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U.S. DISTRICT COURT  
NORTHERN DIST. OF TEX.  
FORT WORTH DIVISION

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CLERK OF COURT

IN THE UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF TEXAS  
FORT WORTH DIVISION

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SECURITIES AND EXCHANGE COMMISSION :  
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 :  
 Plaintiff, :  
 vs. :  
 :  
 G. MATTHIAS HEINZELMANN, III :  
 :  
 Defendant. :  
\_\_\_\_\_

Case No.  
**402 - CV - 0403 - A**

**COMPLAINT**

Plaintiff Securities and Exchange Commission alleges:

**SUMMARY**

1. This case involves a financial fraud perpetrated by G. Matthias Heinzelmann, III ("Heinzelmann" or the "Defendant") while president and a director of Surety Capital Corporation ("Surety Capital" or the "Company"), a Fort Worth based reporting company whose sole asset is its wholly-owned subsidiary, Surety Bank, N.A., ("Surety Bank" or the "Bank"). Surety Capital's stock was publicly traded on the American Stock Exchange during the relevant period, and is currently quoted on the National Quotation Service's Pink Sheets.

2. Beginning in 1996, and continuing through 1999, Heinzelmann diverted refunds due to customers of the Bank's Insurance Premium Finance Division ("IPF) and used the funds to eliminate delinquent balances in other customers' accounts. His diversion of refunds created the appearance that past due loans had been paid off, and

therefore prevented the loans from being charged off and deducted from the Bank's bad loan loss allowance as required.

3. As a result of these false valuations, the Company overstated its pre-tax income by 7% in 1996, and understated its pre-tax losses by 16% in 1997 and 97% in 1998 in the company's periodic reports, *i.e.*, its Form 10-Qs and 10-Ks, filed with the Commission. Also as a result of Heinzelmann's scheme, the Company failed to file its Form 10-Q for the period ending September 30, 1999.

4. By engaging in this conduct, the Defendant directly or indirectly violated or aided and abetted violations of, and unless restrained will violate or aid and abet violations of, the antifraud, reporting and issuer books and records provisions of the federal securities laws, specifically, Sections 10(b), 13(a), 13(b)(5), 13(b)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934 (the "Exchange Act"), [15 U.S.C. §§78j(b), 78(m)(a), 78(m)(b)(5), 78(m)(b)(2)(A) and 78(m)(b)(2)(B)], and Rules 10b-5, 13a-1, 13a-13, 12b-20, 13b2-1 and 13b2-2 [17 C.F.R. §240.10b-5, 240.13a-1, 240.13a-13, 240.12b-20, 240.13b2-1 and 240.13b2-2] promulgated thereunder.

### **JURISDICTION**

5. This Court has jurisdiction of this action pursuant to Section 27 of the Exchange Act [15 U.S.C. §78aa], and 28 U.S.C. §1331.

6. The Commission brings this action pursuant to authority conferred upon it by Section 21(d)(1) of the Exchange Act [15 U.S.C. §78u(d)(1)].

7. The Defendant, directly or indirectly, has made use of the means and instrumentalities of interstate commerce, or of the mails, or of the facilities of a national securities exchange in connection with the acts, practices, and courses of business alleged

herein. Much of Defendant Heinzelmann's conduct described herein, took place in the Northern District of Texas.

### **DEFENDANT**

8. **G. Matthias Heinzelmann, III**, 38, of Fort Worth, Texas, was the president and a director of Surety Capital. Heinzelmann also was executive vice president and a director of Surety Bank, and manager of Surety Bank's IPF division. During the relevant period Heinzelmann controlled virtually every aspect of Surety Bank's IPF division.

### **OTHER ENTITY**

9. **Surety Capital Corporation** is a bank holding company whose securities are registered with the Commission pursuant to section 12(g) of the Exchange Act. The Company's only business activity is the operation of its one subsidiary -- Surety Bank.

