

ADMINISTRATIVE PROCEEDING
FILE NO. 3-6783

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
ROBERT J. CHECK :
(ADVEST, INC., 3-21409) :
 :

INITIAL DECISION

Washington, D.C.
June 26, 1987

Warren E. Blair
Chief Administrative Law Judge

ADMINISTRATIVE PROCEEDING
FILE NO. 3-6783

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
ROBERT J. CHECK : INITIAL DECISION
(ADVEST, INC., 8-21409) :

APPEARANCES: D. Robert Cervera and Catherine S.
Croisant, of the Boston Regional
Office of the Commission, for the
Division of Enforcement.

James C. Heigham, of Choate, Hall &
Stewart, for Robert J. Check.

BEFORE: Warren E. Blair, Chief Administrative Law Judge

These public proceedings were instituted pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") by order of the Commission dated February 9, 1987 ("Order"). The Order directed that a determination be made whether Advest, Inc. ("Advest"), a registered broker-dealer, and Robert J. Check ("Check" or "respondent") had, as alleged by the Division of Enforcement ("Division"), violated Section 15(b)(4)(E) of the Exchange Act by failing to supervise persons subject to their supervision with a view to preventing violations of Section 17(a)(2) of the Securities Act of 1933 ("Securities Act").^{1/}

In substance, the Division alleged that during a period from about January 1, 1983 to on or about May 1, 1986 Advest registered representatives wilfully violated Section 17(a)(2) of the Securities Act by failing to grant sales commission discounts that customers investing in mutual funds were entitled to receive. The Division further alleged that Check in his capacity as Advest's Manager of Mutual Funds failed to supervise with a view to preventing the registered representatives' violations.

Check's answer admits various allegations concerning

^{1/} On February 9, 1987 the Commission issued its Findings and Order Imposing Remedial Sanctions against Advest, Inc., Securities Exchange Act Release No. 24072, 37 SEC Docket 1101. Findings herein are binding only on Check.

Advest's operations and practices relating to sales of mutual funds but denies that Check had supervisory authority over Advest's Operations and Compliance Departments. Check further denies that his duties included supervision of branch managers or individual registered representatives.

As part of the post-hearing procedures, successive filings of proposed findings, conclusions and supporting briefs were specified. Timely filings were made by the parties.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

Respondent

Check's present position with Advest, held since 1980, is that of sales manager of unit trusts. Additionally, for the period between the middle of 1983 to October, 1986 he was Advest's manager of mutual funds. Prior to his employment with Advest Check handled mutual fund sales for Insurance Company of North America from 1968 to 1970. For the next three years he was a regional wholesaler of mutual funds with American Express Investment Management and between 1973 and 1979, the year he joined Advest, he held other positions involving the sale of real estate investment trusts and unit trusts.

Violative Conduct of Advest's Salesmen

The record clearly establishes that during the period from January 1, 1983 to May 1, 1986, approximately 400 of Advest's 800 salesmen violated Section 17 (a)(2) of the Securities Act by overcharging their customers for sales commissions on purchases of mutual fund shares.

Typically, a mutual fund grants customers discounts on sales commissions for volume purchases, with the discount varying according to a schedule included in the fund's prospectus. The levels at which the discounts become effective are called "breakpoints."^{2/} The breakpoints can be reached in connection with a single purchase, or under rights of accumulation ("ROA"), or over a period of 13 months pursuant to a letter of intent ("LOI"). The ROA represents a cumulative quantity discount arrived at by aggregation of a series of purchases by the same customer and the LOI is a statement of intention by the customer to purchase a certain amount over a 13-month period.

^{2/} e.g. Shares of one of the mutual funds sold by Advest carried a sales charge of 7.0% on purchases of less than \$10,000; 6.35% on purchases of \$10,000 but less than \$25,000; 5.2% on purchases of \$25,000 but less than \$50,000; and 4% on purchases of \$50,000 but less than \$100,000.

The record reflects that nearly 400 of approximately 800 Advest salesmen in numerous branch offices failed to grant customers the benefits of breakpoints on multiple purchases. The result was that the salesmen increased their commission income at the expense of the overcharged customers. When in 1986 a Commission compliance examiner called Advest's attention to the problem of overcharges on sales commissions, Advest undertook an examination of its records. It determined from the study that for the period January, 1983 through May, 1986 its mutual fund customers should receive payments in excess of \$600,000 to compensate for the excessive sales charges and for the lost appreciation had the excess been invested for them in fund shares at the time the commissions were paid.

