

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 70777 / October 30, 2013**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3708 / October 30, 2013**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 30772 / October 30, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15235**

**In the Matter of**

**FRY HENSLEY AND  
COMPANY, AND NICHOLAS  
L. FRY, II**

**Respondents.**

**ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS AND  
A CEASE-AND-DESIST ORDER  
PURSUANT TO SECTION 15(b)(6) OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
SECTIONS 203(e), 203(f) AND 203(k) OF  
THE INVESTMENT ADVISERS ACT OF  
1940, AND SECTION 9(b) OF THE  
INVESTMENT COMPANY ACT OF 1940**

**I.**

On March 8, 2013, the Securities and Exchange Commission (“Commission”) instituted proceedings against Fry Hensley and Company (“FHC”) and Nicholas L. Fry, II (“Fry”) (collectively “Respondents”) pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 (“Exchange Act”), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act) and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”).

**II.**

Respondents have submitted an Offer of Settlement (“Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and

203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 (“Order”), as set forth below.

### III.

On the basis of this Order and Respondents’ Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. This matter concerns an investment adviser’s failure to disclose to its clients significant conflicts of interest from which it profited at its clients’ expense. From at least January 1, 2007 to October 2011, registered investment adviser FHC and its president Fry obtained undisclosed compensation in the form of payments from inflated commissions, markups and markdowns (“transaction charges”) charged to their clients by the broker-dealer that FHC and Fry recommend that their clients use. FHC’s agreement with clients provided that they gave Fry discretionary authority to trade in their accounts at their broker-dealer. During the relevant period, Fry typically conducted his equity trading for clients through one of the broker-dealer’s principal trading accounts, first instructing the broker-dealer to buy or sell securities with the market and then instructing it how to allocate the trades to his clients. For equity securities, Fry set the amount of the transaction charges clients paid for these trades, and he typically set them much higher than he could have. Fry’s wife, who was a registered representative at the broker-dealer, received credit for 50% of the transaction charges paid by FHC’s advisory clients, and between January 1, 2007 and October 2011, the broker-dealer credited Fry’s wife with more than \$775,669.09 from inflated transaction charges. During this time, FHC was otherwise insolvent, and Fry used hundreds of thousands of dollars from the above inflated transaction charges to support FHC, which would have otherwise gone out of business. In addition, FHC received undisclosed services from the broker-dealer partly in exchange for the inflated transaction charges. Also during this time, FHC and Fry failed to tell their clients the essential facts about the arrangement described above, and made false and misleading disclosures to them in documents given to clients and filed with the Commission.

2. Specifically, FHC and its clients signed written Portfolio Management Agreements (“PMAs”) that specified the compensation the client would pay for FHC’s advisory services. However, neither FHC nor Fry informed the clients that Fry also directed their broker-dealer to charge them additional, disguised compensation in the form of inflated transaction charges. In addition, FHC’s Forms ADV and firm brochures (Forms ADV Part II) made false and misleading statements to clients about these issues and omitted certain facts that were required to be disclosed. While FHC’s disclosure evolved over time, for most of the relevant period, FHC told clients that it and Fry did not have the authority to set client commission rates, while Fry exercised this authority. And FHC misrepresented to clients that it would comply with its duty to seek to obtain best execution for them, when in fact, Fry was not seeking best execution at their broker-dealer because he directed it to charge his clients much higher transaction charges than he could. Throughout, FHC and Fry failed to tell clients that FHC was insolvent, that Fry was benefiting himself, his wife and FHC at the expense of his clients and that Fry was setting their

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<sup>1</sup> The findings herein are made pursuant to Respondents’ Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

transaction charges much higher than he could in an attempt to prop up his failing advisory business.

### **Respondents**

3. FHC is an Ohio corporation with its principal place of business in Cincinnati, Ohio. FHC is an investment advisory firm that was registered with the Commission as an investment adviser from 1994 until August 2012. In August 2012, FHC withdrew its registration with the Commission. FHC is now registered as an investment adviser with the State of Ohio. According to FHC's August 2012 Form ADV filed with the Commission, FHC had \$32,942,809 in assets under management for 52 client accounts.

