

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2436 / September 30, 2005

ADMINISTRATIVE PROCEEDING
File No. 3-12067

<u>In the Matter of</u>	:	
	:	
APPLIED FINANCIAL GROUP, INC.	:	ORDER INSTITUTING PUBLIC
	:	PROCEEDINGS, MAKING FINDINGS,
AND	:	AND IMPOSING REMEDIAL
	:	SANCTIONS PURSUANT
	:	TO SECTIONS 203(e)
DENNIS HOLCOMBE,	:	AND 203(f) OF THE INVESTMENT
	:	ADVISERS ACT OF 1940
<u>Respondents.</u>	:	

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be instituted against Applied Financial Group, Inc. ("Applied Financial") pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") and against Dennis Holcombe ("Holcombe") pursuant to Section 203(f) of the Advisers Act.

II.

In anticipation of the institution of these administrative proceedings, Respondents have submitted Offers of Settlement ("Offers") that 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 in which the Commission is a party, and without admitting or denying the findings, except as to the jurisdiction of the Commission over them and over the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Public Proceedings, Making Findings, and Imposing Remedial Sanctions Pursuant to Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 ("Order"). Accordingly, IT IS ORDERED that proceedings pursuant to Sections 203(e) and 203(f) of the Advisers Act be, and hereby are, instituted.

III.

On the basis of this Order and the Offers submitted by the Respondents, the Commission finds¹ that:

The Respondents

- A. At all times relevant to this proceeding, Applied Financial was an investment adviser registered with the Commission and headquartered in Atlanta, Georgia.
- B. At all times relevant to this proceeding, Holcombe was Applied Financial's president, a portfolio manager, and its principal stockholder.

The Compliance Officer's Fraud

- C. Between May 2000 and April 2004, Applied Financial's Vice President of Compliance ("Compliance Officer") placed unauthorized orders to sell securities in the accounts of three profit-sharing plans that were clients of Applied Financial. During that time, the Compliance Officer also placed unauthorized orders to sell securities in the account of a profit-sharing plan that was a client of a related pension plan administrator that shared office space with Applied Financial.
- D. The Compliance Officer transferred the proceeds of the unauthorized sale of those securities to the accounts of two individual clients of Applied Financial, an elderly widow and a disabled client ("the conduit accounts"), by forging the signatures of trustees of the profit-sharing plans on checks drawn on the profit-sharing plans' money market accounts that were payable to one of the conduit accounts. The Compliance Officer varied her scheme on other occasions by using forged letters of authorization to transfer securities directly from the profit-sharing plans' accounts to the conduit accounts where she then placed orders to sell the securities.
- E. The Compliance Officer used two methods to transfer the misappropriated funds from the conduit accounts to accounts that she controlled. First, once the assets had been transferred to the conduit account owned by the elderly widow, the Compliance Officer forged the widow's signature on checks drawn on that account that were made payable to herself, to accounts she controlled, or to her creditors. The second method was used to transfer misappropriated funds from the conduit account of the disabled client. The Compliance Officer informed that

¹ The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

client that if she signed blank checks and left them with the Compliance Officer, Applied Financial would use them to purchase securities for her account. The Compliance Officer then used those blank checks to transfer cash to herself, to accounts she controlled, or to her creditors. Of the approximately \$2.5 million that was transferred through each of the conduit accounts, over \$515,000 was transferred through the elderly widow's account during the nine months after she died, notice of which death had been given to the account's custodian by Applied Financial.

