

MEMO# 18348

December 22, 2004

BROKER-DEALER SETTLES WITH SEC AND NASD REGARDING SALES OF SYSTEMATIC INVESTMENT PLANS

[18348] December 22, 2004 TO: BOARD OF GOVERNORS No. 90-04 CHIEF COMPLIANCE OFFICER COMMITTEE No. 36-04 COMPLIANCE ADVISORY COMMITTEE No. 121-04 SEC RULES MEMBERS No. 179-04 SMALL FUNDS MEMBERS No. 132-04 RE: BROKER-DEALER SETTLES WITH SEC AND NASD REGARDING SALES OF SYSTEMATIC INVESTMENT PLANS The Securities and Exchange Commission has issued an order making findings and imposing disgorgement and compliance reforms in an administrative proceeding against a registered broker-dealer for using misleading sales materials to offer and sell mutual-fund investments through an installment method ("systematic plan").¹ The Respondent consented to the entry of the SEC Order without admitting or denying the SEC's findings. In addition, the NASD announced the settlement of similar charges against the Respondent.² The settlements are summarized below. 1 See *In the Matter of First Command Financial Planning, Inc.*, SEC Release Nos. 34-50859 and 33-8513, Admin. Proc. File No. 3-11770 (Dec. 15, 2004) ("SEC Order"). The SEC Order also censures, and imposes a cease and desist order on, the Respondent. Copies of the SEC Order and accompanying press release are available at <http://www.sec.gov/litigation/admin/34-50859.htm> and <http://www.sec.gov/news/press/2004-170.htm>, respectively. Systematic plans allow investors to invest in mutual fund shares indirectly by making fixed monthly contributions – typically ranging from \$100 to \$500 – over a period of at least 15 years. The plans impose a unique sales charge or load that is equal to 50% of the plan's first 12 monthly payments, with no sales load thereafter. 2 See *In re First Command Financial Planning, Inc.*, NASD Letter of Acceptance, Waiver and Consent (Dec. 15, 2004) ("AWC"). A copy of the accompanying press release is available at http://www.nasd.com/stellent/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_012786&ssSourceNodeID=5. The NASD also settled a related action against a supervisor of the Respondent for inappropriately confronting a customer who complained. The supervisor was fined \$25,000 and suspended from acting in any supervisory capacity for 30 days. See *In re James M. Provo*, NASD Letter of Acceptance, Waiver and Consent (Dec. 15, 2004). 2 I. SEC Order A. Findings³ The SEC Order finds that since at least January 1999, the Respondent, whose customer base consists almost entirely of active-duty and retired U.S. military personnel, offered and sold systematic plans by making misleading comparisons between a systematic plan and other mutual funds. For example, according to the SEC Order, sales scripts utilized by the firm erroneously claimed that no-load mutual funds "frequently have some of the highest long-term costs" and are primarily for "speculative" investors. It also finds that the Respondent's sales materials contained misleading statements and omissions concerning the availability to military investors of the Thrift

Savings Plan ("TSP"), a Federal government-sponsored retirement savings and investment plan that offers many of the features of a systematic plan at lower costs. Finally, the SEC Order finds that the Respondent mischaracterized the upfront sales load associated with systematic plans as the only way a fund manager can ensure that most of the shareholders are committed, long-term investors. As a result of the conduct generally described above, the SEC Order finds that the Respondent willfully violated Section 17(a)(2) of the Securities Act of 1933 by making materially misleading statements and omissions concerning, among other things, (1) comparisons between systematic plans and other mutual fund investments; (2) the availability of the TSP to military investors; and (3) the efficacy of the upfront sales load in ensuring that investors remained committed to the systematic plan.

B. Undertakings⁴ The respondent has agreed to certain remedial and corrective measures, as follows:

- **Disgorgement** – The Respondent will pay \$12 million, which will be used for customer restitution and for an investor education program for members of the U.S. military and their families.
- **Independent Consultant** – The Respondent will retain an Independent Consultant acceptable to the staffs of the SEC and the NASD for a period of two years to periodically: (1) review, verify, and report in writing to the staffs of the SEC and the NASD on the restitution process described in the SEC Order; and (2) review and make recommendations concerning the adequacy of the Respondent's sales scripts, training materials, advertising, sales literature, sales training systems and procedures, and supervisory procedures and systems. Within 30 days of the date restitution is required to be completed in the AWC, the Respondent will provide to the staffs of the SEC and the NASD and the Independent Consultant a report detailing the payment of this restitution. The Respondent will require the Independent Consultant to provide an initial report to the Respondent and to the staffs of the SEC and the NASD containing 3 The factual allegations described in the AWC generally mirror those in the SEC Order and, accordingly, will not be discussed separately in this Memorandum. 4 The undertakings described in the AWC generally mirror those in the SEC Order and, accordingly, will not be described separately in this Memorandum. 3 recommendations, if appropriate, for the adoption of revised sales scripts, advertising and sales materials as well as revised procedures by the Respondent with respect to the matters described above under (1) and (2). Within 30 days after delivery of the Independent Consultant's report, the Respondent will either adopt all recommendations made by the Consultant or, if it determines that a recommendation is unduly burdensome or impractical, propose an alternative procedure designed to achieve the same objective. The Respondent will submit the proposed alternative in writing to the Independent Consultant and the staffs of the SEC and the NASD. The Independent Consultant will evaluate the alternative procedure and provide a written decision to the Respondent reflecting his or her recommendation. The Respondent will implement the Independent Consultant's ultimate determination with respect any proposed alternative procedure and adopt all recommendations deemed appropriate by the Independent Consultant.
- **Pre-Use Advertising Filing Requirement** – The Respondent will file with the NASD Advertising Regulation Department all sales literature and advertisements, including scripts, in accordance with the AWC. After filing, the Respondent will use the material only in accordance with the AWC.

II. AWC The Respondent submitted the AWC to the NASD without admitting or denying the NASD's allegations or findings. According to the AWC, the NASD finds that the Respondent:

- made misstatements and omissions in violation of NASD Conduct Rule 2110;⁵
- failed to maintain books and records in connection with the retention and accessibility of certain e-mail communications in violation of Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-4 thereunder and NASD Conduct Rules 2110 and 3110;⁶
- failed to establish and maintain adequate procedures and systems to ensure that its sales practices, sales literature, advertising and retention of e-mail were in compliance with the federal securities laws and NASD rules in violation of NASD Conduct

Rules 2110 and 3010;7 • inappropriately confronted a former customer who complained in violation of NASD Rule 2110; and 5 NASD Conduct Rule 2110 requires that a member, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade. 6 Section 17(a) and Rule 17a-4 describes the records that must be kept by certain exchange members, brokers and dealers. NASD Conduct Rule 3110 requires each member to make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations, and statements of policy promulgated thereunder and with the rules of the NASD and the SEC. 7 NASD Conduct Rule 3010 requires that each member establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations and with the rules of the NASD. 4 • filed an inaccurate Form U-5 in violation of NASD Conduct Rule 2110 and IM-1000-1. Jane G. Heinrichs Assistant Counsel

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