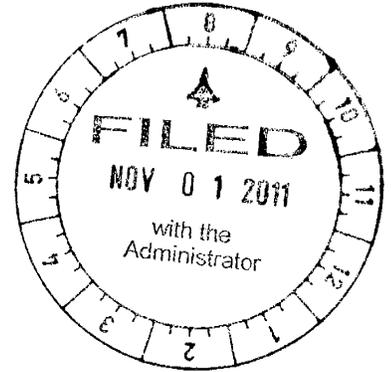


STATE OF OKLAHOMA  
DEPARTMENT OF SECURITIES  
THE FIRST NATIONAL CENTER  
120 NORTH ROBINSON, SUITE 860  
OKLAHOMA CITY, OKLAHOMA 73102



In the Matter of:

Geary Securities, Inc. *fka* Capital West Securities, Inc.;  
Keith D. Geary; Norman Frager; and CEMP, LLC,

Respondents.

File No. 09-141

**MOTION FOR SUMMARY DECISION**  
**AGAINST RESPONDENT NORMAN FRAGER**  
**AND BRIEF IN SUPPORT**

Respectfully submitted,

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**TABLE OF CONTENTS**

TABLE OF AUTHORITIES ..... ii

INTRODUCTION ..... 1

STATEMENT OF MATERIAL FACTS ..... 1

    Background and Relevant Persons..... 1

    May 2009 Net Capital Deficiency ..... 3

    February 2010 Net Capital Deficiencies..... 10

ARGUMENTS AND AUTHORITIES..... 15

    I. THE DEPARTMENT IS ENTITLED TO A SUMMARY DECISION BECAUSE THERE IS NO SUBSTANTIAL CONTROVERSY AS TO ANY MATERIAL FACTS. .... 15

    II. BROKER-DEALERS ARE SUBJECT TO A SHARED SYSTEM OF REGULATORY RESPONSIBILITIES. .... 17

        A. Financial Responsibility Rules..... 18

            1. Federal regulation ..... 18

            2. Oklahoma regulation..... 21

        B. Standards of Professional Conduct ..... 21

            1. Federal regulation ..... 21

            2. Oklahoma regulation..... 22

    III. THE FINOP IS RESPONSIBLE FOR A BROKER-DEALER’S NET CAPITAL COMPLIANCE AND FINANCIAL REPORTING. .... 23

        A. Net Capital Requirements ..... 24

        B. Reporting Requirements..... 25

        C. Action or Inaction by FINOP ..... 26

    IV. RESPONDENT FRAGER VIOLATED NET CAPITAL AND FINANCIAL REPORTING RULES AND STANDARDS OF ETHICAL PRACTICE. .... 28

        A. The Frontier PL-CMO Transactions ..... 29

        B. February 2010 Net Capital Deficiencies ..... 32

CONCLUSION..... 35

APPENDIX

## TABLE OF AUTHORITIES

### Cases

<u>Anderson v. Liberty Lobby, Inc.</u> , 477 U.S. 242 (1986).....	17
<u>Avello v. SEC</u> , 454 F.3d 619 (7th Cir. 2006) .....	23, 24, 29
<u>Avery v. Moffatt</u> , 55 N.Y.S.2d 215 (N.Y. Sup. Ct. 1945).....	21
<u>Burnette v. Dow Chemical Co.</u> , 849 F.2d 1269 (10th Cir. 1988) .....	17
<u>Christopher M. Block</u> , Complaint No. CO5990026, 2001 WL 991569 (N.A.S.D.R. Aug. 16, 2001).....	27
<u>Colonial Realty Corp. v. Bache &amp; Co.</u> , 358 F.2d 178 (2d Cir. 1966).....	21
<u>Dillon Sec., Inc.</u> , 1988 WL 858070 (N.A.S.D.R. Oct. 25, 1988).....	23
<u>E.F. Hutton &amp; Company, Inc.</u> , Exchange Act Release No. 25887, 1988 WL 901859 (July 6, 1988).....	22
<u>Flanders v. Crane Co.</u> , 693 P.2d 602 (Okla. 1984).....	16
<u>Fleet Boston Robertson Stephens, Inc. v. Innovex, Inc.</u> , 264 F.3d 770 (8th Cir. 2001) .....	21
<u>Fox &amp; Co. Inv., Inc.</u> , Complaint No. C3A030017, 2005 WL 3054152 (N.A.S.D.R. Feb. 24, 2005).....	19, 20, 26, 27
<u>Fox &amp; Co. Inv., Inc.</u> , Exchange Act Release No. 52697, 2005 WL 2848468 (Oct. 28, 2005).....	18, 20, 25, 26
<u>George Lockwood Freeland</u> , Exchange Act Release No. 32192, 1993 WL 128746 (Apr. 22, 1993).....	28
<u>Gilad J. Gevanyahu</u> , Exchange Act Release No. 33038, 1993 WL 413629 (Oct. 12, 1993).....	27, 30
<u>Harrison Sec., Inc.</u> , Release No. 256, 2004 WL 2109230 (ALJ Sept. 21, 2004).....	19, 24, 29, 31, 33
<u>Harrison Sec., Inc.</u> , Exchange Act Release No. 50614, 2004 WL 2434257 (Oct. 29, 2004).....	19, 24, 29, 34
<u>Hutchison Fin. Corp.</u> , Exchange Act Release No. 32215, 1993 WL 138533 (Apr. 26, 1993).....	19, 27, 28, 30, 32, 33
<u>Inv. Mgmt. Corp.</u> , Complaint No. C3A010045, 2003 WL 23104683 (N.A.S.D.R. Dec. 15, 2003).....	20, 27
<u>James A. Goetz</u> , 53 SEC 472 (1998).....	22
<u>James S. Davenport</u> , Complaint No. C05010017, 2003 WL 21203078 (N.A.S.D.R. May 6, 2003).....	22

<u>James S. Pritula</u> , Exchange Act Release No. 40647, 1998 WL 774688 (Nov. 9, 1998).....	19, 20
<u>Jenkins v. Wood</u> , 81 F.3d 988 (10th Cir. 1996) .....	16
<u>Knights of Columbus Council 3152 v. KFS BD, Inc.</u> , 791 N.W.2d 317 (Neb. 2010).....	17
<u>Lowell H. Listrom</u> , Exchange Act Release No. 30497, 1992 WL 58904 (March 19, 1992).....	19
<u>Northrip v. Montgomery Ward &amp; Co.</u> , 529 P.2d 489 (Okla. 1974).....	16
<u>Otto v. SEC</u> , 253 F.3d 960 (7th Cir. 2001) .....	17
<u>People v. Cohen</u> , 718 N.Y.S.2d 147 (N.Y. Sup. Ct. 2000).....	17
<u>Respondent</u> , Disciplinary Proc. No. 20060042305-01, 2008 WL 2359719 (N.A.S.D.R. Apr. 10, 2008).....	24, 26, 28, 33
<u>Respondent 1</u> , Complaint No. C8A980059, 2000 WL 33407051 (N.A.S.D.R. Nov. 6, 2000).....	24, 25, 28, 33
<u>Roth v. SEC</u> , 22 F.3d 1108 (D.C. Cir. 1994).....	18
<u>Touche Ross &amp; Co., v. Redington</u> , 442 U.S. 560 (1979).....	19, 20, 26
<u>Vitkus v. Beatrice Co.</u> , 11 F.3d 1535 (10th Cir. 1993) .....	16
<u>Wall Street Access</u> , Decision 06-83, 2006 WL 2237526 n.1 (N.Y.S.E. June 23, 2006) .....	20
<u>William H. Gerhauser</u> , Exchange Act Release No. 40639, 1998 WL 767091 (Nov. 4, 1998).....	19, 22, 26, 33

## **Statutes**

15 U.S.C. § 78a et seq.,.....	17
15 U.S.C.A. § 78b.....	17
15 U.S.C.A. § 78o(c)(3)(A) .....	20
Okla. Stat. tit. 12, § 2056(C).....	16
Okla. Stat. tit. 12, Ch. 2, App., Rule 13 .....	16
Okla. Stat. tit. 71, §§ 1-101 through 1-701 .....	18
Okla. Stat. tit. 71, §§ 1-401 through 1-411 .....	18
Okla. Stat. tit. 71, §1-410(A) .....	21
Okla. Stat. tit. 71, § 1-604 .....	18
Okla. Stat. tit. 71, § 1-608.....	35

## **Rules and Regulations**

17 C.F.R. § 240.15c3-1 .....	18
------------------------------	----

17 C.F.R. § 240.17a-11 .....	25
17 C.F.R. § 240.17a-11(b)(1).....	20
Fed. R. Civ. P. 56(a) .....	16
FINRA Rule 2010 .....	21, 22
NASD Rule 1022 .....	23, 24, 30
Okla. Admin. Code § 660:2-9-3 .....	1, 15, 16
Okla. Admin. Code § 660:11-5-17.....	21, 31, 34
Okla. Admin. Code § 660:11-5-42 .....	22, 23, 31, 34, 35

## INTRODUCTION

The Oklahoma Department of Securities (Department) hereby moves for a summary decision against Respondent Norman Frager (Respondent Frager), pursuant to 660:2-9-3(d) of the Administrative Rules of the Oklahoma Securities Commission and the Administrator of the Department of Securities (Oklahoma Rules), Okla. Admin. Code, 660:1-1-1 through 660:25-7-1. A summary decision against Respondent Frager is appropriate because there is no genuine issue as to any material fact and the Department is entitled to prevail as a matter of law.

