

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 64221 / April 7, 2011**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-14326**

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<b>In the Matter of</b>	<b>:</b>	<b>ORDER INSTITUTING ADMINISTRATIVE</b>
	<b>:</b>	<b>AND CEASE-AND-DESIST PROCEEDINGS,</b>
	<b>:</b>	<b>PURSUANT TO SECTIONS 15(b) AND 21C</b>
	<b>:</b>	<b>OF THE SECURITIES EXCHANGE</b>
<b>Frederick O. Kraus,</b>	<b>:</b>	<b>ACT OF 1934, MAKING FINDINGS, AND</b>
	<b>:</b>	<b>IMPOSING REMEDIAL SANCTIONS AND</b>
<b>Respondent.</b>	<b>:</b>	<b>A CEASE-AND-DESIST ORDER</b>

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**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”) against Frederick O. Kraus (“Kraus” 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 him 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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds that<sup>1</sup>:

#### Summary

These proceedings arise out of violations by GunnAllen Financial, Inc. ("GunnAllen"), formerly a Tampa, Florida-based broker-dealer, of Regulation S-P which governs the privacy and protection of consumer financial information. Between March and June 2010, as it was winding down its business operations and planned to file for bankruptcy, GunnAllen's president, Kraus, authorized the transfer of approximately 16,000 direct application accounts to GunnAllen's National Sales Manager (the "Sales Manager"), and any broker-dealer with whom the Sales Manager affiliated. Direct application accounts are those accounts held by the product issuer, typically a mutual fund or insurance company.

On or before April 23, 2010, when the Sales Manager accepted employment with a new broker-dealer and resigned from GunnAllen, he downloaded nonpublic customer information for the 16,000 accounts on a portable thumb drive. Two weeks after joining the new broker-dealer, the Sales Manager mailed a letter (its content was previously reviewed and approved by Kraus), on GunnAllen letterhead notifying the account holders that GunnAllen could no longer service the accounts, that he and his business partner were servicing the accounts, and advising them of their right to "opt out" of the transfer. This after the fact notice failed to provide customers with a reasonable opportunity to opt out of the transfer because, among other things, it did not provide procedures on how to exercise that right, contact information or even the identity of the new broker-dealer. Thereafter, the Sales Manager supplied the broker-dealer receiving the accounts with nonpublic personal information for the 16,000 accounts, including the product custodian, the account holder's name and address, and the account number and value for each account.

GunnAllen's transfer of this nonpublic information without providing its customers reasonable notice to opt out violated Rule 10(a)(1) of Regulation S-P (17 C.F.R. §248.10(a)(1)), which prohibits broker-dealers from disclosing nonpublic personal information they collect from customers to nonaffiliated third parties unless they notify their customers of their right to opt out of the disclosure in accordance with Rule 7(a) of Regulation S-P (17 C.F.R. §248.7(a)), and they provide their customers with a reasonable opportunity to opt out of the disclosure. The customer information was also transferred to the Sales Manager, and thereafter, the receiving broker, in a manner that placed the information at substantial risk of unauthorized access and use in contravention of GunnAllen's obligation to ensure the security and confidentiality of the information as required by Rule 30(a) of Regulation S-P (the "Safeguard Rule") (17 C.F.R. §248.30(a)). As a result, Kraus aided and abetted and caused GunnAllen's violations of Rules 7(a), 10(a) and 30(a) of Regulation S-P.

#### Respondent

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other persons or entities in this or any other proceeding.

1. Kraus, age 56, resides in St. Petersburg, Florida. From September 2009 to September 2010, Kraus served as President of GunnAllen. Kraus also served as GunnAllen's Chief Financial Officer from October 2008 to September 2010, and the firm's Director of Supervision from January 2005 to August 2009.

### **GunnAllen Financial, Inc.**

2. GunnAllen had a principal place of business in Tampa, Florida and was registered with the Commission as a broker-dealer from March 1986 to April 2010. The firm operated mostly under an independent contractor model and maintained franchise offices nationwide. In March 2010, the Financial Industry Regulatory Authority (FINRA) determined that GunnAllen did not have the requisite net capital to conduct business as a broker-dealer and restricted its operations to liquidating securities transactions. Unable to raise the additional capital it needed to continue to conduct business, in April 2010 GunnAllen discontinued its operations, filed for bankruptcy, and submitted a Broker-Dealer Withdrawal, or "BDW", Form with the Commission withdrawing its registration. The withdrawal became effective on June 11, 2010.

