

STATE OF WASHINGTON  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
SECURITIES DIVISION

IN THE MATTER OF DETERMINING ) Order # S-03-166-03-TO01  
Whether there has been a violation of the )  
Securities Act of Washington by: ) AMENDED STATEMENT OF CHARGES;  
 ) STOP ORDER SUSPENDING THE  
CLS FINANCIAL SERVICES, LLC and its ) PERMIT FOR THE SALE OF MORTGAGE  
affiliates and GERALD CLARK VANHOOK ) PAPER SECURITIES BY CLS FINANCIAL  
 ) SERVICES, LLC; SUMMARY ORDER TO  
Respondents ) CEASE AND DESIST; AND ORDER  
 ) CONDITIONING SECURITIES  
 ) REGISTRATION EXEMPTIONS  
 )  
 )

THE STATE OF WASHINGTON TO: CLS FINANCIAL SERVICES, LLC  
GERALD CLARK VANHOOK

**AMENDED STATEMENT OF CHARGES**

Please take notice that the Securities Administrator of the State of Washington has reason to believe that Respondent, CLS Financial Services, LLC, has violated the Securities Act of Washington and that its violations justify the entry of an order of the Securities Administrator under RCW 21.20.280 to suspend the effectiveness of its current permit for the offer and sale of mortgage paper securities (file number 70011068). The Securities Administrator also has reason to believe that Respondents, CLS Financial Services, LLC and its affiliates and Gerald Clark Vanhook, have each violated the Securities Act of Washington and that their violations justify the entry of an order of the Securities Administrator under RCW 21.20.390 against each to cease and desist from such violations and, pursuant to RCW 21.20.325, justify the conditioning of the exemptions provided by RCW 21.20.320(1), (5), (9), (11) and (17) as to CLS Financial Services, LLC and any of its affiliates. The Securities Administrator also has reason to

STATEMENT OF CHARGES, STOP ORDER,  
SUMMARY CEASE AND DESIST ORDER and ORDER 1  
CONDITIONING EXEMPTIONS

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1 believe that Respondent, CLS Financial Services, LLC, has violated registration and debenture  
2 company provisions of the Securities Act of Washington and that its violations justify the entry  
3 of an order of the Securities Administrator under RCW 21.20.390 and RCW 21.20.732. The  
4 Securities Administrator finds that delay in ordering the suspension of the CLS Financial  
5 Services, LLC permit for the sale of mortgage paper securities; the conditioning of exemptions  
6 available to CLS Financial Services, LLC and any of its affiliates pursuant to RCW 21.20.325;  
7 and the order against all Respondents to cease and desist from violations of the Securities Act  
8 would be hazardous to investors and to the public and that this order should be entered  
9 immediately. The Securities Administrator finds as follows:

10 **TENTATIVE FINDINGS OF FACT**

11 **I. RESPONDENTS**

12 1. CLS Financial Services, LLC (“CLS”) is a Washington limited liability company with  
13 its principal place of business at 4720 200<sup>th</sup> Street SW in Lynnwood, Washington. CLS is  
14 currently registered pursuant to RCW 21.20.210 and WAC 460-33A to sell mortgage paper  
15 securities, as that term is defined in WAC 460-33A-015(4). The securities registration file  
16 number is 70011068.

17 CLS Financial Services, LLC, which was formed on January 31, 2002, is a successor to  
18 CLS Financial Services, Inc., a Washington corporation with its principal place of business at  
19 4720 200<sup>th</sup> Street SW in Lynnwood, Washington. CLS Financial Services, Inc. was incorporated  
20 on March 16, 1990 by Gerald Clark Vanhook, its president. CLS Financial Services, Inc. was  
21 merged into CLS Financial Services, LLC as described in a plan of merger dated May 16, 2002.

22 2. Gerald Clark Vanhook is the managing member of CLS Financial Services, LLC and  
23 is a registered securities salesperson.



