

1 WAYNE STRUMPFER  
Acting California Corporations Commissioner  
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Acting Deputy Commissioner  
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6 Attorneys for Complainant

7  
8 BEFORE THE DEPARTMENT OF CORPORATIONS  
9 OF THE STATE OF CALIFORNIA

10  
11 In the Matter of ) FILE NO. 7397  
 )  
12 THE CALIFORNIA CORPORATIONS ) STATEMENT IN SUPPORT OF ORDER  
 ) LEVYING ADMINISTRATIVE PENALTIES  
13 COMMISSIONER, ) PURSUANT TO CORPORATIONS CODE  
 ) SECTION 25252  
14 Complainant, )  
 )  
15 v. )  
 )  
16 STOCK ADVISORS, INC., )  
 )  
17 Respondent. )

18  
19 Wayne Strumpfer, the Acting California Corporations Commissioner ("Commissioner") of  
20 the Department of Corporations ("Department") alleges and charges as follows:

21 1. Stock Advisors, Inc. holds a valid and unrevoked investment adviser certificate issued  
22 by the Commissioner on August 26, 1999 pursuant to Corporations Code section 25230. Stock  
23 Advisors, Inc. is an investment adviser business located at 19252 Vista Grande Way, Northridge, CA  
24 91326. Stock Advisors, Inc. is a California corporation. Robert E. Welch ("Welch") is Stock  
25 Advisors, Inc.'s president.

26 2. On or about February 22, 2005, the Commissioner commenced a regulatory  
27 examination of Stock Advisors, Inc. The examination revealed violations of regulations  
28

1 promulgated pursuant to the Corporate Securities Law of 1968 (“CSL”), found at Corporations Code  
2 section 25000 et seq.

3 3. One of these violations consisted of Stock Advisors, Inc.’s failure to file annual  
4 financial reports with the Commissioner within 60 or 90 days, as applicable, of the end of Stock  
5 Advisors, Inc.’s fiscal year (Cal. Code Regs., tit. 10, § 260.241.2, subdivision (a)). Stock Advisor’s  
6 fiscal year ends on June 30. The annual report filing requirement provides the Department with a  
7 regulatory mechanism to validate a firm's liquidity and financial integrity on a yearly basis to ensure  
8 that licensees maintain the necessary net capital for the protection of the public. Stock Advisors,  
9 Inc.’s failure to meet its reporting requirements prevented the Department from determining, as part  
10 of its regulatory exam, if Stock Advisors, Inc. met the capital requirements imposed by the CSL and  
11 the regulations enacted thereunder.

12 4. Corporations Code section 25241 provides that investment advisers are required to  
13 maintain books and records that are subject to examination by, and to file such reports as required  
14 by, the Commissioner. Corporations Code section 25241 provides, in pertinent part, as follows:

15 [E]very investment adviser licensed under Section 25230 shall make and keep  
16 accounts, correspondence, memorandums, papers, books, and other records and shall file  
17 financial and other reports as the commissioner by rule requires ....

18 5. California Code of Regulations, title 10, section 260.241.2 (“section 260.241.2”),  
19 subdivision (a), requires the filing of an annual financial report by certain investment advisers. Prior  
20 to April 3, 2003<sup>1</sup>, subdivision (a)(5) of section 260.241.2 required the annual financial reports to be  
21 submitted within 60 days of the investment adviser’s fiscal year-end. The pre-April 3, 2003 version  
22 of subdivision (a)(2) of section 260.241.2, provided as follows:

23 (a) General Rule. Subject to the provisions of subsection (c) of this section, ... every  
24 licensed investment adviser subject to the provisions of Section 260.237.1 of these rules,  
25 shall file an annual financial report containing the information required by a form or forms to  
26 be supplied or approved by the Commissioner, as follows:  
27 ...

28 <sup>1</sup> Various provisions of the regulations were amended and became effective April 3, 2003. This action seeks  
administrative penalties based on violations that occurred under statutes and rules both prior to and after the effective  
date of the amendments. The post-April 3, 2003 version of pertinent regulations are included infra.