- F. The forged checks and letters of authorization described above were honored by the clients' custodian.
- G. Between May 1, 2000, and April 30, 2004, the Compliance Officer used the procedures described above to misappropriate approximately \$5.4 million of the assets of four profit-sharing plans. Each of the profit-sharing plans has entered into a private settlement agreement with Applied Financial, Holcombe, the account's custodian, and others regarding the misappropriated funds.
- H. The Compliance Officer was able to avoid detection of her fraud, in part, because her duties included reconciling Applied Financial's records with those of the accounts' custodian. Specifically, those duties included reviewing the custodian's summary of Applied Financial's previous day's transactions that was sent electronically to Applied Financial each business day. She was responsible for comparing the custodian's summary to the transactions on Applied Financial's blotter, reconciling any discrepancies by correcting either the blotter or the custodian's record, and downloading the corrected summary from the custodian into the recordkeeping system that Applied Financial used to generate statements for its clients.
- I. While the Compliance Officer was reconciling accounts, she deleted every fraudulent transaction from the summary sent by the custodian each business day before that data was downloaded into Applied Financial's recordkeeping system. Unless the Compliance Officer was absent, no one else at Applied Financial reconciled the information received from the custodian with Applied Financial's blotter.²
- J. In addition to the daily reconciliations, the Compliance Officer was the only person at Applied Financial who was specifically responsible for reviewing the confirmations and monthly statements for each client received from the custodian. She was tasked with ascertaining if there were discrepancies between Applied Financial's internal records and those statements. She was also responsible for filing those statements in the appropriate clients' files after they were reconciled. After the Compliance Officer's fraudulent conduct was discovered, Applied

² Although Applied Financial's outside accountant looked at the amount of assets under management for random samplings of selected clients and compared the custodian's records to Applied Financial's invoices for those clients, the accountant's samplings never included the accounts involved in this matter.

Financial discovered that the monthly statements that evidenced the fraudulent transactions were missing from the files of two of the profit-sharing plans and from the files of the two conduit accounts.

The Respondents' Failure Reasonably To Supervise

- K. At all times relevant to this proceeding, the Compliance Officer was an employee of Applied Financial and Holcombe was her supervisor.
- L. Applied Financial's procedures were deficient regarding segregation of duties. Without providing adequate, independent oversight, Applied Financial gave the Compliance Officer: (1) the responsibility to place legitimate orders for securities and the opportunity to enter fraudulent ones; (2) the opportunity to delete fraudulent orders for securities from its internal records; (3) the responsibility to reconcile and file confirmations and monthly statements received for each client from the custodian; and (4) the opportunity to destroy those statements. Thus, the Compliance Officer was able to place fraudulent orders in clients' accounts, to delete the fraudulent transactions before they were incorporated into Applied Financial's records, and to destroy, rather than file, the statements from the custodian that reflected all the transactions in the accounts that were being defrauded without detection. Applied Financial's failure to provide adequate oversight of the Compliance Officer, who was in a position to commit fraud and hide her fraudulent conduct, contributed to its failure to detect and prevent the fraud in which the Compliance Officer engaged.
- M. Applied Financial's procedures regarding the review of client accounts for sales practice abuses were deficient because they did not specify how they were to be applied. Applied Financial's procedures required Holcombe to conduct "regular periodic reviews of each client's account . . . to verify that the account [was] being managed in accordance with: (1) the client's stated investment objectives; (2) AFG policy; (3) existing guidelines and restrictions; and (4) in accordance with the client's investment advisory agreement." Applied Financial's procedures were deficient in that they did not specify how often the reviews were to occur or what documents were to be reviewed. As a result, although Holcombe and others at Applied Financial reviewed certain documents before they conducted annual meetings with clients and at other times as needed, Holcombe's reviews focused on preparing for those meetings and reviewing the accounts' investments as reflected in the electronic records, rather than fulfilling his supervisory obligations. His reviews focused on the inaccurate statements generated by Applied Financial's recordkeeping system that had been altered by the Compliance Officer, rather than the entire file that contained or should have contained the statements or confirmations received from the custodian. The deficiency in that procedure and Holcombe's failure to adhere to it contributed to Applied Financial's and Holcombe's failure to detect and prevent the fraud in which the Compliance Officer engaged.

