IN THE MATTER OF

SECURITY PLANNERS ASSOCIATES, INC.

HOWARD SMOLAR

File No. 3-2267. Promulgated December 17, 1971

Securities Exchange Act of 1934—Sections 15(b) and 15A)

BROKER-DEALER PROCEEDINGS

Failure to Comply with Records Requirements

Improper Extension of Credit

Failure to File Timely Report of Financial Condition

Where registered broker-dealer failed to comply with records requirements, improperly extended credit to customers, and failed to file report of financial condition within prescribed period, in willful violation of the Securities Exchange Act of 1934 and rules thereunder, and where president of broker-dealer failed to exercise reasonable supervision to prevent certain of credit violations, *held,* under circumstances, in public interest to suspend broker-dealer's registration and membership in registered securities association and to suspend president from association with broker-dealer.

APPEARANCES:

Willis H. Riccio and *Edward P. Delaney,* of the Boston Regional Office of the Commission, for the Division of Trading and Markets.

Sumner H. Woodrow and *Harold R. Fisher,* of Balliro and Woodrow, for respondents.

FINDINGS AND OPINION OF THE COMMISSION

Following hearings in these proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934, the hearing examiner issued an initial decision in which he concluded that the broker-dealer registration of Security Planners Associates, Inc. ("registrant") should be revoked, and that registrant should be expelled from membership in the National Association of Securities Dealers, Inc. ("NASD"). He further concluded that Howard Smolar, president and treasurer of

registrant, should be barred from association with a broker-dealer except that, after thirty days, he may become so associated upon an appropriate showing that he will be adequately supervised. We granted respondents' petition for review of the initial decision, and they and our Division of Trading and Markets ("Division") filed briefs. Our findings are based upon an independent review of the record.

Registrant became registered with us in November 1960. During the period covered by the allegations of the order for proceedings as amended, September 1968 to August 1970, L. Dexter Faunce was president and Smolar executive vice-president of registrant until December 1, 1969, when Smolar succeeded Faunce as president. Registrant was charged with violations of our record-keeping provisions while Faunce was president, of the credit-extension regulations while Faunce and then Smolar were president, and of our financial reporting requirements while Smolar was president. Smolar, as well as Faunce, was charged with a failure to exercise reasonable supervision with respect to the record and credit violations.[1]

FAILURE TO COMPLY WITH RECORD-KEEPING REQUIREMENTS

The record supports the examiner's finding that registrant willfully violated Section 17(a) of the Act and Rule 17a–3 thereunder in failing to make or keep current or accurate certain required books and records as set forth below.

An inspection by our staff on June 13, 1969, disclosed that registrant's general ledger had not been posted since April 30, 1969, and the dividend record not since May 31, 1969, and no position record was kept. The last available trial balance of customer and broker-dealer accounts was as of April 30, 1969. In addition, there was a difference of $74,600 between subsidiary records of customers' accounts and the control account. Although after being notified of those deficiencies Faunce advised the staff that registrant had taken steps to correct them, another inspection on July 17, 1969, disclosed that the general ledger had not been posted since May 31, the customer ledger accounts did not show receipts and deliveries of securities or dividends, long positions in the securities ledger did not have offsetting short positions, and the balance in the subsidiary accounts for customers and broker-dealers as of May 31, 1969, exceeded the amount shown in the general ledger control account by $76,239. The deficiencies and the lack of progress in

[1] Pursuant to an offer of settlement, Faunce was censured subject to certain conditions and undertakings by him. Securities Exchange Act Release No. 9191 (June 4, 1971).

curing them were discussed with Faunce and other representatives of registrant, but a further inspection on September 29, 1969, disclosed that customer ledger accounts had not been posted since September 17, and that, on the basis of an examination of a small part of the securities ledger (accounts under letters A through part of C), 34 stock-record cards were out of balance.

Respondents do not dispute the above findings in so far as they relate to the requirements that certain records must be kept and must be accurate. They contend that the Division failed to prove that registrant's books and records were not "current" within the meaning of Rule 17a–3. In our opinion, however, it is clear that a general ledger which has not been posted for 44 or 47 days, a dividend record that has not been posted for 13 days, and customer ledger accounts that have not been posted for 12 days cannot be considered current[2] and delay the preparation of trial balances which, under the Rule, are required at least once a month.[3] Unless records are maintained on a current basis, a broker-dealer is not in a position to know whether he is meeting our net capital requirements, or to demonstrate compliance with the various statutory and rule provisions which we are charged with enforcing, or to answer inquiries of customers in respect of their accounts.

