**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**
**Release No. 8513 / December 15, 2004**

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 50859 / December 15, 2004**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-11770**

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| **In the Matter of**<br><br>**FIRST COMMAND FINANCIAL PLANNING, INC.,**<br><br>**Respondent.** | **ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934.** |

## I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against First Command Financial Planning, Inc. ("First Command" or "Respondent").

## II.

In anticipation of the institution of these proceedings, First Command has submitted an Offer of Settlement (the "Offer"), which 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 to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, First Command consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

## III.

On the basis of this Order and First Command's Offer, the Commission finds that:

## RESPONDENT

1. First Command is a registered broker-dealer, with its principal offices in Fort Worth, Texas. It employs approximately 1,000 registered representatives/agents ("agents") through approximately 200 branch offices throughout the United States and in Germany, England, the Netherlands, Spain, Italy, Guam, and Japan. First Command claims to be "[t]he #1 independent provider of financial plans to the professional military family," and currently has over 297,000 "military families" as customers, including 40% of the current active-duty general officers, one-third of the commissioned officers, and 16% of the non-commissioned officers in the United States military. The great majority of the firm's agents are former commissioned or non-commissioned military officers.

## SUMMARY

2. This matter involves violations of the federal securities laws by First Command in its use of sales materials to offer and sell mutual-fund investments through an installment method known as a "contractual" or "systematic investment plan" ("systematic plan").[1] The systematic plans allow investors to accumulate shares of a specified mutual fund indirectly by contributing fixed monthly payments—typically 180 payments ranging from $100 to $500—over a period of at least 15 years. Systematic plans, including the plans offered and sold by First Command, are subject to a sales charge unique to such plans, often referred to as a "sales and creation charge" or "front end load," that equals 50% of the plan's first 12 monthly payments. There is no front-end sales load after the first 12 payments. From January 1999 through March 2004, First Command received approximately $175 million in front-end sales-load revenue from the sale of systematic plans, which accounted for approximately 70% of its revenue.[2]

3. Since at least January 1999, First Command, using a structured sales process, has offered and sold systematic plans by, in part, making misleading statements and omissions concerning, among other things: (a) comparisons between the systematic plan and other mutual

[1] Systematic plans are legal investments referred to and regulated as "periodic payment plans" under Section 27 of the Investment Company Act of 1940. Periodic payment plans allow investors to accumulate shares of a specified mutual fund indirectly by contributing a fixed amount of money on a regular basis for a specified period. An investor in a periodic payment plan does not directly own shares of a mutual fund. Instead, he or she owns an interest in the plan trust. The plan trust invests the investor's regular payments, after deducting applicable fees, in shares of a mutual fund. An investor in a plan has a beneficial ownership interest in those shares.

[2] The firm also sells conventional load mutual funds issued by various mutual-fund companies to customers who want to invest in such funds. For the load funds, the investor pays a commission ranging from 5% to 5.75%, or less, depending on the amount invested. First Command does not offer or sell no-load mutual funds.

fund investments; (b) the availability of the Thrift Savings Plan ("TSP"),[3] which offers military investors many of the features of a systematic plan at lower costs; and (c) the efficacy of the front-end sales load in ensuring that investors remain committed to the systematic plan. As a result, First Command violated Section 17(a)(2) of the Securities Act.

## FACTS

### The Family Financial Plan

4. First Command markets a comprehensive package of financial services called a "Family Financial Plan" ("FFP") that includes investment products, banking, and insurance offered through First Command, its affiliated bank, and its affiliated insurance agency. The firm's website states that the FFP is "a personalized road map for your journey in pursuit of financial success, encompassing not only the products you have acquired through your First Command representative, but also assets like 401(k) accounts and military retirement income." The site further states that the company maintains a close, but independent, relationship with many "giants of the financial industry," which allows the firm "to provide [the customer] with an objective analysis of [the customer's] situation and to make an independent recommendation for specific products." First Command represents to its customers that the FFP is tailored to the specific needs of the customer based, in part, on a "Confidential Checklist" of personal financial information completed by the customer and the agent. In the usual case, First Command recommends that the customer purchase a life-insurance policy from one of several insurance companies through the firm's insurance agency, open an account at the firm's bank, and purchase mutual funds through one or more of First Command's systematic plans offered by four mutual funds groups.

