ADMINISTRATIVE PROCEEDING
FILE NO. 3-6084

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

JAY W. KAUFMANN & CO. :
RAPHAEL DAVID BLOOM :

INITIAL DECISION

August 2, 1982
Washington, D.C.

Irving Schiller
Administrative Law Judge

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APPEARANCES:

Edwin H. Nordlinger, Patrick J. Finley, and Karen Z. Rosen, New York Regional Office, for the Division of Enforcement

Alfred V. Greco, Esq., for the Respondents

BEFORE:

Irving Schiller,
Administrative Law Judge

THE PROCEEDING

This Public proceeding was initiated by an Order of the Commission dated December 15, 1981 (Order) to determine whether Jay W. Kaufmann & Co. (registrant) wilfully violated and Raphael David Bloom (Bloom) wilfully aided and abetted violations of various provisions of the Securities laws and rules and regulations thereunder, and whether any remedial action is appropriate in the public interest pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934. 1/ In essence, the order charges the respondents with violating and aiding and abetting violations of the bookkeeping and financial reporting, supplemental reporting, fingerprinting, hypothecation, margin or credit and customer protection provisions of the federal securities laws and rules and regulations issued thereunder. The specific provisions of the federal securities laws and Rules thereunder allegedly violated are Sections 17(a), 17(e), 17(f), 15(c)(2), 15(c)(3), and 15 U.S.C. 17(q)(a), 78 (q)(e), 78(q)(f), 78o(c)(2), 78o(c)(3) and Rules 17(a)(3), 17a-4, 17a-5, 17a-11, 17f-2, 15c2-1, 15c3-3 promulgated thereunder. Registrant is also charged with violating Section 7(c) of the Exchange Act§78g(c) and Regulation T, 12 U.S.C. 220 promulgated thereunder by the Federal Reserve Board.

After appropriate notice, hearings were held in New York, New York. Proposed findings of fact, conclusions of law and briefs were filed by the Division of Enforcement (Division) and the respondents.

The findings and conclusions herein are based upon the record and upon observation of the witnesses. Preponderance of the evidence

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1/ 15 U.S.C. § 78o(b), 78s

is the standard of proof applied.

FINDINGS OF FACT AND LAW

The Respondents

Registrant has been registered as a broker-dealer with the Commission pursuant to Section 15 of the Exchange Act since April 28, 1962. It is a member of the National Association of Securities Dealers Inc. (NASD), a national securities association registered pursuant to Section 15A of the Exchange Act. The official files of the Commission disclose that registrant is a limited partnership with offices located at 111 Broadway, New York, New York.

Respondent Bloom became a general partner in August 1972 and has been registrant's sole general partner since June 1979. 2/

Events Preceding Charges of Violations

On or about June 17, 1981 two investigators of the staff of the New York Regional Office entered registrant's premises for the purpose of conducting an examination of registrant's books and records. At that time several employees of the NASD were already engaged in examining registrant's books and records to ascertain whether registrant was in compliance with the applicable provisions of the federal securities laws. After two days of examining registrant's books and records the staff investigators of the New York Regional Office concluded that registrant's records were so inaccurate that it was impossible to tell which records were correct or which were incorrect because of inaccuracies among the various ledgers. Bloom was informed

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2/ The record discloses that as of February 1982 registrant had three limited partners, two of whom became limited partners in November 1977 and the third became such partner in June 1979.

that as of May 30, 1981 there was an under deposit in the customer reserve account and that because of the state of the records registrant's financial position was uncertain. A meeting was held on June 19, 1981 at the Regional Office at which Bloom, his accountant, representatives of the NASD and the staff were present. Bloom acknowledged at the meeting that registrant was not in compliance with the customer reserve account as of May 30, 1981, and that there were problems with the accuracy of its books and records. Registrant, as required by Rule 15c3-3, agreed to discontinue doing business to deposit additional funds in a special reserve account, endeavor to eliminate the inaccuracies in its books and records and take other steps to assure that registrant was in compliance with the applicable rules. Shortly after the June 19, 1981 meeting registrant suspended operations for a period of six weeks during which time its financial position could be ascertained and its compliance with the rules determined.

The specific violations with which registrant and Bloom are charged and the conclusions reached as to each of the charges are detailed below.

Alleged Violations of Section 17(a) and (c) of the Exchange Act and Rules 17((a)3,4 and (5) thereunder. The Bookkeeping and Financial Reporting Provisions

The record establishes that registrant's general ledger for the period ending May 31, 1981 was overstated by at least $147,995.

The documentary evidence demonstrates that for May 1981 registrant's general ledger reflected that $65,732 was in its account at Chemical Bank. Registrant's Chemical Bank statement for the same

period showed $158,046 was on deposit. Giving effect to outstanding checks drawn on that account of $139,205 resulted in the fact that only $18,841 was on deposit in the said Bank. Thus registrant's account at the Chemical Bank was overstated by $46,891.

Similarly, registrants' general ledger for May 1981 indicated $17,822 in its account at Bank Leumi. The Leumi bank statement for the same period showed a deficit of $5,474. Giving effect to outstanding checks drawn on that account of $27,807 a deficit existed of $33,282 in the Bank Leumi's account. The said account was overstated by $101,104. Thus, registrants' general ledger with respect to Chemical Bank and Bank Leumi was overstated by at least $147,995. The record supports the finding that registrant wilfully violated Section 17(a) of the Exchange Act and of Rule 17a-3(a)(2) thereunder.3/

The record establishes that registrants ledgers or other records itemizing each customer's cash and margin account and reflecting debits and credits were improperly maintained. The documentary evidence demonstrates that from May 14 through May 22, 1981 registrant received about $217,700 from 52 customers which it deposited in its proprietary bank account and did not post them to its customers accounts until May 29, 1981. 4/ Thus, registrant wilfully violated

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3/ Rule 17a-3(a)(2) requires broker-dealers to make and keep current ledgers (or other records) reflecting all assets and liabilities, income and expense and capital accounts.