IMPROPER EXTENSION OF CREDIT

The record establishes that registrant willfully violated Section 7(c)(1) of the Act and Section 4(c)(2) of Regulation T promulgated thereunder by the Board of Governors of the Federal Reserve System in that a random sampling of about 275 transactions of registrant between January 1969 and August 1970 disclosed 93 transactions for which full payment was not received within seven business days after the date of purchase and which were not promptly cancelled or otherwise liquidated. These violations involved delinquencies of 1 to 216 days.[4]

Respondents assert that 12 of the transactions involved new issues, and that the Division failed to sustain the burden of

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[2] See *David Joel Benjamin*, 38 S.E.C. 614, 619–20 (1958); *cf. Wanda O. Olds*, 37 S.E.C. 23, 24 (1956).

[3] It is unnecessary to make findings with respect to various additional violations of the record-keeping provisions found by the hearing examiner but not listed in the Division's more definite statement of specified matters of fact and law to be determined, which purported to include all the violations it intended to prove. *Cf. U.S. v. Neff*, 212 F.2d 297, 309 (C.A. 3, 1954).

[4] In determining the number of violations and the extent of the delinquencies, we have taken into account the fact that our staff was led to believe that all the dates shown for transactions posted in the customer ledger were settlement dates, rather than trade dates, and deducted 7 days to arrive at the trade date, when in fact only those posted after August 1, 1969, showed the settlement date.

showing, pursuant to an exception from the date-of-purchase provision in Section 4(c)(2), the date when the security was made available by the issuer for delivery to the purchaser.[5] We agree with the examiner, however, that respondents, by claiming the exception from Section 4(c)(2), had the burden of showing not only that new issues were involved but also when the securities became available for delivery.[6]

Respondents further contend that 13 of the transactions did not violate Section 4(c)(2) because the customers had funds available for payment in other unspecified accounts with registrant. In our opinion, the presence of funds in another account presumably controlled by the customer does not constitute payment within the meaning of Section 4(c)(2) absent written authorization of the account holder for the transfer of such funds within the 7 business-day period.[7] No such authorizations were produced by respondents in those 13 instances.[8]

LATE FILING OF FINANCIAL REPORT

Respondents do not dispute and we find that registrant's report of financial condition as of November 30, 1969, which was due by January 14, 1970 pursuant to Rule 17a–5 under Section 17(a) of the Act, was not filed until February 26, 1970, in willful violation of those provisions. They contend, however, that the violation was only technical. They note that on January 13, 1970, registrant's accountant pursuant to Rule 17a–5(d) requested an extension of time to February 15, 1970, on the ground that an "exceptionally heavy workload" prevented completion of the required audit procedures by the due date, but the request was denied by our staff although similar requests for extensions by registrant with respect to the two preceding annual reports had been granted.

We do not consider the requirement that annual financial reports be filed on time to be merely technical. Such reports not only inform investors but provide a source of information essential to our regulatory functions.[9] Moreover, the fact that

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[5] Section 4(c) (2) as pertinent here requires that, where full cash payment for purchases in special cash accounts is not made within 7 business days, the broker-dealer shall promptly cancel or otherwise liquidate the purchase "except as provided" in Section 4(c) (3). Section 4(c) (3) provides that where an unissued security is purchased, the applicable period is 7 business days after the date on which the security is made available by the issuer for delivery to purchasers.

[6] *Cf. S.E.C.* v. *Sunbeam Gold Mines Co.*, 95 F.2d 699, 702 (C.A. 9, 1938); *Schlemmer* v. *Buffalo, Rochester and Pittsburg Railway Company*, 205 U.S. 1, 10 (1907).

[7] See *Coburn and Middlebrook, Incorporated*, 37 S.E.C. 583, 586–87 (1957).

[8] It is noted that a staff investigator had eliminated from his list of prima facie violations those transactions as to which proper authorizations were produced.

[9] See *Weston and Company, Inc.*, 44 S.E.C. 690, 695 (1971); *W. E. Leonard & Co., Inc.*, 39 S.E.C. 726, 727 (1960); *Wesley S. Swanson*, 41 S.E.C. 697, 698 (1963).

extensions had to be requested in the two preceding years should have called for extra efforts to avoid the necessity of a third request.

FAILURE OF SUPERVISION

The hearing examiner concluded that Smolar, as executive vice-president until December 1, 1969 and president thereafter, a director and major stockholder, and the officer in charge of sales, public relations and the training of salesmen, was under a duty to use reasonable care to see to it that the everyday operations of registrant's business were properly performed.

On the record before us, we cannot agree that Smolar was under such a duty before December 1, 1969. Until that date, Faunce had the exclusive responsibility of supervising the back-office personnel, and while Smolar may have been made generally aware, through his attendance at meetings of registrant's officers, that registrant had back-office problems, they were not discussed in detail in his presence, and he was also aware that Faunce was taking steps to solve them.