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[3] The TSP is a Federal Government-sponsored retirement savings and investment plan, which was set up to provide retirement income for federal employees. The TSP offers the same type of savings and tax benefits that many private corporations offer their employees under so-called "401(k)" plans, but military personnel do not currently receive employer matching contributions. The TSP offers investments in five investment funds: Government Securities Investment (G) Fund, Fixed Income Index Investment (F) Fund, Common Stock Index Investment (C) Fund, Small Capitalization Stock Index Investment (S) Fund, and International Stock Index Investment (I) Fund. None of the investment funds offered by the TSP charges a sales load. Beginning in January 2002, members of the uniformed services were allowed to participate in the TSP by contributing up to 7% of their basic pay each pay period and 100% of any incentive pay or special pay received up to the dollar limits established by the Internal Revenue Code. The contribution limit increases by one percentage point each year through 2005, after which the participant's contributions will be limited only to the Internal Revenue Code's annual limits.

**The Systematic Plans**

5. The sale of systematic plans to military personnel has historically constituted 70% of First Command's mutual-fund business. Since 1970, First Command customers have invested approximately $10.1 billion in mutual funds—of this amount, approximately $7.4 billion has been invested through systematic plans. First Command sells five systematic plans, which, in turn, make purchases from one of five different mutual funds.[4] Under these systematic plans, the investor is to pay 180 fixed monthly installments (15 years), which may be extended to 300 payments (25 years) at the investor's option with no additional sales charge. First Command customers pay a front-end sales load equal to 50% of the first 12 payments, but thereafter pay no additional front-end sales load for the life of the plan.[5] This sales load is received by First Command, which, in turn shares the commission with the selling agent. Assuming a fixed monthly payment of $100, a systematic-plan investor would pay a total of $1200 in the first 12 months. Of this amount, $600 would pay the 50% sales load and $600 would purchase an indirect interest in mutual-fund shares. As required by Section 27 of the Investment Company Act, the systematic plans also permit the purchaser to terminate within the first 45 days, with no sales charge, and within the first 18 months, with a maximum charge of 15%.

6. After an investor completes the first 12 payments, the effective sales load is reduced with each payment. If all 180 payments are made under the plan, the effective sales load on the total investment is 3.33%. If 300 payments are made, then the sales load on the total investment is 2%. Conversely, if the investor ceases making payments or terminates the plan before making all of the required payments under the plan, the effective total sales load may be higher than the average sales load charged by a conventional load mutual fund. According to Lipper Inc., the average load charged by a conventional load equity mutual fund in 2003 was approximately 5.2%**.**

7. The following chart illustrates the effective sales load on the total investment at various discontinuation points:

[4] The mutual funds are: (1) the AIM Summit Investors Fund; (2) the Fidelity Destiny I Fund; (3) the Fidelity Destiny II Fund; (4) the Pioneer Independence Fund; and (5) the Franklin Templeton Capital Accumulation Fund. The Commission's findings herein are limited to First Command and do not reflect on the activities, operations, or merits of these mutual funds.

[5] As indirect mutual-fund investors, systematic-plan investors also pay other expenses assessed at the fund level, which may include management fees, 12b-1 fees (covering distribution expenses and sometimes shareholder-service expenses), and other expenses.

| Contributions Discontinued after: | Sales Load as a Percentage of Amount Invested: |
|---|---|
| 12 payments | 50% |
| 18 payments | 31.6% |
| 24 payments | 25.0% |
| 60 payments | 10.0% |
| 120 payments | 5.0% |
| 180 payments | 3.33% |
| 300 payments | 2.0% |

**<u>First Command's Systematic Plan Completion Rate</u>**

8. Historically, the majority of First Command customers have not completed the systematic plan within the 15-year period. For example, for all First Command systematic plans sold between 1980 through 1987, only 43% of the plans had actually received payments totaling at least the original face amount of the plan (i.e., 180 monthly payments times the original monthly payment commitment) as of June 17, 2004. Simply put, only 43% of the plans were completed during that time period.[6]