4. Fry, age 73, is a resident of Covington, Kentucky. From at least 2004 to the present, Fry has been FHC's sole owner, president and chief compliance officer. From 1993 through June 2008, Fry was associated with Ross, Sinclair and Associates, LLC ("the Broker-Dealer"), as an investment company and variable contracts products representative with a Series 6 securities license only.

### **Other Relevant Entity and Person**

5. The Broker-Dealer is an Ohio limited liability company with its principal place of business in Cincinnati, Ohio. From 2005 through the present, the Broker-Dealer has been registered with the Commission as a broker-dealer.

6. Jane Fry was Fry's wife. Jane Fry was associated with the Broker-Dealer as a registered representative from about 1990 until her death in October 2011.

### **Facts**

#### ***Background***

7. From January 1, 2007 to October 2011 ("relevant period"), FHC was an investment advisory firm that Fry operated with just one or two employees. FHC had written contracts with its clients, called PMAs, which specified the advisory fee that the client would pay for FHC's discretionary advisory services. Fry was responsible for these advisory services, which included that Fry would trade securities in the clients' accounts at their broker-dealer.

8. FHC and the Broker-Dealer had a close relationship for many years. Fry and the Broker-Dealer's president were old friends. From approximately 1994 to October 2010, FHC maintained its office within the Broker-Dealer's Cincinnati office. Also, FHC and Fry recommended that their advisory clients maintain their brokerage accounts at the Broker-Dealer, and the vast majority of FHC's clients did so.

9. Fry's wife, Jane Fry, was listed as the Broker-Dealer registered representative assigned to the accounts of FHC's clients. However, Jane Fry was only nominally the representative for FHC's clients and she did not work on their accounts. In fact, a number of

FHC's clients were unaware that Jane Fry had any association with the Broker-Dealer or their brokerage accounts. The Broker-Dealer credited Jane Fry with 50% of the transaction charges that it charged to FHC's clients for their equity trades. The Broker-Dealer kept the other 50% of such charges.

10. By no later than 2004, FHC was not collecting sufficient advisory fees to cover its expenses.

11. In early 2004, FHC and Fry changed the way they conducted securities trading on behalf of their clients. Prior to March 2004, FHC and Fry conducted equity trading for clients on an agency basis. In this arrangement, when Fry purchased or sold a particular security for a number of clients, he sent an order to the Broker-Dealer for each client.

12. In March 2004, FHC and Fry switched to trading securities in bulk through at least one principal trading account at the Broker-Dealer. In this arrangement, Fry first sent one order to the Broker-Dealer to purchase or sell the total amount of securities with the market in a Broker-Dealer principal trading account. After that trade was completed, and the price that the Broker-Dealer had paid or received for the securities was known, Fry gave the Broker-Dealer the information needed to allocate the securities purchased or sold to FHC's client accounts, specifying which clients would participate and the number of securities each client would purchase or sell. In addition, on equity trades, Fry set the price his clients paid or received, which was different than the price the Broker-Dealer obtained from the market (i.e., Fry set the amount of the markup or markdown).

13. In early 2005, FHC and the Broker-Dealer entered into a contract that provided that the Broker-Dealer would provide office space and certain office services to FHC. In exchange, FHC paid the Broker-Dealer 50% of the advisory fees it collected from its clients. In addition, the Broker-Dealer took FHC's two employees onto its books as employees. However, Fry set their salaries, and the employees continued to work at Fry's direction on FHC's work. FHC and the Broker-Dealer agreed that the Broker-Dealer would deduct from Jane Fry's share of client transaction charges the salary costs that the Broker-Dealer incurred from the employment of FHC's two employees and for FHC's use of the Broker-Dealer's computer trading system. This agreement was amended in 2009 so that FHC was to pay the Broker-Dealer a fixed fee of \$70,000 per year for office space and services, and FHC continued to pay for its former employees' salaries though an offset against the transaction charges credited to Jane Fry. However, over time, FHC's financial condition grew worse, and it could not pay the full amounts it owed to the Broker-Dealer under the contract and began to accrue a growing debt to the Broker-Dealer.