Under the circumstances we make no adverse finding as to Smolar with respect to the charge that he failed to exercise reasonable supervision with a view to preventing violations of the record-keeping provisions and, until December 1, 1969, of the credit provisions.[10] However, after he became president, he had the responsibility of supervising the back office.[11] Accordingly, we conclude that he failed to exercise reasonable supervision to prevent or terminate the unlawful extension of credit with respect to 57 transactions after December 1, 1969.

OTHER MATTERS

Respondents contend that the hearing examiner improperly granted the Division's motion to amend the order for proceedings to extend the period of the credit violations and to add the charge with respect to the late filing of the financial report. They note that the motion to amend was filed by the Division shortly before it submitted a more definite statement with respect to the original order for proceedings and assert that the examiner's granting of the motion at the opening of the hearing did not allow them sufficient time within which to request further specifications.

It appears, however, that the Division in its more definite statement did in fact include specifications of the alleged

[10] See *Midwest Planned Investments, Inc.*, 42 S.E.C. 558, 562 (1965).

[11] Smolar was not charged with a failure of supervision in connection with the financial report due after he became president, and we make no finding in this respect.

credit violations for the period after December 1, 1969, in anticipation of its motion to amend being granted by the examiner. With respect to the added charge of failing to file a financial report for 1969 within the prescribed period, we fail to see how the charge could have been any more specific, and no claim was made by them at the hearing that further specification was necessary.

PUBLIC INTEREST

Respondents urge that the sanctions imposed by the hearing examiner are too severe. They state that registrant is a publicly held corporation and that revocation instead of a suspension would destroy its sale value to the detriment of its approximately 300 innocent stockholders. They further stress that Faunce, during whose tenure as president the major violations occurred, was permitted pursuant to an offer of settlement to continue to act as a principal in his own brokerage firm, and assert that Smolar tried to save registrant's business but would under the examiner's sanctions be precluded from engaging in any securities activities for 30 days and then permitted to occupy only a supervised position.[12]

We agree with the examiner that registrant's violations were serious and extensive. However, we do not think that revocation of registration and expulsion from NASD membership are required in the public interest. Faunce, who had the responsibility of supervising the back office until December 1, 1969, is no longer associated with the firm. Smolar testified that after taking charge of registrant's business on December 1, 1969, he was unable to determine the condition of the company until completion of an audit in March 1970, that more back-office personnel were hired and additional capital was raised, that the deficiencies revealed by the audit were corrected within 90 or 120 days, and that in September 1970 registrant voluntarily ceased doing business and was still not operating as a broker-dealer as of the date of the hearing on December 17, 1970. Under all the circumstances we think the public interest would be adequately served by the suspension for a period of 60 days of registrant's broker-dealer registration and NASD membership.

With respect to Smolar, he is not aided by pointing to the

[12] The examiner noted that the requirement of supervised association in any future employment would not necessarily be permanent.

lesser sanction imposed upon Faunce under the settlement.[13] Offers of settlement are encouraged by the Administrative Procedure Act, and whereas Faunce neither admitted nor denied the charges with respect to him, the record before us established a charge against Smolar. In any event, the remedial action which is appropriate depends upon the facts and circumstances of each particular case and cannot be precisely determined by comparison with action taken against another respondent in the same case or in other cases.[14] However, we have exonerated Smolar of the charge that he failed to exercise reasonable supervision with respect to the credit violations before he became president, and the bookkeeping violations. Under the circumstances, we think the sanction imposed upon him by the examiner should be reduced, and that it is sufficient in the public interest to suspend him from association with a broker-dealer for 20 days.[15]

An appropriate order will issue.

By the Commission (Chairman CASEY and Commissioners OWENS, NEEDHAM, HERLONG and LOOMIS).

[13] In addition to the censure, Faunce among other things was required for a two-year period to send to our staff unaudited quarterly financial statements along with affidavits as to his brokerage firm's compliance with Section 17 of the Act and the rules thereunder; and was prohibited for a one-year period from causing his firm, without the prior consent of our staff, to engage generally in underwritings, to purchase or sell over-the-counter securities as agent or principal, or to make a market in any security.

[14] *Dlugash* v. *S.E.C.*, 373 F.2d 107, 110 (C.A. 2, 1967); *Winkler* v. *S.E.C.*, 377 F.2d 517, 518 (C.A. 2, 1967).

[15] The exceptions to the initial decision of the hearing examiner are sustained to the extent that they are in accord with our decision and overruled to the extent that they are inconsistent therewith.