**<u>First Command's Sales Process For Systematic Plans</u>**

9. First Command sells systematic plans to commissioned and non-commissioned officers of the U.S. military who are of grade E-6 and above.[7] A typical new customer of the firm is approximately 25 years old, has limited savings, and is an inexperienced investor. First Command markets its FFP and systematic plans through a structured sales process that utilizes sales scripts prepared by First Command. The sales scripts include hypothetical dialogues between a First Command agent and a military couple, "Ed and Geri Baker." In addition, the scripts contain instructions to the sales agents on how to present the plans, as well as illustrative sales charts. All First Command agents are required to follow the key points in the sales scripts and are evaluated on the degree to which they make these points in their presentation.

10. The sales process with prospective customers includes (i) an introduction seminar; (ii) a one-on-one initial meeting with a First Command agent; (iii) the preparation of the prospective customer's FFP; and (iv) the presentation of the FFP. One of the goals of the sales process is to present the systematic plan as the military customer's best investment option for long-term wealth accumulation.

6 Of the remaining 57%, 35% were terminated and 22% remained open, including active and inactive accounts. An inactive account is one in which no payment has been made for at least a year.

7 A commissioned officer generally receives a commission upon or shortly after graduating from college at 21-22 years of age. An "E-6" designation is a pay grade that usually denotes a mid-level non-commissioned officer (approximately 10 years of service) such as Staff Sergeant in the Army or Petty Officer First Class in the Navy.

### The Introduction Seminar

11. The sales process begins at one of approximately 700 voluntary sales seminars conducted in proximity to military installations throughout the world each year. First Command relies heavily on "word-of-mouth" advertising and referrals to generate interest in the seminars. The seminar consists of a multi-media presentation with scripted live narration. The presentation includes testimonials from current customers and evokes themes of patriotism, loyalty, discipline, and duty. No specific investment products, including the systematic plan, are offered at the seminars. Instead, the seminars are designed to introduce prospective customers to, among other things, the variety of services offered by First Command, certain investment concepts such as the need for a financial plan, the need for long-term financial and investment goals, and the benefits of dollar-cost averaging. Seminar attendees are encouraged to make an appointment with a First Command agent to develop their own personal "custom made" FFP.

### Initial Sales Meeting with a First Command Agent[8]

12. Before discussing the specifics of the systematic plan, including any mention of the plan's upfront sales load, the sales script for the initial meeting discusses the benefits of dollar-cost averaging and claims that "out of the thousands of funds" you can invest in, the firm's five systematic plans are the "only five mutual funds that are designed to attract *only* dollar cost average investors." The script then introduces a continuing theme that no-load funds attract only "speculators," which prevents a no-load fund manager from having predictable cash flow and from making purchases for the fund at opportune times.[9] At this point in the script, the agent is required to ask what is referred to in the accompanying instructions as a "trial closing" question:

> Agent: . . . Would you prefer one of these funds that were designed *exclusively* for dollar cost averagers or some other type of mutual fund?"
>
> Ed: Definitely one of those five!

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[8] The initial sales meeting is clearly the most important step in the sales process. In fact, the accompanying instructions to the initial-meeting sales script proclaim that "there is every reason to fully expect a vast majority of prospects to conclude the discussion by telling you, 'We want one of these systematic funds.' The real value of this discussion is the fact that it is completely conceptual—there is no need to discuss brokerage percentages, rates of return, etc."

[9] For example, after pointing to a chart illustrating the decline of the stock market during 2000, the agent asks: "And when the market is doing poorly, are speculators more inclined to stay in the market or get out? Ed: They would get out." The agent then asks:

> "Ed, if a fund manager had attracted only *speculators* to his fund, would that fund manager be able to purchase shares of stock or would he be forced to sell?"
>
> Ed: "He would be forced to sell."

