

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

**SECURITIES ACT OF 1933**

**Release No. 8950 / August 7, 2008**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 58325 / August 7, 2008**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-13122**

**In the Matter of**

**FINANCE 500, INC.,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS, PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT  
OF 1933 AND SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER AS TO  
FINANCE 500, INC.**

**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 Section 8A of the Securities Act of 1933 (“Securities Act”) and Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”) against Finance 500, Inc. (“Finance 500” 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 Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order as to Finance 500, Inc. (“Order”), as set forth below.

### III.

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

#### Summary

From October 2002 through August 2005, Finance 500, a broker-dealer, violated Sections 5(a) and 5(c) of the Securities Act by selling a massive number of shares in unregistered offerings under so-called employee stock option programs implemented by thirty-five issuer customers (the "Issuers"). The programs functioned as public distributions of securities using the Issuers' employees as conduits so that the Issuers could raise capital without complying with the registration requirements of the federal securities laws. The Issuers improperly registered the shares sold on Form S-8 registration statements and then received the bulk of the shares' sales proceeds. Finance 500, through one of its registered representatives, administered the brokerage aspects of the programs despite red flags suggesting that the shares it sold were issued through unregistered offerings.

#### Respondent

1. **Finance 500**, a California corporation with its principal offices in Irvine, California, has been registered with the Commission as a broker-dealer since 1982. Finance 500's primary business is selling and underwriting brokered Certificates of Deposit. It also conducts a market making business and a general retail securities business. During the relevant period, the retail business had roughly 80 registered representatives in 15 branch offices and included the employee stock option business that is the focus of this Order.

#### Background

2. Sections 5(a) and 5(c) of the Securities Act prohibit any person from using interstate commerce to directly or indirectly sell or offer to sell a security unless a registration statement is filed with the Commission. Registrants that are subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act and are current in their filings may use Form S-8 registration statements to register the offer and sale of securities to their employees, including consultants, to compensate them for *bona fide* services or to provide incentives. Because of the compensatory purpose and the employees' and consultants' familiarity with the registrant's business, Form S-8's disclosure requirements are abbreviated as compared to statements registering shares to raise capital. A registrant cannot use Form S-8 to issue shares to employees who act as conduits for the sale of S-8 stock to the public because the transaction that takes place – the distribution of securities to the public – is not registered.

3. From October 2002 through August 2005 (the "relevant period"), Finance 500, through one of its registered representatives, provided brokerage services for the employee

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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 person or entity in this or any other proceeding.

stock option programs implemented by thirty-five Issuers. The Issuers were microcap companies that had limited operational histories, generated little revenue and had low priced securities listed on the OTC Bulletin Board that were thinly traded before the Issuers began to issue Form S-8 shares.

4. The Issuers used employee stock plans generally titled Employee Stock Incentive Plans (“ESIPs”) that issued shares registered on Form S-8.<sup>2</sup> Attached to the Forms S-8 were the ESIPs and attorney opinion letters stating that the S-8 shares, when issued and sold, would be validly issued, fully paid and non-assessable.

5. As administered, the Issuers’ ESIP programs shared three key characteristics that, when combined, virtually ensured that the options would be exercised and the underlying shares simultaneously sold to the public at or near the time the options were granted. First, the option exercise price floated with the market value of an Issuer’s stock at the time of exercise. The exercise price was typically set by the Issuers at 85% of the proceeds from the sale of the shares underlying the options. This meant that the options were always “in the money” – or that the exercise price was less than the market price at the time of exercise – and that the employee would receive relatively little benefit from an increase in stock price. Second, the options vested immediately, meaning that the options could be exercised at any time after the date of grant. Third, the programs used a cashless exercise method where the exercise price was remitted to the Issuer from the sales proceeds of the shares underlying the options. Accordingly, the employees did not have to pay any money out-of-pocket to exercise the options.

6. The Issuers and their employees had brokerage accounts with Finance 500. When the Issuers granted the options, they sent Finance 500 share certificates representing the number of Form S-8 shares underlying the options. The great majority of employees had standing orders with Finance 500 to exercise their options immediately. Upon receipt of the share certificates, Finance 500 sold the shares underlying the options in unsolicited sales to the public. Then Finance 500 calculated the options’ exercise price at 85% of the sales price and credited the exercise price proceeds to the Issuers’ accounts and the remainder, minus brokerage and clearing fees, to the employees’ accounts.

7. There was one registered representative responsible for the employee stock option business at Finance 500. The representative brought the business with him from his prior brokerage firm. When the representative began working at Finance 500, the employee stock option business comprised approximately 10% to 15% of his total business, but grew to 60% at its height. The representative became one of the broker-dealer’s top producers and eventually earned the highest commission rate at the firm.

8. The manner in which the Issuers implemented their ESIP programs (*i.e.*, the high-percentage exercise price that was based on the market value at the time of exercise, the immediate vesting and use of a cashless exercise), combined with the employees’ standing orders

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<sup>2</sup> “ESIP programs” means the Issuers’ employee stock options programs where each Issuer issued Form S-8 shares under a series of ESIPs.

to exercise immediately, all but ensured that the options were exercised and the underlying shares simultaneously sold within days of grant. This resulted in millions and, in many cases, billions of shares in each Issuer's stock being sold to the public, which severely diluted the ownership interests of existing shareholders. The Issuers received payment for the exercised options that greatly exceeded their revenues and allowed them to fund their otherwise failing operations. By comparison, the employees received relatively modest amounts (approximately 7%-8% of the sales proceeds).

9. The ESIP programs functioned as public offerings to raise capital. The Issuers essentially used their employees as conduits to offer shares to the public without providing the disclosures required by the registration provisions. As such, the employees acted as underwriters.

10. Because the Form S-8 statements cannot be used to raise capital, no registration statements were in effect or filed as to the shares issued under the ESIP programs. As a result, the shares were sold in unregistered offerings.

11. While administering the brokerage aspects of the ESIP programs, Finance 500 encountered red flags indicating that Issuers' employees were underwriters to unregistered offerings. These red flags included: (1) the employees' nearly immediate exercise of options after grant, (2) the simultaneous exercise and sale of the shares underlying the options, (3) the floating exercise price, (4) the huge number of shares sold in previously thinly-traded stock of microcap companies, (5) the large amounts of money received in each of the Issuers' Finance 500 accounts, (6) the relatively small amounts received in the employee accounts, and (7) the fact that the employees were related to the Issuers.

12. These red flags should have prompted Finance 500 to inquire further as to whether the employees were underwriters in unregistered offerings. Finance 500's inquiries on this subject, however, were inadequate.

13. As a result of the conduct described above, Finance 500 willfully violated Sections 5(a) and 5(c) of the Securities Act,<sup>3</sup> which prohibit using interstate commerce to directly or indirectly, in the absence of any applicable exemption, sell or offer to sell a security unless a registration statement is filed with the Commission.

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<sup>3</sup> 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)).

### **Finance 500's Remedial Efforts**

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

#### **IV.**

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Finance 500's Offer.

Accordingly, pursuant to Section 8A of the Securities Act and Section 15(b) of the Exchange Act, it is hereby ORDERED that:

A. Respondent Finance 500 cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act;

B. Respondent Finance 500 is censured.

C. IT IS FURTHER ORDERED that Respondent shall, within ten (10) days of the entry of this Order, pay disgorgement of \$271,484 and prejudgment interest of \$74,015 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made 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, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Finance 500 as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Robert J. Burson, Senior Associate Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois, 60604.

By the Commission.

Florence E. Harmon  
Acting Secretary