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. ODS File No. 09-141

ADDITIONAL ARGUMENT AND AUTHORITY OF RESPONDENT, NORMAN FRAGER, IN SUPPORT OF HIS RESPONSE TO THE DEPARTMENT'S MOTION FOR RECONDSIDERATION AND HIS CROSS MOTION FOR SUMMARY DECISION

COMES NOW the Respondent, Norman Frager ("Frager"), and respectfully submits his Additional Argument and Authority in Support of his Response to the Oklahoma Department of Securities' (the "Department") Motion for Reconsideration and Frager's Cross Motion for Summary Decision. In support hereof, Frager shows as follows:

Frager agrees that the sole issue before the Hearing Officer is which net capital requirement applied to Geary Securities, Inc. ("Geary Securities") during the month of February 2010. The Department contends that Geary Securities was subject to a $250,000 net capital requirement pursuant to Rule 15c3-1(a)(2)(i) of the rules of the Securities Exchange Commission (the "SEC Rules") whereas Frager contends that Geary Securities was subject to a $100,000 net capital requirement pursuant to SEC Rules 15c3-1(a)(2)(ii) and 15c3-3(k)(2)(i).

As an initial matter, Frager would like to clarify the sixth undisputed fact contained in the Hearing Officer's email of August 28, 2012. Therein, the Hearing Officer stated that it was undisputed "that Geary [Securities] at the time assumed that it had a net capital requirement of $250,000 as evidenced by its member agreement with FINRA and by the firm's adopted policies and member notices sent to FINRA relating to the capital deficiency." This is not entirely accurate. As Frager has stated in prior briefing, there were two separate net capital standards to

which Geary Securities was bound. The first is the net capital requirement pursuant to SEC Rule 15c3-1, which is at issue here. The second is the net capital requirement contained within Geary Securities' Membership Agreement with FINRA. These two standards are wholly separate and, accordingly, any evidence related to what Geary Securities may have believed to be its net capital requirements under its Membership Agreement with FINRA, is wholly separate, not pertinent to this case, and should be disregarded. *See* Affidavit of Samuel Luque, Jr., attached hereto as Exhibit "A" at ¶¶ 29-35; Affidavit of Norm Frager, attached hereto as Exhibit "B" at ¶¶ 10-12; and Deposition of David Paulukaitis at p. 94, attached hereto as Exhibit "C."

In his August 28, 2012, email, the Hearing Officer states as follows:

> In reviewing the exhibits I have taken note of Question #5 in [NASD Notice to Members] 93-30 (Department's Reply and Response, Exhibit 3, page 5, Question #5), in which FINRA states that the SEC has informed it that a fully disclosed introducing broker/dealer may not use a Rule 15c3-3(k)(2)(i) special bank account except for mutual fund transactions. (See also Question #11 in the same FINRA Release in which the statement implies that a bank account established pursuant to paragraph (k)(2)(i) may only be used for mutual fund transactions.) This seems to imply that if a fully-disclosed introducing broker receives any customer funds, except by mistake, that the paragraph (k)(2)(i) special account may not be utilized (except for mutual fund transactions), and thus that the exemption that would lower the net capital requirement to $100,000 is not available.

Frager believes that the Hearing Officer is misapplying Question #5 of the NASD Notice to Members and combining two separate and distinct requirements. Under (k)(2)(i) the firm is required to establish a special account. Furthermore, pursuant to (k)(2)(i), the firm cannot accept customer funds. These requirements are independent and separate and Question #5 turns on the second requirement.

The Question and Answer under 93-30 relating to the special account states as follows:

> Question #5: If an introducing broker/dealer receives checks payable to itself, deposits the checks in a (k)(2)(i) account, and then promptly forwards the funds to its clearing broker/dealer, would the introducing broker/dealer be subject to a minimum net capital requirement of $100,000 or $250,000?

> Answer: The firm would be deemed to have received customer funds if it operates in this manner and, therefore, would be subject to the $250,000 minimum net capital requirement. The SEC has informed us that a (k)(2)(i) account cannot be used by fully disclosed firms, except for mutual fund transactions.

As already shown, Geary Securities did not deposit checks into the (k)(2)(i) account that were made payable to itself. Therefore, the Q&A above does not apply.[1] Geary Securities deposited those checks directly into the Pershing bank account. Such a procedure was not considered in Question #5 and therefore Question #5 is not applicable.

It is clear that a firm may be exempt under (k)(2)(i) by maintaining the required special account without ever using that account. For instance, in several no-action letters, the SEC noted that the special account was only required to be used if the firm is required to deposit customer checks into its own account. *See* No-Action Letter to Hill-Grow Company, attached hereto as Exhibit "D," No-Action Letter to Samson Securities Company, attached hereto as Exhibit "E." Similarly, the SEC stated that if the check could be deposited with, for instance, the clearing firm, it would not need to be deposited into the special account. *See* Exhibit "D" and "E." The rationale for this decision is found in footnote 4 of SEC Release 34-56376 (September 7, 2007), attached hereto as Exhibit "F" which describes the purpose of the customer protection rule as follows:

> n4 17 CFR 240.15c3-3. The purpose of Rule 15c3-3 is to protect customers by assuring that broker-dealers do not use customers' funds or securities to fund the broker-dealer's operations.