13. After attempting to obtain the prospective customer's commitment to dollar cost average in a systematic plan, the script compares systematic plans to other mutual-fund investments in the following exchange:

Agent: . . . There are three categories of funds. First, there are the no-load funds which are popular among short-term traders and speculators. Ed, do you think "no-load" means "free"?

Ed: No.

Agent: Of course not. In fact, no-load funds frequently have some of the highest long-term costs. Next, there are load funds. These funds are generally used for large lump sum investments and are sold through investment professionals who manage many of the larger private accounts in the country. Finally, there are the systematic plans. These are designed for dollar cost averagers and used by dollar cost averagers exclusively.[10]

14. The sales script also makes claims about the differences in "stable cash flow" among the three types of mutual funds. The agent is instructed to use a sales chart that, for the period December 1986 through December 2001, reflects the monthly net cash flow of "no/low-load" funds to be 4.7 times as volatile as that of a systematic plan. The same chart shows that the cash flow in load funds was 2.6 times as volatile as systematic plans during the same period.[11] The script then lays the blame for the cash volatility of no-load and load funds on speculators, claiming "the speculator causes these high fluctuations in cash flow." At this point, the script first mentions the 50% upfront sales load. The script characterizes the load as "pre-paying the sales charges you would otherwise pay over the life of your investment" and claims that the load serves as "a wall to keep out the short-term speculators." The accompanying instructions to the script state that this portion of the script is designed "to let the customer come to the conclusion that the *only way* to keep out speculators is the systematic plan load structure." (Emphasis added.) The instructions also advise the agent:

> Do not dance around the concept of charging a front-load. Be candid with the customer. Inform them of its purpose and stand behind the concept. It works, and is the only way that a fund manager can ensure that most of the shareholders are committed, long-term investors. Remember, the front-load creates the stable cash flow that the systematics enjoy. Help the customer understand and embrace the idea. Focus on the cost-effectiveness of a long-term investment.

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10 The initial meeting sales script makes no mention of the investment funds offered by the TSP, although the TSP is mentioned in the introductory seminar script. As discussed *infra*, the TSP funds also employ a dollar-cost-averaging strategy and are specifically structured for long-term investors.

11 In the event the prospect has sufficient assets to invest a lump-sum amount in a load fund, the instructions to the sales script advise the agent not to "speak negatively about load funds in the stable cash flow discussion. Just state that they are very appropriate for lump sum investments just as [the systematic plans] are for long-term monthly investing." As noted above, First Command also sells load funds to its customers.

15. The initial meeting sales script concludes with a discussion of "another significant benefit of the systematic plan"—the average length of time an investor dollar remains invested in a systematic plan. According to a First Command sales chart used in the sales presentation, from December 1986 through December 2001, the average time an invested dollar remained in a systematic plan was 14.4 years, versus 2.6 years for no/low load funds and 3.1 years for load funds. The script's instructions further claim "this section is where the investment is actually 'sold.' This is where you ask for commitment. Reinforce the advantages of the systematic plan and then ask the closing question: Ed and Geri, with these advantages, is this the type of investment plan you want for your family?"

**Preparation of the FFP**

16. After the prospective customer expresses an interest in receiving a FFP with a systematic plan, the agent completes a financial-data form using First Command's proprietary planning software and electronically transmits the information, together with insurance, banking and specific systematic plan recommendations, to district and regional supervisors who pass the information on to First Command's headquarters in Fort Worth. First Command's written policies advise its agents to recommend systematic plans in every customer's FFP "when the customer has adequate monthly dollars to invest, there is no foreseeable interruption to regular investing, and a sufficient investment time horizon [of at least 15 years] exists to achieve desired objectives." Further, most investors are encouraged to invest in a systematic plan through a Roth IRA and to contribute the maximum amount allowable each year.[12] Once the agent's recommendation reaches headquarters, the customer's information is reviewed and a detailed FFP is prepared. At the end of the process, a glossy FFP is sent back to the agent to present to the customer and close the sale.[13]

**The FFP Presentation**

17. During the FFP presentation, the agent provides the customer the FFP together with applications for the recommended systematic plans and briefly reviews the related underlying

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[12] For example, in 2003, the maximum contribution allowed in a Roth IRA was $3,000. Thus, the typical FFP would recommend that a customer invest $250 per month in his or her systematic plan.

