

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76175 / October 16, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4231 / October 16, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31868 / October 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16657

In the Matter of

**WELHOUSE &
ASSOCIATES, INC., AND
MARK P. WELHOUSE,**

Respondents.

**ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS, A
CENSURE AND A CEASE-AND-DESIST
ORDER PURSUANT TO SECTION 21C OF
THE SECURITIES EXCHANGE ACT OF
1934, SECTIONS 203(e), 203(f), AND 203(k)
OF THE INVESTMENT ADVISERS ACT
OF 1940, AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940**

I.

On June 29, 2015, the United States Securities and Exchange Commission (the “Commission”) instituted administrative and cease-and-desist proceedings pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against Welhouse & Associates, Inc. (“Welhouse”) and Mark P. Welhouse (“Mr. Welhouse”) (collectively, “Respondents”).

II.

Respondents have each submitted an Offer of Settlement (the “Offers”) which the Commission has determined to accept. Solely for the purpose of settling 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 them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section IV.H., Respondents consent to the entry of the Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 (“Order”) as set forth below.

III.

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

SUMMARY

1. From approximately February 2010 to January 2013 (the "relevant time period"), Mr. Welhouse, the sole owner of Welhouse, an investment adviser registered with the State of Wisconsin, engaged in fraudulent trade allocation – "cherry-picking." Mr. Welhouse – and, through him, Welhouse – executed this cherry-picking scheme by unfairly allocating options trades in an S&P 500 ETF called SPY. Mr. Welhouse disproportionately allocated those trades that had appreciated in value during the course of the day to his personal and business accounts, while allocating trades that had depreciated in value during the day to the accounts of his advisory clients. He did this by purchasing the options in an omnibus account and delaying allocation of the purchases until later in the day, after he saw whether the securities appreciated in value.

2. By virtue of their conduct, the Respondents willfully violated Section 10(b) of the Exchange Act [15 U.S.C. §§78j(b)] and Rule 10b-5 [17 C.F.R. §§240.10b-5] promulgated thereunder, and Sections 206(1) [15 U.S.C. §80b-6(1)] and 206(2) [15 U.S.C. §80b-6(2)] of the Advisers Act.

RESPONDENTS

3. **Welhouse & Associates, Inc.**, is a Wisconsin corporation with its principal place of business in Appleton, Wisconsin and has been registered with the State of Wisconsin as an investment adviser since 1999. According to the most recent Form ADV filed in January 2013, Welhouse had approximately 72 accounts and a total of \$4.8 million under management. Welhouse is wholly owned and controlled by Mr. Welhouse. Welhouse's clients are individuals and families.

4. **Mark. P. Welhouse**, age 58, resides in Appleton, Wisconsin. Mr. Welhouse is the owner, principal, and CCO of Welhouse, which he formed in 1999.

RESPONDENTS' CONDUCT

Mr. Welhouse Claimed That His SPY Trades Were Allocated Pro Rata

5. During the relevant time period, Mr. Welhouse and Welhouse's clients had their accounts in custody at a brokerage firm ("the broker"). To execute options trades, Mr. Welhouse made trades in a master account at the broker and later allocated the trades to either his or his clients' accounts.

¹The 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.

6. Mr. Welhouse was interviewed by the Commission staff on January 28, 2014. Mr. Welhouse agreed that the interview could be recorded, and the staff recorded the interview. During that recorded interview, Mr. Welhouse claimed that to allocate a trade, he needed to manually create a spreadsheet with the trade allocation and then submit the spreadsheet on the broker's trading platform. Mr. Welhouse said his practice was to submit the trade allocation for each account to the broker before 5:00 p.m. on the date the trade was made. Mr. Welhouse stated that he used one master account for trades in his four personal accounts and a different master account for his clients' trades. Despite this statement, Mr. Welhouse also stated that there were times when he allocated SPY options trades from the client master account to his personal accounts. Mr. Welhouse called these allocations "mistakes" and stated that the broker called many times and expressed concern about his allocating SPY options from the clients' master account to his personal accounts.

