# U.S. Securities and Exchange Commission

/Annual Report, 1976/

42nd

# 42nd Annual Report of the SEC

for the fiscal year ended June 30, 1976

**SECURITIES AND EXCHANGE COMMISSION**

Headquarters Office
500 North Capitol Street
Washington, D C 20549

**COMMISSIONERS***

RODERICK M HILLS, *Chairman*
PHILIP A LOOMIS, JR
JOHN R EVANS
IRVING M POLLACK

GEORGE A FITZSIMMONS, *Secretary*

Commissioner A A Sommer resigned from the Commission, effective April 2, 1976, leaving one vacancy

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## LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

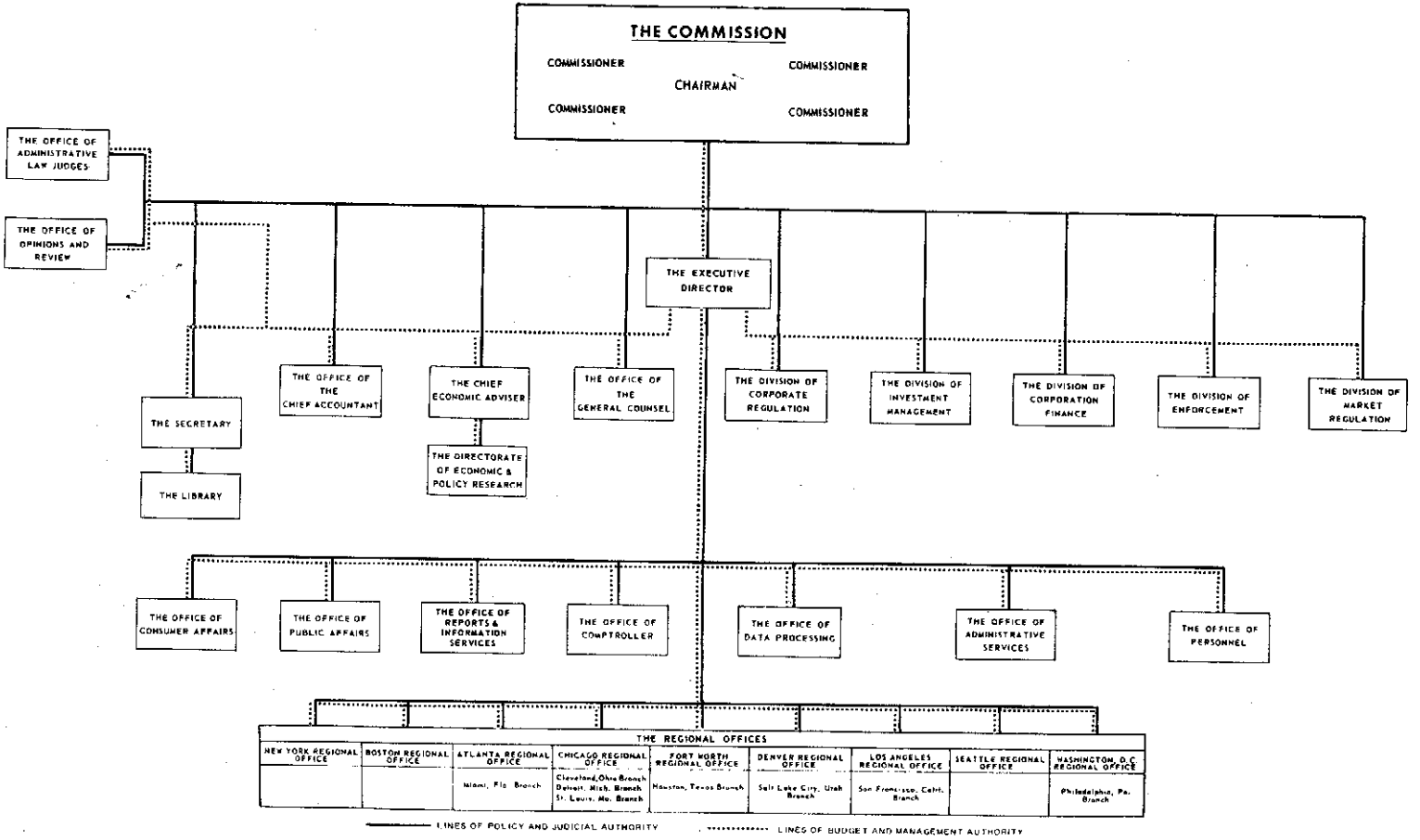
Sirs On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Forty-Second Annual Report of the Commission covering the fiscal year July 1, 1975 to June 30, 1976, in accordance with the provisions of Section 23(b) of the Securities Exchange Act of 1934, as amended, Section 23 of the Public Utility Holding Company Act of 1935, Section 46(a) of the Investment Company Act of 1940, Section 216 of the Investment Advisers Act of 1940, Section 3 of the Act of June 29, 1949 amending the Bretton Woods Agreement Act, Section 11(b) of the Inter-American Development Bank Act; and Section 11(b) of the Asian Development Bank Act

Respectfully,

RODERICK M HILLS
Chairman

THE PRESIDENT OF THE SENATE
THE SPEAKER OF THE HOUSE OF REPRESENTATIVES,
Washington, D C

# SECURITIES AND EXCHANGE COMMISSION



# COMMISSIONERS AND PRINCIPAL STAFF OFFICERS

(As of November 15, 1976)

## COMMISSIONERS

| | Term expires June 5 |
|---|---|
| **RODERICK M. HILLS** of Calif , Chairman | 1977 |
| **PHILIP A. LOOMIS, JR.**, of Calif | 1979 |
| **JOHN R. EVANS** of Utah | 1978 |
| **IRVING M. POLLACK** of New York | 1980 |

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***Executive Assistant to the Chairman:*** **RALPH C. FERRARA**

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- **IRWIN M. BOROWSKI,** Associate Director
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- **THEODORE SONDE,** Associate Director

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- **ANTHONY C. J. NULAND,** Associate Director

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**A. CLARENCE SAMPSON,** Acting Chief Accountant

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**FRANK J. DONATY,** Comptroller
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**ALBERT FONTES,** Director, Office of Personnel
**JAMES C. FOSTER,** Director, Office of Reports and Information Services
**FRANKLIN E. STULTZ,** Associate Director
**RALPH L. BELL,** Director, Office of Data Processing

# REGIONAL AND BRANCH OFFICES

## REGIONAL OFFICES AND ADMINISTRATORS

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Region 2 Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine —Floyd H Gilbert, 150 Causeway St , Boston, Massachusetts 02114

Region 3 Tennessee, Virgin Islands, Puerto Rico, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, part of Louisiana — Jule B Greene, Suite 788, 1375 Peachtree St , N.E., Atlanta, Georgia 30309

Region 4 Illinois, Indiana, Iowa, Kansas City (Kansas), Kentucky, Michigan, Minnesota, Missouri, Ohio, Wisconsin —William D Goldsberry, Room 1708, Everett McKinley Dirksen Bldg., 219 S Dearborn St , Chicago, Illinois 60604.

Region 5 Oklahoma, Arkansas, Texas, part of Louisiana, Kansas (except Kansas City) —Richard M Hewitt, 503 U S Court House, 10th & Lamar Sts., Fort Worth, Texas 76102

Region 6 North Dakota, South Dakota, Wyoming, Nebraska, Colorado, New Mexico, Utah —Robert H Davenport, Two Park Central, Room 640, 1515 Arapahoe Street, Denver, Colorado 80202.

Region 7 California, Nevada, Arizona, Hawaii, Guam —Gerald E Boltz, Room 1710, 10960 Wilshire Boulevard, Los Angeles, California 90024

Region 8 Washington, Oregon, Idaho, Montana, Alaska —Jack H Bookey, 3040 Federal Building, 915 Second Ave , Seattle, Washington 98174

Region 9 Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia —Paul F Leonard, Room 300, Ballston Center Tower No 3, 4015 Wilson Boulevard, Arlington, Virginia 22203

## BRANCH OFFICES

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Detroit, Michigan 48226.—1044 Federal Bldg.

Houston, Texas 77002 —Room 5615, Federal Office & Courts Bldg , 515 Rusk Ave

Miami, Florida 33131 —Suite 701, DuPont Plaza Center, 300 Biscayne Boulevard Way

Philadelphia, Pennsylvania 19106.—Federal Bldg., Room 2204, 600 Arch St

St. Louis, Missouri 63101.—Room 1452, 210 North Twelfth St.

Salt Lake City, Utah 84111 —Room 6004, Federal Reserve Bank Bldg , 120 South State St

San Francisco, California 94102 —450 Golden Gate Ave., Box 36042

## COMMISSIONERS

**RODERICK M. HILLS,** *Chairman*

Chairman Hills was born on March 9, 1931, in Seattle, Washington. In 1952 he received his BA degree from Stanford University and he received his LL.B. in 1955 also from Stanford In law school he was named to the Order of the Coif. During the period 1955–1957, Mr Hills served as law clerk to Mr Justice Stanley F. Reed, Supreme Court of the U S., and during 1969–1970 he was a visiting Professor at the Harvard Law School Mr Hills was a founding partner of the law firm of Munger, Tolles, Hills and Rickershauser, Los Angeles, California Between 1971 and 1975 he was on leave from the firm to serve as Chairman of the Board of Republic Corporation From April 1, 1975, until being named Chairman, Mr Hills served as Counsel to the President of the United States. Mr Hills was Co-chairman of the Domestic Council Task Force on Regulatory Reform for the President Mr. Hills was sworn in as Chairman of the Securities and Exchange Commission on October 28, 1975, for a term expiring on June 5, 1977.

**PHILIP A. LOOMIS, JR.**

Commissioner Loomis was born in Colorado Springs, Colorado, on June 11, 1915 He received an A B. degree, with highest honors, from Princeton University in 1938 and an LL.B. degree, cum laude, from Yale Law School in 1941, where he was a Law Journal editor. Prior to joining the staff of the Securities and Exchange Commission, Commissioner Loomis practiced law with the firm of O'Melveny and Myers in Los Angeles, California, except for the period from 1942 to 1944, when he served as an attorney with the Office of Price Administration, and the period from 1944 to 1946, when he was Associate Counsel to Northrop Aircraft, Inc Commissioner Loomis joined the Commission's staff as a consultant in 1954, and the following year he was appointed Associate Director and then Director of the Division of Trading and Exchanges. In 1963, Commissioner Loomis was appointed General Counsel to the Commission and served in that capacity until his appointment as a member of the Commission. Commissioner Loomis is a member of the American Bar Association, the American Law Institute, the Federal Bar Association, the State Bar of California, and the Los Angeles Bar Association He received the Career Service Award of the National Civil Service League in 1964, the Securities and Exchange Commission Distinguished Service Award in 1966, and the Justice Tom C.

Clark Award of the Federal Bar Association in 1971 He took office as a member of the Securities and Exchange Commission August 13, 1971, and is now serving for the term of office expiring June 5, 1979

**JOHN R. EVANS**

Commissioner Evans was born in Bisbee, Arizona, on June 1, 1932 He received his B S degree in Economics in 1957, and his M S degree in Economics in 1959 from the University of Utah He was a Research Assistant and later a Research Analyst at the Bureau of Economics and Business Research at the University of Utah, where he was also an instructor of Economics during 1962 and 1963 He came to Washington in February 1963, as Economics Assistant to Senator Wallace F Bennett of Utah From July 1964 through June 1971 Commissioner Evans was minority staff director of the U S Senate Committee on Banking, Housing and Urban Affairs and served as a member of the professional staff from June 1971 to March 1973 He took office as a member of the Securities and Exchange Commission on March 3, 1973, and is now serving for the term expiring June 5, 1978

**IRVING M. POLLACK**

Commissioner Pollack was born in Brooklyn, New York, on April 8, 1918 He received a B A degree, cum laude, from Brooklyn College in 1938 and an LL B degree, magna cum laude, from Brooklyn Law School in 1942 Prior to joining the Commission's staff he engaged in the practice of law in New York City after serving nearly four years in the United States Army, where he gained the rank of Captain Mr Pollack joined the staff of the Commission's General Counsel in October 1946 He was promoted from time to time to progressively more responsible positions in that office and in 1956 became an Assistant General Counsel A career employee, Mr Pollack became Director of the Division of Enforcement in August 1972 when the SEC's divisions were reorganized He had been Director of the Division of Trading and Markets since August 1965, and previously served as Associate Director since October 1961 In 1967 Mr Pollack was awarded the SEC Distinguished Service Award for Outstanding Career Service, and in 1968 he was a co-recipient of the Rockefeller Public Service Award in the field of law, legislation and regulation Mr Pollack took the oath of office on February 13, 1974 as a member of the Securities and Exchange Commission, and is now serving for the term expiring June 5, 1980

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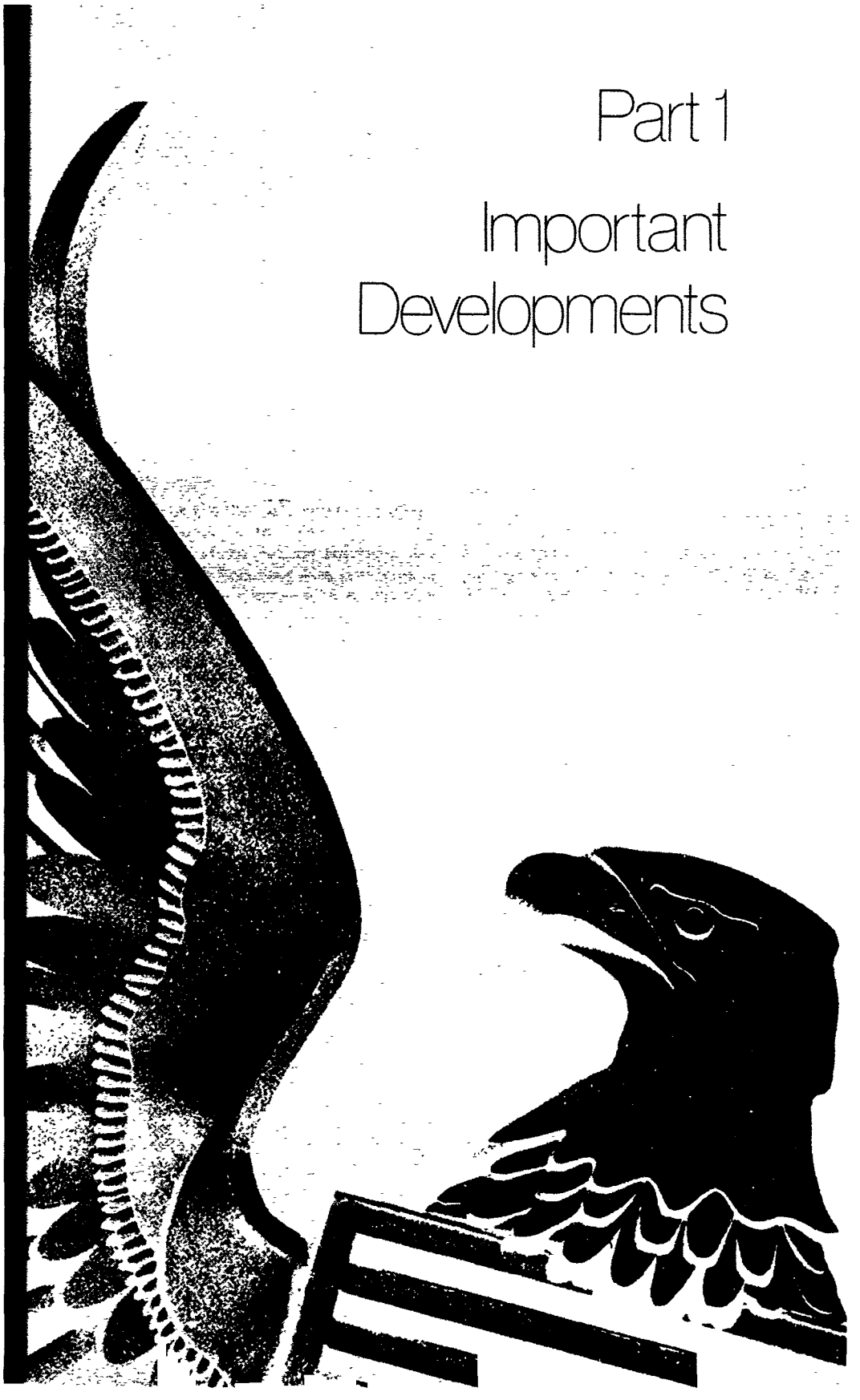


# Part 1

# Important Developments

## MARKET REGULATION

### Introduction

Shortly before the 1976 fiscal year began, Congress enacted the most far-reaching amendments to the Federal securities laws since 1940, the Securities Acts Amendments of 1975.[1] These amendments substantially revise the regulation of securities exchanges and securities associations, and create a regulatory scheme for municipal securities professionals, transfer agents, clearing agencies and securities information processors In addition, the Commission is directed to facilitate the establishment of a national market system for securities and a national system for the prompt and accurate clearance and settlement of securities transactions. The new provisions substantially strengthen the Commission's regulatory and oversight responsibilities with respect to those markets and constitute a major turning point in securities regulation.

At the same time, the securities industry, with the assistance and oversight of the Commission, made significant strides toward the realization of a national market system Such essential components of a central market as consolidated and nationwide limit order protection mechanisms, quotation systems, and transaction reporting systems steadily continue to evolve. The National Advisory Board, appointed by the Commission pursuant to the 1975 Amendments, provided substantial guidance on key policy questions relating to the establishment of a national market system.

During the fiscal year, the Commission adopted and implemented uniform financial responsibility requirements, applicable for the first time to substantially all brokers and dealers. And a uniform financial and operational reporting form was adopted for all registered brokers and dealers, ending duplicative reporting schemes and dramatically reducing the compliance burdens confronting securities professionals especially smaller brokers and dealers.

During the last fiscal year, the Commission began to discharge the broad powers conferred upon it by the 1975 Amendments. By working toward reducing restrictions on the ability of exchange members to trade listed securities in the marketplace of their choice, the Commission took a long step toward strengthening competition in the securities markets and removing artificial hindrances to the flow of transaction volume. The Commission's inquiry into exchange membership and access rules began the process of opening the securities markets to greater participation by financial intermediaries in other sectors of the national and international economy. The Commission also began during the last fiscal year the registration and regulation of securities information processors

In addition, the Commission, in conjunction with the newly formed Municipal Securities Rulemaking Board, commenced development of an integrated pattern of regulation for municipal securities professionals. And the Commission continued working with the options markets in developing an appropriate scheme of regulation for this specialized marketplace.

In response to the directive of the 1975 Amendments, the Commission undertook to

register and to regulate transfer agents and clearing agencies The Commission inaugurated its program for development of the legislatively contemplated system for the clearance and settlement of securities transactions, which program came to include initial consideration of the proposed merger of two major clearing entities

It may be fairly stated that the Commission and the securities industry together have passed through a year of critical importance to the growth and the continued vitality of the Nation's securities markets The events of the past year have done much to promote truly competitive and efficient capital markets, capable of serving the Nation's demand for new investment capital while operating in the public interest and for the protection of investors

## Development of the National Market System

*Advisory Committee on the Implementation of a Central Market System* —As previously reported,[2] the Advisory Committee on the Implementation of a Central Market System issued a Summary Report of its final recommendations on July 15, 1975 [3] The Committee completed its work on September 12, 1975, with the delivery to the Commission of a Supplementary Report[4] outlining the deliberations leading to the Committee's more significant recommendations, noting unresolved issues and setting forth those views which differed significantly from the recommendations of the majority

*National Market Advisory Board* —The 1975 Amendments directed the Commission to establish a National Market Advisory Board (the "Board") comprised of fifteen members (a majority of whom must be associated with brokers or dealers) sitting for terms of from two to five years [5] The Board's initial membership was announced by the Commission in August 1975,[6] and the Board has conducted monthly public meetings since September 1975 The Board is supposed to give the Commission its views on significant regulatory proposals made by the Commission or any self-regulatory organization concerning the establishment, operation and regulation of the securities markets The Board is also to recommend to the Commission the steps it finds appropriate to facilitate the establishment of a national market system and study the possible need for modifying the Act's scheme of self-regulation so as to adapt it to a national market system, including the need for the establishment of a new self-regulatory organization (a "National Market Regulatory Board") to administer the national market system The Board was directed to report the results of its study to Congress by December 31, 1976, with whatever recommendations the Board deems appropriate

As discussed below, the Commission adopted a rule under the Exchange Act (Rule 19c-1)[7] governing off-board trading by members of national securities exchanges At that time, the Commission requested the Board to study three specific problems (i) in-house agency cross transactions (the Commission requested the Board to advise the Commission of its views on this issue no later than October 1, 1976), (ii) off-board principal trading restrictions, and (iii) the development of a composite limit order book. The Board was engaged in these studies as the fiscal year ended

## Off-Board Trading Rules

Section 11A(c)(4)(A) of the Exchange Act[8] directs the Commission to review "any and all" rules of national securities exchanges which limit or condition the ability of their members to buy or sell securities any place but on such exchanges. This section also directs the Commission to report to Congress the results of its review, and to commence a proceeding under Section 19(c) of the Act to amend any such rule imposing a burden on competition which did not appear to the Commission to be necessary or appropriate in furtherance of the purposes of the Act

On September 2, 1975, the Commission reported to Congress the results of its review, including a description of the effects on competition of existing off-board trading restrictions [9] The Commission's report found that certain exchange off-board trading rules did impose burdens on competition which the Commission was not then prepared to conclude were necessary or appropriate in furtherance of the purposes of the Securities Exchange Act On the same date, the Commission issued a release publishing its report to Congress and announcing the commencement of a proceeding, pursuant to Section 19(c) of the Act, to determine.

a. the extent to which such rules engendered significant anticompetitive effects;
b. whether, if such rules were anticompetitive, there were countervailing considerations which appropriately outweighed the need to abrogate or amend such rules at that time; and
c. whether such rules could be appropriately modified so as to further the purposes of the Securities Exchange Act [10]

After eight days of hearings, during which testimony from 63 individuals representing 19 institutions and organizations was received, the Commission adopted Exchange Act Rule 19c–1, on December 19, 1975 (effective March 31, 1976), which reflected its determination that certain aspects of the then existing off-board trading rules imposed burdens on competition which could not be justified in terms of the regulatory objectives of the Exchange Act [11]

Rule 19c–1(a) provides that on and after March 31, 1976, the rules of each national securities exchange may not limit or condition the ability of any member to effect agency transactions on any other exchange or in the over-the-counter market in any equity security listed or traded on that exchange. When it adopted the rule, the Commission also announced its intention

a. to consider further whether in-house agency cross transactions in listed securities should continue to be restricted; [12]
b to consider (after it received the recommendations of the National Market Advisory Board and saw the progress made by that date toward establishment of a national market system) fixing a firm date for the elimination of restrictions on off-board principal transactions; [13] and
c to solicit comments on the characteristics of a proposed central limit order repository and the specifications of any plan for the implementation of such a repository [14]

Seven national securities exchanges filed revised off-board trading rules, and the Commission found (with one exception) that those rules were in conformity with Rule 19c–1 and consistent with the requirements of the Exchange Act [15] The Commission commenced a proceeding to determine whether to disapprove one of the proposed rules, the Public Limit Order Protection Rule ("PLOPR") filed by the New York Stock Exchange ("NYSE") The PLOPR would have limited the ability of NYSE members to effect agency transactions on any other exchange without first clearing public limit orders on the NYSE [16] As potential grounds for disapproval, the Commission noted that the PLOPR appeared to be inconsistent with, among other things, certain sections of the Securities Exchange Act and Rule 19c–1 Shortly after the close of the fiscal year, the NYSE advised the Commission that it wished to withdraw the PLOPR, [17] and, on July 28, 1976, the Commission consented to the NYSE request and terminated its proceeding with respect to the PLOPR [18]

## Composite Limit Order Book

When the Commission adopted Rule 19c–1 governing off-board trading by exchange members, it indicated that it was initiating steps to provide comprehensive limit order protection consistent with the public interest [19] The Commission expressed its belief that public limit orders and the methods by which they are kept play important roles in the securities markets Under certain circumstances, displacement of professional orders by public limit orders is appropriate in the public interest and for the protection of investors, to ensure the fairness of the markets and to provide an opportunity for public orders to meet without the participation of a dealer The Commission, however, found that by their very nature existing exchange mechanisms for the storage of limited price orders are unable to provide full protection for those orders, and that regulatory devices employed to ensure execution of such orders create certain adverse effects which outweigh their laudable objectives The Commission indicated that the solution to these problems appeared to lie in the utilization of existing advanced technology to construct a computerized central limit order repository (a "composite book") designed to provide comprehensive limit order protection to investors. The Commission announced its intention to consult with the National Market Advisory Board and to solicit public comment concern-

ing the characteristics and specifications of a composite book and the appropriate manner of achieving its implementation [20]

After its staff had consulted with the National Market Advisory Board to identify substantive and procedural issues associated with the development of a composite book, the Commission solicited public comment on these issues, including the policy and technical questions associated with ten specified characteristics of any composite book [21] Extensive written comments have been received from numerous individuals, institutions and self-regulatory organizations During the coming year, the Commission will formulate and propose an appropriate course of action with respect to the development of a composite book

## Composite Quotation System

Section 11A(c)(1)(B) of the Exchange Act directs the Commission to assure the prompt, reliable and fair collection, processing, distribution and publication of information with respect to quotations for and transactions in securities and the fairness and usefulness of the form and content of such information Previously, the Commission had indicated its support for a nationwide system making quotations from all market makers universally available (a "composite quotations system") in both its 1972 *Market Structure Statement* [22] and 1973 *Policy Statement* [23]

As previously reported, [24] the Commission in 1972 initiated the development of a composite quotation system by proposing Exchange Act Rule 17a–14 The rule, as originally proposed, [25] would have required all national securities exchanges to make quotations of their specialists available to vendors of market information Similarly, the NASD would have been required to make available to such vendors quotations of over-the-counter market makers in securities listed or traded on exchanges Finally, the rule would have required all such quotations to be made available to vendors on a current and continuing basis

In 1974, the Commission reproposed Rule 17a–14 in substantially revised form [26] The major change was the inclusion of a requirement that quotations be "reported" by self-regulatory organizations (and certain broker-dealers) pursuant to a plan (similar to that required by Exchange Act Rule 17a–15), filed with and declared effective by the Commission, providing for the availability of such quotations to vendors of market information on a realtime, current and continuing basis

Following reconsideration of proposed Rule 17a–14, the Commission determined to adopt initially a different approach designed to enhance the availability of quotation information without potentially burdensome Federal regulation On March 11, 1975, the Commission announced that it had sent letters to all national securities exchanges formally requesting them to eliminate, on or before May 1, 1975, any of their rules or practices which restricted access to or use of such quotation information as they then disseminated, or in the future might disseminate, to quotation vendors At the same time, the Commission announced that it was deferring further consideration of proposed Rule 17a–14 until it had an opportunity to observe the effects of elimination of exchange restrictions on quotation dissemination On May 7, 1975, the Commission announced that it had received responses to its March 11, 1975 request from all national securities exchanges and that all exchanges either had taken the action requested by the Commission or had informed the Commission that they had no rules or practices restricting access to or use of such information In making its announcement, the Commission added that, in its view, the actions taken by the various exchanges would facilitate the establishment of a central market system, as contemplated by the Commission's 1972 *Market Structure Statement* and its 1973 *Policy Statement,* by making possible the composite display of quotation information for multiply traded securities

Since May 1975, several vendors have made major efforts to develop and market a composite quotation service The Commission has found, however, that despite these efforts, the quality of quotation information disseminated to brokers, dealers and investors can be improved substantially, and that numerous problems relating to the dissemination of useful and reliable quotation information have yet to be resolved Exchange markets still do not report "firm" quotations, and no market disseminates information as to quotation size In many cases, quotation information supplied to vendors is not updated

promptly to reflect changes in actual quotations in the various markets. As the fiscal year progressed, it became apparent that the lack of reliable quotations from the various markets was hampering private and self-regulatory efforts to establish a viable composite quotation system, the absence of which in turn was impeding development of a national market system.

On July 29, 1976, the Commission proposed for public comment Exchange Act Rule 11Ac1-1 [27] Rule 11Ac1-1 would require, on and after November 1, 1976, national securities exchanges to collect from their specialists, and the NASD to collect from third market makers, quotations in eligible securities for dissemination by those self-regulatory organizations to quotation vendors. In addition, those organizations also would be obligated to provide such vendors with their specialists' and market makers' quotation sizes if those specialists and market makers elect to make such sizes available for dissemination.

Although the proposed rule neither specifies the manner in which, or the frequency with which the quotations are to be collected, processed, and made available, it would require specialists and third market makers to communicate their quotations promptly in accordance with procedures established by the relevant exchanges or association for the timely dissemination to quotation vendors And the proposed Rule would require quotations covered be "firm," subject to certain exceptions In particular, any specialist or third market maker who is presented with an order for the purchase or sale of any eligible security (other than an odd-lot order) must stand ready to execute a transaction in that security in any amount up to (but in no case exceeding) his published quotation size (or, in the event no quotation size is disseminated, a normal unit of trading) at a price at least as favorable to the buyer or seller as his most recently published bid or asked price The foregoing requirement would not apply if, after dissemination of his published quotation but before the specialist or third market maker received an order (i) a transaction in that security is effected either on the floor of the particular exchange or by the third market maker, or is reported in the consolidated system, or (ii) the specialist or third market maker has communicated a superseding quotation. However, if he did not communicate his superseding quotation within three minutes after a transaction or a report of a transaction, he would be obligated to buy or sell that security in accordance with the general rule as to firmness.

## Consolidated Transaction Reporting System

In addition to its work on developing a composite quotation system, the Commission has assisted in implementing a consolidated transaction reporting system (the "consolidated system") As previously reported,[28] the consolidated system developed as a result of the Commission's adoption in 1972 of Exchange Act Rule 17a-15. The consolidated system has progressed from a pilot state to an operational reporting system, disseminating last sale reports of transactions executed in all reporting markets for securities listed on the New York Stock Exchange ("Network A") and on the American Stock Exchange, plus selected regional listings ("Network B") This follows the Joint Industry Plan declared effective by the Commission in accordance with Rule 17a-15 Moreover, last sale reports in both Network A and Network B securities are now available by means of a high speed data transmission line (the "high speed line"), which for the first time enables investors and market professionals to have such information available on a real-time basis regardless of any delays in the low speed ticker network during periods of heavy trading

During the period since the enactment of the 1975 Amendments, the Commission's staff has met on a regular basis with certain securities information processors, who disseminate consolidated last sale reports, and with the Consolidated Tape Association (the "CTA"), an association of self-regulatory organizations which bears the responsibility of overseeing the Joint Industry Plan for the operation of the consolidated system, and which is registered as an exclusive securities information processor. Other relevant developments include:

a The commencement on April 30, 1976, of Phase II of the Joint Industry Plan, making available both the high speed line and last sale reports in both Network A and Network B

securities, which activated certain revised short sale provisions of Exchange Act Rule 10a–1 and vendor obligations under Rule 17a–15 [29]

b. The Commission's granting of conditional exemptions to certain domestic securities information processors from the display requirements of Exchange Act Rule 17a–15, which became applicable upon the commencement of Phase II.[30] The staff of the Commission is presently studying the requests of certain foreign vendors for conditional exemptions from these display requirements

c. The Commission's solicitation of public comment on whether those provisions of the Joint Industry Plan which prohibit a securities information processor from retransmitting consolidated last sale reports on a continuous basis should be modified or abolished in light of the standards now contained in Sections 11A(b)(5), 11A(c)(1)(C) and 11A(c)(1)(D) of the Exchange Act One securities information processor had asserted that the reasons for initially imposing such prohibitions no longer provide a sound basis for their maintenance.[31]

d. After receipt of several letters from securities information processors, as well as from registered brokers and dealers, questioning the level of fees charged by the CTA for consolidated last sale reports, the Commission's staff has undertaken extensive research into the Act's requirements that securities information processors be able to obtain information from an exclusive processor (such as the CTA) on "fair and reasonable" terms, and on terms that are not "unreasonably discriminatory "

e The Commission has analyzed certain proposed rule changes of the National Association of Securities Dealers, Inc (the "NASD") that would require the reporting of transactions to the CTA at the price at which the transaction was effected inclusive of any commission or commission equivalent (a reporting mode commonly referred to as "net printing" of principal transactions) These rule changes were originally filed by the NASD on June 4, 1975, the date the 1975 Amendments became law Such changes were published for public comment and were declared summarily effective by the Commission in order to permit the scheduled commencement of Network A of the consolidated system,[32] subject to the Commission's prerogative under Section 19(b)(2) of the Exchange Act either to approve the proposed rule changes or to commence proceedings to determine whether such rule changes should be disapproved. On December 24, 1975, the Commission published[33] an NASD amendment of its proposed rule changes which modified the proposal to permit the reporting of transactions at the price recorded on the trade ticket, without recognizing any commission or commission equivalent (commonly referred to as "gross printing" of principal transactions). The proposed modifications eliminated the existing disparity between the reporting of principal transactions effected by NASD members and the reporting of identical transactions effected by members of national securities exchanges. On May 12, 1976, the Commission approved the NASD transaction reporting rules as modified.[34] While finding these reporting rules to be consistent with the requirements of the Exchange Act, the Commission also noted that it intends to continue studying questions related to the reporting of transactions in eligible securities, particularly the method of reporting principal transactions confirmed by a dealer plus or minus a commission, commission equivalent or differential.

## Equal Regulation

In testimony before Congress preceding the passage of the 1975 Amendments, industry representatives urged that the integration of existing market centers into a national market system be accompanied by equal regulation of all market components. The new Section 11A(a) of the Exchange Act directs the Commission to assure fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets. Since the enactment of the 1975 Amendments, the Commission has taken steps to assure such equal regulation in two specific areas: regulation of short sales and anti-manipulative rules.

## Short Sale Regulation

On June 12, 1975, the Commission adopted[35] amendments to its short sale

rules, Exchange Act Rules 10a–1 and 10a–2, to provide for comprehensive regulation of short sales of listed securities in all markets (including the over-the-counter market) in conjunction with the full implementation of the consolidated transaction reporting system.[36] In conjunction with the adoption of those amendments, the Commission proposed two further amendments to Rule 10a–1 to alleviate the impact of the short sale rules on the market-making ability of regional exchange members.[37] After reviewing the comments received on these further proposals (including the views of certain self-regulatory organizations presented at a public meeting held on April 26, 1976), the Commission determined to withdraw the proposed amendments.[38] The Commission is continuing to consider whether any form of short sale regulation is necessary or appropriate in view of the improvements in the reporting of transactions by the consolidated system and the development of more sophisticated techniques for market surveillance by the Commission and the various self-regulatory organizations.

## Anti-Manipulative Rules

By September 1975, each of the self-regulatory organizations participating in the pilot phase of the consolidated transaction reporting system had adopted a uniform anti-manipulative rule in substantially the form recommended by the Commission's Advisory Committee on a Central Market System. In August 1975, through identical letters to all national securities exchanges participating in the consolidated system, the Commission's staff requested verification that all of the anti-manipulative rules recommended by the Commission in September 1974 had been adopted.[39] All these exchanges replied affirmatively. On June 4, 1975, the NASD amended and refiled with the Commission proposed anti-manipulative rules relating to over-the-counter trading in eligible securities, which rules were approved by the Commission on May 12, 1976.[40]

## Automated Routing Systems

Section 11A(c)(1)(E) of the Exchange Act, added by the 1975 Amendments, directs the Commission to assure that all exchange members, brokers and dealers transmit and direct orders for the purchase and sale of qualified securities in a manner consistent with the establishment and operation of a national market system. Two related provisions, Sections 11A(a)(1)(C)(i) and (ii), require the Commission to assure economically efficient executions of securities transactions and fair competition among brokers and dealers, among exchange markets, and between exchange and other markets. In furtherance of this obligation, the Commission has reviewed proposals (1) by several exchanges relating to automatic order routing systems (2) by three large broker-dealers wishing to commence programs for the in-house execution of certain types of customer odd-lot differentials, and (3) by two exchanges wishing to prohibit their members from imposing differential charges on certain types of odd-lot orders.

On November 11, 1975, the Pacific Stock Exchange, Inc. (the "PSE"), filed a proposed rule change with the Commission which would expand the capability of the PSE's automatic order execution system ("COMEX") from 199-share orders to orders not exceeding 300 shares.[41] Additionally, the PSE proposed to broaden the prohibition of the imposition of floor brokerage on COMEX orders which are executed on a formula basis, to cover all market and limit orders. The Commission approved the PSE's proposal on December 23, 1975.[42]

On January 9, 1976, the Midwest Stock Exchange, Inc. (the "MSE"), filed with the Commission a proposed rule change to convert its automatic execution program (available for orders from 100 to 199 shares in certain issues listed on the MSE) ("MAX") from a pilot program to a permanent program.[43] MAX orders are executed on a formula basis in a manner similar to that of COMEX. The Commission approved the MSE's proposal on May 14, 1976.[44]

On February 12, 1976, the New York Stock Exchange, Inc (the "NYSE"), submitted a proposed rule change setting forth procedures for routing and executing 100-share market orders processed through the NYSE's Designated Order Turnaround System ("DOT").[45] DOT orders are executed on the basis of the bid/asked prices quoted on the floor of the NYSE at the time the orders are received on the floor. The Commission ap-

proved the NYSE's DOT proposal on May 19, 1976 [46]

In addition, the Commission analyzed the regulatory and competitive implications of programs by three large broker-dealers to internalize executions of certain types of customer odd-lot orders in listed securities without the imposition of an odd-lot differential This question was presented in connection with requests by these broker-dealers for exemptions from Exchange Act Rules 10a–1 and 10b–6, where applicable, in order to facilitate the operation of these odd-lot programs [47]

Finally, the Commission approved rule proposals submitted by the American Stock Exchange and the Midwest Stock Exchange which would effectively prohibit members of those exchanges (including specialists) acting in the capacity of odd-lot dealers from imposing a differential in connection with the execution of certain types of odd-lot orders [48]

## Access to Exchanges

*General Inquiry*—Section 31(b) of the 1975 Amendments authorizes the Commission to review the rules of any national securities exchange or national securities association to see if any of their rules do not comply with the Exchange Act, as amended The section provides that at any time within one year of the effective date of any amendments to the Act, the Commission may give written notice to an exchange or association specifying the extent to which its rules fail to comply with the provisions of the Securities Exchange Act. After six months have elapsed following receipt of the notice, the Commission may by order suspend the registration of such exchange or association or impose limitations on the activities, functions and operations of the exchange or association if the Commission finds, after notice and opportunity for hearing, that the organization or rules of such exchange or association do not comply with the Exchange Act, as amended

Pursuant to Section 31(b), the Commission announced on March 2, 1976,[49] that it was undertaking a general inquiry of the exchanges, rules relating to membership and association with members in light of certain of the 1975 Amendments, particularly those to Section 6 of the Exchange Act Among other things, Section 6(b) now permits any registered broker or dealer to join a national securities exchange and any person to become associated with a member organization, subject of course to statutory disqualifications and to appropriate financial, operational and competency standards Section 6(b) also embodies a prohibition against exchange rules imposing unnecessary or inappropriate burdens on competition The purpose of the Commission's general inquiry is to assure that exchange regulation of access to membership and association with member organizations is limited to fulfilling the purposes of the Act At the end of the fiscal year, the ten national securities exchanges had responded with a variety of presentations along with proposed amendments to rules as to which notice had been given pursuant to Section 31(b) in connection with the proceeding

*New York Stock Exchange Rule Proposals* —On March 11, 1976, the Commission gave notice of the filing of, and the issuance of an order instituting proceedings to determine whether to disapprove, Rules 309 and 310 as proposed by the NYSE [50] Proposed NYSE Rule 309 would prohibit an NYSE member organization from having as a parent a natural person not a citizen of, or a company not organized under the laws of, the United States, unless the NYSE determined that brokers and dealers domiciled in the United States (or their subsidiaries) could obtain similar access to securities exchanges under the laws and policies of the parent's domicile or principal place of business or both Proposed NYSE Rule 310 would provide that no member organization may function as, control, be controlled by, or be under common control with a person conducting commercial banking operations within the United States

Under Section 19(b) of the Exchange Act, the Commission generally must approve, or institute a proceeding to determine whether to disapprove, a rule change proposed by a self-regulatory organization within 35 days after a publication of notice of filing Before the Commission commenced such proceedings, the NYSE had declined the Commission's invitation to withdraw its proposed rules pending the completion or progress of the forthcoming general inquiry By the end of

the fiscal year, the Commission had received submissions from several interested persons in connection with the pending proceedings

## Trading by Exchange Members

*Section 11(a)* —As amended by the 1975 Amendments, Section 11(a)(1) of the Securities Exchange Act prohibits, with certain specified exceptions (such as market making activities), any member of a national securities exchange from effecting any transaction on such exchange for its own account, the account of an associated person, or an account with respect to which it or any of its associated persons exercises investment discretion. Under Section 11(a), the Commission has broad authority to fashion either more flexible or more restrictive standards in light of changing conditions. Section 11(a)(3) provides that the prohibitions in Section 11(a)(1) do not apply before May 1, 1978, to transactions effected on an exchange by those who were members of that exchange on May 1, 1975

On January 27, 1976,[51] the Commission began a rulemaking proceeding to implement Section 11(a) and requested public comment on a series of related questions In anticipation of May 1, 1978 (and inasmuch as Section 11(a)(1) immediately affected members who joined exchanges after May 1, 1975), the Commission took action to implement certain specific exemptions envisioned by the Congress. First, the Commission adopted Exchange Act Temporary Rule 11a–1(T) to implement the exemption in Section 11(a)(1)(G) for the proprietary transactions of certain types of members where the transactions yield priority, parity, and precedence in execution to public orders. At the same time, the Commission proposed Exchange Act Rule 11a1–2, which would allow members to effect transactions for the accounts of their associated persons, and also transactions for accounts carried by associated persons, only on the same basis that such transactions could be effected for accounts held by the member itself The Commission also proposed an amendment to its recordkeeping rule, Exchange Act Rule 17a–3, which would enable every member, broker or dealer to demonstrate its compliance with Section 11(a)

*Recission of Rule 19b–2* —Exchange Act Rule 19b–2, adopted by the Commission in 1973, required each national securities exchange to adopt rules specifying that every member of the exchange must have as the principal purpose of its exchange membership the conduct of a public securities business, in accordance with that rule Rule 19b–2 had been the subject of extensive litigation [52] Since Section 11(a), as amended by the 1975 Amendments, was intended to displace Rule 19b–2, the rule was rescinded by the Commission [53] Following the rescission of Rule 19b–2, the Commission has approved deletions by national securities exchanges of rules adopted thereunder and has indicated further that such rules are no longer consistent with the Act [54]

## Allocation of Regulatory Responsibility Among Self-Regulatory Organizations

The 1975 Amendments transferred the responsibility from the Securities Investor Protection Corporation to the Commission of designating one self-regulatory organization to inspect members of two or more such organizations ("dual members") for compliance with the applicable financial responsibility rules [55] Section 17(d) of the Exchange Act empowers the Commission to relieve any self-regulator of compliance, enforcement, or other regulatory functions with respect to dual members, and to allocate among the self-regulators rulemaking authority concerning matters as to which such organizations share such authority Such action is to promote competition and coordination among the self-regulators and the development of a national market system and a national system for the clearance and settlement of securities transactions

On April 20, 1976, the Commission adopted Exchange Act Rule 17d–1,[56] which essentially provides that the Commission shall designate one of the self-regulators to which a dual member belongs as responsible for examining the dual member for compliance with applicable financial responsibility rules Under Rule 17d–1, written designation of one such self-regulatory organization relieves all other interested self-regulators of this responsibility to the extent specified in the designation

At the same time, the Commission pro-

posed Rule 17d–2, which is intended to establish the procedural foundation for a comprehensive allocation of regulatory responsibility among the self-regulators, and to promote cooperation among such organizations in assessing their regulatory capabilities The proposed rule would permit two or more self-regulatory organizations to submit to the Commission a joint proposed plan for allocation of specified regulatory functions as to members or participants which they have in common Once such a plan had been declared effective by the Commission, those self-regulators participating in the plan and not designated thereby to assume regulatory responsibility would be relieved of such responsibility to the extent provided by the plan. In the event that proposed plans filed under proposed Rule 17d–2 did not provide for all members or participants of parties to the plan, or did not allocate all their self-regulatory responsibility, the Commission would be empowered, on its own motion after due consideration of the statutory criteria, to designate one or more self-regulators to assume specified regulatory responsibilities with respect to such members or participants. As the fiscal year closed, the Commission was considering public comments upon the allocation program, and responses to the Commission's specific request that the self-regulators submit outlines of allocation plans which they might file in accordance with proposed Rule 17d–2

## Enforcement Obligations of Self-Regulatory Organizations

Section 19(g), which was added to the Exchange Act by the 1975 Amendments, requires every self-regulatory organization to comply with the Act, the rules and regulations thereunder and its own rules and, absent reasonable justification or excuse, to enforce compliance therewith by its members and persons associated with its members Section 19(g)(2) authorizes the Commission to adopt rules relieving any self-regulatory organization of its enforcement responsibilities with respect to specified provisions of the Securities Exchange Act or the rules and regulations thereunder

On May 26, 1976, the Commission published for comment proposed Exchange Act Rule 19g2–1 [57] The proposed rule is designed to provide a format for developing guidelines as to the extent to which self-regulatory organizations should be obligated to enforce the Exchange Act and the rules thereunder. If adopted in the form proposed, Rule 19g2–1 would relieve national securities exchanges and associations from certain enforcement responsibilities primarily with respect to those persons associated with members who neither control members nor engage in securities activities.

## FOCUS Reporting System

In response to indications from the securities industry that the separate financial reporting and surveillance systems of the Commission and the various self-regulatory organizations were imposing an unnecessary burden on brokers and dealers, (especially the smaller firms), the Commission initiated a comprehensive program to review, consolidate and simplify the existing reporting and regulatory requirements applicable to the securities industry The program began with the creation of an Advisory Committee on Broker-Dealer Reports and Registration Requirements,[58] which was subsequently replaced by the Report Coordinating Group, a Federal advisory committee formed in May 1974 [59]

In its First Annual Report to the Commission on June 16, 1975, the Report Coordinating Group recommended the adoption of a Financial and Operational Combined Uniform Single ("FOCUS") Report After considering the recommendations of the Report Coordinating Group and the comments received thereon, and making some changes, the Commission released the FOCUS Report for public comment on October 16, 1975 [60] After making additional changes, the Commission adopted the FOCUS Report and accompanying amendments to Exchange Act Rules 17a–4, 17a–5, 17a–10, 17a–11 and 17a–20 on December 17, 1975 (all of which became effective on January 1, 1976) [61] The report has also been adopted by over 40 state securities agencies

The FOCUS reporting system simplifies the reporting obligations of all brokers and dealers by superseding the existing and often uncoordinated reporting systems of the Commission and the self-regulators with an integrated reporting system based upon general purpose financial statements. The program

consolidates broker-dealer reporting requirements for purposes of surveillance, annual audits, customer statements, and economic data collection. The FOCUS system replaces all similar existing reporting programs of the self-regulatory organizations, such as the Joint Regulatory Report and the NASD's Forms "M" and "Q" The consolidation of these diverse reporting forms into a single reporting system substantially reduces the multiplicity of forms and the frequency of required filings resulting in a considerable reduction in paperwork for the broker-dealer In addition, the FOCUS forms are designed to enable a firm to present its financial condition clearly and efficiently, through the periodic disclosure of key indicators of financial condition, such as a monthly computation of net capital, and detailed financial and operational statements and schedules prepared on a quarterly basis

The structure of the FOCUS Report is designed on a "layering" concept, that is, the complexity of the broker's or dealer's business determines the amount of required information and the frequency of its filing. Part I of Form X–17A–5 consists of twenty-six key indicators of financial condition and must be filed monthly by those brokers and dealers which clear or carry customers' accounts. Part II of Form X–17A–5 comprises comprehensive statements and schedules of financial and operational information, which must be filed on a calendar quarter basis by such brokers and dealers. Part IIA of Form X–17A–5, another quarterly filing, is an abbreviated version of Part II available to those brokers and dealers which introduce their customers' business to another broker or dealer on a fully disclosed basis

Concurrent with the adoption of the FOCUS Report, the Commission approved and declared effective plans filed by eight self-regulatory organizations pursuant to Exchange Act Rule 17a–5(a)(4), which plans dispense with the requirement to file a separate copy of the FOCUS Report with the Commission Under these plans, the American Stock Exchange, Inc , the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Inc , the Midwest Stock Exchange, Inc., the National Association of Securities Dealers, Inc , the New York Stock Exchange, Inc , the Pacific Stock Exchange, Inc , and the Philadelphia Stock Exchange, Inc. have agreed to receive FOCUS Reports directly from those members for which each organization is the designated examining authority This information is reviewed and analyzed by the self-regulators and submitted to the Commission in the form of edited computer tapes, thus providing the necessary data to the Commission without imposing an additional direct filing requirement on members of these self-regulatory organizations

For the first time, Rule 17a–5(a)(2) integrates a broker-dealer's annual audit with the quarterly surveillance reports, thus providing a single coordinated framework of regulation This provision requires that a broker or dealer file a report on Part II or Part IIA of Form X–17A–5 as of the date of the annual audit, if such date does not coincide with a regular calendar quarter filing of a report on Part II or Part IIA This requirement provides the Commission with comparable data in audited and unaudited formats from which the accuracy of the broker's or dealer's quarterly reports may be verified.

The detailed audit requirements embodied in previous financial questionnaires have been eliminated to permit the development of flexible audit procedures suited to the nature and complexity of an individual broker's or dealer's business Rule 17a–5(g) prescribes general audit objectives to be followed in the preparation of annual financial statements and thereafter permits the accountant to exercise his professional judgment with respect to the nature, extent and timing of audit procedures. In rendering his opinion, the auditor is required to reconcile his computations of the firm's net capital (pursuant to Exchange Act Rule 15c3–1) and reserve requirements (pursuant to Exhibit A to Rule 15c3–3) with the corresponding computations in the broker's or dealer's most recent filing of the unaudited Part II or Part IIA of Form X–17A–5 The auditor is also required by Rule 17a–5(h)(2) to inform the Commission if, during the course of the audit or interim work, he determines the existence of material inadequacies which the broker or dealer has not reported promptly or accurately to the Commission

In addition to the revision of Form X–17A–5, the FOCUS reporting system also effects significant changes in the Commission's

Forms X-17A-10 and X-17A-20. The information required by Form X-17A-10, the annual report of revenue and expenses, is substantially reduced and modified to coordinate with corresponding data on the FOCUS Report. Much of the information required by Form X-17A-20, a report utilized by the Commission to monitor the impact of competitive commission rates, has been eliminated, as similar information is developed by the FOCUS Report.

The simplification and unification of the reporting requirements and the flexibility of the revised audit procedures engendered by the FOCUS concept strengthen the regulatory structures of the Commission and the self-regulatory organizations while reducing the time and effort required of brokers and dealers in order to demonstrate compliance. The relative benefits of this new system accrue particularly to smaller brokers and dealers, and have resulted in substantial time and cost savings for such firms The Commission intends periodically to review and modify the FOCUS Report to insure that continued existence of a financial reporting system that keeps pace with an evolving securities industry.

## Uniform Net Capital Rule

For years prior to 1975, brokers and dealers had operated under as many as eight different rules prescribing financial responsibility standards in the form of minimum net capital requirements. Seven national securities exchanges had capital rules which governed their members, and the Commission applied Exchange Act Rule 15c3-1 to other brokers and dealers. Little initial uniformity existed among these rules, and this situation worsened with the passage of time as years of divergent amendatory and interpretive development created further dissimilarities.

Section 15(c)(3) of the Exchange Act, as amended by the 1975 Amendments, required the Commission to establish no later than September 1, 1975, minimum financial responsibility requirements for all brokers and dealers. On June 26, 1975, the Commission fulfilled this congressional directive by adopting a uniform net capital rule which, among other things, superseded the capital requirements of all national securities exchanges.[62] As amended, Rule 15c3-1 perpetuates the Commission's traditional "aggregate indebtedness" standard of capital sufficiency, and introduces a new concept in financial responsibility regulation, the "alternative net capital requirement." The aggregate indebtedness concept, which derives from the provisions of former capital rules, measures a broker's or dealer's liquidity and financial condition in terms of a ratio between substantially all of his liabilities and those of his assets which are readily convertible into cash The alternative net capital requirement, which is available at the election of qualified brokers and dealers, prescribes net capital requirements graduating in direct proportion to the magnitude of a firm's customer-related obligations, as computed in accordance with the Formula for Determination of Reserve Requirements of Brokers and Dealers, constituting Exhibit A to Exchange Act Rule 15c3-3

## Regulation of Municipal Securities Professionals

The 1975 Amendments sought to subject municipal securities professionals to essentially the same scheme of regulation applicable to other securities activities [63] Thus, municipal securities were excised from the Exchange Act's definition of "exempted securities" for purposes of several provisions of the Act, including Section 15(a), which sets forth registration requirements for brokers and dealers.[64] At the same time, the 1975 Amendments added Section 15B(a) to the Act This new provision requires municipal securities dealers utilizing the jurisdictional means and not otherwise registered under Section 15 to register with the Commission.[65] Other provisions of Section 15B establish and set rulemaking standards for the Municipal Securities Rulemaking Board, a self-regulatory organization for the municipal securities industry. Since the enactment of the 1975 Amendments, approximately 310 bank municipal securities dealers, 10 other municipal securities dealers conducting an exclusively intrastate business (but utilizing the jurisdictional means),[66] and 232 brokers and dealers required to register under Section 15 solely by virtue of their municipal securities activities have registered with the Commission. The past fiscal year saw numerous rulemaking initiatives by the Commission and the Municipal Securities Rulemaking Board intended to

provide for the regulation of these municipal securities professionals

*Establishment of the Municipal Securities Rulemaking Board* —Section 15B(b)(1) required the Commission to appoint the initial 15 members of the Municipal Securities Rulemaking Board (the "MSRB"). On June 12, 1975, the Commission solicited recommendations of candidates for appointment to the MSRB.[67] After reviewing over 500 letters recommending approximately 150 individuals, the Commission announced its selection of the initial membership of the MSRB.[68] During the fiscal year, the MSRB made nine proposed rule filings. One of these is discussed below; others are discussed in Part III of this Report

*Definition of the Term "Separately Identifiable Department or Division" of a Bank.*— Section 15B(b)(2)(H) requires the MSRB to define, by rule, the term "separately identifiable department or division [of a bank]" for purposes of the definition of "municipal securities dealer." Such a rule would determine in what circumstances a bank municipal securities dealer could comply with the registration requirements of Section 15B(a) by registering its "separately identifiable" component, rather than by registering the entire bank On October 10, 1975, the MSRB filed four rules, including a rule defining the term "separately identifiable department or division" of a bank, and, on October 15, 1976, the Commission ordered this rule (and certain related definitional proposals) to be put into effect summarily in order to permit the timely and orderly registration of the separately identifiable departments or divisions of banks.[69]

*Adoption of Rules Relating to Registration of Municipal Securities Dealers* —Under Section 15B(a), all municipal securities dealers must register with the Commission On August 11, 1975, the Commission (i) announced that non-bank municipal securities professionals would be required to register on the existing Form BD, (ii) proposed Exchange Act Rules 15Ba2-1 and 15Ba2-2 concerning registration of bank municipal securities dealers and non-bank municipal securities dealers whose business is exclusively intrastate, and (iii) proposed Form MSD for bank registrants.[70]

On October 15, 1975, the Commission adopted Exchange Act Rules 15Ba2-1, 15Ba2-2, two temporary rules (15Ba2-3(T) and 15a-1(T)), and Form MSD, with amendments permitting its use by separately identifiable departments or divisions of banks.[71] The temporary rules provided a six-month grace period for new registrants from the requirement that all municipal securities professionals be effectively registered by December 1, 1975, provided that such persons filed their applications for registration with the Commission not later than November 30, 1975, and complied with applicable provisions of the Act, the rules and regulations of the Commission thereunder, and the rules of the MSRB. The Commission also adopted Rule 15b2B-1, which establishes a definition of, and registration procedures for, separately identifiable departments or divisions of persons referred to in Section 15(b)(2)(B) of the Act.[72]

Shortly after the close of the fiscal year, the Commission adopted Rules 15Ba2-4, 15Ba2-5, 15Ba2-6 and 15Bc3-1 (and related Form MSDW), which relate to the registration of successors to a registered municipal securities dealer, the registration of a fiduciary appointed to continue the business of a registered municipal securities dealer, and the withdrawal of the registration of a municipal securities dealer.[73]

*Capital Requirements for Brokers and Dealers Effecting Transactions in Municipal Securities* —The Commission, aware that its net capital requirements should provide appropriate recognition of the pronounced differences between the municipal securities markets and their corporate securities counterparts, solicited public comment on three occasions during the summer of 1975 concerning the appropriate net capital requirements for brokers and dealers effecting transactions in municipal securities[74] The public's response indicated that these brokers and dealers would need an extended transitional period to conform their operations to the net capital standards of Rule 15c3-1.

Accordingly, on November 20, 1975, the Commission announced [75] a financial responsibility and reporting program pertaining to transactions in municipal securities, the salient feature of which was a series of temporary amendments to Rule 15c3-1, expiring in most cases on June 1, 1976, designed to modify the impact of certain provi-

sions of the rule upon brokers and dealers effecting transactions in municipal securities.[76] At the same time, the Commission again invited public comment concerning the appropriate net capital requirements for these brokers and dealers On May 26, 1976, the Commission announced[77] a second phase of the financial responsibility and reporting program which, among other things, permitted smaller brokers and dealers effecting transactions solely in municipal securities to utilize on a trial basis the principal innovation of the uniform net capital rule, the alternative net capital requirement.[78] This second phase of the Commission's program also extended until October 1, 1976, certain of the previously adopted temporary amendments to Rule 15c3–1 This action, coupled with the Commission's explicit solicitation of impact studies and other appropriate statistical computations from interested members of the public, was intended to enable the Commission to develop solutions to technically intricate questions

*Review and Amendment of Existing Antifraud Rules Applicable to Transaction in Municipal Securities* —During the past fiscal year, the Commission engaged in a detailed review of its existing antifraud rules (adopted under Sections 10(b), 15(c)(1), and 15(c)(2) of the Exchange Act), and existing SECO[79] rules (adopted under provisions renumbered by the 1975 Amendments as Sections 15(b)(7), 15(b)(8), and 15(b)(9) of the Exchange Act) to determine the extent to which such rules should be applicable to transactions in municipal securities effected by brokers and dealers, as well as to such transactions by dealer banks or their separately identifiable departments or divisions.

In November 1975, the Commission solicited public comment on proposals to extend the application of eleven of the antifraud rules adopted under Section 10(b), 15(c)(1) and 15(c)(2) to bank municipal securities dealers, to suspend the application of Exchange Act Rule 15c2–11 to quotations for municipal securities, and to suspend the application of SECO examination rules and rules of fair practice to municipal securities dealers effecting transactions solely in such securities.[80]

In order to afford appropriate time for public comment on these proposed rule changes, and in order to relieve municipal securities brokers and dealers from possibly inappropriate regulatory requirements that would otherwise have applied to them on December 1, 1975, the Commission, on November 26, 1975, adopted Exchange Act Temporary Rule 23a–1(T). This rule preserved, with one exception, the status quo until July 5, 1976, the regulation of municipal securities professionals and transactions in municipal securities [81]

On May 20, 1976, the Commission adopted without major revision its proposed amendments to the SECO rules. At the same time, the Commission made those rules adopted under Section 15(c)(1) of the Act, as well as Exchange Act Rule 15c2–4, applicable to bank municipal securities dealers. Finally, the Commission exempted transactions in municipal securities from Rules 15c2–5, 15c2–7, and 15c2–11.[82]

*Recordkeeping and Preservation Requirements for Municipal Securities Brokers and Dealers.*—Section 17(a) of the Exchange Act requires certain enumerated classes of persons, including registered brokers and dealers, to make and keep such records for such periods of time as the Commission may by rule prescribe. The 1975 Amendments added several classes of persons, including registered municipal securities dealers, to the list of entities subject to the Commission's rulemaking authority with respect to recordkeeping and preservation requirements. At the same time, the 1975 Amendments added to the Act Section 15B(b)(2)(G), which requires the MSRB to prescribe recordkeeping and preservation requirements for municipal securities brokers and municipal securities dealers. Taken together, Sections 17(a) and 15B(b)(2)(G) vest the Commission and the MSRB with concurrent authority to adopt recordkeeping and preservation standards for all registered brokers and dealers effecting transactions in municipal securities, as well as for those banks (or their separately identifiable departments or divisions) registered as municipal securities dealers.

The Commission's recordkeeping and preservation requirements, Exchange Act Rules 17a–3 and 17a–4, apply by their terms to all registered brokers and dealers. Thus, newly registering brokers and dealers effecting transactions solely in municipal securities would come within the ambit of these rules. It

appeared to the Commission that these brokers and dealers might be unfamiliar with the requirements of these rules and, to the extent their operational systems would require modification, might experience difficulty in implementing Rules 17a–3 and 17a–4. On November 20, 1975, in order to afford these brokers and dealers an appropriate transitional period, and to permit the Commission and the MSRB to develop appropriate recordkeeping and preservation requirements for all municipal securities brokers and municipal securities dealers, the Commission adopted[83] and thereafter maintained certain interpretations of Securities Exchange Act Rules 17a–3 and 17a–4 as applied to brokers and dealers effecting transactions solely in municipal securities. These interpretations required such brokers and dealers to make, keep current and preserve in an easily accessible place books and records sufficient to demonstrate their financial condition, to reflect the receipt and delivery of all funds and securities, and to reflect all customer activity

On February 3, 1976, the MSRB made available to interested members of the public an exposure draft of rules establishing recordkeeping and preservation requirements for all municipal securities brokers and municipal securities dealers Thereafter, in accordance with Section 19(b) of the Act, the MSRB filed and the Commission published[84] these proposed rules These rules were under staff review as the fiscal year closed

## Regulation of the Options Markets

As the fiscal year began, three national securities exchanges listed and traded "call" options contracts under programs approved by the Commission in prior fiscal years.[85] The Chicago Board Options Exchange ("CBOE") had initiated listed options trading in April 1973, the American Stock Exchange ("Amex") and the Philadelphia Stock Exchange ("PHLX") began trading exchange listed options in January and June 1975, respectively. During the fiscal year, all three exchanges expanded their options programs amidst dramatically enlarged trading volume, indicative of the increasing interest in this investment vehicle. During this fiscal year, the Pacific Stock Exchange ("PSE") also began an options market.

At the close of the fiscal year, CBOE had 1,319 members trading listed options on 85 underlying stocks. CBOE's average daily trading volume reached approximately 89,000 contracts (compared to 53,000 in the previous fiscal year),[86] representing 8,900,000 shares of the underlying securities. All 650 Amex members had options trading privileges admitting them to a market of listed options on 57 underlying stocks [87] Average daily volume on the Amex climbed from 17,016 to approximately 35,000 contracts. Approximately 230 Phlx members were qualified to effect transactions in listed options for 27 underlying stocks; this exchange attained an average trading volume of 2,600 contracts during its first year of operation.

*Initiation of Listed Options Trading on the PSE* —On March 30, 1976, the Commission approved[88] proposals by the PSE to implement a program for the listing and trading of option contracts on the PSE. Trading on the PSE's options floor commenced on April 9, 1976

In common with other exchanges trading listed options, PSE lists options on underlying securities characterized by wide distribution and active trading and issued by companies with consistent earnings records. PSE's options contracts, like those traded on other exchanges, are made fungible through standardization of such contract variables as expiration date and striking price. PSE has joined other exchanges which trade options as a participant in the Options Clearing Corporation (OCC). The OCC issues, guarantees and registers all exchange traded options in compliance with the federal securities laws, and clears and settles all transactions in such options PSE reports transactions occurring on its option floor to the Options Price Reporting Authority, which serves as a consolidated reporting system for all transactions in exchange listed options.

