

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**  
**January 20, 2006**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12156**

**In the Matter of**

**STEPHEN J. HORNING,**

**Respondent.**

**ORDER INSTITUTING PUBLIC  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTIONS 15(b)(6) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTION 14(b) OF THE SECURITIES  
INVESTOR PROTECTION ACT OF 1970**

**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 against Respondent Stephen J. Horning pursuant to Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 14(b) of the Securities Investor Protection Act of 1970 ("SIPA").

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENT**

1. **Horning**, age 61, resides in Aurora, Colorado and was the registered financial and operations principal ("FINOP"), compliance officer, a director and a registered representative of Rocky Mountain Securities & Investments, Inc. ("Rocky Mountain"), a registered broker-dealer, from 1980 until February 3, 2003, when the firm closed. Horning became president of Rocky Mountain in 1981 and held that position continuously until February 3, 2003. At the time of the firm's closing, Horning was a 39% shareholder.

**B. RELATED ENTITY AND PERSONS**

2. **Rocky Mountain** became registered with the Commission as a broker-dealer in 1980. On February 3, 2003, Rocky Mountain notified the National Association of Securities Dealers ("NASD") that it was not in compliance with its minimum net capital requirement and was ceasing operation immediately. On February 7, 2003, Rocky Mountain was placed in Securities Investor Protection Corporation ("SIPC") liquidation and a trustee was appointed pursuant to SIPA.

On May 3, 2003, Rocky Mountain, through the SIPC Trustee, voluntarily withdrew its registration with the Commission as a broker-dealer. The withdrawal became effective on April 9, 2004.

3. **The head securities trader** (the“trader”) at Rocky Mountain from 1980 until January 24, 2003, bought and sold equities for Rocky Mountain’s retail customers and for the firm’s proprietary accounts.

4. **The operations manager** (the“operations manager”) at Rocky Mountain was employed as a transfer clerk and then cashier, from 1983 until the early 1990s, when she became the firm’s operations manager. The operations manager held that position until the firm’s closure on February 3, 2003. The operations manager ran Rocky Mountain’s back office on a day-to-day basis.

### **C. SUMMARY**

5. From at least April 2002 through January 2003, the trader incurred significant trading losses through her equities trading in Rocky Mountain’s proprietary accounts. The trader attempted to conceal the trading losses by, among other things, entering fictitious profitable trades in Rocky Mountain’s computer system and omitting executed losing trades.

6. From at least April 2002 through January 2003, the operations manager diverted approximately \$4.5 million of customer funds to pay for the trading losses incurred by the trader. Rocky Mountain customers’ cash balances were invested daily in a money market mutual fund through an omnibus account that Rocky Mountain maintained in its name at a New York broker-dealer. This is the money market fund from which the operations manager diverted customer funds to cover Rocky Mountain’s trading losses and hereafter will be referred to as the“Money Market Fund”

### **D. ROCKY MOUNTAIN, AIDED AND ABETTED BY THE OPERATIONS MANAGER, THE TRADER AND HORNING, FAILED TO MAINTAIN REQUIRED NET CAPITAL AND SUFFICIENT CUSTOMER RESERVES, MADE AND KEPT INACCURATE BOOKS AND RECORDS, AND PREPARED AND DISSEMINATED FALSE MONTHLY FOCUS REPORTS AND AUDITED FINANCIAL STATEMENTS**

7. The duties of the operations manager included maintaining Rocky Mountain’s books and records, making Rocky Mountain’s net capital and customer reserve computations, preparing Rocky Mountain’s financial statements, preparing Rocky Mountain’s monthly FOCUS reports, reconciling all trade differences on a daily basis, and performing quarterly securities counts.

8. Rocky Mountain was required to account for the amounts the operations manager diverted from the Money Market Fund as a“short securities difference.” Had the operations manager recorded the diverted amounts as a short securities difference, Rocky Mountain’s net capital would have been reduced by the same amount. The operations manager failed to record the amounts and, as a result, Rocky Mountain’s net capital was overstated in its FOCUS reports from at least April 2002 through February 3, 2003. For the period June 30, 2002 through February 3, 2003, Rocky Mountain had a net capital deficit ranging from

approximately \$793,503 to more than \$3.6 million. Rocky Mountain conducted a securities business while failing to maintain required net capital for the period June 30, 2002 through February 3, 2003.

9. In addition, from at least April 2002 through February 3, 2003, the operations manager understated the amount of funds Rocky Mountain needed to maintain in its customer protection reserve account. For the period June 2002 through December 2002, the operations manager also materially understated Rocky Mountain's aggregate indebtedness by failing to include in her computation the amount required to be on deposit in its customer protection reserve account. The inaccurate computations were reflected in Rocky Mountain's FOCUS reports.