7. Mr. Welhouse said that during the relevant time period, in investing his clients' funds, he followed four investment models: conservative, moderate, aggressive, and options. Mr. Welhouse said that the options model traded only SPY options, but that he also traded SPY options in the other models.

8. Mr. Welhouse stated that he allocated all trades pro rata across all accounts for a particular model (including pro rata across Mr. Welhouse's own accounts and his clients' accounts that were on the same model). Mr. Welhouse also stated that Welhouse's January 2012 Form ADV Part 2A's reference to fair and equitable trade allocation is a reference to Mr. Welhouse's pro rata allocation across a model. Additionally, Welhouse's firm brochures on Form ADV, which the Respondents were required to provide to clients, stated that Welhouse did not trade for its own account and that it restricted the trading of employees' accounts. Welhouse's firm brochures did not disclose that Mr. Welhouse invested in, or bought and sold, the same securities that he recommended to clients, failed to discuss the conflicts of interest such trading presents, and did not disclose how Welhouse addresses the conflicts posed by personal trading, as required by Form ADV. Accordingly, parts of Welhouse's Form ADV, Part 2A were false or misleading. In addition, the Respondents did not otherwise disclose the facts underlying the material conflict of interest posed by Mr. Welhouse's purchase and sale of SPY options for both himself and his advisory clients.

9. Welhouse's written policies and procedures for trade allocation state: (1) "[a]ll clients are assigned to a model portfolio. . ."; and (2) "[w]hen a trade is put on the trade is purchased by the model portfolio and automatically allocated to the clients account" on a pro rata basis. The Welhouse trade allocation policies and procedures also state: "We do not have written order tickets or spreadsheet documents reflecting allocations of orders. Our model portfolios have been in use for over 10 years. Our trade allocations are built into our model portfolios."

Welhouse's SPY Options Trades Were Not Allocated Pro Rata

10. Contrary to Welhouse's policies and procedures and its Form ADV statements, Mr. Welhouse, on behalf of Welhouse, did not allocate SPY options trades pro rata. During the relevant time period, Mr. Welhouse allocated a disproportionate number of profitable SPY options trades to favored accounts (accounts belonging to Mr. Welhouse or another person with the last name Welhouse), while allocating unprofitable SPY options trades to client accounts. Mr. Welhouse did so by trading securities in a master account, typically using a day-trading

strategy, and then delaying the allocations until later in the day when he could determine whether trades had appreciated or declined in value. During the relevant time period, approximately 58% of SPY options trades occurred before 11:00 a.m. while about 58% of SPY options trades were allocated to accounts after 2:00 p.m. Moreover, approximately 47% of SPY options trades were allocated to accounts after 3:00 p.m., during the last hour of regular market hours for options trading. This delay allowed Mr. Welhouse to selectively allocate profitable trades to his personal accounts.

11. For trades that increased in value on the day of the purchase, Mr. Welhouse often day-traded by selling the option on the same day he purchased it, allocating a disproportionate share of those profitable day trades to his personal accounts. For trades that decreased in value on the day of the purchase, Mr. Welhouse often did not sell the option on the day of purchase; he allocated a disproportionate share of these trades to his clients' accounts.

12. According to the broker's internal compliance notes, an employee of the broker told Mr. Welhouse in April 2010 that the broker was monitoring his trade allocations. During this conversation, Mr. Welhouse agreed to separate his personal and client trading in different accounts. Following the April 2010 conversation, the broker's trade allocation surveillance system flagged Mr. Welhouse's joint account nine times between May 2011 and September 2012. In February 2012, another employee of the broker called Mr. Welhouse again because he seemed to be making preferential trade allocations from his clients' master account to his personal account. Mr. Welhouse returned the employee's call, and, during the recorded telephone call, the employee reminded Mr. Welhouse to keep his personal trading separate from his clients' master account and Mr. Welhouse agreed he would do so. Then, in June 2012, another employee of the broker called Mr. Welhouse and told him that he was continuing to allocate trades to his personal account from his clients' master account, which had the appearance of preferential trade allocation. The employee reminded Mr. Welhouse of the two prior conversations on the same issue, and the employee told Mr. Welhouse that the broker would consider blocking allocations from a master account to his personal accounts if the practice continued. In September 2012, the broker flagged Mr. Welhouse's trade allocation a ninth and final time. In December 2012, the broker terminated its relationship with Mr. Welhouse.