4/ The evidence discloses the checks of 4 such customers were not posted to the customer's accounts until 15 days after registrant deposited their checks in its proprietary account , the checks of 7 other customers were not posted to the customer's accounts until 14 days after such deposit and checks of 12 customers were not posted until 11 days after such deposit. The accounts for the remaining 29 customers were posted to the customer's accounts between 7 and 10 days after registrant deposited the customers checks in its proprietary account.

Rule 17a-3(a)(3) which in essence requires broker-dealers, among other things to itemize in its ledger accounts as to each customer's cash and margin account all purchases, sales, and all other debits and credits to such account. In 1974 the Commission published a "Statement Regarding the Maintenance of Current Books and Records By Broker-Dealers" in which it stated, as relevant herein, that under subparagraph (3) of Rule 17a-3 cash receipts and disbursements should be posted to the customers ledger accounts no later than the first business day following the transaction. 5/

The record further establishes that registrants' ledgers and other records reflecting securities failed to deliver and failed to receive as of May 30, 1981 were inaccurate. The documentary evidence as of that date reflects four different figures for securities failed to deliver and three different figures for securities failed to receive. The Commission's examiner testified, and his testimony is credited, as to discrepencies in registrant's records. He testified that registrants' fail to deliver report shows that registrant failed to deliver securities amounting to $873,138.68 and failed to receive $690,247.37 worth of securities. He also testified that registrants' general ledger reflected that registrant failed to deliver $631,501.85 worth of securities and failed to receive $357.597.99 worth of securities . He further testified that registrants' trial balance account showed registrant failed to deliver securities amounting to $767.595.40 and failed to receive $591,779.44 worth of securities. Moreover, registrant's failed to deliver report (noted

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5/ 194 SEC Docket 195, 196 (1974), Securities Exchange Act Release 10756 (April 26, 1974)

above as $873,138.68) adjusted for cross trades reflected yet another figure of $760,512.66. Registrant's comptroller and operations manager testified that registrant's general ledger as of May 30, 1981 was totally unreliable and he could not state which document accurately reflected securities failed to deliver.

The Commission examiner also testified, and his testimony is credited, that an examination of registrant's failed to deliver run and stock record summary revealed there were at least 34 discrepancies between the two records and there were at least 24 discrepancies between the failed to receive run and stock record summary covering securities registrant failed to receive.

The record supports the finding that registrant wilfully violated Rule 17a-3(a)(4)(E) which as pertinent here, requires broker-dealers to make and keep current ledgers reflecting securities failed to receive and failed to deliver.

The record establishes and the documentary evidence supports the finding that on May 28, May 29 and June 1, 1982 registrant failed to mark the time of entry and the time of execution or cancellation of a majority of the memoranda of brokerage orders given or received for the purchases or sales of securities. Registrant wilfully violated Rule 17a-3(a)(6), which as pertinent here, requires broker-dealers to make and keep current a memorandum of each brokerage order given or received for the purchase or sale of securities which shall show the time of entry, and, to the extent possible, the time

of execution or cancellation.

The NYRO examiner testified that when he was conducting his examination of registrant's books and records he inquired of registrant's comptroller whether registrant had prepared a computation of aggregate indebtedness and net capital for May 1981. The comptroller stated that no such computation had been made for May 30, 1981. The comptroller testified that at some later date in June 1981 he did prepare such a computation as of May 30, 1981, but did not dispute the fact that the May 30 computation was not in existence when requested by the Staff examiner. Respondents' contention that registrant timely recorded computations of net capital and aggregate indebtedness for May 1981 is contrary to the record and rejected. The record clearly establishes that the required computation was not in existence at the time itwas required to be produced. Registrant wilfully violated Rule 17a-3(a)(11) which, as relevant here, requires broker-dealers to make and keep current a record of the computation of aggregate indebtedness and net capital, which computations shall be prepared currently at least once a month.

The NYRO compliance examiner, in the course of examining registrant's books on the latter part of June 1981, was preparing a bank reconciliation of Bank Leumi where registrant maintained a bank account. The examiner requested the comptroller to give him the bank stubs for the period ending May 30th but the comptroller was unable to locate or produce them. 6/ Within the meaning of Rule 17a-4(b)(2) registrant failed to maintain the bank stubs in an accessible place. Registrant thus wilfully violated Rule 17a-4(b)(2)

6/ The record shows that at some later date (not clearly stated in the record) the comptroller furnished the examiner with a list of outstanding checks in lieu of the stubs. At the date of the hearing in March 1982 registrant produced photocopies of the check stubs from about April 30 to June 1, 1981, which were received in evidence.

which, as relevant here, requires broker-dealers to preserve all check books, cancelled checks and each reconciliation for a period of not less than three years, the first two in an accessible place.

The record discloses and registrant does not dispute that its annual audit report for 1980 was required to be filed March 1, 1981, that its request 7/ for a 60-day extension of time to file such report was granted and that it was not until June 23, 1981 that registrant finally filed its 1980 report. 8/ The documentary evidence supports the finding that registrant wilfully violated Section 17(e) of the Exchange Act and Rule 17a-5 thereunder. 9/

The record further establishes that during May and June 1981 registrant's books and records were not being currently and accurately maintained. As noted earlier, for example, registrant's ledgers reflecting securities failed to receive and failed to deliver were not kept current and were inaccurate and registrant's customer ledger accounts reflecting debits and credits was not maintained on a current basis. Registrant was required, under such circumstances, to give

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7/ The documentary evidence reveals the request for an extension was filed by registrant's accountant on registrant's behalf.