#### ***FHC and Fry Obtained Undisclosed Compensation and Failed to Seek Best Execution***

14. From at least January 1, 2007 to October 2011, Fry submitted equity security orders directly to the Broker-Dealer. For these trades, Fry set the amount of the transaction charges paid by clients to the Broker-Dealer. During this time, the Broker-Dealer had a \$50 minimum commission which Fry could have and sometimes did instruct the Broker-Dealer to charge his clients. However, Fry typically set his clients' transaction charges at much higher

rates. By failing to seek to obtain the best price or the lowest commission reasonably available for their clients, FHC and Fry breached their obligation to seek best execution for their clients.

15. Between January 1, 2007 and October 2011, Fry caused FHC's advisory clients to pay inflated transaction charges (i.e., more than the minimum) to the Broker-Dealer on more than 10,800 occasions (or on approximately 72% of the total equity trade allocations to clients for which Fry set the amount of the transaction charge) without making adequate disclosure to clients that he was doing so. In these instances, FHC's clients paid an average transaction charge of approximately \$195.40 per trade to the Broker-Dealer.

16. During this time, FHC and Fry caused FHC's clients to pay more than \$1.58 million in inflated transaction charges to the Broker-Dealer, and they secured for themselves and for Jane Fry \$775,669.09 from the undisclosed inflated transaction charges.

17. Each month, the Broker-Dealer credited Jane Fry with 50% of the transaction charges it received from Fry's equity trading for clients. Against these amounts, the Broker-Dealer offset certain amounts owed by FHC to the Broker-Dealer, including the salaries of the two former FHC employees who were then on the Broker-Dealer's books. The Broker-Dealer also offset a monthly salary advance that it paid to Jane Fry in the amount of \$12,500. In addition, the Broker-Dealer paid to Jane Fry any amount of her 50% share of the transaction charges that exceeded the above offsets. These payments were deposited into a joint bank account that Jane Fry shared with Fry.

18. In total, from January 1, 2007 to October 2011, the Broker-Dealer credited Jane Fry with \$775,669.09 in inflated equity transaction charges (i.e., Jane Fry's share of the amount of each client's transaction charges exceeding \$50). During this time, FHC paid the Broker-Dealer for its employees' salaries out of client transaction charges, Fry personally benefited from the deposits into the bank account he shared jointly with Jane Fry, and Fry transferred hundreds of thousands of dollars from that bank account to FHC to pay its other expenses, thus enabling it to stay in business.

### ***False and Misleading Disclosures to Clients in Forms ADV Filed with the Commission***

19. During the relevant period, FHC filed a number of Forms ADV with the Commission, and FHC's disclosure about the issues discussed above evolved over time. Fry was the person with ultimate authority over FHC's Form ADV, and he signed each of them as FHC's president, certifying that the statements and information in them were true and correct.

20. From at least 2007 through April 2010, FHC and Fry answered "no" in response to a question on Part 1 of Form ADV, under the heading "Item 8, Investment or Brokerage Discretion," which asked:

“C. Do you or any *related person* have *discretionary authority* to determine the:

\* \* \*

(4) commission rates to be paid to a broker or dealer for a *client’s* transactions?”

Fry electronically signed these Forms ADV. During this time, for equity security transactions, Fry set the amount of the transaction charges paid by clients to the Broker-Dealer.

***False and Misleading Disclosures in Forms ADV Part II (Firm Brochure)***

21. FHC and Fry made similar false and misleading disclosures in its Forms ADV Part II (i.e. its firm brochure) and their disclosure evolved over time. Fry was the person with ultimate authority over FHC’s ADV Part II firm brochures. As its disclosure changed, FHC did not provide each new version of their firm brochures to clients, but instead, only advised clients by letter that it was available on request. As a result, a number of clients did not get each new firm brochure.

22. From at least 2007 to May 21, 2010, under the heading “12. Investment or Brokerage Discretion,” FHC and Fry checked “no” in response to question 12.A:

“A. Does applicant or any related person have authority to determine, without obtaining specific client consent, the:

\* \* \*

(4) commission rates paid? . . . .”