## STATEMENT OF MATERIAL FACTS

### **Background and Relevant Persons**

1. Capital West Securities, Inc., an Oklahoma corporation, was registered as a broker-dealer under the Oklahoma securities statutes on May 25, 1995. At all times material hereto, the firm's principal business location has been at 211 North Robinson, Suite 200, Oklahoma City, Oklahoma. Frager Answer ¶ 1.

2. In August of 2007, Capital West Securities, Inc. became a wholly-owned subsidiary of The Geary Companies, Inc., a Delaware corporation (Geary Companies). As of December 1, 2009, Capital West Securities, Inc. changed its name to Geary Securities, Inc.<sup>1</sup> Answer by Respondents Geary Securities, Inc., Keith D. Geary, and CEMP, LLC (Geary Respondents' Answer) ¶ 2.

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<sup>1</sup> With respect to all matters addressed herein, the broker-dealer will be referred to as "Geary Securities" or "the Firm".

3. Geary Securities has been a member of the Financial Industry Regulatory Authority, Inc. (FINRA)<sup>2</sup>, formerly known as the NASD, since May of 1995. Geary Securities CRD Record, Organization Registration Status.

4. Keith Geary, a resident of the state of Oklahoma, owns Geary Companies equally with his wife. Keith Geary is the chief executive officer of Geary Companies and is Chairman, Chief Executive Officer and President of Geary Securities. Geary Respondents' Answer ¶ 3.

5. Norman Frager (Frager), at all times material hereto, was the designated Financial Principal for Geary Securities.<sup>3</sup> As the Financial Principal, Frager functioned as the Firm's chief financial officer responsible for the preparation and filing of the Firm's Financial and Operational Combined Uniform Single (FOCUS) reports, to include net capital computations. At all times material hereto, Frager was a resident of the state of Missouri. Frager was present in the Oklahoma City office of Geary Securities two to three days per month. Frager Answer ¶ 3.

6. Respondent Frager has been in the brokerage business since 1967. Frager Dep. 8:7-11.

7. Respondent Frager is experienced in broker-dealer compliance serving as a compliance officer, as president of a brokerage firm, and in various capacities with the NASD and FINRA. Frager Dep. 30:6-16; 31:2-20. ("I've had extensive experience in compliance. . . . My experience with – in compliance, goes back to 1982 when I first became involved with the NASD when I went on the board – the district committee – and I functioned with NASD since then, in the compliance area. And on the Board of Governors, I've done numerous compliance

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<sup>2</sup> FINRA stands for the Financial Industry Regulatory Authority. FINRA is a self-regulatory organization registered as a national securities association with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 (Exchange Act). FINRA was formerly known as the National Association of Securities Dealers, Inc. (NASD).

<sup>3</sup> The affiliation between Respondent Frager and Geary Securities was terminated as of August 31, 2011. Frager Form U5, Uniform Termination Notice for Securities Industry Registration, Sept. 12, 2011.

hearings for them. I've written the sanction guidelines for them, been on numerous subcommittees, been on the membership committee, been on the operations committee. And I'm currently on the Financial Responsibility Committee of FINRA.”).

8. Denise Hintze (Hintze) is Assistant Vice-President for Accounting and Human Resources for Geary Securities. Hintze Dep. 11:12-14. Hintze assisted Respondent Frager with the preparation of the Firm's FOCUS reports, to include net capital computations. Frager Dep. 21:17-19; 149:20-150:15; Hintze Dep. 15:5-14.

9. At all times material hereto, the minimum net capital requirement for Geary Securities was \$250,000. Frager Answer ¶ 14; Frager Dep. 148:6-15; 149:2-3.

10. In the event of a net capital deficiency, a notice is required to be filed with FINRA. Frager Dep. 148:24-149:9, 152:23-153:12, 163:13-21; Roberts Dep. 29:23-30:3<sup>4</sup>; Paulukaitis Aff. ¶ 23.

11. When a broker-dealer has a net capital deficiency, it is required to stop writing trade tickets to buy securities and/or accepting customer checks. Roberts Dep. 30:21-31:3, 35:19-36:8; Frager Dep. 54:22-55:17, 159:3-9.

### **May 2009 Net Capital Deficiency**

12. On May 27, 2009, Geary Securities, through Keith Geary, submitted bid prices to Frontier State Bank (Frontier) on certain of the bank's private label collateralized mortgage obligations (Frontier PL-CMOs). Geary Dep. 107:14-25, Ex. 3.

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<sup>4</sup> At all times material hereto, Althea Roberts was the chief compliance officer for Geary Securities. Roberts Dep. 12:25-13:6.

*Purchase and Sale of Frontier PL-CMOs by Geary Securities*

13. The bid prices submitted by Geary Securities were accepted by Frontier on May 27, 2009. Geary Dep. 107:14-25, Ex. 3. The trades were entered on May 28<sup>th</sup> for same-day settlement. Capital West Securities Inc. MBS/CMO Account, Brokerage Account Statement at 10-11, May 1, 2009 – May 31, 2009.

14. Keith Geary intended for Geary Securities to hold the PL-CMOs for two to three weeks while the PL-CMOs were pooled to collateralize certain mortgage-backed securities to be created and issued by CEMP, LLC (CEMP), an affiliate of Geary Companies. Geary Dep. 59:14-60:1-10; Hintze Dep. 31:9-32:9. CEMP was formed on or about July 16, 2009. Geary Respondents' Answer ¶ 49.

15. Geary Securities purchased the Frontier PL-CMOs in a proprietary account designated as the Firm's MBS/CMO inventory account (MBS/CMO Account). Geary Dep. 59:6-9; Goodman Dep. 34:22-35:1<sup>5</sup>; Capital West Securities Inc. MBS/CMO Account, Brokerage Account Statement at 10-11, May 1, 2009 – May 31, 2009.

16. On June 1, 2009, Keith Geary advised Respondent Frager that he had purchased the Frontier PL-CMOs. Geary Dep. 70:24-71:15. Keith Geary also advised Respondent Frager that he had purchased the Frontier PL-CMOs with the intention of holding them for the CEMP offering. Geary Dep. 71:9-25; 72:15-19; *see* Frager Dep. 113:25-114:11. Respondent Frager advised Keith Geary that Geary Securities would not be able to hold the Frontier PL-CMOs. Geary Dep. 72:15-73:7.

17. The Frontier PL-CMOs were in the MBS/CMO Account on May 31, 2009. Geary Dep. 85:19-25; Hintze Dep. 25:25-26:19.

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<sup>5</sup> Chad Goodman is Senior Vice-President for Sales and Institutional Investments for Geary Securities. Goodman Dep. 11:6-8.

18. Respondent Frager advised that the Frontier PL-CMOs should be removed from the MBS/CMO Account and billed to a customer. Frager Dep. 69:10-11; 71:16-22.

19. On June 1, 2009, Keith Geary arranged for the sale of the Frontier PL-CMOs to two customers of the Firm (Geary Customers) for same day settlement. Geary Dep. 73:9-22; 89:11-15. Respondent Geary considers the trade tickets to have been entered correctly. Geary Dep. 74:24-75:5. The Frontier PL-CMOs were sold from the MBS/CMO Account to the accounts of the Geary Customers on June 1, 2009. Geary Dep. 61:22-25; 73:5-74:23; Paulukaitis Aff. ¶ 18.

#### *Proper Accounting Treatment*

20. Registered broker-dealers must maintain their books and records in accordance with generally accepted accounting principles (GAAP). Frager Dep. 69:13-15.

21. Broker-dealers must maintain their books and records using the accrual basis of accounting. Frager Dep. 62:25. Revenues must be recognized when earned. Liabilities must be recognized when incurred and must remain on the books and records until paid for or otherwise satisfied. Paulukaitis Aff. ¶ 10.

22. Geary Securities was obligated to remit payment to its clearing firm, Pershing LLC (Pershing), in connection with the purchase of the Frontier PL-CMOs. Paulukaitis Aff. ¶ 11. Geary Securities could not pay for those securities. Geary Respondents' Answer ¶ 37; Frager Dep. 61:5-10; Hintze Dep. 37:14-21. Geary Securities effectively borrowed the funds necessary to do so from Pershing. Hintze Dep. 37:14-21; Paulukaitis Aff. ¶ 13. The Firm was required to record a liability in the amount of the borrowed funds. Paulukaitis Aff. ¶ 13.

23. When Geary Securities acquired the Frontier PL-CMOs, it was required to record the value of those securities as an asset on its books and records. Paulukaitis Aff. ¶ 13.