- N. Applied Financial's procedures also required that the monthly statements and confirmations that the custodian sent for each client be reconciled to the information for that client contained in Applied Financial's internal recordkeeping system and then filed in each client's file. Holcombe, who under Applied Financial's procedures, was responsible for making sure that accurate confirmations and monthly statements were properly filed and maintained, did not routinely do so. Because the Compliance Officer deleted all of the fraudulent transactions from the electronic file that was sent by the custodian each day before that file was downloaded into Applied Financial's internal recordkeeping system, there was a discrepancy between Applied Financial's internal records and the confirmations and monthly statements from the custodian for the clients that were being defrauded. Holcombe's failure to determine if clients' files contained accurate confirmations and monthly brokerage statements contributed to his and Applied Financial's failure to detect and prevent the Compliance Officer's fraudulent conduct.
- O. By reason of the conduct alleged in paragraphs III.A through III.J. above, the Compliance Officer willfully violated Section 17(a) of the Securities Act of 1933, and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and willfully aided and abetted Applied Financial's violations of Sections 206(1) and 206(2) of the Advisers Act.³
- P. By reason of the conduct alleged in paragraphs III.A through III.N above, Applied Financial and Holcombe failed reasonably to supervise the Compliance Officer with a view to preventing the Compliance Officer's violations of the securities laws within the meaning of Section 203(e)(6) of the Advisers Act.

IV.

In view of the foregoing, it is appropriate and in the public interest to impose the sanctions specified in the Offers. In determining to accept the Offers, the Commission considered remedial acts promptly undertaken by respondents and cooperation afforded the Commission staff.

Accordingly, IT IS HEREBY ORDERED that:

- A. Pursuant to Section 203(e) of the Advisers Act, Applied Financial is censured;
- B. Pursuant to Section 203(f) of the Investment Advisers Act, Holcombe be, and hereby is, suspended from acting in any supervisory capacity with any investment adviser for a period of twelve months, effective on the second Monday following the entry of this Order;

³ On January 20, 2005, the Commission filed a civil injunctive action against the Compliance Officer based on the conduct described in this order and the U.S. Attorney's Office for the Northern District of Georgia filed criminal charges against the Compliance Officer based on the same conduct. Both of those cases are currently pending.

- C. Holcombe shall provide to the Commission within 30 days after the end of the suspension period described in paragraph IV.B above, an affidavit stating he has complied fully with the sanction described in paragraph IV.B above;
- D. Applied Financial shall pay a civil money penalty in the amount of \$50,000, and Holcombe shall pay a civil money penalty in the amount of \$25,000 to the United States Treasury. Applied Financial shall satisfy this obligation by making payments according to the following schedule: (1) \$10,000 within thirty (30) days of the entry of the Order, plus post-judgment interest;⁴ (2) \$6,000 within one hundred twenty (120) days of the entry of the Order, plus post-judgment interest; (3) \$17,000 within two hundred forty (240) days of the entry of the Order, plus post-judgment interest; and (4) \$17,000 within three hundred sixty (360) days of the entry of the Order, plus post-judgment interest. Holcombe shall satisfy this obligation by making payments according to the following schedule: (1) \$5,000 within thirty (30) days of the entry of the Order, plus post-judgment interest; (2) \$4,000 within one hundred twenty (120) days of the entry of the Order, plus post-judgment interest; (3) \$8,000 within two hundred forty (240) days of the entry of the Order, plus post-judgment interest; and (4) \$8,000 within three hundred sixty (360) days of the entry of the Order, plus post-judgment interest. Each payment shall be: (1) made by United States postal money order, certified check, bank cashier's check, or bank money order; (2) made payable to the Securities and Exchange Commission; (3) 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 (4) submitted under cover letter that identifies Applied Financial and Holcombe as respondents in these proceedings, the file number of these proceedings; a copy of such cover letter and money order or check shall be sent to Richard P. Wessel, District Administrator, Securities and Exchange Commission, 3475 Lenox Road, Suite 1000, Atlanta, GA 30326; and
- E. Applied Financial agrees that if the full amount of any of its payments described above is not made within ten (10) days following the date the payment is required by this Order, the entire amount of the civil penalty of \$50,000 plus post judgment interest minus payments made, if any, is due and payable immediately without further application. Holcombe agrees that if the full amount of any of his payments

⁴ For the purposes of paragraphs IV.D and IV.E of the Order, post-judgment interest shall be calculated through the date of payment at the rate of interest set forth in Rule 600(b) of the Commission's Rules of Practice [17 C.F.R. § 201.600(b)].

described above is not made within ten (10) days following the date the payment is required by this Order, the entire amount of the civil penalty of \$25,000 plus post judgment interest minus payments made, if any, is due and payable immediately without further application.

By the Commission.

Jonathan G. Katz
Secretary