### **The Account Transfers**

3. As it was winding down its business operations in March and April 2010, GunnAllen and its registered representatives transferred the firm's customer accounts to other broker-dealers. In addition to servicing the brokerage accounts held by its clearing firm, GunnAllen serviced and was the broker of record on tens of thousands of direct application accounts held by various mutual fund and variable annuity and insurance companies. As broker of record on the direct application accounts, GunnAllen was entitled to the commissions, trailers and other fees generated by the accounts.

4. On March 28, 2010, GunnAllen sent a letter, drafted by the Sales Manager but reviewed and approved by Kraus, to all of the firm's direct application account customers notifying them that it expected to cease operations on March 31, 2010 (the "First Notice"). The First Notice instructed customers that they had three options for arranging ongoing service of their accounts: (i) they could contact their GunnAllen registered representative to make arrangements to transfer their account to the new firm with which he or she associated, (ii) they could contact a brokerage firm of their own choice and request their account be transferred to that firm, or (iii) they could contact the mutual fund or variable annuity or insurance company holding their investment directly to make arrangements for service.

5. However, on March 30, 2010, just two days after GunnAllen sent the First Notice, Kraus authorized the transfer of approximately 16,000 direct application accounts serviced by GunnAllen to the Sales Manager. Kraus executed "*Block Broker-Dealer Change Authorization for Directly Held Accounts*" forms (the "Block Transfer Forms") covering those accounts and gave the signed Block Transfer Forms to the Sales Manager and another GunnAllen representative with whom the Sales Manager planned to form a business partnership when GunnAllen ceased doing business. By signing the Block Transfer Forms and turning them over to the Sales Manager and his partner, Kraus authorized the transfer of the 16,000 accounts to any

broker-dealer that the Sales Manager and his partner chose to associate with after they left GunnAllen.

6. In April 2010, while assisting Kraus in the wind down of GunnAllen's business operations, the Sales Manager and his partner sought employment with other brokerage firms by offering, among other things, to transfer to them the direct application accounts for which they held the Block Transfer Forms. On April 23, 2010, they were hired by another broker-dealer registered with the Commission (the "Receiving Broker"). The Sales Manager and his partner agreed to share 10% of the commissions, trailers and other fees generated by the accounts with the Receiving Broker and to solicit the account holders to purchase additional products from the Receiving Broker. On that same day, the Sales Manager resigned from GunnAllen.

7. On April 23, 2010, or shortly before then, the Sales Manager downloaded a spreadsheet from a GunnAllen computer server or drive to a personal thumb drive and physically removed it from the firm. The spreadsheet contained the custodian, account holder's name and address, account number and value of the approximately 16,000 direct application accounts covered by the Block Transfer Forms authorized by Kraus. The spreadsheet indicated that the direct application accounts included therein, in the aggregate, had a stated but not confirmed estimated total value of \$850 million as of March 23, 2010.

8. Two weeks after associating with the Receiving Broker, on May 14, 2010, the Sales Manager sent the GunnAllen customers holding the direct application accounts a letter notifying them that their accounts would be transferred to the brokerage firm he was newly associated with unless they objected to the transfer within fifteen days of the date of the letter (the "Second Notice"). Although the Sales Manager drafted and personally paid for the cost of copying and mailing the letter, its content was reviewed and approved previously by Kraus, and it was sent on GunnAllen letterhead. The Sales Manager engaged a third party vendor to copy and mail the Second Notice on his behalf and supplied it with the customer names and addresses he took from GunnAllen on his thumb drive.

9. After mailing the Second Notice, the Sales Manager contacted GunnAllen to see if it had received notices from any customers seeking to opt out of the account transfer, but did not take any other steps to verify customer objections to the transfer and, thereafter, e-mailed the Receiving Broker the customer account information that he had taken from GunnAllen on his thumb drive. His partner also supplied the Receiving Broker with the Block Transfer Forms signed by Kraus.

10. Beginning on June 3, 2010, and continuing through at least June 7, 2010, the Receiving Broker counter-signed the Block Transfer Forms accepting the direct application accounts from GunnAllen. It also delivered the fully executed forms to the appropriate mutual fund and variable annuity and insurance companies along with a letter instructing them to change the broker of record on the direct application accounts from GunnAllen to the Receiving Broker.