Given the concern of the mutual fund industry that mutual fund customers not be overcharged for sales commissions and the fact that Check periodically visited Advest branch offices where he held meetings and seminars in which he stressed the fact that unless mutual fund order tickets indicated ROA or LOI information customers would not receive proper sales discounts, it is reasonable to conclude that many of the Advest salesmen ignored the breakpoint rights of their mutual fund customers for personal benefit. In doing

so, they obtained money fraudulently, in wilful violation of Section 17(a)(2) of the Securities Act.

Respondent's argument that a wilful violation of Section 17(a)(2) of the Securities Act by Advest's salesmen has not been shown because "wilfully" requires at least "intentionally committing the act which constitutes the violation"^{3/} cannot be accepted. As urged by the Division, there is considerable undisputed evidence that Advest salesmen knew or should have known when their customers were entitled to the benefits of breakpoints and that in hundreds of instances those salesmen disregarded the rights of their customers by omitting to disclose on order tickets that breakpoints had been reached on multiple sales. Under the circumstances, the omitted information allowed the salesmen to obtain additional compensation and the omission may be deemed intentional within the meaning of the term "wilfully." It is true, as respondent points out, that the Division did not call a single customer, salesman, or branch manager to testify regarding the sales practice, but the absence of such testimony in no wise weakened the evidence presented by the Division and the reasonable inferences to be drawn from the record. Nor does the fact that there was a widespread

^{3/} Tager v. S.E.C., 344 F.2d 5, 8 (2d Cir. 1965).

failure to grant the benefits of breakpoints absolve the salesmen of fraud, as suggested by respondent. Quite the contrary, it tends to underscore a recognition that a flaw existed in Advest's compliance procedures which salesmen could take advantage of to the detriment of their customers.

Failure of Check to Supervise

In 1983 Advest enjoyed substantial growth in mutual fund sales and began an expansion in the number of its branch offices and in salesmen making those sales. Unfortunately, Advest's compliance procedures were neither geared to accommodate that expansion nor to ensure that customers received the full benefits of breakpoints.^{4/}

Shortly after joining Advest, Check became manager of its Unit Trust Department and with the surge in mutual fund sales in mid-1983 he was also named manager of the Mutual Fund Sales Department. In the latter capacity Check was to assist in marketing and executing trades of mutual funds. As part of those functions, he was required to review mutual fund order tickets to make certain that sufficient information was available to permit a mutual fund purchase. If necessary, he was to attempt to

^{4/} During the relevant period Advest's Policy and Procedures Manual had a mere two pages on compliance requirements for mutual fund sales and no reference to customers' entitlements under ROA and LOI.

secure additional information from the Advest salesman originating a mutual fund purchase. Additionally, Check had the responsibility to train Advest's salesmen in mutual fund sales practices. He carried out that function by holding a series of branch meetings and seminars and sending informational memoranda to Advest's branch offices. Check was also the center for questions occasionally raised by Advest salesmen regarding rights of accumulation, and in some instances would resolve those problems by special handling of the customers' accounts.

The difficulty that Check encountered in processing the mutual fund orders was a consequence of a long-standing Advest policy of holding for administrative convenience customers' mutual fund shares in its own name rather than in the names of the purchasers. That policy permitted only Advest's name to appear of record on the mutual funds' books, and precluded those funds from exercising their usual function of determining when a customer had reached a breakpoint.

Early in his Advest employment Check learned through conversations with Advest's officers, salesmen, and Operations Department personnel that Advest had a general policy of holding customers' securities, including mutual fund shares, in "street name." Check recognized the adverse implications of that practice as it affected

customers' breakpoint rights and suggested changes in the form of the mutual fund order ticket being used by Advest so as to provide spaces and boxes on the ticket where salesmen could insert information regarding ROA and LOI breakpoints. Check's suggested changes were included in order tickets revised as of March, 1985.

Despite his recognition of the ROA and LOI problems caused by Advest's holding fund shares in "street name," and the fact that he received at least 30 to 40 inquiries over a space of three years from salesmen seeking guidance on how to obtain ROA and LOI benefits for their customers, Check did nothing to ensure that customers of mutual funds were not being deprived of those valuable rights. Neither did he bring the problem to the attention of Advest's Compliance Department even when in 1984 a new compliance director inquired into the existence of compliance problems in meetings with personnel in various Advest departments.