8/ The accountant's statement accompanying the financial statements states the accounting firm was "not in the position that we could render an opinion on these financial statements" by reason of the fact that their study and evaluation of the system of internal accounting control for 1980 "disclosed certain weaknesses that we believe to be material."

9/ The said Section and Rule, as applicable here, requires broker-dealers annually to file audited financial statements concerning their financial condition within 60-days after the date of the financial statements. The Rule also provides that in cases of undue hardship a broker-dealer may file an application for an extension of time to file to a specified date not more than 90 days after the date of the financial statements.

telegraphic notice to the Commission at its principal office, the NYRO and the NASD specifying the books and records which were not current and within 48 hours of the telegraphic notice filed a report stating what steps have been taken and are being taken to correct the situation. The record shows that no such telegram or notice was received by the Commission. 10/ Registrant wilfully violated Section 17(a) of the Exchange Act and Rule 17a-11, 17 CFR § 240.17a-11.

With respect to the violations of the bookkeeping and financial reporting requirements found above, respondents, in general, assert that the information required to be maintained may not have been recorded in the books and records as prescribed by the Rules but could be found somewhere in the firm and that while some of the books and records may have contained inaccuracies and the ledgers were not in balance such imbalances and inaccuracies were due primarily to two factors; first, a changeover from manual to computer method of bookkeeping and second an inept back office manager who left the firm shortly before May 30, 1981. The arguments are wholly insufficient to exculpate the firm from the wilfull violation of the record keeping requirements. The provisions of the various rules detailing the appropriate books and records which must be maintained to reflect the operations of a broker or dealer were adopted by the Commission, among other things, in order to determine a firm's financial condition,

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10/ The documentary evidence reveals that as of January 26, 1982 no telegraphic notice or report was received for May or June 1981 by the Commission from registrant.

to ascertain whether the firm is in compliance with regulatory requirements and to protect investors. Allen & Company 22 SEC Docket 961, 964 (1981). In the instant case, it is evident the respondents were unaware that its reserve requirements were inadequate because it could not determine from its books and records that a deficiency existed until the matter was brought to the attention by the Commission staff during an examination of registrants records.

Respondents argument that "there appears to be no precedent cited that books and records currently kept will violate Rule 17a-3 if they are not accurate . . . ." is, to say the least, astonishing. It is axiomatic that when records are required to be kept that they be true and accurate. The Commission has consistently held that the requirement that records be kept embodies the requirement that such records be true and accurate. Alfred D. Lawrence & Co. , 38 SEC 223, 225 (1958); Gill Harkness & Co., 38 SEC 646, 647, 653 (1958); 2 Loss, Securities Regulation 1346, and cases cited in footnote 215 (1961).

The record further discloses that registrant failed to fingerprint two of its employees and one limited partner and failed to maintain documentation which would have disclosed that each person required to be fingerprinted had, in fact, been fingerprinted. In addition the documentary evidence discloses that registrant failed to submit to the Commission a statement relating to two limited partners who,because of the nature of the duties they perform, were exempt from the fingerprint requirements. Registrant is found to

have wilfully violated Section 17(f) of the Exchange Act and Rule 17f-2 thereunder. 11/

Alleged Violations of Section 15(c)(3) and Rule 15c3-3 thereunder (The Customer Protection Provisions)

Registrant is charged with wilfully violating Section 15(c)(3) of the Exchange Act and Rule 15c3-3. The record shows that in May and June 1981 registrant failed to maintain the amount required to be deposited in its Reserve Bank Account. The documentary evidence prepared from registrants' books and records reflects that for the period ending May 30, 1981 registrant was required to have $699,343 on deposit in its Reserve Bank Account. Registrant had on deposit in the said account for the period in question $217,281 which resulted in a substantial deficiency of $482,062. In addition, the record also shows that according to registrant's computation it was required to have on deposit in the above mentioned account only $70,729. Registrants' computation was therefore understated by $628,614.

Rule 15c3-3 requires, among other things, that a broker-dealer maintain a Reserve Bank Account through deposits made therein, cash and /or qualified securities in accounts computed in accordance with a "Formula" attached to the Rule as Exhibit A. The "Formula" contains 14 Items which require computation to determine whether the Reserve Bank Account is adequate. The record demonstrates that registrant failed to compute the Items noted below in the manner required by

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11/ Section 17(f)(2) of the Exchange Act and the Rule thereunder, as pertinent here, requires in essence, that each partner of a broker-dealer be fingerprinted unless he falls within one of several exemptions, that a fingerprint card or other record be maintained for persons required to be fingerprinted, and that a statement be submitted to the Commission of those persons who, because of the nature of the duties they perform fall within one of the exemptive provisions of the Rule.

the "Formula" and one or more of the Notes thereunder.

When registrant computed Item 1 of its Reserve Bank Account for May 30, 1981 it included only free credit balances and omitted to include "other credit balances" in customers security accounts. As a result, registrant reflected only $166,166 in Item 1 of the reserve account. The documentary evidence in the record reflects that the customer credit balances equalled $1,039,088 and that after adjusting that figure (as required by Note A of Exhibit A to Rule 15c3-3) by adding $33,282 representing checks drawn in excess of bank balances and subtracting (a) $193,550 representing monies received pursuant to an underwriting of Pinnacle Petroleum securities, placed in an escrow account and improperly credited to customer accounts and (b) $185,000 to compensate for checks which registrant had paid to customers but which it failed to debit to their accounts, the correct amount which should have been reflected was $693,820. Thus, in calculating Item 1 under the "Formula" registrant's reserve account computation was understated by $693,820.