At the time the SEC no-action letters attached hereto as Exhibits "D" and "E" were drafted (and, indeed, when NASD Notice to Members 93-30 was issued), direct-deposit (electronic scanning) systems such as those utilized by Geary Securities to directly deposit

[1] As noted in the Notice to Members, firms that received customer funds made payable to it that were to be invested in mutual funds could deposit those checks into the special account; the firm would then write a check out of the special account to the mutual fund issuer on behalf of the customer., without being deemed to hold customer funds.

customer funds with Pershing, LLC, did not exist. Accordingly, checks made payable to the broker-dealer had to be deposited into its own account, whereas checks made payable to the clearing firm did not. In this modern day, such is not the case. Regardless of to whom the check is made payable, the check may be directly deposited, immediately, in the clearing firm's account. Accordingly, by using such a system, the underlying purpose of Rule 15c3-3, the customer protection rule, is met in that customer funds are not deposited in any account belonging to the firm and are not therefore at risk.

Accordingly, based on the foregoing, it is clear that Geary Securities was subject to a $100,000 net capital requirement during February 2010.

Respectfully Submitted,

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jmkreth@phillipsmurrah.com
Attorneys for Respondent Norman Fruger

CERTIFICATE OF SERVICE

I hereby certify that on September 14, 2012, a copy of the foregoing document was served on the following via electronic mail:

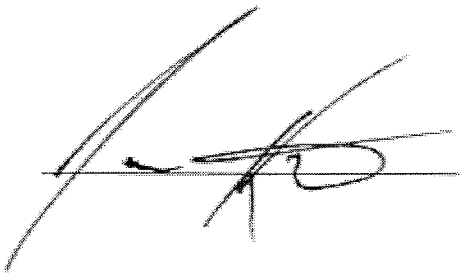
Hearing Officer:
Mr. Bruce R. Kohl
201 Camino del Norte
Santa Fe, NM 87501
e-mail: bruce.koh109@gmail.com

Oklahoma Department of Securities
Brenda London, e-mail: blondon@securities.ok.gov

OKLAHOMA DEPARTMENT OF SECURITIES
120 North Robinson, Suite 860
Oklahoma City, OK 73102

Attorneys for Oklahoma Department of Securities:
Melanie Hall, Director of Enforcement, e-mail: mhall@securities.ok.gov
Terra Shamas Bonnell, Enforcement Attorney, e-mail: tbonnell@securities.ok.gov

OKLAHOMA DEPARTMENT OF SECURITIES
120 North Robinson, Suite 860
Oklahoma City, OK 73102



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In the Matter of:

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Respondents.

File No. 09-141

AFFIDAVIT OF SAMUEL LUQUE, JR.

Samuel Luque, Jr., being of lawful age and being duly sworn, deposes and states as follows:

1. I am currently a securities industry consultant with over 40 years of securities industry and regulatory experience.

2. In my current work as a consultant, I provide a variety of consulting services to broker-dealers, legal professionals and other financial organizations.

3. I am currently registered as a General Securities Representative, General Securities Principal and a Financial and Operations Principal (*FinOP*).

4. During my years as a consultant, I have served as the FinOP for registered broker-dealers that are members of the Financial Industry Regulatory Authority (*FINRA*), which is the successor to the National Association of Securities Dealers, Inc. (*NASD*).

5. From 1984 to 2001, I was employed by the NASD, where I started as an Assistant Director of Compliance before being promoted to Associate Director of Financial Responsibility/Compliance, which position I held from 1986 until my retirement in 2001.

6. My experience at the NASD included 17 years during which I conducted financial examinations of broker-dealers and 17 years during which I trained NASD examiners to conduct such examinations.

7. Before my employment at the NASD, I spent seven (7) years working for the U.S. Securities and Exchange Commission (*SEC*) in various capacities including Securities Compliance Examiner; Senior Compliance Examiner; and Securities Examination Specialist, Division of Market Regulation.

8. After leaving the SEC and before joining the NASD, I co-founded the consulting firm Rubin, Luque, Inc. where I provided compliance and financial regulatory consulting services to broker-dealers.

EXHIBIT
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9. My opinions are based on a review of various documents provided to me by counsel and my broad experience as a securities industry regulator, a FinOP for registered broker-dealers and a compliance consultant.

10. In any given transaction in securities, there are two sides to the transaction – the tender of the securities by the seller and the tender of payment by the buyer.

11. The "trade date" of any given transaction is the date on which the trade is presented for execution.

12. The "settlement date" is the date on which both of the following should have been completed:

    a. the purchaser has made payment to the seller and has received the securities from the seller; and

    b. the seller has delivered the securities and has received the payment from the purchaser.

13. Once settlement and clearance occur, under the net capital rule, the transaction is reported as having been completed as of the trade date.

14. The Depository Trust Company facilitates trading and settlement by providing a system for electronic recording of transactions.

15. Under current securities laws, settlement generally occurs three days following the trade date, but can take longer under certain conditions.

16. Introducing brokers must use clearing brokers to execute transactions in securities by settling transactions submitted by the introducing brokers.

17. When a trade is presented to a clearing broker by an introducing broker, or when payment is advanced by a customer (account with credit balances), the clearing broker must reflect the other side of the transaction (the securities or cash) in an account on its books, i.e. the books and records of the clearing broker.

18. Under such circumstances, the allocation of the securities or cash to an account does not indicate that the transaction has in fact settled or that the securities or cash belongs to the account holder and the transaction and allocation will be revised on the settlement date to reflect the actuality of the transaction.

