

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2194 / November 20, 2003

ADMINISTRATIVE PROCEEDING
File No. 3-11341

IN THE MATTER OF KAUFMAN, BERNSTEIN, OBERMAN, TIVOLI & MILLER, LLC, AND HOWARD M. BERNSTEIN, RESPONDENTS.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(e), (f), AND (k) OF THE INVESTMENT ADVISERS ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), (f) and (k) of the Investment Advisers Act of 1940 ("Advisers Act") against Kaufman, Bernstein, Oberman, Tivoli & Miller, LLC ("Kaufman") and Howard M. Bernstein ("Bernstein") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, each Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), (f), and (k) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers of Settlement, the Commission finds that:

RESPONDENTS

1. Kaufman has been registered with the Commission as an investment adviser since 1998 (File No. 801-56044). Kaufman is based in Los Angeles, California. Kaufman was created in 1998 through the merger of Kaufman and Bernstein, formerly a registered investment adviser (File No. 801-14083) that was founded in 1976, and another company.
2. Bernstein resides in Malibu, California. He founded the predecessor firm to Kaufman in 1976 and has been the manager, compliance officer, and part owner of both Kaufman and its predecessor firm at all relevant times.

BACKGROUND

3. Kaufman acts as the business manager for clients who are employed in the entertainment industry. In 1979, 1986 and 1990, the Commission's examination staff advised Kaufman, and its predecessor, that Kaufman had violated the custody provisions of the Advisers Act, which effectively require an investment

adviser with custody or possession of client assets to hire an independent public accountant to examine the adviser's records. Under Rule 206(4)-2(a)(5),¹ an investment adviser with custody or possession of client funds or securities engages in fraudulent acts, practices or courses of business within the meaning of Section 206(4) of the Advisers Act by taking any action with respect to client funds and securities without having an independent accountant: (1) conduct an annual examination of such client funds and securities "without prior notice" to the adviser, and (2) conduct such examination at least once during each calendar year.

4. The staff advised Kaufman of the violative conduct through Bernstein, who has had primary responsibility for Kaufman's compliance functions and filing obligations at all relevant times. In May 2002, the examination staff conducted a regular examination of Kaufman and discovered that the violations had continued.

FAILURE TO CONDUCT THE EXAMINATIONS WITHOUT PRIOR NOTICE

5. Kaufman's independent accountant did not conduct examinations without prior notice to the adviser, as required by Rule 206(4)-2(a) under the Advisers Act. The examination staff previously advised Kaufman of this deficiency. The examination staff had advised Bernstein that it had observed a pattern of Kaufman's verification examinations commencing on the same date each year. The examination staff advised Bernstein to discontinue this practice and to have Kaufman's accountant select a random date to begin the annual verification examination. Between at least 1998 and 2001, however, the annual verification examination began in the first week of January of the following year. For example, for the calendar years 1998 through 2000, the examination began on the second business day of the following year. For the calendar year 2001, the examination began on the fourth business day of the following year. Given the predictable timing of the examinations, Kaufman and Bernstein were effectively put on notice that the examination would begin in the first few days of January each year. The examinations did not take place, therefore, "without prior notice," but rather followed a predictable pattern that gave Kaufman and Bernstein at least constructive notice as to when the annual examination would occur.

FAILURE TO COMPLETE THE EXAMINATIONS WITHIN THE CALENDAR YEAR

6. Kaufman's independent accountant also did not complete the verification examinations within the calendar year covered by the examination. The examination staff previously advised Kaufman of this deficiency. In telephone conversations in 1986 and 1990, the examination staff informed Bernstein that it had observed that Kaufman's verification examinations had not been completed within the calendar year and informed Bernstein that the examination must be completed within the calendar year that the examination covers. Bernstein, in a letter dated August 20, 1990, assured the examination staff that "this type of deviation will not occur in the future."

7. Kaufman's violative conduct continued. In nine of the ten years between 1991 and 2001, the verification examination was completed in the subsequent calendar year. For example, the verification examination for the 2001 calendar year should have been completed sometime between January 1, 2001 and December 31, 2001. It was completed on October 26, 2002.

LEGAL ANALYSIS

8. Section 206(4) of the Advisers Act and Rule 206(4)-2(a) thereunder provide that a registered investment adviser engages in fraudulent activity if it holds client assets in custody and takes action with respect to those assets without complying with the provisions of Rule 206(4)-2(a). These provisions in essence require that an investment adviser with custody or possession of client funds or securities hire an independent public accountant to examine the adviser's records to ensure that the adviser has not misappropriated any client funds or securities managed by the adviser or misrepresented the amount of funds or securities owned by any client.