24. In the calculation of its net capital after the acquisition of the Frontier PL-CMOs and the proper accounting thereof, Geary Securities would have been required to take a downward adjustment or “haircut” on the value of those securities. Paulukaitis Aff. ¶ 14.

25. Utilizing the 40% haircut applicable to *liquid* securities, the resulting reduction in the net capital of Geary Securities would have been more than \$31.7 million. Paulukaitis Aff. ¶¶ 15, 16.

26. Geary Securities did not have the capital to cover a 40% haircut on the Frontier PL-CMOs. Frager Dep. 54:7-18 (“Well, [15c3-1] requires a 40 percent haircut on liquid securities. And we certainly didn’t have the capital for that.”).

27. The required haircut on the Frontier PL-CMOs was 100% of the value of the Frontier PL-CMOs because there was no readily identifiable secondary market for those securities. Paulukaitis Aff. ¶ 14; Frager Dep. 59:14-16 (“There is no central marketplace for private label CMOs. There is no exchange that I can go buy them.”).

28. A haircut of 100% of the value of the Frontier PL-CMOs equated to a net capital reduction in excess of \$79 million. Paulukaitis Aff. ¶ 14.

29. Geary Securities did not have the capital to cover a 100% haircut on the Frontier PL-CMOs. Paulukaitis Aff. ¶ 16.

*Respondent Frager’s Cover-Up*

30. Respondent Frager advised Keith Geary that for purposes of the May 2009 FOCUS report, the Firm would treat the Frontier PL-CMOs as if the securities were in the accounts of the Geary Customers before the end of May rather than when the securities were actually sold to the Geary Customers on June 1, 2009. Geary Dep. 83:25-85:9.

31. The books and records of Geary Securities reflected an inventory balance in mortgage-backed securities/collateralized mortgage obligations in excess of \$79,000,000 as of May 29, 2009. Hintze Dep. 25:13-25, 27:7-28:1, Ex. 1; Frager Dep. 65:8-16, Ex. 5 at ODS 09-141/CW 2610.

32. Respondent Frager marked through the \$79.3 million balance indicated on the Firm's inventory report and replaced that figure with a zero. Hintze Dep. 34:6-21, Ex. 1; Frager Dep. 78:1-14, 79:24-80:15, Ex. 5 at ODS 09-141/CW 2610. Respondent Frager also made the following notation on the report: "Zero Balance resulting from a/o Billing to McKean Accts & receipt of \$30+ Million in cash from McKean." Hintze Dep. 34:10-21, Ex. 1; Frager Dep. 78:9-14, 80:1-15, Ex. 5 at ODS 09-141/CW 2610.

33. Respondent Frager did not reflect the value of the Frontier PL-CMOs as an asset of Geary Securities for purposes of the May 2009 Focus report. Paulukaitis Aff. ¶ 20. Respondent Frager did include accrued interest on such securities as an asset of the Firm as of May 31, 2009. Frager Answer ¶ 16; Paulukaitis Aff. ¶ 21.

34. In connection with the preparation of the May 2009 FOCUS report, Respondent Frager advised Hintze that the purchases of the Frontier PL-CMOs had been cancelled and rebilled to a customer of Geary Securities as of the end of the month. Hintze Dep. 28:17-25; 29:15-18; 30:14-19; 33:19-24; *see* Frager Dep. 80:9-81:1. Efforts to cancel and rebill the purchases were not made until November of 2009. Geary Dep. 87:11-19; Coker Dep. 39:13-15.

35. Based on her conversation with Respondent Frager, Hintze subtracted the PL-CMO position from the Firm's inventory account balance for purposes of the May 2009 FOCUS report. Hintze Dep. 33:18-34:4.

36. Respondent Frager did not ensure that the matter of a capital deficiency resulting from the Firm's purchase of the Frontier PL-CMOs was adequately addressed. Geary Dep. 72:25-73:7; 86:9-87:13 ("So I'm sure when he came in June and saw that they had been traded, settled out on the 1<sup>st</sup>, that he just assumed they had been backdated."); Frager Dep. 71:16-72:1 ("I have no idea how they were billed."). Respondent Frager never asked for confirmation that the purchases of the Frontier PL-CMOs had been cancelled and rebilled before submitting the May 2009 FOCUS report to FINRA. Hintze Dep. 38:1-3; Frager Dep. 85:12-25.

37. Respondent Frager did not reflect the cost of the securities as a liability to Pershing on the Firm's books and records. Paulukaitis Aff. ¶ 20. Geary Securities accounted for the payment of interest to Pershing to carry the Frontier PL-CMO inventory. Geary Dep. 85:22-86:1, 91:19-20; Hintze Dep. 35:6-20; 37:14-17.

38. The Firm's liability to Pershing was not paid until June 1, 2009, and should have been on the books and records of Geary Securities until payment was made. Paulukaitis Aff. ¶¶ 11, 18.

39. Respondent Frager filed the Firm's FOCUS report as of May 31, 2009, reflecting net capital in the amount of \$1,026,261. Paulukaitis Aff. ¶ 16; Frager Dep., Ex. 5 at ODS 09-141/CW 2594.

#### *The Results of Respondent Frager's Conduct*

40. Geary Securities' acquisition of the Frontier PL-CMOs caused its net capital to be less than it was required to maintain under the net capital rule of the Securities and Exchange Commission (SEC). Paulukaitis Aff. ¶ 16; Hintze Dep. 38:4-7 and 39:4-7.

41. Geary Securities did not cease operations while under its net capital requirement. Geary Dep. 115:25-116:3.

42. Respondent Frager failed to accurately compute the Firm's net capital as of May 31, 2009. Respondent Frager filed a false FOCUS report as of May 31, 2009. Paulukaitis Aff. ¶ 24.

43. Respondent Frager testified that Geary Securities never owned the securities. Frager Dep. 63:1-20; 64:21; 68:25-69:4; 69:8-13. In addition, Respondent Frager blamed Pershing for making a mistake in its books and records. Frager Dep. 69:18-22. Respondent Frager accused Firm personnel of billing the trades in error and wrongfully creating the PL-CMO position in the Firm's inventory account. Frager Dep. 64:19-25; 68:25-69:4. Respondent Frager also testified that the Frontier PL-CMOs should have been put in a CEMP account. Frager Dep. 63:9-20. At the time the Frontier PL-CMOs were put into the MBS/CMO Account, CEMP had not yet been created. Hintze Dep. 32:17-21; *see supra* ¶ 14.

#### *Failure to Notify FINRA*

44. In November of 2009, a representative of the New Orleans office of FINRA advised Respondent Frager that the Firm had a capital violation as a result of the Frontier PL-CMO transactions. Geary Dep. 83:1-18; Frager Dep. 83:3-7.

45. The FINRA representative also advised Respondent Frager to report the capital deficiency to FINRA. Frager Dep. 83:11-15.

46. Respondent Frager disagreed with the FINRA representative and did not file the notice with FINRA. Frager Dep. 83:24-25.

47. Respondent Frager did not attempt to address the net capital issue until November of 2009 when Respondent Frager directed that the trade tickets for the purchases of the Frontier PL-CMOs by the Geary Customers be backdated to May 28, 2009. Coker Dep. 39:13-15; 43:4-

14;<sup>6</sup> Geary Dep. 83:1-84:14 (“I believe they were backdated to the trade date so that it would appear as if they were never held in the firm’s account.”).

48. On November 12, 2009, Respondent Frager directed Karen Coker to cancel the June 1<sup>st</sup> purchases of the Frontier PL-CMOs by the Geary Customers and to rebill the purchases with trade and settlement dates of May 28, 2009. Coker Dep. 34:21-36:5, 41:10-21; Frager Dep. 82:1-6; Goodman Dep. 47:14-48:16.

49. Respondent Frager did not verify how the tickets to cancel and rebill were done. Frager Dep. 83:16-23 (“I thought it was taken care of.”).

50. The tickets to cancel and rebill the purchases of the Frontier PL-CMOs by the Geary Customers were entered on November 12, 2009, for settlement on May 28, 2009; however, the settlement dates for the cancel and rebill tickets were processed by Pershing as June 1, 2009. Coker Dep. 37:22-38:13; Goodman Dep. 47:14-25.

51. Respondent Frager testified that the matter was resolved. Frager Dep. 82:2-6 (“I recall that it was done improperly the first time and ultimately it was – it was done [correctly] when it was pointed out by FINRA that it was done incorrectly. The date should have been the 28<sup>th</sup>.”). Respondent Frager did not ever file a notice with FINRA on behalf of Geary Securities disclosing the May 2009 net capital deficiency. Frager Dep. 83:24-25.

### **February 2010 Net Capital Deficiencies**

52. Prior to February 10, 2010, Geary Securities performed a net capital computation at month end only. Hintze Dep. 21:2-4.

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<sup>6</sup> Karen Coker is the Operations Manager for Geary Securities. Coker Dep. 17:13-14.

