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

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 4679 / April 4, 2017**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-17900**

**In the Matter of**

**Sanford Michael Katz**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

## 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 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Sanford Michael Katz ("Respondent" or "Katz").

## II.

In anticipation of the institution of these proceedings, Respondent 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, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

### Summary

1. These proceedings arise out of breaches of fiduciary duty by Katz in connection with his purchases and recommendations of mutual fund shares for advisory clients. Between January 1, 2009 and January 21, 2014 (the "Relevant Period"), Katz, then an investment adviser representative of Credit Suisse Securities (USA) LLC ("Credit Suisse"), purchased or held Class A mutual fund shares for advisory clients who were eligible to purchase or hold less expensive institutional share classes of the same mutual funds. A significant difference between Class A shares and institutional share classes is the existence of marketing and distribution fees imposed on Class A shareholders pursuant to Section 12(b) of the Investment Company Act and Rule 12b-1 thereunder ("12b-1 fees"), typically 25 basis points per year for Class A shares. The 12b-1 fees are paid out of the assets of the fund as a portion of its expense ratio. In this case, the 12b-1 fees were passed through to Credit Suisse, which in turn paid a portion of that amount to its investment adviser representatives, also referred to as Relationship Managers ("RMs"), including Katz. Thus, 12b-1 fees decreased the value of advisory clients' investments in mutual funds and increased the compensation paid to Credit Suisse and its RMs. During the Relevant Period, Katz's practice of putting advisory clients in Class A shares when those clients were eligible for less expensive institutional share classes resulted in Credit Suisse collecting approximately $2.5 million in 12b-1 fees, approximately $1.1 million of which was paid to Katz. This practice was inconsistent with Katz's fiduciary duty, his representations to clients, and his obligation to obtain best execution for his advisory clients.

### Respondent

2. **Sanford Michael Katz**, 54, resides in San Rafael, California. During the Relevant Period, Katz was a Managing Director and RM in Credit Suisse's San Francisco branch office. Katz had Series 3, 7, and 63 securities licenses and was a registered representative and an investment adviser representative of Credit Suisse.

### Relevant Party

3. Credit Suisse Securities (USA) LLC, a Delaware limited liability company with headquarters in New York, New York, is dually registered with the Commission as a broker-dealer and an investment adviser. Credit Suisse is a wholly-owned subsidiary of Credit Suisse (USA),

[1] The 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.

Inc., which is an indirect wholly-owned subsidiary of Credit Suisse Group AG. The Commission instituted a separate proceeding against Credit Suisse related to these matters.

## Background

4. In October 2008, Credit Suisse hired Katz as an RM in its San Francisco office. At that time, and throughout the Relevant Period, Credit Suisse, through its private banking business ("PB North America"), offered products and services to clients in its capacities as a broker-dealer and an investment adviser. PB North America offered investment advisory programs to clients through RMs pursuant to a fee-based, or "wrap fee," program. A wrap fee is an annual inclusive fee paid by the advisory client to PB North America based on a percentage of the client's assets under management. PB North America's wrap fee covered investment advice, execution, custody, administrative and account reporting services. In 2008, Credit Suisse created the Discretionary Managed Portfolio ("DMP") program to oversee discretionary and non-discretionary wrap fee advisory accounts.

## Mutual Fund Share Class Selection

5. DMP accounts could be invested in an array of securities, including stocks, bonds, and mutual funds, based on the clients' investment objectives and needs. DMP accounts could be invested in a wide selection of mutual funds across numerous mutual fund complexes, including multiple share classes of the same funds. Mutual fund share classes represent an interest in the same portfolio of underlying securities with the same investment objective. The primary difference among the various share classes is their fee structure.

6. Class A shares generally can be purchased in retail brokerage accounts or advisory accounts. Class A shares are sold with sales charges or "loads" in retail brokerage accounts based on the dollar amount of the investment. The sales charges are generally waived for Class A shares purchased in wrap fee or fee-based advisory accounts. Class A shares, including "load-waived"[2] Class A shares purchased in advisory accounts, also carry 12b-1 fees, which are paid from a mutual fund's assets on an ongoing basis for shareholder services, distribution, and marketing expenses.[3] The 12b-1 fee for Class A shares is typically 25 basis points per year.

7. Many mutual funds also offer "institutional" share classes, which are available only to investors who meet certain criteria (*e.g.*, a minimum investment amount or eligible investment program) and do not carry 12b-1 fees.[4] Many of these mutual funds offered institutional share

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[2] Certain mutual funds known as "no load" funds can be purchased in wrap fee accounts but may also have 12b-1 fees. These no load funds are equivalent to "load-waived" Class A shares in wrap fee accounts.

