

## Administrative Proceeding

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Date: 02/24/88  
Firm: Mark Bailey & Co.  
Keywords: Best Execution & Directed Brokerage

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In the Matter of: MARK BAILEY & CO. AND MARK BAILEY  
Admin. Proc. File No. 3-6972, File No. 801-13813

SECURITIES AND EXCHANGE COMMISSION  
INVESTMENT ADVISORS ACT OF 1940, Release No. IA-1105

February 24, 1988

TEXT:

ORDER INSTITUTING PUBLIC PROCEEDINGS, MAKING FINDINGS AND IMPOSING  
REMEDIAL SANCTIONS

I.

The Commission deems it appropriate that public proceeding be instituted pursuant to Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 (Advisers Act) with respect to Mark Bailey & Co. (Registrant) and Mark Bailey (Bailey). In anticipation of these proceedings, Registrant and Bailey have submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party and without admitting or denying the findings contained herein, Registrant and Bailey by their Offer of Settlement, consent to the entry of this Order Instituting Public Proceedings, Making Findings and Imposing Remedial Sanctions as set forth below.

II.

ACCORDINGLY, IT IS ORDERED that proceedings pursuant to Sections 203(e) and 203(f) of the Advisers Act be, and they hereby are, instituted.

III.

On the basis of this Order Instituting Public Proceedings, Making Findings and Imposing Remedial Sanctions and the Offer of Settlement submitted by Registrant and Bailey, the Commission finds that:

1. Registrant has been registered with the Commission as an investment adviser pursuant to Section 203(a) of the Advisers Act from 1978 until the present. In 1985, Registrant provided advisory services to approximately 75 clients representing 100 accounts, all of which have

vested discretionary authority with Registrant. Approximately 48 were non-institutional accounts.

2. From 1978 through the present, Bailey has been the president and the controlling shareholder of Registrant. Bailey has final authority to make or approve all investment decisions for the accounts under management by Registrant. Bailey is responsible for obtaining new clients for Registrant.

3. During the period from at least 1982 through at least April 1985, Registrant's business grew to approximately 100 client accounts with approximately \$66 million of assets under management. Approximately 75 percent of the clients were referred to Registrant by registered representatives of a particular registered broker-dealer (the Brokerage Firm) with whom such clients generally had previously established relationships. At the time these referrals were made, many of these clients who were referred by the Brokerage Firm (Referred Clients) would orally direct Bailey to continue using their registered representative and the Brokerage Firm to effect brokerage transactions for their managed accounts. Registrant's Form ADV disclosed to prospective clients that over 90 percent of Registrant's accounts were broker-directed by the client.

4. At the time Registrant received each newly Referred Client, the clients would be given Registrant's then current, standard investment management contract to sign. This contract appointed Registrant as agent for the client and vested Registrant with full discretionary authority. Additionally, the contract stated, in essence, that the Registrant reserved the right to select the broker who may be used in transactions. As long as price and execution were competitive and the services were for the benefit of the client, the contract reserved the Registrant's right to place transactions with brokers who provided investment research and other services available with brokerage commissions. Nothing in the contract prohibited Registrant and Bailey from negotiating commissions for their clients or required that they do so. Bailey construed the Referred Clients' directions to use a registered representative and the Brokerage Firm as a direction not to negotiate brokerage commissions.

5. During the period from at least 1982 through at least April 1985, Registrant and Bailey violated Section 206(2) of the Advisers Act. Registrant and Bailey, by use of the mails and means and instrumentalities of interstate commerce, directly and indirectly, engaged in transactions, practices and courses of business which would and did operate as a fraud and deceit upon certain of its advisory clients. Registrant and Bailey violated Section 206(2) of the Advisers Act by omitting to state to their non-institutional Referred Clients the following material facts concerning their trading practices necessary in order to make the statements made, as described in III(4) above, in light of the circumstances under which they were made, not misleading:

A. that when directed by the non-institutional Client to use the Brokerage Firm, no attempt would generally be made to negotiate commissions on their behalf and that, as a result, in some transactions these non-institutional clients paid materially disparate commissions depending on their commission arrangement with the referring registered representative established prior to the referral to Registrant and upon other factors such as the number of shares, round and odd lots, and the market for the security;

B. that, beginning in 1984, they placed certain transactions (a "batched transaction") directly with the Brokerage Firm's trading desk wherein portions of the batched transactions were then

allocated to the individual accounts held with the various referring registered representatives and the commissions charged to participating non-institutional clients were in some transactions materially different for the reasons stated in 5. A.;

C. that in batched transactions they would, in some instances, be in a better position to negotiate brokerage commissions if the brokerage was not directed by the non-institutional client;

D. that they did not negotiate volume commission discounts on the batched transactions;

E. that if the non-institutional clients had not directed the Registrant to use the Brokerage Firm, they might be paying less in commissions. However, many, if not all, clients were aware that the Brokerage Firm was a full service, retail broker-dealer and not a discount brokerage firm;

F. that the Registrant and Bailey had a potential conflict between the non-institutional clients' interest in obtaining best execution and Bailey's receiving future referrals from the Brokerage Firm; and

G. that Registrant and Bailey were not obtaining best execution in certain transactions for the reasons stated in 5. A.

IV.

In view of the foregoing, it is in the public interest to impose the Sanctions specified in the Offer of Settlement.

ACCORDINGLY, IT IS ORDERED THAT:

1. Registrant's & Co. be and hereby is censured.
2. Bailey is hereby censured.
3. That Registrant comply with its undertaking to:

(a) fully disclose to its investment advisory clients the existence and terms of its practice regarding brokerage transactions, the effect of such practices on commission charges to its clients, the effect of directing brokerage on Registrant's ability to negotiate commissions, the resulting inability to obtain volume discounts or best execution for broker-directed accounts in some transactions, the resulting disparities in commission charges, and the potential conflict of interests arising from referrals and directed brokerage practices. Clients may be furnished an amended Form ADV, Part II, containing these disclosures.

(b) establish and maintain procedures regarding its brokerage transactions on behalf of its clients designed to prevent future violations of the Advisers Act. Such procedures will be contained in a compliance manual.

(c) amend its Form ADV to disclose Registrant's intended practices with respect to directed brokerage transactions and negotiation of commissions.

(d) amend its standard investment management contract to include a provision whereby the client can elect to continue to direct brokerage through a particular brokerage firm. Such contract would include the disclosure identified in paragraph 3.a. above.

4. That Bailey comply with his undertaking to, for two years, attend 12 hours of continuing education per year concerning the duties of investment advisers.

5. That Registrant and Bailey deliver an affidavit to the Chicago Regional Office stating that they have complied with the above undertakings.

By the Commission.

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