Unlike all other options exchanges except Phlx,[89] PSE lists both a particular underlying security and the corresponding call option contract. Several features of PSE's options program are designed to reduce the possibility of trading option contracts on the basis of market information concerning activity in the underlying stock not yet publicly disseminated, or vice versa For example, PSE separates its options floor from its equities trading floor, in order to prevent direct oral or visual

communication between members on the two floors PSE also prohibits members from effecting transactions of their own accounts when they have learned of large unreported transactions in an option or its underlying security, the effecting transactions for their own accounts involving either the stock or the option until the transaction is disclosed on the ticker or otherwise, and, in the case of orders involving the option, for two minutes thereafter [90]

As the fiscal year drew to a close, other self-regulatory organizations were publicly exploring the possibility of joining PSE as new entrants into the options marketplace Both the Midwest Stock Exchange and the NASD conducted discussions with the Commission's staff pointing toward the possible submission to the Commission of proposed options programs during the coming fiscal year

*Listed Put Option Contracts* —A call option contract essentially provides its holder with the right to purchase for a specified price a specified number of shares of a given security from the seller (or "writer") of the call Conversely, the purchaser of a "put" option acquires the right to sell a given quantity of the underlying security to the writer of the put, at a price specified in the put option contract

Presently, only call options are listed on the four national securities exchanges trading listed options During the fiscal year, the Commission published for public comment rule proposals from all four exchanges providing for the commencement of trading in listed put option contracts on each such exchange [91] Shortly after the fiscal year ended, the Commission addressed a letter to each of the exchanges conveying its intention to defer any decision respecting the initiation of puts trading until after January 1, 1977 [92] The Commission noted that there had not been sufficient opportunity to conduct an overall review of the pilot options trading programs in the context of the ongoing and future development of the securities market systems The Commission also observed that a substantial number of regulatory, surveillance and economic questions related to options trading remained to be resolved However, the Commission expressed its recognition of the "economic logic" for extending exchange options activity to include listed put contracts

*Financial Responsibility Requirements* — The financial structure of the options marketplace revolves around a relatively small number of firms which, as "clearing members" of the Options Clearing Corporation, guarantee, carry and clear the accounts of the substantially more numerous options specialists In this capacity, each clearing member assumes a complex of credit and market risks the magnitude of which depends upon the activities of the options specialists whose trading obligations the clearing member is required [93] to guarantee In early 1976, the Commission determined that it would be appropriate to amend the provisions of its net capital rule relating to the capital treatment of such guaranteed accounts, in order to augment the financial and regulatory incentives upon clearing members to monitor closely the activities of the options specialists in such accounts On February 26, 1976, the Commission proposed amendments to Rule 15c3–1 intended to achieve this purpose. [94] The proposed amendments would require clearing members to consider each specialist's market maker account as a separate entity for purposes of capital computations, no clearing member would be permitted to "cross-net" a liquidating deficit in one such account against equity in another such account The Commission also proposed specific capital treatment for certain dual-position trading strategies known as "spreads" and "hedges," instead of applying separate capital charges to each component of a bona fide hedge or spread Finally, the proposed amendments to Rule 15c3–1 would establish a system of day-to-day control and early warning, whereby clearing members would be required to monitor closely each specialist's market making activities The Commission's staff was studying public comments as the fiscal year ended

## Registration and Regulation of Clearing Agencies

The 1975 Amendments provide for Federal regulation of the securities handling process, including the registration and regulation of clearing agencies and transfer agents, in order to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions Under Section 17A of the Exchange

Act, the authority and responsibility for the registration and regulation of clearing agencies and transfer agents is shared among the Commission and the Federal bank regulatory agencies (*i.e.*, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation.)[95]

Section 17A(b) of the Act, which became effective on December 1, 1975, requires a clearing agency[96] to be registered with the Commission if it performs any clearing agency functions for any security other than an exempted security. The Commission must publish notice of the filing so that interested persons may comment on it. Within certain specified periods, the Commission must either grant the registration by order, or institute proceedings to determine whether registration should be denied.

In November 1975, the Commission adopted Exchange Act Rule 17Ab2-1,[97] which requires each clearing agency to apply for registration or exemption from registration by filing Form CA-1 with the Commission.

On November 26, 1975, the Commission published notice that thirteen clearing agencies had applied for registration.[98] The registrations were declared effective as of December 1, 1975, after the Commission determined that the clearing agencies' operations and rules were adequate to safeguard securities and funds in their custody or control, and that their rules did not fix prices which participants in the clearing agencies must charge to other persons.

When the thirteen clearing agencies were registered on December 1, 1975, the Commission, in accordance with Exchange Act Rule 17Ab2-1, did not make all the determinations called for by subparagraphs (A) through (I) of Section 17A(b)(3) of the Act. Under that rule, the Commission has nine months from the date the registration becomes effective either to make all the required determinations or to institute proceedings (in accordance with Section 19(a)(1)(B) of the Act) to determine whether registration should be denied. This approach was intended to permit clearing agencies in operation prior to December 1, 1975 to be registered in compliance with the Act upon a finding that their operations afforded adequate safeguards to funds and securities in their custody or control, while providing the Commission sufficient time to consider fully the issues involved before making the required determinations, particularly those pertinent to the establishment of a national clearance and settlement system.

Since December 1, 1975, three additional entities have applied to the Commission for registration.[99] One of these is the proposed National Securities Clearing Corporation ("NSCC"), a company combining the clearing operations currently conducted by the three major New York registered clearing agencies, the Stock Clearing Corporation ("SCC"), the American Stock Exchange Clearing Corporation ("ASECC") and the National Clearing Corporation ("NCC"). The Commission has also received fifteen applications for exemption from registration.[100]

On May 28, 1976, the Commission announced the institution of proceedings, including public hearings, to determine whether to grant or deny the application of NSCC for registration as a clearing agency.[101] Public hearings were held on June 16-18, 1976, during which representatives of certain national securities exchanges, the NASD, brokers and dealers, clearing agencies, and other interested persons presented their views and responded to the questions of the Commission and its staff. In addition, numerous letters of comment and other materials were received in connection with these hearings. At the end of the fiscal year, the Commission was evaluating this information to determine whether NSCC's application for registration as a clearing agency should be granted or denied.

## Registration and Regulation of Transfer Agents

Section 17A(c) of the Exchange Act, which became effective on December 1, 1975, requires a transfer agent to become registered with its appropriate regulatory agency[102] if it acts as a transfer agent for any security registered under Section 12 of the Act or for any security which would be registrable but for the exemptions from registration for securities of registered investment companies (Section 12(g)(2)(B)), or for securities issued by insurance companies (Section 12(g)(2)(G)). A transfer agent becomes regis-

tered thirty days after its application for registration is received by the appropriate regulatory agency, unless the agency accelerates, denies or postpones registration in accordance with Section 17A(c) of the Act.

In October 1975, acting in cooperation with the Federal bank regulatory agencies, the Commission adopted Exchange Act Rule 17Ac2-1 and Form TA-1 on which transfer agents are to register with the Commission.[103] The three bank regulatory agencies simultaneously adopted a similar rule and the identical registration form for transfer agents required to register with those agencies. Thereafter, approximately 2,400 transfer agents registered with the Commission and the Federal bank regulatory agencies. In order to provide the Commission and the bank regulators with a central repository of readily accessible information concerning registered transfer agents, the Commission has initiated a program to maintain in its automated data retrieval systems the information contained in those registration forms.

As the fiscal year progressed, the Commission's staff visited several bank, non-bank and issuer transfer agents located in various parts of the country to review their capabilities and performance standards. On the basis of information obtained through the registration process and the staff's contacts with transfer agents, and after consulting with the bank regulators,[104] the Commission on May 12, 1976, published for comment proposed rules under Section 17A(d) of the Exchange Act pertaining to certificate turnaround time, reporting requirements related thereto, response time for confirmation requests, and record-keeping requirements for registered transfer agents.[105] At the end of the fiscal year, the Commission was evaluating the comments of interested members of the public concerning these proposals.

## Street Name Study

Section 12(m) of the Exchange Act, added by the 1975 Amendments, directs the Commission to conduct a study of the practice of recording the ownership of securities in other than the name of the beneficial owner of such securities (the "Street Name Study"), and to determine whether this practice is consistent with the purposes of the Act, and whether steps can be taken to facilitate communications between issuers and the beneficial owners of their securities while retaining the benefits of the practice.

During the fall of 1975, the staff conducted extensive research into both the historical background of street name registration and the scope of its use today. Comments regarding the effect of this practice on appropriate disclosure of the beneficial ownership of corporate securities and on issuer-shareholder communications were solicited from the industry and interested members of the public through field interviews and by Commission release.[106] The Commission's findings were incorporated into a *Preliminary Report*[107] which was submitted to Congress on December 4, 1975. The preliminary report sets forth the the Commission's findings on the history and prevalence of street name registration and seven proposals about improving issuer-shareholder communications.

During the second phase of the Street Name Study, the Commission set out to gather statistical data enabling it to construct an empirical model of the current system of transmitting issuer-shareholder communications through intermediaries, and to evaluate the efficiency, shortcomings, cost, and cost distribution of this system. To that end, the Commission decided to conduct a survey which would monitor the activities of issuers, financial intermediaries, and shareowners during the months of March, April, May, and June, the period commonly referred to as the "proxy season," during which most publicly held companies conduct their shareholders' meetings

The Commission considered conducting a survey which would focus upon one or more past proxy seasons, but numerous interviews led the Commission to conclude that much of the needed information would not be available on an historical basis. Because the survey questionnaires could not be returned and evaluated prior to the date specified in Section 12(m) for the submission of the Commission's final report to Congress, the Commission had to request a six-month extension of the Study's June 4, 1976 submission deadline.

In furtherance of the survey, the Commission sent approximately 100,000 questionnaires to shareowners. Then, after clearance

by the General Accounting Office pursuant to the Federal Reports Act, interrelated questionnaires were sent to 140 brokers, 180 banks, and 195 issuers. As the fiscal year closed, the responses to the Commission's questionnaires were being processed and evaluated for the formulation of its final conclusions and recommendations.

In addition to its empirical study of the issuer-shareholder communications process, the Commission's staff has continued to research and analyze other aspects of street name registration. Upon completion, the Commission will formulate its final conclusions and recommendations and present its report to Congress.

## Lost and Stolen Securities

The 1975 Amendments evidence a congressional determination to create a centralized scheme for dealing with the disruptive effects of the loss, theft or counterfeiting of securities. Section 17(f)(1) of the Exchange Act, added in 1975, directs the Commission to formulate a program for the reporting of missing, lost, counterfeit and stolen securities, and to establish rules for making inquiry with respect to securities coming into the possession or control of certain financial institutions to determine whether such securities have been reported as missing, lost, counterfeit or stolen. Congress directed the Commission to balance the benefits of mandating inquiry in any specific situation against the resultant costs and impact on efficient business practices, and to avoid affecting the status of bona fide purchasers in a manner unjustifiably disruptive of normal commercial transactions.[108]

In January 1976,[109] the Commission published for public comment proposed Securities Exchange Act Rule 17f-1 and a proposed Lost and Stolen Securities Program If adopted, Rule 17f-1 would require enumerated persons, including national securities exchanges and their members, other brokers and dealers, members of the Federal Reserve System and FDIC insured banks, to report all incidents of missing, lost, counterfeit or stolen securities to an "appropriate instrumentality." The "appropriate instrumentality" is defined by proposed Rule 17f-1(a)(2) as any Federal Reserve Bank or Branch thereof with respect to Government or agency issues, and the Commission with respect to all other securities. Furthermore, proposed Rule 17f-1(c) would require institutions subject to the rule to make inquiry with respect to all securities coming into their possession or keeping, unless the security was received from the issuer, from another institution subject to the rule, or from a regular customer where the securities are registered to such customer and the size and nature of the transaction are not inconsistent with past transactions with the same customer.

During the public comment period, at the staff's request, members of the securities and banking industries conducted impact studies to determine the number of reports and inquiries which would be generated by proposed Rule 17f-1 The Commission is in the process of evaluating the findings of these impact studies and the numerous comments received, and expects to complete action on the Lost and Stolen Securities Program, including the adoption of Rule 17f-1 and the design and establishment of a system to process reports and inquiries under the rule, during the new fiscal year

## Fingerprinting of Securities Professionals

Congressional inquiries and Commission analyses indicated that one of the factors contributing to the increase in securities thefts was the inability to identify security risk employees

Section 17(f)(2) of the Exchange Act, enacted in 1975, provides that every partner, director, officer, and employee of every member of a national securities exchange, as well as broker-dealer, registered transfer agent and registered clearing agency shall be fingerprinted and shall submit, or cause to be submitted, such fingerprints to the Attorney General of the United States for identification and appropriate processing The Commission is given authority to exempt certain classes of persons from these requirements in a manner consistent with the public interest and the protection of investors

In November 1975,[110] the Commission issued proposed Exchange Act Rule 17f-2 for public comment. The rule was intended to implement the congressional desire to fingerprint all persons engaged in the sale of securities, having access to securities or

monies or original books and records relating thereto, or supervising persons engaged in such activities and to exempt those who do not The rule was adopted in final form on March 16, 1976,[111] to become effective July 1, 1976, as to persons entering the securities industry after that date, and for persons already employed by or associated with entities subject to the rule until January 1, 1977

The rule is intended to require the fingerprinting of only those persons engaged in the sale of securities, having access to securities or monies or original books and records relating thereto, or supervising persons engaged in such activities For instance, in the case of a registered transfer agent, the rule requires the fingerprinting of only those persons engaged in or having access to "transfer agent activities "

The rule requires organizations subject to the Act to file a statement describing those classes of persons meeting the conditions for exemption In addition, fingerprint record retention requirements are found in Rule 17f–2(d), as well as in companion amendments to Rules 17a–3 and 17a–4, the Commission's recordkeeping and preservation requirements

In order to avoid unnecessary regulatory duplication, Rule 17f–2(b) provides that persons whose fingerprints are submitted to the Attorney General for identification and appropriate processing pursuant to other federal, state or agency law, rule, or regulation may satisfy the fingerprinting requirements by compliance with such other requirement This provision encompasses employees of banks which submit fingerprints for identification and processing to the FBI, the designated agent of the Attorney General for fingerprint identification, and persons submitting fingerprints to the FBI pursuant to state regulations in Arizona, Arkansas, Colorado, the District of Columbia, Idaho, New Jersey, and New York

To facilitate the transmittal of fingerprint records, the rule provides an exemption for persons whose fingerprints are submitted to the Attorney General through a self-regulatory organization pursuant to a plan filed by the self-regulatory organization and approved by the Commission By the close of the fiscal year, the Commission had approved plans submitted by six national securities exchanges and the NASD

## Registration and Regulation of Securities Information Processors

The legislative history of the 1975 Amendments evidences congressional concern over the mechanisms whereby information concerning transactions in securities is disseminated throughout the securities markets Congress observed that continuing debate over the Commission's authority to foster the development of composite last sale and quotation systems could only delay implementation of the communications systems necessary for the national market system, and consequently determined to make clear the Commission's authority over such systems and the entities responsible for their maintenance [112]

This determination was embodied in a new Section 11A(b) to the Exchange Act This provision effectively requires "securities information processors" to register with the Commission, and directs the Commission to permit the registration of only those processors found capable of assuring the prompt, accurate and reliable performance of the functions of a securities information processor

Subject to the Commission's authority to adopt a contrary rule, Section 11A(b) requires only "exclusive" securities information processors to register The term "exclusive processor" is defined by Section 3(a)(22)(B) of the Act to include any securities information processor or self-regulatory organization which, on behalf of a registered national securities exchange or association (or on its own behalf, if the processor is a self-regulator), engages on an exclusive basis in the processing of information with respect to transactions or quotations on an effected registered national securities exchange, or distributed through any electronic system operated or conducted by the NASD

In September 1975, the Commission adopted[113] a registration procedure for exclusive processors consisting of Rule 11Ab2–1 and related Form SIP Completion of Form SIP requires the submission of detailed information regarding the organizational structure, operational capability and functions performed by the applicant After this information has been filed with the Commission, a notice of the filing is published and interested persons are given an opportunity to comment

Finally, within ninety days of the date of publication of such notice (or within a longer period to which the applicant consents), the Commission must by order grant registration or institute proceedings to determine whether registration should be denied In granting registration, the Commission must find, pursuant to Section 11A(b)(3), that the processor has the organization and capacity to perform its functions in a prompt, accurate and reliable manner, to comply with the provisions of Section 11A(b) and any rules promulgated thereunder, to function in a manner consistent with the purposes of Section 11A(b) and, insofar as the applicant acts as an exclusive processor, to operate fairly and efficiently

As of the close of the fiscal year, the Commission had received four applications for registration as securities information processors, and had granted registration to the Consolidated Tape Association ("CTA"), the Options Price Reporting Authority ("OPRA"), and the Securities Industry Automation Corporation ("SIAC"), each of these entities being exclusive securities information processors [114] The Commission also had temporarily exempted, pursuant to its authority under Section 11A(b)(1) of the Act, NASDAQ, Inc from registration,[115] pending a review of its application for registration which is expected to be completed early in the new fiscal year

In addition, the Commission received applications for exemption from registration from Bunker Ramo Corporation ("Bunker Ramo"), P C Service Corporation ("PCSC"), and Quotron Systems, Inc ("Quotron") These applications were granted,[116] subject to certain conditions imposed pursuant to Section 11A(b)(1) of the Act As to Quotron and PCSC, their exemptive orders were conditioned on compliance with Section 11A(b)(5)(A) of the Act (and any rules thereunder) regarding prohibitions or limitations of access to their information services Further, Quotron and PCSC were obliged to conform to Sections 17(a)(1) and 17(b) of the Act (and any rules thereunder), relating to the dissemination of periodic reports and the maintenance of appropriate records for examination by the Commission and other regulatory bodies Finally, as to Bunker Ramo, which previously acted as an exclusive processor on behalf of the National Association of Securities Dealers, Inc ("NASD") in operating the NASDAQ system, the Commission conditioned exemption on Bunker Ramo's compliance with Section 17(b) of the Act (and any rules thereunder), insofar as Bunker maintained records relating to its performance as an exclusive processor for the NASD

The Commission has also published for public comment proposed Exchange Act Rules 11Ab2–2, 11Ab2–3, and 11Ab5–1.[117] Proposed Rule 11Ab2–2 would require an annual submission of current information by registered securities information processors in order to update information previously furnished on Form SIP Proposed Rule 11Ab2–3 would establish a procedure for maintaining continuity of registration, for a limited period, where an entity succeeds to or continues the business of a registered processor without having first completed the registration procedure required by Rule 11Ab2–1. Finally, proposed Rule 11Ab5–1 would require that a registered securities information processor give notice to the Commission (and any aggrieved party) of any prohibition or limitation of access to the services offered by the registrant This rule would implement the notice procedure set forth in Section 11A(b)(5)(A) of the Act The Commission is currently considering certain modifications in the proposed rules which have been suggested by certain interested members of the public

## Commission Rates

Section 6(e)(3) of the 1975 Amendments obligates the Commission to keep itself and Congress abreast of significant events during the transition to negotiated commission charges The first monitoring report was presented to Congress on December 1, 1975, and covered the period beginning May 1, 1975 (the advent of negotiated commission rates) and ending August 31, 1975 [118] The report presented an analysis of the impact of unfixed rates on commission charges by customer type Additional analyses included capsule financial information for various types of New York Stock Exchange member firms and financial summaries for all self-regulatory organizations Also included were analyses relating to the "quality of the market"

The first report was subsequently followed

by two additional and more refined reports to Congress, dated March 29, 1976,[119] and August 10, 1976,[120] which covered the impact of negotiated commission charges through March 31, 1976. In addition to the analysis in the Commission's first report, these reports included a more in-depth analysis of the factors affecting securities commissions, a detailed analysis of the financial results for different types of broker-dealers and for the first time, an analysis of the financial results of Regional and Over-The-Counter Broker-Dealers

From the inception of negotiated commission charges to the end of March 31, 1976, New York Stock Exchange (NYSE) member firms received an estimated $335 7 million less than they would have received under the fixed commission rate schedule applicable immediately prior to May 1, 1975 (assuming equivalent market activity) This revenue foregone amounted to roughly 11.7 percent of commission revenues and 5.8 percent of total revenues received by NYSE member firms during the May 1975-through-March 1976 period

Commission discounts negotiated by public customers from the pre-May fixed commission rate schedule moved from 7.0 percent in the second quarter of 1975 to 13.0 percent in the fourth quarter The average discount declined to 12 3 percent during the first quarter of 1976 This downward drift was attributed to increased retail customer activity rather than a change in competitive pressures Commission discounts received by institutional customers were greater than those received by individual customers. Measured as a percent of order value, institutional commissions in March 1976 were approximately 35 percent below the pre-May 1 commission level, while the same comparison for individual customers revealed a two percent decline from the pre-May level. When measured in terms of commissions per share, commissions for institutions and individuals were 30 percent and 6 percent lower in March 1976 than April 1975, respectively While individuals received reduced commissions on medium to large size orders, they paid slightly higher commissions on their small orders (less than 200 shares). On the other hand, institutions received substantially reduced commissions on all sizes of orders

Not unexpectedly, the discounts granted to institutional customers had their greatest impact on the financial results of NYSE member firms specializing in institutional business As a consequence, institutional firms, as a group, received less than 70 percent of securities commissions they would have received under the rate schedule in effect prior to May 1, 1975 Other groups also registered declines in securities commissions over the eleven months following May 1, 1975, but not to the degree experienced by institutional firms. The introduction of competitive commissions does not appear to have seriously impaired the operating results of Regional and Over-The-Counter Broker-Dealers. Negotiated commission charges do not appear to have negatively influenced the operating results, nor have they significantly affected the liquidity or volatility of securities markets.

## Use of Commission Payments by Fiduciaries

Section 28(e) of the Exchange Act was added in 1975 to assure fiduciaries that, under a system of competitive commission rates, they might use reasonable business judgment in selecting brokers and causing accounts under management to pay commissions Section 28(e) provides generally that a money manager does not breach fiduciary duties under State or Federal law solely by reason of his causing accounts under management to pay brokerage commissions in excess of the amount another broker-dealer would have charged if the manager determines in good faith that the commission is reasonable in relation to the value of brokerage and research services received.

In March 1976, the Commission called attention to practices that appeared to be developing in the payment of brokerage commissions by fiduciary money managers The Commission noted in particular that some fiduciaries appeared to be using their beneficiaries' commissions to obtain products and services which are readily and customarily available and offered to the general public on a commercial basis In addition, the Commission noted, fiduciaries appeared in some instances to be asking that brokers pay all their operating expenses in return for commissions directed to those brokers It also appeared

that fiduciaries were in some cases asking the broker, retained to effect a transaction for the account of a beneficiary, to "give up" part of the commission negotiated by the broker and the fiduciary to another broker designated by the fiduciary for whom the executing or clearing broker is not a normal and legitimate correspondent.

The Commission stated that it did not believe Section 28(e) would apply to those types of arrangements. At the same time, the Commission noted, while Section 28(e) might, under appropriate circumstances, be applicable to situations where a broker provides a money manager with research produced by third parties, the money manager should be prepared to demonstrate the required good faith in connection with the transaction. The Commission cautioned, moreover, that some of the practices and arrangements that had been brought to its attention might constitute fraudulent acts and practices by fiduciaries and that brokers should recognize that their compliance with any direction or suggestion by a fiduciary which would appear to involve a violation of the fiduciary's duty to its beneficiaries could implicate them in a course of conduct violating the antifraud provisions of the Federal securities laws.[121]

## Arab Boycott

Early in 1975, there were widespread reports of the Arab boycott against persons doing business with, or sympathetic to, the state of Israel. The Commission took a number of actions to determine the extent of involvement in the boycott by persons subject to its regulation and to uncover any possible violations of the Federal securities laws. From the outset, the Commission expressed its view that the issues presented by the Arab boycott are serious matters, and that it strongly condemns participation in such boycotts by American citizens and enterprises On November 20, 1975, the Commission published a release stating that discriminatory practices engaged in by persons subject to its regulation would not be tolerated.[122]

The possibility of violations of the Federal securities laws was raised most prominently in connection with reports early in 1975 of Arab requests that American brokers and dealers exclude boycotted brokerage firms from underwriting syndicates formed for the distribution of securities Since such reports surfaced, it has been the Commission's view that the best way to safeguard against such discriminatory practices is for the National Association of Securities Dealers, Inc. ("NASD"), of which most American investment banking firms are members, to take initial responsibility for precautionary measures Under the law, the NASD has responsibility for insuring that its members' conduct is consistent with just and equitable principles of trade [123]

The Commission requested the NASD to monitor closely the composition of its members' underwriting syndicates for indications of possible discriminatory practices and, in December 1975, the NASD submitted to the Commission a report of its monitoring program and subsequent investigation On the basis of the NASD's report and the Commission's own informal inquiries, it appears that there have been no successful attempts to exclude on a discriminatory basis any person from an underwriting of securities registered with the Commission. The NASD did, however, present evidence of two successful attempts by Arab interests to obtain the exclusion of boycotted investment banking firms from participation in offerings of securities which took place outside the United States and which were not required to be registered with the Commission As a result of its investigation, the NASD in July 1976 took disciplinary action against two of its member firms on the basis of their cooperation with Arab-related firms in precluding boycotted firms from offshore underwritings In addition, the NASD issued a notice cautioning all its members against involvement in such discriminatory practices

## Section 31(b) Review

Section 31(b) of the 1975 Amendments authorizes the Commission, at any time within one year of the effective date of any amendment made by the 1975 Amendments to the Exchange Act, to notify any national securities exchange or national securities association of the respects in which its organization or rules are not in compliance with the Act as amended. The Commission is authorized, at any time after 180 days following receipt of such notification, to suspend the registration of any such exchange or associa-

tion or to impose limitations on its activities, functions or operations if the Commission finds, after notice and opportunity for hearing that its rules or organization still fail to conform to the Act Any such suspension or limitation continues in effect until the Commission, by order, declares that such exchange or association is in compliance with the Act's requirements.

During the fiscal year, the Commission's staff conducted an intensive review of the constitutions and rules of the several self-regulatory organizations Particular attention was devoted to self-regulatory requirements in those areas most affected by the 1975 Amendments, such as membership and access restrictions, financial responsibility requirements, and rules limiting or conditioning the ability of brokers and dealers to utilize the services of registered clearing agencies or registered securities information processors Early in the new fiscal year, the Commission expects to be in a position to transmit appropriate notification to each of the self-regulators in accordance with Section 31(b) of the Act.

## DISCLOSURE RELATED MATTERS

### Illegal and Questionable Corporate Payments

On May 12, 1976, the Commission submitted to the Senate Banking, Housing and Urban Affairs Committee the "Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices" The report provides a detailed analysis of information about illegal or questionable foreign payments contained in public documents filed with the Commission

The report indicates that common among almost all of the cases reviewed by the Commission was the apparent failure of the system of corporate accountability to assure a proper accounting of the use of corporate funds, and to assure that documents filed with the Commission and circulated to shareholders do not omit or misrepresent material facts Millions of dollars of funds were inaccurately recorded in corporate books and records to facilitate the making of questionable payments Falsification of records, although known to corporate employees and often to top management, was often concealed from outside auditors and counsel and from outside directors.

The report states that the primary thrust of the Commission's actions has been to restore the efficiency of the system of corporate accountability and to encourage the boards of directors to exercise their authority. To this end the Commission has sought independent review of past disclosure in its enforcement actions and in its voluntary disclosure program

In broad terms, the Commission's voluntary disclosure program, which is administered by the Division of Corporation Finance, requires a company which believes that it may have a disclosure problem with respect to questionable or illegal activities promptly to take the following steps:

1 Authorize a careful in-depth investigation of the facts by persons not involved in the activities in question,

2 Have the board of directors issue an appropriate policy statement about transactions involving illegal or questionable activities, or reiterate any relevant, preexisting policy statement;

3 Consider whether interim public disclosure of the results should be made prior to completion of the investigation; and

4 At the conclusion of the investigation, file a final report of material facts with the Commission, generally on Form 8–K. Companies in the voluntary disclosure program can make disclosures without prior consultation with the Commission's staff and without jeopardizing their participation in the program They can, however, seek the informal views of the Commission itself concerning the appropriate disclosure of certain matters

In order to restore the integrity of the disclosure system and to make corporate officials more fully accountable to their boards of directors and shareholders, the Commission's basic approach has been. (1) To insure that investors and shareholders receive material facts necessary to make informed investment decisions and to assess the quality of management; and (2) To establish a climate in which corporate management and the professionals that advise them become fully aware of these problems and deal with them in an effective and responsible manner

## Advisory Committee on Corporate Disclosure

On February 2, 1976, Chairman Hills announced the appointment of an Advisory Committee on Corporate Disclosure to be chaired by then Commissioner, A. A Sommer, Jr.[124] The function of the sixteen-member panel is to define the purposes and objectives of a corporate disclosure system, to assess the present system in light of those objectives, to assess the costs of the present system and to weigh those costs against the benefits it produces, and to recommend to the Commission any changes it may consider necessary or appropriate to bring the operation of the disclosure system administered by the Commission closer to those objectives

The Committee's work includes identifying the users of the information available in the corporate disclosure system, the users' sources of information, the particular items of information which are of crucial importance to users, and the cost to companies of providing this information. To answer these and related questions, the Advisory Committee is surveying approximately 30 publicly-owned companies, 120 financial analysts, 60 portfolio managers and 8,000 individual investors The Advisory Committee anticipates that when the data from the survey is analyzed the Committee will have the first clear and complete picture of the operation of the disclosure system and that this new understanding will serve as a basis for the Committee's recommendations to the Commission

The Committee is also soliciting position papers from over one hundred trade associations and the public at large on a variety of disclosure issues [125] The following specific topics are among those on which position papers are being sought identification of the objectives of a corporate disclosure system; the feasibility of defining more precisely the "materiality" standard under the federal securities laws, identification of any need for increased disclosure of forward-looking and soft information, identification of any need for increased disclosure of environmental and socially-significant matters and the criteria to be applied in making such a determination, statement of the role of the differential disclosure concept in the SEC's mandated disclosure system; and recommendations for improvement of the shareholder suffrage process.

A final report incorporating recommendations to the Commission is expected on or before July 1, 1977

## Projections

On April 23, 1976, the Commission published for comment proposed Guides 62 and 4, "Disclosure of Projections of Future Economic Performance," of the Guides for the Preparation and Filing of Registration Statements under the Securities Act of 1933 and of the Guides for the Preparation and Filing of Reports and Proxy and Registration Statements under the Securities Exchange Act of 1934, respectively [126] The Commission also announced the adoption of an amendment to Exchange Act Rule 14a-9, and the withdrawal of the other rule and form proposals relating to projections of future economic performance and to changes in control of a registrant which were published for comment on April 28, 1975,[127] to implement the "Statement by the Commission on the Disclosure of Projections of Future Economic Performance "[128]

The proposed Guides set forth the views of the Commission's Division of Corporation Finance on the disclosure of projections in Commission filings In particular, the Guides address three important considerations related to the preparation and disclosure of projections (1) that management have a reasonable basis for its projections, (2) that the projections be presented in an appropriate format, and (3) that the accompanying disclosures facilitate investor understanding of the basis for, and limitations of projections The proposed Guides are not rules of the Commission nor are they published as bearing the Commission's official approval. They represent policies and practices followed by the Division of Corporation Finance in administering the disclosure requirements of the federal securities laws

The staff presently is considering the comments received on the proposed guides.

In announcing these actions, the Commission expressed its general views on the inclusion of projections in Commission filings Among other things, the Commission noted that, at least until February of 1973, its long

standing policy generally not to permit projections in Commission filings may have served as an impediment to the disclosure of projections to investors The Commission also noted that investors appear to want management's assessment of a company's future performance and that some managements may wish to furnish their projections through Commission filings Accordingly, the Commission announced that it will not object to disclosure in filings with the Commission of projections which are made in good faith and have a reasonable basis, provided that they are presented in an appropriate format and accompanied by information adequate to enable investors to make their own judgments

The Commission also expressed the view that reasonably based and adequately presented projections should not subject issuers to liability under the Federal securities laws, even if the projections prove to be in error.

In light of this change of policy, the Commission amended Exchange Act Rule 14a–9[129] to delete the reference to predictions of earnings as being possibly misleading in certain situations

Finally, the Commission indicated that it is not encouraging the making or filing of projections because of the diversity of views on their importance and reliability and noted that this issue, together with the question of whether a "safe-harbor" rule for projections is needed, may be among those appropriately considered by its Advisory Committee on Corporate Disclosure

## Beneficial Ownership

On August 25, 1975, the Commission announced various proposals relating to the disclosure of beneficial owners and holders of record of voting securities [130] These proposals were partly the result of public hearings conducted by the Commission in the fall of 1974 concerning beneficial ownership, takeovers, acquisitions and other related matters [131]

The August proposals included proposed rules and amendments under Sections 13 and 14 of the Exchange Act which would, among other things, (1) provide standards for determination of beneficial ownership for purposes of those sections, (2) require additional disclosure in Schedule 13D acquisition statements about beneficial owners and the nature and extent of their ownership, (3) provide a short form acquisition notice to be used by certain persons acquiring securities in the ordinary course of their business and not for purposes of control; and (4) provide an exemption from the filing requirements of Section 13(d)(1) for certain underwriters who acquire securities in the ordinary course of a firm commitment underwriting

In addition, the proposals would amend various registration and reporting forms requiring disclosure of principal security holders, as well as Schedule 14A, Information Required in Proxy Statement, to require disclosure in such forms, to the extent known by the filing company, of (1) beneficial owners of more than five percent of any class of voting securities and the nature of their ownership; (2) the aggregate amount and nature of beneficial ownership by officers and directors, of each class of voting securities of the issuer or any of its parents or subsidiaries, and (3) the 30 largest holders of record of each class of voting securities (with an exception for persons holding less than $1/10$ of 1% of the outstanding securities of the class) and their voting authority and underlying voting authority, if known

The original comment period on the proposals was to expire on November 30, 1975, however, upon request, the Commission extended the period to January 2, 1976. During that time, the Commission received more than 225 letters of comment from interested persons, including, members of Congress and representatives of the securities industry, the legal profession, publicly-held companies, and institutional and individual investors. During May 1976, the staff of the Division of Corporation Finance completed an extensive review and analysis of the letters of comment and submitted its recommendations on the proposals to the Commission At the close of the fiscal year the Commission was considering the Division's recommendations

## Communications with Beneficial Owners (Proposed Rule 14b–1)

On August 25, 1975, the Commission solicited comments on a proposed new Rule 14b–1 under the Exchange Act dealing with the obligations of registered brokers to forward certain communications to beneficial owners

of securities.[132] If adopted, proposed Rule 14b–1 would require a registered broker (1) to respond promptly, by means of a search card or otherwise, to inquiries by issuers about how many of the broker's customers are beneficial owners of the issuer's securities held of record by the broker or its nominees, and (2) upon receipt of a sufficient number of proxy statements and annual reports to security holders and assurances that its reasonable expenses would be paid by the issuer, to forward such materials in a timely manner to such customers As an alternative to complying with the foregoing obligations, a registered broker would be permitted to furnish an issuer with a list of the customers provided that the broker also furnish authorization to vote such securities in accordance with instructions of the customer.

The comment period on the proposed rules expired November 30, 1975. The Commission's Division of Market Regulation is considering the comments received on the proposals in connection with the Commission's "Street Name Study" mandated by the Securities Act Amendments of 1975.[133]

## Tender Offers

As a further result of the Commission's public hearings on takeovers and acquisitions,[134] the Commission published for comment proposed rules and schedules under the Exchange Act, which, if adopted, would provide specific disclosure and dissemination requirements, additional substantive regulatory protections and other regulations with respect to certain cash tender offers and stock-for-stock exchange offers

The rules and schedules represent the Commission's first comprehensive rulemaking proposals under the Williams Act with respect to tender offers. Among other things, all tender offers would be required to be open for at least fifteen business days after their commencement and for at least ten business days from the announcement of any increase in the offered consideration or the dealer's soliciting fee.

A proposed Tender Offer Statement, Schedule 14D–1, would require a bidder to disclose, among other things, additional information regarding its source of funds and its plans and proposals (regardless of whether it is seeking control) and, for the first time, would specifically require disclosure of its past relationships and negotiations with the subject company whose securities are being sought and disclosure of financial statements and other data when material A proposed Recommendation Statement Schedule 14D–4, would require a subject company or any other person recommending for or against a tender offer to describe, among other things, any actual or potential conflict of interest

A proposed dissemination rule would permit a bidder to communicate its cash tender offer by means of long form publication which is currently used in connection with most cash tender offers, summary publication provided that such an advertisement contains a minimum amount of information and indicates how complete information might be readily obtained, or mailings to all stockholders listed on the stockholders' list, which would be available under the Commission's rules if certain conditions are met

The Commission's proposals would extend the present seven-day withdrawal rights to ten business days, would provide additional, limited withdrawal rights in the event of a competing tender offer, and would permit a bidder to accept any shares deposited on a pro-rata basis throughout the life of a tender offer

Finally, the proposals would integrate all purchases of the subject company's securities by the bidder within forty business days after a tender offer with the offer, would require a bidder to issue a status report whenever it extends the tender offer, and would require a bidder to pay the offered consideration or return the securities deposited within ten business days after the termination of a tender offer

The period for written views and comments on the proposals expires September 30, 1976

## Proposals to Amend Registration Forms

*Proposed Amendments to Forms S–7 and S–16 and Proposal to Rescind Form S–9* — On July 26, 1976, the Commission proposed amendments to Forms S–7 and S–16 and announced a proposal to rescind Form S–9 under the Securities Act [135] The proposals would substantially relax the conditions for using Forms S–7 and S–16,[136] thus making

these short registration forms available to a larger number of issuers which are subject to the reporting requirements of the Exchange Act [137] Form S–7 also would be made available for the registration of securities to be offered in exchange for other securities, as well as for cash In addition, certain of the disclosure items of Forms S–7 and S–16 would be amended to require additional disclosure if there has been a change of the registrant

Issuers using Forms S–7 and S–16 are permitted to omit from the S–7 prospectus, or to incorporate by reference in the S–16 prospectus, certain information already provided to security holders or available to investors in reports filed under the Exchange Act Thus, the proposed amendments reflect recent improvements in the nature and extent of information required to be included in reports and proxy and information statements under that Act, and the increased availability of such information to the investing public

The Commission also proposed to rescind Form S–9, a form presently available for Securities Act registration of non-convertible fixed-interest debt securities by certain issuers, since the proposed amendments to Form S–7 would make that form available to the relatively small number of issuers presently using Form S–9

The comment period on these proposals expires on September 27, 1976

*Form S–8 and Rule 457* —In July 1976, the Commission published for comment certain proposed amendments to Form S–8 [138] and simultaneously withdrew an earlier proposal to amend that form [139] The proposed amendments would expand the availability of the form for securities offered and sold pursuant to certain employee-benefit plans and would rescind its use for reoffers or resales by persons who may be deemed underwriters In a related matter, the Commission adopted an amendment to Rule 457(g) concerning the computation of the filing fee required for registration statements relating to stock bonus and similar plans

## Proposals to Amend and Amendments to Certain Periodic Reports

*Proposed Amendments to Forms 8–K, 10–Q and 10–K* —On July 12, 1976, the Commission proposed amendments to Forms 8–K, 10–Q and 10–K, which are used for current, quarterly and annual reports filed pursuant to Section 13 or 15(d) of the Exchange Act and to the disclosure schedule for proxies and information statements. [140] The proposed amendments would, if adopted, provide for more timely filing of reports on Form 8–K, by requiring such reports to be filed within ten days after the occurrence of the event reported, although registrants would be permitted an additional 60 days time within which to file the audited financial statements required in reports of an acquisition of assets. In addition, the proposals would decrease the number of items of information required to be included in reports on Form 8–K by transferring certain items to Form 10–Q [141]

Present Item 9 (Options to Purchase Securities) would be deleted from Form 8–K, since similar information is required to be included in annual reports on Form 10–K and in proxy and information statements filed pursuant to Section 14 of the Exchange Act

The items remaining on Form 8–K would be renumbered and revised to require additional information concerning changes in control of registrant and non-payment of principal or interest on senior securities A new item, requiring disclosure of the appointment of a receiver or trustee for registrant or its parent in bankruptcy or receivership proceedings, would be added to Form 8–K

In addition, the Commission proposed to separate the disclosure relating to material income changes of an unusual or infrequent nature presently required in reports on Form 8–K The proposed amendments would require notification of such changes in reports on Form 8–K, but the details of such events would be disclosed in reports on Form 10–Q or Form 10–K, for fourth quarter events, where they could be more meaningfully assessed against the financial data in such quarterly or annual reports

In order to make it easier for users of both Forms 10–Q and 10–K, those forms would be revised to require that reference be made to items previously mentioned in 8–K reports filed during the quarter covered by the report

These proposals are intended to provide for more comprehensive quarterly and annual reports, more timely reporting of events of current importance to investors, reduction of

those reports filed on Form 8–K, and substantial savings to registrants and the Commission

The comment period on the proposals expires on September 15, 1976

On June 2, 1976, the Commission proposed amendments to Forms 10–K and 10–Q,[142] to provide for a space on the cover page of each form in which a registrant, at its option, could use to indicate its intention to file a registration statement on Form S–7, S–9 or S–16, on or before the date of its next filing on either Form 10–K or Form 10–Q Receipt of such notice of intent to file would enable the Commission's staff to review promptly the annual, quarterly and current reports filed by registrant under the Exchange Act and, in most cases, to expedite its review of the Securities Act registration statement, when filed

*Adoption of Amendments to Forms 10–Q, 10–K and 12–K to Require a Statement of Outstanding Common Stock* —On June 8, 1976, the Commission adopted amendments to Forms 10–K, 12–K and 10–Q under the Exchange Act requiring corporate issuers to state on the facing sheets to reports on those forms the number of shares outstanding of each class of their common stock [143] The amendments were adopted to aid persons in complying with the volume limitations of Rule 144 by providing them with information upon which those limitations frequently are based

## Stockholder Proposals

Rule 14a–8 of the proxy rules sets forth the requirements applicable to proposals submitted by security holders for inclusion in the proxy soliciting materials of issuers On July 7, 1976, the Commission proposed to amend that rule substantially Among other things, the proposed amendments would eliminate certain shareholder abuses that have occurred in the past, broaden the topics that could be covered by shareholder proposals, and formalize certain grounds for omitting proposals that have been implied, but not stated, in the existing rule [144] In a related matter, the Commission issued a release describing and discussing the informal procedures employed by its staff with respect to shareholder proposals which managements have indicated they intend to omit from their proxy materials [145]

## Stock Appreciation Rights

In connection with the reporting of insider securities transactions under Section 16 of the Exchange Act, the Commission proposed certain amendments to Rules 16b–3 and 16a–6(c) under the Act to include certain transactions in stock appreciation rights within the transactions which may be exempted by those rules [146] The exemption for transactions in stock appreciation rights would be available provided certain conditions are met, including requirements relative to the issuer, the options and rights, and the administration of the plan In addition, the proposals would impose new conditions for the availability of the exemption provided by Rule 16b–3 for option, bonus, appreciation or similar plans

## Disclosure of Environmental Matters

On May 6, 1976, in Securities Act Release No 5704,[147] the Commission announced final action in its rulemaking proceeding concerning disclosure of environmental and other socially significant matters That proceeding had been originally initiated on February 11, 1975,[148] pursuant to the order and opinion of Judge Charles R Richey in *Natural Resources Defense Council, Inc v Securities and Exchange Commission*, 389 F Supp 689 (D D C , 1974) [149] Judge Richey had directed the Commission, among other things, to determine whether the Commission's existing corporate disclosure rules satisfied any applicable requirements of the National Environmental Policy Act of 1969 ("NEPA"), and had recommended that the Commission compile a "legislative-type" record in connection with this undertaking After the culmination of lengthy public proceeding, the Commission, on October 14, 1975, proposed specific new rules regarding environmental disclosure [150]

In Securities Act Release No 5704 the Commission announced that it had determined to adopt so much of the rule proposals as related to the disclosure of capital expenditures for environmental compliance purposes The Commission, however, concluded that another aspect of the proposals, requiring corporate registrants to list and make available to shareholders environmental compliance reports filed with other agencies,

would not provide additional meaningful information to investors interested in the environmentally significant aspects of the behavior of registrants Moreover, the Commission concluded that there was no disclosure alternative which would have provided meaningful additional information without imposing costs and burdens grossly disproportionate to any resulting benefits to investors and the environment

The Natural Resources Defense Council and the other plaintiffs in the litigation which gave rise to this proceeding then asserted that the Commission's rules still failed to satisfy the requirements of NEPA, and requested that Judge Richey order the Commission to correct these alleged deficiencies The court is expected to rule on plaintiffs' contentions during the next several months

## Disclosure of Oil and Gas Reserves

On May 12, 1976, the Commission adopted amendments to Forms S–1 and S–7 under the Securities Act and to Forms 10 and 10–K under the Exchange Act to require the disclosure of oil and gas reserves and to provide definitions and classifications of the term "reserves"[151] These amendments make explicit the disclosures with respect to oil and gas reserves already required under Forms S–1, S–7 and 10 and, for the first time, require such disclosures to be made on an annual basis in a report on Form 10–K In connection with the amendment to Form 10–K, Guide 2 under the Exchange Act, which relates to disclosure of natural gas reserves, has also been amended to make it applicable to reserves disclosed in reports on Form 10–K

The amendments adopted by the Commission are almost identical to those which were proposed for comment on May 30, 1975.[152] They include a requirement to disclose reserve estimates filed with other federal or foreign agencies and to explain any differences between such estimates and those included in filings with the Commission. In response to comments received on the proposals, a requirement to disclose reserve estimates filed with state agencies has been deleted from the amendments, and several *de minimis* limitations have been placed on the disclosure requirements The Commission believes that these requirements would have placed an unwarranted burden on registrants without any corresponding benefit to investors Additionally, definitions or guidance with respect to the meaning of certain terms (net production, gross and net wells and acres and undeveloped acreage) have been inserted for clarification.

## Accounting Matters

*Staff Accounting Bulletins* —In November 1975, the Commission authorized the Division of Corporation Finance and the Office of the Chief Accountant to publish a series of Staff Accounting Bulletins[153] to achieve a wider dissemination of the administrative interpretations and practices utilized by the Commission's staff in reviewing financial statements The statements in the Bulletins are not rules or interpretations of the Commission nor do they bear the Commission's official approval; they represent interpretations and practices followed by the Division and the Chief Accountant in administering the disclosure requirements of the federal securities laws

The process of financial reporting is dynamic and evolutionary. Consequently, new or revised administrative interpretations and practices must be implemented in response to changes in the reporting process. While large accounting firms who practice before the Commission have many opportunities to exchange information and views with the staff, the Commission has been concerned about comments that small accounting firms have fewer such opportunities and may be at an unfair competitive disadvantage because there has been no formal dissemination of staff positions

The purpose of the Bulletins is to mitigate these problems by making available to the public a compilation of certain existing staff interpretations and practices and by providing a means by which new or revised interpretations and practices can be quickly and easily communicated to registrants and their advisers Thus, the Bulletins should not only reduce the staff's workload by eliminating repetitious comments and inquiries, but should

save registrants both time and money in the registration and reporting process.

The first Bulletin (SAB No 1)[154] was issued concurrently with the announcement of the series and included a number of interpretations and practices broken down under ten broad topic headings Eight additional SAB's dealing with accounting matters of current concern were issued through June 30, 1976. Some of the accounting matters dealt with in SAB's 2 through 9 were statements of policy and interpretations as to disclosure and reporting practices for Real Estate Investment Trusts, experiencing difficulties with loan portfolios,[155] accounting for transactions in which Real Estate Investment Trusts transfer assets (usually loans on real estate projects) to bank holding companies in cancellation for debt owed to them,[156] amendments to Form 10-Q and Regulation S-X regarding interim financial reporting,[157] and amendments to Regulation S-X requiring disclosure of Replacement Cost data [158]

*Financial Requirements for Companies in the Development Stage*—In November 1975, the Commission amended Article 5A of Regulation S-X[159] which specifies the requirements for the form and content of financial statements for commercial, industrial and mining companies in the promotional, exploratory or developmental stage The amendments conformed the Commission's accounting and reporting requirements with Statement No 7, "Accounting and Reporting by Development Stage Enterprises," issued by the Financial Accounting Standards Board in June 1975.

The Commission considered that it should revise its requirements for the presentation of financial statements by development stage companies since it had previously announced that the pronouncements of the FASB will be considered to constitute substantial authoritative support for accounting and reporting procedures and practices used in preparing financial statements filed with the Commission The proposed revisions to Regulation S-X were issued for public comment in July 1975 [160] Comments received indicated general agreement with the proposals.

Article 5A prior to revision contained specialized requirements for the financial statements of development stage companies, particularly for balance sheets, and stockholders' equity Income statements were not required of development stage companies. When these specialized requirements were adopted by the Commission, there were no authoritative statements of the accounting profession regarding the appropriate accounting and financial reporting directly applicable to such companies.

The revisions to Regulation S-X eliminated the specialized financial statement requirements for companies to which Article 5A had been applicable and for fiscal periods beginning on or after December 26, 1975, required that financial statements issued by development stage enterprises shall conform to generally accepted accounting principles applicable to established operating enterprises, and that certain additional information shall be disclosed in the financial statements

*Statistical Disclosure by Bank Holding Companies*—On October 1, 1975, the Commission authorized the publication for public comment of proposed Guides 61 and 3, "Statistical Disclosure by Bank Holding Companies," of the Guides for the Preparation and Filing of Registration Statements under the Securities Act and of the Guides for the Preparation and Filing of Reports and Proxy and Registration Statements under the Exchange Act, respectively [161] These Guides are intended to provide registrants with a convenient reference to the statistical disclosures sought by the staff of the Division of Corporation Finance in registration statements and other disclosure documents filed by bank holding companies.

During the comment period, which expired on November 30, 1975, the Commission received comments from approximately 115 interested parties, and the Commission's staff also conferred extensively with representatives of the federal bank regulatory agencies As the fiscal year closed the staff was in the process of making recommendations to the Commission with respect to certain modifications in the proposed Guides, based on the suggestions made by various commentators and intended to publish the Guides in final form in the near future.

As the operations of bank holding companies have diversified, it has become increasingly difficult for investors to identify the sources of income of such companies. And, since various sources of income can have a wide range of risk characteristics, investors

may have difficulty assessing the future earnings potential of a bank holding company without detailed information concerning the company's sources of income and exposure to risks

In preparing the Guides, the staff has been mindful of the investor's need to assess uncertainties, especially through more meaningful disclosure about loan portfolios and related items in filings by bank holding companies In addition, many of the disclosures suggested by the proposed Guides are intended to provide information to facilitate analysis and comparison of sources of income and exposure to risks. Thus, for example, registrants are asked to provide a breakdown of loan portfolios by type of loan This information will assist investors to evaluate the potential impact of future economic events upon a registrant's business and earnings The same reasoning underlies the suggestions for disclosure of sources of funds and sensitivities to interest-rate fluctuations. Among other things, this information should help investors to evaluate the ability of a bank holding company to move in or out of situations with favorable or unfavorable risk/return characteristics

## Railroad Act Amendments

Pursuant to Section 13(b) of the Exchange Act, the Commission is granted authority to, among other things, prescribe the appropriate accounting methods to be used by registrants filing reports with the Commission Section 308(b) of the Railroad Revitalization and Regulatory Reform Act,[162] as enacted on February 5, 1976, significantly amended and expanded this authority As amended, Section 13(b) no longer specifically requires that the Commission allow ICC regulated carriers to file reports submitted to the ICC in lieu of the information specified by other Commission forms In addition, Section 13(b) now provides that Commission rules applicable to registrants whose methods of accounting are prescribed by other laws or regulations may be inconsistent with the disclosure requirements of the other agencies to the extent that the Commission determines that the public interest or the protection of investors so requires.

At the close of the fiscal year the Commission was considering certain proposals which are intended to implement these amendments. The Commission's final views and proposals were to be announced in early September, 1976.

## Monthly Publication of Significant Interpretive Letters

On March 17, 1976, the Commission announced[163] that it had authorized monthly publication in the *SEC News Digest* of a list of significant no-action and interpretative letters issued by the Division of Corporation Finance. The letters listed are those which express certain views of the Division with respect to novel or important questions arising under the Securities Act, the Exchange Act, and the Trust Indenture Act. The list indicates the name of the subject company, the date of the letter and the pertinent section of the act, rule or form discussed.

# INVESTMENT COMPANIES

In June 1976, the Commission approved the re-naming of the Division of Investment Management Regulation to the Division of Investment Management, and approved the transfer of certain functions and personnel to the Division from the Division of Corporation Finance. Both actions are designed to reflect the Commission's determination that Federal statutes and regulations affecting money-management activity should be administered on a coordinated and, to the extent feasible, uniform basis. The Division of Investment Management will continue to be responsible for the administration of the regulatory provisions of the Investment Company and the Investment Advisers Acts of 1940, and will now perform certain functions relating to disclosure requirements applicable to investment companies and certain similar types of issuers

These changes have also been made to place the Division of Investment Management in a better position to examine the laws applicable to various types of money-management activities. For possibly the first time since the enactment of the Investment Company Act, the Division is undertaking a comprehensive review of each of the provisions of this statute and of related legislation The study will seek to identify instances of over-regulation, remedy legislative gaps and ex-

amine certain entities now excluded from coverage to determine the appropriateness of comparable regulation.

In addition, the Division continued its study of an integrated investment company registration and reporting system. It is intended that this system will (1) revise and improve information contained in prospectuses and (2) reduce paperwork by eliminating duplication of information currently required in the forms and reports filed by investment companies with the Commission

## Bank Study

The 1975 Amendments in adding Section 11A(e) to the Exchange Act, authorized the Commission to study the extent to which banks maintain accounts on behalf of public customers for buying and selling securities registered under Section 12 of that Act. The Commission was authorized to determine whether the exclusion of banks from the definitions of "broker" and "dealer" in the Exchange Act are consistent with the protection of investors and other purposes of that Act The Commission was directed to report to the Congress the results of its study by December 31, 1976

The study's major objectives are to (i) document the extent of bank involvement in activities comparable to those performed by broker-dealers; (ii) consider whether existing regulation adequately protects investors using bank-sponsored securities services; (iii) analyze the economic conditions under which banks compete with securities firms and the impact, if any, of existing differences in regulation; (iv) explore the present and potential impact of bank-sponsored securities services on the nation's capital markets; and (v) evaluate the circumstances, if any, under which banks offering securities services should be subject to regulations comparable to those established for securities firms.

Three major categories of bank securities services were considered as part of the study: (i) brokerage services, such as dividend reinvestment plans, automatic investment services and the forwarding of orders to brokers as agents for individual customers; (ii) investment management and advisory services, and (iii) corporate financing ("merchant banking") services, such as formal advice and assistance to corporate issuers in private placements, mergers, acquisitions and divestitures Since very little information concerning those services is publicly available, the study entails the collection of primary data through questionnaires and interviews with officials in both the banking and securities industries

## Variable Life Insurance

In December 1975, the Commission announced a proposal to adopt Rule 6e–2 under the Investment Company Act which would exempt separate accounts formed by life insurance companies to fund certain variable life insurance contracts from the registration requirements of the Act on the condition that such separate accounts comply with all but certain designated provisions of the Act [164] The due date for comments was extended until March 31, 1976.[165]

A variable life insurance contract differs from a traditional whole life insurance policy principally because the death benefit under the contract may or may not increase based upon the performance of a separate account of securities in which a portion of the fixed premiums has been invested. Moreover, the insured accepts the investment risk that the cash surrender value of his policy will be higher or lower than it would otherwise be under a traditional life insurance policy, since this value also reflects the performance of the separate account

The proposal of Rule 6e–2 followed the granting of an application in October 1975 for an order of exemption from certain provisions of the Act filed by Equitable Variable Life Insurance Company ("EVLICO"), the Equitable Life Assurance Society of the United States, and EVLICO's separate account which is registered under the Act as an open-end management investment company.[166] Currently, the Division's Office of Insurance Product Regulation is considering the comments on the proposed Rule and is reviewing developments relating to the sale of variable life insurance contracts by EVLICO, the only insurance company in the United States selling variable life insurance contracts to the general public

## Status of Broker-Dealers as Investment Advisers

As a result of the elimination of fixed commission rates on exchange transactions on May 1, 1975, some broker-dealers may elect to charge separately for investment advisory services which they had previously provided incidentally to their business and without special compensation Since charging separately for investment advice would cause such broker-dealers to become "investment advisers" within the meaning of the Investment Advisers Act, the Commission adopted temporary Rule 206A–1(T), which exempted certain broker-dealers registered under the Exchange Act (except broker-dealers already registered as investment advisers on May 1, 1975) from the provisions of the Advisers Act and the rules and regulations thereunder from May 1, 1975 until August 31, 1975,[167] to provide time for a thorough consideration of questions related to the applicability of the Advisers Act to brokers and dealers

This exemption, which was intended to enable broker-dealers to adjust to unfixed commission rates without the need to comply with the provisions of the Advisers Act, was subsequently extended[168] until April 30, 1976, to provide additional time for the Commission to determine whether and in what form broker-dealers are receiving special compensation for advisory services and the potential impact on such broker-dealers if they were to become subject to the regulatory provisions of the Advisers Act At the same time, the scope of the exemption was narrowed to exclude from its coverage any broker-dealer who performs investment supervisory services or investment management services for special compensation or in a manner which is not solely incidental to his business as a broker-dealer In order to obtain a more meaningful pool of data on which to base a permanent resolution of this question, the Commission, in April 1976, extended this exemption until April 30, 1977 [169]

A result of charging separately for investment advice was that such broker-dealers would be subject to Section 206(3) of the Advisers Act, which makes it unlawful for an investment adviser, if he is acting as such in relation to a particular transaction, to effect the transaction with or for his client under circumstances where the adviser acts either as principal, or as broker for a person other than his client, unless the adviser furnishes his client with prior written disclosure of the capacity in which the adviser is acting and obtains the client's consent to the transaction

On March 31, 1975, the Commission proposed the adoption of new Rule 206(3)–1 under the Advisers Act[170] to exempt investment advisers who are also registered with the Commission as broker-dealers from the disclosure and consent requirements of Section 206(3) of the Advisers Act with respect to certain investment advisory services if such advisers comply with the conditions set forth in the proposed rule This rule was adopted substantially unchanged on August 20, 1975 [171]

## Collins v. S.E.C., Murtaugh v. S.E.C.[172]

On June 23, 1976, the Court of Appeals for the Eighth Circuit, one Judge dissenting, set aside a Commission order which granted a joint application by E I Du Pont de Nemours and Company and Christiana Securities Company for an exemption from the Investment Company Act which would permit the proposed merger of the two companies Application for a rehearing *en banc* was denied on February 27, 1976 The Supreme Court has granted the Commission's petition for certiorari.[173]

## SIGNIFICANT CASES INVOLVING SECURITIES ACTS

*Ernst & Ernst* v *Hochfelder* [174]—The complaint alleged that the defendant accounting firm had aided and abetted the president of a brokerage firm who, in a side arrangement, had perpetrated a fraud on the firm's customers in violation of Section 10(b) of the Exchange Act and Rule 10b–5 thereunder In essence, the theory of the complaint was that the accounting firm had not exercised appropriate auditing procedures in its annual audits of the brokerage firm and that this omission resulted in the accounting firm's failure to discover certain practices, the discovery of which would have led to the discovery of the brokerage firm president's fraudulent activities Discovery of such practices, it was further alleged, would have had to have been reflected in certain reports filed by the broker-

age firm with the Commission and such disclosure would have led to an investigation by various regulatory authorities The plaintiffs contended that such an investigation, in turn, would have led to discovery of the president's fraudulent activities. Thus, a basic issue throughout the litigation was whether the accounting firm was liable for having failed to discover the fraud of the brokerage firm's president.

The Commission had not participated in this litigation in the lower courts nor had it taken any action against the accounting firm When the Supreme Court granted the accounting firm's petition to review the decision of the court of appeals, it requested the Commission to give its view. The Commission filed an *amicus curiae* brief and participated in oral argument.

The Commission argued that Section 10(b) and Rule 10b–5 were not limited to the prohibition of intentional misconduct, but that the section and Rule proscribed negligent as well as intentional misconduct inasmuch as victims of manipulative and deceptive securities practices may be equally injured by both types of conduct.

In its decision, the Supreme Court (6 to 2) rejected the Commission's argument that there should be some circumstances under which civil damage liability may be imposed under Rule 10b–5 for negligent conduct which injures investors The Supreme Court held, instead, that a "private cause of action for damages will [not] lie under § 10(b) and Rule 10b–5 in the absence of an allegation of 'scienter'—intent to deceive, manipulate defraud." It should be noted, however, that the Court, recognizing that "in certain areas of the law recklessness is considered to be a form of intentional conduct for imposing liability for some act," chose not to address the issue "whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b–5" (ibid , n. 12) In addition, the Court also determined not to consider the question "whether scienter is a necessary element in an action for injunctive relief under § 10(b) and Rule 10b–5."[175]

In *TSC Industries* v. *Northway*,[176] a TSC minority shareholder had sued TSC and National Industries, claiming that a proxy statement issued by the two companies recommending shareholder approval of the proposed merger of TSC with National had been incomplete and materially misleading, in violation of Section 14(a) of the Securities Exchange Act and Rules 14a–3 and 14a–9. The Supreme Court agreed with the district court in denying summary judgment for the plaintiff shareholder

The Commission, participating as *amicus curiae*, suggested that the Supreme Court, in formulating a standard of materiality under Rule 14a–9, be mindful that any such standard should balance the need for adequate disclosure with the adverse consequences of setting too low a threshold for civil liability. The Court agreed with these considerations and stated

> " an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote This standard is fully consistent with *Mills* general description of materiality as a requirement that 'the defect have a significant *propensity* to affect the voting process ' It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available "[177]

The proxy statement in question, while prominently displaying the fact that National owned 34% of TSC and that five of TSC's directors were National appointees, had omitted to state fully the degree of control already exercised by National over TSC Specifically, there had been no disclosure that the National officers headed the TSC board and its executive committee and that reports had been filed with the Commission indicating that National could be deemed the parent of TSC The proxy statement, while including the opinion of an investment banking firm favorable to the proposed merger, had not included a letter from the same firm which the

court of appeals believed contained information unfavorable to the proposal Also the proxy statement did not point out purchases made of National common stock by National and a mutual fund whose president was employed by National, even though the price of the National stock was relevant to the fairness of the merger

The Court, noting that the issue of materiality was a mixed question of law and fact, held that a summary judgment, finding omissions to be material as a matter of law, could only be granted after a finding that the omissions were " 'so obviously important to an investor, that reasonable minds cannot differ on the question of materiality ' "

In *Radzanower* v *Touche Ross & Co , et al ,* [178] the Supreme Court held that venue in a suit against a national banking association charged with violating the Federal securities laws was governed by § 94 of the National Bank Act, [179] which provides that an action against a national banking association may be had only in the Federal district court within the district in which the bank has its principal office The Commission filed a brief, *amicus curiae,* in the Supreme Court, taking the position that the venue provisions of the Securities Exchange Act, [180] as the later-enacted statute, should control when a national bank is alleged to have committed a violation of that Act The Court concluded, however, that it presented no insurmountable burden for investors bringing an action against a bank to sue where the bank has its principal office, and ruled that the Federal securities laws neither expressly nor impliedly repealed the narrow venue provisions of the National Bank Act

In *Securities and Exchange Commission* v *Research Automation Corporation, et al ,* [181] the Court of Appeals for the Second Circuit reversed, in part, a default injunction obtained by the Commission pursuant to Rule 37(d) of the Federal Rules of Civil Procedure, which provides for sanctions in the event a party fails to appear for a deposition The court held that such sanctions are unavailable against a party who is physically present at its deposition but who, "in a willful effort to disrupt and to impede discovery, refuses to be sworn or to testify " The court stated that Rule 37(d) must be limited to the case where a defendant literally fails to show up for a deposition It also stated that a party seeking sanctions under these circumstances must first obtain a court order pursuant to Rule 37(a) directing the party to testify, and a violation of such order might result in sanctions.