10. On August 27, 2002, Rocky Mountain filed with the Commission its audited financial statements for the fiscal year ended June 30, 2002. As required under the Exchange Act, Rocky Mountain also sent these financial statements to its customers. The financial statements, which were prepared by the operations manager, materially misstated Rocky Mountain's net capital, customer protection reserve requirements and aggregate indebtedness.

11. The trader made false entries in Rocky Mountain's books and records reflecting securities trading in Rocky Mountain's proprietary accounts. The operations manager made false entries in Rocky Mountain's books and records because of the failure to record the operations manager's diversions of funds from the Money Market Account as a short securities difference and consequent inaccurate computations of net capital, customer protection reserve requirements and aggregate indebtedness. The operations manager also failed to record the diversions from the Money Market Fund in Rocky Mountain's books and records. Accordingly, Rocky Mountain maintained materially inaccurate books and records during the relevant period.

12. Rocky Mountain did not notify the Commission that it was out of compliance with its minimum net capital requirement from at least June 2002 through January 2003 or that it failed to keep current books and records from at least April 2002 through January 2003. The operations manager's concealment of the above activities resulted in Rocky Mountain failing to provide timely notice.

13. The operations manager conducted the quarterly securities count for Rocky Mountain for the quarter ended September 30, 2002. In making this count, the operations manager should have, but did not, include the holdings in the Money Market Fund and the differences between proprietary securities trades shown in Rocky Mountain's books and records and those shown on statements generated by the National Securities Clearing Corporation ("NSCC").

14. Horning, as Rocky Mountain's president and FINOP, was primarily responsible for Rocky Mountain's compliance with the net capital, customer reserve, and reporting requirements, and had a duty to review the relevant computations. Horning was responsible for reviewing and approving the filing of Rocky Mountain's FOCUS reports and financial statements, and signed the FOCUS reports and financial statements. Horning did not fulfill his responsibilities because he failed to review adequately the documentation supporting Rocky Mountain's books and records, net capital and customer reserve computations, FOCUS reports and financial statements, and quarterly securities count, to determine whether they were accurate.

**E. THE TRADER AND OPERATIONS MANAGER COMMITTED FRAUD**

15. The trader incurred significant trading losses through equities trading in Rocky Mountain's proprietary accounts, which the trader attempted to conceal by, among other things, making false entries in Rocky Mountain's books and records. The trader thereby committed securities fraud against Rocky Mountain.

16. The operations manager diverted approximately \$4.5 million of customer funds to pay for the trading losses incurred by the trader. At the same time the operations manager was diverting funds, the operations manager knew, or was reckless in not knowing, that Rocky Mountain was sending to its customers monthly account statements falsely representing that they had certain cash balances in their accounts. In addition, at the same time the operations manager was diverting funds, the operations manager knew, or was reckless in not knowing, that Rocky Mountain was sending to its customers its audited financial statements for the fiscal year ended June 30, 2002, which the operations manager knew, or was reckless in not knowing, were materially misstated. The operations manager thereby committed securities fraud against Rocky Mountain's customers.

**F. HORNING FAILED TO SUPERVISE THE TRADER AND THE OPERATIONS MANAGER**

17. From at least January 2000 through at least January 24, 2003, the trader was subject to Horning's supervision. From at least January 2000 through at least February 3, 2003, the operations manager was subject to Horning's supervision.

18. Through an examination of Rocky Mountain made by Securities and Exchange Commission broker-dealer examiners in January 2001, Horning learned that the trader and the operations manager were responsible for more than \$600,000 in unreported trading losses in Rocky Mountain's proprietary accounts, incurred primarily in 2000. As a result of these losses, Rocky Mountain, among other things, had made errors in calculating net capital and customer reserve requirements, and had filed inaccurate FOCUS reports.

19. Horning was Rocky Mountain's president, FINOP and compliance officer, and was responsible for establishing Rocky Mountain's supervisory policies, procedures, and practices. From at least April 2002 through January 24, 2003, Horning failed reasonably to supervise the trader with a view toward preventing her violations of the federal securities laws as described below, and from at least April 2002 through February 3, 2003, Horning failed reasonably to supervise the operations manager with a view toward preventing her violations of the federal securities laws as described below:

a. Horning established two new supervisory procedures after he learned of the \$600,000 in unreported trading losses described in paragraph 18. One procedure required the operations manager to provide Horning with a summary sheet of trade corrections from the previous day. The other procedure required the operations manager to provide Horning with daily reconciliations of Rocky Mountain's internal trading records as compared to trading records

generated by the NSCC. Horning did not adequately implement these new procedures because, among other things, he made no further inquiry into suspicious data appearing in these reports.

