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CLERK U.S. DISTRICT COURT
CENTRAL DISTRICT OF CALIF.
LOS ANGELES

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12 **UNITED STATES DISTRICT COURT**
13 **CENTRAL DISTRICT OF CALIFORNIA**

14 **CV 09-03697 AHM FMOx**

15 **SECURITIES AND EXCHANGE**
16 **COMMISSION,**

17 Plaintiff,

18 vs.

19 **GENDREAU & ASSOCIATES, INC. and**
JACQUES R. GENDREAU,

20 Defendants.

Case No.

**COMPLAINT FOR VIOLATIONS
OF THE FEDERAL SECURITIES
LAWS**

21
22 Plaintiff Securities and Exchange Commission ("Commission") alleges as
23 follows:

24 **JURISDICTION AND VENUE**

25 1. This Court has jurisdiction over this action pursuant to Sections
26 21(d)(1), 21(d)(3)(A), 21(e), and 27 of the Securities Exchange Act of 1934
27 ("Exchange Act"), 15 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e), and 78aa and
28 Sections 209(d), 209(e)(1), and 214 of the Investment Advisers Act of 1940

1 (“Advisers Act”), 15 U.S.C. §§ 80b-9(d), 80b-9(e)(1), and 80b-14. Defendants
2 have, directly or indirectly, made use of the means or instrumentalities of interstate
3 commerce, of the mails, or of the facilities of a national securities exchange in
4 connection with the transactions, acts, practices, and courses of business alleged in
5 this complaint.

6 2. Venue is proper in this district pursuant to Section 27 of the Exchange
7 Act, 15 U.S.C. § 78aa, and Section 214 of the Advisers Act, 15 U.S.C. § 80b-14,
8 because certain of the transactions, acts, practices and courses of conduct
9 constituting violations of the federal securities laws occurred within this district
10 and defendants reside in this district.

11 **SUMMARY**

12 3. This matter involves the failure of Gendreau & Associates Inc.
13 (“G&A”), a registered investment adviser, and its owner and president, Jacques R.
14 Gendreau (“Gendreau” and collectively with G&A, “Defendants”), to disclose the
15 high degree of risk associated with their investment strategies, and management of
16 client assets in an unsuitable manner in light of the clients’ risk tolerance.

17 4. From at least July 2007 through September 2008, Gendreau employed
18 a high-risk investment strategy for G&A clients and invested client assets using
19 substantial margin. Trading on margin means that the customer has borrowed
20 money from a broker to finance the trade. By borrowing money, the customer can
21 increase the assets he purchases, which provides the potential for greater returns if
22 the investment makes money. Along with the potential for greater returns,
23 however, comes the risk of greater losses. “Margin,” or “margin equity ratio,”
24 refers to the customer’s equity as a percentage of the current market value of the
25 securities held in a margin account. The lower the percentage, the more the
26 customer has borrowed, and the greater both the potential gains and potential risks.

27 5. Initially, Gendreau invested client assets in leveraged mutual funds
28 and exchange-traded funds (“ETFs”) using substantial margin. A leveraged mutual

1 fund uses various financial instruments or borrowed capital, such as margin, to
2 increase the fund's potential returns. An ETF is like a mutual fund in that it tracks
3 an index, commodity, or other group of assets, but it trades like a stock on an
4 exchange with price fluctuations throughout the day.

5 6. As client assets declined dramatically due to Gendreau's high-risk
6 trading strategy, Gendreau started investing client assets in an even riskier manner,
7 by concentrating investments in a limited number of companies in a single sector
8 while still using significant margin. Starting in July 2008, Gendreau invested
9 client funds primarily in a limited number of bank stocks.

10 7. From at least July 2007 through September 2008, Gendreau employed
11 these high-risk investment strategies for clients without adequately disclosing the
12 high-risk nature of the strategies. Gendreau also used these high-risk strategies
13 even though he knew that the investments were not suitable because of the clients'
14 risk tolerance, including the clients' age, retirement status, or need for funds in the
15 short-term.