*Samuel H Sloan, et al* v *Securities and Exchange Commission, et al* [182]—The Court of Appeals affirmed the district court's dismissal of a *pro se* complaint which, among other things, purported to challenge "the legality of the entire structure of securities regulation in the United States " [183] In the course of its opinion, the court held that certain sections of the Exchange Act and rules promulgated thereunder, which were specifically alleged to be unconstitutional, were in fact "valid and reasonable exercises of congressional power under the commerce clause and the SEC's delegated regulatory power, which infringe no constitutional rights of plaintiff " [184] These provisions included Section 27 of the Act (vesting exclusive jurisdiction of actions brought under the Act in the Federal courts), Section 12(g) (registration of securities with the Commission), Sections 15(c)(5) and 19(a)(4) (summary trading suspension power), [185] Rule 15c2–11 (antimanipulative rule respecting publication of quotations), Rule 15c3–1 (broker-dealer net capital rule), and Rule 17a–5 (annual report of broker-dealer financial condition) [186]

In *Securities and Exchange Commission* v *Csapo,* [187] the court addressed Rule 7(c) of the Commission's Rules Relating to Investigations, [188] a rule which generally prohibits an attorney from appearing with a witness in an investigation when that attorney has previously appeared with another witness in the same investigation, unless the rule is waived by a hearing officer Because the Commission had reason to believe that certain principal targets in an investigation were seeking to present a unified front by having their attorneys with many of the witnesses in the investigation, the Commission refused to waive Rule 7(c) when these attorneys sought likewise to appear with Mr Csapo After Mr Csapo refused to appear without these attorneys, the Commission instituted a subpoena enforcement action in the United States District Court for the District of Columbia The district court refused to enforce the subpoena unless the Commission allowed the attorneys

to accompany Csapo The Commission appealed from this order and the Court of Appeals for the District of Columbia Circuit affirmed. It said (533 F 2d at 11)

> "We do not minimize the dangers inherent in counsel representing multiple clients in a single proceeding. It is at least plausible that as matters develop the best interests of Csapo may prove to be antagonistic to those of [other persons represented by the same counsel.] That decision, however, belongs to neither the district court nor the Commission The SEC properly fulfilled its duty by informing those who came before it whether their lawyers had appeared on behalf of others and, if so, the possible conflicts which might arise The choice must then be made by the witness after a full and frank disclosure by his attorney of the attendant risks See ABA Code of Professional Responsibility, Disciplinary Rule 5–105(c) "

Unless the Commission can present "concrete evidence" that the presence of the attorneys would obstruct and impede investigation, the court stated, the witness' right to counsel of his own choosing must prevail

In *SEC* v *Geon Industries, Inc* ,[189] the court of appeals upheld a permanent injunction, issued upon a finding of a violation of Section 10(b) of the Exchange Act and Rule 10b–5 by Geon's president in disclosing material nonpublic information about a proposed merger between Geon and Burmah Oil Co , Ltd., of Great Britain, which disclosure resulted in various transactions in Geon shares The court ruled that the information disclosed about the probability and progress of the merger was material, noting that facts relating to a proposed merger could become material at an early stage because of the importance of the event to the company

The court reversed the district court's dismissal of the Commission's complaint against Geon's secretary-treasurer who had responded in the negative to an inquiry from an Exchange official as to whether problems with the proposed merger accounted for an imbalance in the amount of sell orders for Geon stock, when, in fact, he was in possession of information which indicated otherwise In holding that, under the circumstances, the secretary-treasurer had violated Rule 10b–5, the court emphasized that, while the unverified information might have been misleading if made public, failure to disclose such information upon inquiry of the Exchange prohibited the Exchange from reaching an informed decision on whether to suspend trading in Geon shares

The court affirmed the dismissal of the complaint against a broker-dealer on the ground that the Commission had failed to show the trading on inside information by one of its registered representatives resulted from a lack of reasonable supervision on the part of the firm

*Abrahamson* v *Fleschner* [190]—At the request of the Court of Appeals for the Second Circuit, the Commission filed a brief, *amicus curiae,* in this private litigation addressing certain issues raised under the Investment Advisers Act The Commission stated its view that a private civil action should be permitted for violations of the antifraud provisions of the Advisers Act [191] Under the rationale of recent Supreme Court cases,[192] the Commission argued that a private right of action should be implied because clients of investment advisers are members of the class for whose especial benefit the Investment Advisers Act was enacted, because a private right of action is consistent with the underlying purposes of the legislative scheme of the Act and is implied by its clear purpose, and because the remedy provided by the antifraud provisions is not equivalent to any existing right of action for fraud under common law

The Commission noted in its brief that in December 1975, it had publicly announced that it had submitted legislative proposals to the Congress which would amend the Investment Advisers Act in several ways One of these proposals was that Congress "clarify the existence of a private right of action based on a violation" of the Act [193] As the Commission noted in its brief, the fact that it is seeking clarification of the private right of action in order to put an end to the confusion which exists with respect to this issue[194] should in no way be construed as indicating that a private right of action cannot be implied from the present statutory scheme

In its brief, the Commission also took the position that a partnership having as its prin-

cipal purpose to invest and trade in securities, and the partnership's general partners, who had the sole power to make investment decisions for the partnership, were "investment advisers" as defined in the Investment Advisers Act [195] The statutory definition, the Commission asserted, was meant to include persons who, like certain of the defendants in this action, manage the funds of others for compensation and in the process exercise discretion over the investments made with those funds

In addition, the Commission expressed in its brief its views as to the proper method of computing any damages which the plaintiffs could demonstrate they suffered as a result of defendants' alleged violations of the Investment Adviser Act. The Court of Appeals has not yet ruled in the matter

*In the Matter of Cavanagh Communities Corporation* [196]—The District Court for the Southern District of New York, on appeal from an order of a bankruptcy judge, held, in accordance with the views expressed by the Commission in an *amicus curiae* brief, that the Commission has primary jurisdiction in a question dealing with a stock exchange's decision to delist a security.

Cavanagh Communities Corporation is a publicly-held corporation with common stock and debentures listed on the New York Stock Exchange (NYSE). On February 18, 1975, Cavanagh filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. On the same date, the NYSE suspended trading in Cavanagh's securities and announced an intention to apply to the Commission for delisting Cavanagh thereafter petitioned the bankruptcy judge for an injunction against initiation of delisting procedures by the NYSE

The bankruptcy judge concluded that the listing was "property" within the summary jurisdiction of the court. Moreover, since trading in the securities was already suspended, the bankruptcy judge reasoned that there would be no injury to the public if the delisting application was temporarily enjoined Accordingly, he entered the injunction and the NYSE appealed

The Commission filed an *amicus* brief urging the district court to reverse the bankruptcy judge on the ground that the delisting of securities is a matter exclusively within the jurisdiction of the Commission The Commission pointed out that Section 12(d) of the Exchange Act specifically provides that the proper tribunal to judge the appropriateness and necessity of delisting is the Commission, and further that judicial review was available on a petition for review of any Commission order in the court of appeals. Thus, it was not proper for the bankruptcy judge to interfere with the delisting procedures by deciding whether there would be injury to the public in the absence of delisting.

In an opinion which closely parallels the reasoning of the Commission's brief, Judge Duffy reversed the bankruptcy judge and vacated the preliminary injunction. The court noted that "the statutory authority of the SEC over listing and delisting of securities on an exchange is pervasive and comprehensive," and that the "existence of this regulatory structure indicates congressional concern that the skill and experience of the SEC be applied to delisting procedures." In response to Cavanagh's argument that delisting would be imprudent and unnecessary at the present time, the court noted that the proper course for Cavanagh was to present its views to the Commission in response to NYSE's delisting application.

*Holdsworth* v. *Strong* [197]—In this action, the district court found that the defendant violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, by knowingly making false statements regarding a corporation's ability to pay dividends to induce the plaintiffs to sell their stock in the corporation to him and that plaintiffs had reasonably relied upon these false statements. [198] The district court further found that the defendant concealed the true financial condition of the corporation from the plaintiffs.

On appeal, the majority of the panel of the United States Court of Appeals for the Tenth Circuit found that the plaintiffs had failed to exercise due diligence in connection with the transaction and that their lack of due diligence precluded their recovery.

The Commission filed a brief, *amicus curiae,* when the court agreed to rehear the case, *en banc.* Arguing that the court should hold intentional fraudulent conduct actionable under Rule 10b-5 even if the victim was negligent in failing to discover the fraud, the Commission expressed its concern that a

contrary ruling would encourage persons to chance securities fraud since they may be able to retain their ill-gotten gains simply by showing that the victim was negligent.

Given the broad purposes underlying Section 10(b) and Rule 10b–5, and the Supreme Court's recognition in *Ernst & Ernst* v. *Hochfelder*[199] of a private right of action for intentionally fraudulent conduct, the Commission argued that under the above standards the due diligence defense should be rejected.

The court of appeals, sitting *en banc*, reversed the original panel.

*Tannenbaum* v *Zeller*[200] presented the question of whether fully informed and truly independent directors of a mutual fund are precluded, under the Investment Company Act, from exercising any discretion and good faith business judgment in determining whether to use a portion of the commissions paid by the fund on brokerage transactions to reward broker-dealers which sold fund shares or provided research services instead of recapturing such excess commissions for the fund's direct cash benefit

The issue arose because of the minimum fixed-brokerage commission rate structure that prevailed on the exchanges until May 1, 1975, when it was prohibited by the Commission. Under that system, persons were compelled to pay brokerage commissions according to a fixed rate which did not reflect economies of scale As a result, the brokerage commissions paid by mutual funds far exceeded the actual cost to the broker. The mutual funds had essentially two ways to use these excessive commissions—they could channel the excess to brokers which provided the fund with sales or research services or they could, through a variety of devices, recapture the excess in the form of a direct cash benefit for the funds

The fund in *Tannenbaum* had chosen to use the excess to reward brokers providing sales and research services The plaintiff sued on the ground that the defendant investment adviser had caused the fund to take this course in violation of its fiduciary duty As a defense, the adviser argued that the decision to forego recapture of the excess commissions had been made by the disinterested members of the board of directors in the exercise of a good faith business judgment, and that the adviser could not be held liable for carrying out the instructions of the board The district court agreed with defendant, and plaintiff appealed to the Court of Appeals for the Second Circuit

In an *amicus curiae* brief, the Commission argued that the recapture decision was one that could be committed to the discretion of the disinterested members of the board of directors. Crucial to this position was the fact that this case arose in the context of rapidly changing market conditions which created substantial equities in favor of the defendants in this case. In addition, the structure of the Investment Company Act and two prior decisions by courts of appeals indicated that the recapture question was one area where independent and disinterested directors could exercise business judgment In the context of this case, contrary to the general experience of the Commission, the district court had found that the directors were truly independent of the investment adviser The court had also found that the directors were fully informed of available alternatives for using the excess commissions. Under those circumstances and in view of the unique market conditions prevailing at the time the events occurred, the Commission could not conclude that the directors' judgment to forego recapture was not reasonable

The case is currently awaiting decision by the court of appeals

*Pargas, Inc* v. *Empire Gas*[201]—The action was brought by the target company (Pargas, Inc ) to enjoin a tender offer. At the request of the court, the Commission filed a letter with the court expressing its views on the applicability to tender offers of Regulation T, adopted by the Board of Governors of the Federal Reserve System pursuant to Section 7 of the Exchange Act The Commission noted its practice of referring requests for interpretations of the Regulation to the Board In view of its responsibilities for enforcing the Regulation, however, after consultation with the staff of the Board, the Commission advised the court that it was in agreement with the Board's staff that the Regulation applied to tender offers and that the arrangement of credit involved in the action appeared not to be within any exemption provided in the Regulation.

In *Ayres* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc* ,[202] the Court of Appeals for the

Third Circuit reversed a district court judgment confirming a decision rendered by arbitrators of the New York Stock Exchange. The action arose when plaintiff Ayres retired from his position as a registered representative with Merrill Lynch, and Merrill Lynch then exercised its right to repurchase 8,000 shares of its stock which Ayres, as an employee, had been permitted to buy. At the time it repurchased the stock from Ayres, Merrill Lynch did not disclose that it planned to make a public offering of its common stock Plaintiff brought suit under Section 10(b) of the Exchange Act claiming Merrill Lynch had withheld material non-public information which, if he had known, would have caused him to delay his voluntary retirement and thus not trigger the repurchase of his stock

The district court granted Merrill Lynch's motion for a stay of proceedings pending arbitration based on its contention that the controversy was one arising out of Ayres' employment, subject to compulsory arbitration pursuant to agreement between Ayres and Merrill Lynch. The arbitrators subsequently rendered a decision adverse to Ayres on all claims, and the district court confirmed the decision

The court of appeals concluded, in agreement with the views set forth by the Commission, *amicus curiae*, that the applicable NYSE rule was "not intended to cover a controversy that has a causal connection to the fact of employment as remote as that involved" or "the assertion of legal rights having a source wholly independent of the employment relationship." To conclude otherwise would be to place on the arbitrators the responsibility for applying legal principles that are far removed from the NYSE's interests in self-governance and "the specialized knowledge of industry needs and practices that makes arbitration appropriate when the terms and conditions of the employment relationship are at issue "

Moreover, even if the NYSE rule were intended to govern the situation, the court held that agreements to arbitrate future federal securities controversies would be unenforceable because of the anti-waiver provision of Section 29(a) of the Exchange Act and *Wilko* v. *Swan*, 346 U S 427 (1953), which held that the anti-waiver provision of the Securities Act rendered void a prospective agreement between a brokerage firm and a customer which would have required arbitration of the customer's claim under Section 12(2) of the Securities Act. The prospective waiver of a right to a judicial trial of a cause arising under the securities laws is "inconsistent with Congress' overriding concern for the protection of investors." Slip op. 8

Finally, the court dismissed Merrill Lynch's remaining claims, (1) that no cause of action was stated because Ayres' sale was totally involuntary, and (2) that Section 28(b), which preserves the validity of action taken by a self-regulatory organization "to settle disputes between members or participants," exempts the NYSE rule from the invalidating effect of the anti-waiver provision The case was remanded to the district court

One judge dissented on the grounds that since Merrill Lynch had an "unfettered" right to repurchase Ayres' stock, he had no investment choice to make in the matter His decision was not whether to sell securities, but whether to retire. Therefore, no information was material to Ayres' investment decision and his complaint failed to state a cause of action under Rule 10b–5.

## Commission Litigation

*SEC* v. *National Student Marketing Corp* [203]—As previously reported, Anthony M Natelli, then an auditing partner of Peat, Marwick, Mitchell & Co., and Joseph Scansaroli, a former audit supervisor with that firm, were convicted in the Southern District of New York for their part in preparing interim unaudited financial statements for National Student Marketing Corp. which appeared in a proxy statement delivered to the shareholders and filed with the Commission in 1969. An appeal was taken to the United States Court of Appeals for the Second Circuit.

In affirming Natelli's conviction, the Court enunciated important standards of responsibility for an accountant faced with the opportunity to correct falsehoods in previous financials of which he should be aware in subsequent interim, unaudited, financial statements.[204] The court concluded that "[t]he accountant owes a duty to the public not to assert a privilege of silence until the next annual statement comes around in due time " Natelli's petition for certiorari was denied The court reversed Scansaroli's conviction as to

one specification of the count of the indictment under which he was tried for lack of sufficient evidence, and ordered a new trial with respect to the other count to correct a faulty jury charge. That trial is scheduled to begin in October.

During the previous fiscal year, the District Court granted the Commission's motion to strike a certain affirmative defense asserted by a number of the defendants The defendants alleged that the Commission's injunctive action should be dismissed because the staff, during the course of the investigation, failed to inform prospective defendants of their status as targets of an investigation and to solicit their views as to why they should not be sued. Defendants alleged that this was required by the rules and regulations of the Commission The District Court, finding that no such rule existed, struck the defense as legally insufficient. The ruling was certified for interlocutory appeal under 28 U.S.C. § 1292(b). The United States Court of Appeals for the District of Columbia Circuit upheld the Commission's position and affirmed the District Court's ruling. A motion for reconsideration is pending.

Over the Commission's objections, this action was consolidated by the Judicial Panel on Multidistrict Litigation with several pending private suits concerning National Student Marketing. The resulting litigation caused a substantial delay in the progress of the Commission's action. As a result of this type of experience, a request was directed to Congress for legislation to insure the Commission's right to avoid such involuntary consolidation in the future. Congress responded in 1975 by adding Section 21(g) to the Exchange Act, which requires the Commission's consent for future consolidations under 28 U S.C. § 1407(a).

This action has been the subject of one of the most comprehensive pretrial discovery programs in the Commission's experience. The testimony of more than one hundred thirty witnesses has consumed forty thousand pages of transcript. Five thousand documents have been marked for identification, and many times that number have been produced for inspection. With this lengthy process nearly complete, the Commission's action will proceed to a separate trial late in 1976 or early in 1977.

*SEC* v. *United Brands Company, et al* — The Commission obtained on consent a permanent injunction and other relief against United Brands Company The Commission alleged violations of the reporting and antifraud provisions of the Exchange Act in connection with United Brands' failure to disclose substantial payments to officials of foreign governments in order to secure favorable treatment in connection with its business operations in those countries [205]

In addition to the entry of an order of permanent injunction, certain ancillary relief was ordered by the court and undertaken by United Brands including, among other things, the following:

A. An order requiring the Board of Directors of United Brands to create and maintain a Special Committee to investigate and report to the Commission, the Court and United Brands' Board of Directors on the matters contained in the Commission's complaint, on all other payments from 1970 to date made to officials and employees of foreign governments which were unlawful under the laws of the foreign countries involved, and any unlawful political contributions made in any foreign country The procedures and methods utilized by the Special Committee and the Final Report shall be fully reviewed by Michael Sovern, Dean of the Faculty of Law of Columbia University.

B. United Brands undertook that with respect to any material unlawful expenditure of corporate funds to an official or employee of any foreign government, it will obtain the prior approval of the United Brands Board of Directors as to any such transaction and prior to entering such transaction, publicly disclose the full details of the transaction, whether or not such details are otherwise material

*SEC* v *Emersons, Ltd , et al* —The Commission filed a complaint seeking injunctive relief against Emersons Ltd. ("Emersons"), a corporation with principal offices in Maryland which operates approximately 42 restaurants, and two former officers, John P. Radnay ("Radnay") and Eli Levi ("Levi"). Radnay, Emersons' largest shareholder, was the chairman of the board and president of Emersons. Levi was the treasurer and executive vice president of Emersons

The Commission's complaint alleged that Emersons received substantial payments of

monies from a brewer of beer, a beer wholesaler and producer of liquor, and a producer of wines and distributor of liquor which were made in order to induce Emersons to purchase their products for resale in its restaurants According to the complaint, Emersons' books and records were falsified with respect to the payments

The complaint further alleged that Radnay, in order to conceal the use of a part of the payments from one beer supplier for his own purposes at the end of 1974 falsified certain of Emersons' records and made false statements verbally and in correspondence sent to agents of the Bureau of Alcohol, Tobacco and Firearms and gave false testimony with respect to the payments to the Commission

The complaint further alleged that Emersons failed to disclose in various filings with the Commission the use of substantial amounts of Emersons' funds by Radnay and approximately $9,000 by Levi for home improvements and other uses accruing to their personal benefit In connection with the alleged improper use of these funds, Radnay and Levi caused false entries to be made in Emersons' accounting records

The Commission also alleged that Emersons' financial statements for the 1974 and 1975 fiscal years, the interim periods in the 1975 fiscal year and the income statement for the first quarter of Emersons' 1976 fiscal year were false and misleading in that advertising and computer software costs were improperly capitalized The 1975 fiscal year reported earnings were contrived in order to meet projections of income, year-end meat inventories were overstated, an insurance claim was improperly included in the 1975 accounts receivable balance without disclosure, the 1975 accounting method used for inventory valuation was changed from that used in 1974 without disclosure, and various items in the 1975 year-end inventory were arbitrarily increased

Emersons was required to appoint and maintain on its Board of Directors three additional independent directors, satisfactory to the Commission and approved by the court, and appoint as replacements for any present board members who cease to serve as directors, such additional independent directors in order that such directors constitute a majority of Emersons' Board of Directors Emersons is also to maintain an Executive Committee of the Board, a majority of whose members are to be independent directors. The Board of Directors is to appoint a new chief executive officer and chief financial officer for Emersons

A majority of the independent directors are to appoint a Special Counsel The Special Counsel is to investigate the matters alleged in the complaint and other matters he deems appropriate, make an accounting, file a report of his findings with the court, and, with the approval of certain of the directors, take appropriate action including the institution and prosecution of suits on behalf of Emersons

The judgment entered against Radnay restricts the positions he can hold with Emersons for a period of time, and restricts his access to cash or other assets of Emersons and orders him to make an accounting and pay over to Emersons such monies and other assets of Emersons used for his benefit Radnay, the principal sharholder of Emersons, is further ordered to place all Emersons' securities owned or controlled by him in a voting trust to be controlled by an independent trustee, selected by him and approved by the Commission, for a period of five years but he is not prohibited from selling or pledging his securities In addition, Radnay, who is a lawyer, resigned from practice before the Commission and agreed not to practice before the Commission without prior Commission approval

The judgment against Levi enjoins him from serving for a period of two years as chief financial or executive officer of Emersons or any other public company in which his duties encompass preparation or filing of reports with the Commission Although Levi may continue to serve as a director of Emersons, the judgment restricts his actions and may require his resignation depending upon the findings of the Special Counsel and subsequent decision of the Board of Directors. Levi is, in addition, ordered to make an accounting and pay over to Emersons such monies and other assets of Emersons used for his benefit In addition, Levi, who is an accountant, has agreed not to practice before the Commission, provided that after two years, he may apply to the Commission to practice

*SEC* v *American Institute Counselors Inc* —On November 25, 1975, the Commission obtained injunctions against American Institute Counselors, Inc. ("AIC"), American Institute for Economic Research ("AIER"), certain related Swiss and Liechtenstein corporations including Swiss Credit Bank and Swiss Life Insurance and Pension Company, and certain individuals seeking a Judgment of Permanent Injunction and certain other relief The Commission alleged a fraudulent scheme and course of business whereby the defendants, directly and indirectly, offered to sell and sold to U S investors various gold-related securities, in near total disregard for and in violation of virtually the entire panoply of Federal securities laws, including the securities registration, antifraud, record-keeping and broker-dealer, investment company and investment adviser registration provisions

The District Court also ordered certain ancillary relief, including, among other things, the appointment of a Special Counsel and a Special Auditor, the appointment of new independent trustees for the entities and an investigation into the matters alleged. The judgment also provided that no distribution of funds should be made, without the court's prior approval, to any investor Subsequently, three of the six named individuals consented to permanent injunctions enjoining violations of the Federal securities laws.

The court also restrained certain of the defendants including the Swiss and Liechtenstein entities, from, among other things, effecting any transactions or exercising any powers with respect to certain investment arrangements offered and sold by the defendants to U S. investors Swiss Credit Bank was ordered to transfer to its New York branch office all assets underlying such investment arrangements by the bank on behalf of the defendants.[206]

*SEC* v *The General Tire & Rubber Company* —The Commission obtained on consents permanent injunctions and ancillary relief against The General Tire & Rubber Company and Michael Gerald O'Neil, a director and president of General Tire. The Commission alleged various violations of the securities laws in connection with the making of substantial improper and illegal payments totalling in excess of several million dollars of General Tire corporate funds, the making of domestic political contributions and improper payments to officials and employees of various governments, the falsification of corporate books and records, the utilization of unrecorded and unaccounted funds, violations of foreign currency laws, and the filing of materially false and misleading annual and periodic reports with the Commission

In addition to permanent injunctions, certain ancillary relief was ordered, including the establishment of a Special Review Committee, consisting of General Tire's independent directors, and the retention of a Special Counsel to conduct an investigation into, among other things, the use of corporate funds for unlawful political contributions and improper payments to foreign or domestic government officials and employees, the use of secret or unrecorded funds, the use of agents and consultants for unlawful or improper purposes, and such other matters as may be revealed during the course of the investigation.

*SEC* v *Medic-Home Enterprises, Inc , et al* —In December 1975, in the United States District Court for the Southern District of New York,[207] the Commission instituted an injunctive action against Medic-Home Enterprises, Inc , a corporation engaged in the business of developing and owning nursing homes and related health-care facilities, Bernard Bergman, former chairman of the board of Medic-Home, Samuel A Klurman, president of Medic-Home, Morris Shmidman, former president and presently a director of Medic-Home, and Stanley Bergman, Amram Kass and Moses Braunstein, all former directors of Medic-Home The complaint charged the defendants with violations of the antifraud, reporting, proxy, solicitation and tender offer provisions of the Federal securities laws

The Commission alleged that, beginning on or about January 1, 1970, and continuing to the present, the defendants caused Medic-Home to enter into various transactions among themselves with the result that corporate assets were used for the benefit of such defendants The Commission further alleged that the defendants concealed material aspects of these transactions in materials filed with the Commission and disseminated to the public

Medic-Home, Klurman, Shmidman and Braunstein each consented to permanent injunctions pursuant to which Medic-Home will be required to appoint three independent directors satisfactory to the Commission and approved by the court The independent directors, who will remain on Medic-Home's board for two years, shall conduct an investigation into certain Medic-Home transactions, file with the court and furnish the Commission with copies of their findings and recommendations, and cause Medic-Home to correct filings previously made with the Commission

*SEC v Geo Dynamics Oil and Gas, Inc* [208]—In June 1976, the Commission filed a complaint seeking injunctive and other relief in the U S District Court for the District of Columbia, naming as defendants Geo Dynamics Oil and Gas, Inc , and Milton A. Dauber, of Jenkintown, Pa , Comprehensive Resources Corporation, Geo Resources Corporation, CRC Corporation, Geo Resources Management Corporation, William J Soter, and Martin J Fribush, all of New York, New York, B L Floyd, of Corpus Christi, Texas (all of the above referred to in the complaint as the "Geo Defendants"), Jack P Janetatos and Walter A Slowinski, of Washington, D C , and Fortune Enterprises, Inc , Richard Katcher, and Willian J Kraus, of Cleveland, Ohio

The Commission's complaint charged the Geo defendants with violations of the antifraud provisions of the Federal securities laws, in connection with the offer and sale, between 1970 and 1973, of over $80 million in registered and unregistered limited partnership interests in "leveraged" oil and gas drilling ventures, offered and managed by the Geo defendants A prime appeal of the offering was the claim that investors would be entitled to claim on their tax returns, in the year of their investment, intangible drilling costs ("IDC's") equal to two or three times the amount of their cash invested ("leveraged deductions")

The complaint alleged that the offering documents used to offer and sell the partnership's interests—prospectuses, confidential memoranda (unregistered offering circulars), and tax opinion letters—contained materially false and misleading disclosure of the substance of the transactions on which the leveraged deductions were to be used and of the material risks of adverse tax treatment by the Internal Revenue Service and the courts, and further alleged that millions of dollars in front-end management fees were taken from investors by the Geo defendants on a fraudulent basis

In addition to the allegations of violations of the antifraud provisions, the complaint charged Geo Resources Management Corporation, Geo Dynamics Oil and Gas, Inc , Comprehensive Resources Corporation, CRC Corporation, William J Soter, and Milton A Dauber with violations of the registration and reporting provisions of the securities laws, and Fortune Enterprises, Inc , William J Kraus and Richard Katcher with violations of the broker-dealer provisions

In addition, the complaint alleged that defendants Janetatos and Slowinski, of Washington, D C , on behalf of their law firm, aided and abetted the Geo defendants' antifraud violations in issuing tax opinion letters on the taking of the leveraged deductions, which opinion letters were distributed by the Geo defendants to prospective investors or their advisors, and in reviewing prospectuses contained in the registration statements for certain of the drilling funds The complaint alleged that defendants Janetatos and Slowinski knew or should have known facts concerning the substance of the method of operations of the Geo defendants' drilling ventures, such that they should have known that their opinion letters and the prospectuses did not fully and fairly describe the proposed method of operations of the oil and gas drilling ventures in all respects material to the tax consequences, and did not fully and fairly describe all material risks of adverse tax treatment

The complaint noted that the Internal Revenue Service, after conducting an audit of the 1971 and 1972 drilling programs, has decided to disallow the deductions based on the non-recourse "loan" transactions, on the grounds, among others, that such transactions are shams for tax purposes, and that over 2,000 limited partners will face disallowance of over $80,000,000 in deductions based on the non-recourse "loan" transactions

Defendants Janetatos and Slowinski consented to a final order prohibiting them from

rendering any tax opinion or advice, in connection with any tax-oriented securities offering, without taking reasonable care, including reasonable and appropriate inquiry and investigation, to assure themselves that the proposed method of operations of any entity formed as a result of the offering is fully and fairly described in all respects material to the tax treatment on their tax opinion letter or any other offering document, and that all material risks of adverse tax treatment are fully and fairly described in their opinion letters or in any other offering document As part of their settlement with the Commission, these defendants agreed to obtain review by experienced and knowledgeable securities counsel of the adequacy of disclosures in opinion letters and offering documents, before rendering any opinions or advice

Defendant Katcher consented to a judgment prohibiting him, in connection with the offer and sale of tax-oriented securities, from rendering any tax or other advice or recommendation, or offering and selling such securities, to any client or other persons, without informing such person, where applicable, that he or any entity with which he is associated will receive any commission or other compensation; and from acting as an unregistered broker-dealer.

The complaint seeks permanent injunctive relief against future violations of the relevant provisions of the Federal securities laws by the remaining defendants, as well as the disgorgement by the Geo defendants to the limited partners of those portions of management fees based on the sham non-recourse "loan" transactions, and the issuance of an order maintaining and preserving the assets of defendant CRC Corporation and subsidiaries pending a final determination of the allowability of tax deductions claimed by the limited partners.

*SEC* v *Braniff Airways, Incorporated* [209]—On March 24, 1976, the Commission obtained by consent permanent injunctions against Braniff Airways, Incorporated, its parent corporation, Braniff International Corporation, Harding L. Lawrence, C. Edward Acker and Charles S. South

The Commission alleged that during the period from 1969 to the date of the complaint defendant Braniff Airways, and at certain times the other defendants, maintained a secret fund of corporate monies and unaccounted-for airline tickets with a potential value of over $900,000, that defendants Braniff Airways, Lawrence, Acker and South caused $40,000 in monies from this fund to be used in connection with a single illegal political contribution made in 1972, and that defendants Braniff Airways, Acker and South caused the remaining monies and tickets from the fund to be distributed as extra consideration to travel agents, tour groups and promoters in order to promote the company's international and foreign travel business in violation of the Federal Aviation Act, foreign law and International Air Transport Association ("IATA") resolutions

As part of their consent to this order, the corporate defendants have undertaken to continue their ongoing investigation with respect to such payments and with respect to all other relevant matters as may be revealed in the course of such investigation The corporate defendants have further undertaken to file a report of that investigation with the Commission and the Court.

*SEC* v *Parklane Hosiery Co , Inc* [210]—In May 1976, the Commission instituted an injunctive action against Parklane Hosiery Co., Inc and Parklane's president, chairman of the board and majority stockholder, charging them with violations of the antifraud, proxy and reporting provisions of the Federal securities laws

The complaint alleges that the defendants violated the Federal securities laws in connection with the purchase and sale of Parklane securities relating to the merger of Parklane with a private company which resulted in Parklane's conversion from a publicly-held company to a privately-owned company In connection with Parklane's conversion to the status of a privately owned company, the complaint alleges that the defendants engaged in a scheme whereby they made false and misleading statements and omitted other material facts regarding various facets of the company's scheme to become a private corporation Among other things, Parklane's failure of disclosure concerned the fact that Parklane's corporate status was changed so as to enable Parklane's president to appropriate Parklane's assets for his own personal

benefit (specifically to reduce his own personal indebtedness), the true status of negotiations regarding cancellation of certain of Parklane's leasehold rights, and the fact that the defendants had not provided their appraisers, hired to determine the true value of Parklane stock, with adequate information to make a proper evaluation.

The complaint seeks a permanent injunction against further violations by the defendants and various ancillary relief, including the appointment of a Special Counsel, with broad powers, to conduct an investigation of Parklane, so as to protect and preserve Parklane's assets and the rights of Parklane's former public shareholders

In June 1976, an injunctive hearing was held and completed and the Court reserved decision on the Commission's motions for a preliminary injunction and its motion to consolidate the preliminary hearing with a permanent injunctive trial

*SEC* v. *Joseph Ayoub* [211]—The Commission sought to enjoin two brokers and an employee of a financial printing firm from further violations of the antifraud provisions of the Federal securities laws in connection with the possession, dissemination and misuse of material non-public information concerning an impending tender offer The complaint charged that Charles Boehm, an employee of a financial printer, provided the brokers with a printer's proof of the tender offer prior to the public announcement of the offer It was further alleged that the two brokers then purchased and recommended the purchase of a total of 16,500 shares of the target company's stock, which was trading on the American Stock Exchange. The three defendants all consented to injunctions and the disgorgement of profits obtained by virtue of their conduct

## NOTES TO PART 1

[1] Act of June 4, 1975, Pub L No 94–29, 89 Stat 97 [hereinafter cited by section as 1975 Amendments]

[2] 41st Annual Report, p. 8, 40th Annual Report, p 4.

[3] 41st Annual Report, pp 9-11

[4] SEC Advisory Committee on the Implementation of a Central Market System, *Supplementary Report* (September 12, 1975).

[5] Section 11A(d) of the Exchange Act which was Section 7 of the 1975 Amendments

[6] Securities Exchange Act Release No. 11623 (August 28, 1975), 7 SEC Docket 757.

[7] Securities Exchange Act Release No. 11942 (December 9, 1975), 8 SEC Docket 756.

[8] Section 7 of the 1975 Amendments.

[9] SEC, *Report of the Securities and Exchange Commission on Rules of National Securities Exchanges Which Limit or Condition the Ability of Members to Effect Transactions Otherwise than on Such Exchanges* (September 2, 1975).

[10] Securities Exchange Act Release No. 11628 (September 2, 1975), 7 SEC Docket 762.

[11] Securities Exchange Act Release No 11942 (December 19, 1975), 8 SEC Docket 756

[12] *Id.* 8 SEC Docket 769-771.

[13] *Id* 8 SEC Docket 757

[14] *Id* 8 SEC Docket 773-776 The composite limit order book is discussed at pgs. 5–6, *infra*

[15] Securities Exchange Act Relase No. 12281 (March 29, 1976), 9 SEC Docket 316; Securities Exchange Act Release Nos. 12242-12248 (March 23, 1976), 9 SEC Docket 249-54

[16] Securities Exchange Act Release No. 12249 (March 23, 1976), 9 SEC Docket 255

[17] Letter from James E Buck, Secretary, New York Stock Exchange to Bart Friedman, Assistant Director, Division of Market Regulation, July 2, 1976.

[18] Securities Exchange Act Release No. 12664 (July 28, 1976), 10 SEC Docket 106.

[19] Securities Exchange Act Release No 11942 (December 19, 1975), 8 SEC Docket 756.

[20] *Id.*

[21] Securities Exchange Act Release No. 12159 (March 2, 1976), 9 SEC Docket 76.

[22] SEC, *Statement on the Future Structure of the Securities Markets* (February 2, 1972), 37 Fed Reg. 5286 (1972)

[23] SEC, *Policy Statement on the Structure of a Central Market System* (March 29, 1973)

[24] 41st Annual Report, pp. 13-14.

[25] Securities Exchange Act Release No 9529 (March 8, 1972)

[26] Securities Exchange Act Release No 10969 (August 14, 1974), 5 SEC Docket 735; *see* 41st Annual Report, pp. 13-14

[27] Securities Exchange Act Release No. 12670 (July 29, 1976), 10 SEC Docket 108

[28] 41st Annual Report, p. 11; 40th Annual Report, p 7; 39th Annual Report, p 9.

[29] Securities Exchange Act Release No. 12138 (February 25, 1976), 9 SEC Docket 8

[30] Securities Exchange Act Release No. 12175 (March 8, 1976), 9 SEC Docket 128.

[31] Securities Exchange Act Release No 12162 (March 3, 1976), 9 SEC Docket 85

[32] Securities Exchange Act Release No. 11461 (June 11, 1975), 7 SEC Docket 145.

[33] Securities Exchange Act Release No 11951 (December 24, 1975), 8 SEC Docket 894

[34] Securities Exchange Act Release No. 12432 (May 12, 1976), 9 SEC Docket 623

[35] Securities Exchange Act Release No 11468 (June 12, 1975), 7 SEC Docket 150, *see* 41st Annual Report, p 15

[36] Certain of these amendments were activated only upon commencement of the high speed data transmission line contemplated by Phase II of the Joint Industry Plan for implementation of a consolidated transaction reporting system *See* Securities Exchange Act Release No 12138 (February 25, 1976), 9 SEC Docket 8 This occurred on April 30, 1976 *See* text accompanying notes, 28–34, *supra*

[37] Securities Exchange Act Release No 11468 (June 12, 1975), 7 SEC Docket 150

[38] Securities Exchange Act Release No 12384 (April 28, 1976), 9 SEC Docket 495

[39] Letters from Bart Friedman, Division of Market Regulation to American Stock Exchange, Inc , Boston Stock Exchange, Inc , Cincinnati Stock Exchange, Inc., Detroit Stock Exchange, Inc , Midwest Stock Exchange, Inc., Pacific Stock Exchange, Inc , and PBW Stock Exchange, Inc (August 1 and 2, 1975).

[40] Securities Exchange Act Release No 12432 (May 12, 1976), 9 SEC Docket 623

[41] Securities Exchange Act Release No 11828 (November 14, 1975), 8 SEC Docket 444

[42] Securities Exchange Act Release No 11948 (December 23, 1975), 8 SEC Docket 791.

[43] Securities Exchange Act Release No 12015 (January 14, 1976), 8 SEC Docket 1026

[44] Securities Exchange Act Release No 12451 (May 14, 1976), 9 SEC Docket 675

[45] Securities Exchange Act Release No 12114 (February 18, 1976), 8 SEC Docket 1300

[46] Securities Exchange Act Release No 12461 (May 19, 1976), 9 SEC Docket 678

[47] Letter from Merrill Lynch, Pierce, Fenner & Smith, Inc ("Merrill Lynch") to Lee A Pickard, Director, Division of Market Regulation (September 4, 1975), Letter from Lee A. Pickard to Merrill Lynch (September 30, 1975), Letters from Dean Witter & Co ("Dean Witter") to Lee A Pickard (October 10 and 30, 1975); Letter from Andrew M Klein, Associate Director, Division of Market Regulation to Dean Witter (November 26, 1975), Letter from Mitchell, Hutchins Inc. ("Mitchell, Hutchins") to R J Morrisey, III, Division of Market Regulation (May 5, 1976).

[48] Securities Exchange Act Release No 12380 (April 27, 1976), 9 SEC Docket 494, Securities Exchange Act Release No 12381 (April 27, 1976), 9 SEC Docket 494

[49] Securities Exchange Act Release No 12157 (March 2, 1976), 9 SEC Docket 45

[50] Securities Exchange Act Release No 12181 (March 11, 1976), 9 SEC Docket 131

[51] Securities Exchange Act Release No 12055 (January 27, 1976), 8 SEC Docket 1155.

[52] *See* Securities Exchange Act Release No 12055, at n 3 (January 27, 1976), 8 SEC Docket 1155.

[53] *Id* at 1-3

[54] *E g* , Securities Exchange Act Release No 12056 (January 27, 1976), 8 SEC Docket 1163 (NYSE rules)

[55] S Rep. No 75, 94th Cong , 1st Sess 121 (1974). In this context, the term "self-regulatory organization" denotes national securities exchanges and the NASD, the sole national securities organization.

[56] Securities Exchange Act Release No 12352 (April 20, 1976), 9 SEC Docket 450

[57] Securities Exchange Act Release No 12483 (May 26, 1976), 9 SEC Docket 731

[58] *See* 41st Annual Report, p 17.

[59] *Id*. at 18

[60] Securities Exchange Act Release No 11748 (October 16, 1975), 8 SEC Docket 99

[61] Securities Exchange Act Release No 11935 (December 17, 1975), 8 SEC Docket 808

[62] Securities Exchange Act Release No 11497 (June 26, 1975), 7 SEC Docket 241

[63] See S. Rep No 75, 94th Cong , 1st Sess 43 (1974).

[64] Section 15(a) generally requires brokers and dealers utilizing the mails or any means or instrumentality of interstate commerce to effect transactions in (or to induce or attempt to induce the purchase or sale of) securities, other than exempted securities and certain money market instruments, to become registered with the Commission

[65] The term "municipal securities dealer" is defined by Section 3(a)(30) of the Act to include banks (or their separately identifiable departments or divisions) acting as dealers with respect to municipal securities On the other hand, the terms "broker" and "dealer" employed in Section 15(a) of the Act are defined by Sections 3(a)(4), (5) of the Act to exclude banks

[66] Unlike Section 15(a), Section 15B(a) of the Act contains no exemption from registration for municipal securities dealers utilizing the jurisdictional means to conduct an exclusively intrastate business.

[67] Securities Exchange Act Release No 11469 (June 12, 1975), 7 SEC Docket 157.

[68] Securities Exchange Act Release No 11635 (September 5, 1975), 7 SEC Docket 831.

[69] Securities Exchange Act Release No. 11741 (October 15, 1975), 8 SEC Docket 80.

[70] Securities Exchange Act Release No 11585 (August 11, 1975), 7 SEC Docket 553

[71] Securities Exchange Act Release No 11742 (October 15, 1975), 8 SEC Docket 82

[72] Securities Exchange Act Release No 11881 (November 28, 1975), 8 SEC Docket 636

[73] Securities Exchange Act Release No 12602 (July 7, 1976), 9 SEC Docket 1045

[74] Securities Exchange Act Release No 11656 (September 16, 1975), 7 SEC Docket 872, Securities Exchange Act Release No 11561 (July 30, 1975), 7 SEC Docket 471, Securities Exchange Act Release No 11497 (June 26, 1975), 7 SEC Docket 241

[75] Securities Exchange Act Release No 11854 (November 20, 1975), 8 SEC Docket 459.

[76] The provisions effected by these temporary amendments included, among others, Rule 15c3–1(c)(1)(i) (exclusion of certain adequately collateralized indebtedness from aggregate indebtedness), Rule 15c3–1(c)(2)(iv)(C) (exclusion from net worth of certain receivables), Rule 15c3–1(c)(2)(vi)(M) (haircuts against unduly concentrated securities positions), Rule 15c3–1(c)(2)(ix) (treatment of aged fails to deliver), Rule 15c3–1(f)(1)(alternative net capital requirement as applied to certain municipal securities brokers effecting transactions only with other municipal securities professionals

[77] Securities Exchange Act Release No 12482 (May 26, 1976), 9 SEC Docket 722

[78] As temporarily amended, Rule 15c3–1(f)(1)(a) permits brokers and dealers effecting transactions solely in municipal securities to operate thereunder while maintaining net capital at least equal to the greater of $25,000 or 4% of aggregate debit items computed under the Reserve Formula, 17 CFR § 240 15c3–3a (1976) This temporary amendment, which lowered the minimum net capital dollar requirement under Rule 15c3–1(f)(1)(a) from $100,000 to $25,000, made the alternative net capital requirement available to smaller municipal securities firms which would experience difficulty in maintaining the $100,000 of net capital normally required by Rule 15c3–1(f)(1)(a)

[79] "Securities and Exchange Commission Only " The term refers—and SECO rules apply—to those brokers and dealers who are not members of the National Association of Securities Dealers, Inc

[80] Securities Exchange Act Release No 11876 (November 26, 1975), 8 SEC Docket 541

[81] Rule 23a–1(T) also provided municipal securities brokers a temporary exemption from the requirement in Securities Exchange Act Rule 15c1–4 that a broker disclose either the name of the person from whom the security was purchased or to whom it was sold, or the fact that such information will be furnished upon request This requirement previously had applied to municipal securities brokers *See* Securities Exchange Act Release No 11876 (November 26, 1975), 8 SEC Docket 541

[82] Securities Exchange Act Release No 12468 (May 20, 1976), 9 SEC Docket 681

[83] Securities Exchange Act Release No. 11854 (November 20, 1975), 8 SEC Docket 459

[84] Securities Exchange Act Release No 12362 (April 23, 1976), 9 SEC Docket 482.

[85] *See* 41st Annual Report, pp 15-17, 40th Annual Report, pp 8-9; 39th Annual Report, pp. 10-11.

[86] *See* 41st Annual Report, p. 15

[87] Proposals pending before the Commission at year's end would establish 200 additional Amex memberships for "options principal members" who generally would be restricted to effecting options transactions for their own accounts

[88] Securities Exchange Act Release No. 12283 (March 30, 1976), 9 SEC Docket 317.

[89] *See* 41st Annual Report, p 16.

[90] Pacific Stock Exch R I, § 12(k).

[91] Securities Exchange Act Release No. 11972 (January 2, 1976), 8 SEC Docket 973 (CBOE), Securities Exchange Act Release No. 12231 (March 18, 1976), 9 SEC Docket 216 (Amex), Securities Exchange Act Release No. 12333 (April 12, 1976), 9 SEC Docket 407 (PHLX); Securities Exchange Act Release No 12508 (June 3, 1976), 9 SEC Docket 788 (PSE)

[92] *See* Securities Exchange Act Release No 12601 (July 7, 1976), 9 SEC Docket 1044

[93] *See, e.g* , Chicago Bd. Options Exch. R 8 5(a), which prohibits CBOE "market makers" (specialists) from effecting floor transactions without a Letter of Guarantee from a clearing member

[94] Securities Exchange Act Release No 12148 (February 26, 1976), 9 SEC Docket 11

[95] *See* 41st Annual Report, pp. 4-5 for a description of the allocation of authority and responsibility under Section 17A.

[96] Section 3(a)(23) of the Act defines the term "clearing agency" to include clearing corporations and depositories. Generally, clearing corporations clear and settle transactions between participating broker-dealers Depositories usually hold securities certificates and effect delivery between participants by book entry

[97] Securities Exchange Act Release No. 11787 (November 3, 1975), 8 SEC Docket 328.

[98] Securities Exchange Act Release No 11875 (November 26, 1975), 8 SEC Docket 540

[99] *See* Securities Exchange Act Release Nos 12274 & 12428 (March 29 & May 11, 1976), 9 SEC Docket 305, 622.

[100] *See* Securities Exchange Act Release Nos 11904 & 12109 (December 5, 1975 & February 18, 1976), 8 SEC Docket 694, 1298 One entity subsequently withdrew its application for exemption and filed an application for registration

[101] Securities Exchange Act Release No 12489 (May 28, 1976), 9 SEC Docket 764 The Commission published notice of the filing

of NSCC's application for registration as a clearing agency in Securities Exchange Act Release No. 12274 (March 29, 1976), 9 SEC Docket 305.

[102] Depending upon the entity seeking registration, its appropriate regulatory agency may be the Commission or one of the three Federal bank regulatory agencies (*i e*, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, or the Federal Deposit Insurance Corporation) *See* Securities Exchange Act § 3(a)(34)(B).

[103] Securities Exchange Act Release No 11759 (October 22, 1975), 8 SEC Docket 203 The rule and form were proposed in Securities Exchange Act Release No. 11622 (August 28, 1975), 7 SEC Docket 719

[104] Section 17A(d)(3)(A)(i) of the Act provides that the Commission and the Federal bank regulatory agencies shall consult with each other at least fifteen days before proposing or adopting any rule concerning transfer agents for which the Commission is not the appropriate regulatory authority

[105] Securities Exchange Act Release No 12440 (May 12, 1976), 9 SEC Docket 627

[106] Securities Exchange Act Release No 11708 (October 3, 1975), 8 SEC Docket 4

[107] SEC, *Preliminary Report on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of Such Securities* (December 4, 1975)

[108] H Conf. Rep. No. 229, 94th Cong., 1st Sess 104 (1975)

[109] Securities Exchange Act Release No. 12030 (February 3, 1976), 8 SEC Docket 1092.

[110] Securities Exchange Act Release No 11872 (November 26, 1975), 8 SEC Docket 535 At the same time, the Commission adopted Securities Exchange Act Temporary Rule 17f-2(T), a blanket exemption from fingerprinting requirements intended to afford the industry sufficient time to prepare to implement a fingerprinting program

[111] Securities Exchange Act Release No 12214 (March 30, 1976), 9 SEC Docket 203

[112] S. Rep No 75, 94th Cong., 1st Sess , 9 (1975).

[113] Securities Exchange Act Release No 11673 (September 23, 1975), 7 SEC Docket 918

[114] Securities Exchange Act Release No 12035 (January 22, 1976), 8 SEC Docket 1099

[115] *See* Securities Exchange Act Release No 12079 (January 6, 1976), 8 SEC Docket 1236, Securities Exchange Release No 12190 (March 10, 1976), 9 SEC Docket 141, Securities Exchange Act Release No 12688 (August 4, 1976), 10 SEC Docket 174.

[116] Securities Exchange Act Release No 12036 (January 22, 1976), 8 SEC Docket 1100

[117] Securities Exchange Act Relase No 11763 (September 23, 1975), 7 SEC Docket 918

[118] Report to Congress on "*The Effect of The Absence of Fixed Rates of Commissions*," December 1, 1975.

[119] Second Report to Congress on "*The Effect of The Absence of Fixed Rates of Commissions*," March 29, 1976.

[120] Third Report to Congress on "*The Effect of The Absence of Fixed Rates of Commissions*," August 10, 1976

[121] Securities Exchange Act Release No. 12251 (March 24, 1976), 9 SEC Docket 259

[122] Securities Exchange Act Release No 11860 (November 20, 1975), 8 SEC Docket 473

[123] See Securities Exchange Act Section 15A(b)(6)

[124] Securities Act Release No 5673 (February 2, 1976), 8 SEC Docket 1192

[125] Securities Act Release No 5707 (May 18, 1976), 9 SEC Docket 671

[126] Securities Act Release No 5699 (April 23, 1976), 9 SEC Docket 472

[127] Securities Act Release No. 5581 (April 28, 1975), 6 SEC Docket 746.

[128] Securities Act Release No 5362 (February 2, 1973), 1 SEC Docket 4

[129] 17 CFR 240 14a-9

[130] Securities Act Release No. 5609 (August 25, 1975), 7 SEC Docket 696.

[131] Investigation in the Matter of Beneficial Ownership, Takeovers and Acquisitions of Securities by Foreign and Domestic Persons, Securities Act Release No 5526 (September 9, 1974), 5 SEC Docket 115; Securities Act Release No 5538 (November 5, 1975), 5 SEC Docket 406.

[132] Securities Exchange Act Release No 11617 (August 25, 1975), 7 SEC Docket 712

[133] Securities Exchange Act of 1934, Section 12(m)

[134] Securities Act Release No 5526 (September 9, 1974), 5 SEC Docket 115; Securities Act Release No 5538 (November 5, 1975), 5 SEC Docket 406

[135] Securities Act Release No 5728 (July 26, 1976), 10 SEC Docket 92

[136] The proposed amendments would amend the Rule as to Use of Forms S-7 and S-16 to (1) allow their use if the issuer has any class of securities registered on a national securities exchange, (2) require compliance with Sections 13 and 14 of the Exchange Act for three calendar years and timely filing thereunder for twelve calendar months, (3) reduce the no-default requirement to three years; (4) reduce the net income requirement to $250,000 for three of the last four fiscal years, including the latest fiscal year, and (5) eliminate the continuity of management and earned dividends requirements

[137] The proposed amendments to Forms S-7 and S-16 published for comment in Securities Act Release No 5613 (September 11, 1975), 7 SEC Docket 827, were incorporated in the present proposals and repub-

lished for comment

[138] Securities Act Release No 5723 (July 2, 1976), 9 SEC Docket 1014

[139] Securities Act Release No. 5530 (October 3, 1974), 5 SEC Docket 208

[140] Securities Exchange Act Release No 12619 (July 12, 1976), 10 SEC Docket 15

[141] The items to be transferred to Form 10–Q include Item 3 (Legal Proceedings); Item 4 (Changes in Securities), Item 5 (Changes in Security for Registered Securities), Item 7 (Increase in Amount of Securities Outstanding), Item 8 (Decrease in Amount of Securities Outstanding); and Item 11 (Submission of Matters to a Vote of Security Holders)

[142] Securities Exchange Act Release No 12506 (June 2, 1976), 9 SEC Docket 760

[143] Securities Act Release No 5717 (June 8, 1976), 9 SEC Docket 818

[144] Securities Exchange Act Release No 12598 (July 7, 1976), 9 SEC Docket 1030

[145] Securities Exchange Act Release No 12599 (July 7, 1976), 9 SEC Docket 1040

[146] Securities Exchange Act Release No 12374 (April 23, 1976), 9 SEC Docket 487

[147] 9 SEC Docket 540

[148] Securities Act Release No 5569, 6 SEC Docket 257

[149] The background of this proceeding and Judge Richey's opinion are described in greater detail in the Commission's 41st Annual Report at page 25

[150] Securities Act Release No 5627 (October 14, 1975), 8 SEC Docket 41

[151] Securities Act Release No 5706 (May 12, 1976), 9 SEC Docket 612

[152] Securities Act Release No 5588 (May 30, 1975), 7 SEC Docket 62

[153] Accounting Series Release No 180 (November 4, 1975), 8 SEC Docket 324

[154] Staff Accounting Bulletin No 1 (November 4, 1975), 8 SEC Docket 364

[155] Staff Accounting Bulletin No 4 (January 29, 1976), 8 SEC Docket 1181

[156] Staff Accounting Bulletin No 5 (February 13, 1976), 8 SEC Docket 1330

[157] Staff Accounting Bulletin No 6 (March 1, 1976), 9 SEC Docket 115

[158] Staff Accounting Bulletin No 7 (March 23, 1976), 9 SEC Docket 295, Staff Accounting Bulletin No 9 (June 17, 1976), 9 SEC Docket 916

[159] Accounting Series Release No 181 (November 10, 1975), 8 SEC Docket 402

[160] Securities Act Release No 5601 (July 31, 1975), 7 SEC Docket 457

[161] Securities Act Release No 5622 (October 1, 1975), 7 SEC Docket 969

[162] 45 U S C 801 (February 5, 1976)

[163] Securities Act Release No 5691 (March 17, 1976), 9 SEC Docket 180

[164] Investment Company Act Release No 9104 (December 30, 1975), 8 SEC Docket 932

[165] Investment Company Act Release No 9161 (February 17, 1976), 8 SEC Docket 1321

[166] Investment Company Act Release No 8888 (August 13, 1975), 7 SEC Docket 588, Investment Company Act Release No 8992 (October 16, 1975), 8 SEC Docket 195

[167] Investment Advisers Act Release No 455 (April 23, 1975), 6 SEC Docket 726

[168] Investment Advisers Act Release No. 471 (August 20, 1975), 7 SEC Docket 662

[169] Investment Advisers Act Release No 506 (April 1, 1976), 9 SEC Docket 359.

[170] Investment Advisers Act Release No 448 (March 31, 1975), 6 SEC Docket 549

[171] Investment Advisers Act Release No 470 (August 20, 1975), 7 SEC Docket 686.

[172] 532 F 2d 584 (C A 8, 1976)

[173] Sup Ct No 75–1870, 75–1872

[174] —— U S ——, 96 S Ct 1375 (March 30, 1976).

[175] Similarly, in an earlier footnote the Court remarked that it "need not consider whether civil liability for aiding and abetting is appropriate under[Section 10(b)] and [Rule 10b–5], not the elements necessary to establish such a cause of action" (96 S Ct at 1380)

[176] 96 S Ct 2126 (1976).

[177] *Id* at 2133, *quoting, Mills* v *Electric Auto-Lite Co*, 396 U S 375, 384 (1970)

[178] —— U S ——, No 75–268 (March 30, 1976)

[179] 12 U S C 94

[180] Section 27 of the Securities Exchange Act, 15 U S C 78aa

[181] 521 F 2d 585 (C A 2, 1975)

[182] 535 F 2d 676 (C A 2, 1976)

[183] 535 F.2d at 678

[184] *Id*

[185] The complaint was filed prior to enactment of the Securities Acts Amendments of 1975 which, among other things, consolidated the Commission's summary trading suspension power in the new Section 12(k) of the Act

[186] 535 F 2d at 678

[187] 533 F 2d 7 (C A D C, 1976)

[188] 17 CFR § 240 7(c)

[189] 531 F 2d 39 (C A 2, 1976) For a discussion of the district court proceedings in this case, *see* 41st Annual Report, p 104.

[190] C A 2, No 75–7203

[191] Section 206 of the Investment Advisers Act of 1940, 15 U S C 80b–6

[192] *See Cort* v *Ash*, 422 U S 66, 78 (1975), *Securities Investor Protection Corp* v *Barbour*, 421 U S 412, 418-420 (1975).

[193] *See* Investment Advisers Act Release No 491 (December 15, 1975), 8 SEC Docket 744

[194] *Cf*, *e g*, *Bolger* v *Laventhol, Krekstein, Horwath & Horwath*, 381 F Supp 360 (S D N Y, 1974) with *Gammage* v *Roberts, Scott & Co*, CCH Fed Sec L Rep ¶94,761 (S D Cal, 1974)

[195] Section 202(a)(11) of the Investment Advisers Act, 15 U S.C. 80b–2(a)(11)

[196] —— F. Supp. —— (S D.N.Y , 1976).

[197] No. 75–1144 (C A. 10, 1976)

[198] No. C–190–73 (D. Utah, Dec. 23, 1974)

[199] 96 Sup. Ct. 1375 (1976).

[200] C A. 2, Docket No 75–7503.

[201] D. Md , Civil Action No 76–676.

[202] C.A. 3, No. 75–2007 (decided June 28, 1976), CCH Fed. Sec L Rep. ¶95,643

[203] *See* 41st Annual Report, p 39

[204] *United States* v *Natelli*, 527 F.2d 311 (C.A 2, 1975).

[205] *See* Litigation Release No 7251.

[206] *See* Litigation Release No 7183

[207] *See* Litigation Release Nos 7207 and 7424

[208] *See* Litigation Release No 7423

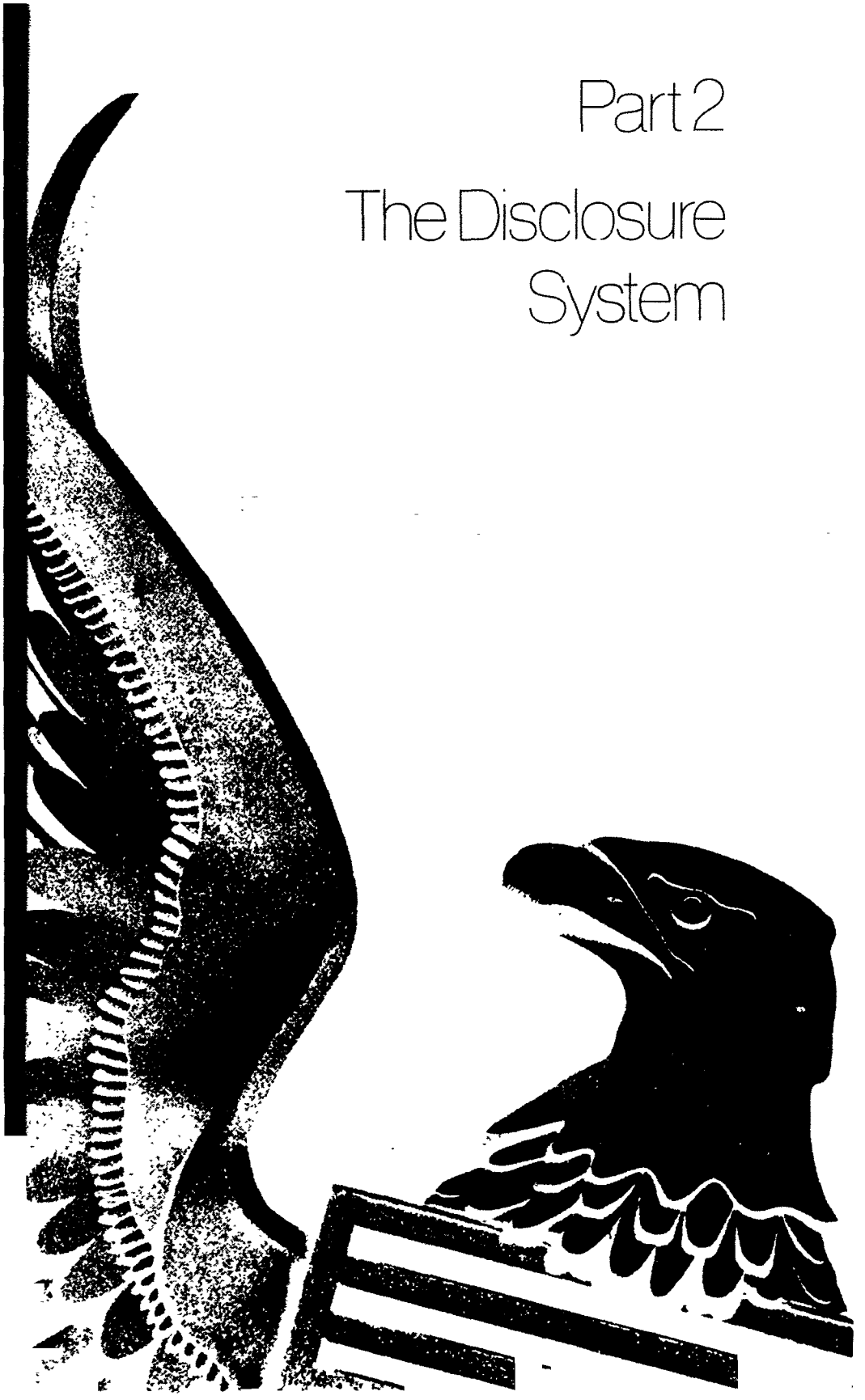
[209] *See* Litigation Release No 7327

[210] *See* Litigation Release No 7383

[211] *See* Litigation Release No 7416

# Part 2

# The Disclosure System



# Part 2

# The Disclosure System

A basic purpose of the Federal securities laws is to provide disclosure of material, financial and other information on companies seeking to raise capital through the public offering of their securities, as well as companies whose securities are already publicly held. This aims at enabling investors to evaluate the securities of these companies on an informed and realistic basis

The Securities Act of 1933 generally requires that before securities may be offered to the public a registration statement must be filed with the Commission disclosing prescribed categories of information Before the sale of securities can begin, the registration statement must become "effective" In the sales, investors must be furnished a prospectus containing the most significant information in the registration statement

The Securities Exchange Act of 1934 deals in large part with securities already outstanding and requires the registration of securities listed on a national securities exchange, as well as over-the-counter securities in which there is a substantial public interest Issuers of registered securities must file annual and other periodic reports designed to provide a public file of current material information The Exchange Act also requires disclosure of material information to holders of registered securities in solicitations of proxies for the election of directors or approval of corporate action at a stockholders' meeting, or in attempts to acquire control of a company through a tender offer or other planned stock acquisition It provides that insiders of companies whose equity securities are registered must report their holdings and transactions in all equity securities of their companies

## PUBLIC OFFERING: THE 1933 SECURITIES ACT

The basic concept underlying the Securities Act's registration requirements is full disclosure The Commission has no authority to pass on the merits of the securities to be offered or on the fairness of the terms of distribution If adequate and accurate disclosure is made, it cannot deny registration The Act makes it unlawful to represent to investors that the Commission has approved or otherwise passed on the merits of registered securities

### Information Provided

While the Securities Act specifies the information to be included in registration statements. the Commission has the authority to prescribe appropriate forms and to vary the particular items of information required to be disclosed To facilitate the registration of securities by different types of issuers, the Commission has adopted special registration forms which vary in their disclosure requirements so as to provide maximum disclosure of the essential facts pertinent in a given type of offering while at the same time minimizing the burden and expense of compliance with the law In recent years, it has adopted certain short forms, notably Forms S-7 and S-16, which do not require disclosure of matters already covered in reports and proxy

material filed or distributed under provisions of the Securities Exchange Act. Another short form for registration under the Securities Act is Form S-8 for the registration of securities to be offered to employees of the issuer and its subsidiaries Recent Commission proposals for the amendment of the three forms referred to above are discussed in Part One of the Annual Report

## Reviewing Process

Registration statements filed with the Commission are examined by its Division of Corporation Finance for compliance with the standards of adequate and accurate disclosure Various degrees of review procedures are employed by the Division.[1] While most deficiencies are corrected through an informal letter of comment procedure, where the Commission finds that material representations in a registration statement are misleading, inaccurate, or incomplete, it may, after notice and opportunity for hearing, issue a "stop-order" suspending the effectiveness of the statement

## Time for Registration

The Commission's staff tries to complete examination of registration statements as quickly as possible The Securities Act provides that a registration statement shall become effective on the 20th day after it is filed (or on the 20th day after the filing of any amendment). Most registration statements require one or more amendments and do not become effective until some time after the statutory 20-day period The period between the filing and effective date is intended to give investors an opportunity to become familiar with the proposed offering through the dissemination of the preliminary form of prospectus The Commission can accelerate the effective date to shorten the 20-day waiting period—taking into account, among other things, the adequacy of the information on the issuer already available to the public and the ease with which facts about the offering can be understood

During the 1976 fiscal year, 2,801 registration statements became effective. Of these, 289 were amendments filed by investment companies pursuant to Section 24(e) of the Investment Company Act of 1940, which provides for the registration of additional securities through amendment to an effective registration statement rather than the filing of a new registration statement For the remaining 2,512 statements, the median number of calendar days between the date of the original filing and the effective date was 29.

## Financial Analysis and Examination

During the fiscal year, the Office of the Chief Financial Analyst of the Division of Corporation Finance began a quarterly publication for the staff about the current status of the nation's economy and significant trends affecting specific industries. It provides the staff with interpretation of leading economic indicators, with identification and description of new vehicles of financing and with projections on type and volume of prospective financing It also comments on novel financing patterns devised to obscure the true nature of reported transactions, uncovered through a quarterly review of investigatory files of the Division of Enforcement.

By the end of the fiscal year, the Office of the Chief Financial Analyst initiated an intensive review of the real estate industry, now in progress.

## Office of Oil and Gas

The Division's Office of Oil and Gas has processing responsibility for all oil and gas drilling program filings, as well as filings covering fractional undivided interests in oil and gas rights Fifty registration statements were filed during fiscal 1976 for oil and gas drilling programs, totaling $530,338,420 And fifteen registration statements covering fractional undivided interests in oil and gas rights were filed aggregating $4,988,775.

In addition to the direct processing of those filings, the Office of Oil and Gas is responsible for reviewing the disclosure relating to the oil and gas business and properties, including data on production and reserves of oil and gas, contained in other filings directly processed by the several branches of the Division of Corporation Finance In fiscal year 1976, such other filings consisted of 208 registra-

tion statements under the Securities Act and 8 offering circulars pursuant to the Regulation A exemption thereunder, as well as 74 registration statements and proxy statements under the Exchange Act

Additional information regarding offerings of fractional undivided interests is contained under Regulation B in this part.

## Real Estate and Other Tax Shelters

On March 17, 1976,[2] the Commission adopted a guide to the "Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships" Originally proposed for public comment on March 1, 1974,[3] the guide contains the comments and suggestions developed by the Division of Corporation Finance in processing registration statements relating to real estate limited partnerships. The guide generally emphasizes disclosure relating to the risk and the conflict of interest inherent in many such offerings, the compensation paid to the program sponsors, the performance record of the sponsors in prior offerings, and the tax ramification of these types of offerings.