[3] 12b-1 fees are paid to the fund's distributor or principal underwriter, which, in turn, generally remits the fees to the broker-dealer (such as Credit Suisse) that distributes or "sells" the fund's shares. Credit Suisse then shared a percentage of those 12b-1 fees with the DMP client's RM.

[4] "Institutional" shares go by a variety of names in the mutual fund industry. As used in this Order, the term refers to share classes that carry neither up-front sales charges nor 12b-1 fees.

classes with high minimum investment thresholds, and many such funds waived or substantially reduced that amount for purchases in wrap fee advisory accounts (such as DMP accounts).[5] An investor who holds institutional share classes of a mutual fund will pay lower fees over time – and earn higher investment returns – than an investor who holds Class A shares of the same fund. Therefore, if a mutual fund offers an institutional share class, and an investor is eligible to own it, it is almost invariably in the investor's best interests to select the institutional share class.

8. During the Relevant Period, Credit Suisse permitted the purchase of load-waived Class A mutual fund shares or institutional share classes in DMP accounts. Credit Suisse's compliance policies, however, provided that prior to making a discretionary mutual fund purchase or recommendation to a client, its RMs were required to review the mutual fund prospectus, consider share class costs, and "explain to the client how sales charges and fees vary within the different classes of shares of a mutual fund." In addition, Credit Suisse's policies and procedures applicable to DMP accounts recited an RM's fiduciary duty "to place the client's best interest above those of [Credit Suisse] or any [PB North America] Relationship Manager."

9. During the Relevant Period, Credit Suisse assigned responsibility for approving mutual fund transactions to its respective offices' Branch Managers. In the San Francisco branch office, the Branch Manager delegated this responsibility to the Branch Administrative Manager ("Administrative Manager").

**Katz's Mutual Fund Share Class Practices and Communications**

10. As an RM, Katz received approval from Credit Suisse to manage DMP accounts in accordance with his own strategy, which utilized investments in mutual funds to a greater degree than other Credit Suisse RMs servicing DMP clients. Katz was one of the most significant RMs at Credit Suisse in terms of assets under management in DMP accounts.

11. Upon joining Credit Suisse, Katz purchased load-waived Class A shares for his clients' DMP accounts, irrespective of whether those clients were eligible to purchase less expensive institutional share classes. Contrary to Credit Suisse policy, Katz did not, in most instances, discuss with his clients the distinctions between mutual fund share classes – particularly the difference in ongoing fees between Class A shares and institutional share classes. Even in instances in which Katz's clients would inquire directly about purchasing the institutional share class of a particular mutual fund, Katz did not acknowledge or address share class conflicts of interest or disclose his method of share class selection. Instead, he executed that particular mutual fund purchase with institutional class shares and continued his practice of purchasing Class A shares of other mutual funds for those same clients and purchasing Class A shares of the same mutual fund for other clients. In addition, Katz transferred Class A mutual fund holdings that his clients maintained with other investment firms into DMP accounts without evaluating whether those clients were invested in the most cost-effective and efficient share class.

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[5] The number of mutual funds that waived their minimum investment requirement, or otherwise permitted wrap fee participants to acquire institutional share classes increased over the course of the Relevant Period.

12. Soon after joining Credit Suisse, Katz's team determined that they were not receiving 12b-1 fee income from his clients' Class A mutual fund holdings in DMP accounts. The reason was that Credit Suisse had previously instructed its clearing broker – whose systems did not segregate Credit Suisse's retirement accounts from its other accounts at the time – to block any 12b-1 fees generated from advisory accounts and return them to the respective mutual fund companies. Katz questioned Credit Suisse management about the block, asserting that he had received credit for such revenue at his prior employer and that his DMP accounts generated $300,000 to $500,000 in annual 12b-1 revenue to Credit Suisse. Following Katz's inquiry, Credit Suisse instructed its clearing broker to lift the block, thereby allowing Credit Suisse and its RMs, including Katz, to receive 12b-1 fees derived from its DMP accounts.[6]

13. In June 2009, an Administrative Manager in the San Francisco branch office questioned Katz's proposed purchase of Class A shares for DMP clients when the mutual fund prospectuses suggested that less expensive institutional share classes may be available and did not approve the transactions. Katz escalated the issue to the San Francisco Branch Manager and to DMP management. After consulting with DMP management, who in turn consulted with Credit Suisse's Legal and Compliance department, the Branch Manager subsequently approved Katz's Class A mutual fund purchases. In response to the Branch Manager's approval, Katz wrote that it was not easy for him to determine eligibility for institutional share classes and that, "[f]or new orders over $1mm our team will try to remember and look for institutional shares when it seems they are available." Thereafter, Administrative Managers approved Katz's purchase of Class A mutual fund shares in DMP accounts without evaluating whether the account was eligible to purchase an institutional share class.