19. Correcting trades indicated on account statements to reflect subsequent activity - "as-of" trades, "cancel and corrections," or "cancel and rebills" - are a routine part of brokerage accounting and are not attempts to conceal a perceived deficiency.

20. The fact that payment is made on the trade date and the fact that the securities appear in an account in the name of the introducing broker on the trade date do not mean that the transaction has settled or that the purchaser has paid for the trade; rather it simply

indicates that the first side of the transaction has been completed and the transaction is pending until a purchaser submits payment for the transaction.

21. If there is a significant amount of time between the date the clearing broker remits payment for a transaction and the date the clearing broker receives payment from the purchaser, the clearing broker will charge the introducing broker costs for advancing the payment.

22. Both sides of the trade are locked into the records of the Depository Trust Company, and the transaction needs to be settled or cancelled by both sides. If the purchaser fails to pay for the securities, the clearing broker will sell the securities in the market and charge any loss and costs incurred to the introducing firm.

23. If a person attempts to purchase a security but never pays for it, even if the person intended to purchase the security, that transaction never settles and the securities are never transferred to the person.

24. I have reviewed the documents presented to me involving the sale by Frontier Bank of Private Label Collateralized Mortgage Obligations (*PL-CMOs*) in late May 2009. I have reviewed Pershing account statements of Geary Securities, Inc.; Joseph McKean and The Eagle Sky Foundation, Inc. (collectively, the *McKean Accounts*); and those documents are consistent with a transaction between Frontier Bank and the McKean Accounts.

25. I have not seen any documentation supporting the payment by Geary Securities, Inc. for the PL-CMOs by Geary Securities, Inc. – the firm did not have sufficient capital in its accounts to make the payment, there is no documentation of funds transferred into or out of the Geary Securities, Inc. accounts to pay for the PL-CMOs and there are no loan documents indicating that Pershing or any other party loaned the funds to Geary Securities, Inc. to settle the transaction.

26. In addition, I reviewed the McKean accounts and the Geary Securities, Inc. account and the payment received by Geary Securities, Inc. is consistent with a profit being earned on the transaction, but not consistent with the purchase of securities by the McKean accounts from Geary Securities, Inc.

27. I have reviewed the annotation on the account statements made by Norman Frager in connection with preparing the May 31, 2009 FOCUS report and that annotation is consistent with the settlement of a transaction after the end of the month into a customer account.

28. Based on my review, there is no documentation supporting any borrowing of funds to purchase the PL-CMOs by Geary Securities, Inc.; accordingly, they were never purchased by Geary Securities, Inc. and the position on the books of Pershing was properly ignored in the calculation of net capital.

29. The membership agreement is an agreement between the Financial Industry Regulatory Authority (FINRA) as successor to the National Association of Securities Dealers, Inc. (NASD) and the broker, in this case Geary Securities, Inc.

30. The membership agreement represents the highest level of business activity that a firm is authorized to conduct under its FINRA/NASD license; however, a firm can voluntarily limit its activities by complying with a lesser standard so that the firm is not required to maintain the level of net capital stated in its membership agreement; provided it complies with the requirements of SEC Rule 15c3-1 (the *Net Capital Rule*).

31. A firm can, but is not required to request an amendment to its membership agreement to rely on a lower net capital requirement, if the firm limits its activities to those allowed for the lesser level under Rule 15c3-1.

32. The Net Capital Rule governs net capital requirements for all broker-dealers registered with the SEC and is the sole basis for determining when a firm has a net capital violation.

33. At any given time, the amount of net capital stated in a firm's membership agreement may be different than the amount of net capital actually required under Rule 15c3-1.

34. To determine if a firm has violated the net capital rule, there must be a finding first of the amount of net capital required based on the business conducted by the firm at the time of the alleged net capital violation under the rule and not under the membership agreement and secondly there must be a finding that the firm conducted a securities business when the net capital was below the minimum level required by the rule based on that type of business (again, not the level in the membership agreement).

35. To have a net capital violation, the firm must have actually conducted a securities business during the time its net capital was less than that required under Rule 15c3-1, irrespective of the amount required in its Membership Agreement.

36. A firm adopts policies and procedures to establish a system reasonably designed to prevent violations of the statutes and rules applicable to its business.

37. A firm can adopt procedures that are more stringent than the statutes or rules applicable to a firm.

38. If a firm violates the procedures, but not the rule, the firm does not have a regulatory violation, but only a failure to follow its own procedures.

39. Conversely, the non-existence of procedures does not mean that the firm has violated the rule that the procedures are intended to address, but only that it possibly did not have adequate procedures in place.

40. The policies and procedures are irrelevant in determining if there is a net capital violation – what determines the violation is the activity of the firm on the date for which the capital violation is alleged.

41. A firm that deposits checks directly to the clearing broker through the Electronic Deposit System, in which the credit appears in the customer's account at the clearing broker on the date of check receipt, has not received or held funds or securities for that customer.

42. Whether or not a customer check is made out to the introducing broker, to determine if there is a net capital violation under the Net Capital Rule, the funds would have to be deposited into the account of the introducing broker, and an immediate electronic deposit into the customer's account at the clearing broker does not constitute holding customer funds for purposes of Rule 15c3-1.

43. The reporting obligations under Rule 17a-11 require reporting if the net capital falls below that required under Rule 15c3-1, not the amount required under the FINRA membership agreement.

By: _____
Samuel Luque, Jr.

Subscribed and Sworn to before me this 13th day of July 2012.