1 have a conditional use permit to operate a granite quarry. Respondents have each failed to  
2 disclose that Granite Northwest’s application for a permit is opposed by the City of Granite Falls  
3 and a neighborhood group. Respondents have each failed to disclose that there are significant  
4 environmental concerns about traffic, noise, water quality and other matters that must be  
5 addressed before a conditional use permit could be issued and that there is no guarantee that  
6 these concerns could be satisfactorily addressed.

7 **V. APPRAISAL**

8 When offering and selling the Granite Northwest L.L.C. participation interests,  
9 Respondents have each represented to investors that the land securing the \$5,487,749.10 note  
10 had an appraised value of \$33 million. Respondents have each further represented to investors  
11 that the loan would have a loan to value ratio as low as 16.63%. However, the \$33 million value  
12 was based upon the “going concern” value of an operating business, with a number of  
13 assumptions about how the business would be conducted, assuming it ever was able to be  
14 conducted. Respondents have each failed to fully disclose the assumptions underlying such  
15 valuation.

16 Respondents have each failed to provide an appraisal for the “as is” value of the land  
17 securing the participation interest investments, although Respondents did include printouts from  
18 the Snohomish County Assessor’s Office which show that the combined “market value” of the  
19 four parcels is less than \$168,000.

20 **VI. LOAN STATUS**

21 When offering and selling the Granite Northwest L.L.C. participation interests,  
22 Respondents have each represented that CLS made a \$5 million loan to Granite Northwest  
23 L.L.C. However, Respondents have each failed to disclose that CLS did not fully fund its loan to

1 Granite Northwest. Respondents have each failed to disclose the amount of the loan proceeds  
2 received by Granite Northwest L.L.C. and how the proceeds have been and are being used.

### 3 **VII. ESCROW ACCOUNT**

4 When offering and selling the Granite Northwest L.L.C. participation interests,  
5 Respondents did not require participation interest investors to make their investment checks  
6 payable to an independent escrow account. Instead, they directed investors to make their checks  
7 payable to CLS. Respondents each failed to deposit investor funds in an independent escrow  
8 account within 48 hours of receipt as required by WAC 460-33A-055.

### 9 **VIII. PRE-SIGNED REQUEST FOR FULL RECONVEYANCE**

10 When selling the Granite Northwest L.L.C. participation interests, CLS Financial  
11 Services, LLC has recommended that investors give CLS a pre-signed request for a full  
12 reconveyance of the deed of trust securing their investment. CLS has represented that the  
13 reconveyance would be forwarded to the offices of an “independent” CPA until CLS provides  
14 proof that the investment “has been satisfied.” The CLS registration statement is incomplete in a  
15 material respect for failing to specifically disclose the name, terms and relationship of the CPA  
16 providing this service to CLS.

### 17 **IX. OUTSTANDING DEBENTURES**

18 On March 1, 1999, the Securities Division entered into a Consent Order with CLS  
19 Financial Services, Inc., a predecessor to CLS, and Gerald Clark Vanhook. The Consent Order  
20 revoked CLS Financial Services, Inc.’s permit to offer and sell debentures as a debenture  
21 company under the definition in RCW 21.20.705 and required continuing compliance with  
22 debenture company provisions of the Securities Act of Washington.

1 The CLS audited financial statements show that on December 31, 2001, CLS Financial  
2 Services, Inc. owed more than \$4.7 million to its debenture holders. When CLS Financial  
3 Services, Inc. was merged into CLS Financial Services, LLC, the debenture holders had a choice  
4 between converting their debentures into membership interests in the LLC or holding their  
5 debentures. At the present time, CLS continues to owe more than \$700,000 to debenture  
6 holders. In October 2003, the Securities Division received complaints from two CLS debenture  
7 holders that their debentures, totaling more than \$120,000, were not paid when due.

#### 8 **X. CLS REAL ESTATE SECURED NOTES**

9 From March 1, 1999 until the present, CLS has offered and sold to Washington investors  
10 notes issued by CLS and purportedly secured by real property. These notes total more than  
11 \$260,000. The proceeds from the sale of the notes have been used as capital or operating funds  
12 by CLS and CLS has engaged in the business of investing, reinvesting, owning, holding or  
13 trading in notes and real or personal property.