As a result of the guide's adoption and the recent decline in registration statements relating to real estate limited partnerships, the Division is no longer processing these filings in one specialized branch However, registration statements relating to other non-oil and gas types of tax shelters, such as cattle feeding and breeding, agribusiness and leasing, as well as condominium offerings, will continue to be processed in a separate branch

## SMALL ISSUE EXEMPTION

The Commission is authorized under Section 3(b) of the Securities Act to exempt securities from registration if it finds that registration for these securities is not necessary to the public interest because of the small offering amount or limited character of the public offering. The law imposes a maximum limitation of $500,000 upon the size of the issues which may be exempted by the Commission.

The Commission has adopted the following exemptive rules and regulations·

| | |
|---|---|
| Regulation A | General exemption for U.S and Canadian issues up to $500,000. |
| Regulation B | Exemption for fractional undivided interests in oil or gas rights up to $250,000 |
| Regulation E· | Exemption for securities of a small business investment company up to $500,000. |
| Regulation F· | Exemption for assessments on assessable stock and for assessable stock offered or sold to realize the amount of assessment up to $300,000 |
| Rules 234-237; 240· | Exemptions of first lien notes, securities of cooperative housing corporations, shares offered in connection with certain transactions, certain securities owned for five years and certain limited offers and sales of small dollar amounts of securities by closely-held issuers. |

## Regulation A

Regulation A permits a company to obtain needed capital not in excess of $500,000 (including underwriting commissions) in any one year from a public offering of its securities without registration, provided specified conditions are met Among other things, a notification and offering circular supplying basic information about the company and the securities offered must be filed with the Commission, and the offering circular must be used in the offering In addition, Regulation A permits selling shareholders not in a control relationship with the issuer to offer in the aggregate up to $300,000 of securities which would not be included in computing the issuer's $500,000 ceiling

During the 1976 fiscal year, 240 notifications were filed under Regulation A, covering proposed offerings of $83,528,448 compared with 265 notifications covering proposed offerings of $91,287,296 in the prior year. A total of 478 reports of sales were filed reporting aggregate sales of $41,116,935 Such reports must be filed every six months while an offering is in progress and upon its termi-

nation Sales reported during 1975 had totaled $49 million Various features of Regulation A offerings over the past three years are presented in the statistical section of the report

In fiscal 1976, the Commission temporarily suspended 10 exemptions where it had reason to believe there had been noncompliance with the conditions of the regulation or with disclosure standards, or where the exemption was not available for the securities Added to 8 cases pending at the beginning of the fiscal year, this resulted in a total of 18 cases for disposition Of these, the temporary suspension order became permanent in 12 cases in 3 by lapse of time, in 2 after hearings, and in 7 by acceptance of an offer of settlement Six cases were pending at the end of the fiscal year

## Regulation B

Regulation B provides an exemption from registration under the Securities Act for public offerings of fractional undivided interests in oil and gas rights where the initial amount to be raised does not exceed $250,000, provided certain conditions are met An offering sheet disclosing certain basic and material information of such offering must be furnished to prospective purchasers at least 48 hours in advance of sale of these securities

Form S–10 is available for the registration of fractional undivided interests in oil and gas rights where the initial amount to be raised exceeds $250,000 or where the exemption is unavailable for any other reason

During the 1976 fiscal year, 365 offering sheets and 462 amendments thereto were filed pursuant to Regulation B and were examined by the Office of Oil and Gas of the Division of Corporation Finance Sales during 1976 under these offerings aggregated $22 5 million During the 1975 fiscal year, 625 offering sheets and 672 amendments were filed covering aggregate sales of $35 4 million For the fiscal year 1974, 625 offering sheets were filed with 751 amendments thereto, covering aggregate sales of $29 1 million

In fiscal 1976, the Commission temporarily suspended the Regulation B exemption for 27 offerors where it had evidence that the offerors had failed to comply with certain requirements

On December 30, 1975, the Commission amended Rule 310 under Regulation B under the Securities Act[4] and adopted a statement regarding selling practices under that regulation The amendment requires the furnishing of satisfactory assurance to the Commission that the relevant State securities administrators have been notified of a proposed offering pursuant to Regulation B

The Commission took the opportunity in this release to caution offerors regarding their responsibility under the Federal securities laws, in view of recent allegations that certain offerors under Regulation B have been engaged in high pressure sales campaigns

On December 23, 1975, the Commission proposed an amendment to Rule 306 under Regulation B[5] to require interests exempt under that regulation to be offered or sold only by registered brokers or dealers. Under the amendment, the issuer would not have to be a registered broker or dealer if all offers and sales of interests created by the issuer for purposes of an offering pursuant to Regulation B were made exclusively by a registered broker or dealer

## Regulation E

Under Section 3(c) of the Securities Act, the Commission is authorized to adopt rules and regulations exempting securities issued by a small business investment company under the Small Business Investment Act Pursuant to that section, the Commission has adopted Regulation E, which conditionally exempts such securities issued by companies registered under the Investment Company Act of 1940 up to a maximum offering price of $500,000. The regulation is substantially similar to Regulation A, described above No notifications were filed under Regulation E for the two preceding fiscal years

## Regulation F

Regulation F provides exemptions from registration for two types of transactions concerning assessable stock First, an assessment levied upon an existing security holder may be exempted under the regulation, provided the assessable stock is issued by a corporation incorporated under the laws of and having its principal business operations

in any State, Territory or the District of Columbia Regulation F provides an exemption also when assessable stock of any such corporation is sold publicly to realize the amount of an assessment levied thereon, or when such stock is publicly reoffered by an underwriter or dealer The exemption is available for amounts not exceeding $300,000 per year The Regulation requires the filing of a notification and other materials describing the offering

During the 1976 fiscal year, 15 notifications were filed under Regulation F, covering assessments of stock of $356,318, compared with 15 notifications covering assessments of $380,318 in 1975

## CONTINUING DISCLOSURE: THE SECURITIES EXCHANGE ACT

The Securities Exchange Act of 1934 contains significant disclosure provisions designed to provide a fund of current material information on companies in whose securities there is a substantial public interest The Act also seeks to assure that security holders who are solicited to exercise their voting rights, or to sell their securities in response to a tender offer, are furnished pertinent information

### Registration on Exchanges

Generally speaking, a security cannot be traded on a national securities exchange until it is registered under Section 12(b) of the Exchange Act If it meets the listing requirements of the particular exchange, an issuer may register a class of securities on the exchange by filing with the Commission and the exchange an application which discloses pertinent information concerning the issuer and its affairs During fiscal year 1976, a total of 90 issuers listed and registered securities on a national securities exchange for the first time and a total of 331 registration applications were filed The registrations of all securities of 117 issuers were terminated Detailed statistics regarding securities traded on exchanges may be found in the statistical section

### Over-the-Counter Registration

Section 12(g) of the Exchange Act requires a company with total assets exceeding $1 million and a class of equity securities held of record by 500 or more persons to register those securities with the Commission, unless one of the exemptions set forth in that section is available or the Commission issues an exemptive order under Section 12(h) Upon registration, the reporting and other disclosure requirements and the insider trading provisions of the Act apply to these companies to the same extent as to those with securities registered on exchanges

During the fiscal year, 241 registration statements were filed under Section 12(g) Of these, 93 were filed by issuers already subject to the reporting requirements, either because they had another security registered on an exchange or they had registered securities under the Securities Act. Included are companies which succeeded to the businesses of reporting companies, and thereby became subject to the reporting requirements

### Exemptions

Section 12(h) of the Act authorizes the Commission to grant a complete or partial exemption from the registration provisions of Section 12(g) or from other disclosure and insider trading provisions of the Act where it is not contrary to the public interest or the protection of investors

At the beginning of the year, 17 exemption applications were pending, and 38 applications were filed during the year Of these 55 applications, 3 were withdrawn, 18 were granted, and 7 denied The remaining 27 applications were pending at the end of the fiscal year

### Periodic Reports

Section 13 of the Securities Exchange Act requires issuers of securities registered pursuant to Sections 12(b) and 12(g) to file periodic reports, keeping current the information contained in the registration application or statement Similar reports are required pursuant to Section 15(d) of certain issuers which have filed registration statements under the Securities Act which have become effective

In 1975, 54,640 reports—annual, quarterly and current—were filed

In 1976, 53,056 reports—annual, quarterly and current—were filed

## Proxy Solicitations

Where proxies are solicited from holders of securities registered under Section 12 or from security holders of registered public-utility holding companies, subsidiaries of holding companies, or registered investment companies, the Commission's proxy regulation requires that disclosure be made of all material facts concerning the matters on which the security holders were asked to vote and that they be afforded an opportunity to vote "yes" or "no" on any matter other than the election of directors Where management is soliciting proxies, a security holder desiring to communicate with the other security holders may require management to furnish him with a list of all security holders or to mail his communication for him A security hlder may also, subject to certain limitations, require the management to include in proxy material an appropriate proposal which he wants to submit to a vote of security holders, or he may make an independent proxy solicitation

Copies of proposed proxy material must be filed with the Commission in preliminary form prior to the date of the proposed solicitation Where preliminary material fails to meet the prescribed disclosure standards, the management or other group responsible for its preparation is notified informally and given an opportunity to correct the deficiencies in the preparation of the definitive proxy material to be furnished to security holders

Issuers of securities registered under Section 12 must transmit an information statement comparable to proxy material to security holders from whom proxies are not solicited with respect to a stockholders' meeting

During the 1976 fiscal year, 6,898 proxy statements in definitive form were filed, 6,807 by management and 9 by nonmanagement groups or individual stockholders In addition, 82 information statements were filed The proxy and information statements related to 6,639 companies, and pertained to 6,616 meetings for the election of directors, 234 special meetings not involving the election of directors, and 39 assents and authorizations

Aside from the election of directors, the votes of security holders were solicited with respect to a variety of matters, including mergers, consolidations, acquisitions, sales of assets and dissolution of companies (190), authorizations of new or additional securities, modifications of existing securities, and recapitalization plans (467), employee pension and retirement plans (58), bonus or profit-sharing plans and deferred compensation arrangements (251), stock option plans (529), approval of selection by management of independent auditors (3,431) and miscellaneous amendments to charters and by-laws, and other matters (1,761)

During the 1976 fiscal year, 477 proposals submitted by 121 stockholders for action at stockholders' meetings were included in the proxy statements of 242 companies Typical of such proposals submitted to a vote of security holders were resolutions on amendments to charters or by-laws to provide for cumulative voting for the election of directors, preemptive rights, limitations on the grant of stock options to and their exercise by key employees and management groups and the sending of a post-meeting report to all stockholders

A total of 268 proposals submitted by 91 stockholders were omitted from the proxy statements of 133 companies in accordance with the provisions of the rule governing such proposals The most common grounds for omission were that proposals were not submitted on time, were not proper subjects for stockholders' action under the applicable State law, or were not significantly related to the issuer's business

During the year, representatives of the American Jewish Congress submitted essentially the same shareholder proposal to 55 companies The proposal requested the Board of Directors of each company to provide the sharholders with a written report describing various aspects of the company's policy towards compliance with the demands of the Arab boycott In 7 instances, the staff refused to agree with the management of the company that the proposal might be omitted from the company's proxy material in accordance with the provisions of the rule governing such proposals The proponent withdrew the proposal in 8 instances, and the staff issued no-action letters agreeing with the management of the company that the proposal might be omitted in 40 cases The grounds for omission were as follows the proposal was

not timely submitted (22), the proposal was not substantially related to the issuer's business (16) and the proponent was not a security holder eligible to vote at the company's meeting (2).

In fiscal 1976, 18 companies were involved in proxy contests for the election of directors which bring special requirements into play In these contests, 510 persons, including both management and nonmanagement, filed detailed statements required of participants under the applicable rule Control of the board of directors was involved in 15 instances In 4 of these, management retained control Of the remainder, four were settled by negotiation, two were won by nonmanagement persons, and five were pending at year end In the other three cases, representation on the board of directors was involved Management retained all places on the board in one contest, opposition candidates won places on the board in two cases

## Takeover Bids, Large Acqusitions

Sections 13(d) and (e), and 14(d), (e) and (f) of the Securities Exchange Act, enacted in 1968 and amended in 1970, provide for full disclosure in cash tender offers and other stock acquisitions involving changes in ownership or control These provisions were designed to close gaps in the full disclosure provisions of the securities laws and to safeguard the interest of persons who tender their securities in response to a tender offer

During the 1976 fiscal year, 1,077 Schedule 13D reports were filed by persons or groups which had made acquisitions resulting in their ownership of more than five percent of a class of securities One hundred seven Schedule 13D reports were filed by persons or groups making tender offers (including 14 tender offers filed with the Commission by foreign nationals), which, if successful, would result in more than five percent ownership In addition, 64 Schedule 14D reports were filed on solicitations or recommendations in a tender offer by a person other than the maker of the offer Eight statements were filed for the replacement of a majority of the board of directors otherwise than by stockholder vote Three statements were filed under a rule on corporate reacquisitions of securities while an issuer is the target of a cash tender offer

Rule 14d–2 under the Exchange Act exempts certain communications involved in a tender offer from the provisions of Regulation 14D Among such communications are those from an issuer to its security holders which do no more than identify the tender offer, state that management is studying the proposal and request the security holders to defer making a decision on the tender offer until they receive management's recommendation Such recommendations must be made no later than 10 days before expiration of the tender offer, unless the Commission authorizes a shorter period

## Insider Reporting

Section 16 of the Securities Exchange Act and corresponding provisions in the Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940 are designed to provide other stockholders and investors generally with information on insider securities transactions and holdings, and to prevent unfair use of confidential information by insiders to profit from short-term trading in a company's securities.

Section 16(a) of the Exchange Act requires every person who beneficially owns, directly or indirectly, more than 10 percent of any class of equity security which is registered under Section 12, or who is a director or an officer of the issuer of any such security, to file statements with the Commission disclosing the amount of all equity securities of the issuer of which he is the beneficial owner and changes in such ownership Copies of such statements must be filed with exchanges on which the securities are listed Similar provisions applicable to insiders of registered public-utility holding companies and registered closed-end investment companies are contained in the Holding Company and Investment Company Acts

In fiscal 1976, 91,894 ownership reports were filed These included 10,898 initial statements of ownership on Form 3, 76,154 statements of changes in ownership on Form 4, and 4,842 amendments to previously filed reports

All ownership reports are made available for public inspection when filed at the Commission's office in Washington and at the exchanges where copies are filed In addition, the information contained in reports filed with the Commission is summarized and pub-

lished in the monthly "Official Summary of Security Transactions and Holdings," which is distributed by the Government Printing Office to about 11,600 subscribers

## ACCOUNTING AND AUDITING STANDARDS

The securities acts reflect a recognition by Congress that dependable financial statements of a company are indispensable to informed investment decisions regarding its securities A major objective of the Commission has been to improve accounting, reporting, and auditing standards applicable to the financial statements and to assure that high standards of professional conduct are maintained by the public accountants who examine the statements The primary responsibility for this program rests with the Chief Accountant of the Commission

Under the Commission's broad rulemaking power, it has adopted a basic accounting regulation (Regulation S-X) which, together with interpretations and guidelines on accounting and reporting procedures published as "Accounting Series Releases," governs the form and content of financial statements filed in compliance with the securities laws The Commission has also formulated rules on accounting for and auditing of broker-dealers and prescribed uniform systems of accounts for mutual and subsidiary service companies related to holding companies subject to the Public Utility Holding Company Act of 1935 The accounting rules and opinions of the Commission, and its decisions in particular cases, have contributed to clarification and wider acceptance of the accounting principles and practices and auditing standards developed by the profession and generally followed in the preparation of financial statements

However, the accounting and financial reporting rules and regulations—except for the uniform systems of accounts which are regulatory reports—prescribe accounting principles to be followed only in certain limited areas In the large area of financial reporting not covered by its rules, the Commission's principal means of protecting investors from inadequate or improper financial reporting is by requiring a report of an independent public accoutant, based on an audit performed in accordance with generally accepted auditing standards, which expresses an opinion whether the financial statements are presented fairly in conformity with accounting principles and practices that are recognized as sound and have attained general acceptance The requirement that the opinion be rendered by an independent accountant, which was initially established under the Securities Act, is designed to secure for the benefit of public investors the detached objectivity and the skill of a knowledgeable, professional person not connected with management

The accounting staff reviews the financial statements filed with the Commission to insure that the required standards are observed and that the accounting and auditing procedures do not remain static in the face of changes and new developments in financial and economic conditions. New methods of doing business, new types of business, the combining of old businesses, the use of more sophisticated securities, and other innovations create accounting problems which require a constant reappraisal of the procedures

### Relations With the Accounting Profession

In order to keep abreast of changing conditions, and in recognition of the need for a continuous exchange of views and information between the Commission's accounting staff and outside accountants regarding appropriate accounting and auditing policies, procedures and practices, the staff maintains continuing contact with individual accountants and various professional organizations The latter include the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB), the principal professional organizations concerned with the development and improvement of accounting and auditing standards and practices The Chief Accountant also meets regularly with his counterparts in other regulatory agencies to improve coordination on policies and actions among the agencies

Because of its many foreign registrants and the vast and increasing foreign operations of American companies, the Commission has an interest in the improvement of accounting and auditing principles and procedures on an international basis To promote such im-

provement, the Chief Accountant corresponds with foreign accountants, interviews many who visit this country and, on occasion, participates in foreign and international accounting conferences.

Professional efforts are being made to improve and harmonize accounting standards among countries through various international accounting conferences and committees One committee, comprised of representatives from thirty-five countries, was established to promulgate international accounting standards This committee has adopted three standards, has proposed a number of other standards and is developing additional proposals. The Commission will continue to cooperate closely with these committees and groups which have as their long-term objective the development of a coordinated worldwide accounting profession with uniform standards

## Accounting and Auditing Standards

The FASB supplanted the Accounting Principles Board of the AICPA in 1973 as the professional organization which establishes standards of financial accounting and presentation for the guidance of issuers of financial statements and public accountants who examine such statements The organization was established on the basis of recommendations by a committee appointed by the AICPA to explore ways of improving this function. The FASB is comprised of seven full-time salaried members who are appointed by a financial accounting foundation that is sponsored by the AICPA and consists of representatives of leading professional organizations The foundation also appoints the members of an advisory council to the Board who serve on a voluntary basis The Commission endorsed[6] the FASB, which it believes will provide operational efficiencies and insure an impartial viewpoint in the development of accounting standards on a timely basis, and stated that the FASB's statements and interpretations would be considered as being substantial authoritative support for an accounting practice or procedure

As of June 30, 1976, the FASB had issued twelve Statements of Financial Accounting Standards and nine Interpretations relating to accounting opinions or standards In addition, it had under active consideration a heavy agenda of technical projects which included financial reporting for segments of a business enterprise, accounting for leases, criteria for determining materiality, conceptual framework for accounting and reporting, financial reporting in units of general purchasing power, business combinations and purchased intangibles, accounting for interest costs, accounting and reporting for employee benefit plans, accounting for the cost of pension plans, financial accounting and reporting in the extractive industries, interim financial reporting, classification of preferred stock, and accounting by debtors and creditors when debt is restructured It had held public hearings on six of the projects and had issued exposure drafts of three proposed statements of standards

The FASB has appointed a permanent screening committee to assist it in identifying emerging practice problems, evaluating their magnitude and urgency, and assessing priorities for their resolution The Chief Accountant and the FASB maintain liaison procedures for consultation on projects of either the Board or the SEC which are of mutual interest. Special liaison procedures have been established regarding the financial accounting and reporting in the extractive industries, because the Energy Policy and Conservation Act of 1975 authorizes the Commission to assure the development and observation of accounting practices by companies engaged in the production of crude oil or natural gas by December 1977 In carrying out these responsibilities, the Commission is required to consult with the Federal Energy Administration, the General Accounting Office, and the Federal Power Commission, and it is authorized to rely on accounting practices developed by the FASB, if the Commission is assured that such practices will be observed to the same extent as if the Commission had prescribed such practices by rule

When the FASB issues improved standards of accounting and financial reporting, the Commission revises its rules and regulations to conform to the improved standards For example, amendments to its regulations were adopted[7] to effect conformity with the standards established in FASB Statement Nos 2 and 7, "Accounting for Research and Devel-

opment Costs" and "Accounting and Reporting by Development Stage Enterprises."

The AICPA appointed another committee to study and refine the objectives of financial statements. It considered the basic questions of who needs financial statements, what information should be provided, how it should be communicated, and how much of it can be provided through the accounting process The committee's report on the objectives of financial statements is being utilized by the FASB as the basis of its study of the conceptual framework for accounting and reporting

More recently, the AICPA established an independent "Commission on Auditor's Responsibilities" which is studying the role of independent auditors to identify auditors' responsibilities in relation to the needs and reasonable expectations of users of financial statements and to recommend actions that the profession should take to assure that independent auditors discharge those responsibilities adequately

This Commission has published a statement of the issues being considered in this study which are summarized in four categories below.

- General issues—
  - The role of the independent auditor
  - Gap between performance and expectations
- The auditor's present responsibilities—
  - Forming an opinion on financial presentations
  - Clarifying the responsibility for detection of frauds
  - Reporting uncertainities
  - Detecting and disclosing adverse management behavior
  - Improving communication in the auditor's standard report
  - Improving auditing methods and techniques
- Extension of the auditor's role—
  - New forms of reporting
  - Evaluating the relationship of nonauditing services to the audit function
- The institutional framework of the audit function—
  - Organizational structure for regulating the profession
  - Policies and procedures for maintaining the quality of audit practice
  - Process of establishing auditing standards
  - Developing individuals as independent auditors
  - Relationships between the auditor and parties interested in the audit function
  - The legal environment of independent auditors.

The Chief Accountant also maintains liaison with other senior committees of the AICPA on projects of mutual interest, principally proposed audit guides and standards of the Auditing Standards Executive Committee and the proposed statements of position of the Accounting Standards Executive Committee Regular meetings are held with the Committee on SEC Regulations to provide information and guidance to the profession concerning the interpretation of and compliance with the Commission's accounting and auditing requirements applicable to registrants and their independent accountants.

## Other Developments

The Commission announced[8] the institution of a new publication series entitled "Staff Accounting Bulletins" in November 1975 to provide information to the public regarding informal and administrative practices and guidelines developed by the accounting staff with respect to specific accounting and auditing problems considered in the review of financial data filed During the fiscal year nine Bulletins[9] were issued.

The Commission issued 17 Accounting Series Releases during the year to provide interpretations or guidelines on matters of accounting principles and auditing standards, to require improved disclosure of financial information by amendment of registration and periodic report forms or Regulation S-X, or to announce decisions in disciplinary proceedings under Rule 2(e) of the Commission's Rules of Practice concerning accountants appearing before it.

Eight releases effected amendments to registration and periodic report forms or Regulation S-X to establish or improve requirements pertaining to the form, content or disclosure in financial statements in the following areas:

(1) Separate financial statements of finan-

cial subsidiaries included in consolidated statements;[10]

(2) Interim financial reporting,[11]

(3) Accounting for research and development costs;[12]

(4) Financial reporting by companies in the development state;[13]

(5) Form and content of financial statements of insurance companies other than life and title insurance companies;[14]

(6) Disclosures regarding leases, compensating balances, and income tax expense;[15]

(7) Financial statements of bank holding companies and banks;[16]

(8) Disclosure of certain replacement cost data[17]

The amendment of Regulation S-X relating to replacement cost data requires the disclosure in a note to financial statements of the current cost at the end of a reporting period of replacing inventories and productive capacity and the amounts of cost of sales, depreciation, depletion and amortization expense computed on the basis of replacement cost during the reporting period. Concurrently with the release adopting that amendment, the Commission published[18] a proposed "safe harbor" rule to insulate persons from legal liabilities that some commentators expressed concern about in regard to disclosure of such data based on subjective judgments and estimates. The Commission also announced its intention to appoint a committee to advise the Chief Accountant on various difficult, complex and technical questions concerning implementation of the new replacement cost rule This advisory committee, which is comprised of 29 persons from industry and the accounting profession, meets regularly with the Chief Accountant and staff to resolve the questions that have been solicited from registrants, accountants and others interested in the problem. The Chief Accountant has also conferred with accounting authorities and government officials in the United Kingdom and The Netherlands regarding their experiences in this area of financial accounting and reporting

The amendments adopted relating to interim financial reporting require condensed financial statements and a narrative analysis of the results of operations to be included in quarterly reports filed and summary data regarding the quarterly results in a fiscal year to be included in a note to the financial statements filed for a fiscal year These requirements were adopted only after alternative proposals[19] and were considered at public hearings[20] In fact, the Commission issued for public comment proposed standards and procedures to be applicable to the review of the interim financial data by independent accountants in the absence of adequate standards and procedures promulgated by the accounting profession.[21] Subsequently, this proposal was withdrawn[22] when Statement on Auditing Standards No 10, "Limited Review of Interim Financial Information," was issued by the AICPA

Other proposed rulemaking releases issued for public comment during the latter part of the fiscal year included (1) amendments which would require life insurance companies and holding companies having only life insurance subsidiaries to file quarterly financial data in notes to annual financial statements,[23] (2) technical amendments of various captions in Regulation S-X requirements for financial statements of insurance companies,[24] and (3) an amendment to Regulation S-X which would modify requirements for reporting certain disagreements with former accountants regarding accounting and financial disclosure matters[25] This latter amendment was adopted,[26] substantially as proposed, shortly after the end of the fiscal year

An interpretive release[27] was issued which provided interpretations and guidelines regarding disclosure by registrants of holdings of securities of New York City and accounting for securities subject to exchange offer and moratorium Concurrently, a proposed amendment to Regulation S-X was published[28] for comment which would require footnote disclosure by all registrants of certain concentrations in securities holdings, as a part of a more generalized effort to deal with the fact that significant concentrations of holdings in any security may warrant disclosure This proposal remains under consideration

The Commission issued opinions in eight proceedings against accountants or accounting firms pursuant to Rule 2(e) of the Rules of Practice during the fiscal year. Under that rule, the Commission may disqualify an attorney or an accountant from practicing before it, either temporarily or permanently, or it may

censure him on grounds specified in the rule. One proceeding[29] was instituted on the basis of the Commission's civil injunctive complaints against a firm's examinations of financial statements of four companies and questions raised in an investigation regarding the firm's audit of the financial statements of another company Under the opinion, the firm was required to have an investigation made of its audit practices with respect to the financial statements of client-registrants of the Commission and to promptly adopt and implement any recommended corrective actions, the firm was required to conduct a study of the percentage of completion method of accounting and establish guidelines to be applied in the conduct of future audits, the firm for a period of six months was not permitted to accept engagements from new clients (with certain exceptions) to examine financial statements to be filed with the Commission, and the firm is required to have reviews conducted in 1976 and 1977 in conformity with the American Institute of Certified Public Accountants' program for the review of quality control procedures of multi-office firms to determine whether the firm has adopted and implemented procedures agreed upon in the proceedings and any corrective actions recommended in the prior required investigation

Three proceedings were instituted on the basis of investigations in which the Commission found that accounting firms did not perform the audits of financial statements of registrants filed with the Commission in accordance with generally accepted auditing standards In one proceeding, the accounting firm was censured by the Commission [30] In the second proceeding, the accounting firm was ordered to employ consultants to review and evaluate its auditing procedures and professional practice in connection with the audits of publicly-held companies and report its conclusions to the Commission, and the firm was ordered not to accept engagements to examine new clients' financial statements to be filed with the Commission until one month after the submission of the consultants' report to the Commission [31] In the third proceeding, the accounting firm was censured and required to participate in a local firm quality peer-review program conducted by the AICPA; and a former partner, who had been the partner in charge of the audit, was suspended from practice before the Commission as an accountant for 60 days and was required to undertake a program of continuing professional education consistent the guidelines recommended by the AICPA [32]

Four proceedings were instituted against accountants on the basis of injunctive actions wherein the accountants were permanently enjoined from violating certain sections of the securities laws. In one proceeding, the Commission ordered that the accountant be suspended from appearing or practicing before it, that he may apply for reinstatement after two years and that his application shall be granted, if (a) there is a showing that he has attended 100 or more hours of professional seminars or courses dealing with registration and disclosure requirements of the Federal securities laws and generally accepted accounting principles and auditing standards, and (b) nothing has occurred during the suspension period that would be a basis for adverse action against him under Rule 2(e) of the Commission's Rules of Practice [33]

In another proceeding, the accountant was permanently suspended from appearing or practicing before the Commission [34] In a third proceeding, the Commission ordered that the accountant be prohibited from appearing or practicing before it as an accountant other than as an employee of an accountant or as a consultant under the supervision of an accountant, and that after 22 months the accountant may apply for reinstatement, provided that satisfactory evidence is submitted of his professional competence as an accountant in his employment during the 22-month period and of his attendance in at least 40 hours of courses or seminars relating to public accounting or auditing in the 12 months immediately preceding his application for readmission [35] In a fourth proceeding, the accountant's resignation from appearing or practicing before the Commission was accepted [36]

## EXEMPTIONS FOR INTERNATIONAL BANKS

Section 15 of the Bretton Woods Agreement Act, as amended, exempts from registration securities issued, or guaranteed as to both principal and interest, by the Interna-

tional Bank for Reconstruction and Development. The Bank is required to file with the Commission such annual and other reports on securities as the Commission determines to be appropriate The Commission has adopted rules requiring the Bank to file quarterly reports and copies of annual reports of the Bank to its Board of Governors The Bank is also required to file advance reports of any distribution in the United States of its primary obligations The Commission, acting in consultation with the National Advisory Council on International Monetary and Financial Problems, is authorized to suspend the exemption for securities issued or guaranteed by the Bank The following summary of the Bank's activities reflects information obtained from the Bank Except where otherwise indicated, all amounts are expressed in U S dollar equivalents as of June 30, 1976

Net income for the year was $220 million, compared with $275 million the previous year Of the $220 million net income earned in the fiscal year ended June 30, 1976, the Executive Directors of the Bank in July 1976 approved the allocation of $120 million to the General Reserve and recommended to the Board of Governors of the Bank that the balance of $100 million be transferred by way of grant to the International Development Association

Repayments of principal on loans received by the Bank during the year amounted to $609 million, and a further $68 million was repaid to purchasers of portions of loans Total principal repayments by borrowers through June 30, 1976, aggregated $7 2 billion, including $4.9 billion repaid to the Bank and $2 3 billion repaid to purchasers of borrowers' obligations sold by the Bank.

Outstanding borrowings of the Bank were $14 6 billion at June 30, 1976 During the year, the Bank borrowed $700 million through the issuance of 2-year U.S. dollar bonds to central banks and other governmental agencies in some 80 countries, $1,275 million in the United States; DM 1,700 million (U S $665.6 million) in the Federal Republic of Germany, 56.7 billion yen (U S $188.6 million) in Japan; SwF 750 million (U S $288 4 million) in Switzerland; SwF 300 million (U S $115.1 million) and DM 100 million (U S $38.4 million) in Saudi Arabia, SwF 100 million (U.S $38 1 million) in the Libyan Arab Republic, DM 400 million (U S $115 3 million) in Kuwait, f 450 million (U S $167 2 million) in the Netherlands, $50 million in Yugoslavia; and $129 5 million from the Interest Subsidy Fund, which is administered by the Bank The Fund, which obtained its resources from voluntary contributions from member governments, was established to subsidize the interest payments to the Bank on loans made to poorer developing countries

These borrowings, in part, refunded maturing issues amounting to the equivalent of $905 million After retirement of $63 million equivalent of obligations through sinking fund and purchase fund operations, the Bank's outstanding borrowings showed a net increase of $2,360 million from the previous year after deducting $284 million representing adjustment of borrowings as a result of currency depreciations and appreciations in terms of U S dollars of the value of the non-dollar currencies in which the debt was denominated

The Inter-American Development Bank Act, which authorizes the United States to participate in the Inter-American Development Bank, provides an exemption for certain securities which may be issued or guaranteed by the Bank similar to that provided for securities of the International Bank for Reconstruction and Development Acting pursuant to this authority, the Commission adopted Regulation IA, which requires the Bank to file with the Commission substantially the same type of information, documents and reports as are required from the International Bank for Reconstruction and Development The following data reflect information submitted by the Bank to the Commission

On June 30, 1976, the outstanding funded debt of the Ordinary Capital resources of the Bank was the equivalent of $1.816 billion, reflecting a net increase in the past year of the equivalent of $210 million During the year, the funded debt increased through a public offering in the United States of $150 million, two public offerings and a private placement in Switzerland totalling the equivalent of $95.9 million, as well as private placements in Italy for $32 5 million and in Germany for the equivalent of $19 6 million In addition, there were drawings totalling $36 9 million under arrangements with Finland, Ja-

pan and the United Kingdom Additionally, $33 7 million of two-year and five-year bonds were sold to Latin American and Caribbean Central Banks or Governmental Agencies and Israel, essentially representing a partial roll-over of a maturing borrowing of $38 million The funded debt decreased by approximately $39 9 million due to downward adjustment of the U S dollar equivalent of borrowings denominated in non-regional currencies The funded debt also decreased through the retirement of approximately $80 7 million from sinking fund purchases and scheduled debt retirement

The Asian Development Bank Act, adopted in March 1966, authorized United States participation in the Asian Development Bank and provides an exemption for certain securities which may be issued or guaranteed by the Bank, similar to the exemptions accorded the International Bank for Reconstruction and Development and the Inter-American Development Bank Acting pursuant to this authority, the Commission has adopted Regulation AD which requires the Bank to file with the Commission, documents and reports as are required from those banks The Bank has 42 members with subscriptions totaling $3 44 billion

Through June 30, 1976, the Bank's net borrowings totaled the equivalent of $931 million In 1976 the Bank issued obligations of the equivalent of $115 million in Germany, $82 3 million in the Netherlands, $49 8 million in Japan, $30.5 million in Saudi Arabia, $26 7 million in Switzerland and $50 million to various Central Banks In 1976, borrowing in the United States was $100 million at 8 5 percent Before selling securities in a country, the Bank must obtain that country's approval

As of June 30, 1976, 13 countries have contributed or pledged a total of $590 million to the original source mobilization of the Bank's concessionary loans fund A total of $57 4 million from Ordinary Capital resources have been set aside by the Board of Governors for concessionary loan purposes Congress appropriated a $25 million contribution during fiscal 1976, bringing U S contributions to $125 million As of the same date, pledges from donor countries for replenishment of the Bank's concessional loan funds amounted to an additional $477 million The total to be contributed could amount to $760 million

## TRUST INDENTURE ACT OF 1939

This Act requires that bonds, debentures, notes and similar debt securities offered for public sale, except as specifically exempted, be issued under an indenture which meets the requirements of the Act and has been duly qualified with the Commission

The provisions of the Act are closely integrated with the requirements of the Securities Act Registration pursuant to the Securities Act of securities to be issued under a trust indenture subject to the Trust Indenture Act is not permitted to become effective unless the indenture conforms to the requirements of the latter Act, designed to safeguard the rights and interests of the purchasers Moreover, specified information about the trustee and the indenture must be included in the registration statement

The Act was passed after studies by the Commission had revealed the frequency with which trust indentures failed to provide minimum protections for security holders and absolved so-called trustees from minimum obligations in the discharge of the trusts. It requires, among other things, that the indenture trustee be a corporation with a minimum combined capital and surplus and be free of conflicting interests which might interfere with the faithful exercise of its duties on behalf of the purchasers of the securities, and it imposes high standards of conduct and responsibility on the trustee During fiscal year 1976, 397 trust indentures relating to securities in the aggregate amount of 25 75 billion were filed

## INFORMATION FOR PUBLIC INSPECTION; FREEDOM OF INFORMATION ACT

On November 21, 1974, Congress passed over President Ford's veto amendments to the Freedom of Information Act [37] which significantly changed the procedures governing the handling of requests made pursuant to the Freedom of Information Act (5 U S C. 552) as well as the scope of certain of the exemptions from the Act's provisions These amendments became effective February 19, 1975 The Commission amended its rules under the Freedom of Information Act (17 CFR 200 80) [38] to reflect the amended provi-

sions of the Freedom of Information Act, these rules specify the categories of available materials and those categories of records that are generally considered nonpublic These rules establish the procedure to be followed in requesting records or copies and provides for a method of administrative appeal from the denial of access to any record. They also provide for the imposition of duplicating fees and search fees when more than one-half man-hour of work is performed by the Commission's staff to locate and make records available In addition to the records described, the Commission makes available for inspection and copying all requests for no-action and interpretative letters received after December 31, 1970, and responses thereto (17 CFR 200 80). Also made available since November 1, 1972 are materials filed under Proxy Rule 14a–8(d), which deals with proposals offered by shareholders for inclusion in management proxy-soliciting materials, and related materials prepared by the staff (17 CFR 200 82)

Following the effective date of the amendments to the Freedom of Information Act, the Commission instituted the practice of issuing a public release, in a series designated Freedom of Information Act Releases, in most administrative appeals decided under the Act The Commission hopes that this series of releases will serve to inform the public as to its disclosure policies under the Freedom of Information Act and of the manner in which it has interpreted and applied the Act to the many types of records maintained by the Commission

Most of the administrative appeals decided by the Commission from the effective date of the amendments to the close of the fiscal year were concerned with investigatory records The seventh exemption of the Act, as amended, provides that the Freedom of Information Act "does not apply" to such records to the extent that their production would "interfere with enforcement proceedings," "deprive a person of a right to a fair trial or an impartial adjudication," "constitute an unwarranted invasion of personal privacy," or cause other types of harm specifically enumerated in the exemption The Commission, in the administrative appeals it has decided, has determined that investigatory records will generally be withheld on the ground that production will "interfere with enforcement proceedings" only if judicial or administrative proceedings brought by the Commission or other law enforcement authorities are in progress or there is a concrete prospect that law enforcement proceedings will be instituted.[39] Evidentiary materials contained in investigatory files closed after the completion of public law enforcement proceedings will generally be available to any person requesting access to them [40] In those cases where investigations are closed by the Commission without the institution of public enforcement action, the Commission has recognized that considerations of personal privacy often require that such records not be disclosed to members of the public,[41] except where a demonstration of particularized need for access to the records sufficient to outweigh considerations of personal privacy has been made [42]

Registration statements, applications, declarations, and annual and periodic reports filed with the Commission each year, as well as many other public documents, are available for public inspection and copying at the Commission's public reference room in its principal offices in Washington, D C and, in part, at its regional and branch offices

The Commission has special public reference facilities in the New York, Chicago and Los Angeles Regional Offices and some facilities for public use in other regional and branch offices Each regional office has available for public examination copies of prospectuses used in recent offerings of securities registered under the Securities Act, registration statements and recent annual reports filed under the Securities Exchange Act by companies having their principal office in the region, recent annual reports and quarterly reports filed under the Investment Company Act by management investment companies having their principal office in the region, broker-dealer and investment adviser applications originating in the region, letters of notification under Regulation A filed in the region, and indices of Commission decisions

During the 1976 fiscal year, 19,218 persons examined material on file in Washington; several thousand others examined files in New York, Chicago, Los Angeles, and other regional offices More than 47,994 searches were made for information requested by individuals, and approximately

12,201 letters were received for information and/or documents

The public may make arrangements through the Public Reference Section of the Commission in Washington, D C to purchase copies of material in the Commission's public files The copies are produced by a commercial copying company which supplies them to the public at prices established under a contract with the Commission Current prices begin at 10 cents per page for pages not exceeding 8 1/2" × 14" in size, with a $3 50 minimum charge Under the same contract, the company also makes microfiche and microfilm copies of Commission public documents available on a subscription or individual order basis to persons or firms who have or can obtain viewing facilities In microfiche services, up to 60 images of document pages are contained on 4" × 6" pieces of film, referred to as "fiche "

Annual microfiche subscriptions are offered in a variety of packages covering all public reports filed on Forms 10–K, 10–Q, 8–K, N–1Q and N–1R under the Securities Exchange Act or the Investment Company Act, annual reports to stockholders, proxy statements, new issue registration statements, and final prospectuses for new issues The packages offered include various categories of these reports, including those of companies listed on the New York Stock Exchange, the American Stock Exchange, regional stock exchanges, or traded over-the-counter Reports are also available by standard industry classifications Arrangements also may be made to subscribe to reports of companies of one's own selection Over one hundred million pages (microimagery frames) are being distributed annually The subscription services may be extended to further groups of filings in the future if demand warrants The copying company will also supply copies in microfiche or microfilm form of other public records of the Commission desired by a member of the public

Microfiche readers and reader-printers have been installed in the public reference areas in Washington, D C and the New York, Chicago, and Los Angeles regional offices, and sets of microfiche are available for inspection there Visitors to the public reference room in Washington, D C may also make immediate reproduction of material on photostatic-type copying machines. The cost to the public of copies made by use of all customer-operated equipment is 10 cents per page. The charge for an attestation with the Commission seal is $2 Detailed information concerning copying services available and prices for the various types of services and copies may be obtained from the Public Reference Section of the Commission

## FREEDOM OF INFORMATION ACT LITIGATION

In *The Bureau of National Affairs, Inc , et al* v *SEC,*[43] the Commission was named in a suit seeking access to the evidentiary materials contained in certain Commission investigatory files which had been closed on the basis of an informal agreement or undertaking with the subjects of the investigation Plaintiffs also sought access to portions of the internal memoranda which formed the basis of the Commission's decision to close the investigations In denying access to the evidentiary materials in these files, the Commission claimed that they were exempt from disclosure because disclosure would be an unwarranted invasion of the personal privacy of the individuals named in the files.[44] The requested portions of the internal memoranda were withheld on the ground that they expressed the opinions and recommendations of the author, and were therefore exempt from compelled disclosure [45]

In April 1976, the United States Supreme Court issued its opinion in *Department of the Air Force* v *Rose,*[46] interpreting the scope of the FOIA exemptions for invasions of personal privacy The Court in Rose indicated that blanket exemptions were not permitted by the Act, rather, an agency's efforts to protect against invasions of personal privacy should be limited to deleting names and identifying details, even where there was some risk that disclosure of the material in that form would disclose the identities of the persons concerned

As a result of the Supreme Court's decision in *Rose,* the Commission re-examined its position in the pending litigation and determined to disclose to plaintiffs the evidentiary materials contained in the particular group of files in issue, subject to the deletion of names and identifying details of persons against

whom no informal action was taken Plaintiffs thereupon amended their complaint to drop their claim to the material deleted from the internal memoranda in question. On July 26, 1976, the district court ordered "that the case be marked settled on the merits," and further ordered that counsel fees and costs of $5,013 be awarded to the plaintiffs

In *Anton, et al* v. *Securities and Exchange Commission,*[47] plaintiffs, who were respondents in a public administrative proceeding instituted by the Commission,[48] sought the disclosure of all the materials contained in or relating to the Commission's proceeding Certain of the requested material was made available, but other records were withheld on the basis of Exemptions 5 and 7 of the FOIA [49] After a hearing on August 26, 1975, the United States District Court entered an order, ruling that all of the records in issue were properly withheld pursuant to the FOIA's exemptive provisions. Plaintiffs took an appeal from the district court's decision,[50] but dropped their appeal after the issues had been briefed.

In *Merrill Lynch, Pierce, Fenner & Smith, Inc* v. *S E.C* , [51] plaintiff, also a respondent in a Commission administrative proceeding, sued to compel release of various records under the FOIA Plaintiff also sought a preliminary injunction against continuation of the administrative proceeding pending resolution of its FOIA claims. On May 27, 1976, Judge Gasch of the District Court for the District of Columbia declined to issue the preliminary injunction The court has not yet ruled on the issue of plaintiff's entitlement to the records in question.

The plaintiff in *Bast* v *S E C* [52] was seeking access to various portions of internal memoranda withheld by the Commission on the ground that they reflected the opinions and recommendations of members of the staff Following an *in camera* inspection of the records in question, the court ruled on May 27, 1976, that all of the withheld records were properly withheld in accordance with Exemption 5 of the FOIA.[53]

In *Todd & Co* v *Mason,*[54] plaintiffs are seeking various materials from the files of the National Association of Securities Dealers, Inc. (NASD) concerning disciplinary proceedings instituted by the NASD against them. Proceeding on the theory that the NASD is an "agency" of the Federal government as that term is defined in the FOIA,[55] Todd & Co requested, from the Commission, materials relating to certain specified NASD positions and policies which, it is claimed, the NASD would be required to maintain and either publish or make publicly available if the NASD were a Federal agency Todd & Co claimed that the Commission is either required to maintain the requested records for the NASD or to take steps to require the NASD to do so After the Commission denied their administrative appeal of the initial staff determination made with respect to their request,[56] Todd & Co amended the complaint in their pending suit against the NASD to include the Commission as a defendant The Commission has filed a motion to dismiss the action or, in the alternative, for summary judgment, which the court had not ruled upon at the close of the fiscal year

## NOTES FOR PART 2

[1] Securities Act Release No 5231 (February 3, 1972)

[2] Guide 60 of the Guides for Preparing and Filing Registration Statements under the Securities Act Securities Act Release No 5962 (March 17, 1976), 9 SEC Docket 180

[3] Securities Act Release No 5465 (March 1, 1974), 3 SEC Docket 606

[4] Securities Act Release No 5662 (December 30, 1975), 8 SEC Docket 807

[5] Securities Act Release No 5660 (December 23, 1975), 8 SEC Docket 751

[6] Accounting Series Release No 150 (December 20, 1973), 3 SEC Docket 275

[7] Accounting Series Release No 178 (October 9, 1975), 8 SEC Docket 39, and Accounting Series Release No 181 (November 10, 1975), 8 SEC Docket 402

[8] Accounting Series Release No 180 (November 4, 1975), 8 SEC Docket 324

[9] Staff Accounting Bulletin No. 1 (November 4, 1975), 8 SEC Docket 364, Staff Accounting Bulletin No 2 (January 9, 1976), 8 SEC Docket 1006; Staff Accounting Bulletin No 3 (January 16, 1976), 8 SEC Docket 1138, Staff Accounting Bulletin No 4 (January 29, 1976), 8 SEC Docket 1181, Staff Accounting Bulletin No. 5 (February 13, 1976), 8 SEC Docket 1330, Staff Accounting Bulletin No 6 (March 1, 1976), 9 SEC Docket 115, Staff Accounting Bulletin No. 7 (March 23, 1976), 9 SEC Docket 295, Staff Accounting Bulletin No 8 (June 4, 1976), 9 SEC Docket 868; Staff Accounting Bulletin No 9 (June 17, 1976), 9 SEC Docket 916.

[10] Accounting Series Release No 175 (July 10, 1975), 7 SEC Docket 339

[11] Accounting Series Release No 117 (September 10, 1975), 7 SEC Docket 816.

[12] Accounting Series Release No 178 (October 9, 1975), 8 SEC Docket 39.

[13] Accounting Series Release No 181 (November 10, 1975), 8 SEC Docket 402.

[14] Accounting Series Release No 183 (November 14, 1975), 8 SEC Docket 434.

[15] Accounting Series Release No. 184 (November 26, 1975), 8 SEC Docket 526

[16] Accounting Series Release No. 185 (December 11, 1975), 8 SEC Docket 692.

[17] Accounting Series Release No. 180 (March 23, 1976), 9 SEC Docket 240.

[18] Securities Act Release No. 5696 (March 23, 1976), 9 SEC Docket 245.

[19] Securities Act Release No 5579 (April 17, 1975), 6 SEC Docket 670

[20] Securities Exchange Act Release No. 11354 (April 17, 1975), 6 SEC Docket 682.

[21] Securities Act Release No. 5612 (September 10, 1975), 7 SEC Docket 825.

[22] Accounting Series Release No 189 (February 9, 1976), 8 SEC Docket 1294

[23] Securities Act Release No. 5689 (March 15, 1976), 9 SEC Docket 178

[24] Securities Act Release No 5716 (June 3, 1976), 9 SEC Docket 761

[25] Securities Act Release No. 5701 (April 29, 1976), 9 SEC Docket 477.

[26] Accounting Series Release No 194 (July 28, 1976), 10 SEC Docket 100

[27] Accounting Series Release No. 188 (January 7, 1976), 8 SEC Docket 961.

[28] Securities Act Release No. 5668 (January 7, 1976), 8 SEC Docket 963.

[29] Accounting Series Release No. 173 (July 2, 1975), 7 SEC Docket 301.

[30] Accounting Series Release No 174 (July 2, 1975), 7 SEC Docket 293

[31] Accounting Series Release No 176 (July 22, 1975), 7 SEC Docket 432

[32] Accounting Series Release No. 191 (March 30, 1976), 9 SEC Docket 363.

[33] Accounting Series Release No 179A (November 24, 1975), 8 SEC Docket 522.

[34] Accounting Series Release No 182 (November 12, 1975), 8 SEC Docket 402

[35] Accounting Series Release No 186 (December 5, 1975), 8 SEC Docket 1006.

[36] Accounting Series Release No 187 (December 15, 1975), 8 SEC Docket 1006

[37] Pub. L. No 93–502

[38] Securities Act Release No 5571 (February 21, 1975), 6 SEC Docket 286.

[39] See, *e g , in the Matter of Request of I Walton Bader,* FOIA Release No. 1 (April 3, 1975), 6 SEC Docket 541; *In the Matter of Request of Jeffrey B. Albert,* FOIA Release No 10 (June 11, 1975), 7 SEC Docket 138.

[40] Securities Act Release No. 5571 (February 21, 1975), 6 SEC Docket 288. *In the Matter of Request of John A Jenkins,* FOIA Release No 11 (June 11, 1975), 7 SEC Docket 139.

[41] *In the Matter of Request of John A Jenkins,* FOIA Release No 11 (June 11, 1975), 7 SEC Docket 139.

[42] *In the Matter of Request of Jung Ja Malandris,* FOIA Release No. 8 (May 29, 1975), 7 SEC Docket 58.

[43] D.D C , No 76–0443.

[44] See 5 U S.C. 552(b)(7)(C).

[45] See 5 U.S C. 552(b)(5).

[46] —— U.S. ——, 44 U.S.L W 4503 (April 21, 1976).

[47] D. Colo , No 75–M–611

[48] *In the Matter of Financial Programs, Inc* , Admin. Proc No. 3–4610

[49] 5 U S C. 552(b)(5), (7) See FOIA Release No. 20 (July 22, 1975), 7 SEC Docket 429

[50] C A 10, No 75–1868.

[51] D D.C , No. 76–0762

[52] E D. Va , No. 76–47–A.

[53] 5 U.S.C. 552(b)(5).

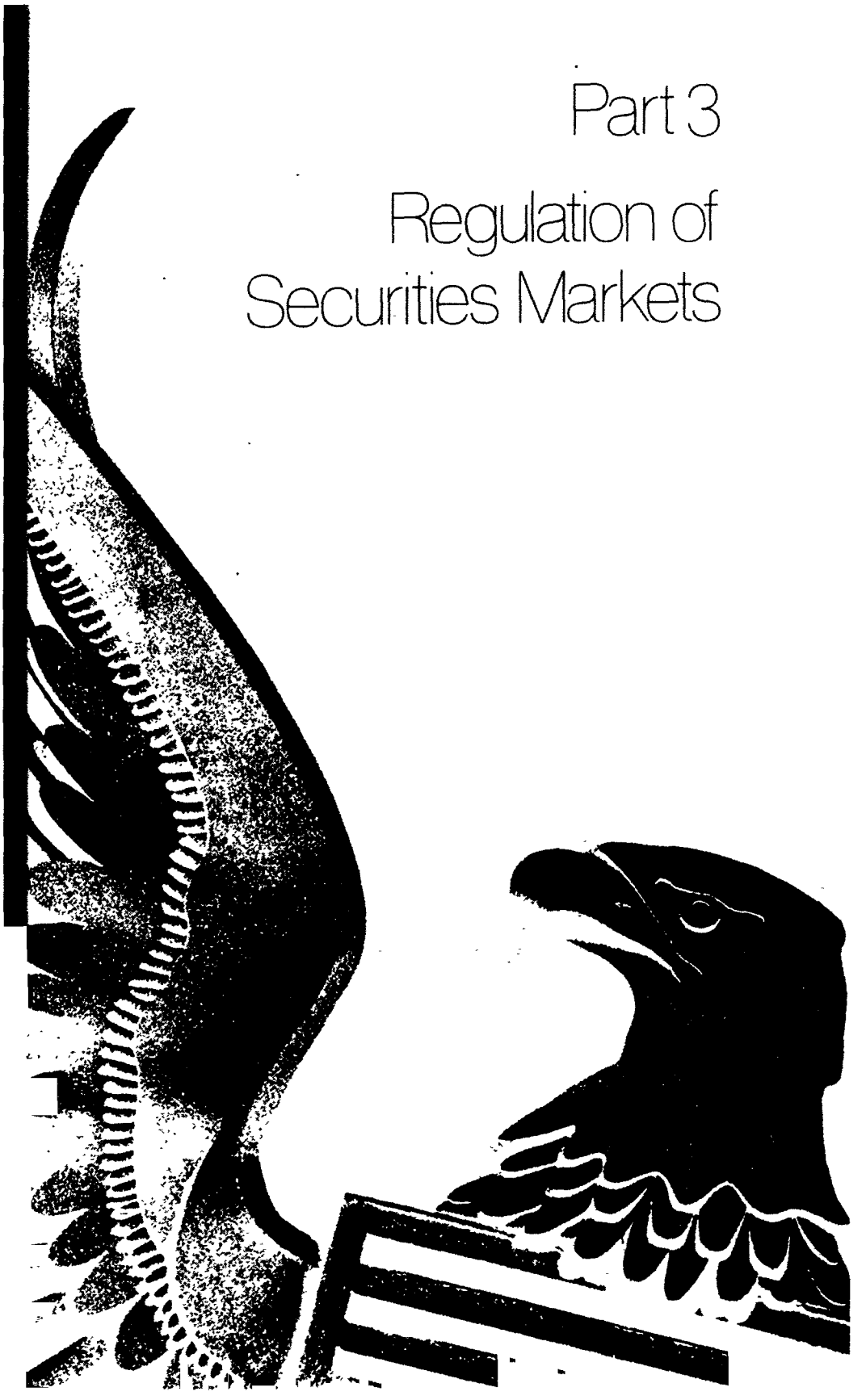
[54] D D C , No 75–1438

[55] See 5 U.S.C 552(e).

[56] See FOIA Release No. 41 (January 20, 1976), 8 SEC Docket 1085

# Part 3

# Regulation of Securities Markets



# Part 3

# Regulation of Securities Markets

In addition to the disclosure provisions discussed in the preceding chapter, the Securities Exchange Act assigns to the Commission broad regulatory responsibilities over the securities markets and persons conducting a business in securities This Act, among other things, requires securities exchanges to register with the Commission, provides for Commission supervision of the self-regulatory responsibilities of registered exchanges, and permits registration of self-regulatory associations of brokers or dealers The Act requires registration of brokers and dealers in securities, and also contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets

The Securities Acts Amendments of 1975 (the "1975 Amendments")[1] established a new self-regulatory organization, the Municipal Securities Rulemaking Board, to formulate rules for the municipal securities industry subject to the oversight of the Commission The amendments also contemplate a national market system and a national system for the clearance and settlement of securities transactions and require municipal securities professionals, certain securities information processors, clearing agencies and transfer agents to register with the Commission Important recent developments concerning regulation of the securities markets are discussed in Part 1 of this Annual Report

## REGULATION OF EXCHANGES

### Registration

The Securities Exchange Act generally requires a securities exchange to register with the Commission as a national securities exchange unless the Commission, acting pursuant to Section 5 of the Act, exempts it from registration because of the limited volume of its transactions [2] As of June 30, 1976, the following eleven securities exchanges were registered with the Commission

American Stock Exchange, Inc
Boston Stock Exchange
Chicago Board Options Exchange, Inc
Cincinnati Stock Exchange
Detroit Stock Exchange
Intermountain Stock Exchange
Midwest Stock Exchange, Inc
New York Stock Exchange, Inc
Pacific Stock Exchange, Inc.
Philadelphia Stock Exchange, Inc [3]
Spokane Stock Exchange

On October 16, 1975, the Commission, pursuant to Section 19(a)(3) of the Act, issued orders withdrawing the registrations of the National Stock Exchange and the Board of Trade of the City of Chicago as national securities exchanges The National Stock Exchange had ceased operations on January 31, 1975, while the Executive Committee of the Board of Trade of the City of Chicago

adopted a resolution in March 1975 to close its securities market [4] On June 30, 1976, the Detroit Stock Exchange ceased operations That exchange is currently in the process of taking the necessary steps to withdraw its registration as a national securities exchange

## Delisting

Pursuant to Section 12(d) of the Securities Exchange Act, a security may be stricken from listing and registration with a national securities exchange upon the exchange's application to the Commission, or may be withdrawn from listing and registration upon the application of its issuer, in accordance with the rules of the exchange and upon such terms as the Commission may impose for the protection of investors Historically, it has been the Commission's view that in evaluating delisting applications, it is not generally the Commission's function to substitute its judgment for that of an exchange, and that where there has been full compliance with the rules of an exchange with respect to delisting, the Commission is required to grant a delisting application The authority of the Commission in such cases is limited to the imposition of terms deemed necessary for the protection of investors [5]

The standards for delisting vary among the exchanges, but generally delisting actions are based on one or more of the following factors (1) the number of publicly-held shares or shareholders is insufficient (often as a result of an acquisition or merger) to support a broad-based trading market, (2) the market value of the outstanding shares or the trading volume is inadequate, (3) the company no longer satisfies the exchange's listing criteria with respect to earnings or financial condition; or (4) required reports have not been filed with the exchange

During the fiscal year, the Commission granted exchange applications for the delisting of 181 stock issues and twenty-two bond issues In the wake of its decision to withdraw its registration as a national securities exchange, the National Stock Exchange applied to strike eighty-five stock and three bond issues from listing and registration Applications granted other exchanges totaled American, twenty-seven stocks and two bonds, New York, twenty-three stocks and fifteen bonds, Pacific, twenty-one stocks and two bonds, Boston, ten stocks, Philadelphia, Midwest and Detroit, five stocks each [6]

The Commission also granted the application of two issuers to withdraw their securities from listing and registration on the Boston Stock Exchange

## Unlisted Trading Privileges

Prior to the 1975 Amendments, Section 12(f) of the Securities Exchange Act provided that a national securities exchange might, upon application to and approval by the Commission, extend unlisted trading privileges to any security listed and registered on another national securities exchange The 1975 Amendments broadened the section to encompass securities not listed on any exchange, other textual changes were intended to express congressional concern over the impact of unlisted trading on the development of a national system, and to clarify that such applications may not be granted if the effect would be to restrict competition [7] At the time the 1975 Amendments were enacted, the Boston Stock Exchange ("BSE") had pending an application for unlisted trading privileges in the common stock of Ludlow Corporation, which was already listed on the New York Stock Exchange ("NYSE") [8] Following notice of BSE's application, Ludlow Corporation filed an objection to the granting of BSE's application and requested a public hearing on the matter On June 25, 1975, the Commission, pursuant to Section 12(f)(2) of the Act, ordered that a public hearing be held concerning BSE's application [9]

The Ludlow matter represents the first application for unlisted trading privileges to be contested since the adoption of the 1975 Amendments and also the first such application which has become the subject of an administrative proceeding in approximately 30 years Ludlow asserted that (i) the Act requires BSE to show that it would establish a trading market in Ludlow stock, (ii) such a market would not divert trading volume from the "primary market" (NYSE) in a manner disruptive to the fair and orderly market currently maintained on the NYSE, and (iii) transactions in Ludlow stock occurring on the BSE without clearing the NYSE specialist's book would not be inconsistent with the protection of investors BSE and the Commis-

sion's staff both asserted that (i) the Section 12(f)(2) standard requires only that the applicant demonstrate that an appropriate medium for trading the subject security exists on its exchange (without necessarily demonstrating that active trading or a particular type of market will automatically develop), (ii) the emphasis on competition evident in the 1975 Amendments outweighs possible concerns of diversion of trading volume from existing primary markets, and (iii) the 1975 Amendments and subsequent implementation thereof by the Commission have established that the development of a national market system is the proper means for protection of investors' limit orders on specialists' books

On May 6, 1976, a Commission Administrative Law Judge issued an Initial Decision granting BSE's application.[10] The Initial Decision held that Section 12(f) and Rule 12f-1 thereunder require only a minimal showing by the applicant exchange, namely, that there exists a degree of local interest in the subject security, that the applicant exchange maintains rules and practices which assure a fair and orderly market in the stock should a market develop on that exchange, and that the subject security currently trades in a fair and orderly fashion The Administrative Law Judge noted that the 1975 Amendments create a presumption in favor of competition and thereby minimize the extent to which potential diversion of trading volume should be considered, and refused to find that trading of Ludlow stock on the BSE, in circumvention of public limit orders on the NYSE, would be inconsistent with the protection of investors

The Commission subsequently granted Ludlow's Petition for Review of the Initial Decision and the matter is currently pending before the Commission

## Exchange Disciplinary Actions

Section 19(d) of the Securities Exchange Act, added by the 1975 Amendments, requires exchanges to report to the Commission for its review any final disciplinary sanction imposed by an exchange that (i) denies membership or participation to any applicant, (ii) prohibits or limits access to services offered by an exchange or member thereof, or (iii) imposes final disciplinary sanctions on any person associated with a member or bars any person from becoming associated with a member

During the fiscal year, five exchanges reported to the Commission a total of 198 separate disciplinary actions, including the imposition in 117 cases of fines ranging from $100 to $20,000, the admonishment of sixteen individuals, the suspension from membership (for periods ranging from one week to five years) of three member organizations and twenty-nine individuals, the censure of eight member firms and twenty-seven individuals, the barring of twenty-eight individuals and the expulsion of two individuals and one member firm

## Exchange Rules

As previously reported,[11] the 1975 Amendments added to the Securities Exchange Act the requirement that self-regulatory organizations file with the Commission any proposed rule or change in an existing rule accompanied by a concise statement of the basis and purpose of the proposed rule change [12] This requirement applies to the rules of exchanges as well as rules of the NASD, clearing agencies and the Municipal Securities Rulemaking Board [13] In general, the Commission is required to publish notice of the proposed rule change and to give interested parties an opportunity to submit their views concerning the proposal Proposed rule changes may not take effect unless approved by the Commission (with the exception of certain types of rule changes, such as interpretations of existing rules, which are permitted to take effect without Commission review, subject to the Commission's powers under Section 19(c) of the Securities Exchange Act to abrogate such rule changes)

On August 19, 1975, the Commission adopted[14] Rule 19b-4 and related Forms 19b-4A and 19b-4B, which provide procedures for self-regulatory organizations to file proposed rule changes for the Commission's approval or to give notice of those rule changes which may take effect without Commission approval The rule also provides the self-regulatory organizations with criteria by which they may determine which of their policies, practices and interpretations are deemed to be rules for the purpose of the

filing requirement. Furthermore, it specifies the procedures to be followed by the Commission in passing upon proposed rule changes.

During the fiscal year, the Commission received 196 submissions from exchanges involving a variety of rules and stated policies The following were among the more significant rule changes approved by the Commission.

1 The NYSE adopted two rule changes affecting previously fixed listing and delisting standards. The first provided for semi-annual downward adjustment in the listing and delisting criteria for publicly-held shares based on fluctuations in the NYSE Composite Index The second rule change provided alternative numerical standards for listing the securities of companies which are not organized under the laws of the United States, these standards are significantly higher than those required of domestic issuers

2 Three exchanges submitted rule proposals to implement or expand automated order routing and execution systems The Midwest Stock Exchange ("MSE") adopted rule changes to convert its "MAX" program for automatic execution of certain market orders from a pilot to a permanent program The NYSE adopted rule changes to implement its Designated Order Turnaround ("DOT") System to expedite automated routing of 100-share market orders to NYSE specialists, and the Pacific Stock Exchange ("PSE") expanded its automated order routing and execution system ("COMEX") to handle orders up to 300 shares

3. The NYSE amended various rules to permit NYSE specialists to become odd-lot dealers in their respective assigned issues

4 Pursuant to the requirements of Section 6(e) of the Securities Exchange Act, as amended, all of the national securities exchanges amended their rules to abolish fixed odd-lot differentials as well as those provisions requiring the imposition of a differential on all odd-lot orders In addition, these exchanges have amended their rules to provide for competitive commission rates on intramember transactions

5 The Chicago Board Options Exchange ("CBOE"), the Philadelphia Stock Exchange ("Phlx") and the Cincinnati Stock Exchange ("CSE") amended their organizational rules to provide for the participation of at least one public director (or governor) on their respective boards.