[13] The vast majority of FFPs do not contain a recommendation that the customer invest in the TSP. First Command's "Statement of Policy" on the TSP states, "if the customer's income allows, Roth IRAs should generally be fully funded before any money is committed to the TSP." The firm's stated reasons for the policy include, among other things, that military personnel do not receive employer-matching contributions and that large annual withdrawals from a TSP account in retirement may increase the investor's income-tax liability. In June 2002 First Command published an article in the firm's monthly agent newsletter that compared two hypothetical investment scenarios where a customer invested $250 monthly in a Roth IRA and in the TSP over 15 years. The scenarios assumed the same annual rate of return (12%) for both investments and assumed the customer's marginal tax rate (27%) remained constant during the investment period and the period the funds were withdrawn from the accounts. Both scenarios also assumed that the investor retired after 15 years and began a systematic withdrawal that would net him $1,200 per month after tax. The article concluded that the TSP account would run out of money in 10.25 years and that the Roth account would run out of money in 10.33 years. However, in calculating the overall return and the period of maximum withdrawal for each account, no costs or loads for the investment products were considered. In the case of a systematic plan invested through a Roth IRA, the upfront load would reduce the total period of withdrawal in the Roth IRA account in the hypothetical scenario from 10.33 years to approximately 9 years.

mutual-fund prospectuses, which are also given to the customers. The FFP presentation script contains many of the same statements in the initial meeting script, including: that systematic plans are "designed exclusively for dollar cost averagers;" that no-load funds attract "speculators;" and that the first year load is "a barrier... designed to keep out speculators." The closing script also contains the following exchange should a prospective customer ask, "But couldn't we dollar cost average into a no-load fund?"

Agent: You could, but Ed, how long, on average, do assets remain in a no-load?

(*Agent is instructed to point to Holding Period chart*)

Ed: 2.6 years

Agent: If the average no load investor withdraws their money from the fund after only 2.6 years, is the fund manager buying or selling stock?

Ed: Selling.

18. The FFP presentation script contains other responses to objections and other trial closing questions. The prospective customers who do not ultimately purchase a systematic plan, citing a preference for no-load funds, are referred to in the agent training materials as "no loaders." Agents are warned not to allow these individuals to discuss First Command with any referrals they may generate as it would be "like voluntarily spreading a cancer in your market."

**Misstatements and Omissions**

**Comparisons to Other Mutual-Fund Investments**

19. The First Command sales scripts make several misleading comparisons to both no-load and non-systematic plan load funds. First, by characterizing no-load funds as funds that "attract only speculators," repeatedly referring to no-load funds as "popular" among speculators, and blaming speculators for the purported high cash volatility in no-load funds, the sales scripts give the erroneous impression that no-load funds attract only speculative investors and that the transactions of these speculative investors prevent the no-load fund manager from making opportune investments. This message is reinforced by the scripts' characterization of First Command's systematic plans as the "only five mutual funds that are designed to attract *only* dollar cost average investors." In fact, a substantial number of no-load mutual funds successfully employ a dollar-cost-averaging strategy and permit investors to make monthly periodic investments in relatively small amounts. While the First Command sales agent is instructed to acknowledge the availability of dollar-cost averaging in other mutual funds—should the investor first ask the question—the rejoinder in the initial-meeting script states incorrectly that, because an average no-load fund investor withdraws his investment every 2.6 years, the fund manager is forced to sell stocks. In reality, fund managers are not necessarily forced to sell stocks when investors redeem shares. They must do so only when there are net redemptions in the fund, and then only if the fund does not have sufficient cash on hand or cannot draw on a credit facility to meet redemptions.