### **Violations of the Privacy Rules**

11. Rule 10(a) of Regulation S-P prohibits brokers and dealers, either directly or through an affiliate, from disclosing nonpublic personal information about their customers to nonaffiliated third parties unless they have provided their customers with a privacy notice describing the nonpublic personal information they disclose, and notify their customers of their right to opt out of any disclosure and afford them a reasonable opportunity to opt out of the disclosure before it is made.

12. Rule 7(a) of Regulation S-P requires brokers and dealers to provide their customers with opt out notices that are clear and conspicuous and that accurately explain customers' opt out rights. The notice must explicitly state that the broker or dealer discloses, or reserves the right to disclose, nonpublic personal information about its customers and that they have the right to opt out of any disclosure. Additionally, the notice must provide a reasonable means by which customers can exercise their right to opt out.

13. GunnAllen violated Rules 7(a) and 10(a) of Regulation S-P by failing to provide the direct application account customers whose accounts were transferred to the Receiving Broker with proper notice and a reasonable opportunity to opt out of the transfer before supplying their personal nonpublic information to the Sales Manager and the Receiving Broker. Also, GunnAllen's disclosure of the information was not covered by any exception from Regulation S-P's notice and opt out requirements, including an exception in Rule 14 of Regulation S-P for disclosures that are required, or are a usual, appropriate, or acceptable method, in connection with the transfer of accounts, because GunnAllen failed to obtain the customers' affirmative consent to transfer the direct applications accounts. The First and Second Notices failed to inform account holders that GunnAllen would physically transfer or, in the case of the Second Notice, had physically transferred, their account information. The Second Notice also failed to provide account holders with a reasonable means to exercise their right to opt out of the transfer, or sufficient time within which to do so. Further, the direct application account customers were not provided with a paper or electronic form to object to the transfer although Rule 7(a)(2)(iii) of Regulation S-P expressly states it is unreasonable "if the only means of opting out is for the consumer to write his or her own letter to exercise the opt out right." Finally, the Second Notice provided only fifteen days to opt out of the transfer although the circumstances did not warrant such a short response period.

14. As a result of the conduct described above, Kraus willfully aided and abetted and caused GunnAllen's violations of Rules 7(a) and 10(a) of Regulation S-P under the Exchange Act.

### **Violations of the Safeguard Rule**

15. Rule 30(a) of Regulation S-P, or the Safeguard Rule, requires every broker and dealer to maintain policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information. The policies and procedures must be reasonably designed to (1) insure the security and confidentiality of customer records

and information; (2) protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.

16. GunnAllen violated Rule 30(a) of Regulation S-P because it knew that there was a reasonably foreseeable risk that its departing registered representatives would disclose customer nonpublic personal information to successor brokerage firms but nonetheless failed to adopt, and did not have in place while winding down its operations, any written policies or procedures addressing the transfer and protection of such information.

17. As president of GunnAllen, Kraus was familiar with Regulation S-P and GunnAllen's responsibilities under the rule for maintaining the confidentiality and physical security of the information that the firm collected from its customers. Nonetheless, he knowingly placed customer information at substantial risk of unauthorized access and misuse when he executed the Block Transfer Forms and authorized the Sales Manager to download customer information for approximately 16,000 GunnAllen direct application accounts to a personal thumb drive that he physically took from the firm.

18. As a result of the conduct described above, Kraus willfully aided and abetted and caused GunnAllen's violations of Rule 30(a) of Regulation S-P.

#### IV.

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

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

A. Respondent Kraus cease and desist from committing or causing any violations and any future violations of Rules 7(a), 10(a) and 30(a) of Regulation S-P under the Exchange Act.

B. Respondent Kraus is censured. R

C. Respondent Kraus shall pay a civil money penalty of \$20,000 to the United States Treasury. Payment shall be made in the following installments: \$5,000 within 10 days of the entry of this Order; \$5,000 within 90 days of the entry of this Order; \$5,000 within 180 days of the entry of this Order; and \$5,000 within 270 days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of the civil penalty, plus any interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check, or bank money order; (B) payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432

General Green Way, Alexandria, VA 22312-0003; and (D) submitted under cover letter that identifies Respondent's name as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and wire transfer, money order or check shall be sent to Teresa J. Verges, Assistant Regional Director, Miami Regional Office, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, FL 33131.

By the Commission.

Elizabeth M. Murphy  
Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), on the Respondent and his legal agent.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray  
Chief Administrative Law Judge  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-2557

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