53. Respondent Frager testified that Geary Securities did not compute its net capital on a daily basis because “you don’t get brownie points just for going through the exercise of showing that you’re in capital compliance.” Frager Dep. 152:14-18.

54. The Firm’s net capital had declined in the months preceding January of 2010 and continued to decrease as the company experienced operating losses. Frager Dep. 154:19-24. In January of 2010, Respondent Frager advised Keith Geary that the Firm would be under net capital if a proposed second CEMP offering did not close and there was no other infusion of capital. Frager Dep. 154:19-155:12; 200:12-22. Keith Geary did not immediately respond. Frager Dep. 200:23-201:1; Roberts Dep. 33:10-34:13.

55. As the Firm was getting closer in January to being undercapitalized, there was discussion between Respondent Frager and Denise Hintze of the need to closely monitor the situation. Hintze Dep. 41:11-25. At that time, Respondent Frager did not direct that the Firm’s net capital be computed more often than monthly. Frager Dep. 154:22-156:24; Hintze Dep. 43:4-10. Respondent Frager did not persistently communicate with Keith Geary about the need for a capital infusion into the Firm. Frager Dep. 202:6-13.

56. Respondent Frager relied on Denise Hintze to notify him of the net capital computations. Frager Dep. 152:7-22; 156:4-157:4; 158:1-15. He also relied on Denise Hintze to communicate with Keith Geary about net capital issues. Frager Dep. 201:2-18.

57. On or about February 10, 2010, the Firm, through Denise Hintze, began performing net capital computations on a daily basis. Hintze Dep. 18:5-10; 20:17-21:1; 44:9-45:5; Frager Dep. 152:13-14.

58. Each business day since February 10, 2010, Denise Hintze has forwarded the Firm's net capital computations to Keith Geary and Respondent Frager. Hintze Dep. 18:5-10; Frager Dep. 152:7-17.

*February 10, 2010 Notice*

59. On February 10, 2010, Respondent Frager filed an SEC Rule 17a-11(b) notice with FINRA reporting the occurrence of a net capital deficiency by the Firm from January 31, 2010, through February 4, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 365-366.

60. On February 4, 2010, the Firm maintained net capital in the amount of \$194,286, a deficiency of \$55,714. The deficiency was discovered by the Firm on February 10, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 365-366.

61. Respondent Frager reported that the Firm conducted a securities business on the dates of the deficiency, that is, January 31, 2010, through February 4, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 365-366.

*February 12, 2010 Notice*

62. On February 12, 2010, Respondent Frager filed an SEC Rule 17a-11(b) notice with FINRA reporting the occurrence of a net capital deficiency by the Firm from February 5, 2010, through February 10, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 369-370.

63. On February 10, 2010, the Firm maintained net capital in the amount of \$185,000, a deficiency of \$65,000. The deficiency was discovered by the Firm on February 12, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 369-370.

64. Respondent Frager reported that the Firm conducted a securities business on the dates of the deficiency, that is, February 5, 2010, through February 10, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 369-370.

*February 26, 2010 Notice*

65. On February 26, 2010, Respondent Frager filed an SEC Rule 17a-11(b) notice with FINRA reporting the occurrence of a net capital deficiency by the Firm from February 11, 2010, through February 25, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 373-374.

66. On February 25, 2010, the Firm maintained net capital in the amount of \$219,267, a deficiency of \$30,733. Frager Dep., Ex. 4 at ODS 09-141/Frager 373-374.

67. Geary Companies paid \$750,000 on a receivable to Geary Securities on February 26, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 373-374.

68. Geary Securities was not in net capital compliance on any day between February 10, 2010 and February 26, 2010. Frager Dep. 166:14-24, 168:4-5. Respondent Frager filed only one SEC Rule 17a-11(b) notice with FINRA during that time period. Frager Dep. 167:7-8; Frager Dep., Ex. 4 at ODS 09-141/Frager 373-374. Respondent Frager did not file that notice until after the Firm was back in net capital compliance. Frager Dep. 168:6-7; Hintze Dep. 47:5-17.

69. Respondent Frager reported to FINRA that the Firm conducted a securities business on the dates of the deficiency, that is, February 11, 2010, through February 25, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 373-374.

*Respondent Frager's Failed Response*

70. Geary Securities was under net capital every day during the period beginning January 31, 2010 and ending February 25, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 365-366, 369-370, 373-374; Hintze Dep. 44:9-13; 45:9-46:2.

71. On February 12, 2010, Respondent Frager filed an SEC Rule 17a-11(c)(3) notice with FINRA (First Early Warning Report) disclosing that the Firm's net capital was below 120% of its required net capital of \$250,000 for the period beginning January 31, 2010, and ending February 12, 2010. The Firm discovered that its net capital was below 120% of its required net capital amount on February 10, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 367-368.

72. On February 26, 2010, Respondent Frager filed an SEC Rule 17a-11(c)(3) notice with FINRA (Second Early Warning Report) disclosing that the Firm's net capital was below 120% of its required net capital of \$250,000 for the period beginning February 13, 2010, and ending February 25, 2010. The Firm discovered that its net capital was below 120% of its required net capital amount on February 10, 2010. Frager Dep., Ex. 4 at ODS 09-141/Frager 371-372.

73. Respondent Frager was required to notify Keith Geary when the Firm was under net capital. Frager Dep. 152:23-153:15. Respondent Frager did not always advise Keith Geary of the net capital deficiencies and/or the notices that were filed with FINRA. Frager Dep. 158:23-25, 164:8-11; 201:8-16.

74. Geary Securities did not cease operations while under its net capital requirement during February 2010. Frager Dep. 160:11-14, Ex. 4 at ODS 09-141/Frager 365-366, 369-370, 373-374; Coker Dep. 45:6-16; Roberts Dep. 33:10-34:7; Hintze Dep. 46:20-25. Respondent Frager attempted to justify his decision not to cease operations by claiming that the Firm's

required net capital was \$100,000. Frager Dep. 160:2-14 (“We always maintained, throughout this period, the minimum capital required to conduct our business, which was \$100,000. So to, I think, shut down trading or shut down the taking of customer orders would have been fool-hardy and not necessary.”).

75. Respondent Frager reported that the Firm’s net capital requirement during the period beginning January 31, 2010 and ending February 25, 2010, was \$250,000. Frager Dep., Ex. 4 at ODS 09-141/Frager 365-366, 369-370, 373-374. Respondent Frager admitted that the Firm was in the wrong by continuing to accept customer checks made payable to the Firm. Frager Dep. 160:2-8.

76. In connection with the SEC Rule 17a-11(b) notice filed on February 26, 2010, Respondent Frager filed the notice with FINRA after the passage of the time necessary for Geary Securities to be back into net capital compliance. Frager Dep. 168:4-7; Hintze Dep. 47:5-17; *see supra* ¶ 68.

## **ARGUMENTS AND AUTHORITIES**

### **I. THE DEPARTMENT IS ENTITLED TO A SUMMARY DECISION BECAUSE THERE IS NO SUBSTANTIAL CONTROVERSY AS TO ANY MATERIAL FACTS.**

The procedure authorized by 660:2-9-3 of the Oklahoma Rules provides a method to summarily dispose of cases under specified circumstances. Subsection (d) of 660:2-9-3 of the Oklahoma Rules provides as follows:

A party may move for summary decision as to any substantive issue in the case. The Administrator, or the Hearing Officer, may issue a summary decision if he finds that there is no genuine issue as to any material fact and that the moving party is entitled to prevail as a matter of law.

The hearing officer’s authority with respect to a summary judgment decision is analogous to that of a state or federal court deciding a motion for summary judgment. *See Okla. Stat. tit.*

12, § 2056(C) (OSCN 2011) (Summary judgment “should be rendered if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law.”); Fed. R. Civ. P. 56(a)(“The court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.”). Accordingly, Oklahoma and federal case law is instructive when interpreting the standard for summary decision provided in 660:2-9-3(d) of the Oklahoma Rules.

Under Oklahoma law, the requirement of “no genuine issue of any material fact” means “no substantial controversy as to any material fact.” *See* Rules for District Courts of Oklahoma, Okla. Stat. tit. 12, Ch. 2, App., Rule 13(a) and (e) (OSCN 2011); *Flanders v. Crane Co.*, 693 P.2d 602, 605 (Okla. 1984). There is no “substantial controversy as to any material fact raised by the issues” if it appears “not only that there is no dispute as to such facts themselves, but also that reasonable people exercising fair and impartial judgment could not reach differing conclusions upon the undisputed facts.” *Flanders*, 693 P.2d at 605 (citing *Northrip v. Montgomery Ward & Co.*, 529 P.2d 489, 493 (Okla. 1974)). “[A]ll inferences and conclusions to be drawn from the undisputed facts must be viewed in the light most favorable to the party opposing the motion.” *Id.* (citing *Northrip*, 529 P.2d at 496-97.) In short, summary judgment should be granted “where it is ‘perfectly clear’ that there are no issues of material fact in a case[.]” *Id.* (citing *Northrip*, 529 P.2d at 497).