By: _____
Notary Public

ERIN R. HAJDU
Notary Public - State of Florida
My Comm. Expires Oct 24, 2014
Commission # EE 21616
Bonded Through National Notary Assn.

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

In the Matter of:

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Keith D. Geary; Norman Frager; and CEMP, LLC,

Respondents. File No. 09-141

AFFIDAVIT OF NORMAN FRAGER

I, Norman Frager, being of lawful age and being duly sworn, depose and state as follows:

1. From 1995 through 2011, I was registered through the Financial Industry Regulatory Authority (*FINRA*) as a Limited Principal - Financial and Operations (*FinOP*) of Geary Securities, Inc. and its predecessor, Capital West Securities, Inc. (hereinafter, collectively, *Geary Securities* or the *Firm*)

2. I have personal knowledge of the information set forth in this Affidavit.

3. I gave testimony through a deposition taken by the Oklahoma Department of Securities (*Department*) on May 13, 2010 during which I discussed the net capital requirements of Geary Securities stating accurately that the Firm was required to maintain net capital in compliance with Rule 15c3-1 (*Net Capital Rule*) promulgated by the U.S. Securities and Exchange Commission (*SEC*) under the Securities Exchange Act of 1934 (*Exchange Act*) and that the Firm was subject to a membership agreement (*Membership Agreement*) with FINRA outlining the net capital requirements and obligations imposed on the Firm by FINRA.

4. The Membership Agreement originally executed by the Firm in 1995 provided for a $100,000 net capital requirement, following the execution of which the Firm set up a special reserve account as authorized by subsection (k)(2) of Rule 15c3-3 (*Customer Protection Rule*) issued by the SEC under the Exchange Act, allowing the Firm to accept customer checks in the future should such an account be needed.

5. Subsequently, in response to customer demand, the Firm sought authorization from the National Association of Securities Dealers, Inc. (*NASD*, one of the entities that was merged to create FINRA) to accept customer checks made payable to the Firm.

6. In February 1998, FINRA delivered an amended Membership Agreement to the Firm providing for a $250,000 net capital requirement that allowed the Firm to accept customer checks made payable to the Firm.

EXHIBIT
B 11

7. Irrespective of the change in net capital, no customer checks were ever deposited into the Firm's account - from inception until 2007, all customer checks were deposited into a local Oklahoma City account owned by the Firm's clearing/carrying firm and, from 2007 forward, all checks were immediately scanned and electronically deposited into the account of the clearing/carrying broker and credited immediately to the customer irrespective of whether the checks were made out to the firm or the clearing broker.

8. The back office operations of the Firm during all of 2009 and 2010 were under the supervision of Althea Roberts, also a registered FinOP, who was responsible for back office operations and who, to my knowledge, attempted to have all customers make checks payable to the clearing broker.

9. During its entire existence, the Firm continued to maintain the special account required by the Customer Protection Rule; however, at no time were any customer funds ever deposited into that account or any other accounts owned by Geary Securities.

10. The Net Capital Rule is distinct from the Firm's Membership Agreement and is self-executing, which means that the Firm will not be in violation of the Net Capital Rule irrespective of its Membership Agreement if the Firm complies with the requirements of the Net Capital Rule.

11. FINRA interpretations and guidance do not overwrite the clear terms of the Net Capital Rule, but give guidance to brokerage firms with respect to FINRA's interpretation of the Net Capital Rule.

12. To my knowledge, the Department was never a party to the Firm's Membership Agreement.

13. Although the Firm was not below net capital under the Net Capital Rule in February 2010 and therefore the Firm was not required to file notices with the SEC under SEC Rule 17a-11, I believed that I was required to make filings with FINRA to notify FINRA that the Firm was below the net capital agreed to in its Membership Agreement and therefore I made several such filings.

14. Because the Firm's net capital, as computed daily, never fell below the $100,000 and because the Firm was promptly forwarding (by electronic deposit) customer checks (regardless to whom made payable) to Pershing, I believed then and I believe now that Geary Securities was in full compliance with the Net Capital Rule and there was absolutely no reason for the Firm to discontinue doing business or to file a series of notices with the SEC under Rule 17a-11.

By: _____
Norman Pruger

Subscribed and Sworn to before me this 31st day of July 2012.

By: Erika E Zumbrunnen
Notary Public

ERIKA E. ZUMBRUNNEN
My Commission Expires
February 1, 2015
St. Charles County
Commission #12391037

STATE OF OKLAHOMA
DEPARTMENT OF SECURITIES
THE FIRST NATIONAL CENTER
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OKLAHOMA CITY, OKLAHOMA 73102

IN THE MATTER OF:

GEARY SECURITIES, INC., f/k/a CAPITAL WEST SECURITIES, INC.; KEITH D. GEARY; NORMAN FRAGER; and CEMP, LLC,

Respondents.

FILE NO. 90-141

DEPOSITION OF

DAVID E. PAULUKAITIS

9:19 a.m.

July 16, 2012

Mainstay Capital Market Consultants, Inc.

1040 Crown Pointe Parkway, Suite 840

Atlanta, Georgia

Colleen B. Seidl, RPR, CRR, CSR-B-1113

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broker dealers and financial principals, so I don't remember anybody asking me whether a particular security would be subject to a hundred percent haircut or something less than that.

Q. In this case you didn't give us anything that backed up that particular statement. You didn't give us an interpretation or a release; is that correct?