#### 14 **XI. MISREPRESENTATION CONCERNING A SECURED NOTE**

15 In at least one case, CLS has misrepresented the position of a deed of trust purportedly  
16 securing a CLS note to a Washington investor. During 2002, CLS issued and offered and sold a  
17 note that it represented would be secured by a second position deed of trust against real property.  
18 However, the investor received a third position deed of trust to secure the investment. Neither  
19 CLS nor Vanhook disclosed that the investor would be given a third position deed of trust, rather  
20 than a second position deed of trust, to secure the investment. Also, less than two weeks prior to  
21 that sale, CLS issued and sold to another investor a note that CLS represented would be secured  
22 by a deed of trust against the same real property.

1 **XII. UNREGISTERED NOTES**

2 The offering of CLS real estate secured notes described in paragraph X and XI of these  
3 Tentative Findings of Fact were never registered under the Securities Act of Washington for sale  
4 in the State of Washington. During its 2003 examination of CLS, the Securities Division  
5 obtained information that CLS had offered and sold its real estate secured notes other than as  
6 “units,” as required by RCW 21.20.320(5).

7 **XIII. DEBENTURE COMPANY VIOLATIONS**

8 From March 1, 1999 until the present time, CLS has continued to offer and sell notes, to have  
9 notes and debentures outstanding and to do business as a debenture company, as defined in RCW  
10 21.20.705. However, CLS has failed to meet statutory liquidity and diversification requirements  
11 for debenture companies.

12 During its 2003 examination of CLS, the Securities Division determined that CLS violated  
13 RCW 21.20.710(1)(c), which requires a debenture company to maintain cash or comparable  
14 liquid assets equal to at least 50% of its required net worth. Based on its compiled financial  
15 statements, as of June 30, 2003, CLS was required to have cash or comparable liquid assets of  
16 approximately \$470,000, yet CLS only had approximately \$145,000 in cash or comparable liquid  
17 assets, as defined by WAC 460-64A-010. Therefore, CLS had a liquidity deficiency of  
18 approximately \$325,000.

19 During its 2003 examination of CLS, the Securities Division also determined that CLS  
20 violated RCW 21.20.820(1), which states that a debenture company shall not loan to any one  
21 borrower more than 2½% of the debenture company’s assets without the prior written consent of  
22 the Director of the Department of Financial Institutions, which was never given to CLS.

23 According to its compiled financial statements, as of June 30, 2003, CLS had total assets of

1 \$20,771,579. However, CLS had outstanding, unsecured loans to Puget Sound Investment  
2 Group, Inc. and other affiliates totaling \$11,787,390, or 56.7% of its assets. CLS had at least \$3  
3 million worth of outstanding, unsecured loans to Puget Sound Investment Group, Inc. CLS also  
4 had outstanding, unsecured loans to Granite Northwest, LLC totaling \$5,487,749, or 26.4% of its  
5 assets.

#### 6 **XIV. PSIG RECEIVERSHIP**

7 Puget Sound Investment Group, Inc. (“PSIG”), an affiliate of CLS, is subject to a pending  
8 receivership. Gerald Clark Vanhook is a 50% shareholder in PSIG. The other 50% PSIG  
9 shareholder, Melvin Johnson, alleges that Vanhook has improperly transferred PSIG assets to  
10 CLS and other affiliates. However, it appears that PSIG assets were purchased with funds from  
11 CLS.

#### 12 **XV. THREAT TO THE INVESTING PUBLIC**

13 The Securities Administrator finds that the continued offering of Granite Northwest  
14 L.L.C. participation interests and the continued offering of CLS real estate secured notes in the  
15 manner described above presents a threat to the investing public.

16 Based upon the Tentative Findings of Fact, the following Conclusions of Law are made:

#### 17 **CONCLUSIONS OF LAW**

##### 18 **I.**

19 The offer or sale of Granite Northwest L.L.C. participation interests and the offer and  
20 sale of the notes and debentures described above constitutes the offer or sale of a security as  
21 defined in RCW 21.20.005(10) and (12), whether in the form of notes, debentures, evidences of  
22 indebtedness or investment contracts.