It appears that Check's review of mutual fund order tickets was self-limited to determining if order ticket information supplied by salesmen was sufficient for him to execute a trade. The absence of information on the ticket regarding ROA and LOI did not trigger an inquiry of the salesman on the possibility of a breakpoint having been reached, although on the immediate sale represented by a ticket under review Check would require

a salesman to recognize the breakpoint if reached in that particular sale. As justification for his inaction in ascertaining whether salesmen were according customers their rights, Check asserted that the salesmen had the responsibility to complete the ticket and that his duty was confined to entering the ticket as a trade unless the ticket had been incorrectly completed.

What is obvious from the record is that when faced with Advest's policy of holding shares in "street name" Check turned a blind eye to the fraud he knew or should have known was being perpetrated upon mutual fund customers by Advest salesmen. Check appears to have rationalized his failure to alert Advest's compliance department by denial of any supervisory responsibility over Advest's salesmen.

Check's refusal to accept supervisory responsibility over activities of Advest salesmen related to mutual fund sales cannot be accepted. The Commission declared many years ago that "[c]ustomers dealing with a securities firm expect, and are entitled to receive, proper treatment and to be protected against fraud and other misconduct, and may properly rely on the firm to provide this protection."^{5/} Although Advest's compliance procedures fell woefully short of providing mutual fund

^{5/} Reynolds & Co., 39 S.E.C. 902, 917 (1960).

customers with the protection they had a right to anticipate, Advest did appoint Check to oversee the firm's mutual fund sales activities. Advest undoubtedly relied upon Check's expertise in the field of mutual fund sales to give guidance to the firm and its salesmen in avoiding legal pitfalls peculiar to that sales area and to ensure that Advest customers were not mistreated. To credit Check's assertion that he did not have the supervisory responsibility over Advest salesmen imposed upon him as manager of mutual fund sales would be to assume unjustifiably that Advest ignored the need for supervisory control in the very area in which it was experiencing rapid growth in the number of its branch offices and size of its sales force.

That this was not the case is clearly evidenced by the fact that Advest expanded Check's duties to include mutual fund sales and as part of those duties required Check to train Advest salesmen in mutual fund sales. To accomplish the training Check made extensive use of seminars held at branch offices and distributed informational memoranda to the sales force. It would not be reasonable to conclude that Advest would make certain that its salesmen were trained in mutual fund sales by a person with Check's experience in that field and not rely upon that person to monitor the salesmen to make certain the training had been effective and required procedures followed.

Moreover, by agreeing as he did in his testimony that department heads were supposed to bring compliance issues to the attention of Advest's compliance director, Check conceded that he understood that his position carried supervisory responsibility. Check also knew that breakpoints involved customers' rights and that the protection of those rights involved compliance issues. With this recognition, Check's failure during his three year tenure as mutual fund sales manager to call the attention of the Compliance Department to the breakpoint problems being raised in inquiries he received from Advest salesmen can only be regarded as an abdication by Check of the supervisory duties he had assumed as department head.

It is therefore concluded that Check had supervisory duties with respect to mutual fund sales by Advest salesmen and that if he had properly discharged those responsibilities Advest customers would have received their breakpoint discounts as a matter of course. It is further concluded, under all the circumstances, that Check, in violation of Section 15(b)(4)(E) of the Exchange Act, failed reasonably to supervise Advest salesmen who were subject to his supervision with a view to preventing violations of Section 17(a)(2) of the Securities Act.

In arguing that he had no direct supervisory responsibility or authority over Advest salesmen because

his department was basically a promotional unit and that branch managers were responsible for seeing that their salesmen followed compliance directives, Check persists in ignoring the supervisory function that accompanied his position. The fact that other Advest officials including the compliance director and branch managers were charged with supervision of the salesmen did not relieve Check of his duty to ensure compliance in the specialized area of mutual fund sales. He was the official who had it in his power to stop a trade if a breakpoint benefit was in question. The fact that on multiple purchases there was no way breakpoints could be picked up from the order tickets reviewed by Check offers no justification for his approval of the trade without a further inquiry, especially where no information was included on the revised ticket indicating whether ROA or LOI benefits had been taken into account by the salesmen.