A. Correct.

Q. I think that there was -- and again I apologize, this may be duplication. But we were talking about the membership agreement net capital requirements and the liability of a firm for net capital under 15c3-1, and I believe you stated very clearly that those are two distinct decisions; that a decision, a net capital violation under 15c3-1 does not depend on the membership agreement; is that correct?

A. Correct.

Q. And that a violation of membership agreement is something between the firm and FINRA?

A. Yes. Yes.

MS. BRYANT: I think that's it. Thank you very much.

EXAMINATION

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8 of 61 DOCUMENTS

1983 SEC No-Act. LEXIS 3206

Securities Exchange Act of 1934 -- Section 15(c)(3) -- Rule 15c3-3 & (k)(3)

Sep 9, 1983

[*1] Hill-Grow Company

TOTAL NUMBER OF LETTERS: 3

SEC-REPLY-1: SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
August 9, 1983

Mr. Allen F. Hill
President
Hill-Grow Company
Rooker, Larsen, Kimball & Parr
Suite 1300
185 South State Street
Salt Lake City, Utah 84111

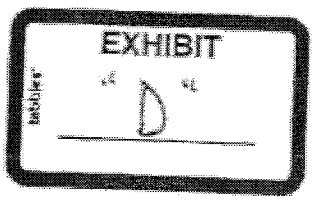
Dear Mr. Hill:

This is in response to your letter of June 24, 1983, on behalf of Hill-Grow Company ("HGC") requesting an exemption from the requirements of Rule 15c3-3 of the Securities Exchange Act of 1934 (*17 CFR § 240.15c3-3*) pursuant to paragraph (k)(3) thereof.

I understand the facts to be as follows: Hill-Grow Company has applied for registration with the SEC and for membership of the NSAD as a broker-dealer selling direct participation programs. Funds for the purchase of such units will be deposited in an escrow account with an escrow bank. When and if the offering closes, the funds will be immediately transferred into the partnership account and will, in no case, pass through the account of the broker-dealer.

As a registered broker-dealer, HGC is subject to the provisions of Rule 15c3-3 and its possession and control and reserve bank account requirements. Paragraph (k)(1) and (k)(2) of that rule exempt certain limited classes of broker-dealers. [*2] Paragraph (k)(3) provides for an exemption if the Commission finds "that the broker or dealer has established safeguards for the protection of funds and securities of customers comparable with those provided for by this rule and that it is not necessary in the public interest or for the protection of investors to subject the particular broker or dealer to the provisions of this rule." Your letter does not disclose sufficient facts to enable the Commission to make such a finding, and we, therefore, cannot grant your requested exemption pursuant to paragraph (k)(3).

Notwithstanding the foregoing, please note that it may also be possible to operate pursuant to the (k)(2)(A)A exemption. The exemption in paragraph (k)(2)(A) states that provisions of the Rule shall not be applicable to a broker or dealer: ". . . who carries no margin accounts, promptly transmits all customer funds and delivers all securities received in connection with his activities as a broker or dealer, does not otherwise hold funds or securities for, or owe money or securities to, customers and effectuates all financial transactions between the broker or dealer and his customers through one or more bank accounts, [*3] each to be designated as "Special Account for the Exclusive Benefit of Customers."



If checks are made payable solely to the issuer or an independent escrow agent, they would not be deposited in the special account. If you contemplate receiving no other customer related funds, it is not necessary that you establish the account to qualify for the exemption. However, many broker-dealers doing this type of business do establish such an account to avoid violation of the rule on those occasions when a customer inadvertently makes a check payable to the broker-dealer.

Please contact us if we can be of further assistance.

Sincerely,
Anne Berling
Staff Accountant

INQUIRY-1: LAW OFFICES OF
ROOKER, LARSEN, KIMBALL & PARR
A PROFESSIONAL CORPORATION
SUITE 1300
185 SOUTH STATE STREET
SALT LAKE CITY, UTAH 84111
TELEPHONE (801) 532-7840
June 24, 1983

Securities & Exchange Commission
Division of Market Regulations
450 5th Street, N.W.
Washington, D.C. 20549

Attention: Michael Macchiaroli

Dear Mr. Macchiaroli:

Enclosed please find a letter from Hill-Grow Company, requesting an exemption from the provisions of SEC rule 15c3-3. If there are any questions or problems concerning this request, plase [*4] contact the undersigned or Richard Clayton of this office at (801) 532-7840.

Sincerely,
Susan Allen
Legal Assistant
June 24, 1984

United States Securities and Exchange Commission
Division of Marketing Regulations
450 5th Street, N.W.
Washington, D.C. 20549

Attention: Michael Macchiaroli

Dear Mr. Macchiaroli:

Hill-Grow Company ("HGC") is in the process of applying for registration with the SEC and the NASD as a broker-dealer selling direct participation programs. To comply with SEC rule 15C3-1(a)(2)(iii) and therefore be allowed to maintain a minimum net capital of $5,000, HGC must meet the following condition:

[The broker-dealer] promptly forwards . . . subscriptions for securities to the issuer, underwriter, sponsor or other distributor of such securities and receives checks, drafts, notes or other evidences of indebtedness payable solely to the issuer, underwriter, sponsor or other distributor who delivers the securities purchased directly to the subscriber.