14. Katz's response to the Branch Manager addressed only the potential availability of institutional share classes for purchases in DMP accounts, referenced a $1 million threshold to limit his selection of institutional shares for clients, and did not take into account the fact that many mutual fund companies waived or substantially lowered minimum investment thresholds for wrap fee accounts. Katz thereafter purchased or held Class A shares for certain DMP clients even when he knew or should have known that his clients were eligible for institutional share classes and even in instances where the client purchase amount was $1 million or more. During the Relevant Period, Katz purchased or held Class A shares for DMP clients where: (a) the mutual fund prospectus indicated that institutional share classes were available for wrap fee accounts, and/or (b) Katz himself had previously purchased the institutional share class for other DMP clients. In sum, Katz, placed his and Credit Suisse's interests above those of his DMP clients by purchasing or holding Class A share mutual funds when those clients were eligible to purchase or hold less expensive share classes.[7]

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[6] Credit Suisse continued to block 12b-1 payments for mutual fund investments in advisory accounts covered by the Employee Retirement Income Security Act of 1974.

[7] Credit Suisse's disclosures regarding its potential receipt of 12b-1 fees were inadequate to advise DMP clients that Katz, or any other Credit Suisse RM, could select or recommend mutual fund investments in share classes that paid 12b-1 fees to Credit Suisse when those clients were eligible to purchase less expensive share classes in the same mutual funds.

**Failure to Obtain Best Execution for DMP Clients' Mutual Fund Transactions**

15. Section 206 of the Advisers Act imposes on investment advisers a fiduciary duty to act for the benefit of their clients. That duty includes, among other things, an obligation to seek best execution for client transactions – i.e., "to seek the most favorable terms reasonably available under the circumstances." *In the Matter of Fidelity Management Research Company*, Investment Advisers Act Rel. No. 2713 (Mar. 5, 2008). The Commission has stated in settled enforcement actions that an investment adviser failed to seek best execution when it caused a client to purchase a more expensive share class when a less expensive class was available.[8] By purchasing Class A shares when his DMP clients were eligible for institutional share classes, and by failing to disclose to his clients that best execution might not be sought for mutual funds with multiple available share classes, Katz breached his duty to seek best execution on behalf of his DMP clients.

**Violation of Law**

16. Section 206(2) of the Advisers Act makes it unlawful for an adviser directly or indirectly to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. Scienter is not required to establish a violation of Section 206(2), but rather may rest on a finding of negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194-95 (1963)). Katz willfully violated Section 206(2) as a result of the negligent conduct described above.[9]

**IV.**

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

Accordingly, pursuant to Section 15(b) of the Exchange Act and Sections 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act.

B. Respondent is censured.

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[8] *See In the Matter of Everhart Financial Group, Inc.*, Investment Advisers Act Rel. No. 4314 (Jan. 14, 2016) (settled matter); *In the Matter of Manarin Investment Counsel, Ltd.*, Investment Advisers Act Rel. No. 3686 (Oct. 2, 2013) (settled matter); and *In the Matter of Pekin Singer Strauss Asset Management Inc.*, Investment Advisers Act Rel. No. 4126 (June 23, 2015) (settled matter).

[9] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

C. Respondent shall, within 10 days of the entry of this Order, pay disgorgement of $1,124,858.89, prejudgment interest of $197,587.38, and a civil money penalty in the amount of $850,000 to the Securities and Exchange Commission. If timely payment of disgorgement or prejudgment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. If timely payment of the civil money penalty is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent 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) Respondent 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 Sanford Michael Katz as a Respondent 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 Melissa R. Hodgman, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5553.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, the penalties paid by the Respondent in this proceeding, along with disgorgement and prejudgment interest, shall be added to a Fair Fund to be established in the Commission's related proceeding, *Credit Suisse Securities (USA) LLC*, A.P. No. 3-17899 (filed April 4, 2017). The Fair Fund will be distributed to affected investors in accordance with a Commission-approved plan of distribution in that proceeding. 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, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it 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 Respondent 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.

**V.**

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, 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 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