b. Before and after he learned of the \$600,000 in unreported trading losses, Horning had primary responsibility for review of Rocky Mountain's order tickets. He did not adequately implement this procedure with a view to preventing the trader's and the operations manager's violations of the securities laws from at least April 2002 through February 3, 2003 because he compared order tickets to the operations manager's summary sheets described above, and not to a more objectively reliable source of information such as NSCC statements.

c. Horning did not institute or implement adequate supervisory procedures regarding tracking of cash balances. After Horning learned of the \$600,000 in unreported trading losses, the operations manager retained complete control over funds administered by or belonging to Rocky Mountain, without any supervision or review by Horning or another Rocky Mountain employee.

d. Before and after he learned of the \$600,000 in unreported trading losses, Horning had primary responsibility for review of records reflecting personal trading by registered representatives, including trade blotters, commission runs, activity reports and end-of-month sales reports. The trader placed fictitious trades in certain registered representatives' personal inventory accounts. Review of the relevant records could have revealed the fictitious trades, but from at least April 2002 through February 3, 2003, Horning did not adequately perform this review.

#### **F. HORNING FAILED TO TAKE ACTION TO AVOID THE FINANCIAL COLLAPSE OF ROCKY MOUNTAIN, RESULTING IN ROCKY MOUNTAIN'S SIPC RECEIVERSHIP**

20. Horning was the president, FINOP, compliance officer and a director of Rocky Mountain at all relevant times. He possessed, directly and indirectly, the power to direct the management, policies and daily operations of Rocky Mountain. On February 7, 2003, a trustee was appointed for Rocky Mountain by the United States District Court for the District of Colorado, pursuant to SIPA.

21. Prior to Rocky Mountain's liquidation, Horning did not take steps necessary to determine Rocky Mountain's compliance with financial responsibility requirements.

#### **G. VIOLATIONS**

22. The trader and the operations manager willfully violated the antifraud provisions of the Exchange Act set forth in Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

23. Rocky Mountain violated Section 15(c)(3) of the Exchange Act and Rules 15c3-1 and 15c3-3 thereunder, which set forth the net capital and customer reserve requirements for broker-dealers. Horning willfully aided and abetted and caused these violations. The operations manager willfully aided and abetted these violations.

24. Rocky Mountain violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, which set forth the requirements for books and records to be maintained by broker-dealers. Horning willfully aided and abetted and caused these violations. The trader and the operations manager willfully aided and abetted these violations.

25. Rocky Mountain violated Section 17(a) of the Exchange Act and Rule 17a-5(a) thereunder, which require the filing of FOCUS reports with the Commission. Horning willfully aided and abetted and caused these violations. The operations manager willfully aided and abetted these violations.

26. Rocky Mountain violated Section 17(a) of the Exchange Act and Rules 17a-5(c) and 17a-5(d) thereunder, which require broker-dealers to send audited financial statements to their customers and to file audited financial statements with the Commission. Horning willfully aided and abetted and caused these violations. The operations manager willfully aided and abetted these violations.

27. Rocky Mountain violated Section 17(a) of the Exchange Act and Rule 17a-11 thereunder, which require broker-dealers to provide notice in the event of net capital or other financial deficiencies and in the event of the broker-dealer's failure to keep and maintain current books and records. Horning willfully aided and abetted and caused these violations. The operations manager willfully aided and abetted these violations.

28. Rocky Mountain violated Section 17(a) of the Exchange Act and Rule 17a-13 thereunder, which require broker-dealers to make quarterly securities counts. Horning willfully aided and abetted and caused these violations. The operations manager willfully aided and abetted these violations.

29. Rocky Mountain violated Section 17(e) of the Exchange Act. Section 17(e)(1)(A) requires registered broker-dealers to annually file with the Commission a certified balance sheet and income statement, and Section 17(e)(1)(B) requires broker-dealers to annually send customers a certified balance sheet. Horning willfully aided and abetted and caused these violations. The operations manager willfully aided and abetted these violations.

### **III.**

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

**A.** Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

**B.** What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b)(6) of the Exchange Act including, but not limited to, civil penalties

imposed pursuant to Section 21B of the Exchange Act, based on his aiding and abetting of Rocky Mountain's violations described above;

**C.** What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b)(6) of the Exchange Act including, but not limited to, civil penalties imposed pursuant to Section 21B of the Exchange Act, based on his failure reasonably to supervise persons subject to his supervision;

**D.** Whether, pursuant to Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing a violation and future violation of any or all of the Sections or Rules specified in Section II. above; and

**E.** Whether, pursuant to Section 14(b) of SIPA, the imposition of a bar or suspension against Respondent is appropriate in the public interest.

#### **IV.**

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not ‘rule making’ within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris  
Secretary