This requirement conflicts with SEC Rule 15C3-3(b)(1) which states:

A broker or dealer shall promptly obtain and shall thereafter maintain the physical possession or control of all fully-paid securities and excess [*5] margin securities carried by a broker or dealer for the account of customers.

and with Rule 15C3-3(e)(1) which states:

Every broker or dealer shall maintain with a bank or banks at all times when deposits are required or hereinafter specified a "Special Reserve Bank Account for the Exclusive Benefit of Customers" (hereinafter referred to as the "Reserve bank Account"), and it shall be separate from any other bank account of the broker or dealer. Such broker or dealer shall at all times maintain in such Reserve Bank Account, through deposits made therein, cash and/or qualified securities in amounts computed in accordance with the formula attached hereto as Exhibit A.

Rule 15c3-1(a)(2)(iii) requires that HGC not retain possession of any securities or funds, but rules 15C3-3(b)(1) and (e)(1) require precisely the opposite. Even SEC Rule 15C3-3(k)(2)(a), an exemption to Rule 15C3-3, requires that the broker-dealer designate a bank account through which business with its customers must be transacted.

To resolve the problem of conflicting regulations, HGC is requesting, pursuant to Rule 15C3-3(k)(3), exemption from the provisions of rule 15C3-3. HGC's registration as a broker-dealer [*6] will be restricted to the sale of limited partnerships in direct participation programs only. Funds for the purchase of such units will be deposited in an escrow account with an escrow bank. When and if the offering closes, the funds will be immediately transferred into the partnership account and will, in no case, pass through the account of the broker-dealer.

Very truly yours,
HILL-GROW COMPANY
By Allen F. Hill, President

LexisNexis®

1981 SEC No-Act. LEXIS 4451

Securities Exchange Act of 1934 -- Section 15 -- Rule 15c3-3, 15c3-3(k)(2)(A)

Dec 28, 1981

[*1] Samson Securities Co.

TOTAL NUMBER OF LETTERS: 2

SEC-REPLY-1: SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
November 27, 1981

Mr. Dennis R. Neill
Samson Securities Company
1700 First National Tower
Tulsa, Oklahoma 74103

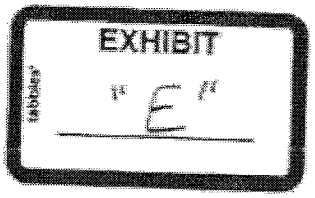
Dear Mr. Neill:

This is in response to your letter of September 2, 1981, on behalf of Samson Securities Company ("Samson"), wherein you request an exemption from Rule 15c3-3 of the Securities Exchange Act of 1934 (*17 CFR 240.15c3-3*) pursuant to paragraph (k)(3) of that Rule.

I understand the pertinent facts to be as follows: Samson is a registered broker dealer whose business is limited solely to acting as a broker in the underwriting of limited partnership interests in oil and gas programs in which its affiliate, Samson Properties Incorporated, serves as the general partner. Samson participates as a broker in these underwritings in accordance with the provisions of Rule 15c2-4(b)(2). Samson does not hold securities or funds for the accounts of customers and does not carry margin accounts. Pursuant to a written escrow agreement, all monies received in connection therewith are forwarded to an independent escrow agent. Based on the foregoing and pursuant to paragraph (k)(3) [*2] of Rule 15c3-3, you request an exemption for Samson from the provisions of that Rule.

As a registered broker-dealer, the firm is subject to the provisions of Rule 15c3-3 and its possession and control and reserve bank account requirements. Paragraphs (k)(1) and (k)(2) of that rule exempt certain limited classes of broker-dealers. Paragraph (k)(3) provides for an exemption if the Commission finds "that the broker or dealer has established safeguards for the protection of funds and securities comparable with those provided for by [the rule] and that it is not necessary in the public interest or for the protection of investors to subject the particular broker or dealer to the provisions of [the rule]." Your letter does not disclose sufficient facts to enable the Commission to make such a finding. We, therefore, cannot grant your requested exemption.

Notwithstanding the foregoing, please note the provisions of Rule 15c3-3 impose only minimal requirements on a broker or dealer who handles no funds or securities. See paragraphs (d) and (e) of Rule 15c3-3. The possession and control requirements of paragraph (d) apply only to customers' securities and the special reserve bank account [*3] for the exclusive benefit of customers in paragraph (e) need only be maintained when there is a deposit requirement. Since your firm has no financial transactions with customers, it should have no deposit requirement. It may also be possible to operate pursuant to the (k)(2)(A) exemption.



The exemption in paragraph (k)(2)(A) provides that the provisions of the Rule shall not be applicable to a broker or dealer:

"... who carries no margin accounts, promptly transmits all customer funds and delivers all securities received in connection with his activities as a broker or dealer, does not otherwise hold funds or securities for, or owe money or securities to, customers and effectuates all financial transactions between the broker or dealer and his customers through one or more bank accounts, each to be designated as "Special Account for the Exclusive Benefit of Customers...."

If checks are made payable solely to the issuer or an independent escrow agent, they would not be deposited in the Special Account. Since you contemplate receiving no other customer related funds, it is not necessary that you establish the Special Account in order to qualify for the exemption. However, many [*4] broker-dealers doing this type of business do establish such an account to avoid violations of the rule on those occasions when a customer inadvertently makes a check payable to the broker-dealer.

I hope these answers are satisfactory. Please contact us if we can be of further assistance.

