Act (the "custody rule") by CMS, an investment adviser registered with the Commission. The custody rule requires investment advisers that have custody of client funds and securities to retain an independent auditor to conduct surprise custody verifications of such funds and securities at least once during each calendar year. CMS had custody of client funds and securities because the firm and its principals had unrestricted access to, and control of, clients' assets for investing and payment of firm expenses, and did not qualify for an exemption. For the years 2001 through 2004, Respondent had custody of client funds and securities but failed to perform the required annual custody verifications.

#### **Respondent**

2. CMS Fund Advisers, Inc. has been registered with the Commission as an investment adviser since 1982, and is located in Philadelphia, Pennsylvania. CMS provides advisory and administrative services to limited partnerships offered and controlled by the firm, and has over \$1 billion in assets under management.

#### **Other Relevant Party**

3. Joseph W. Lutes ("Lutes") has been a principal of CMS since 1998 and the chief financial officer from 1999 to May 2005. Lutes was responsible for ensuring completion of Respondent's custody verifications, including the engagement of an independent accounting firm to complete the verifications.<sup>2</sup>

#### **Facts**

4. In 2000 and 2001, CMS had custody of client funds and securities but did not perform its annual surprise custody verifications as required by the custody rule.

5. The Commission staff accepted Respondent's proposal in February 2002 to rectify the firm's non-compliance with the custody rule by (1) completing a custody verification for 2001 by March 31, 2002; (2) completing a surprise custody verification for 2002 during 2002 following the completion of the 2001 verification; and (3) completing annual surprise custody

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> The Commission has instituted separate administrative and cease-and-desist proceedings against Lutes arising out of the same events described in this Order.

verifications for each subsequent year in the corresponding calendar year in accordance with the custody rule. Respondent also represented that it had engaged one accounting firm to complete all of the required verifications.

6. Lutes was the senior officer responsible for ensuring the completion of Respondent's custody verifications. Lutes knew at the time that CMS made its proposed compliance plan to the Commission staff that the custody verifications could not be completed as represented.

7. Lutes engaged an auditor in February 2002 to perform only the 2001 verification for Respondent. Respondent did not complete the 2001 custody verifications until July 2003.

8. Lutes did not engage an auditor to begin the 2002 and 2003 custody verifications for Respondent until April 2004. Respondent completed these verifications in May 2005.

9. Lutes did not engage an independent auditor to perform the custody verification for 2004 for Respondent until January 2005 and completed the verification in July 2005.<sup>3</sup> In this verification, and in each preceding verification, CMS's auditors discovered no discrepancies in CMS's records of its investor's assets.

10. CMS failed to timely complete the custody verifications as described above. CMS failed to timely engage an auditing firm for the 2002, 2003 and 2004 verifications, or provide a specific deadline to the auditor. Moreover, CMS chose to prioritize other business matters ahead of the verifications with the full knowledge that it would continue to operate in violation of the custody rule.

### **Violation**

11. As a result of the conduct described above, CMS willfully<sup>4</sup> violated Section 206(4) of the Advisers Act and Rule 206(4)-2 promulgated thereunder, as in effect at the relevant time, which prohibit an investment adviser, by use of the mails or any means or instrumentality of

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<sup>3</sup> The Commission amended Rule 206(4)-2 effective November 5, 2003, by eliminating the surprise examination requirement if a qualified custodian sends quarterly account statements directly to the adviser's clients. Respondent has had a qualified custodian providing the required quarterly statements since April 2004. Respondent, therefore, was required to perform a custody verification in 2004 only for the period January through March.

<sup>4</sup> "Willfully," as used in the Order, means intentionally committing the act that constitutes the violation. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

interstate commerce, directly or indirectly, to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative, and which requires an investment adviser who has custody or possession of any funds or securities in which any client has any beneficial interest to verify such funds and securities by actual examination at least once during each calendar year by an independent public accountant at a time that shall be chosen by such accountant without prior notice to the investment adviser.

#### IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

- A. Respondent is hereby censured;
- B. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 promulgated thereunder;
- C. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$115,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies CMS Fund Advisers, Inc. as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Daniel M. Hawke, Associate District Administrator, Securities and Exchange Commission, 701 Market Street, Suite 2000, Philadelphia, Pennsylvania 19106.

By the Commission.

Jonathan G. Katz  
Secretary