Likewise, under federal law, an issue of material fact is considered “genuine” only if a reasonable jury could return a verdict for the non-movant. *Jenkins v. Wood*, 81 F.3d 988, 990 (10th Cir. 1996) (citing *Vitkus v. Beatrice Co.*, 11 F.3d 1535, 1539 (10th Cir. 1993)). The movant has “the burden of showing the absence of a genuine issue of material fact” but is not

required to “negate the nonmovant’s claim.” *Id.* If the movant fulfills its burden, the non-movant “may not rest on its pleadings, but must bring forward specific facts showing a genuine issue for trial[.]” *Id.* Further, the non-movant must show more than the “mere existence of a scintilla of evidence” in support of his position. *Burnette v. Dow Chemical Co.*, 849 F.2d 1269, 1273 (10th Cir. 1988) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 (1986)). The question, as formulated by the United States Supreme Court in *Anderson*, is whether the evidence is “so one-sided that one party must prevail as a matter of law.” *Anderson*, 477 U.S. at 251-252.

Here, the Department is entitled to a summary decision as to Respondent Frager’s liability because the evidence is clearly “one-sided” and, as will be shown below, the Department is entitled to prevail as a matter of law.

## **II. BROKER-DEALERS ARE SUBJECT TO A SHARED SYSTEM OF REGULATORY RESPONSIBILITIES.**

Congress enacted the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78a *et seq.*, to regulate the securities transactions effected on the exchanges and over-the-counter markets. 15 U.S.C.A. § 78b (Westlaw current through P.L. 112-28 approved 8-12-11). While Congress gave regulatory authority over brokers and dealers to the United States Securities and Exchange Commission (SEC), much of the regulatory responsibility at the federal level has been delegated to self-regulatory organizations, subject to SEC supervision. The SEC primarily relies on FINRA to enforce the federal securities statutes, SEC rules and FINRA’s own regulations. *Knights of Columbus Council 3152 v. KFS BD, Inc.*, 791 N.W.2d 317, 325 (Neb. 2010); *Otto v. SEC*, 253 F.3d 960, 964 (7th Cir. 2001). Moreover, broker-dealers are subject to regulation by the securities agencies in the states in which they intend to do business. *People v. Cohen*, 718

N.Y.S.2d 147, 151 (N.Y. Sup. Ct. 2000); *see also* Okla. Stat. tit. 71, §§ 1-401 through 1-411 (Supp. 2010).

Registered broker-dealers must “abide by numerous regulations designed to protect prospective purchasers of securities, including standards of professional conduct, financial responsibility requirements, recordkeeping requirements, and supervisory obligations over broker-dealer employees.” *Roth v. SEC*, 22 F.3d 1108, 1109 (D.C. Cir. 1994); *see also* Subchapter 5 of Chapter 11 of the Oklahoma Rules. Due to their multiple incorporations by reference within the Oklahoma Rules, the rules of the SEC and/or FINRA are extremely relevant in the Oklahoma regulatory scheme. In addition, Section 1-608 of the Oklahoma Uniform Securities Act of 2004 (Oklahoma Act), Okla. Stat. tit. 71, §§ 1-101 through 1-701 (Supp. 2010), encourages the Administrator “to effectuate greater uniformity in securities matters among the federal government, self-regulatory organizations, [and] states” by *inter alia*, “maximizing uniformity in federal and state regulatory standards[.]” Okla. Stat. tit. 71, § 1-608 (Supp. 2010). It follows that interpretations of the pertinent SEC and FINRA rules are particularly instructive when construing the Oklahoma Rules.

## **A. Financial Responsibility Rules**

### ***1. Federal regulation***

Pursuant to its authority under the Exchange Act, the SEC adopted a rule to establish minimum net capital requirements for broker-dealers and the methodology for calculating net capital (the “Net Capital Rule”). *See* 17 C.F.R. § 240.15c3-1 (Westlaw eff. June 5, 2008 and current through Sept. 8, 2011). The Net Capital Rule imposes “fundamental safeguards” on those in the securities industry and is “one of the most important weapons in the [SEC’s] arsenal to protect investors.” *Fox & Co. Inv., Inc.*, Exchange Act Release No. 52697, 2005 WL

2848468, at \*10 (Oct. 28, 2005) (affirming *Fox & Co. Inv., Inc.*, Complaint No. C3A030017, 2005 WL 3054152 (N.A.S.D.R. Feb. 24, 2005)).

The purpose of the Net Capital Rule is to require a firm to always have “sufficient assets that are readily convertible to cash to cover its indebtedness to customers and other broker-dealers in case of financial difficulty.” *James S. Pritula*, Exchange Act Release No. 40647, 1998 WL 774688, at \*2 (Nov. 9, 1998); *see also Lowell H. Listrom*, Exchange Act Release No. 30497, 1992 WL 58904, at \*3 (March 19, 1992). The Net Capital Rule serves to “protect customers from the risks involved in leaving their cash and securities with broker-dealers.” *Touche Ross & Co., v. Redington*, 442 U.S. 560, 570 (1979). More simply put, the net capital requirements are intended to be “an early warning system” of possible financial problems at a broker-dealer. *William H. Gerhauser*, Exchange Act Release No. 40639, 1998 WL 767091, at \*3 (Nov. 4, 1998). To further the protection of investors, it is essential that a firm evaluate its net capital position on a continuing basis. *Hutchison Fin. Corp.*, Exchange Act Release No. 32215, 1993 WL 138533, at \*4 (Apr. 26, 1993).

A broker-dealer calculates its net capital by “deducting illiquid assets from the firm’s net worth, as determined under GAAP, adding to that amount properly subordinated debt and further deducting certain percentages (known as ‘haircuts’) of the market value of the securities held in the firm’s proprietary accounts.” *Harrison Sec., Inc.*, Release No. 256, 2004 WL 2109230, at \*5 (ALJ Sept. 21, 2004) (initial decision) (affirmed by *Harrison Sec., Inc.*, Exchange Act Release No. 50614, 2004 WL 2434257 (Oct. 29, 2004)). In calculating its net worth, a broker or dealer must use the “‘accrual’ method of accounting, pursuant to which the firm must recognize revenues when earned and liabilities when incurred.” *Id.*; *see Pritula*, 1998 WL 774688, at \*3.

The SEC, by rule, has also prescribed reporting requirements for brokers and dealers. The required reports are critical to the regulatory oversight of brokers and dealers, allowing for a proactive, rather than reactive, approach to investor protection. *See Touche Ross & Co.*, 442 U.S. at 569-71. As with the records on which they are based, the reports must be true and correct. *Inv. Mgmt. Corp.*, Complaint No. C3A010045, 2003 WL 23104683, at \*7 (N.A.S.D.R. Dec. 15, 2003).

One of the principal reports and regulatory tools required by the SEC is the FOCUS report. In addition to general information about the broker or dealer, each FOCUS report contains the firm's financial statements and net capital computation. *Wall Street Access*, Decision 06-83, 2006 WL 2237526, at \*3 n.1 (N.Y.S.E. June 23, 2006). Evidencing the critical nature of the FOCUS report is the requirement that an individual, acting with the approval of the broker or dealer, certify that the report is accurate prior to its filing. *Id.* at \*3.

Further, at any time a broker or dealer's net capital falls below the minimum amount required, the firm must give notice of that deficiency, on that same day, to the SEC and to its primary self-regulatory organization. 17 C.F.R. § 240.17a-11(b)(1) (Westlaw eff. June 5, 2008 and current through Sept. 8, 2011); *see Pritula*, 1998 WL 774688, at \*5. The broker or dealer must also cease its securities business while below the firm's minimum net capital requirement. 15 U.S.C.A. § 78o(c)(3)(A) (Westlaw eff. Sept. 29, 2006 through July 21, 2010); *Fox & Co. Inv., Inc.*, Complaint No. C3A030017, 2005 WL 3054152, at \*6 (N.A.S.D.R. Feb. 24, 2005) (affirmed by *Fox & Co. Inv., Inc.*, Exchange Act Release No. 52697, 2005 WL 2848468 (Oct. 28, 2005)).

## ***2. Oklahoma regulation***

As part of this state's regulatory scheme, the Oklahoma Act authorizes rulemaking by the Administrator of the Department to establish minimum financial requirements for registered broker-dealers. Okla. Stat. tit. 71, §1-410(A) (Supp. 2010). Accordingly, 660:11-5-17 of the Oklahoma Rules provides as follows:

(a) General requirement. All broker-dealers registered under the Securities Act **shall at all times have and maintain net capital** of no less than the highest minimum requirement applicable to each broker-dealer **as established by the SEC in 17 CFR 240.15c3-1**.

(b) Calculation of "net capital." As used in this subchapter, net capital shall mean the net worth of a broker-dealer calculated according to the formula established by the SEC. (Emphasis added.)

In establishing the minimum financial requirements for registered broker-dealers, the Administrator of the Department has simply adopted the SEC's net capital requirements.