During this time, for equity security transactions, Fry set the amount of transaction charges paid by clients to the Broker-Dealer.

23. In its Form ADV Part II in effect from September 15, 2007 to May 20, 2010, also under heading 12, FHC and Fry checked “yes” in response to question 12B:

“B. Does applicant or a related person suggest brokers to clients?”

Because FHC and Fry checked “yes,” the instructions required them to “describe on Schedule F the factors considered in selecting brokers and determining the reasonableness of their commissions.” FHC and Fry made no disclosure of the factors they considered, and omitted to disclose their financial incentive to direct brokerage to the Broker-Dealer, including that the Broker-Dealer was carrying two of FHC’s employees on its books, that the Broker-Dealer was providing FHC with use of its computerized trading system, and that these benefits were being paid for by inflated transaction charges.

24. In addition, from at least 2007 to May 21, 2010, FHC’s firm brochure stated that Fry was a registered representative at the Broker-Dealer, and that he would earn “normal

commissions” on client trades made through it. However, the disclosure that Fry would earn “normal” commissions is misleading, because, FHC and Fry failed to state that Fry was setting the clients’ transaction charges, and at much higher rates than he could have set. And FHC and Fry still did not disclose to clients that Jane Fry, FHC and Fry were benefiting from 50% of the inflated charges.

25. FHC and Fry prepared a new Form ADV Part II that was in effect from May 21, 2010 to March 30, 2011. In this Brochure, FHC and Fry changed their answer to Question 12A, “Investment or Brokerage Discretion,” now answering “yes,” indicating that that they now had authority to determine the commission rates paid by its clients, disclosing for the first time that they were determining the client transaction charges. But they still did not disclose to clients Fry set client transaction charges much higher than he could have.

26. Also in this version of FHC’s brochure, FHC and Fry stated: “Although the commission and/or transaction fees paid by Registrant’s clients shall comply with the Registrant’s duty to obtain best execution, a client may pay a commission that is higher than another qualified broker-dealer might charge to effect the same transaction where the Registrant determines, in good faith, that the commission/transaction fee is reasonable in relation to the value of the brokerage and research services received.” This statement was also false and misleading, as FHC and Fry were not seeking to obtain best execution at the Broker-Dealer, but instead, were setting client transaction charges at much higher rates than they could have.

27. In this version, FHC and Fry also answered “yes” to Item 12B: “Does applicant or a related person suggest brokers to clients?” Because FHC and Fry checked “yes,” the instructions required them to “describe on Schedule F the factors considered in selecting brokers and determining the reasonableness of their commissions.” In explaining, FHC and Fry for the first time included a discussion of the conflict of interest that arose from Jane Fry’s position with the Broker-Dealer and that the Broker-Dealer provided FHC with services that were paid for “through commission sharing . . . .” In addition, in a different part of Schedule F, FHC and Fry stated that “the brokerage commissions or transaction fees charged by the designed broker-dealer/custodian are exclusive of, and in addition to, Registrants investment management fee.” However, FHC and Fry still did not disclose that Fry was setting client transaction charges at much higher rates than he could have.

28. FHC prepared a new Form ADV Part 2 dated March 31, 2011. The instructions for Item 12, as now amended, required FHC and Fry to disclose the factors they considered in selecting or recommending brokers and in determining the reasonableness of the broker’s compensation, and required them to disclose, among other things, the research, products or services they received from the Broker-Dealer. Under “Item 12 – Brokerage Practices,” FHC and Fry now stated that “we do not solicit or accept soft dollar benefits from any brokerage firm, including [the Broker-Dealer].” In another part of this brochure, under the heading “Additional Fee and Expenses,” FHC and Fry stated that “we recommend [the Broker-Dealer] based on the full range and quality of its services, including the value of the research provided, execution capability, financial responsibility, and responsiveness to our clients, and not merely comparative trading costs.” FHC and Fry also stated that they were authorized to determine the commission rates paid by their clients at the Broker-Dealer, and that Fry’s wife would earn commissions on securities

trades. However, FHC and Fry failed to disclose that they were directing the Broker-Dealer to charge their clients more than necessary in order to benefit Fry, his wife, and to compensate the Broker-Dealer for providing certain services to FHC.