### **THE FRAUDULENT SCHEME**

#### **Heinzelmann's Scheme to Hide Loan Losses**

10. Surety Bank conducts business from its main office in Fort Worth, and six branches located throughout Texas. The Bank provides customary retail and commercial banking services, and specialized in premium finance lending to businesses and individuals who were unable to pay their insurance policy premiums up-front. The Bank generally financed 75% of the premium, requiring the loan customer to pay the remainder as a down payment. When a policy was cancelled prior to the end of the coverage term, the insurer refunded the unearned premium less any cancellation fees. The Bank held a security interest in the unearned premium for all premium finance loans. Accordingly, when a policy was cancelled, the insurer remitted the entire unearned premium to the

Bank. Upon receipt, the Bank was to use the funds to pay off the loan balance and then refund any remaining funds to the borrower.

11. From 1996 through September 1999, Defendant Heinzelmänn single-handedly carried out an elaborate scheme to hide loan losses in Surety Bank's IPF division. During this period, Heinzelmänn caused the diversion of premium refunds owed to 2,398 IPF loan customers, in the total amount of \$1,827,392. The Company subsequently reversed the diversions and recognized losses, including interest and misclassified expenses, totaling \$2,780,000.

12. Defendant Heinzelmänn diverted the premium refunds, to protect his own stature within the Company by concealing bad loan losses within his division. Most IPF customers entitled to premium refunds were unaware of their entitlement, and did not, therefore, detect their losses. Those who made inquiry were directed to Heinzelmänn and were provided a refund.

13. Defendant Heinzelmänn physically intercepted premium refund checks that had been generated but not yet mailed to facilitate his diversion scheme. In addition, he created false journal entries that consisted of miscellaneous debits, balance transfers and credit reversals. To avoid detection, Defendant Heinzelmänn instructed the Bank's computer consultant to write a program that would "consolidate" accounts, i.e. combine into a single debit and credit multiple debits and credits within an account. This allowed Heinzelmänn to execute adjustments on a batch, or volume, basis. In addition, the program so completely altered the books, records and accounts of the Bank that the adjustments appeared as original transactions, and no trace of the original entries remained in the Company's general ledger.

14. Defendant Heinzelmann, as Surety Capital's president, had a significant role in fulfilling Surety Capital's reporting obligations to the Commission and the Company's shareholders during the relevant period. In addition, Defendant Heinzelmann had a significant role in the preparation and filing of all of Surety Capital's 10-Ks and 10-Qs.

**Effect of Heinzelmann's Scheme on Surety Capital's Financial Statements**

15. As a result of Heinzelmann's scheme, Surety Capital included false and misleading financial information in 14 periodic reports filed with the Commission between 1996 and 1999. Specifically, Heinzelmann's scheme caused Surety Capital to overstate its pre-tax income by 7% in 1996, and understate its pre-tax losses by 16% in 1997 and 97% in 1998. Further, Surety Capital failed to file its Form 10-Q for the period ending September 30, 1999.

16. Subsequent to the uncovering of Heinzelmann's scheme and his termination, Surety Capital restated its financial statements for 1997 and 1998 in its Form 10-K for 1999. The restatement demonstrated that Surety Capital's understated loan losses had a material impact on the Company's financial statements filed with the Commission. These financial statements, however, are not audited because the Company has been unable to secure a qualified, independent audit firm willing to provide an audit opinion for these periods.

17. The following chart shows the effect of misstatements (overstatement of income in 1996 and undersatement of loss in 1997 and 1998) on the Company's periodic reports in 1996 through 1998:

Filing	Reported Income/(Loss)	Diverted Refunds	Overstatement/Understatement
1996 10 K	\$2,636,115	\$180,000	7%
1997 10 K	(\$5,276,374)	\$837,000	16%
1998 10 K	(\$1,295,356)	\$1,261,000	97%

## CAUSES OF ACTION

### FIRST CLAIM

#### Violations of Section 10(b) of the Exchange Act and Rule 10-5 Thereunder

18. The Commission repeats and realleges paragraphs 1 through 17 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

19. Defendant Heinzelmann, in connection with the purchase and sale of securities, by use of the means and instrumentalities of interstate commerce and by use of the mails has: (a) employed devices, schemes and artifices to defraud; (b) made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (c) engaged in acts, practices and courses of business which operate as a fraud and deceit upon purchasers, prospective purchasers and other persons.