## **B. Standards of Professional Conduct**

### ***1. Federal regulation***

FINRA enforces a set of rules that defines the expected conduct of broker-dealers in dealing with their customers. *Fleet Boston Robertson Stephens, Inc. v. Innovex, Inc.*, 264 F.3d 770, 772 (8th Cir. 2001). In the securities industry, however, it is not always practicable "to define by statute or by administrative rules having the effect of law every practice which is inconsistent with the public interest or with the protection of investors." *Avery v. Moffatt*, 55 N.Y.S.2d 215, 228 (N.Y. Sup. Ct. 1945). FINRA Rule 2010 was adopted as a catch-all provision to address a "wide variety of misconduct, including merely unethical behavior." *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178, 182 (2d Cir. 1966). FINRA Rule 2010, hereinafter referred to as the "J&E Rule", provides as follows: "[a] member, in the conduct of its business, shall

observe high standards of commercial honor and just and equitable principles of trade.” FINRA Rule 2010 (amended by SR-FINRA-2008-028 eff. Dec. 15, 2008) (formerly, NASD Rule 2110). The just and equitable principles of trade incorporate ethical principles that exceed the statutory requirements of the securities laws. *E.F. Hutton & Company, Inc.*, Exchange Act Release No. 25887, 1988 WL 901859, at \*6 (July 6, 1988).

In applying the J&E Rule, the pertinent question is whether the securities professional’s conduct reflects on his “ability to comply with regulatory requirements necessary to the proper functioning of the securities industry and protection of the public.” *James S. Davenport*, Complaint No. C05010017, 2003 WL 21203078, at \*3 (N.A.S.D.R. May 6, 2003) (citing *James A. Goetz*, 53 SEC 472, 477 (1998)). The answer to that question is simplified in the event of a rule violation. The SEC has “consistently maintained that a violation of another SEC or NASD rule or regulation constitutes a violation of the requirement to adhere to ‘just and equitable principles of trade’ embodied in the NASD Rules[.]” *William H. Gerhauser*, Exchange Act Release No. 40639, 1998 WL 767091, at \*5 (Nov. 4, 1998).

## **2. Oklahoma regulation**

The conduct of broker-dealers and their agents registered under the Oklahoma Act is measured by this state’s standards of ethical practices. Subsection (a) of 660:11-5-42 of the Oklahoma Rules states in part:

This rule is intended to set forth the standards of ethical practices for broker-dealers and their agents. Any noncompliance with the standards of ethical practices specified in this section will constitute unethical practices in the securities business[.]

Subsection (b) of the rule sets forth the expectations associated with operating a securities business under Oklahoma law. Included within this state’s ethical standards is the following:

A broker-dealer and his agents **shall not violate any federal securities statute or rule or any rule of a national securities exchange or national securities association of which it is a member** with respect to any customer, transaction or business effected in this state. (Emphasis added.)

Rule 660:11-5-42(b)(1) of the Oklahoma Rules. Therefore, a violation of an SEC or FINRA rule in and of itself constitutes unethical conduct under the Oklahoma Rules. Further, like the rules of FINRA, there is a catch-all provision to address a variety of misconduct, to wit:

A broker-dealer and his agents, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

Rule 660:11-5-42(b)(1) of the Oklahoma Rules.

### **III. THE FINOP IS RESPONSIBLE FOR A BROKER-DEALER'S NET CAPITAL COMPLIANCE AND FINANCIAL REPORTING.**

Because of the importance of the net capital and financial reporting rules in the regulatory scheme, a broker-dealer must have a qualified financial and operations principal (FINOP) to assure its compliance with such rules. NASD Rule 1022 (amended by SR-FINRA-2009-092 eff. Dec. 31, 2009, and still in effect); *Dillon Sec., Inc.*, 1988 WL 858070, at \*9 (N.A.S.D.R. Oct. 25, 1988). The role of the broker-dealer FINOP is unique; the FINOP does not simply compile numbers or act as a bookkeeper. *Avello v. SEC*, 454 F.3d 619, 626 (7th Cir. 2006). The duties of the FINOP include:

- (A) final approval and responsibility for the accuracy of financial reports submitted to any duly established securities industry regulatory body;
- (B) final preparation of such reports;
- (C) supervision of individuals who assist in the preparation of such reports;
- (D) supervision of and responsibility for individuals who are involved in the actual maintenance of the member's books and records from which such reports are derived;
- (E) supervision and/or performance of the member's responsibilities under all financial responsibility rules promulgated pursuant to the provisions of the [Securities Exchange Act of 1934]; . . . [and]
- (G) any other matter involving the financial and operational management of the member.

NASD Rule 1022(b)(2).<sup>7</sup> With these duties, the FINOP is ultimately accountable for performance of the broker-dealer's obligations under the financial responsibility rules. *Respondent 1*, Complaint No. C8A980059, 2000 WL 33407051, at \*11 (N.A.S.D.R. Nov. 6, 2000). While the actual wording of the rules makes violations directly attributable to the securities firm, the FINOP is liable for the firm's violations. *Avello*, 454 F.3d at 624-25.

### **A. Net Capital Requirements**

Ensuring the broker-dealer's compliance with the Net Capital Rule is a particularly important aspect of the FINOP's prescribed duties. The FINOP is charged with knowing the Net Capital Rule and properly applying its provisions. *Respondent 1*, 2000 WL 33407051, at \*12. The FINOP must confirm that the broker-dealer's net capital is correctly calculated and that the firm maintains its required minimum net capital at all times. *Respondent*, Disciplinary Proceeding No. 20060042305-01, 2008 WL 2359719, at \*3 (N.A.S.D.R. Apr. 10, 2008). It is also incumbent upon the FINOP to inquire into all matters within the scope of his responsibilities to determine any impact on the broker-dealer's net capital position. *Harrison Sec., Inc.*, Release No. 256, 2004 WL 2109230, at \*48 (ALJ Sept. 21, 2004) (initial decision) (affirmed by *Harrison Sec., Inc.*, Exchange Act Release No. 50614, 2004 WL 2434257 (Oct. 29, 2004)). Even more attention by the FINOP is required when the broker-dealer is operating near its net capital limitation. *Respondent 1*, 2000 WL 33407051, at \*12.

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<sup>7</sup> It is important to note that a designated FINOP is responsible for performing these duties whether he works full-time or part-time and whether he works on-site or off-site. *Respondent 1*, Complaint No. C8A980059, 2000 WL 33407051, at \*11 (N.A.S.D.R. Nov. 6, 2000).

## B. Reporting Requirements

In connection with a broker-dealer's reporting obligations, it is the FINOP who is responsible for the timeliness and accuracy of the financial reports submitted to the applicable regulatory authorities. *Respondent 1*, 2000 WL 33407051, at \*12. Among the required submissions for which the FINOP is responsible are FOCUS reports, annual financial statements and special notices of any financial problem involving the broker-dealer. Two such submissions are described below:

(b)(1) Every broker or dealer whose net capital declines below the minimum amount required pursuant to Rule 15c3-1 shall give notice of such deficiency that same day in accordance with paragraph (g) of this rule. The notice shall specify the broker or dealer's net capital requirement and its current amount of net capital. If a broker or dealer is informed by its designated examining authority or the Commission that it is, or has been, in violation of Rule 15c3-1 and the broker or dealer has not given notice of the capital deficiency under this Rule 17a-11, the broker or dealer, even if it does not agree that it is, or has been, in violation of Rule 15c3-1, shall give notice of the claimed deficiency, which notice may specify the broker's or dealer's reasons for its disagreement.

\* \* \*

(c) Every broker or dealer shall send notice promptly (but within 24 hours) after the occurrence of the events specified in paragraphs (c)(1), (c)(2), (c)(3) or (c)(4) of this rule in accordance with paragraph (g) of this rule:

\* \* \*

(3) If a computation made by a broker or dealer pursuant to Rule 15c3-1 shows that its total net capital is less than 120 percent of the broker's or dealer's required minimum net capital[.]

17 C.F.R. §240.17a-11.

The reporting requirements "are not technical but involve fundamental safeguards imposed for the protection of the investing public on those who wish to engage in the securities business." *Fox & Co. Inv., Inc.*, Exchange Act Release No. 52697, 2005 WL 2848468, at \*10 (Oct. 28, 2005). The reports "provide the regulatory authorities with the necessary information

to oversee compliance with and enforce the various statutes and regulations with which they are concerned.” *Touche Ross & Co., v. Redington*, 442 U.S. 560, 569 (1979).

### C. Action or Inaction by FINOP

Violations of the Net Capital Rule are serious. *William H. Gerhauser*, Exchange Act Release No. 40639, 1998 WL 767091, at \*8 (Nov. 4, 1998). By engaging in business when not net capital compliant, a broker-dealer and its FINOP subject customers to undue risks. *Id.* A broker-dealer that operates while under net capital is in violation of the J&E Rule and the FINOP who permits the firm to do so is also in violation of the J&E Rule. *Respondent*, 2008 WL 2359719, at \*3 (N.A.S.D.R. Apr. 10, 2008).