6 The PSE amended its rules to institute a pilot program for competitive market making in one issue which is dually listed and traded on the PSE and two other national securities exchanges

7. All national securities exchanges amended their trading rules to conform to Securities Exchange Act Rule 19c–1, which decrees the phased elimination of exchange restrictions on off-board transactions in exchange securities [15]

8. The Commission did not object to initiation of trading in the same class [16] of options by more than one exchange (dual trading). [17] Presently, options which are the subject of dual trading must have the same expiration dates and exercise prices on one exchange as those of the same class which are traded on another exchange. Thus, members of the public are able to "shop markets" to place orders for identical option contracts in the market where they receive best execution [18]

## EXCHANGE INSPECTIONS

### NYSE Specialist Surveillance Inspection

From July 30 through August 1, 1975, members of the Commission staff conducted an inspection of the NYSE's Market Surveillance Division The purpose of the inspection was to determine the extent, if any, to which NYSE specialists were engaged in the practices of "print splitting" and "narrowing spreads" [19] As the fiscal year closed, the staff was currently reviewing documents and data compiled during the course of the inspection to determine the effectiveness of the NYSE's rules and surveillance program in this area

### American Stock Exchange Arbitration Inspection

On January 26–28, 1976, members of the Commission staff conducted an inspection of the American Stock Exchange ("Amex") Department of Arbitration The purpose of the inspection was to review and evaluate the Amex arbitration program to determine whether it provides a fair procedure through

which the interests of the public and investors are protected. The inspection included review of the administration of such matters by the Amex staff, the selection and composition of arbitration panels, types of cases and issues involved, and the appropriateness of awards.

Subsequently, the staff made the following recommendations to the Director of the Department of Arbitration:

1 That the Amex delete that portion of its Rule 602 which, in cases where the amount in controversy exceeds $1,000, permits the Director to appoint a five person arbitration panel, four of whom would be connected with the securities industry. In addition, the staff suggested that public claimants be entitled to a panel composed entirely of persons having no affiliation with the securities industry.

2 That the Amex resume its past practice of making a record of arbitration proceedings, to assist any party wishing to appeal the decision to the courts and to aid the Commission in the performance of its oversight responsibilities.

3 That the Amex resume its past practice of requiring its Conduct Division to review arbitration proceedings to determine whether disciplinary action against the member may be warranted, particularly where the decision is rendered against the member firm.

4 That the exchange's advertising and public relations programs be expanded to inform the public more adequately of the availability of its arbitration facilities.

## Boston Stock Exchange Inspection

On February 17–19, 1976, members of the Commission staff conducted an inspection of the Boston Stock Exchange ("BSE"), focusing on the BSE's market surveillance program, floor procedures and performance of the BSE's specialists in securities traded on the BSE pursuant to unlisted trading privileges In addition, the staff examined BSE's internal operating and disciplinary procedures and reviewed disciplinary and arbitration proceedings conducted by the BSE in recent years. Issues raised by the inspection were under analysis at the end of the fiscal year

## NYSE Department of Enforcement Inspection

On October 17, 1975, the Commission's staff informed the NYSE of findings after its inspection of the NYSE Department of Enforcement The inspection was intended to evaluate the Department's effectiveness in investigating and prosecuting rule violations by members, member firms and registered employees.

In its letter, the staff requested the Department's views as to what factors (including working conditions and salaries) may account for the turnover[20] of enforcement attorneys and what steps the Department believes can be taken to improve the situation The staff recommended that consideration be given to filling an enforcement attorney vacancy and a vacant special counsel position in order to enable the Department to maintain the resources required to investigate and prosecute a relatively large number of cases. It was further suggested that the Department develop procedures for utilizing the examining staff of the Member Surveillance Division to gather evidence pertinent to a case under investigation and to determine whether rule violations are widespread within a firm

The staff also recommended the maintenance of flow charts or other appropriate records tracking the progress of investigations through their final disposition, in order to assure that investigations are handled expeditiously and formal charges, where necessary, are filed timely In order to assist the Commission in the exercise of its oversight responsibilities, the staff recommended that the Department make more detailed closing records of cases in which no disciplinary action is taken. The staff suggested further that after the Department had become reasonably current in the handling of its present "major complaint"[21] caseload, the guidelines applicable to NYSE Rule 351, which requires the prompt reporting by member firms of rule violations, lawsuits and various other matters involving member firms and their registered employees, be amended downward to increase the number of significant claims reported. Finally, it was recommended that the Department resume its review of arbitration cases, inasmuch as such proceedings are a valuable source of possible rule violations

## American Stock Exchange Options Program Inspection

On September 16 and 17, 1975, members

of the Commission's staff inspected certain aspects of the Amex's options pilot program, with special attention given to activities of option traders and to Amex's surveillance of such activities The staff sought to determine, among other things, the extent to which option traders were discharging the affirmative obligations imposed by Amex rules to maintain fair and orderly markets.[22]

The inspection revealed that Amex needed a procedure for ascertaining whether one or more option traders were present in a trading crowd and thereby subject to affirmative trading obligations. In consultation with the Commission staff, Amex adopted a rule and related surveillance procedures requiring that at least one option trader be present in the crowd when a customer's order is executed by a floor broker [23] The rule gives Amex a more effective means of determining whether unsatisfactory market conditions exist and whether such conditions are attributable to the failure of option traders to discharge their affirmative responsibilities.

## Philadelphia Stock Exchange Options Program Inspection

On August 27, 1975, members of the Commission's staff conducted an inspection of the Philadelphia Stock Exchange ("Phlx") to determine whether the Exchange's facilities and surveillance programs were adequate to accommodate the expansion of its recently established[24] option trading program [25] Special attention was given to an examination of Phlx's floor facilities and the ability of floor personnel to keep quotations current, report trades, and conduct orderly options trading.

The staff team concluded that the operational aspects of the Phlx option pilot program were satisfactory and that the organizational framework of the Exchange's regulatory and surveillance programs appeared adequate to accommodate expansion It was noted, however, that more comprehensive assessment of the Phlx's regulatory and surveillance systems could not be made until its options pilot program achieved higher trading volume and a larger number of option classes.

## Chicago Board Options Exchange Inspection

On December 2–4, 1975, the Commission staff conducted an inspection of the Chicago Board Options Exchange ("CBOE") which focused primarily on CBOE's regulatory and surveillance programs. Special attention was devoted to CBOE's evaluation of the performance of its market makers and board brokers and allocation of option classes to those members. The staff found that CBOE's performance in the area of floor member evaluation had improved considerably since the time of the Commission staff's last inspection.[26]

The inspection also revealed significant new developments in CBOE's market surveillance program. At the time of the inspection, CBOE was in the process of restructuring this program to include methods employed by the NYSE to monitor stock trading in periods of unusual market activity. The staff suggested that CBOE's current procedures not be discarded until the new procedures have been fully evaluated.

The inspection of CBOE's Investigation Section[27] led to staff recommendations that CBOE adopt a system enabling it to maintain records more fully describing instances in which market makers are given permission to trade at variance with their obligations to maintain fair and orderly markets.[28] Members of the CBOE staff stated that they would institute a procedure for keeping such records.

The staff also sought to determine the extent to which CBOE members engaged in "front-running" of blocks,[29] "up-ticking" (or "down-ticking") at the close of business[30] and prearranged spread transactions.[31] At the time of the inspection, CBOE appeared to have made progress in establishing surveillance programs for the detection of these practices.

The Commission staff paid particular attention to CBOE's surveillance program for detecting members' holding positions in excess of the maximum limits set forth in CBOE's rules.[32] The Commission's staff suggested that CBOE facilitate its review procedures by arranging to have position reports sent on a regular basis to its Trading Procedure Department as well as to its Compliance Department.

## SUPERVISION OF NASD

The Securities Exchange Act provides that

an association of brokers and dealers may be registered with the Commission as a national securities association if it meets the standards and requirements for the registration and operation of such associations contained in Section 15A of the Act. The Act contemplates that such associations will serve as a medium for self-regulation by over-the-counter brokers and dealers. In order to be eligible for registration, an association's rules must be designed to protect investors and the public interest, to promote just and equitable principles of trade and to meet other statutory requirements Registered securities associations operate under the Commission's general supervisory authority, which includes the power to review disciplinary actions taken by an association, to approve or disapprove changes in the association's rules and to abrogate, alter or supplement such rules The National Association of Securities Dealers, Inc. ("NASD"), is the only such association registered with the Commission under the Act

In adopting legislation to permit the formation and registration of national securities associations, Congress provided an incentive to membership by permitting such associations to adopt rules precluding any member from dealing with a nonmember broker or dealer except on the same terms and conditions and at the same prices as the member deals with the general public The NASD has adopted such rules As a practical matter, therefore, membership is necessary for profitable participation in many underwritings since members properly may grant only to other members price concessions, discounts and similar allowances not granted to the general public.

By the close of the fiscal year, 2,928 brokers and dealers were NASD members, a decrease of sixty-three members during the year. This loss reflects the net result of 303 admissions to and 366 terminations of membership. The 1975 Amendments provide, for the first time, for the registration with the Commission of municipal securities professionals, consequently, approximately 250 municipal securities brokers and dealers became members of the NASD. The number of members' branch offices decreased by forty-four to 5,968 as a result of the opening of 916 new offices and the closing of 960. During the fiscal year, the number of registered representatives and principals (which categories include all partners, officers, traders, salesmen and other persons employed by or affiliated with member firms in capacities which require registration) decreased by 2,984 to 194,718 as of June 30, 1976. This decrease reflects the net result of 14, 793 initial registrations, 16,633 re-registrations and 34,410 terminations of registrations during the year.

During the fiscal year, the NASD administered 40,762 qualification examinations, of which 14,295 were for NASD qualification, 2,025 for the Commission's SECO program[33] and the balance for other agencies, including major exchanges and various state securities regulators

## NASD Rules

Prior to the 1975 Amendments, the Securities Exchange Act required the NASD to file for Commission review copies of proposed rules or rule amendments 30 days prior to their proposed effectiveness. The Commission could disapprove them if it found them inconsistent with the requirements of the Act Otherwise, the Commission would issue a statement to the effect that it had reviewed such proposed rules or rule amendments and had "not disapproved" them Moreover, the Commission would generally review, in advance of publication, general policy statements, directives and interpretations issued by the NASD Board of Governors pursuant to its powers to administer and interpret NASD rules

Section 19(b) of the Act, as amended by the 1975 Amendments, gave the Commission more explicit oversight authority over the NASD's rulemaking processes (as well as those of other self-regulators) and provided further statutory criteria for such Commission oversight [34] Proposed NASD rule changes are now filed with the Commission, after which the Commission generally has thirty-five days from the time the notice of the proposal has been published in which to approve the proposal, or to institute proceedings to determine whether the proposal should be disapproved. If the Commission finds good cause for immediate approval upon filing, and publishes its reasons for so finding, the Commission may approve the

proposed rule change or amendment prior to the thirtieth day after publication.

During the fiscal year, numerous proposed changes to NASD rules were submitted to the Commission for its consideration. Among the major filings which the Commission approved were.

(1) Adoption of a new interpretation and explanation by the Board of Governors of Article III, Sections 1, 27 and 28 of the NASD Rules of Fair Practice concerning personal or private securities transactions by persons associated with a member firm and such member's responsibility to supervise such transactions. The new interpretation and explanation is designed (1) to give an NASD member notice of the private securities activities of its associated persons (2) to give notice to persons associated with a member that their involvement in private securities transactions outside the scope of their association with the member may require their registration as brokers, dealers or investment advisers under Federal or state securities laws, and (3) to advise members of their obligations to supervise the private securities transactions of their associated persons In this regard, an associated person contemplating such transactions is required to notify the member in writing of his intention, which notice provides a mechanism to assist members in satisfying their supervisory responsibilities The new interpretation appeared necessary in view of past instances of private securities transactions involving associated persons in which customers mistakenly believed that the transaction was sponsored by the member

(2) Adoption of new Article XVIII of the NASD's By-Laws and Schedule G thereunder concerning, among other things, the reporting of transactions in eligible securities in the consolidated transaction reporting system (the "consolidated system") contemplated by Securities Exchange Act Rule 17a-15,[35] and anti-manipulation rules relating to over-the-counter trading in such securities The new requirements provide that principal transactions effected by NASD members must be reported in the consolidated system at the price recorded on the trade ticket without taking into account any commission, commission equivalent, or differential imposed in connection with the transaction. The new procedures effectively eliminate the previous disparity between the reporting of principal transactions effected by NASD members and the reporting of identical transactions effected on national securities exchanges

(3) Amendments to Schedule D under Article XVI of the NASD By-Laws to eliminate capital requirements for market makers authorized to enter quotations in the NASDAQ (National Association of Securities Dealers Automated Quotation) System, to modify block reporting requirements, to revise fees for Level I NASDAQ usage, to reduce the NASDAQ market maker requirements to require only one market maker (instead of two) for any security traded on NASDAQ, to outline procedures on limitation of access to the NASDAQ System, and to permit the inclusion in the NASDAQ System of securities issued by certain open-end investment companies registered under the Investment Company Act The NASD eliminated the NASDAQ capital requirements because the recent amendments to Securities Exchange Act Rule 15c3-1 established an industry-wide uniform net capital rule [36] Moreover, in order to improve the NASD's market surveillance program and to provide better information to the public, the NASD amended its block reporting regulations to require daily reporting of the total number of block transactions executed for all issues in which a firm is a registered market maker. With regard to the inclusion of certain open-end investment companies in NASDAQ, it appeared that since shares of these companies were not continuously offered and were already traded in the over-the-counter market, it was in the interest of the investing public to provide broader dissemination of quotations in such shares. Other admendments to Schedule D specify the reasons for which the NASD may summarily limit or prohibit access to NASDAQ by issuers and market makers, and outline the procedures for NASD review of grievances arising from such action. Section 15A(h)(3) of the 1975 Amendments gives the NASD authority to take such summary action under certain circumstances

(4) Amendments to Schedule D of the NASD By-Laws to permit the inclusion in the NASDAQ System of stabilizing bids accompanied by penalty stipulations. The penalty stipulation is imposed by the underwriter of a new issue upon a participant in a selling group when the participant sells back to the

underwriter shares which the former had agreed to distribute in furtherance of the offering In this situation, the penalty stipulation generally provides that the participant forfeits its selling concession on those shares sold back to the underwriter

The NASD theretofore had considered a stabilizing bid qualified by a penalty stipulation as not representing a "firm" quotation (*i e*, the bid is so conditioned that it does not represent an opportunity for certain members to sell to the managing underwriter at the quoted price) [37] However, the amendment to Schedule D now permits inclusion in NASDAQ of a stabilizing bid accompanied by a penalty stipulation, provided the stipulation only deprives a member of the syndicate of its selling concession for any shares returned to the managing underwriter via the stabilizing bid

## NASD Inspections

During the fiscal year, the Commission's staff inspected the NASD's district offices in Atlanta, Boston and Cleveland,[38] the NASDAQ and Market Surveillance Departments of the NASD's Washington headquarters, and the NASD's Arbitration Department, located in New York City. These inspections were conducted as a part of the Commission's continuing oversight of the NASD's performance of its self-regulatory functions The inspection program also is designed to improve coordination between NASD and Commission programs for regulation and enforcement activities in the over-the-counter markets.

The NASD district office inspections by the Commission involved a review of (1) the composition and effectiveness of the District Committees, the District Business Conduct Committees ("DBCC's"), examination subcommittees, nominating committees and quotations committees, (2) the administrative management and functioning of the district staffs, especially their working relationships with the various committees comprised of representatives of NASD member firms, (3) the district staffs' cooperation with the Commission's regional offices, the exchanges and other interested regulatory bodies including the state securities regulators, (4) the effectiveness of NASD disciplinary procedures, and (5) the need, if any, for adoption of new rules or amendments to existing NASD or Commission rules, or NASD policies and interpretations Problems encountered during these inspections included (1) questions concerning the adequacy of enforcement of the NASD's Mark-Up Policy by certain DBCC's, (2) a need to generate greater consistency with respect to the timely initiation of disciplinary proceedings and the severity of sanctions imposed, (3) instances of insufficient specificity in written decisions memorializing DBCC disciplinary action, (4) the possible need for greater representation of non-exchange member firms on the various DBCC's, and (5) occasionally insufficient administration and enforcement of the NASD's in-firm supervision standards. All these problems were reviewed with representatives of the NASD's National Office during the course of the fiscal year, and appropriate corrective action had been initiated by year's end.

The objectives of the NASD Arbitration Department inspection were to review and evaluate (1) the NASD's arbitration procedures to determine the quality and fairness of its program, (2) the administrative procedures used by the NASD arbitration staff, (3) the selection and composition of arbitration panels to ensure the fairness of its proceedings and lack of discrimination, and to survey (4) the types of cases and issues involved, and (5) the awards made by the arbitration panels The inspection revealed delays in the processing of disputes submitted to the NASD for arbitration The staff noted that as of the inspection date, approximately fifty-three cases remained "open" or unresolved Of this number, thirty-three cases had remained open for periods ranging from six months to a year after the date of their submission for arbitration At least one case had been open for nearly two years. A meeting with the NASD on this matter will be scheduled early in the coming fiscal year.

The inspection of NASD's NASDAQ operations[39] revealed a need to improve enforcement of the NASD's minimum requirements of two market makers[40] and 500 shareholders of record for inclusion of a securities issue on NASDAQ, and of the NASD's policy with respect to "crossed markets" The inspection also uncovered a delay in implementing a NASDAQ "Bid Analysis Program" which was designed in 1974 by the NASD

and the Commission to detect market manipulation. Finally, the undesirable consequences of the high turnover rate of personnel in NASDAQ's Market Surveillance Section was noted by the Commission's staff.

In subsequent discussions with the NASD's representatives concerning implementation of the NASDAQ Bid-Analysis Program, the NASD stated that it planned to start a pilot program along these lines by September of 1976 The NASD also agreed to meet with the Commission's market surveillance staff to discuss the NASD's plans for the program With respect to the personnel problems in NASDAQ's Market Surveillance Section, the NASD pointed out that this section—particularly its antifraud department—is now fully staffed with experienced personnel, and is expected to be more effective in the future.

The inspection of the NASD's Arbitration Department revealed delays in the processing of disputes submitted to the NASD for arbitration. The staff noted that as of the inspection date, approximately fifty-three cases remained "open" or unresolved Of this number, thirty-three cases had remained open for periods ranging from six months to a year after the date of their submission for arbitration At least one case had been open for nearly two years. The NASD's Arbitration Department staff said that the main reasons why these fifty-three cases remained open were difficulties in scheduling mutually convenient hearing dates and delaying tactics by certain parties to these proceedings A meeting with the NASD on this matter will be scheduled early in the coming fiscal year

## NASD Disciplinary Actions

The Commission receives from the NASD copies of its decisions in all cases where disciplinary action is taken against members or persons associated with members Generally, such actions are based on allegations that the respondents have violated specified provisions of the NASD's Rules of Fair Practice Where violations by a member firm are found, the NASD may impose such sanctions as expulsion, suspension, limitation of activities or operations, fine, censure or other fitting sanction If the violator is an individual, his registration with the NASD may be suspended, he may be barred from association with any member, or he may be fined, censured, or otherwise suitably sanctioned.

During the past fiscal year, the NASD reported to the Commission final disposition of 348 disciplinary complaints in which 209 members and 523 individuals were named as respondents Complaints against nine members and thirty-two individuals were dismissed for failure to establish the alleged violations. Thirty-five members were expelled from membership and twenty-one members were suspended for periods ranging from one day to two years. Fines also were imposed in many of these cases. In 126 cases, members were fined amounts ranging from $25 to $20,000, and in eighteen cases members were censured. Additionally, 157 persons associated with member firms were barred or had their registrations revoked, and eighty-one had their registrations suspended for periods ranging from one day to five years Finally, 206 other individuals were censured or fined amounts ranging from $100 to $20,000.

## Review of NASD Disciplinary Actions

Disciplinary actions taken by the NASD are subject to review by the Commission on its own motion or on the timely application of any aggrieved person. Prior to the 1975 Amendments, the effectiveness of any penalty imposed by the NASD in those cases accepted for review by the Commission was stayed pending such review. However, Section 19(d) of the Securities Exchange Act, as amended, provides in part that the effectiveness of any sanction imposed by the NASD (or any self-regulatory organization) is not stayed pending appeal to the Commission unless the Commission so orders. If the Commission finds, on appeal or on review by its own motion, that the disciplined party committed the acts found by the NASD and that such acts violated the specified rules, the Commission must sustain the NASD's action unless it finds that the penalties imposed are excessive or oppressive, in which case it may reduce or set aside such penalties The Commission, however, may not increase the penalties imposed by the NASD

At the beginning of fiscal 1976, thirty proceedings for review of NASD disciplinary de-

cisions were pending before the Commission, and during the year fourteen additional cases were brought up for review The Commission disposed of twenty-nine of these appeals In seventeen cases, the Commission affirmed the NASD's action The Commission dismissed the appeal in one case because of respondent's failure to file a brief, modified the NASD's findings or penalties in eight cases, remanded two cases to the NASD, and permitted withdrawal of one appeal At the close of the fiscal year, fifteen appeals were pending

Three significant opinions emerged during the fiscal year In *Unified Underwriters, Inc*,[41] the Commission affirmed the NASD's findings that the respondent violated the NASD's Rules of Fair Practice by failing to comply with its interpretations respecting free riding and withholding Here, during the course of a distribution, respondent purchased for its own account shares in several public offerings at the public offering price When these shares advanced to an immediate premium in the aftermarket, and after respondent had held these shares for periods ranging from seven to ninety days, respondent sold these shares in the openmarket for a profit The respondent argued that its actions did not violate the NASD interpretation since it was not a participant in the distribution and since its purchases were not made with a view to distribution but solely for investment purposes The Commission found, however, that respondent's trading was for the purposes of realizing short-term capital gains and that, since the shares were immediately resold, respondent did not intend to hold the shares for investment Accordingly, the respondent was held to have engaged in a distribution and violated its obligation to make a bona fide public offering at the public offering price

In *Todd and Company, Inc* [42] the Commission affirmed the NASD's findings that respondents arbitrarily set the market price in the trading of the common stock of Automated Medical Laboratories, Inc, just after Todd had completed selling Automated's first public offering of 250,000 shares, in order to induce customers to purchase and sell that stock in large quantities The Commission held that the respondents' prices were not determined as "passive responses to market forces" but were "artificial devices invented for the purpose of generating demand " Further, the Commission found that the respondents engaged in a "crass manipulation that could not possibly be deemed privileged under any conceivable legal theory "[43]

In reviewing the penalties, the Commission noted that respondent Langbein, the firm's president, appeared to have been influenced by erroneous legal advice and, accordingly, reduced the duration of his suspension and that of his firm from twelve months to six months However, the Commission affirmed a $50,000 fine imposed against respondents [44]

In *Frank De Felice Ph D & Associates, Inc*,[45] the Commission affirmed the findings of the NASD that the respondents violated just and equitable principles of trade by obtaining loans under two subordination agreements without disclosing to the lenders the firm's financial situation, affording them a clear description of the terms of the subordination agreement, or informing them that the protections afforded customers by the Securities Investors Protection Act of 1970 were not available to them Although some of this information was a part of the agreement, the Commission noted that the "legalistic boilerplate" in the form agreement was no substitute for the clear statement in ordinary language which respondents were obligated to give the lenders However, due to a lack of evidence indicating deliberate deception, the NASD's sanction was reduced to ninety-day suspension for each respondent

## Review of NASD Membership Action

Under Section 15A(g)(2) of the Exchange Act, the NASD must notify the Commission of its intention to admit a registered broker-dealer subject to a statutory disqualification to membership, or to permit a statutorily disqualified person to become associated with a member, not less than thirty days prior to admission of the member or association of the person At the time of the filing of such notice, the NASD may apply for an order stating that the Commission will not proceed under those provisions of the Act empowering the Commission to exclude the firm or associated person, notwithstanding the disqualification The Commission, in its discre-

tion and subject to such terms and conditions as it deems necessary, may issue an order permitting such membership or association if it finds such action appropriate in the public interest and for the protection of investors At the beginning of the fiscal year, four applications of this nature were pending before the Commission During the year, eight applications were filed, five were approved and three were withdrawn, leaving four applications pending at the end of the year

## SUPERVISION OF THE MUNICIPAL SECURITIES RULEMAKING BOARD

Under Section 19(b) of the Exchange Act and Rule 19b–4 thereunder, the Municipal Securities Rulemaking Board ("MSRB") is required to file with the Commission any proposed rule change, accompanied by a concise general statement of the basis and purpose of such proposed rule change In general, the Commission must then publish notice of the proposed rule change together with the terms of such change or description of the subjects and issues involved, and must give parties an opportunity to submit their views Most proposed rule changes may not take effect unless approved by the Commission, however, certain rule changes, including those establishing or changing a fee, dues or other charges imposed by the MSRB or rules concerned solely with the administration of the MSRB, need not be approved by the Commission before taking effect

Prior to June 30, 1976, the MSRB had made nine filings of proposed rules Five of the filings embodied proposals which became summarily effective without Commission approval [46] Those rules concerned definitions, MSRB fees and administration, and the definition of a "separately identifiable department or division" of a bank [47] In addition, the Commission approved a proposal establishing a $100 initial assessment to be paid by all municipal securities brokers and municipal securities dealers [48] At the close of the fiscal year the three remaining filings, which concern professional standards and recordkeeping requirements, were under review by the Commission [49]

## REVENUE, EXPENSES AND OPERATIONS OF SELF-REGULATORY ORGANIZATIONS[50]

Self-regulatory organizations receive approximately 70 percent of their revenue from five sources transaction charges, listing fees, communication fees, clearing fees, and depository fees The nature of these revenue sources make the viability of self-regulatory organizations highly dependent upon price fluctuations and the trading volume

Total share volume of securities traded on all national securities exchanges and over-the-counter increased by 26 7 percent between calendar years 1974 and 1975, bringing 1975 share volume to 7 6 billion.[51] As a result of this increased trading activity, combined self-regulatory organization revenues increased to $206 million, up $33 million from the 1974 total.[52]

Changes in major revenue components between 1974 and 1975 were as follows

Revenues from transaction fees increased to $33 million from $24 million,

Revenues from listing fees increased to $32 million from $26 million,

Revenues from communication fees increased to $26 million from $21 million,

Revenues from clearing fees increased to $35 million from $30 million,

Revenues from tabulating services increased to $14 million from $11 million,

Revenues from all "other" sources declined to $38 million from $39 million

The expenses of the self-regulatory bodies are concentrated in two areas, employee costs and communication and data processing costs These costs accounted for 75 percent of the $192 million in self-regulatory expenditures for 1975

Net income of self-regulatory organizations increased in 1975 1975 pre-tax income amounted to $14 million, a considerable improvement over the $1 million loss recorded in 1974 During the first six months of 1975, self-regulatory organizations saw their pre-tax income climb even higher, reaching $15 million [53]

## Financial Results of the NASD

Each year the Commission reviews the NASD's proposed fee and assessment schedule, its supporting financial statements for the current and past fiscal years, and proposed budget for the following fiscal year The fee and assessment schedule must comply with Section 15A(b)(5) of the Securities Exchange Act, which requires the NASD to allocate dues equitably among its members

The NASD's statement of financial results for its fiscal year ended September 30, 1975 revealed that the NASD's equity increased to $9 2 million from $7.8 million in the prior year This increase in the NASD's equity resulted from higher net operating earnings and from profitable operations of the National Clearing Corporation, the NASD's wholly-owned clearing subsidiary.

Operating revenues of the NASD were $13 0 million, an increase of $0.8 million or 7 percent, and resulted from $1.8 million more income received from NASDAQ issuer fees. Other sources of income generally declined. For the second consecutive year, fees charged for administering qualifications examinations declined by 25 percent to $2.4 million in fiscal year 1975, versus $3 1 million in fiscal year 1974. Member assessments and branch office fees also declined to $5 9 million in fiscal year 1975 from $6.4 million in 1974, an 8 percent decrease.

During the 1975 fiscal year, operating expenses of the NASD declined to $12.0 million from $12.1 million in fiscal 1974 The decline is attributable to a continuation of the NASD's cost cutting programs which have been instituted in recent years. Thus, increases in operating revenues, taken together with decreased operating expenses, resulted in net operating income of $0.9 million as opposed to $0.1 million in the prior year, a marked increase. Additionally, in fiscal year 1975, the National Clearing Corporation had net income of $0.5 million which, when added to the NASD's net income, increased the Association's equity by $1.4 million, compared with a net loss of $0.6 million in its 1974 fiscal year

## NASD Budget

A review of the NASD budget is conducted as a part of the Commission's regulatory oversight responsibilities. During recent years, the Commission has been specifically concerned with the NASD's budgeting regarding its program for examination of member broker-dealers, in order to assure that the NASD has a sufficient examiner staff to carry out its enforcement and surveillance responsibilities. The NASD budget for fiscal year 1976 provides for expenditures of $13 5 million, against actual expenditures of $12 0 million in fiscal year 1975, an increase of $1.5 million. The increase is largely attributable to the increase in staff required to fulfill additional regulatory responsibilities imposed by the 1975 Amendments, which require the NASD to oversee the municipal securities activities[54] of its members and to enforce rules promulgated by the MSRB

The NASD projects the addition of 250 new member firms which deal exclusively in municipal securities and consequently has budgeted for an additional 46 examiners at a cost of approximately $0 6 million The budget provides for 556 full-time employees, a net increase of 62 positions over the NASD staff as of June 30, 1975, and an increase of 32 positions over the prior staff budget of 524

The NASD has projected its income for fiscal year 1976 at $13.5 million, based upon its current schedule of fees and assessments The NASD fee structure remains unchanged for fiscal year 1976, but the annual assessment base has been modified to reflect the proration of assessments for part-year membership in the NASD, and has been expanded so that the amount to be reported by members as gross income now will include income from transactions in municipal securities

## American Stock Exchange, Midwest Stock Exchange, National Association of Securities Dealers, and New York Stock Exchange

In calendar year 1975, the markets governed by the four largest (in terms of total revenue) self-regulatory organizations—the American Stock Exchange ("Amex"), Midwest Stock Exchange ("MSE"), NASD, and the New York Stock Exchange ("NYSE")—experienced rising share volume On the NYSE, volume rose from 3 8 billion in 1974 to 5 1 billion in 1975, an increase of 32 percent

Over the same period of time, MSE share volume increased 20 percent, share volume from over-the-counter transactions by members of the NASD increased 17 percent, and Amex share volume increased 14 percent. This rise in share volume resulted in increased revenues for these four self-regulatory organizations.[55]

Although the Amex experienced the smallest percentage increase in share volume of the four largest self-regulatory organizations, it experienced the largest percentage increase in revenues, in part due to its initiation of trading in listed options.[56] The 1975 total revenue of the Amex was 24 percent above that for 1974. Transaction fees, which doubled between 1974 and 1975, accounted for much of the increase. This rapid rise in revenues, coupled with only a 16 percent rise in expenses, gave Amex its first profitable year since 1972

The MSE posted a 15 percent increase in revenue between 1974 and 1975, a percentage gain exceeded only by Amex. This gain in revenue was not attributable to any one source but was generated by an increase in most revenue components, the exception being communication fees which dipped slightly. Although the MSE's expenses increased during 1975, its revenues increased at a higher rate, resulting in 1975 net income surpassing that of 1974 by over $910,000

The NYSE ranked third among the four largest self-regulatory organizations in percentage gain in total revenue between 1974 and 1975. The rise in NYSE's share volume caused transaction fees to increase by $2 5 million. Listing fees climbed from $20 million in 1974 to $23 million in 1975. Similarly, increases occurred in revenues arising from communication fees, clearing fees and depository fees, contributing to an $11 million increase in total revenue. Much of the revenue improvement was carried through to pretax income, which in 1975 was $9 million higher than in the previous year.

NASD revenues are not as sensitive to changes in volume as are those of the national exchanges. As a result, the NASD experienced the smallest percentage increase in total revenue of the four largest self-regulatory organizations between 1974 and 1975, approximately six percent. This rise in revenue, however, was sufficient to move the NASD from an operating loss of $0.8 million in 1974 to pre-tax earnings of $1.3 million for 1975

## Boston Stock Exchange, Chicago Board Options Exchange, Pacitic Stock Exchange and Philadelphia Stock Exchange

Like the four largest self-regulatory organizations, the next four self-regulatory organizations (in terms of gross revenue) also experienced rising revenues, expenses and volume [57] The Boston Stock Exchange ("BSE") generated a 24 percent increase in share volume; the Chicago Board Options Exchange ("CBOE") experienced a 154 percent increase in contract volume; the Pacific Stock Exchange ("PSE") gained 26 percent in volume, and the Philadelphia Stock Exchange ("Phlx") gained nine percent in share volume during 1975.

The CBOE's large increase in volume generated a 130 percent increase in its transaction fees and a rise of nearly 800 percent in its communication fees. Expenses for the CBOE, however, rose by only 76 percent during 1975 As a result, the CBOE erased its 1974 loss of $445,000 by earning $1.3 million in 1975.

The BSE's rise in revenues came from significantly increased transaction fees and clearing fees, both of which are highly correlated to exchange share volume. Share volume on the BSE increased by 27 percent from 43 million shares in 1974 to 54 million shares in 1975. Expenses also rose between January and December 1975. This resulted in net income climbing to $356,000 in 1975, a substantial improvement over the $11,000 recorded in 1974.

The PSE also experienced increases in revenue due to greater volume However, the PSE experienced large increases in communication, data processing, collection, and other expenses primarily associated with the exchange's preparation for option trading and with enhancement of data processing capabilities at the exchange's service bureau Consequently, pre-tax income slipped from $517,000 in 1974 to a loss of $75,000 in 1975.

The Phlx also registered gains in total revenue. Between 1974 and 1975 Phlx gained 16 percent in total revenue primarily

due to a 42 percent rise in transaction fees. Unlike PSE, however, Phlx's pre-tax income increased to $84,000 in 1975 compared to a pre-tax loss of $341,000 in 1974.

## Cincinnati Stock Exchange, Detroit Stock Exchange, Intermountain Stock Exchange, and Spokane Stock Exchange

Three of the four smallest self-regulatory organizations—Cincinnati Stock Exchange ("CSE"), Detroit Stock Exchange ("DSE"), Intermountain Stock Exchange ("ISE") and Spokane Stock Exchange ("SSE")—deviated to some extent from the trend experienced by the eight larger self-regulatory organizations discussed above,[58] the exception being the CSE In 1975, CSE quadrupled its 1974 share volume of 2 million shares. This generated a 13 percent increase in revenues, a relatively small increase in expenses, and a near tripling of net income

The ISE did not fare as well. ISE volume declined during 1975 by 38 percent. However, because the ISE's primary sources of revenue are not dependent upon volume, the decline in total revenues was only 10 percent ISE managed to reduce its expenses during 1975 and, as a result, its pre-tax income rose by 33 percent over 1974 levels

The DSE also experienced a decline in revenues during 1975, and ceased operations on June 30, 1976[59] primarily because of declines in both volume and membership Between January and December 1975, share volume for DSE declined by 75 percent from 1 2 million shares in January to 0 3 million shares in December Share volume showed an additional decline of 74,000 shares between the fourth quarter of 1975 and the first quarter of 1976. The number of individual members of DSE fell from 55 to 44 during the period 1974 to 1975, a decline of 20 percent

The SSE, which receives income primarily from membership dues and listing fees, experienced small increases in revenues and expenses with no significant change in net income. SSE also sustained a 50 percent decline in trading volume between 1974 and 1975 but, because SSE's sources of revenue are unrelated to volume, the financial condition of SSE was not seriously affected.

## Expenses and Operations of the Municipal Securities Rulemaking Board ("MSRB")

Section 23(b) of the Securities Exchange Act, as amended by the 1975 Amendments, requires that the Commission submit "a statement and analysis of the expenses and operations of each self-regulatory organization in connection with the performance of its responsibilities under this title " The only responsibility of the MSRB under the Securities Exchange Act is rulemaking for the municipal securities industry. The MSRB income of $793,468 was derived from two fees established by rules adopted pursuant to Section 15B(b)(2)(J) of the Securities Exchange Act Fees include a one hundred dollar initial fee paid by all municipal securities brokers and municipal securities dealers and an underwriting assessment equal to 005% of the face amount of all municipal securities which are purchased from an issuer as part of a new issue by a municipal securities broker or a municipal securities dealer which have a final stated maturity of not less than two years from the date of the securities Over 70% of the MSRB's expenses were for salaries and other employee compensation, travel and meetings. In its first nine months of operation the MSRB had net income of $282,000

# BROKER-DEALER REGULATION

## Registration

Brokers and dealers who use the mails or a means or instrumentality of interstate commerce in the conduct of an interstate securities business are required to register with the Commission [60]

As of June 30, 1976, there were 5,308 broker-dealers registered, compared with 3,546 a year earlier This represents an increase of 1,762, or 50 percent since June 30, 1975. The large increase in effective registrations is due primarily to the fact that brokers and dealers who confine their business to transactions on a national securities exchange ("floor members"), and municipal securities professionals were required to register with the Commission for the first time as of December 1, 1975, pursuant to Section

15(a) of the Securities Exchange Act as amended by the 1975 Amendments Of the total of 5,308 effective registrations, approximately 1,800 registrants were floor members and 260 were municipal securities professionals

During fiscal 1976, 503 registrations were terminated, of which 442, or 87 9 percent, were withdrawn by the broker or dealer and sixty-one, or 12 1 percent, were revoked or cancelled by the Commission. During the year, 2,293 new applications became effective, while 250 new applications were either withdrawn, returned or denied

## Recordkeeping and Preservation Requirements

Securities Exchange Act Rules 17a–3 and 17a–4 require registered brokers and dealers, *inter alia,* to make, keep current, and preserve for prescribed intervals specified books and records relating to their business During the past fiscal year, the Commission twice amended these recordkeeping and preservation requirements. On August 25, 1975, the Commission adopted[61] amendments to Rule 17a–3(a)(12)(i)(h), which then required brokers and dealers to obtain, for each associated person, a record of any arrests, indictments or convictions for any felony or misdemeanor, other than minor traffic offenses As amended, the provision requires the maintenance of such records only with respect to arrests, indictments or crimes which may directly reflect on an individual's trustworthiness in dealing with customers' funds and securities In March 1976, the Commission adopted[62] amendments to Rules 17a–3 and 17a–4 to require the maintenance and preservation of records arising out of Securities Exchange Act Rule 17f–2, which implements the provisions of Section 17(f)(2) of the Securities Exchange Act requiring the creation of industry-wide programs for the fingerprinting of industry personnel and the submission of such fingerprints to the Attorney General of the United States for identification and appropriate processing

## Financial Responsibility Requirements

The implementation and refinement of the Commission's uniform net capital rule, discussed in Part 1 of this report,[63] constituted the most significant development of the past fiscal year in the area of financial responsibility requirements for brokers and dealers During the year, the Commission's staff evolved new procedures to expedite the processing of public inquiries and interpretive requests addressed to the uniform net capital rule and related financial responsibility and reporting requirements. The staff got over sixty phone inquiries a week and answered more than 800 letters requesting interpretations of these regulations during the fiscal year

The Commission's financial responsibility and reporting program for newly registering brokers and dealers in municipal securities[64] involved two provisions of Securities Exchange Act Rule 15c3–3, the customer protection rule On November 20, 1975,[65] in order to afford these brokers and dealers an appropriate period of adjustment to possibly unfamiliar regulatory requirements, the Commission suspended until January 31, 1976, Rule 15c3–3(d), which obliges brokers and dealers to verify and obtain possession and control of their customers' fully paid and excess margin securities. At the same time,[66] in recognition of the difficulty frequently experienced in promptly acquiring a particular municipal security, the Commission reaffirmed the indefinite suspension of the "buy-in" requirements of Rule 15c3–3(m) as applied to municipal securities

## Broker-Dealer Examinations

The Securities Acts Amendments of 1975 augmented the Commission's broker-dealer examination responsibilities. As amended, Section 15(b)(2)(C) of the Act requires the Commission (or a self-regulatory organization acting at the Commission's direction) to examine each newly registered broker or dealer within six months of the granting of its registration. During the past fiscal year, the Commission implemented a Post Effective Conference Program wherein each new SECO[67] registrant receives such an examination from the Commission The self-regulatory organizations have similar responsibility in the case of newly registered brokers or dealers for which such an organization is the designated examining authority [68]

In addition to the Post Effective Conference Program the Commission has continued its

regular examination program for both SECO brokers and dealers and members of self-regulatory organizations.

The Commission's examination program for SECO brokers and dealers consists of two types of examinations. The first type is a routine examination conducted once a year to determine the financial and operational condition of the SECO firm The second type of examination, the so-called "cause" examination, is conducted whenever a financial or operational problem has been noted in a firm. Cause examinations generally emphasize the particular problem encountered rather than the overall condition of the firm. During the previous fiscal year, the Commission conducted 193 routine examinations and 92 cause examinations of SECO firms; approximately the same number of SECO examinations conducted the previous fiscal year.

As part of the Commission's responsibility to oversee the operations of self-regulatory organizations, and in keeping with the pattern of self-regulation in the securities industry, the Commission conducts an ongoing review of the regulatory programs of the various self-regulatory organizations. One phase of this review consists of an on-site examination of the self-regulatory organization's examination and compliance programs and facilities The second phase—the "oversight" examination—is designed to evaluate both the financial and operational condition of the subject broker or dealer, and the quality of the most recent examination of that firm performed by its self-regulator. Commenced promptly after the completion of an examination made by the self-regulator, an oversight examination includes a physical inspection of the broker-dealer's books and records and supporting materials and a review of the firm's selling practices. The program contemplates a simultaneous comparative review of the working papers and reports of the examination conducted by the self-regulatory organization during the corresponding period.

The Commission's headquarters office staff has primary responsibility for on-site inspections of the self-regulatory organization's headquarters office, while the Commission's regional offices have primary responsibility regarding the oversight examination program Representatives from the headquarters and regional offices hold quarterly meetings to discuss the results of both on-site inspections of the self-regulators and oversight examinations. Subsequent to such meetings, conferences or other communications take place with the self-regulatory organizations, during which the staff conveys its analysis of and any recommendations concerning the self-regulator's programs Moreover, the specific results of a particular oversight examination generally are discussed with the self-regulator immediately after the examination

The second type of examination of a member firm of a self-regulatory organization is a cause examination, nearly identical in purpose and scope to the Commission's cause examinations of SECO brokers and dealers

During the previous fiscal year, the Commission conducted 390 oversight examinations and 384 cause examination of such member firms, a slight increase over the total number performed in fiscal year 1975, and in keeping with the goal set by the Commission for such examinations

The Commission continues to update its Broker-Dealer Examination Manual and Checklists in order to reflect the current rules and regulations applicable to brokers and dealers In addition, the Commission prepares and distributes to all regional offices educational materials on new regulatory developments or examination techniques to supplement the Broker-Dealer Examination Manual and familiarize the securities compliance examiners with such matters.

The self-regulatory organizations similarly have developed and updated their examination manuals and checklists during the past fiscal year. In addition, these organizations prepare educational material on regulatory developments for their examiners. Such materials are often the subject of examiner training sessions

To further coordinate the Commission's regulatory efforts between its headquarters and regional offices, the Commission staff prepares and transmits to the regional offices a monthly status report regarding new rule proposals and regulatory developments, the Commission's examination program and the surveillance and examination efforts of the self-regulators

## Early Warning and Surveillance

The Commission is responsible for the financial and operational soundness of all registered brokers and dealers. In this connection, pursuant to Section 5(a) of the Securities Investor Protection Act of 1970, the Commission requires each self-regulatory organization to provide the Commission with early warning lists identifying member firms which may be in or approaching financial difficulty or which may require closer-than-normal surveillance for other reasons This information is collected by the staff on at least a biweekly basis and is transmitted to the appropriate Commission regional office, which verifies the condition of those firms on the early warning list Each firm on the list is subjected to intensified monitoring by the regional office, acting in conjunction with the firm's self-regulatory examining authority

Other early warning techniques employed by the Commission include Securities Exchange Act Rule 17a–11, which requires a broker or dealer to notify the Commission and the appropriate self-regulator if the firm falls below certain standards of financial and operational soundness, measured in terms of capital sufficiency and adequacy of books and records If a firm drops below a level specified in the Rule, it must take immediate remedial action and begin an accelerated financial and operational reporting cycle to provide the Commission with current information about how well the firm is complying with the rules

The Commission periodically reviews the early warning and surveillance tools of the self-regulatory organizations to insure that they constitute sound, effective programs which will enable each organization to detect and monitor member firms that are in or approaching financial difficulty at the earliest possible time

The Commission's program for reviewing the early warning and surveillance programs of the self-regulatory organizations has two phases In the first phase, on-site inspections of the self-regulatory organizations, the Commission's staff reviews and attempts to strengthen where necessary, a self-regulator's early warning and surveillance programs, while at the same time evaluating and defining the goals, procedures, budget and staffing of those programs During the past fiscal year, the Commission's staff conducted on-site inspections of the early warning, surveillance and examination programs of the Chicago Board Options Exchange, Boston Stock Exchange, Midwest Stock Exchange, American Stock Exchange, and the Pacific Stock Exchange. The staff also completed an on-site inspection of the Philadelphia Stock Exchange initiated in the previous fiscal year [69] In addition, the Commission staff conducted on-site inspections of the examination, early warning and surveillance programs of the NASD district offices in New Orleans, Kansas City, Boston, and Los Angeles With regard to all self-regulators, in particular those not receiving on-site inspections during the past fiscal year, the Commission maintains on-going communications with the organizations to determine the status of their regulatory programs, especially in such areas as meeting examination goals, surveillance of member firms on the early warning list, and new regulatory developments

The second phase of this review, generally carried out by the Regional Offices, involves an on-site review of member firms of self-regulators to determine their understanding of and compliance with the various early warning standards and procedures applicable to them. As a rule, the Regional Offices combine their evaluation of a member organization's understanding of and compliance with applicable early warning standards with a review of that firm's financial and operational soundness and of the self-regulator's most recent examination of that firm

The efforts of the Commission, in conjunction with those of the self-regulators, to develop comprehensive and effective early warning and surveillance programs constitute one explanation for the steady decline in the number of securities firms who have been subject to liquidation in the past several years.[70] Indeed, liquidation proceedings under the Securities Investor Protection Act of 1970 have been commenced only once during the first seven months of 1976.

## Training Program

The Commission firmly believes in the need for comprehensive periodic training programs for securities compliance examiners,

both those on the Commission's staff and those employed by the various self-regulatory organizations Such training efforts broaden the knowledge and the skills of the examiners, and acquaint them with the latest modifications to examination procedures Accordingly, in the past fiscal year the Commission has carried out a series of training courses, some directed only toward Commission examiners and others toward regulatory organizations' examiners Some of these programs are developed and conducted by SEC personnel, others utilize the expertise of individuals and organizations not connected with the Commission The Commission encourages its own compliance examiners to improve their skills through correspondence courses, seminars, and lecture courses provided by colleges and universities; and in appropriate cases, the Commission pays tuition fees on behalf of its examiners

The Commission's internally developed training efforts essentially consist of four distinct programs

1 Periodic two-day training seminars conducted at each regional office and dealing with the Commission's oversight examinations Such seminars review the results of oversight examinations, discuss any new and important developments or techniques emerging from these examinations, and provide an opportunity for the regional offices to discuss with staff members of the self-regulatory organizations, who are invited to the seminars, means whereby examination programs and techniques may be refined and more closely coordinated

2 Two-day seminars held twice each year in each regional office for the more experienced securities compliance examiners on the subject of examination techniques Such seminars discuss significant new developments in the industry and particular examination techniques that may be utilized to deal with such developments.

3. One four-day training seminar held at the Commission's headquarters This seminar increasingly employs audiovisual instruction and provides examiners from the Commission, the self-regulatory organizations and State securities commissions with information on basic examination techniques, as well as the various regulatory programs of the Commission pertaining to broker-dealer financial and operational compliance The seminars generally include lecture and workshop sessions, with representatives from the Commission and the self-regulatory organizations participating as lecturers, commentators and workshop session leaders

4 Bi-weekly, one-hour training sessions in the regional offices for the Commission's examiners These sessions focus on new developments, regulatory problems, rules and examination techniques

The individuals charged with primary responsibility for each regional office's examination program meet every three months with members of the Commission's staff to discuss new training and examination techniques, areas where additional training is required, and the strengths and weaknesses of the Commission's regulatory current program Such meetings ensure uniformity of regulation throughout the Commission's regional offices and contribute to the continuing refinement of the Commission's training and examination programs

The Commission's three volume Broker-Dealer Examination Manual contains, among other things, a compendium of Commission rules, releases, and other relevant documentation Taken together with examination checklists and other supplementary material, it is intended to provide the Commission's examiners with a centralized reference source of the rules, interpretations, examination procedures and techniques with which they must be familiar In conjunction with the Manual, the Commission utilizes professionally produced training films and case problems which illustrate the proper procedures for conducting a thorough examination of a broker or dealer

In addition to inviting examiners employed by the self-regulatory organizations to certain of the Commission's training programs, the Commission also works with the self-regulators to improve their own training programs The Commission periodically reviews the training efforts of the self-regulators and has encouraged each self-regulator to hold informal, bi-monthly training programs and more formal annual training sessions for their own examination staffs In many instances, the Commission's examiners have been invited to attend or participate in such sessions

## Regulatory Burdens on Brokers and Dealers

The Commission has been sensitive to the impact of its regulations and reporting requirements, in addition to those of the self-regulatory organizations, upon all brokers and dealers and especially upon smaller firms. As a consequence, during recent years it has undertaken a number of programs aimed at streamlining and simplifying such requirements for the entire securities industry.

The Commission has reviewed and continues to review its financial and operational reporting rules and related reporting requirements and those of the self-regulatory bodies in an effort to alleviate the burden of compliance faced by brokers and dealers, and especially smaller broker-dealers, and to assure that such rules and regulations reflect the role of the small broker-dealer in the Nation's securities markets. To the extent that it is found that the benefit to the public interest contemplated by the Commission's rules and regulations is not commensurate with the burden imposed on brokers and dealers, and in particular on smaller firms, the Commission has modified rules and regulations through the use of provisions creating appropriate partial or complete exemptions from certain regulatory obligations

Other efforts by the Commission in this area include the formation in May 1974 of a Federal advisory committee, the Report Coordinating Group, to advise the Commission on simplifying and standardizing various reporting forms used by the Commission and the self-regulatory organizations.[71] This project has produced concrete results in the form of the FOCUS reporting concept which, as discussed in Part 1 of this Annual Report,[72] dramatically lessens the burdens placed upon brokers and dealers to demonstrate compliance with the Commission's financial and operational regulations.

Another equally important product of the Report Coordinating Group's efforts has been the development of uniform forms for the registration of brokers and dealers (Form BD), and their agents and associated persons (Form U-4) As previously reported,[73] these forms have achieved increasingly wide acceptance among the Commission, self-regulatory organizations, and State securities regulators. During the fiscal year, four additional States adopted Form BD and one adopted Form U-4. Thus, to date, forty-nine States, the Commission, and the NASD accept Form BD, these regulators, as well as all national securities exchanges, accept Form U-4

In January 1976, the Report Coordinating Group recommended adoption of uniform interpretations of certain terms in item 10 of Form BD in order to permit consistent responses by all registrants On February 6, 1976, the Commission formally adopted these interpretations [74] Other jurisdictions and organizations which have adopted Form BD have informally indicated their concurrence with the recommendations of the Group

Two other Federal advisory committees established by the Commission in recent years have had as one of their purposes the providing of assistance to the small broker-dealer community. The Central Market System Advisory Committee was created to ensure the maintenance of an appropriately competitive environment for the brokerage community, especially for the smaller firms [75] The other committee, the Broker-Dealer Model Compliance Program Advisory Committee, was responsible for compiling a guide to common regulatory obligations of broker-dealers, particularly small broker-dealers, and for suggesting ways to comply with such obligations [76]

# CLEARANCE AND SETTLEMENT

## Progress Toward a National System of Clearance and Settlement of Securities Transactions

During the past fiscal year, with the Commission's active encouragement, entities involved in securities processing improved their ability to complete securities transactions promptly and accurately For example, depositories instituted transfer agent custodian ("TAC") programs which are designed to reduce both the number of certificates maintained in depositories and certificate movement between depositories and transfer agents [77]

During the fiscal year, the continued development of interfaces among clearing corporations and depositories, which immobilize securities certificates by allowing participants to move securities throughout the country by book entry, tended to reduce costs and accelerate the settlement process

As a result of such improvements, as well as the increased participation in depositories by brokers and dealers, banks and other institutions, the Commission believes that progress is being made toward the development of an efficient national system for the clearance and settlement of securities transactions This progress made can be measured by the fact that securities processing mechanisms efficiently handled record trading volume during the early months of calendar year 1976. The Commission expects that the continued development and refinement of clearing and depository services will attract more persons to become participants in these systems in order to realize the substantial benefits which accrue from such participation. Increased participation will in turn further reduce the dependency of the clearance and settlement mechanisms upon the physical movement of certificates

## Rule Changes of Registered Clearing Agencies[78]

During fiscal year 1976, numerous changes in, or additions to, the rules, practices and operations of the thirteen registered clearing agencies[79] were submitted to the Commission for its approval under the provisions of Section 19 of the Securities Exchange Act [80] The following are among the more significant items on which the Commission acted favorably·

1 The Midwest Securities Trust Company ("MSTC") established several programs designed to facilitate the handling of securities MSTC's Transfer Agent Custodian ("TAC") Program[81] permits the depository to retain a working supply of certificates while depositing the remaining certificates with a transfer agent bank to be held in custody in the form of a balance certificate registered in the name of MSTC's nominee This aids securities processing by reducing certificate movement between the depository and the transfer agent The Depository Input Satellite System[82] allows MSTC participants to deposit securities with banks acting as agents for MSTC and to receive credit for the deposits at MSTC prior to the actual physical delivery of securities from the banks to MSTC MSTC also expanded its depository interface with Pacific Securities Depository Trust Company ("PSDTC") to permit book entry movements of securities from PSDTC to MSTC [83]

2 MSTC amended its rules to provide for increased representation on MSTC's Board of Directors for five Chicago clearing house banks which participate in MSTC by allowing the banks to nominate five of the eleven Board members [84]

3 Pacific Clearing Corporation ("PCC") established satellite facilities in Seattle, Washington,[85] Portland, Oregon[86] and Denver, Colorado [87] The purpose of these facilities is to provide access to the clearing and depository operations of PCC and PSDTC for broker-dealers, banks and other qualified users in the Seattle, Portland and Denver areas.

4 The Pacific Stock Exchange, Inc. initiated interfaces between PSDTC and the Depository Trust Company ("DTC") and MSTC [88]

5. Stock Clearing Corporation ("SCC") developed a mechanism for the processing of odd-lot transactions on the New York Stock Exchange, Inc. ("NYSE") through SCC's continuous net settlement ("CNS") system [89]

6 The NYSE adopted and the Commission approved[90] amendments to DTC's rules to enable the NYSE to sell part of the capital stock of DTC to its participants The amendments permit direct ownership of DTC shares by institutional participants. Broker-dealer participants are not permitted to own DTC shares directly. Instead, the NYSE, the American Stock Exchange, Inc , and the NASD act as representatives of their members

7 DTC also amended its fee schedule[91] to enable DTC's fees to bear a closer relationship to its costs

8 Stock Clearing Corporation of Philadelphia ("SCCP") adopted new procedures allowing SCCP members to pledge securities held in SCCP's depository to the Options Clearing Corporation in order to guarantee option contracts written by SCCP members [92]

9 Boston Stock Exchange Clearing Corporation ("BSECC") adopted procedures to im-

plement a market-to-market requirement applicable to transactions on the Boston Stock Exchange having a contract price not exceeding $250,000.[93] This action was designed to protect clearing members of BSECC from losses resulting from the failure of other clearing members to settle such trades.

In approving these proposals, the Commission acted with a view toward facilitating the development of a national system for the prompt and accurate clearance and settlement of securities transactions, and the elimination of securities certificate movement in connection with the settlement of securities transactions.

## Expenses and Operations of Registered Clearing Agencies

Section 23(b) of the Securities Exchange Act, as amended by the 1975 Amendments, requires that the Commission submit "a statement and analysis of the expenses and operations of each self-regulatory organization in connection with the performance of its responsibilities under this title, for which purpose data pertaining to such expenses and operations shall be made available by such organization to the Commission at its request." The 1975 Amendments also require clearing agencies to register as separate self-regulatory organizations as of December 1, 1975 The revenue and expense figures for all registered clearing agencies other than TAD Depository Corporation, Bradford Securities Processing Services, Inc. and Options Clearing Corporation (which were not wholly owned subsidiaries of a national securities exchange or the NASD when the 1975 Amendments were signed into law) are included in the revenue and expense analyses of their respective parent self-regulatory organizations.[94] This precludes comparison between those clearing agencies and the remaining registered clearing agencies; it has not, therefore, proven possible to set forth separate and uniform financial data for registered clearing agencies. Separate statements and analyses of the operating results of each registered clearing agency will be available for inclusion in the Commission's Annual Report for fiscal year 1977.

## Exemptions

During fiscal year 1976, the Commission received six applications from transfer agents for exemption from registration under Section 17A(c) of the Act. All six applicants were informed that the Commission's staff would not recommend that the Commission grant an exemption, and that the staff would consider the applications as withdrawn unless the applicant indicated otherwise. Only one applicant indicated a desire for further consideration; this application was pending at the close of the fiscal year

Fifteen applications for exemption from registration as a clearing agency under Section 17A(b) of the Act were filed. One entity withdrew its exemption request and the remaining applications—which are discussed in Part 1 of this Report[95]—are being considered.

# SECURITIES INVESTOR PROTECTION CORPORATION

The Securities Investor Protection Act[96] of 1970 (the "SIPC Act") established the Securities Investor Protection Corporation ("SIPC") to provide certain protections to customers of member brokers and dealers who are unable to meet their financial obligations to such customers. SIPC is a non-profit membership corporation, the members of which are most of the registered brokers and dealers [97] While SIPC is funded primarily through assessments on its members, under certain conditions it may borrow up to $1 million from the United States Treasury.[98]

## Proposed Legislation to Amend the Securities Investor Protection Act of 1970

In October 1975, the Commission testified before the Subcommittee on Consumer Protection and Finance of the House Committee on Interstate and Foreign Commerce on a bill to amend the SIPC Act [99] This bill grew out of a June 1974 report[100] to the SIPC Board of Directors by a Special Task Force appointed by SIPC to consider possible changes in the 1970 Act. Among other things, the bill would: (1) permit SIPC to make direct payments to customers in certain relatively small cases by amending existing procedures requiring

court-appointed trustees in all SIPC liquidations; (2) permit customer accounts to be transferred in bulk to other SIPC members in appropriate cases rather than to be liquidated on an individual basis; and (3) raise the dollar limitations upon the protections available to individual customers. The Commission expressed its support for the bill and offered certain comments. At the end of the fiscal year, this proposed legislation—as well as a companion Senate bill[101]—was still pending

## Litigation Related to SIPC

In *SEC* v. *Morgan, Kennedy & Co , Inc ,*[102] the trustees of a profit sharing plan trust that held an account with the debtor broker-dealer asserted that the 108 beneficiaries of the trust were separate customers of the debtor, each entitled to protection under the SIPC Act or, alternatively, that the several trustees were separate customers. The United States District Court for the Southern District of New York held that each of the beneficiaries was a separate customer. In January 1976 the United States Court of Appeals for the Second Circuit reversed the district court, holding that only the trust itself was a customer for purposes of the SIPC Act.[103] On June 14, 1976, the Supreme Court declined to review that decision.[104]

In *SEC* v. *Executive Securities Corporation,*[105] certain broker-dealers and educational institutions which had loaned securities to the debtor asserted that they were customers of the debtor with respect to such loans and therefore entitled to protection under the SIPC Act. A Federal court of bankruptcy held that secured stock lenders which had no other securities accounts or dealings with the debtor were not customers within the meaning of the SIPC Act, and, therefore, were not entitled to the protection of the SIPC Fund.

## Proposed Amendment to SIPC By-Laws

In June 1975, SIPC submitted to the Commission a proposed amendment of its by-laws which would have required SIPC members to display the SIPC symbol in their offices and to include a reference to SIPC in their advertising. On August 28, 1975, the Commission determined to disapprove the proposed amendment on the grounds that the SIPC Act does not vest SIPC with the authority to require such display by its members[106]

## REGULATION OF SECO BROKER-DEALERS

Under Section 15(b) of the Securities Exchange Act, the Commission is responsible for prescribing rules establishing qualifications standards for all brokers and dealers, including those who are not members of the NASD ("nonmember" or "SECO" brokers or dealers) This section also empowers the Commission to adopt rules governing the business conduct of SECO brokers and dealers, in order to provide regulation of such brokers and dealers comparable to that provided by the NASD for its members

At the close of the fiscal year, the number of SECO brokers and dealers registered with the Commission and not entitled to an exemption from the Commission's SECO rules[107] totaled 309,[108] and the number of associated persons of such firms (*i e ,* partners, officers, directors, sole proprietors and employees not engaged in merely clerical or ministerial functions) totaled 23,236.

Securities Exchange Act Rule 15b9–2 imposes an annual assessment to be paid by SECO brokers and dealers to defray the cost of their regulation by the Commission. During the fiscal year, the Commission proposed to amend Rule 15b9–2 and the annual assessment schedule for SECO brokers and dealers for fiscal year 1976 (Form SECO–4–76). The proposals would·

(1) reduce the current annual personnel assessment from $15 to $5,
(2) introduce a 0 375 percent assessment on annual gross income from over-the-counter transactions,
(3) reduce the initial fee for individuals filing Form U–4 from $50 to $35,
(4) change the due date for SECO annual assessments from June 1 to September 1; and
(5) change the SECO fiscal year from July 1 to October 1 cycles, to conform the SECO fiscal year to the new Federal fiscal year

The modifications to the SECO fee and assessment schedule were designed to miti-

gate inequities in the assessment structure primarily resulting from the inclusion in SECO of a number of municipal securities brokers and dealers who were required to register with the Commission by the 1975 Amendments and elected not to join the NASD The proposed amendments to both rule and schedule were adopted by the Commission shortly after the close of the fiscal year [109]

## SHORT SELLING INTO UNDERWRITTEN OFFERINGS

As previously reported,[110] the Commission, on April 2, 1975, published for public comment, among other things, a revised version of proposed Securities Exchange Act Rule 10b–21, which was first proposed in 1974 [111] Proposed Rule 10b–21 would impose certain limitations on purchases to cover short sales where such short sales were effected before the commencement of an offering involving securities of the same class or series

These proposals were intended to regulate certain trading practices which continue to be of substantial concern to the underwriting community Short selling by hedge funds and other persons reportedly continue to take place in anticipation of underwritten offerings, particularly of securities traded over-the-counter Such short selling may be intended to create downward pressure on the trading market, forcing the issuer or underwriter to lower the offering price, thereby permitting short sellers to cover their short sales at lower prices with securities purchased in the offering or in the lower aftermarket This practice has reportedly caused issuers and underwriters to abandon prospective offerings The Commission is continuing to study these and other associated trading practices in order to initiate appropriate regulatory action

## EXEMPTIONS

Of three requests received for exemptions from the broker-dealer registration requirements, one was granted pursuant to Section 15(a)(2) as necessary and appropriate in the public interest and for the protection of investors

Securities Exchange Act Rule 10b–6 places certain prohibitions upon trading in securities by persons interested in a distribution of such securities During the fiscal year, approximately 360 exemption requests under paragraph (f) of Rule 10b–6 were granted on facts indicating that the transactions did not appear to constitute manipulative or deceptive devices or contrivances within the meaning of the rule

During this year the Director of the Division of Market Regulation, pursuant to delegated authority, exempted two life insurance companies registered as broker-dealers from the provisions of the uniform net capital rule, Securities Exchange Act Rule 15c3–1. Due to the special nature of their business, their financial position, and the safeguards established by those firms for the protection of customers' funds and securities, the Commission was satisfied that it was not necessary or appropriate in the public interest or for the protection of investors to subject such broker-dealers to the provisions of Rule 15c3–1.

The Commission monitors the impact of competitive commission rates by obtaining pertinent data on a quarterly basis from certain brokers and dealers through Securities Exchange Act Rule 17a–20 and related Form X–17A–20. Some brokers and dealers subject to the rule's filing requirements cannot, because of special circumstances or an unusual business mix, provide the Commission with meaningful information regarding competitive commission rates Consequently, during Fiscal Year 1976, the Commission granted exemptions from the Form X–17A–20 filing requirement to twenty-one brokers and dealers.

Other applications for exemption from the provisions of the Securities Exchange Act are discussed elsewhere in this Annual Report, in connection with the individual provisions thereof germane to these applications.

## NOTES FOR PART 3

[1] Act of June 4, 1975, Pub L No 94–29, 89 Stat. 97 (hereinafter cited by section as 1975 Amendments)

[2] The Honolulu Stock Exchange is the only securities exchange presently exempted from registration

[3] On May 10, 1976, the PBW Stock Exchange, Inc changed its name to the Philadelphia Stock Exchange, Inc

[4] See 41st Annual Report, pp. 65–66

[5] See *Ecological Science Corp.*, Securities Exchange Act Release No 10217 (June 13, 1973), 1 SEC Docket No 20 at 5, and cases

cited therein. During fiscal year 1976, the Commission followed this approach in cases involving the removal of two securities listed on the American Stock Exchange, Inc. See *Clary Corp* , Securities Exchange Act Release No 11751 (October 20, 1975), 8 SEC Docket 196, *BBI, Inc*., Securities Exchange Act Release No. 11686 (September 26, 1975), 7 SEC Docket 978.