1 (2) The annual report for investment advisers shall contain a Statement of Financial  
2 Condition. Supporting schedules shall contain computations of net capitals, aggregate  
3 indebtedness and ratios required under Section 260.237.1 and the certificate of the accountant  
4 required under subsection (e) of Section 260.237 of these rules.

5 6. Prior to April 3, 2003, California Code of Regulations, title 10, section 260.237.1  
6 (“section 260.237.1”) contained the capital requirements for investment advisers. Subdivision (a)(2)  
7 of section 260.237.1 provided, in pertinent part, as follows:

8 (a) No investment adviser who has any power of attorney from any investment advisory  
9 client to execute transactions . . . shall permit its total aggregate indebtedness to exceed 500%  
10 of its tangible net capital or permit its current aggregate indebtedness to exceed its current net  
11 capital; and,  
12 ...

13 (2) If the investment adviser has any power of attorney from any investment advisory client  
14 to execute transactions and does not have regular or periodic custody or possession of any of  
15 its investment advisory clients’ securities or funds, except the receipt of prepaid subscriptions  
16 for periodic publications, or other investment advisory services, it shall at all times have and  
17 maintain tangible net capital of not less than \$5,000 ....

18 Subdivision (c) of section 260.237.1 provided that for purposes of section 260.237.1,  
19 subdivision (a), all financial information shall be determined in accordance with generally accepted  
20 accounting principles.

21 7. The Department's examiner found during the regulatory exam on February 22, 2005,  
22 that Stock Advisors, Inc. had power of attorney and discretionary power to execute transactions in  
23 the brokerage accounts of its investment adviser clients. Therefore, prior to April 3, 2003, Stock  
24 Advisors, Inc. was required to meet the capital requirements provided for under section 260.237.1,  
25 subdivision (a)(2), and to show proof of compliance with this regulation by filing annual financial  
26 reports, as required by section 260.241.2, subdivision (a).

27 8. The post-April 3, 2003 version of section 260.241.2, subdivision (a)(5), requires the  
28 filing of an annual financial report by certain investment advisers within 90 days of their fiscal year-  
end. Further, the post-April 3, 2003 version of subdivision (a)(2) of section 260.241.2 provides as  
follows:

(a) General Rule. Subject to the provisions of subsection (c) of this section, ... every  
licensed investment adviser subject to the provisions of Section 260.237.1 or Section  
260.237.2, as applicable, of these rules, shall file an annual financial report containing the

1 information required by a form or forms to be supplied or approved by the Commissioner, as  
2 follows:

3 ...  
4 (2) This annual report for investment advisers shall contain a Statement of Financial  
5 Condition. Supporting schedules shall contain computations of net capitals, aggregate  
6 indebtedness and ratios required under Section 260.237.1 or minimum financial requirements  
7 required under Section 260.237.2, as applicable, and the certificate of the accountant required  
8 under subsection (e) of Section 260.237 of these rules.

9  
10 9. After April 3, 2003, an investment adviser licensed prior to April 01, 2003 may  
11 comply with either the minimum financial requirements in section 260.237.1 or those found in  
12 California Code of Regulations, title 10, section 260.237.2 (“section 260.237.2”) until January 1,  
13 2005, at which time section 260.237.1 shall become inoperative and an investment adviser shall  
14 comply with the minimum financial requirements of section 260.237.2 (Cal. Code Regs., tit. 10, §  
15 260.237.1). In pertinent part, subdivision (a)(2) of the post-April 3, 2003 version of section  
16 260.237.1 is identical to the pre-April 3, 2003 version of that section.

17 The post-April 3, 2003 version of subdivision (a) of section 260.237.2 provides, in pertinent  
18 part, as follows:

19 ...  
20 (a) Every investment adviser who has custody of client funds or securities shall maintain at  
21 all times a minimum net worth of \$35,000, and every investment adviser who has  
22 discretionary authority over client funds or securities but does not have custody of client  
23 funds or securities, shall maintain at all times a minimum net worth of \$10,000.