1 II.

2 As set forth above, the CLS Financial Services, LLC registration statement comprising  
3 the specific offering circular and other registration materials are in violation of RCW  
4 21.20.280(1) because they are incomplete in material respects and contain statements that are  
5 false and misleading with respect to material facts.

6 III.

7 As set forth in Tentative Findings of Fact XII, CLS Financial Services, LLC has violated  
8 RCW 21.20.140 because no registration for the offering of CLS real estate secured notes is on  
9 file with the Washington Securities Administrator.

10 IV.

11 As set forth above in Tentative Findings of Fact II through VIII and Tentative Finding of  
12 Fact XI, when offering and selling Granite Northwest L.L.C. participation interests and when  
13 offering and selling CLS real estate secured notes, Respondents have each violated RCW  
14 21.20.010 by making untrue statements of material fact or omitting to state material facts  
15 necessary in order to make the statements made not misleading.

16 V.

17 As set forth in Tentative Findings of Fact V, CLS Financial Services, LLC has violated  
18 RCW 21.20.280(2) and WAC 460-33A-105 by failing to give investors an “as is” real estate  
19 appraisal for property securing a mortgage paper security.

20 VI.

21 As set forth in Tentative Findings of Fact VII, CLS Financial Services, LLC has violated  
22 RCW 21.20.280(2) and WAC 460-33A-055 by accepting checks that are not made payable to an  
23

1 independent escrow account and by depositing investor checks to a CLS operating account,  
2 instead of depositing them with an independent escrow account.

3 VII.

4 As set forth in Tentative Findings of Fact IX and X, CLS Financial Services, LLC is a  
5 “debenture company” as defined by RCW 21.20.705(1).

6 VIII.

7 As set forth in Tentative Findings of Fact XIII, CLS Financial Services, LLC has  
8 violated RCW 21.20.710(1)(c) by failing to maintain cash or comparable liquid assets of at  
9 least 50% of its required net worth.

10 IX.

11 As set forth in Tentative Findings of Fact XIII, CLS Financial Services, LLC has  
12 violated RCW 21.20.820(1) by lending to one borrower more than 2½% of the debenture  
13 company’s assets without the prior written consent of the Director of the Department of  
14 Financial Institutions.

15 X.

16 The Securities Administrator finds and concludes that an emergency exists, that the  
17 continued violations of RCW 21.20.010, RCW 21.20.140 and RCW 21.20.280 and the continued  
18 availability of exemptions to CLS and its affiliates without conditions under RCW 21.20.320(1),  
19 (5), (9), (11) and (17) constitute a threat to the investing public, and that a summary order  
20 suspending securities registration, revoking exemptions and ordering Respondents to cease and  
21 desist from securities violations is in the public interest and necessary for the protection of the  
22 investing public.

1 **SUMMARY ORDER**

2 Based on the foregoing, NOW, THEREFORE, IT IS HEREBY SUMMARILY  
3 ORDERED that the mortgage paper securities permit (file #70011068) for CLS Financial  
4 Services, LLC is suspended.

5 It is further SUMMARILY ORDERED that CLS Financial Services, LLC shall  
6 immediately give notice of the suspension of its mortgage paper securities permit to all of its  
7 affiliates, employees and registered securities salespersons.

8 It is further SUMMARILY ORDERED that the availability of exemptions pursuant to  
9 RCW 21.20.320(1), (5), (9), (11) and (17) for CLS Financial Services, LLC and its affiliates is  
10 hereby conditioned and will require a filing of the offering circular and appropriate notice of any  
11 claim of exemption with the Securities Division at least 30 days prior to the offer or sale of any  
12 such securities.

13 It is further SUMMARILY ORDERED that CLS Financial Services, LLC and Gerald  
14 Clark Vanhook shall each give immediate notice of the conditioning of exemptions from  
15 registration pursuant to RCW 21.20.320(1), (5), (9), (11) and (17) to all affiliates of CLS  
16 Financial Services, LLC.