9. Under Rule 206(4)-2(a)(5), an investment adviser with custody of client funds or securities engages in fraudulent acts, practices or courses of business within the meaning of Section 206(4) of the Advisers

Act by taking any action with respect to such funds and securities without having an independent accountant:

(1) conduct an actual examination to verify those funds and securities at least once during each calendar year at a time to be chosen by the accountant "without prior notice" to the adviser; and

(2) promptly thereafter file a verification certificate with the Commission setting forth the accountant's findings in the examination. See *In the Matter of H.P. Hambrick Co., Inc.*, Advisers Act Release No. 1622 (Mar. 18, 1997). When the Commission adopted this rule, it characterized the "without prior notice" provision as requiring a "surprise" examination. See *Adoption of Rule 206(4)-2 Under the Investment Advisers Act of 1940*, Release No. 40-123 (Feb. 27, 1962). The Commission need not prove scienter to establish a violation of Section 206(4). *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992).

10. As a result of the conduct described above, Kaufman willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2(a) thereunder.²

11. As a result of the conduct above, Bernstein willfully aided and abetted and caused Kaufman's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2(a) thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions specified in Kaufman's and Bernstein's Offers of Settlement.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(k) of the Advisers Act, that Respondents Kaufman and Bernstein cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-2(a) promulgated thereunder;

Pursuant to Sections 203(e) and 203(f) of the Advisers Act, that Respondents Kaufman and Bernstein be, and hereby are, censured;

Pursuant to Section 203(i) of the Advisers Act, that Respondent Kaufman shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of \$12,500 to the United States Treasury. Such payment shall be:

- (1) made by United States postal money order, certified check, bank cashier's check or bank money order;
- (2) made payable to the Securities and Exchange Commission;
- (3) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and
- (4) submitted under cover letter that identifies Kaufman and Bernstein as Respondents in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Sandra J. Harris, Associate Regional Director, Office of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., Ste. 1100, Los Angeles, CA 90036;

Pursuant to Section 203(i) of the Advisers Act, that Respondent Bernstein shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of \$12,500 to the United States Treasury. Such payment shall be:

- (1) made by United States postal money order, certified check, bank cashier's check or bank money order;
- (2) made payable to the Securities and Exchange Commission;

(3) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (4) submitted under cover letter that identifies Kaufman and Bernstein as Respondents in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Sandra J. Harris, Associate Regional Director, Office of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., Ste. 1100, Los Angeles, CA 90036; and

Respondent Kaufman shall comply with the following undertakings:

To retain, within thirty days of the date of this Order, at its expense, an Independent Consultant, not unacceptable to the Commission's staff. Kaufman shall require the Independent Consultant to conduct a review of Kaufman's compliance policies and procedures with respect to Section 206(4) of the Advisers Act and Rule 206(4)-2(a) thereunder, including Kaufman's policies and procedures relating to its independent public accountant:

- (a) performing the annual examination of Kaufman's records, funds and securities "without prior notice" (i.e. without actual or constructive notice);
- (b) completing the annual examination within the calendar year covered by the examination; and
- (c) complying with such other policies or procedures as are reasonably expected to prevent and detect the types of violations of the federal securities laws involving Kaufman's actions described in Section III;

At the end of that review, which in no event shall be more than three months after the date of the issuance of this Order, Kaufman shall require the Independent Consultant to submit to Kaufman and to the Commission's Pacific Regional Office an Initial Report. The Initial Report shall describe the review performed, the conclusions reached and shall include any recommendations deemed necessary to make the policies and procedures adequate. Kaufman may suggest an alternative procedure designed to achieve the same objective or purpose as that of the recommendation of the Independent Consultant. The Independent Consultant shall evaluate Kaufman's proposed alternative procedure. Kaufman, however, shall abide by the Independent Consultant's final recommendation;

Within six months of the date of this Order, Kaufman shall, in writing, advise the Independent Consultant and the Commission's Pacific Regional Office of the recommendations it is adopting;

Within twelve months of the date of this Order, Kaufman shall require the Independent Consultant to complete its review and submit a written final report to Kaufman and the Commission's Pacific Regional Office. The Final Report shall describe the review made of Kaufman's compliance policies and procedures relating to Section 206(4) of the Advisers Act and Rule 206(4)-2(a) thereunder; set forth conclusions and recommendations and any proposals by Kaufman; and describe how Kaufman is implementing those recommendations and proposals;

Kaufman shall take all necessary and appropriate steps to adopt and implement all recommendations contained in the Independent Consultant's Final Report;

No later than three months after the date of the Independent Consultant's final report, Kaufman shall submit to the Commission's Pacific Regional Office an affidavit setting forth the details of its efforts to implement the Independent Consultant's recommendations as set forth in the Final Report and its compliance with them;

For good cause shown and upon timely application by the Independent Consultant or Kaufman, the Commission's staff may extend any of the deadlines set forth in these undertakings; and

Kaufman shall require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Kaufman, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of an authorized representative of the Pacific Regional Office of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Kaufman, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

By the Commission.

Jonathan G. Katz
Secretary

Footnotes

1 On September 11, 2003, the Commission voted to amend Rule 206(4)-2. The subparagraphs of the rule refer to the rule, as it was in effect immediately prior to these amendments.

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