24 10. As stated above, the Department's examiner found during the regulatory exam on  
25 February 22, 2005, that Stock Advisors, Inc. had power of attorney and discretionary power to  
26 execute transactions in the brokerage accounts of its investment adviser clients. Therefore, after  
27 April 3, 2003, Stock Advisors, Inc. was required to meet either the minimum financial requirements  
28 provided in either section 260.237.1, subdivision (a)(2), or section 260.237.2, subdivision (a), and to  
show proof of compliance with one of the two regulation sections by filing annual financial reports,  
as required by section 260.241.2, subdivision (a). At the time of the February 22, 2005 examination,  
Stock Advisors, Inc. had failed to submit its annual financial reports for the fiscal years ending in  
2002, 2003, and 2004, in violation of California Code of Regulations, title 10, section 260.241.2,  
subdivision (a). As a result of Stock Advisors, Inc.'s violation of section 260.241.2, subdivision (a),

1 the Department was unable to determine, at the end of Stock Advisors, Inc.'s fiscal year, if the firm  
2 was in compliance with the net capital requirements of section 260.237.1 and/or section 260.237.2.

3 11. A prior regulatory examination of Stock Advisors, Inc. on November 15, 2001, also  
4 revealed, in part, the failure to file an annual financial report for the year 2001. In correspondence  
5 with the Department at that time, Mr. Welch assured the Department that Stock Advisors, Inc. would  
6 not repeat the annual financial report filing violation in the future.

7 12. Corporations Code section 25252 authorizes the Commissioner to issue an order  
8 levying administrative penalties against any investment adviser for willful violations of any  
9 provision of the CSL and any rules promulgated thereunder. Specifically, Corporations Code  
10 section 25252 provides, in pertinent part:

11 The Commissioner may, after appropriate notice and opportunity for hearing, by orders, levy  
12 administrative penalties as follows:

13 ...

14 (b) Any broker-dealer or investment adviser that willfully violates any provision of this  
15 division to which it is subject, or that willfully violates any rule or order adopted or issued  
16 pursuant to this division and to which it is subject, is liable for administrative penalties of not  
17 more than five thousand dollars (\$5,000) for the first violation, not more than ten thousand  
18 dollars (\$10,000) for the second violation, and not more than fifteen thousand dollars  
19 (\$15,000) for each subsequent violation.

20 13. By reason of the foregoing, Stock Advisors, Inc. has willfully violated California  
21 Code of Regulations, title 10, section 260.241.2, subdivision (a), justifying the imposition of  
22 administrative penalties. Stock Advisors, Inc., as a licensee, was obligated to have knowledge of,  
23 and to comply with, the provisions of the Corporate Securities Law and the regulations thereunder to  
24 maintain its investment adviser certificate. Furthermore, the Department had given Stock Advisors,  
25 Inc. prior notice of the requirements of California Code of Regulations, title 10, section 260.241.2,  
26 subdivision (a). Stock Advisors, Inc. has continued to violate this regulation, despite the  
27 Department's actual notification and Mr. Welch's assurances of future compliance.

28 14. Therefore, pursuant to Corporations Code section 25252, the Commissioner seeks  
administrative penalties for Stock Advisors, Inc.'s failure to file required annual financial reports, in  
willful violation of California Code of Regulations, title 10, section 260.241.2, subdivision (a).

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WHEREFORE, good cause showing, and pursuant to Corporations Code section 25252, the California Corporations Commissioner prays for an order levying administrative penalties in the total amount of \$750.00, for violation of California Code of Regulations, title 10, section 260.241.2, subdivision (a).

Dated: March 27, 2006

WAYNE STRUMPFER  
Acting California Corporations Commissioner

By: \_\_\_\_\_  
ALEXANDER M. CALERO  
Corporations Counsel  
Enforcement Division