Sincerely,
John C. Bryce
Staff Attorney

INQUIRY-1: Samson Securities Company
2700 First National Tower
Tulsa, Oklahoma 74103
918 583-1791
September 2, 1981

Department of Market Regulation
Securities and Exchange Commission
Washington, D.C. 20549

RE: Samson Securities Company Rule 15c3-3 Under
the Securities Exchange Act of 1934

Dear Sir or Madam:

Please be advised that Samson Securities Company is registered with the Securities and Exchange Commission effective January 23, 1981 (File No. 8-25632). Pursuant to certain undertaking filed with the National Association of Securities Dealers, Inc., Samson Securities Company limits its business to the offering of sale and units of limited partnership interest in oil and gas programs in which its affiliate, Samson Properties Incorporated, serves as the general partner.

Pursuant to applicable regulations, Samson Securities Company [*5] does not hold securities or funds of its customers. All moneys received by investors in limited partnership offerings are promptly deposited with the bank which is serving as the escrow agent for a particular offering. The provisions governing the operations of the escrow account are filed with the Securities and Exchange Commission as an exhibit to the registration statement for each program sponsored by Samson Properties Incorporated. As we believe the escrow arrangement provides satisfactory protection for all funds received from potential investors, we respectfully request pursuant to Rule 15c3-3 (k)(3) an exemption from the requirements of Rule 15c3-3, including the exemption provision set forth in Rule 15c3-3 (k)(2)(A) requiring the broker or dealer to establish bank accounts designated as "Special Account for the Exclusive Benefit of Customers of Samson Securities Company". We believe that the establishment of such an account is not necessary since no funds are paid to Samson Securities Company by investors, but all such funds are deposited in the appropriate escrow account maintained by agreement between Samson Properties Incorporated and the escrow agent.

Should you [*6] have any questions with regard to this exemption request, please contact the undersigned at 800-331-3058.

Thank you for your attention to this matter.

Very truly yours,
Dennis R. Neill

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1 of 1 DOCUMENT

[NO NAME IN ORIGINAL]

SECURITIES AND EXCHANGE COMMISSION

Release No. 34-56376

2007 SEC LEXIS 2484

September 7, 2007

ACTION:

[*1] ORDER GRANTING A CONDITIONAL EXEMPTION TO BROKER-DEALERS FROM REQUIREMENTS IN RULES 15c3-1 AND 15c3-3 UNDER THE SECURITIES EXCHANGE ACT OF 1934 TO PROMPTLY TRANSMIT CUSTOMER CHECKS FOR THE PURCHASE OF DEFERRED VARIABLE ANNUITY CONTRACTS

TEXT: I. Background

The Securities and Exchange Commission (the "Commission") today approved new National Association of Securities Dealers ("NASD") n1 Rule 2821. n2 NASD Rule 2821 sets forth recommendation requirements (including a suitability obligation), principal review and approval requirements, and supervisory and training requirements with respect to transactions in deferred variable annuities.

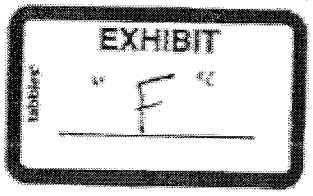
n1 On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Exchange Act Release No. 56146 (July 26, 2007), *72 FR 42190* (Aug. 1, 2007).

[*2]

n2 See Exchange Act Release No. 56375 (Sep. 7, 2007).

According to the NASD, it designed the rule to address significant and persistent sales-practice problems in sales of deferred variable annuities. One component of Rule 2821 is a requirement that registered principals perform a comprehensive and rigorous review of the transactions. Specifically, Rule 2821(c) states, in part, that: "Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity."

Many broker-dealers are subject to lower net capital requirements under Securities Exchange Act of 1934 ("Exchange Act") Rule 15c3-1 n3 and are exempt from the requirement to establish and fund a customer reserve account under Rule 15c3-3 n4 because they do not carry customer funds or securities. Some of these broker-dealers [*3] receive checks from customers that are made out to third parties. Pursuant to Rules 15c3- 1 and 15c3-3, a broker-dealer is not deemed to be carrying customer funds if it "promptly transmits" the checks to the third parties. n5 For purposes of Rules 15c3-1 and 15c3-3, the term "promptly transmit" means when "such transmission or delivery is made no later than noon of the next business day after the receipt of such funds or securities." n6



n3 *17 CFR 240.15c3-1*. The purpose of Rule 15c3-1 is to ensure that a broker or dealer at all times has sufficient liquid assets to promptly satisfy the claims of customers if the broker or dealer goes out of business.

n4 *17 CFR 240.15c3-3*. The purpose of Rule 15c3-3 is to protect customers by assuring that broker-dealers do not use customers' funds or securities to fund the broker-dealer's operations. Among other things, Rule 15c3-3 requires that a broker-dealer make a periodic computation of the amount of money it is holding that constitutes customer funds or funds obtained from the use of customer securities. If this amount exceeds the amount of money customers owe the firm, the broker-dealer must deposit the excess in a special reserve bank account for the exclusive benefit of the firm's customers.

[*4]

n5 When it amended the net capital rule in 1992, the Commission stated that a broker-dealer shall not be deemed to receive funds from customers if it receives checks made payable to certain entities other than itself (such as another broker-dealer or an escrow agent) and promptly transmits such funds. Exchange Act Release No. 31511 (Nov. 24, 1992), *57 FR 56973* (Dec. 2, 1992).

n6 See Exchange Act Release No. 31511 (Nov. 24, 1992), note 11, and *17 CFR 240.15c3-1(c)(9)*.

According to the NASD, a broker-dealer may need to hold customer checks for more than one business day in order to comply with Rule 2821.