Alleged violations of the net capital and reporting rules were the subject of consideration by the NASD and then the SEC in *Fox & Company Investments, Inc.* Complaint No. C3A030017, 2005 WL 3054152 (N.A.S.D.R. Feb. 24, 2005) (affirmed by *Fox & Co. Inv., Inc.*, Exchange Act Release No. 52697, 2005 WL 2848468 (Oct. 28, 2005)). Fox and Company Investments, Inc. (Fox) was a broker-dealer for which James W. Moldermaker (Moldermaker) served as president and FINOP. *Fox & Co. Inv., Inc.*, 2005 WL 3054152, at \*1. The NASD’s allegations against the firm and FINOP included the following: (1) Fox operated, and Moldermaker allowed it to operate, a securities business while below the firm’s minimum net capital requirement; (2) Fox and Moldermaker kept financial records that were materially inaccurate; and (3) Fox, through Moldermaker, filed materially inaccurate FOCUS reports. *Id.* The NASD found the allegations to be true and those findings were affirmed on appeal. *Id.* at \*9; see also *Fox & Co. Inv., Inc.*, 2005 WL 2848468, at \*10.

Fox was found to have conducted a securities business with net capital that was materially below the firm’s minimum requirement, in violation of the Net Capital Rule and the

J&E Rule. *Fox & Co. Inv., Inc.*, 2005 WL 3054152, at \*9. As set forth below, Moldermaker was equally at fault:

As president and FINOP of Fox, Moldermaker was responsible for ensuring that Fox complied with its net capital obligations. Membership and Registration Rule 1022(b)(2)(E) (FINOP is charged with the duty to supervise and/or perform the member's responsibilities "under all financial responsibility rules promulgated pursuant to the provisions of the [Exchange] Act"). His failure to do so violated Conduct Rule 2110 [now the J&E Rule].

*Id.* With respect to the inaccurate records and FOCUS reports, the NASD National Adjudicatory Council in *Fox & Company* cited to *Inv. Mgmt. Corp.*, 2003 NASD Discip. LEXIS 47, at \*20 (citing *Hutchison Fin. Corp.*, Exchange Act Release No. 32215, 51 SEC 398, 399, 1993 WL 138533 (Apr. 26, 1993)) as follows: "[t]he SEC has repeatedly held that the duties to maintain records and file reports require that such records and reports be true and correct." *Id.* Failing to file accurate FOCUS reports is a violation of Exchange Act Rule 17a-5 and Conduct Rule 2110 (citation omitted)." *Id.*

In addition to its net capital violations, a firm's failure to provide notice of a net capital deficiency was addressed in *Christopher M. Block*, Complaint No. CO5990026, 2001 WL 991569 (N.A.S.D.R. Aug. 16, 2001). In *Block*, the FINOP did not file the required notice when the broker-dealer was operating without its required minimum capital. The failure to report the net capital deficiency was found to be a violation of SEC Rule 17a-11 and the J&E Rule. *Id.* at \*6.

In connection with the net capital requirement, a FINOP's inaction easily becomes problematic. For example, in *Gilad J. Gevaryahu*, Exchange Act Release No. 33038, 1993 WL 413629 (Oct. 12, 1993), a recurring monthly payable was omitted from the firm's financial statements with the knowledge of the FINOP. The accrual of the item would have created a net capital deficiency for the firm. The FINOP, accepting the president's claim that there was no

liability for that month, did not further investigate the matter or seek documentation to support the claim. The SEC found that the FINOP's "action amounted to a total abdication of his responsibilities as FINOP." *Id.* at \*3. Likewise, in *Hutchison Fin. Corp.*, 1993 WL 138533, the FINOP was aware that the firm was operating near its net capital minimum limitation. Yet, the FINOP made no effort to assure the broker-dealer's compliance with the Net Capital Rule and "was only remotely involved in the monitoring of [the firm's] net capital." *Hutchison*, 1993 WL 138533, at \*5. The SEC found that the FINOP "displayed a level of inattention to the problem that was clearly inappropriate." *Id.*

It is also important to note that the action and/or inaction of broker-dealer management does not relieve the FINOP of his responsibilities. *Respondent 1*, 2000 WL 33407051, at \*12. Moreover, if the FINOP cannot successfully perform his duties, he must resign. *Respondent*, Disciplinary Proceeding No. 20060042305-01, 2008 WL 2359719, at \*4 (N.A.S.D.R. Apr. 10, 2008) (FINOP cited for net capital violation when he did not resign after he was unable to persuade president of firm to take action to avoid net capital deficiency); *George Lockwood Freeland*, Exchange Act Release No. 32192, 1993 WL 128746, at \*3 (Apr. 22, 1993) (FINOP must insist that owner of broker-dealer cooperate and comply with financial reporting and net capital requirements or resign).

#### **IV. RESPONDENT FRAGER VIOLATED NET CAPITAL AND FINANCIAL REPORTING RULES AND STANDARDS OF ETHICAL PRACTICE.**

At all times material hereto, Respondent Frager was the Firm's designated FINOP. *See supra* ¶ 5. As such, Respondent Frager was responsible for the supervision and/or performance of the obligations of Geary Securities under the financial responsibility rules. *See Respondent*, 2008 WL 2359719, at \*3. Conversely, Respondent Frager was responsible for the Firm's

failures to comply with the net capital and reporting requirements. *See Avello v. SEC*, 454 F.3d 619 (7th Cir. 2006).

#### **A. The Frontier PL-CMO Transactions**

It is undisputed that Keith Geary intended to purchase the Frontier PL-CMOs for the account of Geary Securities. *See supra* ¶¶ 14, 16. It is also undisputed that the Frontier PL-CMOs were in the Firm's inventory as of the end of May 2009. *See supra* ¶ 17. Keith Geary did not arrange for the sale of the Frontier PL-CMOs to the Geary Customers until June 1, 2009. *See supra* ¶ 19. Based on this evidence, and as explained below, Respondent Frager had no reasonable basis for his accounting treatment of the Frontier PL-CMOs on the books and records of Geary Securities.

First, Geary Securities, through Respondent Frager, failed to record the value of the Frontier PL-CMOs as an asset of the Firm. *See supra* ¶ 33. Respondent Frager attempts to justify this accounting treatment by claiming that the Frontier PL-CMOs were never owned by the Firm. *See supra* ¶ 43. Interestingly, however, Geary Securities, through Respondent Frager, recorded accrued interest on the securities as income to the Firm. *See supra* ¶ 33.

Further, since Geary Securities did not pay for its intended purchase of the millions of dollars of Frontier PL-CMOs, its clearing firm carried the Firm as part of the settlement process, thereby, creating a liability/payable for Geary Securities (the "Pershing Liability"). *See supra* ¶ 22. GAAP required that the Pershing Liability be accrued on the Firm's books and records when incurred. *See Harrison Sec., Inc.*, Release No. 256, 2004 WL 2109230, at \*5 (ALJ Sept. 21, 2004) (initial decision) (affirmed by *Harrison Sec., Inc.*, Exchange Act Release No. 50614, 2004 WL 2434257 (Oct. 29, 2004)). However, Respondent Frager was well aware that if the Pershing Liability was properly accounted for on the books and records of Geary Securities, a

large net capital deficiency would result. *See supra* ¶¶ 25, 26. In his game of pretend, Respondent Frager treated the Frontier PL-CMOs as if they were in the accounts of the two Firm Customers prior to June 1, 2009. *See supra* ¶ 30. Instead of complying with GAAP, Respondent Frager eliminated the PL-CMO inventory balance with the stroke of a pen and consciously refused to recognize the Pershing Liability. *See supra* ¶¶ 31, 32. As a result of his improper accounting treatment, Respondent Frager caused an inaccurate FOCUS report to be filed for the month of May 2009. *See supra* ¶ 42.

In addition to his accounting duties, Respondent Frager was required to supervise and be responsible for the individual(s) involved in the preparation of the financial reports and actual maintenance of the Firm's books and records on which the financial reports were based. *See* NASD Rule 1022(b)(2). It was also incumbent upon Respondent Frager to inquire into any matter that could impact the Firm's net capital position. *See Gilad J. Gevaryahu*, Exchange Act Release No. 33038, 1993 WL 413629, at \*3 (Oct. 12, 1993); *Hutchison Fin. Corp.*, Exchange Act Release No. 32215, 1993 WL 138533, at \*5 (Apr. 26, 1993). He did not do so. Respondent Frager provided no advice or direction to Keith Geary on removing the Frontier PL-CMOs from the Firm's inventory and he made no effort to inquire about the implementation of that process. *See supra* ¶ 36. Yet, Respondent Frager represented to his subordinate, Denise Hintze, that the trades were canceled and rebilled to a customer of Geary Securities as of the end of the month, thereby giving her the green light to exclude the securities from the Firm's inventory balance. *See supra* ¶¶ 34-36. Instead of supervising Denise Hintze, Respondent Frager led her astray.