16 8. In August and September 2008, Gendreau implemented his riskiest
17 strategy by investing client assets – regardless of the client's risk tolerance – solely
18 in the preferred shares of two banks using substantial margin. Even though
19 Gendreau knew that this was a very risky investment strategy, Gendreau
20 misrepresented to clients that the investments were “guaranteed” and/or involved
21 “practically no risk.” Moreover, in employing this strategy, Gendreau disregarded
22 instructions from several clients who had told Gendreau to invest their assets
23 exclusively in cash.

24 9. In a matter of days, G&A clients collectively lost about \$12 million,
25 or 72%, of the assets that Gendreau managed. Moreover, about 42 G&A clients
26 owe the broker that made the margin loans about \$300,000 due to margin loans.

27 10. By engaging in the conduct described in this complaint,
28 Defendants, directly and indirectly, engaged in acts, practices, and courses of

1 business in violation of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and
2 Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, and Sections 206(1) and 206(2) of
3 the Advisers Act, 15 U.S.C. §§ 80b-4, 80b-6(1) and 80b-6(2). Moreover, G&A
4 violated Section 204 of the Advisers Act, 15 U.S.C. § 80b-4, and Rule 204-2
5 thereunder, 17 C.F.R. § 275.204-2, and Gendreau aided and abetted G&A's
6 violations of Section 204 of the Advisers Act, 15 U.S.C. § 80b-4, and Rule 204-2
7 thereunder, 17 C.F.R. § 275.204-2.

8 11. The Commission brings this action for a judgment permanently
9 restraining and enjoining Defendants against future violations of the federal
10 securities laws, ordering disgorgement of ill-gotten gains and prejudgment interest
11 thereon, and imposing civil penalties against each Defendant.

12 **DEFENDANTS**

13 12. Gendreau & Associates, Inc. is a California corporation with its
14 principal executive offices in Monarch Beach, California. G&A has been
15 registered with the Commission as an investment adviser since July 6, 2007.
16 During 2007 and 2008, G&A had up to 185 clients and about \$97 million in assets
17 under management.

18 13. Jacques R. Gendreau, age 67, resides in Dana Point, California, and
19 formed G&A in 2007. Gendreau has been G&A's president and chief compliance
20 officer since its formation. During the relevant time period, Gendreau made the
21 investment decisions for G&A clients.

22 **THE FRAUDULENT SCHEME**

23 **Gendreau Failed To Disclose The Significant Risks Associated With His** 24 **Investment Strategy And To Consider Client Risk Tolerance**

25 14. From 2007 through September 2008, Gendreau managed client funds
26 by employing high-risk investment strategies. Generally, Gendreau encouraged his
27 clients to become highly leveraged in various ways regardless of the clients' risk
28 tolerance. Gendreau maximized his clients' leverage by: (1) using significant

1 margin (resulting in margin equity ratios of about 50%); (2) encouraging clients to
2 increase their investments by borrowing against their homes; (3) persuading clients
3 to invest with money withdrawn or borrowed from their retirement accounts so that
4 it could be traded on margin; and (4) investing heavily in leveraged mutual funds
5 and ETFs. Employing each of these methods, often simultaneously, Gendreau
6 offered clients potential large gains, but also exposed them to large losses.

7 15. The client agreements between G&A and its clients provided that
8 Gendreau would analyze the “client’s investment objectives, liquidity needs, time
9 horizon, and risk tolerance level” in order to “select[] the asset class allocation
10 which achieves the highest expected return compatible with client risk tolerance.”

11 16. Despite this representation, Gendreau employed a one-size-fits-all
12 investment strategy and made investments using significant margin even though
13 doing so was inconsistent with many clients’ risk tolerance. Gendreau employed
14 this investment strategy for clients who were retired, close to retirement, had
15 limited assets and income, or needed those assets in the short-term. Gendreau also
16 continued to employ this investment strategy for clients who expressed concerns to
17 Gendreau about preserving their assets.

18 17. For example, throughout 2008, a married couple whose investment
19 portfolio was comprised mostly of funds borrowed against their home and
20 retirement account based on Gendreau’s advice, repeatedly emailed Gendreau
21 about losses they were suffering. The couple informed Gendreau that they were
22 relying on the money in their investment portfolio to refinance their home and to
23 pay other short-term expenses. Despite this, Gendreau continued to utilize a high-
24 risk investment strategy and invested these clients’ funds using substantial margin.