20. As a part of and in furtherance of his scheme, Defendant Heinzelmann caused Surety Capital to misstate its loan losses and therefore materially misstate its financial condition in its periodic reports filed with the Commission for fiscal years 1996 through 1999. In his capacities as Surety Capital's president and a member of the board, Heinzelmann was directly responsible for the filing of the false and misleading reports with the Commission.

21. Defendant Heinzelmann made the above-referenced misrepresentations and omissions knowingly or recklessly disregarding the truth.

22. By reason of the foregoing, Defendant Heinzelmann violated and, unless enjoined, will continue to violate the provisions of Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 thereunder [17 C.F.R. §240.10b-5].

### **SECOND CLAIM**

#### **Violations of Section 13(a) of the Exchange Act [15 U.S.C. §78m(a)], And Rules 13a-1, 13a-13 and 12b-20, Thereunder**

23. The Commission repeats and realleges paragraphs 1 through 17 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

24. Defendant Heinzelmann aided and abetted Surety Capital's violations of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20 thereunder by causing Surety Capital to file with the SEC materially false financial statements in periodic reports on Forms 10-K and 10-Q, as set forth above.

25. By reason of his foregoing acts and practices, Defendant Heinzelmann aided and abetted Surety Capital's violations and, unless enjoined, will continue to aid and abet violations of Section 13(a) of the Exchange Act [15 U.S.C. §78m(a)] and Rules 13a-1, 13a-13, and 12b-20 thereunder [17 C.F.R. §§240.13a-1, 240.13a-13 and 240.12b-20].

### **THIRD CLAIM**

#### **Violations of Section 13(b)(5) of the Exchange Act [15 U.S.C. §78(b)(5)], and Rules 13b2-1 Thereunder**

26. The Commission repeats and realleges paragraphs 1 through 17 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

27. Defendant Heinzelmann violated Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder, by diverting premium refunds owed to Bank customers to illegally reduce Surety Capital's loan loss expenses, and thereby causing Surety Capital to understate loan loss expenses and other liabilities and overstate income on its books and records, as set forth above.

28. By reason of his foregoing acts and practices, Defendant Heinzelmann violated and, unless enjoined, will continue to violate Section 13(b)(5) of the Exchange Act [15 U.S.C. §78(m)(b)(5)] and Rules 13b2-1 [17 C.F.R. §240.13b2-1] promulgated thereunder.

#### **FOURTH CLAIM**

##### **Violations of Section 13(b)(5) of the Exchange Act and Rule 13b2-2 Thereunder**

29. The Commission repeats and realleges paragraphs 1 through 17 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

30. Defendant Heinzelmann, while serving as an officer and director of Surety Capital, omitted to state material facts, necessary in order to make statements made, in light of the circumstances under which they were made, not misleading to accountants in connection with an audit required under the Exchange Act. That is, in connection with Surety Capital's audits from 1996 through 1999, Defendant Heinzelmann failed to disclose to auditors his on-going scheme to underreport loan losses, and failed to inform auditors of the diverted premium refunds owed to customers.

31. Defendant Heinzelmann, while serving as an officer and director of Surety Capital, made false and misleading statements to accountants in connection with an audit required under the Exchange Act. That is, the Defendant signed and delivered



management letters to Surety Capital's accountants falsely affirming that Surety Capital had disclosed all material transactions and financial records to its auditors. Moreover, Heinzelmann knowingly presented financial statements to its auditors that understated Surety Capital's bad loan losses.

32. By reason of the foregoing, Defendant Heinzelmann has violated and, unless enjoined, will continue to violate Section 13(b)(5) of the Exchange Act [15 U.S.C. §78m(b)(2)(5)] and Rule 13b2-2 thereunder. [17 C.F.R. §§240.13b2-1 and 240.13b2-2].