13. Mr. Welhouse stated that he had allocated from the clients' master account to his personal account several times and that the broker had spoken to him about this practice numerous times before it ceased. Mr. Welhouse stated that any allocations from the clients' master account to his personal account were "mistakes." To support his claims that he had allocated trades pro rata, Mr. Welhouse described how, based on his memory, the performance of his clients' SPY options trades during the period 2009 to 2013 was similar to that of his own SPY options trades.

Mr. Welhouse Reaped Substantial Profits From His Cherry-Picking Scheme

14. Commission staff in the Division of Economic and Risk Analysis ("DERA") analyzed first-day profits and one-day returns for both Mr. Welhouse's personal accounts and his clients' accounts. To do this, DERA first classified all SPY options trades as either day trades or multi-day trades. Day trades are those where both the purchase and sale occur on the same day. All other trades are multi-day trades. DERA analyzed only the first-day return of both day

trades and multi-day trades because it is only on the day of purchase, when Mr. Welhouse allocated the trade, that he had the opportunity to cherry-pick the profits.

15. During the relevant time period, Mr. Welhouse allocated 496 SPY options trades to his personal accounts and 1,127 to his clients. The total cost of these trades was \$7.25 million for Mr. Welhouse's personal accounts and \$8.46 million for his clients' accounts. Mr. Welhouse's total first-day profits on these 496 trades was \$455,277. In contrast, Mr. Welhouse's clients suffered a total first-day loss of \$427,190. The average first-day return for the trades Mr. Welhouse allocated to himself was 6.28%, while his clients' average first-day return was -5.05%. Combined, the first-day return for all SPY options trades was \$28,087, for an average first-day return of 0.18%. In other words, if Mr. Welhouse had allocated all SPY options' first-day returns on a pro rata basis, every SPY options client (including Mr. Welhouse and all his clients who owned SPY options) would have had made a first-day return of 0.18%. By comparing Mr. Welhouse's actual first-day returns of 6.28% to the overall average of 0.18%, DERA concluded that Mr. Welhouse reaped \$442,319 in ill-gotten gains.

16. The following chart summarizes the profitability of the SPY option trading:

SPY-Options	Investment	1-Day Profits	1-Day Return	N	Average Profit Per Trade
<u>Panel A: All Trades</u>					
Welhouse Accounts	\$7,248,754	\$455,277	6.28%	496	\$918
Non-Welhouse Accounts	<u>\$8,463,500</u>	<u>-\$427,190</u>	<u>-5.05%</u>	<u>1,127</u>	<u>-\$379</u>
All Accounts	\$15,712,254	\$28,087	0.18%	1,623	\$17
<u>Panel B: Day Trades</u>					
Welhouse Accounts	\$5,622,098	\$560,883	9.98%	334	\$1,679
Non-Welhouse Accounts	<u>\$3,913,718</u>	<u>\$139,194</u>	<u>3.56%</u>	<u>487</u>	<u>\$286</u>
All Accounts	\$9,535,815	\$700,077	7.34%	821	\$853
<u>Panel C: Multi-Day Trades</u>					
Welhouse Accounts	\$1,626,657	<u>-\$105,606</u>	<u>-6.49%</u>	162	<u>-\$652</u>
Non-Welhouse Accounts	<u>\$4,549,782</u>	<u>-\$566,384</u>	<u>-12.45%</u>	<u>640</u>	<u>-\$885</u>
All Accounts	\$6,176,439	<u>-\$671,990</u>	<u>-10.88%</u>	802	<u>-\$838</u>