Registrant was required to include in Item 4 of the "Formula" the amount of customers' securities failed to receive. Such amount calculated by registrant as of May 30, 1981 was stated as $53,924. The documentary evidence which reflects the amounts appearing in registrant's stock record and its customer-related fail to receive run totalled $113,001. Under Item 4 of the "Formula" the fail to receive item must also include the amount by which the market value of securities failed to receive and outstanding more than thirty days exceeds their contract value. 12/ The records reveals that such fail to receive items

12/ Note D of Exhibit A to Rule 15c3-3.

over 30-days amounted to $3,451. Hence, Item 4 of registrant's reserve computation should have reflected a total of $116,452 rather than $53,924..

Registrant calculated Item 5 under the "Formula", which requires a computation of the credit balances in firm accounts attributable to principal sales to customers, in the amount of $8,711. The documentary evidence from registrants' books and records revealed that the correct amount should have been $36,370. Thus, Item 5 was understated by $27,659 for May 30, 1981.

Registrant, in calculating the market value of short securities for May 30, 1981, failed to reflect the market value in all suspense accounts over 30 calendar days as required by Item 8 under the "Formula." The documentary evidence, from registrant's suspense account statement and stock record, revealed the amount of $103,858 should have been included in response to Item 8.

In response to Item 10 of the "Formula" registrant inserted $214,850 for secured customers debit balances for May 30, 1981. The documentary evidence disclosed that based on registrants' records, the correct amount of secured customer debit balances was, in fact, $227,992.

In calculating Item 12 of the "Formula" registrant stated that $25,382 represented the amount of securities registrant failed to deliver, not older than 30 calendar days. The documentary evidence, based on registrant's records, establishes that $113,165 is the correct amount which should have been included in response to Item 12 for May 30, 1981.

Subparagraph (e)(3) of Rule 15c3-3, as pertinent here, requires a broker or dealer to make computations on a weekly basis to determine the amount required to be deposited in its Reserve Bank Account calculated in accordance with the "Formula"; provided, however, where the broker or dealer meets certain criteria stated in said subparagraph he may in the alternative make the computation on a monthly basis. The record discloses that registrant was required to make computations on a weekly basis since it was unable to meet the criteria for making monthly computations and that for a period of at least two or three weeks following May 30, 1981 registrant failed to make the required weekly computations.

Upon the basis of all of the foregoing registrant wilfully violated Section 15c(3) of the Exchange Act and Rule 15c3-3(e) thereunder.

Alleged Violation of Section 15(c)(3) of the Exchange Act and Rule 15c3-3(b) and (d) thereunder

Paragraph (b)(1) of Rule 15c3-3 requires a broker or dealer promptly to obtain and thereafter maintain the physical possession or control of all fully-paid and excess margin securities carried by a broker or dealer for the account of customers. The record discloses that in at least three instances, noted below, registrant failed to obtain and maintain physical possession or control of all fully paid and excess securities.

(1) April 9, 1981 one of registrant's customers was long 2,000 shares of Work Wear Inc. which were shown in a good control position and labelled street, safe-keeping. However, registrant removed the 2,000 shares, used them for a customer bank loan and thereby placed them in a non-control position. Under the formula set forth in the above mentioned rule only 1772 shares were available for the customer bank loan. Thus, the documentary evidence sustains the finding that registrant

created a deficit by removing the 228 shares of fully paid and excess margin securities from a good control position and placing them into a customer bank loan.

(2) Similarly on or about April 9, 1981 another of registrant's customers was long 2,000 shares of Bio-Rad Laboratories which were shown in a good control position and labelled street, safe keeping. Registrant removed 1,000 shares using them for a customer bank loan and placed them in a non-control position. Under a formula set forth in the above mentioned rule only 437 shares were available for the customer bank loan. Thus, the documentary evidence sustains the finding that registrant created a deficit by removing the 563 shares of fully paid and excess margin securities from a good control position and placing them into a customer bank loan.

(3) In the third instance registrant on or about April 9, 1981 removed 24,700 shares of Solid State Technology, Inc. from a good control location (street, safe keeping, Box and Suspense) used them for a customer bank loan and thereby placed them in a non-control position. Under a formula set forth in the above mentioned rule only 17,964 were available for the customer bank loan. Thus, the documentary evidence sustains the finding that registrant created a deficit by removing 6,736 (24,700 less 17,964) shares of fully paid and excess margin stock from a good control location and placing them into a customer bank loan.

In addition the record discloses that in each of the three foregoing instances an examination of registrant's stock record dated April 30, 1981 revealed that registrant, after creating the deficits described above, failed to recall the shares of the respective securities which it placed in a non-control position within five business days, the period of time prescribed by paragraph (4)(1) of Rule 15c3-3 for obtaining physical possession or control of securities placed in a non-control position.

The record also sustain a finding that in May and June 1981 registrant failed to make a daily determination of the quantity of fully-paid and excess margin securities in its possession and control and the quantity of such securities not in its possession or control as required by paragraph (d) of Rule 15c3-3.

Registrant also failed to comply with subparagraph (4) of

paragraph (d) of the aforesaid Rule which requires a broker or dealer to prepare and maintain a current and detailed description of its possession and control procedures. The record lacks any evidence that registrant either prepared or maintained the required detailed description of procedures.

Respondents contend that the record and exhibits are insufficient to show that registrant was not in compliance with the aforesaid Rule. The argument is without foundation and rejected. The documentary evidence which supports the findings made above, consists of charts prepared from registrant's stock record and other books and records. The underlying records from which such charts were prepared, were also received in evidence. The charts clearly reflect the customers' account number, the number of shares each customer was long in either Work Wear Inc., Bio-Rad Labs and Solid State Technology, the market price of each of the said securities on April 9, 1981, the debit balance in each account, a computation of 140% of such debit balance as required by the Rule, the number of shares in control location, the number of shares available for the respective customer's bank loan and the manner in which the respective deficits were created. No evidence was offered by respondents to refute the factual information set forth in the charts, on the basis of which the findings hereunder are made.

Respondents also contend that at any point within the five day period specified, (presumably when the securities in the non-control position should have been recalled) "with the slightest variance in market price, registrant could have been in compliance."

(Underscoring supplied). Respondents urge that there is no evidence of any price set forth in the record or exhibits during the five business day periods. The Division having established by documentary evidence that securities were improperly removed from a good control position and placed in a non-control position met the burden of proof by a preponderance of evidence that registrant failed to comply with Rule 15c3-3(b) and (d). Thereafter, respondents bore the burden of establishing that such securities were either in a good control position at all times or that registrant, in fact, recalled the shares from the non-control location to a good control location within the specified time period. Subparagraph (2) of paragraph (b) of the Rule in question provides, in pertinent part as relevant here, that the burden of proof shall be on the broker or dealer to establish that the failure to obtain physical possession or control of securities carried for the account of customers is merely temporary and solely the result of normal business operations and to establish he has taken timely steps in good faith to place them in his physical possession or control. The record demonstrates registrant offered no proof that its failure to obtain physical possession of customers securities as required was temporary and solely the result of business operation nor did it offer proof to establish it took timely steps to place them in its control. Registrant failed to meet its statutory burden of proof. Bloom testified he was unaware of the firm's obligation to obtain physical possession of fully paid and excess margin securities of customers , nor was he aware of the 140% computation required to

be made under the said Rule.

Respondents argument that with the slightest variance in market price, within the five day specified period, registrant could have been in compliance is without substance and rejected. The Rule does not state that when securities are placed in a non-control location a change in the market price would automatically result in placing such securities back in a control location. Under the Rule, once the securities are placed in a non-control location the registrant was required to obtain physical possession or control within the specified period and not speculate that there would be a change in the market price which would relieve the registrant from complying with the Rule. At the very least, registrant should have established that it took timely steps in good faith to place the securities in its physical possession or control. In the instant case no such steps were taken by registrant.

Alleged Violations of Sec 15(c)(3) of the Exchange Act and Rule 15c3-3(m)

A chart received in evidence, prepared from registrant's books and records, reveals that from about April 1, 1981 to about June 30, 1981 there were at least fifteen (15) occasions when registrant executed a sell order of a customer and failed to obtain possession of securities from such customers within ten business days after the settlement date. Under such circumstances registrant was required by Paragraph (m) of Rule 15c3-3 to close the transaction with the customer by purchasing securities of a like kind and quantity. Registrant pursuant to paragraph (n) of the aforesaid Rule, could have applied within 10-days after settlement date to a national securities

exchange or association for an extension of time within which to obtain securities necessary to complete a customer's sell order. Registrant never applied for an extension of time.

The evidence demonstrates that as of May 30, 1981 registrant in 4 instances failed to receive customers' securities between 5 and 27 days after completion of a sell order, that as of June 30, 1981 in 8 instances registrant failed to receive customers' securities between 3 and 32 days after completion of a sell order; that on June 19 one customer's securities was received by registrant 35 days late and on June 24 one customer's securities was received 11 days late while another customer's securities was received by registrant 9 days late. Accordingly, registrant wilfully violated Section 15(c) of the Exchange Act and Rule 15c3-3(m) thereunder.

With respect to the violations of the customer protection provisions of Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder respondents repeat, in general, their arguments that if there were any miscalculations it was due to inexpert handling of a conversion by the firm from manual to a computer, the ineptitude of the operations manager and his departure without notice. As noted earlier concerning the bookkeeping violations, the arguments are wholly insufficient to exculpate respondents from the wilfull violations found. The customer protection Rule was adopted by the Commission in an effort to prevent misuse of customer funds by requiring that such funds may not be used by brokers or dealers for operating expenses of the firm. Reserve Bank accounts are required to be maintained by brokers or dealers computed weekly or monthly

under certain conditions in a manner specified in the Rule for the protection of customers. It is no excuse to say that miscalculations were caused by changing from manual recording to computer system nor is it an acceptable excuse to claim that an inept manager was employed and that no violation should be found.

Alleged Violations of Sec 15(c)(2) of the Exchange Act and Rule 15c2-1 thereunder

The record discloses that for the period from April 10 to July 28, 1981 registrant, in connection with a loan it obtained from the Chemical Bank,collateralized such loan by using securities carried for the accounts of seven customers. Registrant failed first to obtain the written consents from at least four of such customers as required by subparagraph(1) of Rule 15c2-1(a) thereby hypothecating the securities of such customers. Registrant thus wilfully violated Sec 15(c)(2) of the Exchange Act and Rule 15c2-1 promulgated thereunder.

Respondents contend that there is no evidence in the record or exhibits offered to prove that the mails or instrumentalities of interstate commerce were used by respondents in effecting transactions in securities in violation of Sections 15(c)(2) and 15(c)(3) of the Exchange Act and Rules 15c2-1 and 15c3-3(b),(d),(e) and (m) thereunder. The argument lacks merit. The documentary evidence included in the record includes copies of buy and sell orders from customers and confirmations to customers for transactions completed during the May, June 1981 period. 13/ A perusal of these order

13/ See Exhibits 12, 12A thru j, 13 13a thru j, 14, 14a thru l and Exhibits 11 and 11-1 thru 15 which reflect customer transactions during the period referred to in the text.

tickets indicates they contain the name of the customer, the name of the security bought or sold, the price and the date of the transaction. The confirmations for each of the transactions contain the same information plus the address of the customer and the telephone numbers of the registrant including both the New York area code and an "800" area code and separate number. Each of the confirmations requests the customer to retain the confirmation for income tax purposes. It would be incredible to conclude that a broker such as registrant could have effected transactions without the use of the telephone, an instrumentality of interstate commerce, to obtain the buy or sell order or provide the customers with the confirmation without the use of the mails, particularly since at least three of the customer's addresses were either in Florida or California.

Moreover, Section 15(b)(3) of the Exchange Act provides, as pertinent here, that any provision which prohibits any act, practice or course of business if the mails or any means or instrumentalities of interstate commerce is used in connection therewith shall also prohibit any such act, practice or course of business by any registered broker, irrespective if any use of the mails or means or instrumentality of interstate commerce in connection therewith. The Commission has implemented this by Rule 0-8 which extends the same concept to any rule which prohibits any act if the mails or interstate commerce is used. 14/

14/ Reg 240.0-8 states: "Any provisions of any rule or regulation under the Act which prohibits any act, practice, or course of business by any person if the mails or any means or instrumentality of interstate commerce are used in connection therewith, shall also prohibit any such act, practice, or course of business by any broker or dealer registered pursuant to Section 15(b) of the Act or any person acting on behalf of such a broker or dealer, irrespective of any use of the mails or by any means or instrumentality of interstate commerce.

Alleged Violations of Section 7(c) of the Exchange Act and Regulation T Promulgated thereunder By the Federal Reserve Board.

A review of registrant's records revealed that during the period March 1, through May 30, 1981 registrant purchased securities for customers in special cash accounts of at least ten customers and directly and indirectly extended, maintained and arranged for, credit to and for such customers. The records further show that such customers did not make full cash payment for the securities within seven business days after the date the securities were purchased. Registrant did not promptly cancel or otherwise liquidate the transaction nor was any application made to the National Association of Securities Dealers for an extension of time within which to make payment. No payment had been received in seven of such transaction which were between 5 and 43 days late as of May 30, 1981 and no payment had been received in three such accounts which were between 15 and 27 days late as of June 30, 1981. Having extended credit to customers beyond seven business days, registrant wilfully violated Section 7(c) of the Exchange Act and Regulation T promulgated thereunder by the Federal Reserve Board.

Responsibility of Bloom for aiding and abetting registrant's violation

The Order charges that Bloom wilfully aided and abetted each of the alleged wilfull violations committed by the registrant. Bloom admits that in August 1972 he became a general partner of registrant and has been registrant's sole general partner since June 1979. Bloom does not dispute that he was and is responsible for all of registrant's activities. He testified that his function generally is to oversee the entire operation of registrant from production of business to

coordination "to the end result, which I guess, reflects on a profit and loss statement. I pretty well cover everything or I am responsible for everything." Bloom urges he did not aid and abet any violations because he had no general awarness of improper activity, did not knowingly render substantial assistance in the violation and he relied completely upon his back-office manager. The agreement is without substance since it is contrary to the evidence and his own testimony that he was personally responsible for all of the registrant's activities. Having assumed such responsibility he must be held accountable for all of the activities which includes responsibility for the proper and accurate maintainance of registrant's books and records as well as compliance with the Commission's rules and regulations. Claimed reliance on a back-office manager does not exculpate Bloom from the responsibility for exercising necessary supervision to make certain that registrant complied with legal requirements

The Commission and the Courts have consistently held that brokers and dealers are "charged" with the responsibility of insuring that their firm's books and records are kept in compliance with the requirements of the Exchange Act. SEC v Resch-Cassin & Co., 362F. Supp. 964, 979 (S.D.N.Y. 1973); In the Matter of Jerome H. Shapiro 46 SEC 472, 475, 476 (1976)

The Commission and the Courts have also held that under the federal securities laws a person may be found to have aided and abetted a violation if there is established that a securities law violation was committed, that the alleged aider and abettor knowingly and substantially assisted in the conduct that constitutes the violation and that he was aware that his role was part of an activity

that was improper or illegal. SEC v Falstaff Brewing Corp., 629 F 2d 62, 72 (C.A. D.C. 1980); Investors Research Corp v. S.E.C., 628 F 2d 168,177 (C.A. D.C. 1980), Art. denied - U.S. -. Here, as noted above, registrant committed numerous violations. The record clearly demonstrates that Bloom knowingly and substantially assisted in the conduct constituting the violation. In the latter part of 1980 Bloom determined to convert from a manual to a computer system of keeping books and records and knew from early 1981 that registrant was using both manual and a partial computer operation to record the activities of his firm. Yet he did nothing until late April or early May 1981 to ascertain whether the books and records were being maintained accurately or whether they complied with the requirements of the rules and regulations. By such conduct he is found to have knowingly and substantially assisted in registrant's violations. Finally, it is equally clear from the record that Bloom was aware that registrant's books and records did not accurately reflect registrant's operations and that because of his conduct he was unable to determine whether registrant was in compliance with financial reporting requirements, the customers protection provision, the hypothecation rule or the margin and credit provision. The record then amply supports the finding that Bloom aided and abetted all of registrant's violations found above.

Willfulness

Respondents assert that none of the alleged violations were wilfull. To buttress that argument respondents, in essence, claim that neither registrant nor Bloom intended to commit the alleged violations and that any failure to comply with the requirements was, as noted earlier, primarily caused by the changeover from a manual

operation to a sophisticated computer system. In addition, respondents urge that respondents relied upon an inept back-office manager's assurance that the firm's backlog which was accumulating would be adequately resolved once the computer was properly functioning. In this connection respondents maintain that the underlying records were available, that the ledgers merely required reconciliation and adjustment and that the imbalances which caused great discrepancies in the firm's general ledger were the direct result of a half manual, half computer method of bookkeeping. None of these claims expiate respondents from the requirements of the Exchange Act or the rules thereunder. To prove "wilfulness" as used in Section 15(b) of the Exchange Act does not necessitate proof that a broker-dealer deliberately violated the law. The Commission and the Courts have consistently held that as used in the above mentioned Section "wilfully" means intentionally committing the acts which constitute the violation. There is no requirement that the broker-dealer also be aware that he is violating one of the Rules or the Securities Acts. Tager v S.E.C.344 F 2d 5,8 (2d Cir. 1965). All that is required is proof that the broker-dealer acted intentionally in the sense that he was aware of what he was doing. Arthur Lipper & Co. v S.E.C.547 F2d 171, 180 (2d Cir. 1976). The record amply demonstrates that both registrant and Bloom were aware that from early 1981 and certainly during May-June 1981 period that books and records were in such a deplorable condition that there was no assurance that the firm's books and records were in compliance with applicable Rules or that they accurately reflected the operations or financial eondition of the firm. For example, the findings, detailed above, of wilfull violation of Rule 17a-3 is based upon the fact that registrant's records reflected

four different figures for securities failed to deliver as of May 30, 1981 and three different figures for securities failed to receive as of the same date. Another example is the findings, noted earlier, that registrant's Reserve Bank Account was below the minimum requirement of Rule 15c3-3 and was deficient by some $482,000. Registrant's violations found, as detailed above, were "wilfull" within the meaning of the Exchange Act and the Rules thereunder and Bloom is found to have wilfully aided and abetted such violations.

Public Interest

The only remaining question is whether in light of the foregoing findings of wilfull violation any remedial sanction is in the public interest. Respondents urge that, for the reasons stated below, no remedial sanction is warranted. Throughout the hearing respondents blamed its failure to maintain accurate books and records as prescribed by the Exchange Act and Rules thereunder to an inept back-office manager and a conversion from a manual method of recording operations to a computer system. In their brief respondents state that in the latter part of 1980 and the beginning of 1981 respondents "found themselves in a position that their books and records needed upgrading in order to handle the increase in business." Respondents determined to install a computer on the assurances of the back-office manager that "the firm's backlog that was accumulating would be adequately resolved." The record contains no information as to what steps were taken by Bloom from the beginning of 1981 to about May 1981 to ascertain that the computer system was operating effectively to clear up the backlog. The

record reveals that in May 1981 Bloom was aware that the back-office problems were not being resolved by the new computer installation. The back-office manager left and was replaced. Though it is true that registrant was changing to a computer system it is evident that such change started early in 1981 and by May 1981 registrant's books and records were in a lamentable state.

Respondents further urge that in connection with any determination of whether a remedial sanction is warranted consideration should be given to the fact that at a meeting held on June 19, 1981 with Bloom, his accountant, the staff of the Commission and members of the NASD present, registrant after being informed that a preliminary investigation of registrant's records disclosed apparent serious violations of many key provisions relating to registrant's financial stability, Bloom, recognizing that the Exchange Act prohibits broker-dealers from engaging in business unless they comply with the applicable financial responsibility provisions, agreed to and did, suspend registrant's activities for a period of six weeks so that a resolution could be made as to registrant's financial position. Respondents further urge that consideration also be given to the fact that in addition to suspending operations, registrant increased its capital ($300,000), segregated customers cash ($200,000); began liquidating its positions and delivered securities and cash balances to its customers. Registrant claims that during the period of suspension it sustained a loss in excess of $250,000. 15/ Finally, respondents point out that no damage or loss was sustained

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15/ Other than Bloom's statement there is nothing in the record to show how this alleged loss was calculated or what it represented.

by any customer for any record keeping deficiences and that its books and records are now substantially in compliance with the Commissions bookkeeping rules and regulations.

Though the foregoing measures which were adopted manifest a desire on the part of the respondents to remain in business and bring registrant's books and records into compliance with the applicable Rules and Regulations, they were procedures undertaken only after an investigation was made by Commission personnel which disclosed grave violations and which, under the circumstances, would have required operations to cease until at least such time as registrant's condition could be ascertained. It is evident that since the beginning of 1981 registrant continued to conduct a retail business including acting as a market-maker and without paying careful attention to whether its books and records were current or accurate or whether it was finacially capable of protecting its customers or fulfill its obligations to other broker-dealers. Thus, respondents were imperilling both customers and others. Respondents' reliance on what they characterized as an inept back-office manager is no excuse for abdecating their responsibilities. The Commission has held that failure of a back-office to generate reliable data necessary for compliance with regulatory requirements where the basic cause of the violations 16/ was the inattention to the proper running of a broker-dealer office from the standpoint of maintaining books and records constituted grounds for the imposition of a sanction. In the Matter of Jerome H. Shapiro 46 S.E.C. 472, 479 (1976).

16/ These included recordkeeping requirements and improper hypothecation of securities.

In addition to giving consideration to the foregoing factors raised by respondents, cognizance must be taken of respondents' past conduct in order to determine whether, any remedial sanction is in the public interest. The record discloses that registrant on four occasions was censured and fined by the NASD for violations of the Rules of Fair Practice of the NASD and the federal securities laws. On January 3, 1974, registrant was censured and fined $750; on December 15, 1975 registrant was censured; on July 6, 1980 registrant was censured and fined $1,000 and on November 17, 1965 registrant was censured and fined $1,000. On August 5, 1972 Bloom was fined $2,000 and suspended for five days and on December 15, 1975 Bloom was censured by the NASD. 17/

In June 1969 Bloom consented to the entry of a permanent injunction enjoining him from further violations of Sections 5(a) and (c) of the Securities Act of 1933, as amended, 15 U.S.C. 77e(a) and 77e(c). Bloom contends that no consideration should be given to the injunction with respect to levying any sanctions against him since the language of the consent to the injunction appears to bar any consideration of the consent decree for the impositions of any sanction against Bloom without proving the prior underlying facts. The argument is not acceptable. The consent states that it shall not be used as "a sole basis for an administrative proceeding or as a basis for the imposition of a sanction by the . . . Commission arising out of defendent Bloom's participation in the offer and sale of General Electronics stock . . ." The consent is neither being used as the sole basis for this administrative proceeding nor the basis for the imposition of a sanction arising out of Bloom's participation in the offer and sale of General Electronics stock . . ." The injunction as a record of past

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17/ The record does not disclose the nature of registrant's or Bloom's conduct which prompted the NASD sanctions.

conduct by Bloom will be weighed along with the other sanctions noted above imposed by the NASD against Bloom in the past. Sanctions imposed by the NASD on prior occasions have been considered by the Commission when weighing the appropriateness of a sanction it intended to invoke in a current administrative proceeding. Goffe-Carkener-Blackford Securities Corp., et al 45 S.E.C. 975,981 (1975).

All of the arguments advanced by respondents that no sanctions are warranted have been considered as appears from the analysis above. In determining that it is in the public interest to impose sanctions several factors stand out which justify the conclusions reached. The gravity of the numerous violations found, though characterized by respondents as bookkeeping and records deficiencies must be viewed in context of the public interest and potential harm to registrant's customers. The possibility of harm was evident at the time the Commission's staff conducted its investigation of registrants records since the staff was unable to ascertain the true financial condition of the firm. With respect to determining whether to impose sanctions upon Bloom, consideration is given to his admission that he was in charge of the entire operation of the firm and his testimony that he was "responsible for everything." In addition, the record reveals his apparent lack of knowledge of some of the basic rules and regulations. He testified, for example, he was unaware of the firm's obligation to obtain physical possession of fully paid and excess margin securities of customers nor was he aware of the definition of "excess margin securities" as set forth in Rule 15c3-3(a)(5).

The Commission in promulgating the requirements, pertinent here, detailing the types and contents of records which must be prepared and maintained by broker-dealers, the financial reports which must be prepared and timely filed, the manner in which securities of the firm and customers must be kept and segregated, concluded that such requirements were necessary to ensure that broker-dealers have the financial capacity to protect the funds and securities of its customers. Though respondents took corrective action when violations were found it does not absolve them from their failure to comply. Respondents claim that its records are now substantially in compliance does not cure their past violations. Registrant is presently conducting business and is required to comply with all the rules and regulations. Deliberating the entire record it is concluded that the sanctions described below should be imposed.

The sanctions which are regarded as essential in the public interest are fashioned to impress upon respondents the necessity of making certain at all times that registrant's books and records may not be relegated to a secondary consideration dependent either upon time available or what respondents believe more important matters which require their attention. To verify that compliance with the Commissions rules and regulations will not be regarded as insignificant, registrant will, for a period of two years, be required to file quarterly reports designed to assure that its books and records are being maintained currently and accurately. Respondent Bloom who was found to be responsible for all of registrants operations will be suspended for sixty (60) days. Such sanctions are deemed essential for remedial and deterrent purposes and, are deemed adequate, appropriate and necessary in the public interest.

IT IS ORDERED that registrant is hereby suspended for a period of sixty (60) days provided however, the sixty day suspension shall not take effect at this time, upon condition that registrant file quarterly reports with the Regional Administrator of the Commission's New York Regional Office in the form of a certificate signed by an independent public accountant certifying that registrant's books and records are being currently maintained in compliance with the Commission's Rules and Regulations.

The first of such quarterly reports shall be filed on or prior to September 10, 1982 for the period ended August 31, 1982 and subsequent records filed within 10 days after the end of each succeeding quarter until the quarter ending August 31, 1984.

In the event registrant fails timely to file any such quarterly report, or such report reflects that registrant's books and records are not being maintained as required by the Commission's Rules and Regulations, registrant shall cease operation and the sixty day suspension shall immediately become effective.

IT IS FURTHER ORDERED that Raphael David Bloom is hereby suspended from association with any broker-dealer for sixty (60) days.

This order shall become effective in accordance with and subject to Rule 17(f) of the Commission's Rules of Practice 17CFR 201.17(f).

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition

for review, or the Commission takes action to review as to a party, this initial decision shall not become final with respect to that party. 18/

Irving Schiller
Administrative Law Judge

August 2, 1982
Washington, D.C.

18/ All proposed findings, conclusions, and supporting arguments of the further have been considered. To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the findings, conclusions and views stated herein they have been accepted, and to the extent they are inconsistent therewith they have been rejected. Certain proposed findings and conclusions have been omitted or not relevant or as not necessary to a proper determination of the material issues presented.