UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8756 / November 21, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54806 / November 21, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12484

In the Matter of **BEAR, STEARNS & CO. INC.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission (the "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 Bear, Stearns & Co. Inc. ("Bear Stearns," the "Firm," 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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934, as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. Respondent

Respondent Bear Stearns, a subsidiary of The Bear Stearns Companies Inc., is a worldwide investment bank and broker-dealer with its principal place of business in New York. In addition to its institutional sales force, Bear Stearns employs salespersons in its Private Client Services division ("PCS") who service individual and small institutional accounts. Bear Stearns is registered as a broker-dealer with the Commission pursuant to Section 15(b) of the Exchange Act and is a member of the NASD and the New York Stock Exchange ("NYSE").

B. Summary

In 2002 and 2003, Bear Stearns violated Section 5 of the Securities Act when five of its salespersons sent customers unauthorized e-mails and faxes that contained sales materials concerning securities offerings during the period after a registration statement had been filed, but before the Commission had declared the registration statement effective ("quiet period"). At the time of this conduct, the securities laws prohibited issuers and their underwriters from making written offers of securities during quiet periods in a form other than the prospectus.[1] In all, the five Bear Stearns salespersons collectively sent approximately ninety e-mails and faxes in violation of Section 5 of the Securities Act.

Bear Stearns also failed reasonably to supervise its employees with a view to preventing and detecting these violations. While Bear Stearns had policies in place during the relevant period requiring pre-approval and post-transmission review of electronic communications, the Firm failed to effectively implement these policies. None of the violative e-mails discussed below was reviewed by a supervisor before being sent to customers. Further, Bear Stearns' policy of reviewing e-mail after transmission, which called for the review of all outgoing e-mail, could not reasonably have been expected to detect or prevent the violative communications, given the volume of e-mails requiring review. Consequently, Bear Stearns failed to prevent or detect most of the violative e-mails discussed below at the time they were transmitted, including dozens of e-mails that described offerings as attractive investment opportunities, without identifying any risk factors, and e-mails that attached "internal use only" sales memoranda. Through its failure to effectively implement its own policies and procedures, Bear Stearns did not reasonably supervise its employees with a view to preventing and detecting its salespersons' Section 5 violations described herein.

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[1] In 2005, the Commission adopted new rules under the Securities Offering Reform. *See Securities Offering Reform*, Securities Act Release No. 8591 (June 29, 2005).

C. Facts

1. Background: Bear Stearns' Policies and Procedures Regarding Its Review of Employees' Outgoing E-mails

During 2002 and 2003 (the "relevant period"), Bear Stearns' firm-wide policies and procedures required that "ALL outgoing correspondence, including letter[s], memos and handwritten notes, must be approved in advance of sending" by branch management. (Emphasis in original.) The pre-approval policy expressly applied to outgoing e-mail and transmissions via facsimile.

Firm policies, repeated in PCS branch management supervisory guides, stated that "all" outgoing correspondence must be approved by branch management "prior to sending." In particular, the management guides noted that written communications regarding securities subject to pending distributions "are not permitted" unless prepared by the Syndicate Department for external distribution, and that correspondence regarding securities sold by prospectus "may be subject to specific requirements and disclosures prior to sending."

Pursuant to these policies, Bear Stearns salespersons were prohibited from mailing any hard-copy correspondence, regardless of subject matter, without management pre-approval. With respect to electronic communications, however, Bear Stearns did not screen all e-mails prior to transmission in order to prevent unauthorized business-related correspondence. Instead, Bear Stearns provided training on the types of external e-mail that required approval, and relied upon its sales force to seek approvals when necessary.[2] Bear Stearns relied on its policies and training its staff regarding those policies, and did not evaluate the efficacy of those policies and procedures even after a December 2002 incident in Bear Stearns' San Francisco office called into question the reliability of that system.

Bear Stearns policies and procedures governing PCS branch management also provided for the review of salespersons' e-mails after they were disseminated.[3] The policies stated that "[a]ll outgoing electronic mail (e-mail) will be forwarded to the designated reviewer on the day it is transmitted," and that "such e-mail will be monitored . . . ." Pursuant to these policies, any outgoing e-mail sent by PCS salespersons during the relevant period was simultaneously copied and sent to e-mail boxes in the compliance

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[2] NASD Rule 3010(d)(2) and NYSE Rule 342, in effect during the period in question, provided guidance for broker-dealers concerning compliance with the law and rules governing supervision and review of public communications. With respect to incoming and outgoing correspondence and e-mail, a broker-dealer, such as Bear Stearns, must either: (1) have a "pre-use" policy whereby public communications, such as e-mails, are reviewed before being sent to clients; or (2) sufficiently educate its employees about the Firm's communications policies and procedures, document the employees' education and training, and ensure that the Firm's policies are implemented and followed. See SEC Release Nos. 39510, 39511 (Dec. 31, 1997).