[6] In addition, applications by two exchanges to strike the stock of State Savings and Loan Association were granted by the Federal Home Loan Bank Board, pursuant to authority given to the Board by Section 12(i) of the Securities Exchange Act of 1934

[7] See S Rep No 75, 94th Cong , 1st Sess. 106 (1975), H Conf. Rep No 229, 94th Cong., 1st Sess. 95 (1975)

[8] Application for Unlisted Trading Privileges in Common Stock of Ludlow Corp by the Boston Stock Exchange, File No. 7–4596 (filed April 23, 1974)

[9] Securities Exchange Act Release No 11492 (June 25, 1975), 7 SEC Docket 738

[10] Boston Stock Exchange, Administrative Proceeding File No. 3–4646 (May 6, 1976)

[11] 41st Annual Report, p 67.

[12] Section 19(b) of the Securities Exchange Act, as amended by Section 16 of the 1975 Amendments.

[13] For a description of the Municipal Securities Rulemaking Board, see 41st Annual Report, p 7

[14] Securities Exchange Act Release No 11604 (August 19, 1975), 7 SEC Docket 652

[15] Securities Exchange Act Rule 19c–1 is discussed at pages 4–5, *supra*

[16] As used here, the term "class of options" means all option contracts of the same type, *i e* , put or call, covering the same underlying stock.

[17] *Cf* Rule 19b–4, Filing No PBWSE–76–2 (filed January 19, 1976) The Commission neither required nor discouraged dual trading of options However, the Commission's previous insistence that initiation of option trading programs on more than one national securities exchange should be conditioned, among other things, on the achievement of a national options clearing system, establishment of a common system for reporting and disseminating last sale information for options transactions and agreement as to standardization of terms of listed options helped insure that there would not be obstacles to such trading *See* Securities Exchange Act Release No. 10981 (August 22, 1974), 5 SEC Docket 224.

[18] At the end of the fiscal year, the Commission had under consideration a proposal by the PSE to permit dual trading with different expiration dates

[19] "Print splitting" is the reporting of a single sale of several round lots as several smaller sales—for example, printing a 1,000 share transaction as five 200 share transactions. "Narrowing quotations" is a related practice which involves re-quoting the stock between split trade reports by raising the bid or lowering the offer after a transaction has occurred but before the card used to report the transaction on the consolidated tape has been placed in the reader

[20] As of December 31, 1974, five of the nine enforcement attorneys have been with the NYSE for less than one year, three had from one to two years of NYSE experience and one had been with the NYSE for six years

[21] New York Stock Exch Educ Cir No 353 (January 10, 1972) defines major complaint as "any written complaint which involves (1) claim of actual damages in excess of $10,000, or (2) claim for damages which is settled for an amount exceeding $2,500

[22] When they enter the trading crowd, options traders assume certain responsibilities to assist specialists in their options market making capacity These responsibilities are set forth in American Stock Exch. Rule 958 See also 41st Annual Report, p 69.

[23] Commentary 07 to American Stock Exch Rule 958.

[24] See 41st Annual Report, p 16.

[25] Phlx had proposed to expand its option trading program by the listing of call options on five additional underlying stocks which would bring the total number of underlying stocks listed on the Exchange up to fifteen See Rule 19b–4, Filing No SR–PBWSE–75–2 (filed September 15, 1975)

[26] See 41st Annual Report, pp 67–68

[27] The Investigation Section deals with all problems brought up in complaints of members and customers relating to floor operations It also supervises trading on the floor and investigates apparent trading violations

[28] See generally Chicago Bd. Options Exch Rule 8 7.

[29] This practice involves trading options with the knowledge that a block transaction is about to occur in the underlying stock, or that a block transaction has occurred but has not yet affected the option price

[30] This practice involves executing a small trade at the close of business for the purpose of moving the option price up or down, possibly in order to affect the market maker's margin requirements favorably

[31] This practice involves the execution of "wash sales" in option spread transactions and may be done for tax reasons

[32] See Chicago Bd Options Exch Rule 4 11

[33] Those registered broker-dealers which are not NASD members are referred to as SECO broker-dealers See p 99, *infra*

[34] See pp 79–80, *supra*

[35] See pp 7–8, *supra*

[36] See p 14, *supra*

[37] However, Schedule D did permit (and continues to permit) inclusion of stabilizing bids that were unqualified by legend or penalty stipulations

[38] The staff also discussed with the NASD concerns raised by a staff inspection of the

NASD's Chicago District Office during fiscal year 1975. See 41st Annual Report, p 72

[39] On February 9, 1976, the NASD completed its purchase of the NASDAQ facilities from Bunker Ramo Corp and organized this operation as a wholly-owned subsidiary, NASDAQ, Inc , which will be registered with the Commission as a securities information processor pursuant to Section 11A of the Securities Exchange Act See pp 22–23, *supra.*

[40] Subsequently, the Commission approved certain amendments to Schedule D of the NASD's By-Laws, including an amendment to reduce the NASDAQ market maker requirement to one See text accompanying note pp 84–85, *supra*

[41] Securities Exchange Act Release No 11729 (October 14, 1975), 8 SEC Docket 69

[42] Securities Exchange Act Release No 12279 (March 29, 1976), 9 SEC Docket 311

[43] *Id* at n 17

[44] On April 15, 1976, the Commission issued an order granting Todd and Company, Inc. and Thomas K Langbein a stay, pending disposition of their appeal to the Third Circuit

[45] Securities Exchange Act Release No 12564 (June 22, 1976), 9 SEC Docket 947

[46] Securities Exchange Act Release No 11741 (October 15, 1975), 8 SEC Docket 80, Securities Exchange Act Release No 11838 (November 17, 1975), 8 SEC Docket 448, Securities Exchange Act Release No 12004 (January 12, 1976), 8 SEC Docket 1019, Securities Exchange Act Release No 12052 (January 27, 1976), 8 SEC Docket 1154, Securities Exchange Act Release No 12168 (March 5, 1976), 9 SEC Docket 125

[47] See p 15, *supra*

[48] Securities Exchange Act Release No 11916 (December 11, 1975), 8 SEC Docket 702

[49] See Securities Exchange Act Release No 12177 (March 8, 1976), 9 SEC Docket 130, Securities Exchange Act Release No 12362 (April 23, 1976), 9 SEC Docket 482, Securities Exchange Act Release No 12469 (May 20, 1976), 9 SEC Docket 690.

[50] Section 23(b) of the Securities Exchange Act, as amended by the 1975 Amendments, requires that the Commission submit "a statement and analysis of the expenses and operations of each self-regulatory organization in connection with the performance of its responsibilities under this title, for which purpose data pertaining to such expenses and operations shall be made available by such organization to the Commission at its request " The following discussion is responsive to that requirement

[51] A breakdown of 1975 exchange share volume, together with compilations of exchange share volume and dollar volume in recent years, may be found in pt. 9 *infra,* Table 17

[52] See pt. 9 infra, Table 6

[53] See generally pt 9 *infra,* Table 6

[54] See pp 14–17, *supra*

[55] See generally pt 9 *infra,* Table 6.

[56] See p 17, *supra*

[57] See generally pt 9 *infra,* Table 6.

[58] See pt 9 *infra,* Table 6

[59] See p. 78, *supra*

[60] Section 15(a) of the Securities Exchange Act, as amended by the 1975 Amendments, now requires the registration of brokers and dealers who were previously exempt from registration because they confined their securities business to an exchange. Brokers and dealers who confine their activities to exempted securities, as defined in Section 3(a)(12) of the Securities Exchange Act, continue to be exempt from the registration requirement Effective December 1, 1975, municipal securities are no longer defined as exempted securities for purposes of the registration requirement applicable to brokers and dealers

[61] Securities Exchange Act Release No. 11615 (August 25, 1975), 7 SEC Docket 710

[62] Securities Exchange Act Release No 12214 (March 16, 1976), 9 SEC Docket 203

[63] See p 14, *supra*

[64] See pp 14–17, *supra*

[65] Securities Exchange Act Release No 11854 (November 20, 1975), 8 SEC Docket 459

[66] *Id*

[67] "Securities and Exchange Commission Only " In this context, the term refers to brokers and dealers who are neither members of the National Association of Securities Dealers, Inc , nor designated to another self-regulatory organization for examination purposes.

[68] See Securities Exchange Act Release No 12352 (April 20, 1976), 9 SEC Docket 450

[69] See 41st Annual Report, p 80

[70] See 5 Securities Investor Protection Corp. Ann Rep (1975)

[71] See 41st Annual Report, pp 17–19, 84.

[72] See pp 12–14, *supra*

[73] See 41st Annual Report, p 19.

[74] Securities Exchange Act Release No. 12078 (February 6, 1976), 8 SEC Docket 1234

[75] See 41st Annual Report, pp 8–11, 40th Annual Report, p 4

[76] See 41st Annual Report, p 19, 40th Annual Report, p 5.

[77] Generally, in a TAC program the depository maintains a working supply of certificates of a particular issue, while depositing the remaining certificates with the transfer agent to be held in its custody in the form of a balance certificate registered in the name of the depository As the need for certificates in the depository changes, the depository adjusts its in-house inventory by increasing or decreasing the number of shares held in-house in nominee name, correspondingly decreasing or increasing the number of shares held by the transfer agent. Appropriate shipments of securities between the depository

and transfer agent are made to effect these adjustments

[78] The 1975 Amendments required clearing agencies to register separately with the Commission as self-regulatory organizations no later than December 1, 1975. Prior to that date, the rule changes of registered clearing agencies which were wholly-owned subsidiaries of exchanges or the NASD were filed by the parent organization

[79] As of June 30, 1976, the following thirteen clearing agencies were registered with the Commission: American Stock Exchange Clearing Corporation, Boston Stock Exchange Clearing Corporation, Bradford Securities Processing Services, Inc., The Depository Trust Company, Midwest Clearing Corporation, Midwest Securities Company; Options Clearing Corporation, National Clearing Corporation, Stock Clearing Corporation, Stock Clearing Corporation of Philadelphia, Pacific Clearing Corporation, Pacific Securities Depository Trust Company, and TAD Depository Corporation

[80] The 1975 Amendments amended Section 19(b) of the Act to provide a detailed procedure by which the Commission reviews each proposed rule change by a self-regulatory organization, including a registered clearing agency

[81] See Securities Exchange Act Release No 12579 (July 6, 1976), 9 SEC Docket 1027

[82] See Securities Exchange Act Release No 12077 (February 6, 1976) 8 SEC Docket 1233

[83] See Securities Exchange Act Release No 12394 (April 29, 1976), 9 SEC Docket 510

[84] Securities Exchange Act Release No 12107 (February 13, 1976), 8 SEC Docket 1296

[85] Securities Exchange Act Release No 11857 (November 20, 1975), 8 SEC Docket 471.

[86] Securities Exchange Act Release No 12324 (April 7, 1976), 9 SEC Docket 379

[87] Securities Exchange Act Release No 12571 (June 23, 1976), 9 SEC Docket 955

[88] Securities Exchange Act Release No. 11856 (November 20, 1975), 8 SEC Docket 471.

[89] See Securities Exchange Act Release No. 12486 (May 27, 1976), 9 SEC Docket 738, Securities Exchange Act Release No 12006 (January 12, 1976), 8 SEC Docket 1020.

[90] Securities Exchange Act Release No 11723 (October 9, 1975), 8 SEC Docket 65

[91] Securities Exchange Act Release No. 12103 (February 12, 1976), 8 SEC Docket 1256.

[92] Securities Exchange Act Release No 12305 (April 2, 1976), 9 SEC Docket 371

[93] Securities Exchange Act Release No 12198 (March 12, 1976), 9 SEC Docket 193

[94] See pt. 9, Table 6

[95] See pp. 19–20, *supra*

[96] 15 U S C §§ 78aaa–78111 (1970)

[97] Exempted from membership are brokers and dealers whose business consists exclusively of (1) the distribution of shares of mutual funds, (2) the sale of variable annuities, (3) the business of insurance, or (4) the business of rendering investment advisory services to certain investment companies or insurance company separate accounts *Id* § 78aaa(a).

[98] *Id* § 79ddd

[99] H R 8064, 94th Cong., 1st Sess (1975).

[100] See 41st Annual Report, p 86, 40th Annual Report, p 64

[101] S 1231, 94th Cong., 1st Sess (1975)

[102] [1975–1976 Transfer Binder] CCH Fed Sec L Rep para 95,228 (S D N Y 1975), *rev'd sub nom SIPC v Morgan, Kennedy & Co.*, 553 F 2d 1314 (2d Cir.), *cert denied*, 96 S Ct 2650 (1976)

[103] *SIPC* v *Morgan, Kennedy & Co.*, 553 F 2d 1314 (2d Cir 1976), *rev'g SEC v Morgan, Kennedy & Co.*, [1975–1976 Transfer Binder] CCH Fed Sec L Rep para 95,228 (S D.N Y 1975)

[104] 96 S Ct 2650 (1975)

[105] Civil No 75–733 (S D N Y., Feb 23, 1976)

[106] The pending legislation to amend the SIPC Act would expressly confer such authority upon SIPC

[107] In March 1976, the Commission announced, in Securities Exchange Act Release No. 12160 (March 3, 1976), 9 SEC Docket 80, the amendment of Securities Exchange Act Rules 15b8–1, 15b9–1, 15b9–2, and 15b10–1 through 15b10–6 to provide an exemption from such rules for brokers and dealers whose activities are generally confined to a national securities exchange Specifically, a broker or dealer is exempt from the SECO provisions if (1) it is a member of a national securities exchange, (2) it carries no accounts of customers, and (3) its annual gross income derived from the purchases and sales of securities otherwise than on the exchange of which it is a member is no greater than $1,000, provided, however, that gross income derived from transactions otherwise than on such national securities exchange which are effected for its own account with or through another registered broker or dealer is not subject to that dollar limitation

[108] This represents an increase of seven such brokers and dealers from the prior fiscal year, and constitutes the third consecutive increase in the number of effective SECO registrations The past year's increase may be attributed to the SECO registration of several brokers and dealers effecting transactions in municipal securities required to register by the 1975 Amendments

[109] Securities Exchange Act Release No 12700 (August 10, 1976), 10 SEC Docket 217. The change in the SECO fiscal year had

the effect of postponing the filing deadline for Form U–4 from June 1 to September 1 For this reason, it has not proven possible to include in this year's Annual Report a table derived from the Form U–4 filings indicating the principal activities of SECO brokers and dealers. See 41st Annual Report, p. 182

[110] 41st Annual Report, pp. 89–90

[111] Securities Exchange Act Release No. 10636 (February 11, 1974), 3 SEC Docket 540. At the same time, the Commission proposed Securities Exchange Act Rule 10b–20, which would prohibit underwriters and dealers participating in a distribution from requiring a purchaser, in order to receive an allocation of the security, to pay consideration in addition to the amount indicated in the prospectus or to perform any other act such as purchasing an additional security in an unrelated offering (so-called "tie-in" arrangements) The Commission also proposed amendments to its recordkeeping requirements for brokers and dealers, Securities Exchange Act Rule 17a–3, intended to assist brokers and dealers in complying with provisions of the securities laws relating to short sales

# Part 4
# Enforcement

# Part 4

# Enforcement

The Commission's enforcement activities, which are designed to combat securities fraud and other illegal activities, continued at a high level during the past year. These activities encompass civil and criminal court actions, as well as administrative proceedings conducted internally. Where violations of the securities laws are established, the sanctions which may result range from censure by the Commission to prison sentences imposed by a court.

The enforcement program is designed to achieve as broad a regulatory impact as possible within the framework of resources available to the Commission. In light of the capability of self-regulatory and state and local agencies to deal effectively with certain securities violations, the Commission seeks to promote effective coordination and cooperation between its own enforcement activities and those of other agencies

## DETECTION

### Complaints

The Commission receives a large volume of communications from the public. These consist mainly of requests for information and complaints against broker-dealers and other members of the securities community as well as complaints concerning the market price of particular securities During the past year, approximately 5,300 complaints against broker-dealers were received, analyzed and answered. Most of these complaints dealt with operational problems, such as the failure to deliver securities or funds promptly, or the alleged mishandling of accounts In addition, there were about 11,000 complaints received concerning investment advisers, issuers, banks, transfer agents, mutual funds or similar matters.

The Commission seeks to assist persons in resolving complaints and to furnish requested information Thousands of investor complaints are resolved through staff inquiries of the firms involved While the Commission does not maintain an arbitration program to resolve disputes between brokerage firms and investors, a complaint may lead to the institution of an investigation or an enforcement proceeding, or it may be referred to a self-regulatory or local enforcement agency

### Market Surveillance

The Commission's staff has devised procedures to identify possible violative activities in the securities markets through surveillance of listed securities This program is coordinated with the market surveillance operations of the New York, American and regional stock exchanges, as well as the various options exchanges

In this regard, the Commission's market surveillance staff maintains a continuous watch of transactions on the stock and options exchanges and reviews reports of large block transactions to detect any unusual price and volume variations It also monitors financial news tickers, financial publications and statistical services In addition, the staff has supplemented its regular reviews by receiving daily and periodic market surveillance reports from the exchanges and the NASD which provide in-depth analysis of information de-

veloped by them To augment its surveillance capabilities, the staff is using various data processing services so that irregular trading activity will be promptly detected and effectively investigated

For those securities traded by means of the NASDAQ system, the Commission also has developed a surveillance program, which is coordinated with the NASD's market surveillance program, through a review of weekly and special stock watch reports

For those over-the-counter securities not traded through NASDAQ, the Commission uses automated equipment to provide an efficient and comprehensive surveillance of stock quotations distributed by the National Quotation Bureau. This is programmed to identify, among other things, unlisted securities whose price movement or dealer interest varies beyond specified limits in a pre-established time period. When a security is so identified, the equipment prints out current and historic market information. Other programs supplement this data with information concerning sales of securities pursuant to Rule 144 under the Securities Act, ownership reports, and periodic company filings such as quarterly and annual reports These data, combined with other available information, are analyzed for possible further inquiry and enforcement action

In addition, recognizing that the computer provides the most expeditious method of reviewing and analyzing the voluminous trading data generated by the securities markets, the Commission has developed a program which provides an analysis of the bid listings for each security by summarizing specified types of activity by each broker-dealer firm submitting price quotations for that particular security.

The staff oversees tender offers, exchange offers, proxy contests and other activities involving efforts to change control of public corporations Such oversight includes review not only of trading markets in the securities involved, but also filings with the Commission of required schedules, prospectuses, proxy material and other information

## INVESTIGATIONS

Each of the acts administered by the Commission authorizes investigations by it to determine if violations have occurred Most of these are conducted by the Commission's regional offices Investigations are carried out on a confidential basis, consistent with effective law enforcement and the need to protect persons against whom unfounded charges might be made Thus, the existence or results of a nonpublic investigation are generally not divulged unless they are made a matter of public record in proceedings brought before the Commission or in the courts During the fiscal year 1976, a total of 413 investigations were opened, as against 490 in the preceding year

## ENFORCEMENT PROCEEDINGS

The Commission has available a wide range of possible enforcement remedies It may, in appropriate cases, refer its files to the Department of Justice with a recommendation for criminal prosecution The penalties upon conviction are specified in the various statutes and include imprisonment for substantial terms as well as fines

The securities laws also authorize the Commission to file injunctive actions in the Federal district courts to enjoin continued or threatened violations of those laws and applicable Commission rules In injunctive actions, the Commission frequently has sought to obtain ancillary relief under the general equity powers of the Federal district courts The power of the Federal courts to grant such relief has been judicially recognized The Commission often has requested the court to appoint a receiver for a business where investors were likely to be harmed by continuance of the existing management It also has requested court orders which, among other things, restrict future activities of the defendants, require that rescission be offered to securities purchasers, or require disgorgement of the defendants' ill-gotten gains

The Commission's primary function is to protect the public from fraudulent and other unlawful practices and not to obtain damages for injured individuals Thus, a request that disgorgement be required is predicated on the need to deprive defendants of profits derived from their unlawful conduct and to protect the public by deterring such conduct by others.

If the terms of any injunctive decree are violated, criminal contempt proceedings may

be filed as a result of which the violator may be fined or imprisoned

The Federal securities acts also authorize the Commission to impose remedial administrative sanctions Administrative enforcement proceedings involve alleged violations of the securities acts or regulations by firms or persons engaged in the securities business Generally speaking, if the Commission finds that a respondent willfully violated a provision of or rule under the securities acts, failed reasonably to supervise another person who committed a violation, or has been convicted of or enjoined from certain types of misconduct, and that a sanction is in the public interest, it may revoke or suspend the registration of a broker-dealer or investment adviser, bar or suspend an individual from the securities business or from association with an investment company, or censure a firm or individual. Proceedings may also cover adequacy of disclosure in a registration statement or in reports filed with the Commission Such a case may lead to an order suspending the effectiveness of a registration statement or directing compliance with reporting requirements The Commission also has the power to suspend trading summarily in a security when the public interest requires

## ADMINISTRATIVE PROCEEDINGS

Summarized below are some of the many administrative proceedings pending or finally disposed of in fiscal 1976

*Mitchum, Jones & Templeton, Inc* [1]—In an initial decision which became the final decision of the Commission, Mitchum, Jones & Templeton ("registrant"), a Los Angeles broker-dealer, was found to have aided and abetted violations of antifraud and other provisions of the securities laws in connection with its participation in a registered 1972 stock offering of SaCom The administrative law judge concluded that the public interest did not warrant imposition of a sanction

Registrant was a member of the underwriting syndicate for the SaCom offering However, its syndicate department manager had an undisclosed understanding with the managing underwriter that registrant would not be subject to the normal underwriter's risk of having to take unsold stock into its investment account None of the shares for which registrant was committed were sold, pursuant to the understanding, the managing underwriter purchased those shares for its own account upon termination of the syndicate The failure to disclose the understanding was held to render the representations concerning registrant in the registration statement and otherwise materially misleading

In holding that it was not necessary or appropriate to sanction registrant, the administrative law judge noted, among other things, that the misconduct represented an isolated occurrance, that it has not been proven that registrant had failed reasonably to supervise, and that the responsible employee had not been associated with registrant since 1973

*Chartered New England Corp* [2]—The Commission instituted administrative proceedings against Chartered New England Corp ("Chartered"), a New York broker-dealer, its president, two vice presidents and a registered representative The order alleged, among other things, that the respondents violated the antifraud and registration provisions of the Federal securities laws in connection with Chartered's activities as an underwriter and a market-maker in the securities of Audio Media Corp

On accepting offers of settlement from the respondents, the Commission suspended two of the respondents for specified periods of time from association with a broker or dealer The Commission also required that Chartered and the remaining respondents, with certain exceptions, not engage in the activities of a broker or dealer for a period of three months and not engage in offers of securities for a period of nine months The order further required, with respect to Chartered, procedures for compliance with the securities laws and specified additional sanctions against an individual vice president which included, among other things, a prohibition against sharing in the profits of Chartered for a nine-month period

*Michael Batterman, et al* [3]—The Commission accepted offers of settlement from Michael Batterman, who had been a registered representative with a broker-dealer now no longer in business, from Ragnar Option Corporation, an options dealer, and from Ragnar's principal executive officer, Victor Sperandeo These respondents were found to have manipulated the market for the common stock of Vetco Offshore Industries, Inc ,

which was then listed on the American Stock Exchange ("AMEX").

In essence, respondents developed a system of buying and selling options for Vetco stock in such a way as to insure that when the stock to cover those options was purchased or sold on the AMEX, those orders would arrive simultaneously and be matched against each other These transactions created a false and misleading appearance of active trading in Vetco stock In addition, Batterman, who was writing most of the options involved, entered simultaneous orders to purchase and sell short Vetco stock (involving over 180,000 shares) for accounts over which he had discretionary authority These "wash" sales also created a false and misleading appearance of active trading Batterman's use of his discretionary accounts for this purpose also constituted a fraud against his customers, who were required to pay a brokerage fee on these "wash" sales and who realized substantial losses because of margin requirements

In addition to consenting to a censure, Ragnar and Sperandeo agreed to restrict their dealings in options in specified terms so as to prevent recurrance of the type of trading which produced their part in the manipulation Batterman, also on consent, was barred from the securities industry, with the proviso that after two years he could apply for permission to become associated in a non-supervisory position upon a showing that he will be adequately supervised

*Paul L Rice*[4]—The Commission suspended Rice from association with any broker-dealer for 30 days Rice was a salesman for a former broker-dealer firm The sanction was based on the Commission's findings that Rice had arranged for two of his customers to sell 698,000 shares of unregistered common stock of United Australian Oil, Inc in violation of the Securities Act's registration provisions The Commission stated "Rice's argument that the responsibility for complying with the Securities Act's registration and prospectus-delivery requirements rested wholly on his superiors goes much too far Salesmen also have some measure of responsibility in these matters This is not to say that they must be finished scholars in the metaphysics of the Securities Act But familiarity with the rudiments is essential "

*IOS, Ltd and Arthur Lipper, III*[5]—The Commission barred IOS, Ltd (S A.) of Geneva, Switzerland, and Arthur Lipper, III, president of Arthur Lipper Corporation, a broker-dealer firm, from association with any broker-dealer, and revoked the broker-dealer registration of Lipper Corp It discontinued the proceedings against Investors Planning Corporation of America (IPC), now known as CIP, Inc., a broker-dealer which was principally owned by IOS In determining to discontinue that aspect of the proceedings, the Commission noted that IPC "was never an independent actor" and that "its present owners are wholly unaffiliated with IOS "

The remedial action was based on findings that, during 1967 and 1968, IOS, which managed unregistered off-shore investment companies, arranged to have Lipper Corp execute those companies' over-the-counter portfolio transactions and pay or "give up" a portion of the commissions on such business to IPC The Commission concluded that IOS and IPC, aided and abetted by Lipper Corp and Lipper, violated the antifraud provisions In reaching this conclusion, the Commission found that· "Since neither of the IOS respondents (IOS and IPC) performed any brokerage function in connection with the over-the-counter transactions handled by Lipper Corp , it is apparent that they did nothing in return for the income that they derived from those transactions They simply caused the funds to divert $1,450,000 to them Lipper Corp. was a mere conduit for the diversion No extended discussion is required to demonstrate that this was a gross breach of fiduciary duty by the IOS respondents. . Since the Lipper respondents (Lipper Corp and Lipper) knew about IOS's relationship to the foreign funds, and since their active assistance was an essential element of the scheme, they were clearly participants in the IOS respondents' breach of trust "

The Commission also concluded that IOS and IPC engaged in a similar rebative commission scheme with other brokers (not the Lipper respondents) in connection with the New York Stock Exchange portfolio transactions of Fund of America, Inc , a registered investment company for which IPC was the principal underwriter and investment adviser In addition, the IOS respondents were found

to have violated specified provisions of the Investment Company Act

Arthur Lipper, III, and Lipper Corp. have appealed the Commission's decision to the United States Court of Appeals for the Second Circuit, which appeal is still pending [6]

*Collins Securities Corporation*[7]—The Commission revoked the broker-dealer and investment adviser registrations of Collins Securities and barred its president, Timothy Collins, from association with any broker or dealer After two years, he may apply to the Commission for permission to become so associated in a position which is not connected with the making of markets in securities

The Commission found that respondents had manipulated the market for the common stock of Big Horn National Life Insurance Company, and sold the stock to customers without disclosing that they had artifically inflated its price They were also found to have violated the antimanipulative provisions of Rule 10b–6 under the Exchange Act and failed to comply with credit extension, recordkeeping and reporting requirements.

In rejecting Collins' argument that, as chief executive officer of a large broker-dealer firm, he could not be held responsible for every infraction of credit extension, recordkeeping and reporting requirements, the Commission stated: '[T]he president of a broker-dealer has the responsibility for compliance with all applicable requirements. He retains that responsibility unless and until he reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that the person in question is not properly performing his duties '

Respondents have appealed the Commission's decision to the United States Court of Appeals for the District of Columbia Circuit, and that court has granted a stay of the sanctions pending disposition of the appeal [8]

*Spangler and Nassar Firms*[9]—The Commission revoked the broker-dealer registrations of Richard C Spangler, Inc. and Nassar and Co. Inc , and barred Richard C Spangler, Jr and George M Nassar, the respective presidents of Spangler, Inc and Nassar, Inc , from association with any broker-dealer It also granted the request of the firm of Albert Teller and Co Inc , for the withdrawal of its broker-dealer registration, and censured its president, Albert Teller.

The Commission found that Spangler, Nassar and Teller, Inc fraudulently sold the stock of Interamerican Industries, Ltd , a company which had a "commercially untried" oral contraceptive pill and "whose prospects turned entirely on an alleged scientific breakthrough " Spangler, Nassar and Teller, Inc were found to have made misrepresentations concerning the testing, efficacy and sales of Interamerican's pill, and prospective rises in the market price of its stock

In excluding the Spangler and Nassar respondents from the securities business, the Commission said; "In Nassar's case, as in Spangler's, we deal with a high-pressure sales effort that lasted for a long time, was unsupported by any semblance of an adequate foundation, and was characterized by grossly reckless price predictions." As to Teller, Inc and Teller, the Commission found that the case against them stood on a "different footing " It observed "The Teller officials who sold Interamerican stock fraudulently are no longer with the firm And Teller, who owned virtually all of the firm's stock, made no fraudulent representations himself His dereliction stems solely from a failure to supervise."

In ordering withdrawal and censure, it took into account "the purely vicarious nature of Teller, Inc 's liability and the fact that Teller's misconduct was limited in extent and brief in duration."

Nassar has appealed the Commission's decision as to him and his firm to the United States Court of Appeals for the District of Columbia Circuit.[10]

## TRADING SUSPENSIONS

The Securities Exchange Act authorizes the Commission summarily to suspend trading in a security traded either on a national securities exchange or in the over-the-counter market for a period of up to ten days if, in the Commission's opinion, such action is in the public interest During fiscal 1976, the Commission initiated a new procedure permitting a person adversely affected by a trading suspension to petition the Commission in writing to terminate the suspension if he has reason to believe that it is not neces-

sary in the public interest or for the protection of investors." As a result of the Securities Acts Amendments of 1975, authority to suspend trading in securities of banks was transferred from the Commission to the Federal bank regulatory agencies. The Commission has sought to provide technical assistance and coordination to these bank regulatory agencies if it should appear that a suspension of trading in bank securities may be necessary

During fiscal 1976, the Commission suspended trading in the securities of 126 companies, an increase of 11 percent over the 113 securities suspended in fiscal 1975 and a 54 percent decrease from the 279 securities suspended in fiscal 1974 Of the 126 companies whose securities were the subject of trading suspensions in fiscal 1976, 70 were suspended because of delinquency in filing required reports with the Commission In most other instances, the trading suspension was ordered either because of substantial questions as to the adequacy, accuracy or availability of public information concerning the company's financial condition or business operations, or because of transactions in the company's securities suggesting possible manipulations or other violations.

For instance, on March 25, 1976, the Commission suspended trading in the securities of Presley Companies, pending clarification of rumors relating to the company's entry into the field of energy technology [12] The Commission's action occurred shortly after a rapid increase in the price of Presley's stock amid conflicting reports of an arrangement whereby the company acquired the licensing rights to a device which purportedly produced hydrogen gas from tap water. Subsequently, on May 20, 1976, the Commission initiated proceedings to determine whether the company had failed to comply with certain provisions of the Exchange Act by filing reports which, among other things, omitted material information required to be stated therein, or necessary to make statements therein not misleading

## DELINQUENT REPORTS PROGRAM

Fundamental to the success of the disclosure scheme of the Federal securities laws is the timely filing in proper form and content of annual and other periodic and current reports required to be filed by issuers and individuals The Delinquent Reports Program was started by the staff two years ago to identify required reports which have not been timely filed and, when appropriate, to recommend remedial enforcement action. Such enforcement action entails alerting the public to the lack of current and accurate information and, where necessary, seeking a court order requiring the filing of delinquent reports coupled with an injunction against further violations of the Exchange Act's reporting provisions.

The staff of the Commission continuously monitors compliance with the periodic reporting requirements of Sections 13 and 15(d) of the Exchange Act. When Commission records indicate a delinquency, the staff will, among other things, mail the registrant a notice of detected delinquency and request that a written explanation be filed under cover of Form 8-K On July 14, 1975[13], the Commission announced its intention to include thereafter in a registrant's public file certain correspondence to and from a registrant concerning its delinquency notwithstanding the registrant's continued filing responsibilities This procedure makes available to the public a delinquent registrant's reasons for failing to meet its statutory disclosure obligations.

The Commission suspended trading in the securities of approximately seventy registrants during the 1976 fiscal year primarily based on their failure to file at least one required annual report These suspensions were temporary—they ran for one ten-day period for each delinquent registrant Approximately twenty, or about 29 percent, of the seventy suspensions involved registrants whose securities were listed for trading on a national securities exchange

During this fiscal year, the Commission initiated five civil actions against delinquent registrants seeking court orders compelling the immediate filing of delinquent reports and permanently enjoining future analagous Exchange Act violations. Three of those actions were resolved by consents to the entry of, *inter alia,* final judgments of permanent injunction;[14] one case, *SEC* v. *Western Orbis Company,* was resolved by the grant of a summary judgment in favor of the Commission which included a final judgment of permanent injunction,[15] and one action is pend-

ing.[16] Another civil action under this Program, *SEC* v *United Communities Corp and Alexander L Guterma*, initiated on May 27, 1975 and resolved by consent on July 28, 1975, is noteworthy because the Commission sought and obtained injunctive relief against both the delinquent registrant and its chief executive officer.[17]

In this fiscal year, the Commission also initiated two civil contempt proceedings based on delinquencies in spite of court ordered injunctions against such violations Both proceedings are pending but one deserves particular mention. *SEC* v *VTR, Inc* was a civil injunctive action settled by a consent upon which a Final Judgment of Permanent Injunction was entered on April 19, 1973 by the United States District Court for the District of Columbia. Having detected subsequent violations of this injunction, the Commission initiated a civil contempt proceeding on August 26, 1975 against both VTR, Inc and its chief executive officer, David E Jordan [18] There have been several hearings on this matter and the Court has found both VTR, Inc. and Jordan in civil contempt of its Final Judgment of Permanent Injunction [19] However, some of the violations continue, and the Court has granted the Commission's requested remedial relief including the appointment of a limited receiver (i) to oversee the preparation and filing of delinquent VTR Exchange Act reports, and (ii) to submit recommendations for a program to assure future VTR compliance with its Exchange Act and Court ordered filing obligations [20] Moreover, the Court decreed that VTR be fined $25 per day and Jordan be fined $75 per day for each day of continued civil contempt The Commission has moved for the entry of judgments of fine against VTR and Jordan on three separate occasions and the Court has granted such judgments resulting in aggregate fines against VTR, Inc. of $4,975 and aggregate fines against Jordan of $14,925. To date $6,000 of such fines have been paid into the registry of the Court. This matter is still pending.[21]

## CIVIL PROCEEDINGS

During fiscal 1975, the Commission instituted a total of 158 injunctive actions Some of the more noteworthy injunctive proceedings and significant developments in actions instituted in earlier years are reported below Several of these enforcement actions were achieved through coordination between self-regulatory bodies and the Commission's enforcement staff

In *SEC* v *Eastern Freightways Inc*, [22]—the Commission filed a complaint seeking injunctive and ancillary relief on November 19, 1975 against Eastern Freightways, Inc ("Eastern"), Associated Transport Inc ("Associated"), Myron P Shevell, Henry Epstein, and Paul W Levine The Commission alleged, among other things, the misappropriation of $1 3 million from the Employee Retirement Pension Fund of Associated, the misappropriation of Eastern's funds to acquire common stock of Associated in violation of an Interstate Commerce Commission order, and the falsification of books and records to avoid disclosure of these transactions Based on consents filed by both Eastern and Associated, the court issued on the same day a permanent injunction granting the relief sought On March 16, 1976, the court issued a permanent injunction against Shevell, Epstein, and Levine based on consents filed by these individual defendants

The relief obtained in these actions includes, among other things, the appointment of additional independent members of the Boards of Directors of Eastern and Associated, the maintenance of an executive committee consisting of the new additional directors, and the appointment of a new chief executive officer, as well as the appointment of additional trustees to the Eastern and Associated Employees Retirement Pension Funds The court further ordered that Eastern and Associated appoint separate special counsels to conduct a full investigation into the allegations in the Commission's complaint, as well as any other matters deemed appropriate

On April 22, 1976 both Eastern and Associated filed petitions for reorganization pursuant to Chapter XI of the Bankruptcy Act Later, on April 28, 1976 Eastern and Associated filed "Consents to Adjudication" and were ultimately declared bankrupt Due to the filing of the bankruptcy proceedings by Eastern and Associated, the investigation being conducted by the respective special counsels was terminated In June 1976, Eastern resumed operations, on a scaled-down basis,

pursuant to Chapter XI of the Bankruptcy Act. It is anticipated that the investigation of the special counsel for Eastern will resume upon approval by the Bankruptcy Court.

*SEC* v. *PRF Corp.* involved alleged violations by PRF of the proxy provisions of the Federal securities laws.[23] The complaint charged that, by use of a false and misleading proxy statement, the shareholders were solicited to vote on a conversion of Class A stock, owned by the controlling shareholder and his family and associates, into common stock in such a way that the only practical effect of such conversion was to increase by 2,000 percent the dividend rights of the former Class A stockholders at the expense of the common stockholders The complaint also charged that the shareholders were not informed that there was a substantial question as to the legality of such a conversion. The complaint further charged that the proxy statement did not disclose other material facts, including the purpose and effect of a plan to buy 1,000,000 shares of common stock from the estate of the controlling shareholder at his death for $1,500,000 In addition, the complaint alleged that PRF's proxy statement failed to include the information required by the Commission's proxy rules and regulations and that it did not provide the shareholders of PRF the opportunity to vote against proposals as required by the Commission's proxy rules

PRF consented to an order permanently enjoining it from violating the proxy provisions of the Federal securities laws Certain ancillary relief was ordered by the court, including.

1. An order voiding the amendment to PRF's certificate of incorporation converting the Class A stock into common stock at a twenty-for-one ratio

2. An order voiding the approval by PRF's shareholders of a plan for PRF to purchase 1,000,000 shares of common stock from the estate of PRF's controlling shareholder at a price of $1,500,000.

3. An order requiring PRF to appoint a special agent satisfactory to the Commission to investigate and evaluate any submission to PRF's shareholders of a proposal to convert Class A stock into common stock or a proposal to buy stock owned by the controlling shareholder and requiring PRF to include the special agent's evaluation in any proxy statement containing any such matter.

4. An order enjoining PRF from converting Class A stock into common stock or from entering into any agreement to buy stock owned by the controlling shareholder, unless the matter is submitted to the PRF shareholders and approved by a majority of the votes cast by the common stock shareholders of PRF who own no Class A stock.

The case of *SEC* v *Firestone Tire & Rubber Co , et al ,* involves use of corporate funds for unlawful political contributions, both domestic and foreign, over a period of 8 years The Commission obtained injunctive and ancillary relief against Firestone, Robert P. Beasley, formerly its executive vice president and vice-chairman of the Board of Directors, and Raymond C Firestone, chairman of Firestone's Board of Directors and formerly chief executive officer.[24] In its complaint, the Commission alleged, among other things, that periodic and annual reports and proxy materials filed by Firestone with the Commission during the period from 1968 through June 15, 1976 were false and misleading in violation of the antifraud, proxy and reporting provisions of the Federal securities laws.

In addition to the injunction, the court's order prohibited the use of corporate funds for unlawful political contributions or similar unlawful purposes; prohibited Firestone from making any materially false or fictitious entries in its books and records and from maintaining any unrecorded fund of corporate monies; and required Firestone to continue an investigation conducted by its audit committee into the use of corporate funds to make payments to foreign government officials or for unlawful political contributions.

In *SEC* v. *Foremost-McKesson Inc ,* the Commission obtained a permanent injunction and ancillary relief against Foremost-McKesson based on allegations that it had violated the antifraud, reporting and proxy solicitation provisions of the Federal securities laws [25] Foremost-McKesson consented to the entry of the court's judgment without admitting or denying the allegations in the Commission complaint.

The complaint alleged that during the period from 1971 to 1976 Foremost-McKesson, the largest wholesale distributor of wine and spirits in the United States and an importer of

alcoholic beverages, made undisclosed payments of approximately $6 million, in the form of cash payments and free merchandise, to retailers and wholesalers, to induce the purchase of wine and spirits products it distributed, in possible violation of the Federal and state liquor laws. The complaint further alleged that Foremost-McKesson made undisclosed cash payments of approximately $231,000 to various officials of foreign governments to influence foreign governmental action, and falsified its books and records with respect to these cash and merchandise payments.

In addition, the court restrained and enjoined Foremost-McKesson from making materially false or fictitious entries in its books and records, and required it to maintain adequate and accurate documentation with respect to the matters referred to in the complaint. It also agreed to:

A. Complete an investigation, commenced as a result of the Commission's investigation by its Audit Committee, outside counsel and independent auditors, into various matters referred to in the complaint.

B. Submit a written report, within 210 days, by the Audit Committee, to its Board of Directors; and to have a person satisfactory to the Commission review the procedures and methods used by the Audit Committee.

C. Prohibit (1) any cash payment or rendering of merchandise in violation of Federal, state or local liquor laws or regulations, and (2) the payment of anything of value which is material in nature directly or indirectly to any foreign governmental official or entity controlled or owned by any foreign government.

*SEC* v *Audio Media Corp* —On October 30, 1975, the Commission obtained permanent injunctions against Audio Media Corp. (formerly known as Eastern Sound Co. Inc.), two of its officers, and Johnson & Ries, a public relations firm formerly engaged by Audio Media.[26] The injunctions, to which defendants consented, were based on Commission allegations that Audio Media distributed false and misleading offering circulars in connection with a Regulation A offering of its stock and warrants and a further offer to exchange the original warrants for new warrants exercisable at a lower price, that the defendants issued false and misleading press releases, annual reports, and letters to shareholders; that Audio Media offered for sale and sold 6,000 shares of its common stock when no registration had ever been filed with the Commission and the transactions did not comply with Rule 144

*SEC* v. *Chicago Milwaukee Corp , et al* — On June 29, 1976, the Commission obtained permanent injunctions against Chicago Milwaukee Corp. ("CMC"), Chicago, Milwaukee, St. Paul and Pacific Railroad Company ("Milwaukee Road") and four officers and directors of the two defendant companies.[27] Each of the defendants consented to the injunctions without admitting or denying the allegations in the Commission's complaint

The complaint alleged that CMC and the Milwaukee Road had made false and misleading statements and had omitted to state material facts in registration statements and annual reports between 1968 and 1974 concerning, among other things, significant alteration in the operations of a Milwaukee Road subsidiary. The subsidiary was directed by Milwaukee Road officials to commence and continue substantial sales of its timberland for the purpose of maintaining the solvency of the Milwaukee Road Further, it was alleged that the defendants had failed to disclose that corporate accounting books and records and official corporate documents had been falsified to cover up a rescission by the Milwaukee Road of a $4 million dividend from a subsidiary in 1972 in order to avoid the railroad's obligation to pay interest to certain of its bondholders.

The Commission's complaint also alleged that the defendants had failed to disclose that millions of dollars of deferred roadway maintenance had been incurred by the Milwaukee Road; that certain of Milwaukee Road's books and financial statements had been falsified to conceal a material contingent liability in connection with a sale of land; and that the books and records had been falsified to conceal the operation of a corporate political contributions fund

The court's order compels CMC and the Milwaukee Road to correct their existing filings with the Commission. Further, CMC was ordered to continue to maintain a special committee of its Board of Directors to conduct an investigation into the matters alleged and to prepare a report of its investigation, which will be submitted to the Commission and to

CMC and Milwaukee Road shareholders. The full Board of Directors of CMC and of the Milwaukee Road are to take such action as they deem appropriate with regard to the findings and recommendations contained in the Report

*SEC v. Kalvex, Inc., et al* [28]—This action was instituted in December 1974 to enjoin Kalvex Inc., Emanuel L. Wolf, Kalvex's president and chairman of the board, and Robert L. Ingis, a Kalvex director and former vice-president, from further violations of Sections 13(a) and 14(a) of the Exchange Act and Rules 13a-1, 13a-13, 14a-3, and 14a-9 thereunder. The complaint alleged that Kalvex's Forms 10-K and 10-Q for 1972 and 1973, and its proxy statements issued in connection with its stockholders annual meetings for those years, failed to disclose (1) a scheme to kick-back $8,500 to Ingis from a Kalvex supplier, (2) the receipt by Ingis of approximately $6,000 of corporate funds, as a result of Ingis' submission of "expense" vouchers to Kalvex for expenses unrelated to any corporate purpose, and (3) Wolf's submission of expense vouchers to both Kalvex and to Allied Artists Pictures Corporation, a publicly-held corporation controlled by Kalvex, in order to receive reimbursement for the same expenses from both companies.

Kalvex consented to an injunction in which it agreed to (1) establish a financial controls and audit committee to adopt procedures to prevent a recurrence of acts similar to those charged in the complaint, and (2) retain a special auditor to ascertain whether any officers, directors, and employees of Kalvex received expense reimbursements that were not for a valid business purpose. Wolf's consent included the return of approximately $80,000 to Kalvex. Ingis chose to litigate the action, and the court issued a decision granting the Commission's motion for summary judgment against him. [29] The court found that the omission of the above facts in Kalvex's proxy statements, and in its annual and quarterly reports, was material to a reasonable stockholder, even though there was neither a fight for corporate control nor a proxy contest in progress. Ingis, who is also a certified public accountant, subsequently consented to an order of the Commission prohibiting him from appearing or practicing as an accountant before the Commission for a twenty-two month period. The Court's application of the proxy and reporting provisions of the Federal securities laws in this action may well be significant in connection with other enforcement actions involving management fraud, kickbacks, and overseas payments.

*SEC v. The Rovac Corporation, Inc., et al*—On May 13, 1976, the Commission obtained permanent injunctions against The Rovac Corporation ("Rovac"), Bond, Richman & Co., Inc. ("Bond Richman"), Stanley A. Morgenstern ("Morgenstern"), Thomas C. Edwards ("Edwards"), Dennis Caterine ("Caterine"), and John A. Wert ("Wert"), based on allegations that the defendants variously violated Section 10(b) of the Exchange Act and Rules 10b-5, 10b-6 and 10b-9 thereunder and Sections 5(a), 5(b) and 5(c) of the Securities Act in connection with transactions in the securities of The Rovac Corporation. [30]

The complaint alleged that, the defendants, in connection with the "all-or-none" offering of Rovac securities in October 1974, defrauded investors by representing that the securities were offered on an "all-or-none" basis while engaging in certain non *bona fide* sales of Rovac securities which were company financed or guaranteed against loss by the underwriter. The complaint also alleged that by virtue of the above described "parking" transactions, the offering did not close on the purported closing date, but rather continued until the parked securities had been sold to the public.

In a separate administrative proceeding pursuant to Section 15(b) of the Exchange Act, Bond Richman was suspended from engaging directly or indirectly in any underwriting activities whatsoever for 180 days, and Morgenstern, its chairman of the board, was suspended from association with any broker-dealer, investment company or investment adviser for a period of 90 days and thereafter suspended from engaging directly or indirectly in any underwriting activities whatsoever for an additional 90 days.

In *SEC v. Waste Management, Inc., et al.*, the defendants consented to permanent injunctions prohibiting further violations of the reporting and proxy provisions of the Exchange Act. [31] Among other things, the complaint alleged the maintenance of an off-the-books "slush fund" used for political purposes. In addition to the company, Harry

Wayne Huizenga, vice-chairman of the board of directors, and Earl Edward Eberlin, a regional manager, were named as defendants

*S E C* v. *Standard Prudential Corporation, et al* [32]—The Commission filed a civil injunctive action against Standard Prudential Corporation and its chief executive officer, Theodore H. Silbert Standard was charged with issuing a false and misleading prèss release describing the purported sale of an option to acquire 1 6 million shares of Talcott National Corporation stock The complaint alleged that the release omitted to disclose, in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, that Standard had not abandoned its previously devised plans to acquire Talcott shares or to merge with Talcott, which acquisition or merger would have required approval by the Federal Reserve Board, and that Standard was seeking to sell the option to a purchaser who would agree that Standard retain absolute control over the final disposition of the shares, including the right of Standard to acquire the shares from the purchaser Standard was also charged with violating Section 13(d) of the Exchange Act and Rule 13d-1 thereunder in connection with a filing of a Schedule 13D with the Commission relating to the Talcott block. The defendants consented to a permanent injunction enjoining future violations of Sections 10(b) and 13(d) of the Exchange Act and Rules 10b-5 and 13d-1 thereunder The court order also provided, among other things, for the formation of a committee to prepare a plan satisfactory to the Commission for the disposition of the Talcott shares The plan was submitted to the Commission by Standard's independent committee in August 1975 and found to be provisionally satisfactory, provided that Standard enter into an agreement with an acceptable purchaser to sell the block of Talcott shares.

*S E C* v *United Americas Bank, Konos Associates and Abbey J Butler*—The Commission brought an injunctive action against United Americas Bank for alleged excessive extensions of securities credit in violation of Section 7(d) of the Exchange Act and Regulation U promulgated thereunder by the Board of Governors of the Federal Reserve Board [33]

The two other defendants, Konos Associates and Abbey J. Butler, were charged with unlawfully obtaining excessive securities credit from the Bank in violation of Section 7(f) of the Exchange Act and the Federal Reserve Board's Regulation X In addition, these two defendants were charged with having engaged in manipulative short sales of securities in order to drive down the price of a block of securities they knew was about to be offered, illegally effecting short sales on minus ticks or zero minus ticks, making deceitful representations to the broker-dealers regarding ownership of stocks and trading in certain securities while in possession of material non-public information

Konos Associates and Abbey J Butler consented to the entry of permanent injunctions The litigation against the Bank continues

*SEC* v *Petrofunds, Inc , et al* —On May 26, 1976, the Commission filed a complaint against Petrofunds, Inc [34] ("Petrofunds"), McRae Oil Corporation ("McRae Oil"), McRae Consolidated Oil and Gas, Inc ("Consolidated"), James A McRae ("J A McRae"), David Kelly ("Kelly"), J Frank Benson ("Benson"), Osias Biller ("Biller") (hereinafter collectively referred to as "the Petrofund defendants"), Louisiana Gas Purchasing Corporation ("LGP"), Louisiana Gas Intrastate, Inc of Shreveport ("LGI"), Sunny South Oil and Gas, Inc ("SSOG"), Houston National Bank ("HNB"), Bromley DeMeritt, Jr ("DeMeritt"), Henry Becton ("Becton"), Sidney Raphael ("Raphael"), Edmund D'Elia ("D'Elia"), the law firm of Raphael, Searles, Vischi, Scher, Gover and D'Elia ("RSV"), Thomas Leger & Co ("Leger & Co "), Thomas Leger ("Leger"), Edward Coulson ("Coulson"), Bennett J Roberts, Jr ("Roberts") and Edward C Dorroh ("Dorroh")

The complaint charged (1) each of the defendants with violations of the antifraud provisions of the Securities and Securities Exchange Acts, (2) the Petrofunds defendants and defendant DeMeritt with violations of the registration provisions of the Securities Act, (3) defendants Petrofunds, Consolidated, Leger & Co , Leger, J A McRae, Kelley, Benson, Biller and Roberts with violations of the financial reporting provisions of the Exchange Act, and (4) defendant Biller with violations of the broker-dealer registration provisions of the Exchange Act

The complaint alleged that interests in oil and gas drilling programs were offered and

sold by use of false and misleading statements which failed to disclose or falsely or inadequately described, among other things, (1) the extensive misuse, diversion and misappropriation by the Petrofunds defendants, Dorroh, DeMeritt, Becton, Coulson, Roberts and others of monies invested by, and assets belonging to, the public investors, (2) the failure by the Petrofunds defendants and defendant HNB to properly maintain public investors' monies in custodian accounts at HNB, (3) the misuse of gas reserves, in which the Petrofunds drilling programs own majority working interests, for the benefit of the Petrofunds defendants and defendants LGP, LGI and others, (4) the nature and effect of certain transactions between the drilling programs and companies affiliated with or controlled by defendant J A. McRae; (5) the manner and timing of oil and gas leasehold aquisitions, (6) the skimming-off of interests in various oil and gas leaseholds by certain of the defendants; (7) the amounts paid as commissions to defendants Biller, Raphael, and others for the sale of drilling program interests to the public, and (8) the potential tax ramifications and/or risks associated with the aforesaid acts and practices.

The Commission sought, among other things, (1) a tempoary restraining order and preliminary injunction against the Petrofunds defendants and defendants LGP, LGI, SSOG and Dorroh; (2) permanent injunctions against each of the defendants, and (3) an order appointing a temporary receiver for defendants Petrofunds, Consolidated, McRae Oil, LGP, LGI and SSOG

After granting temporary restraining orders against defendants Petrofunds, McRae Oil, Consolidated, LGP, LGI and SSOG, the court heard oral argument on the Commission's request for a preliminary injunction and other relief against the Petrofunds defendants and defendants LGP, LGI, SSOG and Dorroh. In denying the Commission's request the court stated "It may well be that upon a trial, where the disputed fact issues are fully explored and the court afforded an opportunity to appraise the demeanor of witnesses and to evaluate their credibility in making its fact determination, plaintiff may fully and abundantly establish its various claims so as to entitle it to the full relief it seeks "

*SEC* v. *Howard R Hughes*[35]—Following the death of Howard Hughes in April 1976, the court, on the Commission's motion, agreed to substitute his estate as defendant (the case now being re-captioned *SEC* v *Lummis et al* in the action, filed in March 1975 by the Commission, which alleged a sequence of actions by Hughes, his wholly owned company Summa, his attorney and Summa director, Chester C. Davis, and his assistant, Robert Maheu, arising from the bid by Hughes in 1968 to purchase the assets of Air West, a regional West Coast airline. The Commission's complaint alleged, among other things, that Hughes (a) hired public relations man James "Jimmy the Greek" Snyder to disseminate false and misleading reports to shareholders, (b) made contributions to certain political figures who had spoken on Snyder's request in support of the Hughes offer, (c) caused the issuance in both 1968 and again in 1970 of materially false and misleading proxy statements, and (d) engaged in a scheme of stock manipulation and lawsuits against Air West directors opposed to his offer to force those directors to change their votes to his support. The Commission alleged that Air West shareholders had been led to believe that they would receive $22 for their shares and supported the Hughes offer for that reason, when ultimately, through valuations of assets and forced write downs alleged not to be in accordance with the Purchase Agreement, the shareholders received only $8 75

Since the institution of the action, the Commission has withstood a motion to dismiss, and has had most of the defendants' affirmative defenses stricken from the record. Judgment by default has been obtained against James Snyder. Howard Hughes on two occasions failed to appear for depositions, and both he and his companies (of which the Court declared him to be the Managing Agent) have been defaulted. The Commission has been conducting extensive discovery since November 1975, and expects this to continue through this fiscal year with a trial on the merits against the remaining parties shortly thereafter.

In *S.E C* v *Thermal Power Co., et al,*[36] the Commission filed an injunctive action against the Natomas Company, Thermal Power Company and their respective presidents, Dorman Commons and Daniel MacMillan,

alleging that the defendants violated the tender offer and antifraud provisions of the Exchange Act in connection with the Natomas Company's attempt to take control of Thermal Power Company The Natomas Company eventually acquired approximately 97 percent of Thermal Power Company stock in spite of competing tender offers by Union Oil Company and Aquitaine Company The Commission alleged that the defendants had failed to disclose that (a) the main purpose for an agreement to sell a 42 percent block of Thermal Power Company stock to the Natomas Company was to defeat the competing tender offers by Union Oil Company and Aquitaine Company, (b) Dorman Commons and Daniel MacMillan had secretly agreed to cancel the sale of this block of Thermal stock if the Natomas Company failed to gain control of Thermal Power Company, (c) The proceeds from the sale of the block of stock would be loaned back to Natomas Company, (d) Natomas Company offered Daniel MacMillan an employment contract, and (e) Thermal Power Company's board of directors owned a substantial amount of the company's stock at a relatively low tax basis when they initially recommended Natomas Company's tax-free exchange of stock and agreed to support Natomas Company's bid for control This represents one of the few times that the Commission has attempted to use the tender offer provisions of the securities laws to protect shareholders from actions by incumbent management This case is currently in litigation

In *SEC* v *Cosmopolitan Investors Funding Co , et al,* the Commission sought to enjoin Cosmopolitan Investors Funding Co , Robert J DiStefano, Robert R Nelson, Ramon N D'Onofrio, Alfred P Herbert, Herbert & D'Onofrio A G , formerly known as D'Onofrio & Feeney A G , Ernst Ballmer and Bank Hofmann A G from further violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Cosmopolitan Investors Funding Co , Robert R. Nelson and Robert J DiStefano from further violations of Sections 13(a) and 14(a) of the Exchange Act.[37]

The complaint alleged that during 1970 and 1971, the defendants engaged in a scheme to defraud the purchasers and sellers of the common stock of Cosmopolitan The complaint alleged that Nelson and DiStefano with $210,000 of the corporate funds of Cosmopolitan purchased shares of two off-shore mutual funds which were of little or no value and that these "investments" were made with the understanding that $85,000 of these funds would be deposited in secret Swiss bank accounts for the personal benefit of DiStefano and Nelson, the president and vice-president of Cosmopolitan, respectively

The complaint further alleged that defendants Cosmopolitan, Nelson and DiStefano filed or caused to be filed with the Commission periodic reports and proxy statements during this period which were false and misleading in that they failed to disclose the corporate monies kicked back to Nelson and DiStefano and reflected a net value of $147,500 for these "investments", which were, in fact, of little or no value

Subsequently, on April 16, 1976, permanent injunction and ancillary relief against Nelson was granted Nelson consented to the entry of the judgment without admitting or denying the allegations of the Commission's complaint Nelson was ordered to pay to the court the sum of $10,000 and prohibited from assuming a position as either an officer or director of any public company except upon a showing satisfactory to the court that measures have been taken to prevent the conduct alleged in the Commission's complaint or conduct of similar object or purport Previously, permanent injunctions had been entered against Cosmopolitan, D'Onofrio and Herbert & D'Onofrio

In *SEC* v *American Beef Packers, Inc , et al ,* American Beef Packers, Inc , a large Omaha meat packing corporation, which had petitioned in January 1975 for relief under Chapter XI of the bankruptcy law, and its former chief officer and director and two other directors were named as defendants in an injunctive action filed by the Commission on February 25, 1976 [38] The complaint, in part, alleges the defendants violated the proxy and antifraud provisions of the Federal securities laws in that, among other things, the defendants failed to disclose the following matters (1) the source and intended use of $94,000 cash found in offices of the company and the use made of similar unaccounted cash, if any, that had been in the company offices, (2) the use of funds by the company which should have been turned over to General

Electric Credit Corporation in accordance with a financing agreement, (3) the reasons for and duration of the practice of the company and its subsidiary in paying rebates to foreign customers, and (4) an illegal agreement of management to manipulate upwards the price of common stock of the company In addition to injunctive relief prohibiting future violations, the Commission seeks the appointment of a special master and an order enjoining each individual defendant from acting as an officer or director of any public company except upon a showing to the court that procedures have been instituted to prevent recurrence of the same or similar violative conduct alleged in the complaint The trial of this case is scheduled for October 1976

*SEC* v *Scott-Gorman Municipals, Inc* [39]— In September 1975, the Commission instituted an injunctive proceeding against Scott-Gorman Municipals, Inc ("Scott-Gorman"), a municipal bond dealer and Scott Gorman's four officers alleging violations of the antifraud provisions of the Federal securities laws

The Commission charged that the defendants engaged in a fraudulent course of conduct whereby they failed to deliver fully paid-for notes, bonds and other securities to their customers, failed to disclose the true financial condition of Scott-Gorman; and failed to disclose that fully-paid-for customers' notes, bonds and other securities were being illegally hypothecated, on Scott-Gorman's behalf, at various lending institutions

Prior to the Commission's action, Scott-Gorman had filed a petition in Bankruptcy Court pursuant to Chapter XI reorganization The Commission intervened in the Bankruptcy Court against Scott-Gorman in order to name Scott-Gorman as a defendant in its own suit and to request the appointment of a receiver for Scott-Gorman

The Bankruptcy Court granted the Commission's application to intervene and following a hearing on the Commission's motion, a receiver was appointed on the recommendation of the Bankruptcy Court Thereafter, a Trustee in Bankruptcy was appointed for Scott-Gorman in order to liquidate the firm

Following a hearing on the Commission's motion for a preliminary injunction against the defendants, the court preliminarily enjoined the four individual defendants from violating the antifraud provisions of the Federal securities laws and ordered the imposition of a temporary freeze on the individual defendants' personal assets pending a determination of customers' losses

The court has yet to set a trial date with respect to a hearing for permanent injunction

## CRIMINAL PROCEEDINGS

In August 1975, after investigations by both the Commission and the U S Attorney for the Southern District of New York, a grand jury indicted James E Corr, III and seven other persons associated with broker-dealers, for violations of the antifraud provisions of the Federal securities laws [40] The defendants were charged with manipulating the over-the-counter market in the securities of Jerome Mackey's Judo, Inc during 1972 and 1973 by purchasing stock and not paying for the shares upon delivery, by using swap transactions, and by parking shares to keep them from being sold in the market Prior to trial, three of the defendants pleaded guilty to conspiring to violate the antifraud provisions of the Federal securities laws Another defendant pleaded guilty to fraud in connection with the purchase and sale of securities These defendants were sentenced to prison terms of from three to six months Another defendant also pleaded guilty to securities fraud and was given a suspended sentence, and placed on probation for two years After trial, defendants Corr and Roger Drayer were found guilty and sentenced to prison terms of 2-1/2 years and four months, respectively; appeals by these two defendants were argued before the Court of Appeals for the Second Circuit in July 1976 The jury was unable to reach a verdict as to Barry Drayer, the remaining defendant

As a result of the Commission's referral of its investigative files to the Department of Justice in the Stirling Homex Corporation matter, an eleven count indictment was returned against four of the former principal officers of Stirling Homex Corporation, David Stirling, Jr , William G Stirling, Harold M Yanowitch, and Edwin J Schultz, and an attorney-employee for the company, Rubel L Phillips, charging them with fraud in connection with the 1970 and 1971 public distribu-

tion and sale of Stirling Homex common and preferred stock for nearly $40 million.[41]

The indictment charges that the defendants used fraudulent devices to inflate Stirling Homex's earnings in SEC registration statements, and annual and interim reports and related documents The indictment further charges that in 1969 and 1971, the defendants boosted reported sales and profits by including substantial sales of land to shell corporations which lacked any real ability to pay, and by making the sales at prices which were artifically inflated. The indictment also charges that, in 1971, a fraudulent sale of modules to a shell corporation was included in sales and profits on the basis of a forged $15 million dollar government financing commitment

The indictment also alleged that even though the company's principal business was manufacturing modular homes, the bogus land sales amounted to 18 percent of Stirling Homex's earnings for 1969 and nearly half of its six-month earnings for 1971 The indictment also specified that a forged commitment letter was used to double earnings in the six and nine-month reports for fiscal 1971

The indictment further charges that seven officers and employees of the United Brotherhood of Carpenters and Joiners of America received payoffs in the form of $240,000 worth of Stirling Homex stock purchased at $76,800 less than the fair market value. Later, when the fair market value declined, their stock was repurchased from them at $136,000 above that price.

The above indictment resulted from a referral of the Commission's investigative files after the Commission had completed a civil injunctive action against Stirling Homex Corporation, six of its officers and directors and Merrill Lynch, Pierce, Fenner & Smith Inc The Commission also had issued a Report of Investigation in the Matter of Stirling Homex Corporation Relating to the Activities of the Board of Directors of Stirling Homex Corporation, and, pursuant to Rule 2(e) of the Commission's Rules of Practice, had issued opinions imposing certain remedial sanctions against Stirling Homex's two independent auditors, Harris Kerr Forester & Co and Peat Marwick Mitchell & Co [42]

The trial of the criminal prosecutions involved in the Equity Funding[43] case finally came to a conclusion in July 1975 with the sentencing of the three independent accountants who had been convicted following a four months' trial in the Federal District Court in Los Angeles Each of them was sentenced to terms of imprisonment followed by four years' probation and a requirement that each contribute 2,000 hours to community service. Twenty-two individuals have been indicted as a result of the Equity Funding scandal and of those only the three accountants had a full jury trial Sentences of the other 19 defendants who plead guilty to various charges ranged from eight years' imprisonment and a $20,000 fine for the principal architect of the scheme, Stanley Goldblum, to two years' probation for the two most minor figures in the scandal The convictions of the three accountants are presently on appeal before the United States Court of Appeals for the Ninth Circuit.