20. Moreover, the initial-meeting script states that no-load funds "frequently have some of the highest long-term costs." In reality, the long-term costs of owning no-load funds are, on average, substantially lower than the costs of owning load funds.[14] Moreover, the no-load investment index funds offered by the TSP have substantially lower net expense ratios than the average no-load fund and the systematic plans sold by First Command.[15] Further, the claim that no-load funds frequently have some of the highest long-term costs fails to account for the impact of the 50% upfront sales load on the long-term costs of systematic plans, both in terms of the actual costs and the lost opportunity costs in terms of the overall return.

21. The initial-meeting script also states that load funds are "generally used for large lump sum investments and are sold through investment professionals who manage many of the larger private accounts in the country." In fact, many conventional load funds and no-load funds offer services in which investors may make monthly contributions as low as $50 per month. These services, known as "automatic investment programs," "asset builders," or "account builders," allow investors to purchase shares on a regular basis, including, for example, by electronically transferring money from a bank account or paycheck. Unlike the systematic plans at issue here, these services allow investors to purchase shares directly from the mutual fund. Most mutual funds do not charge a fee for setting up or terminating these services.

22. The scripts and "cash-flow" and "holding-period" charts convey the message that empirical data support the claim that no-load funds have nearly five times the cash-flow "volatility" as systematic plans and that the average no-load investor withdraws his cash from a no-load fund every 2.6 years. These statements, and the statement that no-load funds "have some of the highest long term costs," clearly imply that the systematic plans will perform better than other funds over the long term. However, there is no empirical evidence to support the inference that systematic plans will outperform other funds due to low "cash-flow volatility." Further, while the cash-flow chart depicts a 15-year period, internal First Command cash-flow volatility studies show a substantially smaller variation in volatility among the three categories of investments when shorter time periods are used, such as five and 10 years.[16]

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14 For example, the average total shareholder cost ratio for load funds between 1980 and 1997 ranged from a low of 2.11% to a high of 3.02%. In contrast, the total average shareholder cost ratio for no-load funds ranged from 0.78% to 0.89%. John D. Rea and Brian K. Reid, *Trends in the Ownership Cost of Equity Mutual Funds*, INVESTMENT COMPANY INSTITUTE PERSPECTIVE, November 1998, at 10.

15 The latest available expense figures for the TSP funds reflect that for 2003, the net-expense ratio for each of the five investment funds was .10%. By contrast, the non-load-adjusted net-expense ratios for the First Command systematic plan funds for 2003 ranged from .46% to 1.50%. According to Morningstar Inc., the average net-expense ratio in 2003 for the approximately 3000 no-load funds was 1.21%.

16 A First Command internal study calculated that, in the five-year period from 1998 to 2003, cash-flow volatility of load funds and no-load funds was, respectively, 2.1 and 1.6 times greater than that of systematic plans. Another internal study showed that, in the 10-year period from 1993 to 2003, cash-flow volatility of load funds and no-load funds was, respectively, 3.6 and 2.4 times greater than that of systematic plans.

23. Finally, the cash-flow and holding-period charts note that the source of the data for no-load funds and load funds is the Investment Company Institute ("ICI").[17] In fact, although First Command obtained the cash-flow and holding-period data from the ICI, First Command—not the ICI—produced the reports and made the calculations reflected in the charts. Moreover, the script refers to the holding-period chart as demonstrating that the average no-load investor withdraws his money after only 2.6 years. But the ICI data First Command used to prepare the chart warned that the data "cannot be used to measure the holding period for the *typical* fund investor." (Emphasis added.) In fact, according to the ICI warning, "a small number of shareholders can and likely do generate a disproportionate percentage of the total redemptions, thereby masking the activity of the typical investor."[18]

**The Availability of the TSP to Military Investors**

24. First Command claims its "objective" recommendations in the FFP will encompass not only investment products sold by First Command, but also "assets like 401(k) accounts . . . ." Moreover, as noted above, in discussing the types of available investment funds, the script states there are only three categories of funds: no-load funds, load funds, and systematic plans. The script further characterizes no-load funds as popular among short-term traders and speculators. In fact, the TSP, which is the equivalent of a 401(k) account, provides another category of investment funds available to military personnel. The TSP investment funds have many of the same investment characteristics as no-load mutual funds and systematic plans. For example, the TSP funds are designed for long-term investors and each fund permits investors to make periodic payments in a dollar-cost-averaging strategy. However, unlike systematic plans, the TSP funds do not charge a sales load.