[3] Although such after-the-fact review would not, of course, have prevented an initial violation, properly implemented it could have aided in the prevention of subsequent violations.

department. At times, total PCS e-mails sent on a daily basis numbered in the thousands. Faxes sent using Bear Stearns' computers were also forwarded to compliance office computers for review. Employees in the compliance offices, in turn, were responsible for reviewing all external e-mail and faxes sent by PCS salespersons.[4]

In practice, however, because of the large amounts of e-mail to be reviewed, and because Bear Stearns devoted limited resources to this task, supervisors and compliance officers did not always actually review the entire contents of all e-mails. Instead, they typically reviewed e-mail by using an "auto-preview" feature that enabled the reviewers to limit their review to the first few lines of any e-mail. Despite the large volume of outgoing e-mail, Bear Stearns did not revise its procedures, add staff, or otherwise enhance its systems to adequately review that volume of e-mail.

2. Bear Stearns Discovered Certain Violative E-Mails Shortly After They Were Transmitted

In late December 2002, two salespersons in Bear Stearns' San Francisco office sent e-mails to customers about an upcoming mutual fund offering that included sales information not contained in the prospectus. One person's e-mails attached excerpts from an investor's guide on the offering, while the second individual's e-mails included a list of "reasons" why the salesperson considered the fund an "investment worthy of consideration." Bear Stearns detected these e-mails shortly after they were disseminated and soon thereafter terminated the salespersons' employment, but took no additional action.

Nearly one year later, in late November 2003, during the course of a review of sent e-mail, Bear Stearns compliance personnel discovered that, earlier that month, three PCS salespersons in the New York office had sent a number of e-mails to customers about two upcoming initial public offerings ("IPOs") during their respective quiet periods. The e-mails contained sales information other than the statutory prospectus.

- One salesperson sent e-mails to twenty-one individuals at thirteen hedge-funds concerning the upcoming IPOs of two different issuers, one a software company and the other an information technology company, saying "both deals are going to be good." The e-mails attached six pages from the preliminary prospectus for the information technology company that described the IPO's terms and a general overview of that issuer's business and industry, but failed to describe any risk factors. The e-mails also attached an internal Bear Stearns sales force memorandum for the software company's IPO that included "key selling points," among other things, but only a partial list of risk factors. The memorandum was clearly marked "confidential" and "internal

[4] Additionally, Bear Stearns policies limited communications during the offering period and provided that the only written material to be used to solicit indications of interest during an offering was the preliminary prospectus. Salespersons forwarding a preliminary prospectus to a client were instructed to make no comment on the securities other than to provide the expected offering date. Salespersons were provided training on these policies at the time they were hired, and periodically thereafter.

use only," and specifically said in highlighted portions on every page that it was for use "only" by Bear Stearns salespersons and that "receipt of or access to these materials by any other person is prohibited."

- A second salesperson in the New York office e-mailed the internal sales force memorandum for the software company to a prospective investor.

- A third salesperson in the same office sent an e-mail that identified the Bear Stearns analyst who would cover the software company following its IPO, and quoted the analyst's purported revenue and earnings estimates for 2003 and 2004.

Upon discovering these communications, Bear Stearns notified both issuers, and informed the individuals who received the e-mails that they would be precluded from participating in the IPOs. Bear Stearns also notified the Commission staff. Both issuers filed amendments to their registration statements that disclosed the e-mails as risk factors.

On December 1, 2003, Bear Stearns' compliance staff discovered that a fourth PCS salesperson, located in the Firm's San Francisco office, had sent e-mails to at least four customers about two upcoming notes issued and underwritten by Bear Stearns. The e-mails included personal messages in which the salesperson described the notes as an attractive investment opportunity. For example, the individual informed one customer in writing that the notes were "designed to meet the conservative but bullish stance of many of our clients," and had been "very well received by those looking to protect their investment fully but understand the need for participation" in the Nasdaq 100. Another e-mail advised a customer that the offering was "very attractive in the current tax environment."