*U S v Leslie Zacharias, et al* [44]—A fifty-nine count indictment was returned against Leslie Zacharias, Louis Martino, Norman Brodsky, Albert Rubenstein, Arthur Souretis and Fritz Johnson charging the defendants with violations of the registration and anti-fraud provisions of the Federal securities laws and mail fraud and conspiracy in connection with a scheme to distribute large quantities of unregistered shares of Pollution Dynamics Corporation It was alleged that, in order to carry out the scheme, Norman Brodsky, an attorney, wrote bogus opinion letters to the transfer agent for the company for the purpose of removing restrictions on stock owned by Martino, president of Pollution Dynamics The case, which was prosecuted by the New England Organized Crime Strike Force, resulted in the conviction of Brodsky, Martino and Fritz Johnson, a securities salesman, on their entry of guilty pleas to violations of the antifraud provisions of the Exchange Act. Brodsky and Martino each received two-year sentences of which three months were to be served in jail and Johnson received a two-year sentence and a $2,000 fine The other defendants are awaiting trial

*U S v Netelkos, et al* [45]—Christian-Paine & Co , Inc., ("CP"), a broker-dealer firm registered with the Commission, and its former president, Joseph Rega, Jr consented to permanent injunctions in April 1974 for violations of the antifraud, net capital, hypotheca-

tion, and bookkeeping provisions of the Exchange Act CP is currently being liquidated pursuant to the Securities Investor Protection Act of 1970.

Rega, Christos Netelkos, an undisclosed principal of CP, George Santoriello, a cashier for CP, Charles Gamarekian, an officer of the firm, Georgett Ysrael, bookkeeper, Ross Pascal, and Lucille Ditta, a trader for CP were indicted by a grand jury for illegally hypothecating customers' securities, falsifying books and records of CP, and submitting false reports and financial statements to the Commission.

After an eight week trial, Netelkos, Rega, Gamarekian, Santoriello, and Ysrael were convicted of conspiracy, unlawful hypothecation and sale of customers' securities, making and keeping false books and records, and submitting false statements to Federal officers.

Netelkos was sentenced to eleven years in prison and fined $50,000; Rega was sentenced to five years and fined $20,000. Gamarekian was sentenced to five years and fined $20,000; and Ysrael and Santoriello were both sentenced to eighteen months in prison. The indictment against Pascal was dismissed and Ditta is presently awaiting trial.

*U S v Fred C. Tallant, Sr, et al.*[46]—On November 21, 1975, Fred C. Tallant, Sr., and William M. Womack, Jr. of Atlanta, were sentenced on their pleas of nolo contendere to a twelve-count indictment charging them with violations of Section 17(a) of the Securities Act, the Mail Fraud statute (18 U.S.C. 1341) and the Conspiracy statute (18 U.S.C. 371) and further charging Womack with violating the Obstruction of Justice statute (18 U.S.C. 1505).

Tallant was sentenced to three years imprisonment on each of the eleven counts, the terms to run concurrently and all but three months of the sentence to be suspended. He was also fined the maximum amount on each of the eleven counts for a total of $40,000, to be paid within ninety days after the period of his confinement. Tallant was also sentenced to a five-year period of probation. Womack was sentenced to three years imprisonment on each of twelve counts, the terms to run concurrently and all but two months of the sentence to be suspended. He was also fined a total of $15,000 to be paid within 150 days after the period of his confinement. Womack was also sentenced to a five-year period of probation.

The fraudulent scheme charged in the indictment involved, among other things, the acquisition by the defendants of shares of common stock of Preferred Land Corporation and the sale of those shares in the course of the distribution of later higher priced issued as original issue stock of the corporation Funds received by Preferred Land from such sales were diverted to the use and benefit of defendants The charge of obstruction of justice involved the falsification of books and records of Preferred Land presented during the Commission's investigation.

Because of a continuing problem of "shell corporation" promotions originating from the Salt Lake City area, a special unit of the securities fraud section of the Department of Justice was assigned to work closely with Commission attorneys and investigators in Denver and Salt Lake City. A number of investigations were completed, and indictments were obtained in four cases with seventeen persons and three corporations named as defendants.

*U S v. Rio de Oro Mining Company, et al* [47]—This case involved charges of securities fraud against a New Mexico corporation and three Salt Lake City promoters on which all of the defendants were convicted after a two-week trial. During the period before trial, attorneys of the Commission and the Department of Justice worked closely with attorneys of the Vancouver, British Columbia, Regional Office of the Canadian Department of Justice, since one defendant, Francis C. Lund, a Salt Lake City lawyer, was a fugitive in Vancouver. Extradition proceedings were commenced to return Lund to the United States for trial—the first such proceeding on securities fraud charges in recent years. Lund agreed to voluntarily return to the United States two days before the hearing was to commence.

The indictment charged Rio de Oro Mining Company, Francis C. Lund, Virgil Redmond, and Carl Powers with participating in a scheme to defraud purchasers of Rio de Oro Mining stock by causing false and misleading statements to be made concerning mining activities at the Red Creek Mine in Duchesne County, Utah. They falsely represented the

corporation's interest in the mining property, the nature and extent of the mining activity and the value of the coal deposit. They falsely represented the corporation's intent to conduct the open-pit method of mining on the property. Other charges related to false statements made concerning contracts to sell coal, the ownership and operations on uranium and gold mining properties, and the arrangements for the financing and construction of an electric power plant at the Red Creek Mine.

The defendants were convicted on 8 counts of securities fraud and each was sentenced to 24 years in Federal Prison. These sentences were later reduced to a total of 18 years in prison and fines of $40,000 for Lund and Powers and a fine of $24,000 for Redmond. Two of the three defendants are in prison while the case is on appeal to the Court of Appeals for the Tenth Circuit.

*U S v. Richard T. Cardall, et al.*[48]—This trial related to charges of false and misleading statements made in the sale of the stock of International Chemical Development Corporation totalling over one million dollars. Two individual defendants, Richard T. Cardall and Frank Lloyd Parks, were tried together with the corporation and were convicted on nine counts and sentenced originally to 45 years each in prison. The sentences were later reduced to 18 years in prison and a $50,000 fine. The corporation pled *nolo contendere* and was fined $10,000. Another defendant, William L. Allen, of Ogden, Utah, pled guilty to one count of the sale of unregistered stock and was sentenced to five years in prison.

The violations charged involved the reactivation of a "corporate shell," and the promotion and sale of its stock by means of false and misleading statements, including statements relating to purported activities of the corporation in extraction of valuable minerals from the waters of the Great Salt Lake in Utah. The case is presently on appeal to the Court of Appeals for the Tenth Circuit

*U S. v. John J. Badger, et al*[49]—John J. Badger, Jay Victor Miller, Evelyn Mitchener and John E. Worthen were tried on a 14-count indictment charging a scheme to defraud shareholders of Flying Diamond Corporation, a Utah corporation engaged in mineral and oil exploration. The indictment charged that the defendants caused the stock transfer agency of Flying Diamond to issue stock in the names of nominees of the defendants and that stock was then sold through brokerage accounts by the defendants. Miller and Worthen also were charged with transporting the forged and altered stock certificates in interstate commerce. At the trial, Badger was convicted on three counts of securities fraud and one count of sale of unregistered securities Sentences were imposed as follows. Badger was sentenced to five years in prison and five years probation. Miller, who pled guilty to one count of sale of unregistered securities and one count of securities fraud, was sentenced originally to five years in prison. He was later sentenced to one year in prison and five years probation

In a later trial, Miller was also convicted of three counts of criminal contempt of a District Court injunction prohibiting certain activities by the stock transfer agent of Flying Diamond and was sentenced to five years in prison. Mitchener pled guilty to an information charging securities fraud and was sentenced to two years' probation. The charges against Worthen, who was then serving a 10-year prison sentence on another conviction, were dismissed

*U.S v. E. M. "Mike" Riebold, et al*[50]—In another criminal securities case, E.M "Mike" Riebold, the principal officer of a New Mexico natural resources company, and Donald Morgan, a former senior officer of the First National Bank of Albuquerque, New Mexico, after a nine week trial, were convicted by a jury of misapplication of bank funds, wire fraud, mail fraud, securities fraud, interstate transportation of stolen property and false statements in a registration statement Prior to trial, defendant Harold Morgan, an attorney, had pled guilty to one count of securities fraud; and Hillard Crown, an accountant, had pled guilty to one count of submitting a false statement to a bank in connection with the loan. The remaining defendant, E.J Hammon, also pled guilty prior to trial to one count of securities fraud This case involved the obtaining of over $5 million in loans by Riebold and his affiliated companies through fraudulent means from several banks and investors throughout the country. The successful prosecution of this case resulted from a joint investigation by the SEC and the FBI

in connection with the U S Attorney's Office for the District of New Mexico Defendants Harold Morgan and Riebold are appealing their convictions. Riebold was sentenced to five years in prison followed by five years' probation. Donald Morgan was sentenced to two years in prison followed by five years' probation Defendants Harold Morgan, Crown and Hammon were sentenced to six months in prison followed by five years' probation

*U S v Goss, et al* [51]—Cadmus L. G Goss, Richard F. Vande Vegte, Arthur John Kirsch, Rosland Stewart Moore, Donald William Sparks and Elary Rinehard were indicted in a 51 count indictment charging them with mail fraud, sale of unregistered securities and securities fraud in connection with the offer and sale of promissory notes of New Life Trust, Inc., of Phoenix, Arizona The indictment charged that New Life Trust operated a land development business near Dateland, Arizona, known as El Camino de Sol As a part of this business, New Life Trust issued corporate notes, purportedly secured by first realty mortgage on lots or portions of lots of the El Camino de Sol subdivision. The indictment charged that the land had been previously mortgaged, sold or was otherwise encumbered. The defendants allegedly sold these corporate mortgage notes to investors in Iowa, Nebraska, Minnesota, Illinois and elsewhere Then, allegedly, through NLT, the defendants disbursed monthly interest payments from the proceeds of the offering to the investors for a time in accordance with the terms of the corporate mortgage notes to lull the investors into a false sense of security and to induce the investors to buy more notes The case is presently awaiting trial

*U S v Harold Goldstein, et al*—Harold Goldstein, Daniel Goldstein, a/k/a/ Neil Daniels, Paul Levine, a/k/a Henry Harper, Roger C Anderson and Donald McCoy were charged in a thirty count indictment with violations of the Federal securities laws, mail fraud and conspiracy to defraud [52]

This indictment followed a Commission investigation into the activities of the defendants in connection with the offer and sale of investment contracts in gold concentrate, a form of gold ore. The defendants' sales, which began in January 1975, exceeded $1 million Among other things, the defendants represented to customers that they would refine, ship and store the gold concentrate on behalf of those customers. The defendants failed to disclose that the purported source of the gold concentrate was not in operation and that they had no current supply of concentrate available to satisfy customer orders

Most of these same defendants were already subject to permanent injunctions for violations of the registration and antifraud provisions of the Federal securities laws

The criminal indictment of these defendants is the first involving the sale of gold to United States citizens since the prohibition on the ownership of gold was lifted on December 31, 1974

An important part of the Commission's criminal enforcement program is its criminal contempt proceedings. In *U S v. William Robert Cook,* [53] William Robert Cook was convicted of three counts of criminal contempt after a six-day trial The contempt arose from his disobeying the provisions of a permanent injunction entered against him in 1970 The defendant had engaged in a course of conduct in willful disobedience of the injunction in the offer and sale of fractional undivided working interests in oil and gas leases He distributed fraudulent Schedule B sheets, made false statements to investors, using high pressure "boiler room" telephone salesmen, and improperly used investors' monies. This case is particularly significant in that the defendant received a three-year prison term. The conviction was affirmed by the U.S. Court of Appeals for the Fifth Circuit

In another criminal contempt proceeding, which arose in connnection with the civil injunctive action entitled *SEC v. TransJersey Bancorp,* the Commission charged that the defendants had engaged in a scheme to manipulate the price of TransJersey securities from $13 per share in September 1975 to $27 per share in October 1975.[54] Ralph Iannelli, who had been previously enjoined from engaging in manipulative conduct, was found guilty of criminal contempt after an eight-day jury trial. This criminal proceeding was instituted and tried by the Commission's staff rather than through a referral of the case to the Department of Justice. Iannelli was given a two-year suspended sentence and place on probation for two years

*U S v. Tom R. Rodgers* [55]—On an appeal from his criminal contempt conviction, which

sought to set aside the prior consent decree on which the contempt charge was based, Tom R Rodgers argued that he did not have effective counsel at the time he consented to the injunction The Court of Appeals for the Fifth Circuit held that the Sixth Amendment right to effective counsel does not apply to civil proceedings The court also stated: "Consent Decrees would not be worth very much if every violation of them had to be prosecuted *de novo* as a violation of the securities acts. We think it is safe to conclude that Congress did not intend for enforcement of the securities acts to be confined in this way . "

## Organized Crime Program

The prosecution of securities cases is often based primarily on circumstantial evidence requiring extensive investigation by highly trained personnel. The difficulties in such investigations and prosecutions are compounded when elements of organized crime are involved. Witnesses are usually reluctant to cooperate because of threats or fear of physical harm. Books, records, and other documentary evidence essential to the investigation and to a successful prosecution may be destroyed or nonexistent. The organized crime element is adept at disguising its participation in transactions, through the use of aliases and nominee accounts, by operating across international boundaries, and by taking advantage of foreign bank secrecy laws. It frequently operates through "fronts" and infiltrates legitimate business concerns. Organized crime also has an extensive network of affiliates throughout this country in all walks of life, and in many foreign nations. As a result of these problems, civil and criminal litigation involving organized crime can result in unusually lengthy proceedings. Despite these difficulties, the Commission, working in cooperation with other enforcement agencies, has been able to make major contributions to the fight against organized crime.

During the fiscal year 1976, the organized crime program focused principally on two goals. (1) increasing the Commission's effectiveness in obtaining current reliable information relating to organized criminal activity in the securities industry; and (2) aggressively pursuing to completion investigations of situations brought to the Commission's attention as potentially involving the the infiltration of elements of organized crime into the industry

In order to increase the flow of reliable data, an intelligence unit was established in 1974 in the Division of Enforcement Its principal function is to maintain channels of communication with state, local and other Federal agencies, as well as comparable agencies of foreign governments, which might have information on organized criminal activity in the securities industry. Information received by this unit is correlated with other available information and evaluated in light of the Commission's responsibilities under the Federal securities laws. Information indicating possible securities law violations by organized criminal elements is relayed by the intelligence unit to those other members of the staff whose principal duties are to investigate activity by organized crime This program has already generated a significant number of new cases, as well as contributing new sources of information to ongoing investigations

In furtherance of the intelligence function, members of the staff have continued to participate in seminars and lectures sponsored by state and local governments and their representatives have been included in the Commission's training programs This has alerted local authorities to the role of the Commission in curtailing organized criminal activity in the securities industry. Members of the Commission staff are also assigned on a full time basis to certain of the Justice Department's Organized Crime Strike Forces. Both the Strike Forces and the Commission staff have benefited thereby in learning more about organized criminal activity in the securities industry.

As a result of the organized crime unit's enforcement efforts during the past fiscal year, the Commission filed injunctive actions naming 23 persons and contributed to the return of indictments naming 17 individuals and the convictions of 35 of them Two persons considered to be important members of organized crime were enjoined, three such members were indicted and three convicted on indictments returned in prior years The Commission presently has 58 matters under investigation involving organized crime

After an extensive Commission investigation and the efforts of the Organized Crime

Strike Force in Manhattan, on June 29, 1976, a Federal grand jury in the Southern District of New York indicted seven individuals, including Guido Benigno, and two former stock brokers charging them with securities fraud and conspiracy in connection with the offer and sale of counterfeit American Home Products Corporation stock certificates. The indictment alleges that as part of the scheme, the defendants caused Seed Capital Corporation, a former New York stock brokerage firm, to deliver 13,000 fraudulently issued shares to purchasers in exchange for approximately $1,400,000 Thereafter, the defendants caused Seed Capital to issue checks for $1,300,000 which the defendants then cashed

In another significant case the Commission filed a civil action in the U.S District Court for the Southern District of New York, on April 26, 1976, seeking a permanent injunction against John C Doyle and eight others, to prevent further violations of the anti-fraud and antimanipulation provisions of the Securities Exchange Act of 1934 in connection with transactions in the securities of Canadian Javelin Limited The complaint alleges that Doyle, the principal shareholder of Canadian Javelin, and the other defendants participated in a scheme to manipulate the market price of Canadian Javelin stock on the American Stock Exchange.

## Cooperation with Other Enforcement Agencies

In recent years the Commission has given increased emphasis to cooperation and coordination with other enforcement agencies, including the self-regulatory organizations, enforcement agencies at the state and local level, and certain foreign agencies. Its programs in this area cover a broad range For example, the Commission believes that certain cases are more appropriately enforced at the local rather than the Federal level where the activities, while perhaps violating the Federal securities laws, are essentially of a local nature In these instances, the Commission authorizes the referral of the case to the appropriate state or local agency, and members of the staff familiar with it are made available for direct assistance to that agency in its enforcement action. A member of the staff has been specifically designated as a liaison with state enforcement and regulatory authorities

The Commission also has fostered programs designed to provide a comprehensive exchange of information concerning mutual enforcement problems and possible securities violations During the fiscal year, it continued its program of annual regional enforcement conferences These conferences are attended by personnel from state securities agencies, the U S Postal Service, Federal, and state and local offices of self-regulatory associations, such as the NASD. They provide a forum for the exchange of information on current enforcement problems and new methods of enforcement cooperation One result of these conferences has been the establishment of programs for joint investigations Although the conferences were initially hosted by the Commission's regional offices, many state and local agencies are now serving as sponsors or co-sponsors

## SWISS TREATY

The ratification process continued on the Treaty between the United States and Switzerland on Mutual Assistance in Criminal Matters.[56] Negotiations on this Treaty began in 1969 and culminated in its signing in Bern in May of 1973. The Swiss ratification procedure, which included implementing legislation believed necessary, was completed in the middle of January 1976. The Treaty was transmitted to the President in early February and to the Senate in the middle of February The Senate Foreign Relations Committee held hearings on the Treaty in the middle of June, and it was approved by the Senate approximately a week later The exchange of instruments of ratification should follow shortly The Treaty takes effect 180 days after that date.

In general, the Treaty provides for broad cooperation between the two countries in criminal matters. Provision is made for assistance in locating witnesses, obtaining witnesses' statements and testimony, the production and authentication of business records, and the service of judicial and administrative documents. The Treaty also provides for special assistance in cases involving organized crime

The Treaty should be of assistance to the Commission in major cases where Swiss

financial institutions are utilized to engage in securities transactions in the United States, or where funds resulting from illegal activities are secreted in such situations

## FOREIGN RESTRICTED LIST

The Commission maintains and publishes a Foreign Restricted List which is designed to put broker-dealers, financial institutions, investors and others on notice of unlawful distributions of foreign securities in the United States The list consists of names of foreign companies whose securities the Commission has reason to believe have been, or are being offered for public sale in the United States in violation of the registration requirement of Section 5 of the Securities Act of 1933 The offer and sale of unregistered securities deprives investors of all the protections afforded by the Securities Act of 1933, including the right to receive a prospectus containing the information required by the Act for the purpose of enabling the investor to determine whether the investment is suitable for him While most broker-dealers refuse to effect transactions in securities issued by companies on the Foreign Restricted List, this does not necessarily prevent promoters from illegally offering such securities directly to investors in the United States by mail, by telephone, and sometimes by personal solicitation. During the past fiscal year, 15 corporations were added to the Foreign Restricted List, bringing the total number of corporations on the list to 99 The following companies were added during the year

*Hemisphere Land Corporation, Limited* [57]—Information came to the attention of the Commission that this corporation was offering by mail from Nassau in the Bahamas in the United States interests in Canadian land These investment contracts are securities.

The solicitations mailed to prospective investors included a subscription agreement entitled "Purchase Reservation" to reserve from one to four "units" at $2,000 per unit of unspecified, and undeveloped, land in Varrenes, Quebec, Canada, represented to be at the price of 40 ¢ per square foot After an investor completed payments, which may be made on a monthly basis for the units, the company would decide which parcels of land would go to the investor The arrangement contemplated that at that time the investor would receive a deed to one or more specific lots selected by Hemisphere This deed would be subject to the restriction of an option obligating the investor to sell the same land back, at any time upon request, to Hemisphere at $1 20 per square foot, or at such higher price as the market value, independently appraised, might establish at the time of re-purchase. There would be no obligation upon Hemisphere to repurchase parcels of land being distributed by means of these investment contracts

No Securities Act registration statement covering these investment contracts had been filed with the Commission

*American Industrial Research, S A* [58]—This Mexican corporation, also known by the name of Investigacion Industrial Americana, S.A , has been making a public offering in the United States by mail sent from San Jose, Costa Rica and by telephone calls from Mexico City Investors are solicited to buy "units" consisting of 2000 of its "shares of beneficial interest" at $3 20 per unit with warrants to purchase another 1,000 of these shares at the same price.

No financial information was available about this corporation, and there was little information available as to the identity of its promoters or the intended disposition of any funds that were being obtained from investors in the United States. Since this corporation has not filed a Securities Act registration statement covering any of its units, shares or warrants, the public offering of these securities constituted a violation of Section 5 of the Act

*Duncannon Spirits, Ltd* [59]—This Bahamian corporation has been offering shares of its stock to investors in the United States stating that it was engaging in contract sales of Scotch whiskey. The information that normally would be available to investors from the filing of a registration statement and supplying each investor with a prospectus containing the information required by the Securities Act was not available Since no registration statement had been filed with the Commission covering shares of stock of Duncannon Spirits, Ltd , all sales of this security that had taken place in the United States were in violation of Section 5 of the Act

*Royal Greyhound and Turf Holdings Limited*[60]—This South African corporation was offering its shares of stock and secured convertible redeemable debentures to investors in the United States A prospectus that stated it was filed in Pretoria, South Africa, on September 25, 1975, contained the following information The purpose of the corporation is to develop dog and horse racing in the Kingdom of Swaziland in Africa The corporation has an option to acquire 90 percent of the stock of Gorman Investment (Proprietary) Limited, a private company incorporated under the laws of the Kingdom of Swaziland, from which it has obtained an exclusive license to develop dog racing and horse racing The latter company also owns the land in Swaziland necessary to build a stadium and a dog racing track.

Royal Greyhound and Turf Holdings was offering 10 million shares at 17 ¢ per share To the extent that an insufficient number of shares were sold to raise the necessary capital, the corporation was offering secured, convertible, redeemable debentures bearing an interest rate of 14 percent per annum to make up the difference in raising the necessary capital The above described prospectus further stated that the debentures were to be secured by a first mortgage on the property owned by Forman Investment, and that the proceeds from the sale of shares and debentures might be loaned to this company to construct a modern stadium including a dog racing track and totalisators in the cities of Mbabane and Manzini.

No Securities Act registration statement, covering either these shares of stock or debentures, had been filed with the Commission by Royal Greyhound and Turf Holdings, thus, the public offer or sale of those securities in the United States was in violation of Section 5 of this Act.

*Aguacate Consolidated Mines, Incorporated*[61]—This Costa Rican corporation was offering its shares of stock by mail and by telephone to investors in the United States Its written solicitations stated that it had obtained mineral rights to 2,347 acres in Costa Rica that included old gold mines that had not been worked for a number of years It further stated that the consideration for these mineral rights was 250,000 shares of its stock and a "deferred note" for $75,000, given to the company's vice-president, and another 250,000 shares and "deferred note" for $75,000 to Atlanta Foreign Investments, whose president was also the president of Aguacate Consolidated Mines. The list of shareholders in the United States to whom shares of Aguacate Consolidated Mines had been offered and sold showed that there were about 450 shareholders residing in 43 states ,Approximately two and a half million shares had been issued and were outstanding. By February 5, 1976, this corporation was offering to sell 125,000 additional shares to its shareholders at $2.25 per share.

The records of the Commission disclosed that no Securities Act registration statement had been filed with the Commission covering the shares of stock of Aguacate that had been publicly offered and sold to investors in the United States. Therefore, the shares of Aguacate being publicly offered and sold in the United States were offered and sold in violation of the provisions of Section 5 of the Act.

*Financieras*—Information came to the attention of the Commission that investors in the United States were being solicited by broker-dealers, investment advisers and others, to purchase, and were purchasing, securities in the form of promissory notes and financial certificates of *Credito Minero* v. *Mercantil A A , Financiera de Fomento Industrial, S A , Financiera Comermex, S A ,* and *Financiera Metropolitana, S A* [62] No registration statement had been filed pursuant to the provisions of the Securities Act with respect to these securities. Accordingly, the Commission placed Credito Minero v. Mercantil, S.A., Financiera de Fomento Industrial, S.A., Financiera Comermex, S.A. and Financiera Metropolitana S.A. on the Foreign Restricted List

The Commission also alerted investors, broker-dealers investment advisers and the public that other Mexican financieras (Mexican financial institutions), which had not been identified to the Commission, may be selling unregistered notes, financial certificates or other securities to investors in the United States The Commission will place additional financieras on the Foreign Restricted List when information comes to the Commission that such financieras are offering to sell or

are selling unregistered securities to United States investors

*ASCA Enterprises Limited* [63]—The Commission received information that ASCA Enterprises, Limited, of Hong Kong, was engaged in publicly offering its securities by mail in the United States, and offering shares in two pooled investment accounts created and managed by ASCA Enterprises, Limited One pooled fund was to be used to make investments in common stocks and the other to make investments in commodities No registration statement under the Securities Act of 1933 has ever been filed with the Commission covering any of the shares being offered by ASCA Enterprises Limited.

*Whisky Investment Contracts*—The Commission received information that certain apparently affiliated corporations of London, England were engaged in the offering and sale to investors in the United States of investment contracts for investment in Scotch whisky in storage in Scotland.

No registration statement under the Securities Act of 1933 had been filed with the Commission covering any of these investment contracts that were being offered

The investment procedure being used closely follows the procedure in other whisky investment cases in which Federal courts, in Commission enforcement actions, had decided that similar sales of whisky in storage in Scotland constitute sales of investment contracts that are securities as the term "security" is defined in Section 2(1) of the Securities Act of 1933. These cases are *SEC* v. *M A Lundy Associates*, 362 F. Supp. 266 (R.I. July 2, 1973), and *SEC* v. *Haffenden-Rimar International, Inc.*, 362 F. Supp 323 (E.D. Va. August 8, 1973) Accordingly, the Commission placed on the Foreign Restricted List the following corporations Atholl Brose Ltd.; Atholl Brose (Exports) Ltd ; Strathross Blending Company Limited; Derkglen, Ltd., and Henry Ost & Son, Ltd [64]

## NOTES TO PART 4

[1] Securities Exchange Act Release No 12680 (August 2, 1976), 10 SEC Docket 167

[2] Securities Exchange Act Release Nos 12105 (February 13, 1976), 8 SEC Docket 1296; 12376 (April 26, 1976), 9 SEC Docket 492; 12497 (June 1, 1976), 9 SEC Docket 781.

[3] Securities Exchange Act Release No. 12278 (March 29, 1976), 9 SEC Docket 307

[4] Securities Exchange Act Release No. 11667 (September 22, 1975), 7 SEC Docket 915

[5] Securities Exchange Act Release Nos 11773 (October 24, 1975), 8 SEC Docket 273, 11980 (January 6, 1976), 8 SEC Docket 976

[6] *Arther Lipper Corp* v *SEC*, C A 2 (No 76–4067)

[7] Securities Exchange Act Release Nos 11767 (October 24, 1975), 8 SEC Docket 250, 11946 (December 22, 1975), 8 SEC Docket 789.

[8] *Collins Securities Corp* v *SEC*, C A.D.C (No 75–2200)

[9] Securities Exchange Act Release No. 12104 (February 12, 1976), 8 SEC Docket 1257

[10] *Nassar & Co , Inc , et al.* v *SEC*, C.A.D C (No. 76–1278)

[11] Securities Exchange Act Release No 12361 (April 22, 1976), 9 SEC Docket 482.

[12] Securities Exchange Act Release No 12262 (March 25, 1976), 9 SEC Docket 266.

[13] Securities Exchange Act Release No 11534 (July 14, 1975), 7 SEC Docket 405

[14] *SEC* v *TMC Mortgage Investors*, Litigation Release Nos. 7059 (August 26, 1975), 7 SEC Docket 753, and 7232 (January 14, 1976), 8 SEC Docket 1046, *SEC* v *Hallcraft Homes, Inc*, Litigation Release Nos 7133 (October 24, 1975), 8 SEC Docket 315, and 7396 (May 18, 1976), 9 SEC Docket 707, *SEC* v *Servotronics Inc and Munro Games Inc*, Litigation Release Nos. 7440 (June 11, 1975), 9 SEC Docket 919, and 7506 (July 30, 1976), 10 SEC Docket 193

[15] Litigation Release Nos. 7247 (January 21, 1976), 8 SEC Docket 1138, and 7384 (May 5, 1976), 9 SEC Docket 573

[16] SEC v. Stelber Industries, Inc., Litigation Release No 7268 (February 10, 1976), 8 SEC Docket 1290

[17] Litigation Release Nos 6909 (May 30, 1975), 7 SEC Docket 94, and 7039 (August 12, 1975), 7 SEC Docket 603

[18] Litigation Release No 7063 (August 29, 1975), 7 SEC Docket 810.

[19] Litigation Release No. 7170 (November 18, 1975), 8 SEC Docket 516

[20] Litigation Release No 7385 (May 6, 1976), 9 SEC Docket 574, and 7431 (June 3, 1976), 9 SEC Docket 815.

[21] Litigation Release Nos 7307 (March 10, 1976), 9 SEC Docket 175, 7385 (May 6, 1976), 9 SEC Docket 574, and 7505 (July 29, 1976), 10 SEC Docket 139

[22] Litigation Release No 7171 (November 19, 1975), 8 SEC Docket 517

[23] Litigation Release No 7408 (May 24, 1976), 9 SEC Docket 753.

[24] Litigation Release No. 7443 (June 15, 1976), 9 SEC Docket 920

[25] Litigation Release No 7479 (July 7, 1976), 9 SEC Docket 1074.

[26] Litigation Release No 7142 (October 30, 1975), 8 SEC Docket 318.

[27] Litigation Release No. 7472 (June 29,

1976), 9 SEC Docket 1009.

[28] Litigation Release No. 6654 (December 27, 1974), 6 SEC Docket 40.

[29] Litigation Release No. 6977 (July 10, 1975), 7 SEC Docket 367.

[30] Litigation Release No. 7393 (May 13, 1976), 9 SEC Docket 668.

[31] Litigation Release No. 7333 (March 29, 1976), 9 SEC Docket 362

[32] Litigation Release No 6830 (April 14, 1975), 6 SEC Docket 708

[33] Litigation Release No. 7478 (July 2, 1976), 9 SEC Docket 20.

[34] Litigation Release No. 7412 (May 26, 1976), 9 SEC Docket 754

[35] Litigation Release No. 7464 (June 24, 1976), 9 SEC Docket 982

[36] Litigation Release No 7048 (August 19, 1975), 7 SEC Docket 691.

[37] Litigation Release No. 7366 (April 23, 1976), 9 SEC Docket 533

[38] Litigation Release No. 7300 (March 4, 1976), 9 SEC Docket 115

[39] Litigation Release No 7095 (September 23, 1975), 7 SEC Docket 19.

[40] Litigation Release No 7349 (April 12, 1976), 9 SEC Docket 443.

[41] Litigation Release No. 6960 (July 2, 1975), 7 SEC Docket 370

[42] Securities Exchange Act Release Nos. 11514 (July 2, 1975), 7 SEC Docket 293, 11516 (July 2, 1975), 7 SEC Docket 298, and 11517 (July 2, 1975), 7 SEC Docket 301.

[43] Litigation Release No 7196 (December 5, 1975), 8 SEC Docket 724.

[44] Litigation Release Nos. 6615 (December 17, 1974), 5 SEC Docket 656 and 7148 (November 18, 1975), 8 SEC Docket 361

[45] Litigation Release No. 7246 (January 12, 1976), 8 SEC Docket 16.

[46] Litigation Release No. 7192 (December 3, 1975), 8 SEC Docket 33.

[47] Litigation Release No. 7151 (November 4, 1975), 8 SEC Docket 363.

[48] Litigation Release No. 7150 (November 4, 1975), 8 SEC Docket 362

[49] Litigation Release No. 7293 (February 26, 1976), 9 SEC Docket 35.

[50] Litigation Release No. 7164 (November 12, 1975), 8 SEC Docket 514.

[51] Litigation Release No 7194 (December 3, 1975), 8 SEC Docket 685

[52] Litigation Release No. 7466 (June 25, 1976), 9 SEC Docket 1008.

[53] Litigation Release No. 6812 (April 2, 1975), 6 SEC Docket 594.

[54] Litigation Release No. 7394 (May 14, 1976), 9 SEC Docket 707.

[55] *U.S.* v. *Tom R. Rodgers,* C.A. 5, 1976, Summary Cal Nos. 75-3010 and 75-3098.

[56] See 41st Annual Report, p. 122.

[57] Securities Act Release No 5633 (October 23, 1975), 8 SEC Docket 236.

[58] Securities Act Release No. 5635 (October 24, 1975), 8 SEC Docket 237.

[59] Securities Act Release No 5646 (November 21, 1975), 8 SEC Docket 524.

[60] Securities Act Release No. 5649 (December 1, 1975), 8 SEC Docket 634

[61] Securities Act Release No 5697 (March 26, 1976), 9 SEC Docket 304.

[62] Securities Act Release No 5698 (April 5, 1976), 9 SEC Docket 367.

[63] Securities Act Release No 5713 (May 27, 1976), 9 SEC Docket 715

[64] Securities Act Release No 5712 (May 27, 1976), 9 SEC Docket 715

# Part 5

# Investment Companies and Advisers

# Part 5

# Investment Companies and Advisers

Under the Investment Company Act of 1940 and the Investment Advisers Act of 1940, the Commission is charged with extensive regulatory and supervisory responsibilities over investment companies and investment advisers The responsibility for discharging these duties lies with the Division of Investment Management

Unlike other Federal securities laws, which emphasize disclosure, the Investment Company Act provides a regulatory framework within which investment companies must operate. Among other things, the Act (1) prohibits changes in the nature of an investment company's business or its investment policies without shareholder approval, (2) protects against management self-dealing, embezzlement or abuse of trust, (3) provides specific controls to eliminate or mitigate inequitable capital structures, (4) requires that an investment company disclose its financial condition and investment policies, (5) provides that management contracts be submitted to shareholders for approval and that provision be made for the safekeeping of assets, and (6) sets controls to protect against unfair transactions between an investment company and its affiliates

Persons advising others on their securities transactions for compensation must register with the Commission under the Investment Advisers Act This requirement was extended by the Investment Company Amendments Act of 1970 to include advisers to registered investment companies The Advisers Act, among other things, prohibits performance fee contracts which do not meet certain requirements, fraudulent, deceptive or manipulative practices, and advertising which does not comply with certain restrictions.

Investment companies and assets under the management of investment advisers constitute important resources for investment in the nation's capital markets In order to continue their role of channeling individual savings into capital needed for industrial development, investment companies and investment advisers must have the confidence of investors, and the safeguards provided by the Investment Company and Investment Advisers Acts contribute to sustaining such confidence

## NUMBER OF REGISTRANTS

As of June 30, 1976, there were 1,286 active investment companies registered under the Investment Company Act, with assets having an aggregate market value of over $80 6 billion Those figures represent a decrease of 17 in the number of registered companies and an increase of nearly $6 4 billion in the market value of assets since June 30, 1975 Further data is presented in the statistical section of this Report At June 30, 1976, 3,857 investment advisers were registered with the Commission, representing an increase of 437 from a year before

During the fiscal year, the Division's staff conducted examinations of 260 investment companies and 425 investment advisers, 17 and 21 respectively, more than during fiscal 1975. It is the Commission's ultimate objective to examine all investment company registrants within the first year after registration, and to examine each registered investment

company and registered investment adviser every other year This should provide effective regulatory oversight As a result of the Commission's examination and investigation program in 1976, numerous violations of the Investment Company Act and of the Investment Advisers Act were uncovered, and approximately $1,582,928 were returned to investment companies and their shareholders Ten investment company and forty investment adviser matters were referred to the Division of Enforcement for possible action

## PROPOSED LEGISLATION

### Investment Advisers Act Amendments of 1976

On December 11, 1975, the Commission transmitted to Congress proposed amendments to the Investment Advisers Act of 1940 to provide substantial additional protections to investment advisory clients

These proposals, designed to upgrade the standards and quality of regulation of investment advisers, would provide the Commission with the authority to prescribe minimum qualification standards and financial responsibility requirements for registered advisers In addition, the legislation would (1) make certain technical and conforming changes, (2) eliminate the "intrastate" exemption provided in the Act, (3) clarify the existence of a private right of action based on a violation of the Act, (4) amend the definition of "person associated with an investment adviser," and (5) authorize and direct the Commission to study

(i) the extent to which persons not included in the definition of investment adviser or specifically excluded therefrom engage in activities similar to those engaged in by investment advisers and whether such exclusions are consistent with the Act's underlying purposes; and

(ii) the extent to which the establishment of one or more self-regulatory organizations would facilitate the Act's purposes

On February 3 and 4, 1976, the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, held hearings on S 2849, a bill substantially similar to the Commission's proposals Following the Subcommittee's consideration of the measure, the full Committee on Banking, Housing and Urban Affairs favorably reported S 2849 on May 20, 1976, with certain changes A companion bill, H R 13737, was the subject of hearings on May 20 before the Subcommittee on Consumer Protection and Finance of the House Committee on Interstate and Foreign Commerce, and the full Committee, which adopted the changes made by the Senate Committee

## THE NASD MAXIMUM SALES LOAD RULE

On October 10, 1975, the Commission approved the National Association of Securities Dealers' maximum sales load rule relating to mutual fund shares and certain other redeemable securities [1] Section 22(b) of the Investment Company Act gives the NASD authority, with Commission oversight, to promulgate and enforce rules to prevent sales charges which are "excessive " The statute provides that such rules must allow for "reasonable" compensation for sales personnel, broker-dealers, and underwriters, and for "reasonable" sales loads to investors

For mutual funds and single-payment contractual plans the rule essentially provides a ceiling of 8 50% on sales charges (declining to 6 25% for larger purchases), but conditions the right to charge the maximum on the fund's offering (1) dividend reinvestment at net asset value, (2) rights of accumulation, and (3) volume discounts, as defined in the rule A specific deduction from the maximum allowable sales charge is imposed for failure to provide each of the services

The rule change also provides maximum sales loads ranging from 8 50% down to 6 50% on single-payment variable annuities, and a maximum of 8 50% of total payments as of a date not later than the twelfth year after purchase for multiple-payment variable annuity contracts

## CONTRACTUAL PLAN RESERVE REQUIREMENTS LOWERED

On October 22, 1975, the Commission amended Rule 27d-1 under the Investment Company Act [2] This revision, which became effective December 15, 1975, modified the reserve requirements for front-end load con-

tractual plans ("periodic payment plans") The reserve requirements were established by the Commission in 1971[3] and are designed to ensure that sponsors of front-end load periodic payment plans will be able to carry out their obligations to refund sales charges pursuant to Sections 27(d) and 27(f) of the Investment Company Act The revision of these requirements was based upon data filed with the Commission on the sales, persistency and refund experience of more than 32,000 front-end load plans during the two years following the adoption of the reserve requirement The revision was designed to prevent unnecessary burdens upon plan sponsors, while continuing to ensure proper protection for investors

## PROPOSED RULES

### Rule 15a–2

On March 25, 1976,[4] the Commission proposed the adoption of new Rule 15a–2 under the Investment Company Act[5] to provide a procedure which funds may follow in order to be certain that annual continuances of their advisory and principal underwriting contracts meet the requirement of Sections 15(a)(2) and 15(b)(1) of the Act that such continuances be "specifically approved *at least annually* "

One purpose of the statutory requirement is to prevent the life of an advisory or distribution contract from continuing for an unreasonable period of time without re-evaluation by directors or shareholders Another purpose is to assure that the decision to continue a contract is based on sufficient information as to the performance of the investment adviser or principal underwriter to be meaningful

Under the proposed rule the management of a fund could be certain of fulfilling these purposes by having the directors or shareholders vote on the continuance of a contract during a specified period prior to the date a contract would terminate, if its continuance were not so approved The rule would not preclude consideration of a contract at more frequent intervals and would not prescribe the exclusive method of complying with Section 15 of the Act

The Division is analyzing the comments received and is preparing appropriate recommendations to the Commission

### "Open-Seasons" Rule

In August 1975, the Commission published for comment proposed Rule 22d–4[6] and a proposed amendment to Rule 134 under the Securities Act of 1933 which together would further implement the recommendations of the Division's August 1974 "Mutual Fund Distribution Report " These proposals would permit mutual funds, their principal underwriters, and dealers to offer fund shares at reduced or no load to qualifying repeat investors At year end, the comments were being analyzed by the staff

### Temporary Rule 6c–2(T) and Proposed Rule 6c–2

In February 1974, the Commission adopted Temporary Rule 6c–2(T) and proposed for public comment a permanent measure, Rule 6c–2[7] to provide corporations organized pursuant to the Alaska Native Claims Settlement Act of 1971[8] ("ANCSA corporations" and "Settlement Act" respectively) blanket exemptive relief from a substantial number of provisions of the Investment Company Act

The corporations, over 200 in number, were created to receive, hold, and administer the land, mineral rights and cash awarded by the United States Government to Alaska's Native Indian, Aleut and Eskimo populations in settlement of their aboriginal claims to the land in the State of Alaska During the first few years of the existence of the ANCSA corporations, only the cash portion of the award was actually distributed to the companies, and many of the Settlement Act companies invested the cash in securities Hence, a substantial number of these entities became investment companies within the meaning of the Act, and registered pursuant to Section 8(a) of the Act

On January 2, 1976, the Settlement Act was amended to exempt ANCSA corporations from all provisions of the Act, as well as all provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934[9] As a practical matter this amendment makes registration under the Act by an ANCSA corporation both unnecessary and inappropriate. The Commission proposed,[10] therefore, pursuant to Section 8(f) of the Act, to declare by order upon its own motion that such ANCSA corporations as had registered

have ceased to be investment companies as defined in the Act and rescinded Rule 6c-2(T)

## Rule 206(4)-4

On March 5, 1975, the Commission proposed the adoption of new Rule 206(4)-4 and new paragraph (14) of Rule 204-2(a) under the Investment Advisers Act [11] The proposed rules are intended to assure that existing and prospective clients of an investment adviser obtain written disclosure of material information which would enable such persons to evaluate, among other things, the adviser's qualifications, methods, services and fees They generally would require that investment advisers furnish a written disclosure statement to every client and prospective client (other than a registered investment company) upon entering into, extending or renewing an advisory contract with such client and that copies of each such disclosure statement be maintained by investment advisers as part of their recordkeeping obligations under the Advisers Act. The proposed written statement would include, among other things, a description of the types of services offered, length of time the investment adviser has been in such business, investment techniques, sources of information used, general standards of education and business background required of advisory personnel and the basis of fee charges There are additional disclosure requirements for advisers providing investment supervisory services or managing investment advisory accounts. During this fiscal year, the staff has analyzed the comments received on this proposal and is now considering an alternative approach to accomplishing the proposal's objectives

## Rule 204-2(j)

In order to strengthen the protections afforded by the Investment Advisers Act to investment advisory clients, one amendment to the recordkeeping rule was made Rule 204-2 requires investment advisers to maintain such books and records as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors The recordkeeping requirements of Rule 204-2 serve as an important safeguard against fraudulent securities trading practices.

Rule 204-2(c) requires that books and records be maintained and preserved "in an easily accessible place" and that partnership articles and corporate books and records be maintained at the investment adviser's principal office In this regard, there has been some uncertainty as to whether places outside the territory of the United States are "easily accessible " To resolve this question, the Commission adopted new paragraph (j) under Rule 204-2 [12] which requires a nonresident investment adviser either (1) to maintain and preserve copies of the books and records at a location within the United States and file with the Commission a notice specifying the address of such place, or (2) to file with the Commission an undertaking to furnish copies of such books and records upon demand by the Commission. The rule is substantially similar to Rule 17a-7 under the Securities Exchange Act.

## Rules Concerning Applications for Orders Filed Under Investment Advisers Act

On May 13, 1976, the Commission proposed the adoption of Rules 0-4, 0-5, and 0-6 [13] under the Advisers Act, which would establish rules governing the filing and processing of applications for orders under the Advisers Act The proposed rules, which are similar to the rules under the Investment Company Act concerning applications, are intended to provide the Commission with the kind of formal and complete record normally required as the basis for Commission action on applications for orders The Division is presently considering the comments received on the proposed rules.

## Rule 202-1

The Division became concerned that certain provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") encouraged persons who were otherwise exempt from registration to register under the Investment Advisers Act in order to insulate trustees of their employer-sponsored employee benefit plans from liability for a breach of fiduciary duty by in-house managers In order to extend ERISA's substantial protec-

tions to beneficiaries of such plans, the Commission proposed on September 29, 1975,[14] and adopted on March 12, 1976,[15] Rule 202–1, which excludes from the definition of an investment adviser a person who offers investment advice to an employee benefit plan, as defined in ERISA, sponsored by his employer, if such person does not otherwise engage in the investment advisory business or hold himself out generally to the public as an investment adviser

## APPLICATIONS

One of the Commission's principal activities in the regulation of investment companies and investment advisers is the consideration of applications for exemptions from various provisions of the Investment Company and Investment Advisers Acts or for certain other relief under these Acts. Applicants may also seek determinations of the status of persons or companies. During the fiscal year, 224 applications were filed under the Investment Company Act, and final action was taken on 265 applications There were no applications filed under the Advisers Act, and final action was taken on two As of the end of the year, 115 applications were pending under both Acts

Under Section 6(c) of the Investment Company Act, the Commission, by order upon application, may exempt any person, security or transaction from any provision of the Act, if and to the extent such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act Under Section 206A of the Advisers Act, the Commission has identical authority with regard to provisions of that Act Under Section 17 of the Investment Company Act, affiliates of a registered investment company cannot participate in a joint arrangement with the registered company and cannot sell to or purchase from the registered company unless they first obtain an order from the Commission Many of the applications filed with the Commission relate to these actions

Among the applications disposed of during the fiscal year, the following were of particular interest

The Commission issued an opinion and order under the Investment Company Act denying the application of International Funeral Services of California, Inc ("International") for exemption from all provisions of the Act [16] International's application sought exemption from the Act to permit it to finance its funeral service operations by selling its 4 1/2 percent 20-year debentures on the installment basis to the purchasers of International's pre-need funeral service contracts International anticipated that the debentures would be used to pay for funeral services supplied by International to the pre-need purchaser at death By using the debentures, International would be able to obtain the immediate use of the cash proceeds from the sale of the debentures and avoid a California law which requires that the cash proceeds from the sale of pre-need funeral service contracts be placed in trust until the funeral services are performed

The Commission's decision was based upon a determination that, if International issued and sold its debentures on the installment basis, it would be a face-amount certificate company and thus an investment company within the definition of Section 3(a)(2) of the Act and that International did not propose to meet the statutory requirements of the Act for face-amount certificate companies with respect to cash surrender rights and values and the maintenance of reserves to meet surrender values and maturity amounts The Commission's opinion noted that "purchasers of applicant's debentures would thus assume all of the risks inherent in the traditional face-amount certificate But they would have none of the protections envisaged by Congress" The fact that the debentures would be tied to the performance of funeral services by International was not viewed as a basis for distinction International has filed an appeal of the Commission decision which, as of the end of the fiscal year, is pending before the United States Court of Appeals for the Eighth Circuit [17]

During the fiscal year, the Continental Illinois National Bank and Trust Co of Chicago requested assurance that the Division would not recommend that the Commission take action to require it to register under the Investment Company Act a collective trust fund (CIRT) used as an investment medium for trusts which meet the requirements of Section 401 of the Internal Revenue Code

(the "Code") and trusts which meet the requirements of Section 408(e) of the Code (individual retirement accounts)

The Division denied Continental's request on the basis that the proposed collective fund would not be a "collective trust fund maintained by a bank consisting *solely* of assets of such [Code Section 401] trusts" (emphasis added) within the meaning of Section 3(c)(11) of the Act

Continental thereafter sought reconsideration of the Division's position, and asked that the matter be submitted to the Commission The Commission agreed with the decision to deny the request for a "no action" position, and further asked that the Division inform Continental that the Commission had taken no position on the legal conclusions set forth in the Division's earlier no-action response, but had based its determination on its view that the proposal raised significant legal and policy issues which could not properly be considered in the context of a no-action letter.

At the end of the fiscal year, the staff was engaged in considering an application for exemption filed by Continental pursuant to Section 6(c) of the Act

During the fiscal year, several mutual funds organized as limited partnerships applied for exemptive orders under various provisions of the Investment Company Act Until recently, it had not been feasible for a mutual fund registered under the Act to operate in limited partnership form because State partnership laws did not authorize voting powers for holders of limited partnership shares As a result, such a fund could not satisfy the requirements of the Act which mandate shareholder voting on specified matters. However, recent amendments of the laws of some States permit limited partners to be granted certain voting powers without the exercise of such powers being deemed to be "control" of the business Previously, such control would have subjected limited partners to unlimited liability as general partners

The Commission has granted exemptions to several limited partnerships during the fiscal year [18] These exemptions have been sought by municipal bond funds and "exchange" funds, both of which depend upon their limited partnership form for the tax treatment they seek to achieve. For example, the tax exempt character of income from municipal securities is "passed through" to holders of limited partnership interests, but such income would lose its tax exempt character if it were distributed as dividends to shareholders of a mutual fund organized as a corporation In addition, the limited partnership device, unlike the corporation, presently permits investors to exchange appreciated securities for interests in limited partnerships without the recognition of capital gains at that time However, legislation currently pending in Congress might eliminate this "tax-free" exchange privilege for limited partnerships, and such funds are awaiting a resolution of the tax status of exchanges before commencing operation

## OTHER DEVELOPMENTS

### "Money Market" Funds

Throughout the fiscal year, "money market" funds continued to be a dynamic segment of the mutual fund industry Generally, these are funds which invest in short-term debt securities such as treasury bills, commercial paper and certificates of deposit. Money market funds raise unique regulatory questions because of their short-term nature and the characteristics of the securities in which they invest.

The initial two questions addressed by the Division were the methods by which money market funds value portfolio securities and calculate rates of return or "yield" With respect to these matters, the Commission published for comment proposed guidelines[19] designed to standardize valuation of short-term debt securities by these funds and to establish uniform calculations to be used in reporting money market fund yields and rates of return.[20] In addition to analyzing the comments that were received on these proposals, the Division developed computer simulations of money market fund portfolios and, in February 1976, held a public meeting to solicit additional views from interested persons. The Division expects to complete its study of this matter in the near future.

### Registration of Foreign Investment Companies

Foreign investment companies, which generally are prohibited by Section 7(d) of the

Investment Company Act from selling their securities in this country, offer an opportunity for investing in diversified pools of securities issued by companies in foreign countries On December 2, 1974, the Commission issued a release[21] requesting public comments on whether foreign investment companies should be permitted to register under the Investment Company Act and allowed to sell their shares in this country and, if so, under what conditions The issues raised in this release were consistent with a recommendation of the Organization for Economic Cooperation and Development that member countries review their regulation of investment companies, and when deciding whether to permit a foreign investment company to operate in their country, give substantial weight to whether such company is domiciled in a country which complies with the OECD's rules on operation of investment companies The Commission also sought comments on related issues, including whether such companies could be allowed to register and sell shares in this country without sacrificing the high level of investor protection embodied in the Act.

In response to the release, the Division of Investment Management received approximately fifty comments, including comments from domestic and foreign investment companies, representatives of the United States and of foreign government agencies and United States investors After consideration of these comments, the Division recommended to the Commission that certain factual and legal questions which are crucial to the determinations which must be made pursuant to the Act can best be resolved on a case-by-case basis and in the context of formal applications filed by individual companies for exemptions from specific provisions of the Act and for orders permitting such companies to register under the Act and to sell their shares in the United States The Division also recommended that rule-making would be premature at this time

The Commission adopted this recommendation and published a statement of policy and guidelines for the filing of applications for orders permitting registration.[22] The release stated that the Commission would entertain applications filed by foreign investment companies pursuant to Section 7(d) of the Act which may incorporate requests for exemption from other sections of the Act with which a foreign applicant is unable to comply The release also set forth certain minimum prerequisites to filing, such as a minimum size, and described information which should be included in any such application No foreign investment company has yet sought to avail itself of this procedure, although overtures have been made by several

## Securities Depository System

During the past fiscal year, the Division continued to study the problems that may be presented when an investment company uses a securities depository either directly or through a custodianship of its assets

Section 17(f) of the Investment Company Act provides that subject to Commission regulation, a registered management investment company, or any permitted custodian for such company, with the consent of the company, may deposit all or any part of the securities owned by the company in a system for the central handling of securities established by a national securities exchange or national securities association registered with the Commission, or such other person as may be permitted by the Commission, pursuant to which system all securities of any particular class or series of any issues deposited within the system are treated as fungible and may be transferred or pledged by bookkeeping entry without physical delivery of such securities

A letter issued by the Division indicated that no action would be recommended to the Commission against a fund which authorizes its bank custodian to use the Federal Book Entry Deposit System in connection with treasury securities owned by the fund if the fund's Board of Directors approve the arrangement, at least once a year, after making certain determinations in good faith

The Division is continuing to consider what rules, if any, are necessary or appropriate for the protection of investors in connection with the participation in a depository by an investment company.

## "Index" Funds

A recent innovation in the investment company industry is the so-called "index fund,"

an investment company whose principal investment objective is to seek to match the performance of an established common stock index Shortly following the end of the past fiscal year, the first registration statement for a fund seeking to match the performance of Standard and Poor's Corporation Composite Stock Price Index was filed The development of the index fund concept was accelerated with the recent enactment of federal pension reform legislation which imposes certain obligations on persons acting in a fiduciary capacity with respect to retirement fund investments Index funds are seen by some as a means by which fiduciaries may discharge these obligations in a prudent manner while achieving the investment performance of a diversified pool of common stocks

## Reallocation of Management Compensation

Mutual Liquid Assets (the "Fund") wants to start a no-load mutual fund which will invest in money market securities The Fund's manager and distributor of its shares will be Athena Management Incorporated ("Athena")

Instead of providing for the payment of sales and distribution expenses either out of a sales load charged the investor or as an out-of-pocket expense of the manager-adviser/distributor, as other investment companies do, Athena intends to reallocate one-half of the management compensation to be paid under the management agreement with the Fund to the securities dealers who have sold the Fund's shares It is contemplated that under the agreement the manager will receive monthly compensation at the annual rate of 1/2 of 1 percent of the average net asset value of the Fund

The Fund requested assurance that the Division would not recommend that the Commission take any action concerning these arrangements The Division granted the Fund's request. But it advised the Fund that the staff is presently analyzing a number of issues related to the distribution of investment company shares, including the question of whether any portion of the assets of an open-end fund may be properly used, directly or indirectly, to pay distribution expenses In addition, it stated that, if it subsequently were to decide that the procedure described above does not comply with the Act, steps must be taken immediately to modify the procedure accordingly The Division further stated that its position assumed that the Fund's directors would be fully informed of the uncertain legal status of the proposed arrangement and would consider the appropriateness of the Fund's entering the arrangement in light of such information

## NOTES FOR PART 5

[1] Securities Exchange Act Release No 11725, Investment Company Act Release No 8980 (October 10, 1975), 8 SEC Docket 66 The maximum sales load rule was approved as an amendment to Article III, Sections 26 and 29, of the NASD Rules of Fair Practice

[2] Investment Company Act Release No 8999 (October 22, 1975), 8 SEC Docket 227

[3] Investment Company Act Release No 660 (July 2, 1971)

[4] Investment Company Act Release No 9219 (March 25, 1976), 9 SEC Docket 288

[5] An earlier form of the proposed rule was published on October 18, 1968 (Investment Company Act Release No 5517) and withdrawn March 25, 1976 (Investment Company Act Release No 9218, 9 SEC Docket 287

[6] Investment Company Act Release No 8894 (August 19, 1975), 7 SEC Docket 639

[7] Investment Company Act Release No. 8251 (February 1974), 3 SEC Docket 140

[8] 43 U S C 1601, et seq

[9] PL 94-204, 89 Stat 1145

[10] Investment Company Act Release No 9150 (February 6, 1976), 8 SEC Docket 1282

[11] Investment Advisers Act Release No 442 (March 5, 1975), 6 SEC Docket 414

[12] Investment Advisers Act Release No 477 (September 26, 1975), 7 SEC Docket 103

[13] Investment Advisers Act Release No 516 (May 13, 1976), 9 SEC Docket 661

[14] Investment Advisers Act Release No 478 (September 29, 1975), 7 SEC Docket 1014

[15] Investment Advisers Act Release No 503 (March 12, 1976), 9 SEC Docket 234.

[16] Investment Company Act Release No 9112 (January 5, 1976), 8 SEC Docket 997

[17] *International Funeral Services of California, Inc* v *SEC* (CA 8, No 76-1174)

[18] See e g , *In the Matter of Vance, Sanders Exchange Fund,* Investment Company Act Release No 9111 (January 5, 1976), 8 SEC Docket 996, and *In the Matter of Kemper Municipal Bond Fund, Ltd ,* Investment Company Act Release No. 9251 (April 19, 1976), 9 SEC Docket 463.

[19] Investment Company Act Release No 8757 (April 15, 1975), 6 SEC Docket 703

[20] Investment Company Act Release No 8816 (June 12, 1975), 7 SEC Docket 141

[21] Investment Company Act Release No 8596 (December 2, 1974), 5 SEC Docket 640

[22] Investment Company Act Release No 8959 (September 26, 1975), 7 SEC Docket 1002

# Part 6

# Public Utility Holding Companies

# Part 6

# Public Utility Holding Companies

Under the Public Utility Holding Company Act of 1935, the Commission regulated interstate public utility holding company systems engaged in the electric utility business and/or retail distribution of gas The Commission's jurisdiction also covers natural gas pipeline companies and other nonutility companies which are subsidiary companies of registered holding companies. There are three principal areas of regulation under the Act (1) the physical integration of public utility companies and functionally related properties of holding company systems, and the simplification of intercorporate relationships and financial structures of such systems; (2) the financing operations of registered holding companies and their subsidiary companies, the acquisition and disposition of securities and properties and certain accounting practices, servicing arrangements, and intercompany transactions, (3) exemptive provisions relating to the status under the Act of persons and companies, and provisions regulating the right of persons affiliated with a public-utility company to become affiliated with another such company through acquisition of securities

## COMPOSITION

At the end of calendar 1975, there were 20 holding companies registered under the Act There were 18 registered holding companies within the 15 "active" registered holding-company systems [1] The remaining two registered holding companies, which are relatively small, are not included among the "active" systems.[2] In the 15 active systems, there were 68 electric and/or gas utility subsidiaries, 63 nonutility subsidiaries, and 16 inactive companies, or a total of 165 system companies, including the top parent and subholding companies Table 31 in Part 9 lists the active systems and their aggregate assets

## FINANCING

### Volume

During fiscal 1976, a total of 12 active registered holding company systems issued and sold 62 issues of long-term debt and capital stock aggregating $3 4 billion pursuant to authorization by the Commission under Sections 6 and 7 of the Act Table 32 in Part 9 presents the amount and types of securities issued and sold by these holding company systems.

The dollar volume of these financings represents a 21 percent increase over the previous fiscal year Bonds and debentures issued and sold increased 36 percent, and preferred stock increased 53 percent However, the amount of common stock issued and sold decreased 13 percent

## PROCEEDINGS

*American Electric Power Company*—American Electric Power Company (AEP), a registered holding company, has filed an application to acquire the common stock of Columbus and Southern Ohio Electric Company, a nonassociate electric utility company. The Division of Corporate Regulation and the Department of Justice oppose the acquisition, arguing that AEP had not sustained its burden of showing substantial economies which would result from the acquisition and that the

acquisition would have anticompetitive effects warranting disapproval under the Act. The Administrative Law Judge denied the application. ADP appealed to the full Commission. The Commission heard oral argument on October 8, 1974. Dissatisfied with the state of the record, the Commission subsequently ordered AEP and certain other parties to answer in supplemental briefs certain questions presented by the Commission relating to the alleged economies. After submission of briefs by AEP and others, the matter is now before the Commission for decision.

*Central and South West Corporation* ("CSW")—Several Oklahoma municipalities have complained to the Commission that CSW's electric utility subsidiaries are not operated as an integrated electric system as required by Section 11(b)(1), and have requested a hearing on that issue. CSW has one Oklahoma and two Texas subsidiaries. It also has a fourth subsidiary serving portions of Louisiana, Arkansas and Texas. CSW's Texas companies have been interconnected with several other large Texas utilities in a completely intrastate system Exchange of power within the CSW system across the Oklahoma-Texas border is not permitted under an agreement between CSW and the other companies.

The matter was set down shortly after the close of the fiscal year for hearing before an administrative law judge

*Delmarva Power and Light Company*—On April 5, 1972, the Commission instituted proceedings under Section 11(b)(1) to determine whether Delmarva should be required to divest itself of its gas utility operations Delmarva and its Maryland and Virginia subsidiaries constitute a large integrated electric system. Delmarva then filed an application for exemption under Section 3(a)(2), which exempts from the Act a holding company which is predominantly an operating company. The two proceedings were consolidated for hearing and the Division of Corporate Regulation opposed Delmarva's application for exemption.

In his initial decision, to which the Division has taken exception, the administrative law judge held that Delmarva's gas business was not retainable under the Act, but that, in light of the Commission's recent decision in *Union Electric*,[3] which highlighted the problems created by the energy crisis, Delmarva would not be required to divest its gas business. The law judge further held that Delmarva was entitled to an exemption under Section 3(a)(2) of the Act and that compliance with the Section 11 integration standards is not necessary as a precondition to granting such an exemption.

*Empire State Power Resources, Inc* — Consolidated Edison Company of New York, Inc , Long Island Lighting Company, New York State Electric and Gas Corporation, Niagara Mohawk Power Corporation and Rochester Gas and Electric Corporation, five of the seven sponsors of Empire State Power Resources, Inc. ("ESPRI") have jointly applied to the Commission under Section 3(a) of the Act for an order exempting them as holding companies with respect to ESPRI, and, in the case of Niagara and Rochester, for authorization under Section 10 to acquire ESPRI's stock

ESPRI will be jointly owned by its sponsors. It will construct and own generating facilities throughout New York State to supply electricity to its sponsors. ESPRI is expected to construct 13 nuclear and 3 coal-fired base-load units with a rated capacity of 18,600 MW. The sponsors estimate that the construction costs during the period 1980–1991 will exceed $20 billion.

ESPRI represents the most significant effort on the part of utility companies in any State or region of the country to coordinate construction and operation of jointly owned facilities.

No hearing has yet been scheduled on the application, although a consumer group has requested one. The New York Public Service Commission, however, has held extensive hearings on the matters relating to the project within that Commission's jurisdiction.

*Ohio Power Company*—Ohio Power, an electric utility subsidiary of American Electric Power Company, filed an application for authority to issue short-term notes in an aggregate amount of up to $270 million through June 30, 1976. Ormet Corporation, Ohio Power's largest single customer, opposed the application and requested a hearing. A hearing was held on the proposal December 3–5, 1975. After the hearing, the Division of Corporate Regulation and Ormet argued to the Commission that Ohio Power had not demon-

strated any need for the full amount of the borrowing authority requested. The Commission agreed. In its Opinion of April 27, 1976, the Commission authorized Ohio Power to issue only $190 million in short-term debt through June 30, 1976.[4]

*North Penn Gas Company*—The Commission approved a negotiated plan filed pursuant to Section 11(e) of the Act under which Penn Fuel System, Inc. ("System") proposed to acquire 100 percent of the common stock of North Penn Gas Company ("North Penn") and up to 93 percent of the outstanding common stock of Penn Fuel Gas, Inc ("Penn Fuel"). System was also granted an exemption under Section 3(a)(1) of the Act.[5] On February 2, 1976, the Federal District Court in Philadelphia ordered that the plan be enforced.

Under the plan, System will acquire about 243,000 shares of North Penn common stock at $18.50 per share, payable $3.10 in cash and the balance in 10 percent serial installment notes on which the final payment will be due on December 31, 1979. System will also issue its common stock to the Ware family in exchange for the remaining shares of North Penn common stock and up to 93 percent of the outstanding common stock of Penn Fuel.

## HOLDING COMPANY DEBT

Section 7(c)(1) of the Act identifies common stock and first mortgage bonds as the primary source of long-term utility system financing. Congress, however, has authorized the Commission to approve alternate methods of financing in exceptional circumstances.

In 1969 and 1970, the Commission excepted the sale by General Public Utilities Company (GPU) of $100 million of holding company unsecured debentures from Section 7(c)(1) (Rel. 35–16540, November 28, 1969 and Rel. 35–16892, November 4, 1970). There was little choice Massive investment in plant under construction had outrun the bonding power of the operating companies and the short-term borrowing limits of the Act. Practical limits on common stock sales left the debentures the only feasible source of financing.

During the difficult financial times of the recent fiscal year, the Commission again exercised its exemptive authority to allow The Southern Company to sell $125 million of six-year notes[6] and Northeast Utilities to sell $50 million of ten-year notes.[7]

## FINANCING OF FUEL AND GAS SUPPLIES

Fuel curtailments have made it increasingly necessary for electric and gas utilities, including those registered under the Act, to invest in their own sources of supply and their own delivery facilities.[8] During fiscal 1976, the Commission allowed 8 registered systems to invest over $100 million in these activities.[9]

## AMENDMENT OF FORM U5S AND RULE 48(b) UNDER THE ACT

The Commission amended Form U5S, the Annual Report for registered holding companies under the Act, in two ways. First, the Form was changed to require that a registered company report total annual compensation of employees, other than officers, paid more than $40,000 by system companies. The Form previously required a report of total compensation in excess of $15,000 The amendment was made to conform to the requirements of Form 10–K.