**The Efficacy of the Up-Front Sales Load in Keeping Long-Term Investors Committed to the Systematic Plan**

25. First Command mischaracterizes the upfront sales load as the only way a fund manager can ensure that most of the shareholders are committed, long-term investors. Indeed, First Command sales data reflect that the high upfront sales charge has not "worked" to keep most systematic plan investors committed to the plan for the full 180 payment (15-year) period. Of all systematic plans sold from 1980 through 1987, only 43% had actually received payments totaling at least the original face amount of the plan (i.e., 180 monthly payments times the original monthly payment commitment) as of June 17, 2004. As previously noted, 35% of the plans had been terminated and 22% were either active or inactive.

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[17] The ICI is a national association of the U.S. investment-company industry. Its membership includes approximately 8,605 mutual funds, 630 closed-end funds, 135 exchange-traded funds, and five sponsors of unit investment trusts. Its mutual fund members represent 86.6 million individual shareholders with approximately $7.5 trillion in investor assets.

[18] ICI *Fundamentals*, Vol.10, No.1, March 2001.

## LEGAL ANALYSIS

### Section 17(a)(2) of the Securities Act

26. Section 17(a)(2) of the Securities Act provides that it is "unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they made, not misleading." A broker for non-discretionary accounts, such as First Command, "is obliged to give honest and complete information when recommending a purchase or sale." *DeKwiatkowski v. Bear Stearns & Co.,* 306 F. 3d 1293, 1302 (2d Cir. 2002). The Commission does not have to show *scienter* to establish a violation of Section 17(a)(2) of the Securities Act. *Aaron v. SEC*, 446 U.S. 680, 697 (1980). "The Commission can establish a violation of Section 17(a)(2) . . . by showing merely that the [statement] was materially false and misleading and that defendants negligently caused those misrepresentations or omissions." *SEC v. Solucorp Indus. Ltd.*, 274 F. Supp.2d 379, 419 (S.D.N.Y. 2003) (quoting *SEC v. Scott*, 565 F. Supp. 1513, 1525-26 (S.D.N.Y. 1983)).

27. First Command violated Section 17(a)(2) of the Securities Act by making materially misleading statements and omissions concerning, among other things, (a) comparisons between the systematic plan and other mutual fund investments; (b) the availability of the TSP to military investors; and (c) the efficacy of the upfront sales load in ensuring that investors remained committed to the systematic plan.

28. As a result of the conduct described above, First Command willfully violated Section 17(a)(2) of the Securities Act.[19]

## UNDERTAKINGS

29. In anticipation of the institution of these proceedings and a related disciplinary action by the NASD alleging, among other things, misleading sales practices in connection with sales of systematic plans, First Command has submitted a Letter of Acceptance, Waiver, and Consent ("AWC") to the NASD to settle the related disciplinary action. First Command has agreed to undertake certain remedial and corrective measures, as follows:

a. First Command shall pay $12 million, which shall be used for customer restitution and for an investor-education program for members of the United States military and their families, as described below:

i. **Restitution**. First Command shall pay restitution to all First Command customers who purchased and terminated a Systematic

[19] "Willfully" as used in this Order means intentionally committing the act which constitutes the violation, *see Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

Investment Plan during the period specified in the AWC who paid an effective sales load greater than 5%. Restitution to these customers shall be the difference between the actual sales load paid and 5% and shall be paid, along with interest, in accordance with the terms of the AWC.

ii. **Investor Education**. First Command shall pay $12 million, less restitution payments described above, for investor education. This amount shall be payable to the NASD Investor Education Foundation, a tax-exempt, non-profit grant administration organization, to be used for the investor-education needs of members of the United States military and their families. The payments for investor education shall be made to the NASD Investor Education Foundation in accordance with the terms of the AWC.