The difficulties that Check encountered by reason of understaffing of his department, the lack of an automated system to replace the department's manual procedures, and the unavailability of "numerous categories of information" ^{6/} needed to permit adequate review of multiple transactions cannot be considered exculpatory. Unquestionably the conditions under which Check was forced to

6/ Brief for Respondent Robert Check, May 29, 1987, at 12.

operate were burdensome but the inadequacies referred to would not have interfered with Check's reporting to compliance the problem with breakpoints that he had early recognized as inherent in Advest's policy of holding customers' securities in "street name." Neither was there any impediment to his involving the compliance department in a resolution of the conflict existing between recognition of customers' breakpoint rights and adherence to Advest's "street name" policy before it escalated into a firm-wide problem.

Check's contentions that Advest's established compliance procedures were adequate within the meaning of Section 15(b)(4)(E) of the Exchange Act and that he had reasonably discharged the duties and obligations incumbent upon him by reason of such procedures are not supported by the record. Advest's compliance procedures with respect to mutual fund sales were palpably deficient. No procedures were in place assuring that customers received recognition of their breakpoint rights and no provision of the compliance manual addressed those rights. Indeed, as Check recognized, Advest's unwritten policy of holding securities in "street name" was in derogation of those rights. Nor does Advest's giving its branch managers basic compliance responsibility for their respective offices strengthen Check's position. The Commission has consistently held "that a system of supervisory

procedures which rely solely on the branch manager is insufficient." ^{7/} The assignment of responsibility to the Compliance Department did not lessen Advest's reliance in its procedures upon supervision by branch managers, and, in any event, during the relevant period it did not have as Check must have known, the expertise which was required to recognize and correct the break-point problem.

Were Advest's procedures considered adequate, Check still could not prevail. Under those procedures, such as they were, Advest had invested Check with the responsibilities not only to properly orient Advest salesmen with respect to procedures to be followed in a specialized area of securities business having unique demands, but also of determining if the salesmen were honoring his instructions and not taking advantage of mutual fund customers by enriching themselves at the expense of those customers. As found earlier, Check did not reasonably discharge the duties and obligations incumbent upon him by the procedures in place during his tenure as Advest's manager of mutual funds.

PUBLIC INTEREST

Having found that Check violated Section 15(b)(4)(E) of the Exchange Act, it is necessary to consider the remedial action appropriate in the public interest.

7/ Shearson Lehman Brothers, Inc., 36 SEC Docket 1075, 1085 (1986).

The Division recommends that respondent be suspended for a period of 90 days from association with any broker or dealer and from association with any member of a national securities exchange or registered securities association, and that thereafter he be restricted from holding any proprietary or supervisory position for a period of one year. In support of its recommendation the Division argues that "Check has not admitted to doing anything wrong and that he and the securities industry must be put on notice that failure of supervision will not be tolerated." The Division also notes that Check's failure to supervise imposed a financial burden upon investors and diminished investor confidence in the securities industry. Check views the Division's recommendation on sanctions as excessive and points to an unblemished twenty years in the securities and insurance business. He argues that the only charge against him is of negligent supervision, that he lacked direct supervisory or compliance responsibilities, and that Advest had voluntarily made its mutual fund customers financially whole.^{8/}

^{8/} Check also raises other points for consideration on the question of sanctions which are deemed immaterial or irrelevant, i.e. Advest's settlement on the basis of a censure, the failure of the Division to proceed against any other Advest individuals with supervisory responsibilities, and the highly technical nature of the overcharges which went undetected in the course of of an NASD audit in the summer of 1985.

Upon careful consideration of the record and the arguments and contentions of the parties, it is concluded that in the public interest Check should be suspended from association with any broker or dealer for 30 days. Such suspension should be sufficient to protect the public interest and to impress upon Check that being a supervisor in a large organization requires that conflicts between a firm's procedures and the rights of that firm's customers must be resolved with a view toward advancing the interests of the customers who rely upon the integrity of the firm and its supervisory personnel to shield them from fraud. ^{9/}

ORDER

IT IS ORDERED that Robert J. Check be suspended for a period of 30 days from association with any broker or dealer.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Rules of Practice.

Pursuant to Rule 17(f) of the Rules of Practice,

9/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.

this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.



Warren E. Blair
Chief Administrative Law Judge

Washington, D.C.
June 26, 1987