17. The difference between Mr. Welhouse's first-day profit and that of his clients is highly statistically significant. To test whether the first day profitability of trades allocated to

Mr. Welhouse's personal accounts was significantly different from that of those allocated to his clients' accounts, a simulation was run one million times. The simulation tests the possibility that although Mr. Welhouse's accounts were very profitable, he simply selected a lucky combination of trades by chance. Mr. Welhouse's \$455,277 profit was substantially higher than every one of the one million random simulations. These results show that there is only an infinitesimal likelihood of achieving by chance a profit like Mr. Welhouse's. Finally, when comparing the proportion of profitable trades allocated to Mr. Welhouse's accounts to the proportion of profitable trades allocated to Mr. Welhouse's clients' accounts, the likelihood of Mr. Welhouse's personal accounts receiving such a high proportion of profitable trades by pure random chance is less than one in one trillion.

Welhouse's clients were not aware of the cherry-picking scheme

18. Mr. Welhouse's clients were not aware that he was trading options in their accounts, or that he was using those accounts to further his own interests by cherry-picking profitable day trades. The Commission staff interviewed three Welhouse clients who experienced significant investment losses on SPY options trades, including unprofitable first day returns. In each instance, the client considered himself or herself to be an inexperienced investor seeking a conservative approach in managing his or her accounts. None of the clients was aware that he or she had invested in options on the S&P 500 Index, and two of the clients did not know what options were. Each of the clients' practice was to review the total account value in a periodic account statement, and these clients did not review the performance of underlying account holdings. Although these reviews could have revealed Mr. Welhouse was trading options, they could never have revealed the cherry-picking scheme. One of the clients recalled significant account losses. When the client asked Mr. Welhouse about the losses, Mr. Welhouse told the client that he had experienced the same losses in his personal accounts. Mr. Welhouse did not reveal that he was selectively allocating trades to client accounts.

VIOLATIONS

19. As a result of the conduct above, Welhouse and Mr. Welhouse willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Mr. Welhouse also willfully aided and abetted and caused Welhouse's violations of those provisions. Section 10(b) of the Exchange Act makes it unlawful for any person to use or employ, in connection with the purchase or sale of any security any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. Rule 10b-5 under the Exchange Act makes it unlawful for any person, directly or indirectly, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

20. As a result of the conduct above, Welhouse and Mr. Welhouse also willfully violated Sections 206(1) and 206(2) of the Advisers Act. Mr. Welhouse also willfully aided and abetted and caused Welhouse's violations of those provisions. Section 206(1) of the Advisers Act prohibits any investment adviser from employing any device, scheme, or artifice to defraud any client or prospective client, and Section 206(2) of the Advisers Act prohibits any investment

adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 21C of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act of 1940, it is hereby ORDERED that:

A. Respondents Welhouse and Mr. Welhouse shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act.

B. Respondent Welhouse is censured.

C. Respondent Mr. Welhouse be, and hereby is:

Barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

D. Any reapplication for association by Respondent Mr. Welhouse will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent Mr. Welhouse, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

E. Respondents shall, within 10 days of the entry of this Order, pay, jointly and severally, disgorgement of \$418,141 (consisting of \$442,319 in ill-gotten gains, less \$24,178 that Respondents have demonstrated to Commission staff they have previously paid to a harmed investor), and prejudgment interest of \$50,918.60 to the Securities and Exchange Commission. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, transfer them to the general fund of the United States Treasury, subject to

Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

F. Respondents shall, within 10 days of the entry of this Order, pay, jointly and severally, a civil money penalty in the amount of \$300,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment of disgorgement, prejudgment interest and civil penalty must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Welhouse & Associates, Inc. and Mark P. Welhouse as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert B. Baker, Assistant Regional Director, Asset Management Unit, Division of Enforcement, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110.

G. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payments of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor

Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

H. It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent Mr. Welhouse, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent Mr. Welhouse of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary