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ADMINISTRATIVE PROCEEDING
FILE NO. 3-5797

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

MICHAEL E. TENNENBAUM :

(Bear, Stearns & Co., 8-00293) :

Filed 7/25/80

INITIAL DECISION

July 24, 1980
Washington, D.C.

Ralph Hunter Tracy
Administrative Law Judge

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APPEARANCES: Bobby C. Lawyer and Steven N. Machtinger of the San Francisco Branch Office for the Division of Enforcement.

Richard L. Jaeger for Michael E. Tennenbaum

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

This is a public proceeding instituted by an order of the Commission (Order) dated July 16, 1979, pursuant to Sections 15(b), 19(h)(2) and 19(h)(3) of the Securities Exchange Act of 1934 (Exchange Act) to determine whether the above-named respondent failed reasonably to supervise, with a view to preventing violations alleged in the Order, persons who were subject to his supervision and who committed such violations, as alleged by the Division of Enforcement (Division), and the remedial action, if any, that might be appropriate in the public interest.

The proceeding has been determined as to 4 respondents 1/ by means of offers of settlement which were accepted by the Commission. Therefore, this decision is applicable only to the remaining respondent, Michael E. Tennenbaum, although, in view of the nature of the charges and the factual circumstances it will, also, necessarily involve findings with respect to some or all of the respondents.

The Order alleges, in substance, that Bear Stearns & Co., (Stearns or registrant), Richard A. Graham (Graham) and Philip A. Schaefer (Schaefer) wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 (Securities Act) and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and that Tennenbaum failed reasonably to supervise those persons under his supervision with a view to preventing the alleged violations.

1/ The Commission's action concerning these respondents is reflected in respective Securities Exchange Act Releases, as follows: Bear, Stearns & Co. 16025, July 16, 1979; Richard A. Graham and Larry E. Friend, 16237, October 3, 1979; Philip A. Schaefer, 16392, December 3, 1979.

Respondent was represented by counsel throughout the proceeding and proposed findings of fact and conclusions of law and supporting briefs were filed by the respondent and the Division.[2/]

The findings and conclusions herein are based upon clear and convincing evidence as determined from the record and upon observation of the witnesses.

FINDINGS OF FACT AND LAW

Respondents

The remaining respondent, who is the only one subject to this decision, is Michael E. Tennenbaum (Tennenbaum). He was born on September 17, 1935, and received a B.S. degree in industrial engineering from Georgia Institute of Technology in 1958. Following 2 years as an officer in the U.S. Army Signal Corps he attended Harvard Graduate School of Business receiving an M.B.A. degree in 1962. Upon graduation from Harvard he joined Drexel-Burnham & Co. and in April 1964 he moved to Bear, Stearns in its New York office as a commissioned retail salesman. After about 5 years with Bear, Stearns he was made a general partner, and shortly afterwards was asked to start an investment and management department. Shortly after that he was given joint responsibility for the research department and later joined the

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2/ In answer to the Division's reply brief respondent's counsel submitted a 19-page response in the form of a letter. This, in turn, was replied to by the Division. Although not provided for in the Commission's Rules of Practice, both documents have been considered and made a part of the record.

risk arbitrage department where he was one of the decision makers in connection with the management of the firm's money. In 1974 he was asked to start an options department and as it grew it became his full time activity until July 1977 when he transferred to Bear, Stearns Los Angeles office where he has been engaged in investment banking projects.

Richard A. Graham was employed by Bear, Stearns in its San Francisco office from May 20, 1974 until September 16, 1977, as a registered representative. From May 7, 1976 until January 31, 1977 he also served as the retail sales manager for the San Francisco office.

Options

An option is the right to buy or sell 100 shares of a stock by a specified date at a specified price, regardless of the market price. Trading in listed options began in April 1973 when the Commission granted registration as an exchange to the Chicago Board Options Exchange (CBOE) which had been organized for the purpose. (Securities Exchange Act Release No. 9985/ February 1, 1973). Trading was initially limited to call options in 16 underlying stocks. Options are now traded on 5 exchanges nationwide. The Options Clearing Corporation (OCC) acts as the "issuer" of all listed options traded on the exchanges and prepares and files a prospectus with the Commission under the Securities Act of 1933. The OCC, also, serves as the clearing house for option transactions on the exchanges.

Some of the strategies which may be employed in investing in options are:

Buying options, a bullish strategy designed to earn a profit if the option appreciates based on an increase in the price of the underlying stock. Because options are good for only short periods of time (not more than 9 months) buying options is far more risky than buying stock, for, in the absence of a significant gain in the underlying stock, the investor stands to lose his entire investment in a short period of time.

Covered writing, involves selling (or writing) options against shares of stock already owned and is considered a relatively conservative strategy.

Uncovered (naked) writing, involves selling an option while not owning the underlying stock and accordingly, involves a high degree of risk.

Spreading, involves the establishment of simultaneous long and short positions in options which relate to the same underlying stock, but vary as to exercise price and/or expiration date. Spreading, like buying options, is speculative in that, among other reasons, the investor may lose his entire investment in a short period of time. In addition, spreading entails especially significant commission costs, in that it involves two transactions each time a spread position is created or closed. If spread positions are created and closed repeatedly within short periods of time, the risks as well as the commissions are especially great.

Violations

The remaining respondent in this proceeding, Tennenbaum, is charged with failing to reasonably supervise persons subject to his supervision with a view to preventing violations committed by them. Although two respondents who allegedly committed violations were named as being under Tennenbaum's supervision the Division, in its presentation of the evidence has focused on one, Graham.

The Order alleges that from May 20, 1974 to September 16, 1977, Graham wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 (Securities Act) and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in that in connection with the purchase and sale of securities he (i) employed devices, schemes, and artifices to defraud; (ii) obtained money and property by means of making untrue statements of material facts and omitting 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 (iii) engaged in acts, practices and courses of business which would and did operate as a fraud and deceit upon purchasers and sellers of securities.

As part of the above described conduct Graham induced customers to grant him discretionary authority for trading their accounts by means of misrepresentations and omissions to state material facts regarding the risks of option trading; effected securities transactions which were excessive in size and frequency in view of financial resources and character of such accounts; effected transactions in discretionary accounts which were excessively speculative in view of the objectives and degree of investment sophistication and understanding of the customers involved; effected transactions beyond the scope of the discretionary authority granted by the customers; made untrue statements of material facts and omitted to state material facts concerning, among other things: the rate of return that might be achieved through listed options trading without engaging in a high degree of risk; the speculative nature of transactions to be conducted in customer accounts; the risks inherent in certain strategies; the impact of commissions upon customer accounts; the kinds of options strategies that would be effected in customer accounts; and the extent to which trading accounts would be monitored.

Graham opened at least 36 discretionary accounts for customers, in which he engaged in various options strategies. In some accounts he engaged only in covered writing, in others in covered writing and spreading while in others he did spreading only. He primarily employed spreading strategies although he did naked writing and some extremely complex investment transactions, such as "butterfly spreads," which entail simultaneous purchase and sale of options in the same class, with the same expiration date, so that for every two options sold, two options-one with a higher exercise price and one with a lower exercise price-are bought.

A number of customers were introduced to Graham by Philip Schaefer, another salesman in the San Francisco office. Graham had an agreement whereby Schaefer would introduce customers to Graham and the two salesmen would then split the commissions generated by Graham's trading in the customers' accounts.

During the hearing testimony of 9 investors was introduced by stipulation between the Division and respondent Tennenbaum. These 9 investors had given Graham discretionary authority over a total of 11 accounts during the period from May 20, 1974 to September 16, 1977. As shown in the following table, the total investment in the accounts was $737,685 and Graham's transactions for these accounts resulted in commissions of $478,154 to him and losses of $301,354 to investors.

Amount invested	Commissions	Net Loss	Percentage of Loss	Annual Commission Rate
$ 54,871	$ 47,562	$24,149	40%	43%
19,029	3,077	19,029	100%	10%
140,147	47,254	31,937	23%	19%
49,862	14,504	17,332	35%	23%
84,808	49,990	9,362	11%	23%
21,604	8,870	11,811	55%	26%
144,937	85,120	64,138	44%	24%
113,211	167,180	86,998	77%	60%
33,411	17,132	23,752	71%	125%
19,075	2,344	2,235	12%	93%
56,730	35,121	10,611	19%	32%
$737,785	$478,154	$301,354	41%	65%

The testimony of the above 9 investors was the same or similar in almost every respect. They all desired a conservation of capital with a reasonably secure income and did not want to take any undue risks. Graham assured them that he would engage in covered writing primarily but in every instance he engaged in highly speculative transactions including naked writing and various spreads. He promised anywhere from 15 to as high as 40 percent return without loss and with little or no risk. Several investors complained of excessive trading and that they did not understand the activity in their account. At least one complaint of loss was settled with payment to the investor by Bear, Stearns on the condition that the complaint be withdrawn.

In a letter to Bear, Stearns in June 1977, one investor complained of an "inordinate amount of trading in my account resulting in losses to me and considerable profit to you. I believe the excess trading is inconsistent with the original concept presented to me by Mr. Graham." This complaint conveys the consensus of opinion of the 9 investors that Graham had ignored their expressed intent to conserve capital and, instead, had engaged in excessive trading in highly speculative issues with resulting losses to them and high commissions to Graham.

The record fully supports a finding that Graham willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[3/]

Supervision

The Order charges that Bear, Stearns & Co. (registrant),

3/ It is found that Graham acted with scienter, therefore his violations were clearly wilfull. However, scienter is not necessary to establish violations of Section 17(a)(2) and 17(a)(3) of the Securities Act. Aaron v. Securities and Exchange Commission, 48 U.S.L.W. 4603 (6-2-80). All findings of fraud are made under both those sections. The findings that Graham also violated Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder are merely cumulative. First Pittsburgh Securities Corporation, Exchange Act Release No. 16897/June 16, 1980.

Larry H. Friend (Friend) and Tennenbaum failed reasonably to supervise, with a view to preventing the violations found above, persons who were subject to their supervision and who committed such violations. In view of the fact that registrant and Friend have settled and the Division has presented evidence of violations only with respect to Graham the issue has narrowed down to the failure of Tennenbaum to properly supervise Graham.

Section 15(b)(4)(E) of the Exchange Act provides an independent ground for the imposition of a sanction against a broker or dealer or a person associated with a broker or dealer who

> "... has failed reasonably to supervise, with a view to preventing violations of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purpose of this subparagraph (E) no person shall be deemed to have failed reasonably to supervise any other person if —
> (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and
> (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with."

Respondent asserts that the responsibility for supervision of Graham had been delegated to others and that the authority for the direct supervision of Graham lay with persons and departments of the firm other than himself. Respondent admits he designed the system for supervising options transactions but that the responsibility for ensuring that the system functioned properly rested with others, including Larry Friend, the partner in charge in Los Angeles who was regional supervisor for the San Francisco office, and the compliance department of Bear, Stearns in New York.

When trading in listed call options commenced on the Chicago Board Options Exchange (CBOE) in April 1973, the Exchange issued rules to be followed by all firms wishing to become members of the CBOE and to transact business with the public through the facilities of the CBOE. The rules in effect during the period herein required, in pertinent part, that member firms designate a Registered Options Principal (ROP), who is an officer or general partner of the firm, to be responsible for the supervision of options customer accounts.[4/] This designation later became Senior Registered Options Principal (SROP) and was the position occupied by Tennenbaum from the beginning of Bear, Stearns' activities in options until he transferred to Los Angeles in July 1977. All sales representatives who engaged in selling options had to, also, take an examination and become registered with the CBOE. They later became designated as Registered Options Principal. (ROP)

Sometime in the later part of 1973 or early 1974 Tennenbaum was asked by a Bear, Stearns partner to set up an options department and he thereupon spent a week studying options procedures at

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4/ Rule 9.8. Every member organization shall provide for the supervision, by a Registered Options Principal who is an officer or partner of the member organization, of all of its customer accounts and all orders in such accounts, insofar as such accounts and orders relate to option contracts.
.01. A Registered Options Principal, in meeting his responsibility for supervision of customers' accounts and orders, may delegate to qualified employees responsibility and authority for supervision and control of each branch office handling options transactions, provided that the Registered Options Principal shall have overall authority and responsibility for establishing appropriate procedures of supervision and control over such employee.

the CBOE in Chicago. Upon his return to New York he agreed to accept the responsibility for starting options trading at Bear, Stearns. Tennenbaum testified that he designed the system for supervising options and established the criteria for customer option trading.

In a memorandum dated January 15, 1975, entitled Bear, Stearns' Option Compliance Program, addressed to partners and top management of the firm, Tennenbaum sets forth guidelines to be followed. These require that, in a format to be agreed upon between the compliance department and the SROP, the customer shall acknowledge what types of option transactions he intends to engage in through Bear, Stearns. Exceptions in customer accounts monitored by compliance shall promptly be brought to the attention of the appropriate supervisory personnel, who will deal with any problems that are uncovered and make appropriate written reports thereon for the compliance file. Substantial exceptions and evidence of non-compliance will be referred to the SROP by the compliance department. Also, in every Bear, Stearns' office in which sales personnel deal in option transactions, the resident partner, together with those he designates as supervisory sales personnel, shall become ROPs. They are to be responsible for suitability of option transactions carried on through their branches. Bear Stearns' director of compliance will assist both them and the SROP in surveillance of customer option transactions. However, they shall be responsible to the SROP with respect to compliance exceptions in the area of option transactions. The director of compliance will immediately notify, in writing, both the SROP as well as those people to become ROPs of the deadlines that have been established for their taking the necessary examination.

M. David Hyman, a limited partner and director of the legal and compliance department at Bear, Stearns testified that Tennenbaum was the senior ROP of the firm and as such was responsible for options compliance in 1974. Hyman and Tennenbaum devised the system of controlling options transactions within accounts by coding the accounts so that an exception report would be produced which could be followed up if accounts were not approved for options. Tennenbaum was also responsible for approving certain salesmen to have discretionary accounts. He was the only one at Bear, Stearns who could give that approval. 5/ If there was any question as to whether or not a particular account should be approved for uncovered writing the decision ultimately would be made by Tennenbaum. He was also responsible for the floor activities of the option exchanges and coordinating the execution of orders.

5/ CBOE Rule 9.10(a) provides for discretionary account as follows:

> No member organization shall exercise any discretionary power with respect to Exchange transactions in a customer's account unless such customer has given prior written authorization and the account has been accepted in writing by a Registered Options Principal who is an officer or partner of the member organization. Such written authorization must be renewed annually. Each discretionary order shall be approved and initialled on the day entered by the Registered Options Principal, or in the case of a branch office, by a branch office manager, provided that such approval shall be confirmed within a reasonable time by the Registered Options Principal. Every discretionary order must be identified as discretionary on the order at the time of entry. Discretionary accounts shall receive frequent appropriate supervisory review by the Registered Principal.

Graham apparently was actually hired by Larry Friend (Friend) in May 1974, although Tennenbaum and others in the Bear, Stearns organization knew and recommended Graham who had been with Loeb, Rhoades in San Francisco. Friend, who was located in Los Angeles,was the partner in charge of both the Los Angeles and San Francisco offices. At the time Graham was hired Bear, Stearns was planning to expand retail operations in its San Francisco office. Shortly after joining Bear, Stearns Graham expressed an interest in conducting discretionary options transactions in customer's accounts. There was no ROP in San Francisco and Friend, who was not an ROP, was concerned as to how Graham's options transactions would be supervised because,as he testified, "there was no way I was going to monitor from Los Angeles what was being done in options in San Francisco, since I did not have an extensive enough background to look over something like that." Accordingly, he discussed the situation with Tennenbaum who, according to Friend, was the partner in charge of the options area on a national basis. Graham was aware that he was being supervised from Los Angeles with regard to transactions other than in the options area.

During most of the pertinent period herein the San Francisco office was run in what Tennenbaum described as a loosely knit manner with various people in charge, designated by Friend, including Graham, who was retail sales manager from May 7, 1976 to January 31, 1977. There was no ROP as prescribed by CBOE rules and Tennenbaum's own rules and although Tennenbaum was urging people on the west coast to take the ROP exam, no one did. It was not until February 1, 1977, when Marshall Geller, a limited partner, was appointed manager that the San Francisco office was properly managed. Geller, who is still there, supervises San Francisco and reports directly to New York. He, also, became an ROP.

There was very little option activity in San Francisco prior to the arrival of Graham. However, it wasn't long before Friend became concerned about the amount of trading Graham was doing in his customer's accounts and discussed it with Tennenbaum to whose judgment he deferred. Tennenbaum and others in New York devised a method of reviewing customer's options transactions on a daily basis and computing the equity in the account. This was known as a portfolio status review (PSR) and the customer would be furnished a copy so that he would be aware of the activity in his portfolio as well as the increase or decrease in his equity in the account. Friend was instructed by the compliance department to put Graham's accounts on PSR. He did not know what the breakdown was in New York concerning authority for determining possible or potential problems in Graham's option accounts.

Tennenbaum testified that he had insisted on the PSR being operated on a computer system but that the computer would break down which delayed the computation in the accounts as well as the receipt of the information in New York. During the summer of 1976 the PSR system seemed to be working and Tennenbaum testified:

"...I had every reason to believe that the system was functioning." However, the record shows continued difficulty with the PSR, particularly with regard to Graham's accounts. Some blamed it on Graham and he blamed it on others. When the PSR did not work the compliance department did the computations manually.

In any event Tennenbaum was aware of the situation. He testified that the compliance department showed Graham's accounts to him early in 1977, as they were too active and losing money. He asked to see the figures "and they looked terrible." Tennenbaum testified that there was no ROP in the San Francisco office but that "as a matter of record, it is possible that I was. I know at one point, I was."

At least as early as July 1974 Tennenbaum was aware of problems with Graham. A customer of Graham's had not executed a customer's agreement, as required by the CBOE, after 3 requests and Graham was sent a notice that there was to be no further trading in the account.

On January 15, 1975, Tennenbaum issued his memo on the options compliance program. (<u>Supra</u> p. 11) It should be noted that one of the features of both the CBOE and the Bear, Stearns' rules concerning option transactions was the suitability of investors. In other words the salesman had to obtain certain information concerning a customer's income, net worth, investment sophistication, etc. and submit a form to New York where the accounts could be surveilled. If an account appeared to have too much activity, based on the qualifying information, or was losing equity or generating excessive commissions then steps were supposed to be taken to apprise the investor of the situation and make sure he agreed with what was taking place. This was one of the purposes of the PSR system. If New York thought that the customer should be notified then it was left up to the salesmen to do it. This is where much of the difficulty with Graham arose as he did not want to inform his customers and objected to anyone else doing it.

On March 5, 1975, Hyman addressed a memo to Tennenbaum concerning three of Graham's accounts which were heavy traders in options. In Hyman's opinion the nature of the activity in the accounts was such that the supervisor should make inquiry to satisfy himself that the customers were aware of the activity and he considered Tennenbaum a supervisor for that purpose. After discussion with Graham, Tennenbaum decided that it was appropriate to continue to operate the accounts. However, Tennenbaum informed Graham by memo that under certain conditions he (Tennenbaum) was to be notified in writing that the transaction was in the best economic interest of the client.

Hyman testified that he deferred to Tennenbaum's judgment in the matter. It was shortly after this that the PSR system was established so as to provide each options customer with a monthly statement of the equity in his account. Graham was instructed to put all of his discretionary accounts on the PSR.

Tennenbaum advocated giving Graham discretionary authority and applying surveillance but there was disagreement as Hyman was not in favor of any discretionary accounts in options. Whenever there was any difficulty in such accounts Hyman automatically turned to Tennenbaum who testified "I was willing to take the burden."

On an inspection of the San Francisco office in September 1975 Hyman found that although there were only 4 retail brokers there was a lack of control or direction over this phase of the business. The retail sales manager had made no effort to understand the activity in Graham's accounts. He was afraid that if he questioned Graham that Graham would resign and go to another firm. Hyman told the manager that in his view Graham controlled many of his option accounts and that any accounts that generated $1,000 a month or more in commissions should be sent a quarterly letter stating the equity in the account. Hyman talked to Graham who was not receptive to the idea. Graham had also been preparing option recommendations in quantity for distribution but these had never been shown to the compliance department. Based upon Hyman's report the firm began to look for another manager for San Francisco and eventually settled on Marshall Geller.

For a period of time following this inspection, Tennenbaum was approving individual discretionary transactions in Graham's accounts. This was done before Geller became manager and had taken the ROP exam. The overall activity in Graham's options accounts had raised questions beginning in 1974, which Friend discussed with Hyman and Tennenbaum. It was discovered that Graham had handled a number of accounts on a discretionary basis without notifying the compliance department and without getting authority from the customer. Graham continually stalled in complying with requirements. He was not happy having equity results sent to customers.

On October 10, 1975, Hyman sent a memo to Tennenbaum and David Cranston (then in charge in San Francisco) concerning 6 of Graham's accounts and stating that in "view of the substantial activity in these accounts it appears that some of them may be controlled by Graham in which event it is believed necessary to advise the customer of the equity in the account so that he will not be surprised by the year end results." On October 15,1975 Hyman sent another memo to Tennenbaum regarding Graham's option accounts.

On October 17, 1975, Tennenbaum sent a memo to Hyman which says: "Please do not press Dick Graham to undertake this procedure now. The fundamental problem is lack of supervision over the San Francisco office. Hopefully you and Marvin can remedy this." (Marvin is Marvin Davidson, Bear, Stearns managing partner). Davidson overruled Tennenbaum on this occasion and directed that letters be sent to customers.

On April 6, 1976, Tennenbaum addressed a memo to all Partners, Branch Manager's and ROP's, Subject: Options Compliance:

"Recent review of option approval forms has indicated deviation from firm policy in the following area: Uncovered Option Writing; Discretionary options transactions. No such transactions are permitted without written approval from the Senior Registered Options Principal.

"While the Senior Registered Options Principal of the firm has the personal regulatory responsibility, it is impractical for him to personally supervise all option transactions."

During the remainder of 1976, and until at least May 23, 1977, Graham continued to be a primary source of concern to Tennenbaum and other executives at Bear, Stearns, as numerous memos in the record make clear. Reference to a few of these will serve to illustrate the type of problems which arose during the period.

On August 11, 1976, Graham addressed a memo to Tennenbaum, stating that, subject to Tennenbaum's approval, he has accepted an invitation to speak before the San Francisco Option Society on September 16, 1976. He refers, also, to a meeting with Dan Dorfman to update material, previously sent to Tennenbaum, which he expects to appear in both New York and New West magazines. The article, which subsequently appeared in the New York magazine of October 11, 1976, was by Dan Dorfman and described Graham and his option strategy.

In a memo dated October 7, 1976, addressed to Hyman, entitled: Option Compliance in the San Francisco and Los Angeles Offices, Tennenbaum describes a recent visit and makes several suggestions for improvement in those offices (and probably others). He suggests that a special section on options compliance be included in the rules provided to branch office managers, ROP's and registered representatives. Also, that the managers and ROP's receive copies of the CBOE and ASE rules relating to suitability. In addition, a special memo should be prepared and sent to registered representatives incorporating the criteria the firm expects them to follow in all phases of options transactions. Tennenbuam says that if the compliance department would draft such a memo he would be happy to assist in its development.

In August 1976 it was ascertained that of a list of 35 discretionary accounts supplied by Graham the New York office had discretionary papers for only 16. Accordingly, Graham was requested to obtain the required papers on the other 19. Also a number of his accounts were not on the PSR program.

On January 27, 1977, Tennenbaum addressed a memo to 7 persons in the Los Angeles and San Francisco offices, including Graham, stating that "... in order to ensure proper supervision of the option activities in your office, it is imperative that you take and pass the ROP exam within the next 30 days."

On February 11, 1977, Geller, who had become manager of the San Francisco office on February 1, 1977, requested the compliance, margin and option departments to proceed in due haste to update him completely on all the existing problems and questions which are arising regarding the accounts for which Graham is responsible. "...without a complete knowledge of what has transpired over the last three year period in this office... we are doing nothing but perpetuating, in my opinion, a very serious matter."

On May 6, 1977, Hyman addressed a memo to Tennenbaum concerning a complaint received by Geller about an account of Graham's being excessively traded. Hyman is concerned about this complaint "because a number of Graham's accounts have had substantial activity and have incurred losses." Also, "just advised yesterday that the problem we thought corrected some months ago in the PSR still exists." Hyman goes on to say: "In view of this complaint and the other recent problems we have had with Richard (Graham) in trying to secure his cooperation in complying with the firm's procedures for discretionary option accounts, I recommend that Mr. Graham be told that he must confine all future options activity to covered writing only or else place his accounts under the direction of the Hedged Option Investment Department. Because the daily review of Graham's activity is made by you in New York and the monthly review of his accounts is made by Marshall (Geller) in San Francisco, supervision is made more difficult."

On May 23, 1977, the Executive Committee of Bear, Stearns, imposed a fine of $2,500 on Graham for failing to follow the firm's established procedures with respect to the handling of his discretionary accounts. Among the items enumerated were: "You failed to take steps to see that the PSR system was accurately maintained in order to provide customers with a statement of the equity in their account each month; and accounts were opened by you without indicating on the new account form that you held discretion with respect to that account, although we understand that the firm has received all the necessary papers for such accounts or they are being forwarded."

Graham left Bear Stearns on September 16, 1977.

Conclusion

The evidentiary record in this proceeding leads to the inescapable conclusion that Tennenbaum was Graham's supervisor and, as such, had responsibility for the enforcement of the CBOE rules relating to options, as well as the Bear, Stearns' rules which he promulgated. The CBOE rules obligate a member organization to designate an officer or partner to supervise all options activities and to be responsible for the granting and exercise of discretionary authority in connection therewith. 6/ Tennenbaum was designated to those positions as SROP of the firm. Although CBOE Rule 9.8 allows delegation of authority under certain conditions the Commission has repeatedly held that even though the president of a broker-dealer firm reasonably delegated authority over a particular area, he is not relieved of responsibility if he is aware of improper conduct. 7/

There is no question that Graham needed supervision - the question is who had the responsibility for it. Tennenbaum asserts that he merely set up the supervisory procedures and left it to others to implement them. However, this position ignores the CBOE rules under which Tennenbaum was designated SROP for Bear, Stearns, and the guidelines which he developed and circulated for the participation of Bear, Stearns in option transactions. In addition, the evidence clearly shows that Davidson, Hyman, Friend and Graham all deferred to Tennenbaum as being Graham's supervisor for options matters.

Tennenbaum failed to enforce his own procedures despite numerous warning flags. He did not insist on anyone being qualified as an ROP in San Francisco before allowing options transactions; Graham was never required to comply with the PSR system for keeping his customers informed as to the status of their accounts; no inquiry was ever made of Graham's customers to ascertain whether

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6/ CBOE Rules 9.2; 9.8; 9.10.

7/ In the Matter of Irwin Schloss, Exchange Act Release No. 16934/June 26, 1980. See, also, Section 15(b)(4)(E)(ii), page 9, supra.

they had properly granted him discretion over their accounts or approved the activity in them; and steps were never taken to halt excessive trading or the commissions generated by it. Further, no effort was made to revoke Graham's discretionary authority despite evidence of abuse.

Brokers and dealers are under a duty to supervise the actions of employees and in large organizations it is especially imperative that the system of internal control be adequate and effective and that those in authority exercise the utmost vigilance whenever a remote indication of irregularity reaches their attention. 8/ As the Court said in R. H. Johnson & Company v. S.E.C., 198 F.2d 690, 698 (C.A. 2, 1952), *cert. denied* 344 U.S. 855 (1952), a contrary rule "would encourage ethical irresponsibility by those who should be primarily responsible."

It is found that Tennenbaum failed reasonably to supervise Graham with a view to preventing the violations found herein to have been committed by Graham.

Other Matters

When counsel for respondent Tennenbaum submitted his brief on May 23, 1980, he also submitted a letter obtained by Bear, Stearns from the New York Stock Exchange purporting to show the number of compliants received against Bear, Stearns by the NYSE as compared to the number of complaints received for all firms.

8/ Reynolds & Co., 39 S.E.C. 902, 916 (1960).

Counsel asked that the record be reopened for the limited purpose of receiving this evidence. The Division of Enforcement objects to its reception on the ground that it is irrelevant.

During the course of the hearing a motion was made by counsel for respondent for similar records obtained by the Commission staff from various sources during the investigation which led to the publication of the special study of the options market. My denial of that motion as irrelevant was affirmed by the Commission. The present motion is also denied as being irrelevant.

Public Interest

The remaining issue concerns the remedial action which is appropriate in the public interest with respect to the finding of Tennenbaum's failing to reasonably supervise Graham. The Division proposed that Tennenbaum be suspended from association with any broker or dealer for a period of six months, and that he thereafter be permitted to be so associated only in a non-supervisory capacity. Respondent, on the other hand, asserts that no sanction is required.

Respondent points out that in 1977 he moved to the Los Angeles office of Bear, Stearns and is no longer involved with the supervision of options transactions. He is now in the area of investment banking and in this capacity is not responsible for supervising any of the firm's personnel.

Tennenbaum, while denying any responsibility for Graham, did testify that he managed the options department at Bear, Stearns, was a member of the options advisory committee to the Pacific

Stock Exchange (PSE) and a member of the NASD arbitration panel on options for New York. He stated that he originally had overall responsibility for options at Bear, Stearns but later became more of a coordinator between various departments. When he left New York he conveyed all of his options files to the functional areas that were succeeding him in responsibility for the options department. Any files relating to individual compliance problems were conveyed to the compliance department.

In dealing with public interest requirements in a particular case weight must be given to the effect of the decision on the welfare of investors as a class and on standards of conduct in the securities business generally. If these proceedings are to be truly remedial, they must have a deterrent effect not only on the present respondent, but also on others who may be tempted to engage in similar misconduct. 9/

The appropriate remedial action as to a particular respondent depends on the facts and circumstances applicable to him and cannot be measured precisely on the basis of action taken against other respondents, 10/ particularly where, as here, the action respecting others is based on offers of settlement which the Commission deemed appropriate to accept. 11/

9/ Thomas A. Sartain, Sr., Exchange Act Release No. 16561/February 8, 1980: Arthur Lipper Corporation v. S.E.C., 547 F.2d 171, 184 (C.A. 2, 1976), cert. denied, 343 U.S. 1009.

10/ Dlugash v. S.E.C., 373 F.2d 107, 110 (2d Cir., 1967).

11/ Benjamin Werner, 44 S.E.C. 745, 748 (1971).

Failure of supervision - which may result in derivative responsibility for the misconduct of others - connotes an inattention to supervisory responsibilities, a failure to learn of improprieties when diligent application of supervisory procedures would have uncovered them. 12/ However, this is not the case here where Tennenbaum was aware of the misconduct of Graham and allowed it to go unchecked for 3 years.

Upon consideration of all the circumstances, including Tannenbaum's previously unblemished record and the fact that he no longer exercises supervisory responsibilities in the options area it is believed that the public interest requirements will be served by a one-month suspension from association with any broker or dealer.

Accordingly, IT IS ORDERED that Michael E. Tennenbaum is suspended from association with any broker or dealer for one month.

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

Pursuant to that Rule, this initial decision shall become the final decision of the Commission as to each party who has

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12/ Madison Management Corp., 42 S.E.C. 390, 392 (1964); General Investing Corp., 41 S.E.C. 952, 958 (1964).

not filed a petition for review pursuant to Rule 17(b) within fifteen days after service of the initial decision upon him, 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, the initial decision shall not become final with respect to that party. 13/

Ralph Hunter Tracy
Administrative Law Judge

July 24, 1980
Washington, D.C.

13/ All proposed findings and conclusions and contentions have been considered. They are accepted to the extent they are consistent with this decision.