II. Discussion

The Commission has decided to exempt broker-dealers from any additional requirements of Rules 15c3-1 or 15c3-3 due solely to a failure to promptly transmit a check made payable to an insurance company for the purchase of a deferred variable annuity product by noon of the business day following the date the [*5] broker-dealer receives the check from the customer, provided:

(i) the transaction is subject to the principal review requirements of NASD Rule 2821 and a registered principal has reviewed and determined whether he or she approves of the purchase or exchange of the deferred variable annuity within seven business days in accordance with that rule;

(ii) the broker-dealer promptly transmits the check no later than noon of the business day following the date a registered principal reviews and determines whether he or she approves of the purchase or exchange of the deferred variable annuity; and

(iii) the broker-dealer maintains a copy of each such check and creates a record of the date the check was received from the customer and the date the check was transmitted to the insurance company if approved, or returned to the customer if rejected.

The purpose of Rule 15c3-1 is to ensure that a broker or dealer at all times has sufficient liquid assets to promptly satisfy the claims of customers and other creditors if the broker or dealer goes out of business. One purpose of Rule 15c3-3 is to protect customers by assuring that broker-dealers do not use customers' funds or securities to fund the [*6] broker-dealer's operations. The reasons these rules require that a broker-dealer promptly forward checks is to reduce the risk that a broker-dealer or an associated person of a broker-dealer will convert or misuse customer funds or securities and to assure that the price of the security the customer purchases has not moved substantially from the date the customer decided to purchase that security.

In the Approval Order for Rule 2821 we stated,

"[Proposed Rule 2821] is designed to curb sales practice abuses in deferred variable annuities. Its recommendation requirements provide a specific framework for a broker-dealer's suitability analysis of these securities. By setting forth factors that a broker-dealer must specifically consider in recommending deferred variable annuities and requiring the registered representative to obtain certain information from his or her customers, the proposed rule should improve communications between registered representatives and customers regarding these securities. The supervisory review component should foster a thorough analytical review of every deferred variable annuity transaction in a timeframe that will limit the possibility of unsuitable recommendations [*7] and transactions. The proposed rule as a whole is geared

to protecting investors by requiring firms to implement more robust compliance cultures, and to give clear consideration of the suitability of these complex products."

Further, we found that Rule 2821 is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Consequently, we approved NASD's proposed Rule 2821.

As we believe the NASD's Rule 2821 to be in the public interest but a broker- dealer would be burdened with additional requirements under Exchange Act Rules 15c3- 1 and 15c3-3 were it to comply with Rule 2821, we must balance the investor protections provided by Rules 15c3-1 and 15c3-3 with those provided by Rule 2821. For this reason, we have specifically tailored the above-described exemption.

First, the exemption is specifically limited to situations where a broker-dealer has failed to promptly transmit "a check made payable to an insurance company for the purchase of a deferred variable annuity product," and "the transaction is subject to the principal review requirements of NASD Rule 2821 [*8] and a registered principal has reviewed and determined whether he or she approves of the purchase or exchange of the deferred variable annuity within seven business days in accordance with that rule." In all other situations where a check is received by a broker-dealer and is not promptly forwarded, the full provisions of both Rule 15c3-1 and 15c3-3 still apply.

Second, the exemption requires a broker-dealer to promptly transmit such checks no later than noon of the business day following the date a registered principal reviews and determines whether he or she approves of the purchase or exchange of the deferred variable annuity. This is designed to assure that the broker-dealer holds the customer's check no longer than is necessary to comply with Rule 2 82 1.

Third, a broker-dealer must maintain a copy of each such check and create a record of the date the check was received from the customer and the date the check was transmitted to the insurance company if approved, or returned to the customer if rejected. This requirement will allow the broker-dealer's compliance and internal audit departments, as well as Commission, self-regulatory organization, and other examiners to verify that [*9] a broker-dealer is complying with the provisions of this exemption.

For the foregoing reasons, the Commission finds that granting the above- described exemption is necessary and appropriate in the public interest, and is consistent with the protection of investors.

III. Conclusion

Accordingly, IT IS ORDERED, pursuant to Section 36 of the Exchange Act n7 that, a broker-dealer shall be exempt from any additional requirements of Rules 15c3-1 or 15c3-3 due solely to a failure to promptly transmit a check made payable to an insurance company for the purchase of a deferred variable annuity product by noon of the business day following the date the broker-dealer receives the check from the customer, provided:

> n7 Section 36 of the Exchange Act authorizes the Commission, by rule, regulation, or order, to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions from any provision or provisions of the Exchange Act or any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

[*10]

(i) the transaction is subject to the principal review requirements of NASD Rule 2821 and a registered principal has reviewed and determined whether he or she approves of the purchase or exchange of the deferred variable annuity within seven business days in accordance with that rule;

(ii) the broker-dealer promptly transmits the check no later than noon of the business day following the date a registered principal reviews and determines whether he or she approves of the purchase or exchange of the deferred variable annuity; and

(iii) the broker-dealer maintains a copy of each such check and creates a record of the date the check was received from the customer and the date the check was transmitted to the insurance company if approved, or returned to the customer if rejected.

By the Commission.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawNegotiable InstrumentsGeneral OverviewInsurance LawIndustry RegulationInsurance Company Operations RepresentativesBrokersSecurities LawSelf-Regulating EntitiesNational Association of Securities Dealers
#ENDSEG###

10/24/2007