3. Subsequent Investigations Revealed That Bear Stearns Had Failed to Discover Other E-Mails Sent During Quiet Periods

Following Bear Stearns' disclosure to the Commission staff concerning the e-mails, both the staff and Bear Stearns commenced investigations that ultimately revealed that these same four salespersons, and at least one additional representative in Bear Stearns' Boston office, collectively had sent dozens of additional e-mails and faxes in 2002-03 concerning certain offerings during their respective quiet periods. Despite policies and procedures that required Bear Stearns supervisors and compliance personnel to review all external communications both before and after dissemination, Bear Stearns had failed to detect all but one of these earlier violative e-mails. They included the following:

- The salesperson in the San Francisco office had sent approximately thirty-six e-mails to prospective investors in July, September, October, and November 2003 concerning two Bear Stearns-issued notes during their respective quiet periods. The e-mails typically described the offerings in favorable terms,

often encouraging the recipients to invest. For example, the e-mails described the offerings as a "conservative vehicle that will render nominal but safe returns"; a "choice worth exploring"; "a gift"; an "attractive" option; and "custom built for clients." Bear Stearns had failed to detect any of these e-mails at the time they were sent, despite the frequency with which they were disseminated. In one week in September 2003, the salesperson sent at least one violative e-mail every single day; on November 28, 2003 alone, the representative sent sixteen violative e-mails.

- In early November 2003, one of the salespersons in the New York office had sent at least seven additional e-mails to customers that touted various upcoming offerings. In one e-mail, the salesperson noted that one offering was in "great shape," while another was in "good shape." The remaining six e-mails attached copies of confidential sales force memoranda concerning the software company's IPO and an unrelated follow-on offering.

- In mid-November 2003, in response to a customer's request for information about the software company's IPO, another of the salespersons in the New York office replied by e-mail that the offering had drawn "a lot of interest from small cap tech buyers." The e-mail also described some of the company's acquisitions and future business prospects.

- The third salesperson in the New York office, one week before sending the November 2003 e-mails that attached sales information concerning the information technology company and the software company's IPOs, faxed identical materials to customers. Because the faxes were sent via Bear Stearns' computer system, copies were also forwarded to Bear Stearns' compliance offices for review by compliance personnel, but were not detected.

- A salesperson in Bear Stearns' Boston office had sent at least five e-mails to various customers in 2002 and 2003 that touted certain upcoming IPOs and follow-on offerings. In one April 2002 e-mail, the representative described the issuer as having a "sterling" balance sheet, adding that the company had grown "both organically and through acquisition, to their credit. . . . Good Company in small cap area." In another 2002 e-mail, the salesperson touted an IPO as follows: "Interest high. Numbers compelling, mix, political, etc. Margins above avg . . . valued right . . . strong mgmt."[5] The same individual,

[5] The inadequacy of Bear Stearns' e-mail review procedures is further shown by the Firm's failure to detect numerous e-mails sent by two of these salespersons in 2002 and 2003 that violated the Firm's policies and procedures because they included internal-use-only documents and information. The e-mails did not violate Section 5 because they were not related to securities offerings. The documents typically included a warning plainly visible on the first page that read "strictly for internal use" or "internal use only." Although these e-mails did not violate the federal securities laws, their detection would have alerted Bear Stearns supervisors that these salespersons were not following Firm policies regarding outgoing communications, and could have enabled management to more effectively supervise these individuals with a view toward preventing subsequent violations of the securities laws.

in November 2003, had also provided two customers with Bear Stearns' internal financial model for the software company.

Despite Bear Stearns' policies requiring pre-approval of all business-related external communications and post-transmission review of all e-mail, the company did not have effective systems to implement the policies. Even after Bear Stearns detected violative communications, it failed to take reasonable steps to prevent and detect additional violations. In one instance, on November 18, 2003, one of the salespersons in the New York office e-mailed to certain customers a copy of a confidential sales force memorandum concerning a follow-on offering. Upon discovering the e-mail on November 20, 2003 as part of a routine review, a compliance employee admonished the salesperson for disseminating an "internal-use only" document outside the Firm, but took no further steps.

4. Bear Stearns' Remedial Steps in Late 2003

After discovering the violative e-mails in late November and early December 2003, Bear Stearns took a number of steps to prevent recurrence of similar problems in the future, including: installing a software program designed to block dissemination of employee e-mail that contained certain objectionable words or phrases; fully employing a previously-installed software program to enhance its manual review of already-sent e-mail; conducting firm-wide meetings to reiterate its policies concerning external communications; restructuring its compliance department to better enable compliance officers to perform surveillance-related tasks, including review of outgoing e-mail; and disciplining the salespersons who provided the sales information discussed herein. Additionally, Bear Stearns cooperated with the Commission staff in its investigation by, among other things, sharing the results of its own internal investigation.

D. Violations

1. Bear Stearns Violated Section 5(b) of the Securities Act

Section 5(b) of the Securities Act requires that a prospectus used after the filing of a registration statement meet the requirements of Section 10 of the Securities Act.[6] Section 2(a)(10) of the Securities Act broadly defines "prospectus" to include any written communication that offered any security for sale. E-mails are a form of written communication. Section 2(a)(3) of the Securities Act broadly defines "offer" to include attempts to dispose of, or solicitations of offers to buy, a security for value.