17 It is further SUMMARILY ORDERED that CLS Financial Services, LLC and Gerald  
18 Clark Vanhook and their affiliates, agents and employees shall each cease and desist from  
19 offering or selling securities in any manner in violation of RCW 21.20.010, the anti-fraud section  
20 of the Securities Act of Washington.

21 **NOTICE OF INTENTION TO ENTER A CEASE AND DESIST ORDER**

22 Based on the above Tentative Findings of Fact and Conclusions of Law, the Securities  
23 Administrator intends to enter a cease and desist order against Respondents for violations of the

24 STATEMENT OF CHARGES, STOP ORDER,  
SUMMARY CEASE AND DESIST ORDER and ORDER 11  
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1 registration and debenture company provisions of the Securities Act of Washington. Upon  
2 request by Respondents, the Office of Administrative Hearings shall set a time and place at  
3 which a hearing will be held to determine whether the order to cease and desist should be entered  
4 against Respondents.

### 5 **AUTHORITY AND PROCEDURE**

6 This Amended Statement of Charges; Stop Order Suspending the Permit for the Sale of  
7 Mortgage Paper Securities by CLS Financial Services, LLC; Summary Order to Cease and  
8 Desist; and Order Conditioning Securities Registration Exemptions is entered pursuant to the  
9 provisions of RCW 21.20.280, RCW 21.20.325, RCW 21.20.732 and RCW 21.20.390 and is  
10 subject to the provisions of Chapter 21.20 RCW and Chapter 34.05 RCW. The Respondents,  
11 CLS Financial Services, LLC and its affiliates and Gerald Clark Vanhook, may each make a  
12 written request for a hearing as set forth in the NOTICE OF OPPORTUNITY TO DEFEND  
13 AND OPPORTUNITY FOR HEARING accompanying this amended statement of charges and  
14 orders.

15 If CLS Financial Services, LLC fails to make a timely hearing request, the Securities  
16 Administrator intends to adopt the above Tentative Findings of Fact and Conclusions of Law as  
17 final and enter against CLS a Stop Order Revoking Effectiveness of Its Permit for the Sale of  
18 Mortgage Paper Securities, an Order Conditioning Securities Registration Exemptions, and a  
19 Final Order to Cease and Desist, including provisions to cease and desist from violating RCW  
20 21.20.140, the securities registration section of the Securities Act of Washington, provisions to  
21 cease and desist from violating RCW 21.20.010, the anti-fraud section of the Securities Act of  
22 Washington, and provisions to cease and desist from violating RCW 21.20.710(1) and RCW  
23 21.20.820(1), debenture company requirements for liquidity and diversification.

1 If Gerald Clark Vanhook fails to make a timely hearing request, the Securities  
2 Administrator intends to adopt the above Tentative Findings of Fact and Conclusions of Law as  
3 final and enter against Vanhook an Order Conditioning Securities Registration Exemptions and a  
4 Final Order to Cease and Desist, including provisions to cease and desist from violating RCW  
5 21.20.140, the securities registration section of the Securities Act of Washington, and provisions  
6 to cease and desist from violating RCW 21.20.010, the anti-fraud section of the Securities Act of  
7 Washington.

8 **CONTINUING INVESTIGATION**

9 The Securities Division is continuing to investigate whether there have been any  
10 additional violations of the Securities Act of Washington by CLS Financial Services, LLC,  
11 Gerald Clark Vanhook and any of their affiliates, employees or agents.

12 WILLFUL VIOLATION OF THIS ORDER IS A CRIMINAL OFFENSE.

13 Dated this 6<sup>th</sup> day of November, 2003

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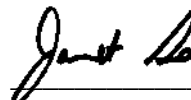
16 Deborah R. Bortner  
17 Securities Administrator

18  
19 Approved by:

20 

21 Michael E. Stevenson  
22 Chief of Enforcement

Presented by:

23 

24 Janet So  
Financial Legal Examiner