

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73219 / September 25, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3938 / September 25, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16168

In the Matter of

**COLORADO FINANCIAL
SERVICE CORPORATION**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, AND SECTION 203(e) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), and Section 203(e) of the Investment Advisers Act of 1940 (“Advisers Act”), against Colorado Financial Service Corporation (“CFSC” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

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

Summary

1. These proceedings arise out of CFSC's failure to properly handle customer funds in connection with two private placements in which it participated in 2010. In connection with one private placement, CFSC, a registered broker-dealer, received, deposited, and held three customers' funds. As a result of that conduct, CFSC failed to comply with its net capital and customer protection obligations and willfully violated Section 15(c)(3) of the Exchange Act and Rules 15c3-1 and 15c3-3 thereunder.¹ In addition, by failing to provide notifications to the Commission of its net capital deficiencies, and by failing to create and maintain accurate books and records, CFSC willfully violated Sections 17(a) of the Exchange Act and Rules 17a-3 and 17a-11 thereunder.

2. In connection with the second private placement, which was a contingent offering, CFSC received customer funds and forwarded those funds to the issuer, instead of the issuer's bank escrow agent. As a result, CFSC willfully violated Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder.

Respondent

3. CFSC is a Colorado corporation with its principal place of business in Centennial, Colorado. Since December 7, 2000, CFSC has been registered as a broker-dealer with the Commission and a member of the Financial Industry Regulatory Authority ("FINRA"). Between June 8, 2012 and August 8, 2013, CFSC was also registered with the Commission as an investment adviser. Since 2013, CFSC has been a registered investment adviser in several states. CFSC has no prior disciplinary history with the Commission. In February 2014, CFSC settled a regulatory action with FINRA in which it consented, without admitting or denying the allegations, to findings that it had failed to establish, maintain, and enforce adequate systems and written procedures to supervise and review electronic communications and to conduct due diligence into private placements and non-traded real estate investment trusts. Pursuant to the settlement, CFSC was censured and paid a \$10,000 fine.

¹ A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

CFSC Willfully Violated the Exchange Act's Net Capital, Customer Protection, Notification, and Books and Records Requirements

4. Section 15(c)(3) of the Exchange Act authorizes the Commission to prescribe rules and regulations with respect to the financial responsibility and related practices of broker-dealers. Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder require that a broker-dealer generally effecting transactions in securities "at all times have and maintain net capital" no less than the greatest of the highest minimum requirement applicable to its business. The net capital rule requires different minimum amounts of net capital based on the nature of a firm's business (for example, whether the firm holds customer funds or securities), and the method a firm uses in computing its net capital. The rule is designed to require a broker-dealer to maintain sufficient liquid assets to meet all obligations to customers and counterparties and have adequate additional resources to wind down its business in an orderly manner without the need for a formal proceeding if the firm fails financially. A broker-dealer must cease conducting a securities business if the amount of net capital maintained by the firm falls below the minimum required amount. During the relevant time, CFSC determined that its minimum net capital requirement pursuant to Rule 15c3-1(a) was the greater of 6 2/3 percent of its aggregate indebtedness or \$5,000.

5. Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder require, among other things, that broker-dealers subject to the rule perform a calculation to determine the amount of funds that must be maintained in a special reserve account for the exclusive benefit of customers. Rule 15c3-3 is intended to protect customer funds and securities in the possession of broker-dealers. During the relevant time, CFSC was relying on an exemption set forth in Rule 15c3-3(k)(2)(ii), which exempts a broker-dealer from the rule's substantive provisions if, among other things, the broker-dealer acts as an introducing broker-dealer and clears all transactions with and for customers on a fully disclosed basis with a clearing broker-dealer that carries all of the accounts of such customers.

6. In February and March 2010, a CFSC branch office served as a placement agent for a private offering of securities. In connection with that offering, three CFSC customers were provided with "Inbound Wire Instructions" that provided wire information for the branch office's bank account. The branch office received these three customers' funds, deposited them into a bank account held in the name of the branch, commingled the funds with other branch office funds from its non-brokerage business, and waited several days before forwarding the funds to the issuer.

7. By receiving and holding customer funds in February and March 2010, CFSC rendered itself ineligible to rely on the \$5,000 minimum net capital requirement of Rule 15c3-1(a)(2)(vi). During the time that CFSC was holding customer funds, it was required to maintain \$250,000 in net capital pursuant to Rule 15c3-1(a)(2)(i); however, CFSC's net capital was below the required \$250,000 and it continued its broker-dealer securities business and effected transactions in securities. As a result, CFSC willfully violated Exchange Act Section 15(c)(3) and Rule 15c3-1 thereunder.

8. By receiving, depositing, and holding customer funds in a bank account in the name of one of its branch offices, CFSC handled customer funds in a manner inconsistent with the terms of the exemptions from Rule 15c3-3 and rendered itself ineligible to rely upon any of the Rule

15c3-3 exemptions. These actions created customer liabilities for CFSC, which subjected the firm to the substantive provisions of Rule 15c3-3, including the customer reserve formula computation and reserve bank account deposit requirements. Because CFSC did not perform required reserve formula calculations or maintain cash and/or qualified securities in a reserve bank account for amounts owed to customers, CFSC willfully violated Section 15(c)(3) under the Exchange Act and Rule 15c3-3 thereunder.

9. CFSC's main office was unaware of the branch office's receipt of customer funds and therefore failed to account for them on its books and records and failed to file on a timely basis the requisite notifications with the Commission of its net capital deficiencies. As a result, CFSC willfully violated Section 17(a) of the Exchange Act and Rules 17a-3(a)(3) and 17a-11 thereunder.

CFSC Willfully Violated the Exchange Act's Contingent Offering Requirements

10. Pursuant to Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder, a broker-dealer that is participating in a contingent securities offering, other than a firm-commitment underwriting, must promptly transmit all customer funds to a bank which has agreed in writing to hold all such funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred.

11. Between February and April 2010, an issuer conducted a private offering of securities in which CFSC participated. Pursuant to the private placement memorandum for the offering, all investor funds would be held in an escrow account until \$10,000,000 was raised. If \$10,000,000 was not raised by April 30, 2010, all investor funds were to be returned.

12. In March and April 2010, a CFSC registered representative solicited three customers to subscribe to the contingent offering. In each case, the customers wrote checks payable to the issuer. The CFSC registered representative, rather than depositing the checks into the escrow account, sent these customers' funds directly to the issuer, which deposited the funds in its operating account. The issuer did not raise \$10,000,000 by the April 30, 2010 deadline, and the customers' funds were not returned immediately after the contingency failed. By providing funds directly to the issuer in connection with this contingent offering, CFSC willfully violated Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder.

IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. Respondent CFSC cease and desist from committing or causing any violations and any future violations of Sections 15(c) and 17(a) of the Exchange Act and Rules 15c2-4, 15c3-1, 15c3-3, 17a-3, and 17a-11 thereunder.

B. Respondent CFSC is censured.

C. Respondent CFSC shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of \$25,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying CFSC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Thomas J. Krysa, Esq., Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Byron G. Rogers Federal Building 1961 Stout Street, Suite 1700, Denver, CO 80294-1961.

By the Commission.

Brent J. Fields
Secretary