25 18. A retired couple in their late sixties emailed Gendreau in April 2008,
26 instructing him to put their money in cash because they could not afford to lose any
27 more money. That couple had borrowed about \$1 million against their home and
28 had withdrawn half of the husband’s retirement savings on Gendreau’s advice.

1 They told Gendreau that they needed the returns on their investments to pay their
2 monthly expenses. Even though the couple told Gendreau of their reduced risk
3 tolerance, he continued to utilize his high-risk strategy and invested these clients'
4 funds using substantial margin.

5 19. Gendreau also touted the fantastic potential returns from his
6 investment strategy without adequately disclosing that the strategy was high-risk.
7 For example, various versions of a brochure Gendreau provided to clients claimed
8 that from 2004 through 2007, client accounts increased by 42% per year and that
9 Gendreau's goal was for his clients' accounts to "DOUBLE EVERY 2 ½
10 YEARS." The promotional materials even promised that clients could "add a zero
11 to their account balance every 8¼ years" so that, according to the materials, a
12 \$100,000 investment would be worth \$1 billion in 33 years. By contrast, risks
13 relating to margin were generally only mentioned once within the 17-page
14 brochure. That single disclosure was inadequate. Specifically, the brochure stated:

15 MARGIN RISKS: By using Margin we have been able to reach a
16 return 3 to 4 times higher than the SP-500 index. This increases the
17 return as well as the risk of loss. For example, recently the SP-500
18 has been moving up by more than 10% per year and correcting down
19 by up to 5% in one month. Our Portfolios have been going up by
20 more than 100% per year and also correcting down, by up to 20%.

21 20. G&A's Form ADV filed provided to clients also failed to provide
22 adequate disclosures of the risks associated with the investment strategy, stating
23 only that "investment methods involve a Beta 2 to 4 times higher than the [S&P
24 500]," which G&A stated meant that "when market conditions are favorable,
25 clients can achieve greater returns than the [S&P 500]" and "that when market
26 conditions are not favorable, clients may lose more than the [S&P 500] declines."

27 21. When Gendreau used his one-size-fits-all investment strategy, he
28 knew that it was unsuitable for many of his clients because of their lower risk
tolerance, yet he failed to adequately disclose that his strategy was high-risk.

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1 **In July 2008, Gendreau Began Taking Greater Risks**

2 **When Investing Client Funds**

3 22. In July 2008, Gendreau changed his investment strategy from
4 investing in mutual funds and ETFs to investing, on margin, up to 100% of client
5 assets in the common stocks of about ten banks.

6 23. This strategy of buying bank stocks using significant margin was highly
7 risky because it only focused on about ten companies in a single sector, and involved
8 using substantial margin. Once again, Gendreau used this strategy for clients for
9 whom it was unsuitable, including clients that had previously told Gendreau that they
10 were concerned about losing money in their investment portfolios.

11 24. Consistent with his past practice when explaining his investment
12 strategies to clients, Gendreau highlighted his projections for returns while failing
13 to adequately disclose the associated risks. For example, in an email to clients
14 explaining this shift in strategy, Gendreau claimed that the bank stock prices would
15 potentially increase two to seven times and that clients “should be able to increase
16 [their] investment 3-5 times according to [their] level of margin.” He did not
17 mention that the investment strategy was very risky. By mid-August, the bank
18 shares had declined significantly in value, Gendreau had sold the bank stock, and
19 his clients had suffered substantial losses.

20 **In September 2008, Gendreau Implemented His Riskiest**

21 **Investment Strategy**

22 25. From late August through early September 2008, Gendreau emailed
23 clients explaining that he had developed a new investment strategy. Gendreau’s
24 new strategy was to invest all client assets in the preferred stock of two banks
25 using significant margin. Gendreau told clients that this strategy would yield
26 annual returns of 15.5% based on the preferred stocks paying certain dividends.
27 Gendreau told clients that these returns were “guaranteed” or involved “practically
28 no risk.”