Because the e-mails described above were written communications that offered securities prior to the effective date of the registration statement, they were prospectuses which had to meet the requirements of Section 10 of the Securities Act. *See*, *e.g.*, *In re*

[6] A Section 10 prospectus must contain virtually all of the information required in a registration statement, other than exhibits and other information, such as pricing and pricing-related information. In the IPO context, a Section 10 prospectus must contain a *bona fide* price range.

Gold Properties Restoration Co., Inc., Release No. 6953 (Aug. 27, 1992); *SEC v. People's Bank of Brevard, Inc.*, Litigation Release No. 12753 (Jan. 14, 1991); *In re Martin Rothman*, Release No. 23654 (Sept. 30, 1986). The e-mails sent by Bear Stearns' sales force did not contain the information required by Section 10 of the Securities Act. When Bear Stearns' representatives disseminated those written communications about the pending offerings during their quiet periods, the individuals and the Firm willfully violated Section 5(b) of the Securities Act.[7] The Commission is not required to prove scienter in an action under Section 5(b). *See*, *e.g., SEC v. Willis*, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

2. Bear Stearns Failed Reasonably to Supervise Its Salespersons

Section 15(b)(4)(E) of the Exchange Act requires broker-dealers to supervise reasonably, with a view to preventing violations of the federal securities laws, persons subject to their supervision. Through its management structure, Bear Stearns was responsible for supervising the salespersons who sent the e-mails in violation of Section 5(b) of the Securities Act. Bear Stearns failed reasonably to supervise with a view to preventing the salespersons' violations of Section 5(b).

"The Commission has repeatedly emphasized that the duty to supervise is a critical component of the federal regulatory scheme." *In the Matter of Oechsle International Advisors, L.L.C.*, Admin. Proc. File No. 3-10554, 5 (August 10, 2001). Section 15(b)(4)(E) provides that a broker-dealer may discharge this responsibility by having "established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect" such violations. "Where there has been an underlying violation of the federal securities laws, the failure to have or follow compliance procedures has frequently been found to evidence a failure reasonably to supervise the primary violator." *In the Matter of William V. Giordano*, Admin. Proc. File No. 3-8933 (January 19, 1996). In addition to adopting effective procedures for supervision, broker-dealers "must provide effective staffing, sufficient resources and a system of follow up and review to determine that any responsibility to supervise delegated to compliance officers, branch managers and other personnel is being diligently exercised." *In the Matter of Mabon, Nugent & Co*., Admin. Proc. File No. 3-6207 (January 13, 1983).

Although Bear Stearns's pre-review policy required the review of all outgoing e-mail, none of the communications described above was reviewed by a supervisor before being sent to customers. Bear Stearns' procedure for reviewing electronic communications after transmission was not a reasonable method of detecting violative communications, and failed to identify most of the violative e-mails. Given the large volume of e-mail that they were tasked with reviewing, the reviewers in some instances merely scanned subject lines and ignored attachments or "internal use only" headings. Effective implementation of its pre- and post-transmission review policies could have

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7 "Willfully" as used in this Order means intentionally committing the act which constitutes the violation, *Cf. Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

enabled Bear Stearns to prevent and detect the salespersons' transmission of the approximately ninety violative e-mails, the vast majority of which were sent during four months in 2003.

Because Bear Stearns salespersons violated Section 5(b) of the Securities Act, and the Firm failed to employ an effective system to implement the procedures designed to detect or prevent such violations, Bear Stearns failed reasonably to supervise its employees for purposes of Section 15(b)(4)(E) of the Exchange Act.

IV.

Bear Stearns will review its procedures regarding the monitoring of outgoing electronic communications by its employees. Within ninety days of the issuance of this Order, unless otherwise extended by the staff of the Commission for good cause shown, Bear Stearns undertakes and agrees to certify to the Commission in writing that it has completed its review and that it has established procedures, and a system for applying such procedures, which are reasonably expected to prevent and detect, insofar as practicable, violations of Section 5 of the Securities Act.

V.

In determining to accept the Offer, the Commission considered remedial acts voluntarily taken by Respondent, as well as cooperation that Respondent afforded the Commission staff during its investigation of this matter.

VI.

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

A. Respondent Bear Stearns be, and hereby is, censured pursuant to Section 15(b)(4) of the Exchange Act.

B. Respondent Bear Stearns shall cease and desist from committing or causing any violations and any future violations of Section 5(b) of the Securities Act.

C. Respondent shall comply with the undertakings enumerated in Section IV., above.

By the Commission.

Nancy M. Morris
Secretary