#### **FIFTH CLAIM**

##### **Aiding and Abetting Violations of Sections 13(b)(2)(A) and 13 (b)(2)(B) of the Exchange Act [15 U.S.C. §§78 (b)(2)(A) and (B)]**

33. The Commission repeats and realleges paragraphs 1 through 17 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

34. Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, commonly referred to as the "books and records" and "internal controls" provisions, respectively, of the Foreign Corrupt Practices Act, require generally that issuers with a class of securities registered pursuant to Section 12 of the Exchange Act ("Section 12 issuers") make and keep books, records and accounts, which, in reasonable detail, accurately and fairly reflect their transaction and disposition of assets, and devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: transactions are executed in accordance with management's general or specific authorization; transactions are recorded as necessary to permit preparation of financial statements in conformity with general accepted accounting principles or any other criteria applicable to such statements and to maintain accountability for assets; access to assets is permitted only in accordance with management's general or specific authorization; and the

recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. Section 12 issuers are also responsible for ensuring that their wholly-owned subsidiaries comply with Sections 13(b)(2)(A) and 13(b)(2)(B).

35. Defendant Heinzelmann aided and abetted Surety Capital's violations of Section 13(b)(2)(A) of the Exchange Act, by directly or indirectly causing Surety Capital to falsify its books, records and accounts, as set forth above.

36. Defendant Heinzelmann aided and abetted Surety Capital's violations of Section 13(b)(2)(B) of the Exchange Act. Through his position as Surety Capital's president and through his operational control of the Bank's IPF Division, Heinzelmann prevented Surety Capital from devising and maintaining a system of internal accounting controls of the type described in paragraph 34, above

37. By reason of his foregoing acts and practices, Defendant Heinzelmann aided and abetted Surety Capital's violations and, unless enjoined, will continue to aid and abet violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§78m(b)(2)(A) and 78m(b)(2)(B)].

#### **PRAYER FOR RELIEF**

WHEREFORE, the Commission respectfully requests that this Court issue Orders:

#### I.

Permanently enjoining Defendant Heinzelmann and his officers, agents, servants, employees, attorneys, and those persons in active concert or participation with him who receive actual notice by personal service or otherwise, from violating, directly or

indirectly, Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)], and Rule 10b-5 thereunder [17 C.F.R. §240.10b-5].

II.

Permanently enjoining Defendant Heinzelmann and his officers, agents, servants, employees, attorneys, and those persons in active concert or participation with him who receive actual notice by personal service or otherwise, from violating, directly or indirectly, Section 13(a) of the Exchange Act [15 U.S.C. §78m(a)] and Rules 13a-1, 13a-13, and 12b-20 thereunder [17 C.F.R. §§240.13a-1, 240.13a-13 and 240.12b-20].

III.

Permanently enjoining Defendant Heinzelmann and his officers, agents, servants, employees, attorneys, and those persons in active concert or participation with him who receive actual notice by personal service or otherwise, from violating, directly or indirectly, Section 13(b)(5) of the Exchange Act [15 U.S.C. §§78m(b)(5)], and Rules 13b2-1 and 13b2-2, thereunder [17 C.F.R. §§240.13b2-1 and 240.13b2-2].

IV.

Permanently enjoining Defendant Heinzelmann and his officers, agents, servants, employees, attorneys, and those persons in active concert or participation with him who receive actual notice by personal service or otherwise, from violating, directly or indirectly, or aiding and abetting violations of Sections 13(b)(2)(A) and (B) of the Exchange Act [15 U.S.C. §§78m(b)(2)(A) and (B)].

V.

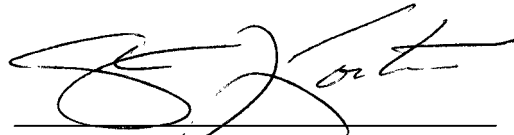
Enter an order requiring Defendant Heinzelmann to pay a civil penalty, pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. §78u(d)(3)], as a result of his violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and for aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder, in an amount to be determined by the Court.

VI.

Enter an order barring Defendant Heinzelmann from acting as an officer or director of any issuer required to file reports pursuant to Sections 12(b), 12(g) or 15(d) of the Exchange Act, pursuant to Section 21(d)(2) of the Exchange Act [15 U.S.C. § 78u(d)(2)].

VII.

Granting such other relief as this Court may deem just and proper.



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