### ***False and Misleading Disclosures to Clients in FHC's Portfolio Management Agreements***

29. FHC and its clients signed PMAs that spelled out the agreement between FHC and the clients. During the relevant period, the PMAs stated that "this management agreement represents our entire understanding with regard to the matters specified here and any changes must be in writing." The PMA specified the advisory services that FHC would provide and the compensation the clients would pay (typically as a percentage of assets in their account). The PMA also noted, in a section titled "Other Fees," that: "Our management fee is payment for management of your account by Fry Hensley & Company. Any transfer fees, transaction fees, redemption fees, sales loads, wiring fees, etc. charged against your account by any third parties are separate from our management fee and will be deducted from the account by the Custodian." But while stating that their Broker-Dealer would charge transaction fees to their accounts, FHC failed to tell clients that Fry (and not the Broker-Dealer) was setting the amount of these charges, and at much higher rates than he could.

### ***Failure to Disclose FHC's Financial Condition***

30. Throughout the relevant period, FHC failed to disclose to its clients that its financial condition was so seriously impaired that it was reasonably likely to impair its ability to provide services to its clients. FHC also did not disclose that it stayed in business only because Fry received additional compensation in the form of payments from inflated transaction charges, and because Fry transferred hundreds of thousands of dollars of those client funds to FHC. Without this infusion of client funds, FHC would not have been able to stay in business.

### **Violations**

31. As a result of the conduct described above, FHC willfully violated Sections 206(1), 206(2), 206(4), Rule 206(4)-4 thereunder, and Section 207 of the Advisers Act.

32. As a result of the conduct described above, Fry willfully violated Sections 206(1), 206(2), and Section 207 of the Advisers Act. In addition, as a result of the conduct described above, Fry willfully aided and abetted and caused FHC's violations of Sections 206(1), 206(2), 206(4), Rule 206(4)-4 thereunder, and Section 207 of the Advisers Act.

### **Disgorgement and Civil Penalties**

33. Respondent FHC has submitted a sworn Statement of Financial Information dated April 26, 2013 and other evidence, and has asserted its inability to pay disgorgement plus prejudgment interest and a civil penalty.

34. Respondent Fry has submitted a sworn Statement of Financial Condition dated April 29, 2013 and other evidence, and has asserted his inability to pay disgorgement plus prejudgment interest and a civil penalty.

#### IV.

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

Accordingly, pursuant to Section 15(b)(6) of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent FHC shall cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2) and Section 207 of the Advisers Act;

B. Respondent Fry shall cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2) and Section 207 of the Advisers Act;

C. Respondent Fry be, and hereby is:

1. barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, provided however, that for a period of up to 30 days from the entry of this Order, Fry may, solely for the purpose of winding down FHC's investment advisory business, continue to be associated with FHC while FHC acts as an investment advisor; and

2. prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

D. Respondent FHC is censured.

E. Any reapplication for association by Respondent Fry will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

F. Respondents FHC and Fry shall pay, on a joint and several basis, disgorgement of \$775,669.09 and prejudgment interest of \$118,988.33, but that payment of such amount is waived based upon Respondent FHC's sworn representations in its Statement of Financial Information dated April 26, 2013, Respondent Fry's sworn representations in his Statement of Financial Condition dated April 29, 2013 and other evidence submitted to the Commission.

G. Based upon Respondent FHC's sworn representations in its Statement of Financial Information dated April 26, 2013, Respondent Fry's sworn representations in his Statement of Financial Condition dated April 29, 2013 and other evidence submitted to the Commission, the Commission is not imposing a penalty against Respondents.

H. The Division of Enforcement may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondents provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement, pre-judgment interest and the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondents was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondents may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement, interest and a penalty should not be ordered; (3) contest the amount of disgorgement and interest to be ordered, or the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy  
Secretary