b. First Command shall retain an Independent Consultant, ("Consultant") not unacceptable to the staffs of the Commission and the NASD, for a period of two years, to (i) review, verify, and report in writing to the staffs of the Commission and the NASD on the restitution process described above and (ii) review and make recommendations concerning the adequacy of First Command's**:** (1) sales scripts; (2) training materials; (3) advertising; (4) sales literature; (5) sales training systems and procedures (written and otherwise); and (6) supervisory procedures and systems.

c. First Command shall provide to the staffs of the Commission and the NASD and the Independent Consultant, within 30 days of the date restitution is required to be completed in the AWC, a report detailing the payment of this restitution, including: (i) a detailed description of the efforts made to locate customers identified as entitled to restitution; (ii) the results of the restitution program, including the number of customers identified as entitled to restitution, the dollar amount of restitution owed, the number of customers located and unable to be located, and dollars owed to customers located and not located; and (iii) satisfactory proof of payment of the restitution or of reasonable and documented efforts undertaken to effect restitution.

d. **Report on Independent Consultant Recommendations.** First Command shall require the Consultant to provide an initial report to First Command and to the staffs of the Commission and the NASD containing recommendations, if appropriate, for the adoption of revised sales scripts, advertising and sales material as well as revised procedures by First Command with respect to the matters described in Paragraph 29. b., Subpart (ii), above. Within 30 days after delivery of the Consultant's report, First Command shall 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. First Command shall submit such proposed alternatives in writing to the Consultant and the staffs of the Commission and the NASD. Within thirty days of receipt of any proposed alternate procedure, the Consultant shall: (i) reasonably evaluate the alternative procedure and determine whether it will achieve the same objective as the consultant's original recommendation; and (ii) provide First Command with a written decision reflecting his or her determination. First Command will implement the Consultant's ultimate determination with respect to any proposed alternative procedure and must adopt all recommendations deemed appropriate by the Consultant. Thereafter until the expiration of the two year engagement period, First Command shall require the Consultant periodically to review and report to First Command and the staffs of the Commission and the NASD concerning the adequacy of its sales scripts, advertising, sales material and procedures. First Command shall cooperate fully with the Consultant, and obtain the cooperation of its employees, contractors, and affiliates. First Command will place no restrictions on the Consultant's communications with the staffs of the Commission and the NASD. Upon request, First Command will provide the staffs of the Commission and the NASD with copies of any communications between the Consultant and it, and any documents that the Consultant reviewed or relied upon in connection with the engagement.

e. **Pre-Use Filing Requirement.** First Command shall file with the NASD Advertising Regulation Department all sales literature and advertisements (including all sales scripts) in accordance with the terms of the AWC. After filing, First Command shall use such material only in accordance with the terms of the AWC.

f. First Command shall require the Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with First Command, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Consultant in performance of his/her duties under this Order shall not, without prior written consent of the staffs of the Commission and the NASD, enter into any employment, consultant, attorney-client, auditing or other professional relationship with First Command, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

In determining whether to accept First Command's Offer, the Commission has considered the related NASD action and the remedial actions that First Command has agreed to undertake as described herein.

## IV.

In view of the foregoing, the Commission deems it appropriate, and in the public interest to impose the sanctions agreed to in First Command's Offer.

Accordingly, pursuant to Section 8A of the Securities Act and Section 15(b) of the Exchange Act, it is hereby ORDERED that:

A. First Command is censured;

B. First Command cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act;

C. First Command shall pay disgorgement and prejudgment interest, which obligation shall be satisfied by compliance with the customer-restitution and investor-education program described in Paragraph 29. a., above, and more fully set forth in the AWC in the related NASD disciplinary action; and

D. Not later than six months after the date of the Order, unless otherwise extended by the staff of the Commission for good cause shown, First Command's chief executive officer shall certify in writing to the staff of the Commission that First Command has made the payments for customer restitution and investor education described in Paragraph 29. a., above, and that it has taken all necessary and appropriate steps to adopt and implement all recommendations and proposals of the Independent Consultant.

By the Commission.

Jonathan G. Katz
Secretary