From the outset, Respondent Frager failed to notify FINRA of the Firm's May 2009 net capital deficiency. *See supra* ¶ 51. A few months later, Respondent Frager ignored a representative of FINRA who advised him to give notice to FINRA. *See supra* ¶¶ 44-46.

Although Respondent Frager disagreed with the FINRA representative regarding the existence of the net capital deficiency, he “was not free to refuse to send the notice.” *See Harrison Sec., Inc.*, 2004 WL 2109230, at \*35. Moreover, in a failed effort to resolve the issue with FINRA in November of 2009, Respondent Frager directed that the Frontier PL-CMO trades be canceled and rebilled for settlement on May 28, 2009. *See supra* ¶¶ 47-48, 50. Again, Respondent Frager did nothing to confirm that the trades were canceled and rebilled as he instructed. *See supra* ¶ 49. Had he done so, Respondent Frager would have learned that Pershing did not accept a settlement date for these trades that was prior to June 1st. *See supra* ¶ 50. Respondent Frager seems to ignore the fact that the purchases of the Frontier PL-CMOs by the two Firm Customers were settled on June 1, 2009, leaving the Firm’s exorbitant net capital deficiency unaddressed.

In summary, Respondent Frager permitted Geary Securities to conduct a securities business while the Firm did not maintain the required minimum net capital, in violation of SEC Rule 15c3-1, the J&E Rule, and 660:11-5-17 and 660:11-5-42(b)(1) of the Oklahoma Rules. Respondent Frager also caused Geary Securities to fail to maintain an accurate net capital computation as of May 31, 2009. As a result, Respondent Frager caused Geary Securities to file a false and misleading FOCUS report for the month ended May 31, 2009, that showed the Firm was net capital compliant when such was not the case, in violation of SEC Rule 17a-5, the J&E Rule and 600:11-5-42(b)(1) of the Oklahoma Rules. Further, the inaccurate information on the May 2009 FOCUS report was material, given that it masked the fact that the Firm maintained net capital at a level that was millions of dollars below the required minimum. Respondent Frager also failed to notify the regulatory authorities of the net capital deficiency, in violation of SEC Rule 17a-11, the J&E Rule and 660:11-5-42(b)(1) of the Oklahoma Rules.

Respondent Frager has continually ignored the relevant facts herein, particularly the fact that Geary Securities owned the Frontier PL-CMOs as of midnight on May 31, 2009. Respondent Frager has blatantly disregarded Keith Geary's stated intent to buy and hold the Frontier PL-CMOs, thereby, concealing the true financial condition of the Firm and its net capital deficiency. In failing to acknowledge the deficiency, Respondent Frager has failed to accept responsibility for his misconduct. Instead, he blamed Pershing for a mistake on its books and records. He accused Firm personnel for billing the trades in error, thereby, wrongfully creating the PL-CMO position in the Firm's inventory account. He also claimed that the securities should have been placed in a CEMP account, even though CEMP did not exist at the time of the trades. Rather than being diligent in performing his duties as to this particular issue, Respondent Frager has only made inaccurate assumptions.

#### **B. February 2010 Net Capital Deficiencies**

By Respondent Frager's own admission, the capital position of Geary Securities, in the months preceding January of 2010, had deteriorated to the point that the Firm was operating close to its permissible limits. *See supra* ¶ 54. While his attention to the Firm's net capital position became of greater import, Respondent Frager did nothing more to monitor the situation – continuing only to have a net capital computation performed at month end. *See supra* ¶¶ 55-56. Indeed, in spite of the warning signs, Respondent Frager remained only slightly involved. *See supra* ¶¶ 55-56.

Respondent Frager relied extensively on Denise Hintze, the internal accountant for Geary Securities, to monitor the Firm's net capital position and to communicate with Keith Geary. *See supra* ¶ 56; *see also Hutchison Fin. Corp.*, Exchange Act Release No. 32215, 1993 WL 138533, at \*5 (Apr. 26, 1993) (FINOP relied on internal bookkeeper in connection with the firm's net

capital position and was held responsible for a net capital violation). Respondent Frager did not persist in assuring the net capital compliance of the Firm and he made no specific arrangements to be kept informed about Keith Geary's efforts to attain the necessary capital infusion. *See Hutchison Fin. Corp.*, 1993 WL 138533, at \*5; *Respondent 1*, Complaint No. C8A980059, 2000 WL 33407051, at \*12 (N.A.S.D.R. Nov. 6, 2000); *Respondent*, Disciplinary Proceeding No. 20060042305-01, 2008 WL 2359719 (N.A.S.D.R. Apr. 10, 2008) (FINOP must do whatever is necessary to fulfill his responsibilities as FINOP). Respondent Frager merely left Mr. Geary to his own devices.

Geary Securities could not conduct a securities business unless it maintained at least \$250,000 in net capital. *See supra* ¶ 9. By January 31, 2010, the Firm was undercapitalized. *See supra* ¶ 59. Still, Respondent Frager did nothing more to satisfactorily address the situation or to assure the Firm's net capital compliance. As the Firm's own records show, from January 31 through February 25, 2010, Respondent Frager allowed Geary Securities to conduct a securities business when the Firm's net capital was below the required minimum. *See supra* ¶¶ 70, 74. While Geary Securities remained operational at all times during this twenty-six (26) day period, Respondent Frager subjected the Firm's customers to undue risks. *See William H. Gerhauser*, Exchange Act Release No. 40639, 1998 WL 767091, at \*8 (Nov. 4, 1998).

On each day between February 10<sup>th</sup> and February 26<sup>th</sup>, Denise Hintze performed a net capital computation and forwarded the same to Respondent Frager. *See supra* ¶¶ 57-58. Each such computation reflected a deficiency in net capital. *See supra* ¶ 70. With knowledge of the daily deficiencies, Respondent Frager failed to file the appropriate regulatory notices within twenty-four (24) hours of discovery of each deficiency. *See supra* ¶¶ 59, 62, 65; *see also Harrison Sec., Inc.*, Release No. 256, 2004 WL 2109230, at \*35 (ALJ Sept. 21, 2004) (initial

decision) (affirmed by *Harrison Sec., Inc.*, Exchange Act Release No. 50614, 2004 WL 2434257 (Oct. 29, 2004)). Respondent Frager further failed in his duties by postponing the filing of his only notification for the February 11<sup>th</sup> through 25<sup>th</sup> time period until February 26, 2010, when Geary Securities was once again net capital compliant. *See supra* ¶¶ 65, 68.

From January 31, 2010, to February 25, 2010, Respondent Frager was also delinquent in filing the early warning reports required by SEC Rule 17a-11(c)(3). For example, Respondent Frager waited over two weeks to file an early warning report after discovering the Firm was 120% below its net capital requirement on February 10, 2010. *See supra* ¶ 72. Finally, in connection with the regulatory notices that were filed, Respondent Frager did not always advise Keith Geary of the regulatory notice filings or even the net capital deficiencies themselves. *See supra* ¶ 73.

Respondent Frager again failed to accept responsibility for his misconduct. He failed to acknowledge the net capital violations by going so far as to assert, under oath, that the Firm's minimum net capital requirement was only \$100,000 during the time period in question. *See supra* ¶ 74. This assertion was made after Respondent Frager repeatedly reported in regulatory filings that the Firm's net capital requirement during the period beginning January 31, 2010 and ending February 25, 2010, was \$250,000. *See supra* ¶ 75.

In summary, on multiple occasions, Respondent Frager allowed Geary Securities to conduct a securities business while under the minimum net capital requirement, in violation of SEC Rule 15c3-1, the J&E Rule, and 660:11-5-17 and 660:11-5-42(b)(1) of the Oklahoma Rules. He failed to report such deficiencies to the regulatory authorities, in violation of SEC Rule 17a-11, the J&E Rule and 660:11-5-42(b)(1) of the Oklahoma Rules. He also failed to file the

required early warning reports, in violation of SEC Rule 17a-11, the J&E Rule and 660:11-5-42(b)(1) of the Oklahoma Rules.

### CONCLUSION

As set forth above, the Department is entitled to a summary decision as to Respondent Frager's liability. The material facts pertaining to the cause of action against him are undisputed. Respondent Frager's misconduct amounted to a complete abdication of his duties as the FINOP of Geary Securities. With his education and experience, there is no justification for Respondent Frager's conduct.

Section 1-604 of the Act provides in pertinent part as follows:

A. If the Administrator determines that a person has engaged, is engaging, or is about to engage in an act, practice, or course of business constituting a violation of this act or a rule adopted or order issued under this act or constituting a dishonest or unethical practice. . . , the Administrator may:

1. Issue an order directing the person to cease and desist from engaging in the act, practice, or course of business or to take other action necessary or appropriate to comply with this act[.]

Because the law supports such action and it is in the public interest, the Department hereby requests a summary decision as to Respondent Frager's liability, in favor of the Department. The Department further requests an order against Respondent Frager to cease and desist any act, practice or course of business constituting a violation of the Act and/or the Oklahoma Rules.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above and foregoing motion was mailed and email this 1st day of November, 2011, with postage prepaid, to:

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