The Form has also been amended to allow reporting companies to substitute a statement of the total loans to and guarantees for employees for the itemized list previously required.

The Commission also amended Rule 48(b) which formerly exempted, automatically, all loans to or guaranties by system companies for the account of employees that otherwise would require Commission authorization. As amended, Rule 48(b) limits the automatic exemption to a maximum of $10,000 for any one employee. That limit however will not apply to the financing of an employee's residence.[10]

## NOTES TO PART 6

[1] Three of the 18 are subholding utility companies in these systems. They are The Potomac Edison Company and Monongahela Power Company, public utility subsidiaries of Allegheny Power System, Inc., and Southwestern Electric Power Company, a public utility subsidiary of Central and South West Corporation.

[2] These holding companies are British American Utilities Corporation and Kinzua Oil and Gas Corporation.

[3] See 41st Annual Report, p 142

[4] Holding Company Act Release No 19502, 9 SEC Docket 515

[5] Holding Company Act Release No 19254 (November 20, 1975), 8 SEC Docket 482

[6] Holding Company Act Release No 19439 (March 23, 1976), 9 SEC Docket 272.

[7] Holding Company Act Release No 19519 (May 7, 1976), 9 SEC Docket 637.

[8] See, *e g*, *Public Service Company of Oklahoma*, Holding Company Act Release No 19090 (July 17, 1975), 7 SEC Docket 413, *Indiana & Michigan Electric Company*, Holding Company Act Release No 19064 (June 26, 1975), 7 SEC Docket 346, *Ohio Power Company*, Holding Company Act Release No 19036 (June 12, 1975), 7 SEC Docket 163, *Appalachian Power Company*, Holding Company Act Release No 18971 (May 7, 1975), 6 SEC Docket 868 and No 18363 (April 3, 1974), 4 SEC Docket 50, *Middle South Utilities, Inc*, Holding Company Act Release No 18966 (May 2, 1975), 6 SEC Docket 806, No. 18785 (January 23, 1975), 6 SEC Docket 172, and No. 18221 (December 17, 1973), 3 SEC Docket 258; *Transok Pipe Line Company*, Holding Company Act Release No 18933 (April 14, 1975), 6 SEC Docket 691, *Columbia Gas System, Inc*, Holding Company Act Release No 18749 (December 31, 1974), 6 SEC Docket 22

[9] The need for Commission approval of such nonutility businesses has been well established. See, *e g*, *Columbia Gas & Electric Corporation*, 17 SEC 494 (1944), *Appalachian Electric Power Company*, 27 SEC 1029 (1948); *General Public Utilities Corporation*, 32 SEC 807 (1941); *Columbia Hydrocarbon Corporation*, 38 SEC 149 (1957); *Arkansas Power & Light Company*, Holding Company Act Release No 17400 (December 17, 1971)

[10] Holding Company Act Release No 19489 (April 15, 1976), 9 SEC Docket 434

# Part 7

# Corporate Reorganizations

# Part 7

# Corporate Reorganizations

The Commission's role under Chapter X of the Bankruptcy Act, which provides a procedure for reorganizing corporations in the United States district courts, differs from that under the various other statutes which it administers. The Commission does not initiate Chapter X proceedings or hold its own hearings, and it has no authority to determine any of the issues in such proceedings The Commission participates in proceedings under Chapter X to provide independent, expert assistance to the courts, participants, and investors in a highly complex area of corporate law and finance. It pays special attention to the interests of public security holders who may not otherwise be represented effectively

Where the scheduled indebtedness of a debtor corporation exceeds $3 million, Section 172 of Chapter X requires the judge, before approving any plan of reorganization, to submit it to the Commission for its examination and report If the indebtedness does not exceed $3 million, the judge may, if he deems it advisable to do so, submit the plan to the Commission before deciding whether to approve it When the Commission files a report, copies of summaries must be sent to all security holders and creditors when they are asked to vote on the plan The Commission has no authority to veto a plan of reorganization or to require its adoption

The Commission has not considered it necessary or appropriate to participate in every Chapter X case Apart form the excessive administrative burden, many of the cases involve only trade or bank creditors and few public investors The Commission seeks to participate principally in those proceedings in which a substantial public investor interest is involved However, the Commission may also participate because an unfair plan has been or is about to be proposed, public security holders are not represented adequately, the reorganization proceedings are being conducted in violation of important provisions of the Act, the facts indicate that the Commission can perform a useful service, or the judge requests the Commission's participation

The Commission in its Chapter X activities has divided the country into five geographical areas. The New York, Chicago, Los Angeles and Seattle regional offices of the Commission each have responsibility for one of these areas Supervision and review of the regional offices' Chapter X work is the responsibility of the Division of Corporate Regulation of the Commission which, through its Branch of Reorganization, also serves as a field office for the southeastern area of the United States

## PROPOSED BANKRUPTCY LEGISLATION

During the fiscal year, the Commission submitted an extensive report to Congress[1] on two pending bills which are intended to replace the present Bankruptcy Act. The bills were prepared by the Commission on the Bankruptcy Laws of the United States (S 236 and H 31) and the National Conference of Bankruptcy Judges (S 235 and H 32). Commissioner Philip A Loomis, Jr , testified with respect to this report before a Senate sub-

committee on November 5, 1975, and before a House subcommittee on April 5, 1976.

The proposed legislation for the most part deals with consumer bankruptcy matters Thus, the Commission's report was limited to the small portion of the legislation dealing with rehabilitation of corporations The Commission expressed particular concern in the report that certain important investor safeguards now in Chapter X, including Commission participation as advisor to the courts and parties and parties to the reorganization, would be eliminated under the proposed legislation

## SUMMARY OF ACTIVITIES

In fiscal year 1976, the Commission entered 4 new Chapter X proceedings involving companies with aggregate stated assets of approximately $765 million and aggregate indebtedness of approximately $684 million Including the new proceedings, the Commission was a party in a total of 124 reorganization proceedings during the fiscal year.[2] The stated assets of the companies involved in these proceedings totaled approximately $4 5 billion and their indebtedness about $4.0 billion

During the fiscal year, 9 proceedings were closed, leaving 115 in which the Commission was a party at year end

## ADMINISTRATIVE MATTERS

In Chapter X proceedings, the Commission seeks to protect the procedural and substantive safeguards afforded parties in such proceedings. The Commission also attempts to secure judicial uniformity in the construction of Chapter X and the procedures thereunder.

*Cavanaugh Communities Corporation* [3]—On appeal by the New York Stock Exchange ("Exchange") , the district court vacated an order of the bankruptcy judge enjoining the Exchange from applying to the Commission to delist the debtor's securities. The court, as urged by the Commission in an *amicus curiae* brief, held that the bankruptcy judge lacked the power to issue the injunction because the Commission has statutory authority over the listing and delisting of securities on national exchanges.[4] The district court also indicated that it agreed with the Exchange's contention that an exchange listing is not "property" within the meaning of the Bankruptcy Act

*Interstate Stores, Inc* [5]—The trustees contracted to sell certain real estate for $650,000. At the hearing on the application to approve the sale, a second party offered to pay $675,000, the original offeror agreed to pay this amount. The second party then increased his offer to $685,000. The original party claiming surprise at this competitive bidding, stated he was unprepared at that time to pay more. The bankruptcy judge concluded the hearing and directed the trustees to submit an order authorizing the sale for $685,000 Following the hearing, the first party offered to pay $725,000, but the bankruptcy judge confirmed the sale to the other party for $685,000.

The original party asked the bankruptcy judge to vacate his order and to reopen bidding The Commission supported his position The bankruptcy judge denied his request. He appealed to the district court, which vacated the order confirming the sale and remanded the matter to the bankruptcy judge. Subsequently, at a hearing before the bankruptcy judge, the trustees sold the real estate, after spirited bidding, to the original offeror for $1,210,000.

In another aspect of this proceeding, the trustees sought expungement of a $38 million proof of claim. The claimant sought to modify an order of the bankruptcy court staying suits against the bankrupt so as to permit the prosecution of its $38 million claim in a California state court. The Commission supported the trustees in their efforts to have this claim tried in the Chapter X court. The Commission contended that in light of the size of the claim and the central importance of its resolution to the formulation of a plan of reorganization, the Chapter X court must hear and summarily determine the trustees' application to expunge under Section 196 of the Bankruptcy Act. The Commission further argued that if the claim were determined by a California state court, public investors would be deprived of the Commission's assistance in the resolution of that claim.

The bankruptcy judge in effect determined that the claim could proceed to trial in California. The trustees appealed to the district court The district court directed the Chapter

X court to retain jurisdiction to determine the claim

The claimant appealed to the Second Circuit. At the close of the fiscal year, this appeal was pending.

*C I P Corporation* [6]—The Commission supported the trustee in urging the Court of Appeals for the Sixth Circuit in Cincinnati to affirm the district court's ruling which permitted the sale of certain real estate free and clear of certain liens with the proceeds to be placed in escrow subject to further order of the court

The Commission argued in its brief that the questions of when and under what circumstances property may be sold free of liens in a reorganization case is "in the sound discretion of the District Judge " [7] Here, the court did not abuse its discretion since the lien of the appellant would attach to the proceeds, which exceeded the value of the claim

The Commission also urged that other issues raised by appellant concerning the validity, enforceability and priority of its mortgages were clearly not ripe for appeal since the district court had not ruled on these matters because of the need for further evidentiary hearings

*King Resources Company* [8]—The Court of Appeals for the Tenth Circuit, as urged by the Commission, affirmed the district court's holding that senior debt is not entitled to post-petition interest at the expense of subordinate debentures, where the subordination agreement was to principal and interest to the date of payment, but did not specifically provide for subordination to post-petition interest [9]

The district court's order disallowed the claims of senior creditor banks for post-petition interest from the funds otherwise distributable to publicly-held debentures which were subordinated to the senior debt by the terms of the indenture pursuant to which those debentures were issued Since the district court had determined that the debtor was insolvent, the general rule that interest stops on the date of the filing of the petition applied

*Equity Funding Corporation of America* — Certain claimants filed appeals to the Court of Appeals to prevent consummation of the trustee's plan of reorganization for Equity Funding Corporation of America ("EFCA") and to overturn the lower court's denial of their claims [10] The appellants had unsuccessfully sought a stay of the reorganization proceedings pending the resolution of their appeals

The claimants had been convicted of numerous counts of fraud in connection with the issuance of false financials in connection with the sale of EFCA securities,[11] and were defendants in the litigation described infra [12] Their claims in the reorganization proceeding exceeded $1 5 billion

The lower court had rejected their claims because (1) they were not timely filed, (2) they lacked sufficient detail to show any indebtedness owing from the debtor, (3) their claims for indemnity and contribution were not allowable since such claims are limited under the plan to legal and defense expenses and then only if the action is terminated without a finding of fraud, and (4) that even if otherwise allowable, the claims are barred under the doctrine of equitable subordination

As of the close of the fiscal year, the appeals were still pending

## TRUSTEE'S INVESTIGATION AND STATEMENTS

A complete accounting for the stewardship of corporate affairs by the prior management is a requisite under Chapter X One of the primary duties of the trustee is to make a thorough study of the debtor to assure the discovery and collection of all assets of the estate, including claims against officers, directors, or controlling persons who may have mismanaged the debtor's affairs The staff of the Commission often aids the trustee in his investigation

*Equity Funding Corp of America* [13]—The trustee had filed suit against the independent accountants who reviewed the fraudulent financial statements and rendered their opinion that the statements fairly represented the financial condition of the companies.[14] The accountants are also defendants in litigation brought by Equity Funding Corp of America's ("EFCA") security holders to recover the losses allegedly suffered from the purchase of EFCA's securities

The trustee seeks recovery for the estate under two general categories of damages The first involves $3,750,000 for recovery of the fees paid to the accountants for work incompetently performed and for the fees and

costs incurred by the estate in ascertaining EFCA's true financial condition The second part of the trustee's suit claims recovery for all of the liabilities incurred by EFCA and its subsidiaries from the publication of false financial statements. This part of the action involving hundreds of millions of dollars essentially duplicates the claim by EFCA's security holders.

Since it was clear that the defendant's ability to pay for any judgment on any of these causes of action would be limited, the trustee and representatives of the security holders agreed to a division of a partial recovery. The agreement, which was incorporated into the plan of reorganization, provided for a maximum recovery for the estate of $2.4 million plus certain costs If the recovery exceeded about $4 9 million, the estate would receive about $2.45 million and the other plaintiffs the same amount plus all of the balance.

*Beverly Hills Bancorp* [15]—The trustee of this holding company has had no business to conduct and is liquidating the estate. In an effort to hold down the mounting administrative costs, the Commission applied for an order directing the trustee to complete his investigation, prepare and file his Section 167 report, and prepare and file a plan of reorganization by a specified time.

The Commission, to assist the trustee in his investigation, had made the Commission's enforcement investigative transcripts available in a pending civil suit under the Securities Act.[16] The trustee had appointed a special counsel to conduct the investigation, but it appeared that his activities were limited to reading the Commission's investigative transcripts

The Commission contended in its application that the thorough investigation contemplated by Congress to be made by the disinterested trustee was the cornerstone of Chapter X, upon which a plan or report would be based.[17] The Commission urged that the trustee's investigatory function required affirmative discovery as opposed to relying on available work done by others for more specific purposes.[18] The court continued the hearing on the Commission's application pending resolution of certain collateral matters.

## PLANS OF REORGANIZATION

Generally, the Commission files a formal advisory report only in a case which involves substantial public investor interest and presents significant problems. When no such formal report is filed, the Commission may state its views briefly by letter, or authorize its counsel to make an oral or written presentation During the fiscal year the Commission published four advisory reports, two of which supplemented a prior advisory report, dealing with four plans of reorganization [19] Its views on five other plans of reorganization were presented to the courts either orally or by written memoranda [20]

*Equity Funding Corp. of America* [21]—The trustee proposed a plan of reorganization for this holding company premised upon a series of compromises interrelated since the claims of each class of creditors affected those of every other class. Equity's principal assets are two substantial operating insurance companies valued at about $100 million. Consolidated assets of the new enterprise will be about $400 million with the principal consolidated liabilities being $235 million of reserves for policy liabilities.

The plan would create a new holding company which would issue about $27 million of income notes to secured bank creditors and 7,900,000 shares of its stock, valued at $87 million, to be divided among other creditors Certain other secured creditors whose claims aggregated about $50 million were paid in cash from the proceeds of liquidation of their collateral.

Even though Equity was found to be insolvent so that its common stock did not participate as such, about $21 million in new common stock (20 percent of the estate) was allocated to settle the class action suits asserted principally by stockholders. Their net losses estimated at about $170 million. About $20 million of common stock was allocated in settlement of claims of $64 million to publicly-held subordinated debenture holders. In addition, the subordinated debentures issued by EFCA's Euro-dollar subsidiary shares $1.5 million in cash from the subsidiary estate in addition to their stock distribution as subordinated guaranteed debt of EFCA. The claims of the original shareholders in one of the insurance comapnies who sought to reclaim

in kind the insurance shares of which they were defrauded in a 1971 merger were also settled under the plan by an allocation of $12 million of common stock of the reorganized company. The remaining $34 million of common stock was distributed primarily to bank creditors with claims of $40 4 million and miscellaneous claims of about $4.3 million.

The Commission filed an advisory report concluding that the plan was fair and equitable and feasible.[22] The plan was overwhelmingly accepted by all classes of creditors and was consummated on March 21, 1976.

*King Resources Company.*[23]—At the conclusion of plan hearings, the court referred the trustee's internal plan of reorganization to the Commission for report. The plan provided for full payment in cash of administrative costs, priority claims and secured claims Unsecured creditors, including owners of the publicly held subordinated debentures, face value $41 million, will receive 25 Class A and 25 Class B shares for each $1,000 of claims.

The two classes have identical rights except that the Class A shares have a $20 liquidation preference if the reorganized company is liquidated. To give recognition to the contractual subordination, the plan provided that the senior creditors would receive in the actual distribution only Class A shares, while the subordinated debentures would receive after exchanging their Class A shares for senior creditors Class B shares about 10 Class A shares and 40 Class B shares for each $1,000 claim.

The public shareholders of the debtor will not participate as shareholders since the debtor estate was found to be insolvent However, the plan proposes to compromise the class action claims on behalf of the shareholders and public debenture holders, which are based on, among other things, violation of Federal and State securities laws, by issuing to this class about 15 percent of the common stock of the new company.

The Commission's advisory report concluded that the plan could be found to be fair and equitable and feasible, if amended in certain respects.[24] The Commission concluded that, since liquidation of the new company was remote, the liquidation preference did not give sufficient recognition to the subordination provision of the indentures. To afford senior creditors their contractual rights, the Commission recommended that the Class A shares be convertible into one and one-half shares of Class B shares at the holder's option during the first five years after reorganization

The Commission also recommended that additional evidence be taken with respect to the value of the assets of International Resources Limited, a wholly owned subsidiary of the debtor. The foreign debentures had an independent claim to these assets as well as equal rank with the domestic debentures on a guarantee by the debtor The trustee allowed a $1 million nonsubordinated claim in recognition of this right, but the record was inadequate to evaluate the fairness of this proposal

The trustee amended this plan to provide for the conversion feature, as urged by the Commission, but limited this privilege to two years. The first year the conversion rate is one and one-half shares of Class B for each Class A share and the second year the rate is one and one-quarter shares of Class B stock for each Share of Class A.

The senior creditor banks appealed the district court's order approving the plan of reorganization, arguing that the court erred by (i) not considering a plan of liquidation for the debtor, (ii) valuing the debtor's nonproducing Artic properties on a discounted cash flow method; (iii) including all unsecured creditors in a single class, and (iv) not providing adequate compensation under the plan to senior creditors in recognition of their senior rights

The Commission argued, as it concluded in its advisory report, that the trustee properly valued the Artic interests and that the plan correctly included senior creditors in the one class of unsecured creditors. With regard to a plan of liquidation, the Commission noted that while Section 216(10) of Chapter X permits such a plan, nevertheless, "the court should be 'reorganization minded' and not 'liquidation minded.' "[25] The general policy of Chapter X to preserve values, keep businesses operating and maintain employment far outweighs the banks' desire for liquidation.

To afford senior creditors their contractual rights under the subordination provision, the Commission urged that the plan be amended to provide for a longer conversion period as orginally suggested in the advisory report.

Since, however, almost a year had elapsed from the date of approval of the plan, the time to begin the conversion period should commence from confirmation of the plan rather than from its consummation

*Imperial '400' National, Inc* [26]—An internal plan of reorganization was proposed by the trustee, creditors committee and a large stockholder providing for the issuance by a reorganized Imperial of (i) notes (two series), common stock, plus cash payments in satisfaction of general unsecured creditor claims, including interest, (ii) common stock in satisfaction of subordinated public debentureholder claims, including interest, and (iii) common stock to shareholders equivalent to their interest in the estate The Commission filed a third supplemental advisory report stating that the plan was not "fair and equitable, and feasible "[27] The plan was unfair because it afforded preferred treatment to certain large creditors by offering them a series of notes which were senior to the notes offered small creditors. Further, it was this essentially unfair aspect of the plan upon which its feasibility was predicated. In addition, the plan's feasibility was premised on the availability of a tax loss carry-forward, an assumption that was open to question The Commission suggested proposed amendments to make the plan fair, equitable and feasible

Thereafter, the plan was amended substantially in accordance with the Commission's suggestions, including the issuance of identical notes to all general unsecured creditors The Commission filed a fourth supplemental advisory finding that the plan as amended was fair, equitable and feasible [28] The plan was approved and confirmed by the court

*First Home Investment Corp of Kansas, Inc.* [29]—The debtor is a publicly-held face amount certificate company registered under the Investment Company Act of 1940. Over 22,000 public investors purchased more than $50 million of its stock and face-amount certificates

The trustee and the Investors' Protective Committee A ("Committee") jointly proposed a plan of reorganization providing for the establishment of a reorganized company authorized to operate a mortgage banking company and to engage in related business activity The company was solvent with a shareholder equity of over $40 million, an increase from that recorded as of the filing of the petition.

The plan provides for full payment in cash of the costs of administration, tax claims, and the claim of unsecured creditors (other than holders of face-amount certificates) Outstanding face-amount certificates will continue to be secured by qualified assets on deposit with the Union National Bank of Wichita, Kansas. Holders may redeem their certificates for their cash surrender value If not redeemed, the terms and conditions of these certificates will be honored except that the reorganized corporation will not accept any funds for further investment, lend any money under the face-amount certificates, nor make any annuity payments under certain of the face-amount certificates

Shareholders will be permitted to resell to the corporation up to one-half of their common stock for cash at 90 percent of asset value, except those who own fewer than 200 shares may redeem all their shares The shareholders are also given the alternative to accept a 7 percent, 7-year note for 100 percent of asset value instead of cash, or shareholders can retain a full common stock position

The Commission in its advisory memorandum concluded that the plan was fair and equitable and feasible but recommended certain minor amendments which were substantially adopted by the court The plan was accepted and confirmed in April 1976

*Omega-Alpha, Inc* [30]—The trustee filed a plan of orderly liquidation for this publicly-held holding company which wholly owns one operating subsidiary, the Okonite Company ("Okonite") The principal feature of the plan is the sale of the debtor's stock ownership in Okonite for $44 million plus $1 million in forgiveness of debt to an Employees Stock Ownership Trust ("ESOT") which Okonite created for the benefit of its employees.[31] The ESOT is financing the purchase through a $13 million loan from the New Jersey Economic Development Authority with the remaining funds being borrowed from banks The sale agreement provides for a procedure for resolving a claim of $12.2 million under the tax consolidated agreement between the debtor and Okonite

The Commission filed an advisory memo-

randum concluding that the plan was fair and equitable and feasible The plan called for the payment in full of costs of administration, tax and governmental claims and claims of $850 or less. Also, secured bank claims of about $15 million will be paid in full in cash. The remaining cash will be distributed to unsecured creditors, including public subordinated debenture holders, with recoginition of the subordination provisions of the indentures. Since the debtor was found to be insolvent, no participation was afforded to shareholders.

The plan was approved and confirmed by the court whereupon the sale of Okonite to the ESOT was consummated

Valhi, Inc., holder of about $7.6 million face amount of the debtor's subordinated debentures as a result of a tender offer conducted during the proceeding at a price of $30 net per $100 principal amount, has appealed to the district court, the confirmation of the plan contending that the bankruptcy judge erred by not considering its alternative "internal" plan filed at the time of confirmation and by permitting certain creditors to vote for the trustee's plan. At the close of the fiscal year, the matter was still pending before the district court.

*Maryvale Community Hospital, Inc.* [32]—At the close of the fiscal year, the district judge ordered the trustee to make the final distribution to public bondholders pursuant to a confirmed plan of orderly liquidation which terminated a long, but very successful, Chapter X proceeding in which the Commission played an active role throughout.

The case grew out of the public issuance of high-interest first mortgage bonds by charitable nonprofit corporations in the southwest in the early 1960's. In 1963, Maryvale bondholders filed a fraud suit under the Federal securities laws and a creditors' petition for reorganization under Chapter X. The petition was approved but was vigorously contested, and the Commission intervened in the public interest and supported the petitioning creditors, who were faced at the outset with a basic jurisdictional issue.[33]

The court-appointed trustee managed the debtor's business operations and eventually sold the hospital for a sum sufficient to repay bondholder principal, simple interest, and interest on defaulted interest at eight percent according to the terms of the indenture. While the trustee's plan to pay the proceeds to the bondholders was upheld on appeal,[34] distribution of a substantial portion was delayed by extensive litigation over a claim asserted by the former pathologist for the hospital Ultimately, the trustee prevailed,[35] and the bondholders received the final payment amounting to approximately 158 percent of the face value of the bonds Pursuant to the plan, the court fixed a bar date to expire not less than five years on or before which bondholders may claim their dividends, at the end of which, since the debtor is a charitable corporation, any unclaimed funds will be distributed to designated Arizona nonprofit organizations

*Lyntex Corporation, et al* [36]—The plans of reorganization contemplating orderly liquidation of the debtor and its subsidiaries[37] provided for the subordination of all costs and expenses of administration of the superseded Chapter XI proceedings to those incurred in the Chapter X proceeding. The court, in an unreported memorandum decision, rejected the Commission's position that the applicable "fair and equitable" standard requires equal treatment for cost and expenses of administration in both proceedings, but agreed that all administrative costs and expenses within each proceeding be treated equally by the terms of the plans. The plans of orderly liquidation as amended were approved by the court

*Bubble Up Delaware, Inc , et al* [38]—The co-trustees developed a consolidated plan of reorganization providing for the distribution of the proceeds from the previous sale of the debtors' assets as going concerns [39] The plan proposed a settlement of the pending controversy between the public stockholders of the Parent company who had claims based upon the Federal securities laws and the general creditors of all three related debtor estates. Essentially, the co-trustees' plan provided for substantively consolidating the three debtor estates and allocating by way of compromise the combined assets to the various creditor groups on a percentage basis

In its memorandum on the plan filed with the court, the Commission pointed out that the "formula for distribution . is the result of negotiation and compromise among the interested parties" and that while compromises form a normal part of corporate reorganiza-

tions, they must be fair and equitable with an adequate record to support that conclusion.[40] It also noted that the plan provisions applied the leading cases on the issue of consolidation[41] and that the provision for recognition of rescission claimants based on Federal securities fraud claims was proper [42]

## ACTIVITIES WITH REGARD TO ALLOWANCES

Every reorganization case ultimately presents the difficult problem of determining the compensation to be paid to the various parties for services rendered and for expenses incurred in the proceeding The Commission, which under Section 242 of the Bankruptcy Act may not receive any allowance for the service it renders, has sought to assist the courts in assuring economy of administration and in allocating compensation equitably on the basis of the claimants' contributions to the administration of estates and the formulation of plans. During the fiscal year 525 applications for compensation totaling about $23.5 million were reviewed

*Farrington Manufacturing Company, et al.*[43]—The Court of Appeals for the Fourth Circuit held that the lower court's award of $350,000 for a Chapter X trustee was insufficient and adopted the Commission's recommendation of $575,000 for services rendered through June 30, 1973 [44] With respect to counsel fees subsequent to that date, as urged by the Commission, the court of appeals remanded in order that the notice required by Chapter X be given to creditors.

The Fourth Circuit noted in accordance with the position of the Commission that counsel to a Chapter X trustee

> "is an officer of the court charged with specific duties and responsibilities for the performance of which it is entitled to fair recompense. This, of course, does not mean that it is to be paid for unnecessary services or for services ineptly done But, so long as its services are within the proper range of its duties and are performed with reasonable competency, it is to be compensated, not necessarily by the same yardstick as 'similar services command in purely private employment' but sufficient in amount to induce competent counsel to undertake the labors incident to a reorganization proceeding in reliance on the willingness of the Court later to deal fairly with it "[45]

The court, agreeing with the Commission, also held that there was no justification for the district court to reduce by 50 percent the pre-Chapter X expenses of an indenture trustee (to be paid out of the distribution for the debenture holders) payable pursuant to the trust indenture, and that its services during the Chapter X proceeding which were beneficial to the estate should be paid as a cost of administration, rather than from the amount available for distribution to the debenture holders, as ordered by the district court.

The court in commenting that the district court "apparently disregarded the SEC's evaluation of counsel's services and recommendation of a proper allowance therefor" stated that the Commission's fee recommendations in reorganization cases are entitled to great weight.[46]

*National Telephone Company, Inc , et al* [47]—Shortly after a transfer of the proceedings from Chapter XI to Chapter X upon the motion of certain creditors, eight law firms applied for fees totalling more than $300,000 for services rendered during the Chapter XI proceedings. The Commission urged that the applications be denied without prejudice suggesting that they be resubmitted at the conclusion of the Chapter X proceedings Among other things, the Commission advised the court that the misfiling under Chapter XI and the prolonged eight-month proceeding under a wrong chapter of the Bankruptcy Act raised questions concerning the benefits conferred on the estate, which questions could only be answered at the conclusion of the Chapter X proceeding upon an adequate record [48]

At the close of the fiscal year, the court had not rendered a decision with respect to the applications.

*U S Financial, Inc* [49]—The trustee of this large publicly-owned real estate conglomerate sought "interim compensation based upon an annual salary of $125,000, payable monthly . . subject to periodic review and examination by the court." After a hearing, the bankruptcy judge allowed interim compensation of $10,000 per month until further order of the court and directed the trustee to file quarterly "report of services" which was

noticed for periodic hearings for "review" by the court While he submits a report of services rendered, the trustee files no application for allowance of compensation

The Commission objected to this procedure for compensating a Chapter X trustee, asserting that it did not comply with the established periodic application, notice, and hearing procedure originally suggested by the Commission and adopted by the courts in compliance with Section 247 of the Bankruptcy Act [50] When the bankruptcy judge entered a subsequent order approving the trustee's report of services and prior payment of $30,000 for the first quarter, the Commission filed a notice of appeal to the district court asserting that the procedure followed by the bankruptcy judge did not comply with the application, notice, and hearing provisions of Section 247 of the Bankruptcy Act and Chapter X Rules 10–215 and 10–216 In its brief, the Commission pointed out that Chapter X is a public investor protection statute which, *inter alia,* contains "detailed machinery governing all claims for allowances from the estate,"[51] and that the procedure adopted by the lower court does not permit the court or parties in interest to evaluate the services rendered before interim fees are paid and undermines the important statutory right to be heard on all allowances from the estate [52] Although briefed, the appeal had not been heard before the close of the fiscal year.

*Interstate Stores, Inc* [53]—The independent trustee applied for a second interim allowance of $40,000 for services rendered over a one-year period General counsel for the trustee sought a first interim allowance of $575,000 for services rendered over a 17 1/2 month period. In addition, various special counsel for the trustee retained for particular tasks and who had expended insubstantial amounts of time requested interim fees

Approximately 22 percent of general counsel's reported total time expended on the estate during the period (9,670 hours) was not supported by adequate time records A portion of the independent trustee's time was not substantiated by time records. The Commission recommended to the bankruptcy judge interim allowances of $450,000 and $25,000 to general counsel and the independent trustee, respectively. The Commission also recommended that approximately one-half of general counsel's expenses, for which reimbursement was sought, was not properly chargeable to the estate and should be disallowed. The Commission also recommended that the payment of interim allowances to four special counsel be denied without prejudice pending completion of their work

Apart from reducing the request of the independent trustee by $5,000, the bankruptcy judge granted all the applications in full, without setting forth any reasons in law or fact why he declined to follow the Commission's recommendations Subsequent to the close of the fiscal year, the Commission appealed the bankruptcy judge's decision to the district court. [54]

## INTERVENTION IN CHAPTER XI

Chapter XI of the Bankruptcy Act provides a procedure by which debtors can effect arrangements with respect to their unsecured debts under court supervision. Where a proceeding is brought under that chapter but the facts indicate that it should have been brought under Chapter X, Section 328 of Chapter XI and Rule 11–15 of the Rules of Bankruptcy Procedure authorize the Commission or any other party in interest to make application to the court to transfer the Chapter XI proceeding to Chapter X.

Under Rule 11–15, which became effective as of July 1, 1974, the Commission as well as other parties in interest, except the debtor, have 120 days from the first date set for the first meeting of creditors to file a motion The time may be extended for good cause. A motion made by the debtor for transfer, however, may be made at any time. The rule requires a showing that a Chapter X reorganization is feasible This in effect means that a motion can be granted only if the court finds both that Chapter XI is inadequate and reorganization under Chapter X is possible The prior procedure for filing a Chapter X petition after the granting of the motion and a separate hearing on the petition has been abolished.

Attempts are sometimes made to misuse Chapter XI so as to deprive investors of the protection which the Securities Act of 1933 and the Securities Exchange Act of 1934 are designed to provide In such cases the Commission's staff normally attempts to resolve the problem by informal negotiations If this

proves fruitless, the Commission intervenes in the Chapter XI proceeding to develop an adequate record and to direct the court's attention to the applicable provisions of the Federal securities laws and their bearing upon the particular case

*W T Grant Company* [55]—Grant's filing of a Chapter XI petition on October 2, 1975, triggered the single largest attempted business rehabilitation instituted under the Bankruptcy Act At that time, Grant operated about 1,070 retail stores throughout the United States and employed 62,000 persons. The Chapter XI petition reflected assets and liabilities of $1,016,776,242 and $1,030,556,198, respectively, as of September 4, 1975 The public investor interest in Grant consisted of i) $117,336,000 in principal amount of debentures (3 issues) held by 3,600 persons; ii) 75,000 shares of preferred stock held by 500 persons; and iii) 14 million shares of common stock held by 35,000 persons Grant was indebted to a consortium of 27 banks in the aggregate sum of $641 million The banks asserted security interests in customer receivables, merchandise inventories and certain securities of a large Canadian majority-owned retail store chain subsidiary

At the outset, there were impediments to the transfer of the case to Chapter X The debtor-in-possession order, entered on October 2, 1975, contained provisions authorizing the banks to accelerate payment of $90 million they lent back to Grant, in the event of a transfer motion Another ex parte order authorized the banks to terminate their credit card agreements with Grant in the event of a transfer motion Grant and others advised that any motion to transfer would be vigorously contested and the banks made it clear that they would litigate the usage of collateral in Chapter X. At the same time, the Commission was assured by Grant and others that the objective of the Chapter XI filing was rehabilitation and reorganization

The business of Grant at the time of its Chapter XI filing was in a state of turmoil Trade credit was unavailable and the flow of merchandise into the stores was reduced to a trickle. Difficulties were even incurred in getting merchandise for the Christmas selling season by paying cash on delivery and cash before delivery In short, the business posture of Grant was so chaotic and a transfer motion would have introduced such inordinate complexities that the Commission was precluded as a practical matter from making such a motion until there was some stabilization in the business.

Grant embarked on a swift liquidation program. Between November 1975 and January 1976, 67 percent of the Grant chain was liquidated (712 stores). As a result of the liquidations, there was a fund of $320 million to which secured creditors (primarily the consortium of 27 banks) laid claim, and upon the use of which Grant's viability depended A mere 4-1/2 months after Grant's Chapter XI filing, the court on February 12, 1976, granted the liquidation request of the creditors' committee (six banks and five trade creditor representatives), with Grant's consent, and ordered the remaining 359 stores liquidated The debtor's testimony that, among other things, the creditors' committee resolution to liquidate was "terminal" and "lethal" precluded any residual possibility that a Chapter X petition could be filed in "good faith."[56] On April 13, 1976, Grant was adjudicated a bankrupt and a straight liquidating bankruptcy trustee was thereafter appointed

During the Chapter XI proceedings, the Commission opposed the payment of bonuses aggregating $2.7 million to a professional liquidator. The court awarded less than 10 percent of the amount sought The Commission unsuccessfully opposed the payment of interim fees to the attorneys for the debtor Unfortunately, however, Grant was liquidated prior even to the expiration of the time under Bankruptcy Rule 11-15 for the Commission to transfer the case to Chapter X.

*GAC Corporation, et al* [57]—The Commission and certain debenture holders moved under Section 328 and Rule 11-15 of the Bankruptcy Rules to transfer these proceedings to Chapter X. The debtor is a holding company which operates an extensive land development business through subsidiaries GAC Properties, Inc. ("Properties"), the primary operating subsidiary, sells subdivided lots and home sites to the public on the installment sales basis pursuant to the Interstate Land Sales Full Disclosure Act [58] GAC Properties Credit, Inc ("Credit"), a subsidiary of Properties, was created in 1970 to facilitate the selling of $100 million in debentures to the public through two $50 million issues. Thereafter, its sole business activity was pur-

chasing receivables generated from Properties' land sales

On a consolidated basis, the companies listed $436 million in assets and about $384 million in liabilities as of December 31, 1974 The debtor reported losses of about $28 million for the year ended December 31, 1975, with installment land sales declining 95 percent from its peak in 1971 of $128 million

The companies' capitalization now includes about $79.2 million of two issues of senior debentures held by about 6,000 persons and about $53 5 million of convertible subordinated debentures held by about 3,000 persons The debtor also has publicly-held issues of preferred stock, and its common stock is held by about 25,000 persons

The Commission in its transfer motion urged, among other things, that there was a need for a thorough investigation by an independent trustee and that rehabilitation of the company required a substantial adjustment of widely held public debt. The parent company consented to the Commission's transfer motion and on May 19, 1976, the court ordered the company transferred from Chapter XI to Chapter X and subsequently appointed the previously appointed receivers of Properties and Credit as co-trustees of the parent corporation. Subsequent to the close of the fiscal year, the Court granted the Commission's motion with respect to the two primary subsidiaries.

*Continental Investment Corporation* [59]—The Commission filed a motion pursuant to Section 328 of Chapter XI and Rule 11–15 of the Rules of Bankruptcy Procedure to transfer this proceeding to Chapter X. The debtor is a diversified financial services holding company which through various operating subsidiaries is engaged in the business of life insurance, investment company management and oil and gas partnership management The Chapter XI petition reflected assets and liabilities of $51.2 million and $80.2 million, respectively The debtor's capitalization includes two outstanding issues of subordinated debentures in the principal amount of $38 6 million held by about 1,600 persons In addition, there are close to 13 million shares of outstanding common stock held by some 4,100 persons.

Prior to the filing of its Chapter XI petition, the debtor attempted a voluntary restructuring of, among other things, its public debt pursuant to proxy solicitation materials and a registration statement filed with the Commission The attempt failed because of a failure to obtain the required 95 percent debenture holder acceptances The debtor did obtain, however, the requisite number of acceptances from debenture holders for confirmation of a plan of arrangement under Chapter XI [60] The debtor then filed a petition under Chapter XI together with a plan of arrangement to affect the public debt in the manner that was attempted through the aborted voluntary restructuring, and with the pre-filing acceptance in hand sought swift confirmation

The Commission moved to transfer the case to Chapter X arguing (i) Chapter X is required where more than a minor adjustment of the rights of public debenture holders is necessary, (ii) public debenture holders are entitled to "fair and equitable" treatment, (iii) the plan of arrangement was not feasible because, among other things, certain litigation claims against the debtor were not dischargeable in Chapter XI, (iv) a comprehensive reorganization rather than a "simple composition" of unsecured debt was required, (v) there was a need for a new management and an investigation by a disinterested trustee into the debtor's past activities, and (vi) the debtor sought to circumvent the protections afforded public investors by Chapter X through the use of prefiling acceptances

At the close of the fiscal year, the bankruptcy judge had not rendered a decision on the Commission's transfer action.

*Continental Mortgage Investors* [61]—The Commission and certain senior creditors, including banks and institutions, filed motions to transfer this Chapter XI case involving a $600 million real estate investment trust to Chapter X The debtor has outstanding $46 million of convertible subordinated debentures held by 2,000 public investor-creditors and 20 8 million shares of beneficial interest held by 28,000 public investors The Commission in its motion argued, among other things, that there was a need for a thorough investigation by an independent trustee, and that rehabilitation of the debtor required a substantial adjustment of widely held public debt

The Commission pressed for the mainte-

nance of the *status quo* pending a determination of its transfer motion, in order that going concern values and assets were not dissipated before a reorganization attempt under Chapter X could get underway. The need for maintenance of the *status quo* was accentuated by indications that the debtor may be contemplating liquidation rather than rehabilitation and by the delays obtained by the debtor, over strong Commission objections, of the hearing on the transfer motion. Indeed, the Commission felt it necessary to appeal the order of the bankruptcy judge adjourning for 90-days the hearing on the transfer motion.

At the close of the fiscal year, a hearing on the Commission's transfer motion had still not been held. And, despite the Commission's insistence on maintenance of the *status quo*, the debtor obtained authority on a number of occasions to dispose of assets.

*Esgro, Inc* [62]—The Commission's appeal to the district court from the bankruptcy judge's denial, without prejudice, of a Section 328 transfer motion was dismissed when the debtor agreed to amend its plan of arrangement so as substantially to increase the amount payable to its public debenture holders in settlement of their claims [63]

The Commission brought to the debtor's attention that its proxy material soliciting consents to the arrangement may have been materially misleading in violation of proxy provisions of the Securities Exchange Act.[64] When the debtor sought confirmation despite the pending appeal, the Commission moved to stay confirmation and, alternatively, to intervene in the Chapter XI proceeding[65] to enforce compliance with the proxy antifraud provisions and to object to confirmation. The Commission requested that the court void the consents because of the alleged violation of the proxy provisions [66]

When the debtor agreed to amend materially its proposed arrangement for the benefit of the general creditors and debenture holders, the Commission withdrew its objections as did the Official Creditors' Committee, which also had filed objections. The order confirming the modified arrangement became final; the Commission then dismissed its appeal.

*National Telephone, Inc et al* [67]—During the pendency of a motion by certain creditors to transfer the proceedings from Chapter XI to Chapter X, the majority shareholder and former chairman sought to convene a special meeting of stockholders to remove three of the company's six directors. He failed however to comply with the proxy provisions of the Securities Exchange Act of 1934 The Commission supported an application for an order barring the holding of the meeting on the grounds that, among other things, such a meeting, absent filing with the Commission and transmittal to stockholders of an information statement, would violate the Securities Exchange Act of 1934. Based on this ground, the court enjoined the convening of the special meeting of stockholders.

*American Beef Packers, Inc and Beefland International, Inc* [68]—The Commission intervened in this Chapter XI proceeding and joined with the States of Iowa and Nebraska in seeking the appointment of a receiver pursuant to Section 332 of Chapter XI. American Beef, which is publicly held, has assets of about $110 million and liabilities of over $92 million. The application alleged, among other things, that preferential transfers of money were made to affiliates of American Beef before and after the Chapter XI filing; that certain officers and directors were subjects of investigations by various state and Federal agencies; and that American Beef was mismanaged by its officers and directors in that it diverted funds from its principal creditors, issued checks drawn on accounts insufficient to pay the checks, and applied funds necessary for its continued operations for capital improvements.

The application became moot when a proposed plan of arrangement requiring new management was confirmed. The majority of claimants, whose claims arose from the sale of livestock and livestock feeds were paid 55 percent of their claims in cash with the remainder to be paid from available cash flow. Trade creditors were paid 50 percent of their claims in full satisfaction thereof.

*Scott, Gorman Municipals, Inc.* [69]—The Commission intervened in this Chapter XI case involving a municipal bond dealer and sought the appointment of a receiver pursuant to Section 332 of Chapter XI and Bankruptcy Rule 11-18(b). In this connection, the Commission alleged that substantial sums of securities, notes and bonds of the

debtor's customers were illegally pledged and misappropriated. After an evidentiary hearing a receiver was appointed. The Commission further sought and was granted a clarification of its Chapter XI stays of all actions against the debtor, so as to permit the commencement of a lawsuit against the debtor and its principals for violations of the Federal securities laws. Shortly thereafter a complaint was filed by the Commission for violations of the antifraud provisions of the Securities Act of 1933 and of the Securities Exchange Act of 1934.[70]

Ultimately, the debtor was adjudicated a bankrupt and a bankruptcy trustee appointed

## NOTES TO PART 7

[1] A substantially identical report was submitted to the Subcommittee on Civil Rights and Constitutional Rights of the House Committee on the Judiciary and to the Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary.

[2] A table listing all reorganization proceedings in which the Commission was a party during the year is contained in Part 9.

[3] S D.N.Y , No. 75–B–243. Previously reported in 41st Annual Report p. 161

[4] Section 12(f) of the Securities Exchange Act of 1934, 15 U S.C. 781(f).

[5] S.D.N.Y., No. 74–B–614–802, inclusive. Previously reported in 41st Annual Report, pp. 157–158.

[6] S.D Ohio, No. B–1–75–1181.

[7] In re Dania Corp., 400 F 2d 833, 836 (5th Cir. 1968).

[8] D. Colo , No. 71–B–2921. Previously reported in 41st Annual Report, p. 150, 40th Annual Report, p. 127 and 39th Annual Report, pp. 121–122.

[9] In re King Resources Company, __F.2d__ (10th Cir. 1976).

[10] C.D. Cal., No. 73–03467–HP. Previously reported in 40th Annual Report, pp. 124–126; 39th Annual Report, p. 120.

[11] *Lichtig* v. *Loeffer*, C.A. 9 No. 76–1052.

[12] *United States of America* v. *Stanley Goldblum, et al.*, Case No. CR–13390–July (C.P. col).

[13] C.D. Cal., No. 73–03467–HP. Previously reported in 40th Annual Report, pp. 124–126; 39th Annual Report, p. 120.

[14] *Loeffler* v. *Wolfson, Weiner, Ratoff & Topsin, et al.* (Civil Action No 75–301–MDL).

[15] C.D. Cal., No. 74–4409.

[16] *SEC* v. *Beverly Hills Bancorp* C.D., Cal., No. 74–2348.

[17] *SEC* v *U.S. Realty & Improvement Co* , 310 U.S. 434 (1939); *SEC* v. *American Trailer Rental Co* , 379 U.S. 594 (1965)

[18] See the leading case of *Committee, et al.* v. *Kent*, 143 F.2d 684 (4th Cir. 1944).

[19] *In re Imperial '400' National, Inc.*, Corporate Reorganization Release Nos. 315 (July 30, 1975), 7 SEC Docket 339 and 318 (February 24, 1976), 9 SEC Docket 36; *In re King Resources Company*, Corporate Reorganization Release No 316 (August 13, 1975), 7 SEC Docket 604; *In re Equity Funding Corporation of America*, Corporate Reorganization Release No. 317 (November 25, 1975), 8 SEC Docket 589.

[20] *In re Bubble Up Delaware, Inc.*, C D Cal., Nos. 78641–FW, 7956–FW, and 80470–FW; *In re First Home Investment Corp of Kansas, Inc.*, D. Kans., No 24075 B–2; *In re Lyntex Corporation*, S.D N Y , No. 73–B–751, *In re Maryvale Community Hospital, Inc* , D. Ariz , No B–9352–PHX; *In re Omegal-Alpha, Inc* , N.D Texas, No. BK–3–74–454–G

[21] C D. Cal., No. 73–03467–HP. Previously reported in 40th Annual Report, pp. 124–126; 39th Annual Report, p. 120

[22] *In re Equity Funding Corporation of America*, Corporate Reorgarization Release No 317 (November 25, 1975), 8 SEC Docket 589.

[23] D. Colo , No. 71–B–2921. Previously reported in 41st Annual Report, p 150; 40th Annual Report, p. 127; and 39th Annual Report pp 121–122.

[24] *In re King Resources Company*, Corporate Reorganization Release No. 316 (August 13, 1975), 7 SEC Docket 604.

[25] See *A-Cos Leasing Corporation* v. *Wheless*, 422 F.2d 522, 525 (5th Cir. 1970).

[26] D N J., No. B–656–65 Previously reported in 40th Annual Report, p. 128; 39th Annual Report, pp 124–125; 38th Annual Report, pp. 117, 122, 125; 36th Annual Report, pp 176–177, 190, 35th Annual Report, p. 161; 33rd Annual Report, pp. 132, 137; 32nd Annual Report, p. 94

[27] *In re Imperial "400" National, Inc.* Corporate Reorganization Release No. 315 (July 30, 1975); 7 SEC Docket 339. Earlier advisory reports on other plans in this case were reported in Corporate Reorganization Release Nos 312 (July 12, 1972); 313 (July 29, 1973), 2 SEC Docket 377; and 314 (May 15, 1974), 7 SEC Docket 604.

[28] Corporate Reorganization Release No. 318 (February 24, 1976), 9 SEC Docket 36.

[29] D. Kans., No. 24075 B–2. Previously reported in 40th Annual Report, pp. 125–126.

[30] N D. Texas, No. Bk–3–74–454–G. Previously reported in 41st Annual Report, p. 158.

[31] The original offer of $41 million was increased $3 million after another proponent offered a higher price for Okonite at the approval hearing.

[32] D. Arizona, No. B–9352–PHX. Previously reported in 30th Annual Report, p 100, and 35th Annual Report, p 165

[33] See *In re Maryvale Community Hospital, Inc.*, 307 F. Supp 304 (D. Ariz. 1969), at note 4, p. 306 The case presented a novel question of whether an eleemosynary corporation could be the subject of an involuntary petition for reorganization under Chapter X. Section 4

of the Bankruptcy Act 11 U.S C 22. But see *In re Allen University,* 497 F.2d 346 (C.A. 4, 1974).

[34] *In re Maryvale Community Hospital, Inc* , 456 F 2d 410 (9th Cir. 1972)

[35] *In re Maryvale Community Hospital, Inc.,* 456 F.2d 414 (9th Cir 1972), *cert. denied,* 409 U.S 879 (1972); *In re Maryvale Community Hospital, Inc* Memorandum (9th Cir , November 5, 1975)

[36] S D N Y., No. 73–B–751. Previously reported in 40th Annual Report p. 131, 41st Annual Report, p. 156

[37] A plan of reorganization under Chapter X may contemplate an orderly liquidation. *Country Life Apartments, Inc* v *Buckley,* 145 F.2d 935 (2d Cir. 1944), 6 *Collier on Bankruptcy,* p. 206 (14 ed. 1972).

[38] C D Calif , Nos. 78641–FW, 7956–FW, and 80470–FW. Previously reported in 39th Annual Report, p 121.

[39] See 39th Annual Report, p. 121.

[40] *Protective Committee* v *Anderson,* 390 U S. 414 (1968).

[41] *Chemical Bank of New York Trust Company* v *Kheil,* 369 F 2d 845 (2d Cir. 1966); *In re Flora Mix Candy Co ,* 432 F.2d 1060 (2d Cir. 1970); *Anaconda Building Materials* v. *Newland,* 336 F 2d 625 (9th Cir 1964).

[42] *In re Four Seasons Nursing Centers of America, Inc.,* 472 F.2d 747 (10th Cir 1973).

[43] E.D va , No 17–71–A, 256–71–A and 257–71–A. Previously reported in 41st Annual Report, pp. 151–153, 156–157; 39th Annual Report, pp 123–124, 38th Annual Report, p 118.

[44] *In re Farrington Manufacturing Co.,* __ F.2d__ (4th Cir 1976), See 41st Annual Report, pp. 156–157

[45] *In re Farrington Manufacturing Co , supra,* n. __at__

[46] *In re Farrington Manufacturing Co , supra,* n. __at__, citing *Finn* v. *Childs Co ,* 181 F.2d 431, 438 (2d Cir. 1950); *In re Solar Mfg Corp.,* 215 F.2d 555, 562 (3d Cir 1954)

[47] D Conn , No. H–75–665.

[48] *In re Imperial "400" National, Inc.,* 432 F 2d 232 (3rd Cir 1970); *In re McGann Manufacturing Co , Inc ,* 188 F 2d 110 (3d Cir. 1951), *In re Keystone Holding Co ,* 117 F 2d 1003 (3d Cir 1941), 6A *Collier on Bankruptcy,* pp. 1009–1011 (14th ed 1972) and cases cited therein

[49] S.D. Calif., No 17007–K. Previously reported in 41st Annual Report, p. 158

[50] The procedure and rationale are set forth in detail in 6A *Collier, Bankruptcy,* 14th ed., Par. 13.16, p 1011

[51] *Brown* v. *Gerdes,* 321 U S 178 182 (1944)

[52] *Cf In re Farrington Manufacturing Co ,* __F.2d__ (4th Cir. 1976) *In re Cybern Education, Inc.,* 478 F.2d 1340 (7th Cir. 1973).

[53] S.D.N Y , No. 74–B–614–802, inclusive Previously reported in 41st Annual Report, pp. 157–158

[54] The rule governing the weight to be accorded Commission fee recommendations in Chapter X proceedings is that such recommendations "should not be exceeded without definite findings why this step is necessary." *Finn* v *Childs,* 181 F 2d 431, 438 (2d Cir 1950), *Scribner & Miller* v *Conway,* 238 F.2d 905, 907 (2d Cir. 1956); *Securities Investor Protection Corp* v. *Charisma Securities Corp ,* 506 F.2d 1191, 1196 (2d Cir 1974); *In re Polycast Corp ,* 289 F. Supp 707, 722 (D. Conn. 1968)

[55] S.D.N.Y 75–B–1735

[56] A party seeking to transfer a case under Bankruptcy Rule 11–15 must show that Chapter X petition can be filed in "good faith." This means, among other things, that it is not unreasonable to expect a successful reorganization. Section 146(3), 11 U S C 546 (3).

[57] S.D Fla., No. 76–131–Bk–NCR–H, Properties, No 76–816–Bk–JE–H; Credit, No 76, 1812–Bk–JE. In addition, 47 other subsidiaries of Properties have filed Chapter XI petitions

[58] 15 U.S C. §§ 1701–20, 1970

[59] D Mass., No. 76–1158–G.

[60] A majority in number and amount of a creditor class is sufficient and binds all members of that class Section 362 of the Act, 11 U S.C 762

[61] D. Mass , 76–0593

[62] C D Calif , No 73–02510 Previously reported in 41st Annual Report, p. 159

[63] A $1,000,000 contingent cash payment from the sale of certain assets was made a firm commitment. Additionally, the debtor agreed to pay the creditors an additional $1,000,000 with interest over four years

[64] See note 60, p. 163, 41st Annual Report regarding the necessity for compliance with these provisions

[65] Citing *SEC* v *United States Realty & Improvement Co ,* 310 U.S. 434 (1940), *SEC* v. *American Trailer Rental Co.,* 379 U.S. 594 (1965) While the stay was denied, the court permitted intervention.

[66] See *In re First Home Investment Corp of Kansas, Inc ,* 368 F. Supp. 597 (D. Kansas 1973), *SEC* v. *Crumpton Builders, Inc ,* 337 F 2d 907 (5th Cir. 1964)

[67] D.C Conn. No H–75–665.

[68] D Neb , Nos. Bk–75–0–17 and 18.

[69] S.D N.Y , 75–B–1538

[70] S.D.N Y , 75–C–4373

# Part 8

# SEC Management Operations

# Part 8

# SEC Management Operations

A number of important developments occurred in 1976, contributing to increased operating efficiency, improved service to the public, and effective use of the Commission's resources The Commission awarded a new contract for the public dissemination of filed information The contractor plans a number of user workshops in major cities over the next two years, and increased promotion of its new "Searchline" telephone service that offers research of filings to subscribers and non-subscribers Projects for future improvements in operations depend to a large extent on our ability to cope with our own paperwork problems The Commission has been successful in obtaining funding in 1977 to initiate a program for technological improvements. During 1977, the Commission plans to embark on a comprehensive micro-imagery program which will, over a three year period, convert all active official public filings and formal correspondence to microfiche The microfiche program will be combined with a reliable on-line document indexing, tracking and retrieval system It is anticipated that the Commission will benefit by extensive use of telecommunications, including comprehensive data-entry systems, designed to eliminate a substantial amount of clerical effort and improve the accuracy and timeliness of essential information

## ORGANIZATIONAL CHANGES

The Commission established an Office of Consumer Affairs on May 20, 1976 The Office is charged with protecting the interests of consumers, i e., smaller individual investors, in their dealings with the securities industry and in providing special representation for such investors in matters before the Commission.

An Office of Small Business Policy was established in the Commission's Office of Economic and Policy Research. The function of this Office is to direct and coordinate the Commission's examination of the efficacy and impact of securities regulation on small businesses

To assure coordination between the Commission's relations with the press and with Congress, and to provide increased emphasis in both areas, the Commission combined the Offices of Public Information and Congressional Affairs.

Effective April 2, 1976, the Commission changed the name of the Division of Investment Management Regulation to the Division of Investment Management Additionally, the Commission approved the transfer of functions and personnel from the Division of Corporation Finance relating to disclosure requirements applicable to investment companies and certain similar types of issues to the Division of Investment Management

## INFORMATION HANDLING

Significant progress was made during the year in furthering the Commission's use of electronic data processing (EDP) in support of its information handling activities.

Certain EDP systems were developed as a result of the implementation of the Securities Acts Amendments of 1975. These systems involved the creation of information bases on

municipal securities dealers and transfer agents, and the addition of new data elements to the broker-dealer registrant information base. Assistance was also provided to the Commission's staff through the technical review of documents filed by securities information processors to determine the adequacy of required information.

In a related area, the Office of Data Processing was extensively involved in the design and development of a computer system for processing information contained on the broker-dealer Financial and Operational Combined Uniform Single Report (FOCUS Report) [1]

An EDP system was also developed to facilitate statistical analyses of information collected by the Commission in support of its Street Name Study [2]

Currently under development is a system for more effectively indexing information relating to SEC registrants that will allow more efficient use of many EDP data files and will serve as the central or master index for locating and retrieving the filings of companies reporting to the Commission.

Plans for the coming year include the implementation of a limited telecommunications capability to support the previously mentioned central index and certain other information systems Also planned is the completion of a five-year automatic data processing program to establish long-range information systems goals and provide for significant expansion and further development of EDP within the Commission

## OFFICE OF CONSUMER AFFAIRS

As noted above, the Commission established an Office of Consumer Affairs in response to the President's four point regulatory reform program. The Office was charged with protecting the interests of consumers, i e., smaller individual investors, in their dealings with the securities industry and in providing special representation for such investors in matters before the Commission.

As its first assignment, the Office was instructed by the Commission to draw up a proposal for the establishment of a meaningful investor dispute grievance system which would utilize, if possible, the securities industry's self-regulatory organizations. The procedures should be designed to avoid any cumbersome, inefficient, or overly expensive requirements which would discourage smaller consumers in the securities industry from asserting their grievances and claiming monetary damages In this regard, they will perform the same function as existing small claims courts. On June 9, 1976, the Commission invited public comment on the need for and possible structure of such a system and scheduled a public forum on this matter for July, 1976.

In addition to proposing a dispute grievance procedure, the Commission asked the Office to explore the possibility of improving its consumer protection program by upgrading the Commission's complaint processing effort; providing for greater Commission oversight of the complaint processing procedures of the self-regulatory organizations; instituting a legal aid system for injured consumers who meet requisite qualifications, reviewing the Commission's standards for participation as *amicus curiae* in court cases involving injury to consumers; making greater use of public investigatory proceedings; increasing the Commission's consumer education program, and providing for greater consumer input in Commission rulemaking proceedings.

To aid in accomplishing the above the Commission on June 9, 1976, invited all interested persons to submit in writing their ideas for a procedure that will be available nationwide through the self-regulatory organizations to investors for settling disputes arising out of dealings in securities between a customer and a registered broker-dealer.[3] In this release the Commission also invited the people who had submitted written comments to make an oral presentation at an informal public forum held on July 15, 1976.

## OFFICE OF PUBLIC INFORMATION

The Office of Public Information has the responsibility for disseminating news about Commission actions. This is done principally through the daily publication of the SEC News Digest The News Digest summarizes such matters as: (1) proposed public offerings of securities for which a Securities Act registration statement is filed; (2) notices of filings of applications and of all orders, deci-

sions, rules and rule proposals issued by the Commission, and (3) court actions in litigation involving the Commission's enforcement program

The News Digest is made available to the press immediately after it is reproduced each day. It is also reprinted and distributed, on a subscription basis, by the Government Printing Office Currently there are 3,055 subscribers In addition, the Office of Public Information assembles copies of important releases, orders, decisions, rules and rule proposals for daily distribution to the media and all self-regulatory organizations.

The Office is also called upon to respond to approximately 75–100 daily telephone inquiries from the press and the general public The Office also receives approximately 25–40 letters per week from the general public seeking assistance on a wide range of securities related matters

During the past year, the Office of Public Information initiated a consumer education program through the use of written and audio-visual aides Several small brochures, designed as guides and warnings to investors, were printed and distributed. "Eagle on the Street", a narrated slide program on the history and current role of the SEC, was produced It has been seen by a variety of groups, including graduate business and law school students and civic and professional organizations Copies of the program have been placed with the National Audio Visual Center for sale to the general public

## ACTIVITY UNDER FREEDOM OF INFORMATION ACT

During the year, the Commission determined to centralize and coordinate staff activity on FOIA matters and assigned responsibilities to the Office of Reports and Information Services The first FOIA Officer for the Commission was appointed and a Branch of FOIA and Privacy Act created in the Office of Reports and Information Services

The Commission's Freedom of Information rules, revised on February 19, 1975, provide that the public can inspect or obtain copies of all records maintained by the SEC with the exception of certain specified categories of information Most financial and other information filed by registered companies has always been available for inspection or copying by the public. However, the public was denied access to certain categories of material, notably investigatory records Pursuant to various FOIA requests, the Commission has made available for public inspection many records which had traditionally been considered confidential Among these records are portions of the Broker-Dealer and the entire Investment Advisers and Investment Company Inspection Manuals, the Summary of Administrative Interpretations under the Securities Act of 1933 and the Commission's periodic Securities Violations Bulletin Moreover, the Commission has made available, pursuant to particular FOIA requests, staff letters of comment on registration statements or other filings and Wells Committee submissions.

From July 1, 1975 through June 30, 1976, the Commission received 730 requests for information pursuant to the FOIA

## PERSONNEL MANAGEMENT

The permanent personnel strength of the Commission totalled 1,922 employees on June 30, 1976, as shown below

| | |
|---|---|
| Commissioners | 4 |
| Staff | |
| Headquarters Office | 1,217 |
| Regional Offices | 701 |
| Total Staff | 1,918 |
| Grand Total | 1,922 |

### Recruitment

During 1976, the Commission focused its recruitment activities on the strengthening of its Equal Employment Opportunity Program Under the leadership of a top-level committee chaired by a Member of the Commission, the SEC pursued an active attorney recruitment program which included on-campus visits combined with a thorough screening and review of applications at the Headquarters level to insure consideration of candidates from all segments of the population The Committee also developed a cooperative training program to enable graduate students in nonlegal curricula to participate in the work of the SEC and to broaden the Commission's recruitment base Though most of the results of these efforts will not be seen until the transitional quarter and early fiscal 1977 appointments, the Commission did increase by 23 6 percent the number of female attorneys on the staff,

the number rose from 55 at the end of fiscal year 1975 to 68 at the end of 1976, and represents a gain of 183 percent in the last three fiscal years.

The Office of Personnel developed and obtained Civil Service Commission approval for an Upward Mobility Training Agreement, which will facilitate the advancement of the Commission's current clerical and secretarial employees into the professional and technical staff of the Commission

## Personnel Management Evaluation

In July 1975, the Civil Service Commission issued its report on personnel management evaluation of the SEC A number of specific deficiencies were noted and several recommendations were made to improve personnel management practices. A substantial amount of time and resources were devoted to the correction and improvement of these areas, and most were resolved to the mutual satisfaction of the SEC and CSC One of the more significant areas addressed by CSC dealt with the grade structure and position management of the Securities Compliance Examiners These are key non-attorney jobs within the agency, and it is of utmost importance that examiners be given assignments that are professionally challenging and offer meaningful opportunity for advancement. The Commission has begun an effort to develop more clearly defined job criteria for the journeyman and senior level examiners positions, so that distinctions between grade levels will be both meaningful and equitable This will be an ongoing program which will require monitoring over the next several years

The Commission initiated its own management review and evaluation program during fiscal year 1976 with a team of management and personnel specialists, who began with a review of the operations and personnel management activity of the newly organized Division of Investment Management Similar reviews are scheduled throughout the Commission during the transitional quarter and into fiscal year 1977

## Training and Development

The training and development efforts during fiscal year 1976 included the major categories of Executive Development, Affirmative Action and Professional Skills:

*Executive Development:* Designed to enhance the performance and potential of our middle management, this opportunity enabled seven GS–14/15's to attend advanced management development training. In addition, the SEC sent three of its top management executives to the Federal Executive Institute and to the Executive Seminar Center

*Program Development* The SEC worked closely with the National Audio Visual Center to develop a film on trial proceedings; this film is being utilized by many of our professional staff throughout the agency. The American Institute of Certified Public Accountants provided under contract a series of seminars on advanced and "refresher" accounting principles designed to keep our accounting and financial staff up to date with the dynamics of the accounting discipline.

An Internal Mobility Program was developed. When implemented in early fall, this program will encourage senior professionals to seek temporary positions outside of their organization (but within the SEC) that will provide them with broadening work experiences that could be useful to them when they return to their permanent assignments.

*Affirmative Action:* Our Tuition Support Program was utilized by over 100 employees as a means of assistance in the pursuit of undergraduate education. Plans for next year call for an incorporation of this program into a larger Upward Mobility Program.

*Professional Skills Development.* Emphasis was once again placed on inhouse "technical" training both in the Regions and in Washington. Enforcement, regulations and investment training conferences were conducted for both new and "seasoned" professionals. A senior trial attorney seminar is now being planned for the winter months. This program will address the needs of regional enforcement attorneys who must litigate significant cases on an infrequent basis.

## OFFICE SPACE

During the first quarter of the fiscal year, the Office of Management and Budget upheld the Commission's appeal against the General Services Administration's decision to assign a new but unsatisfactory headquarters building to this agency. Following this outcome, the

Commission explored other alternatives that would enable it to centralize all of its Washington metropolitan area offices in one building or in a few buildings in close proximity to each other at a site that would be easily accessible to visitors and members of the securities industry and allow for staff expansion over the next several years. Although an adequate location at an acceptable price was not found, a new headquarters remains a high priority for the Commission.

The General Services Administration, with the approval of the Congress, signed a new five year lease for Capitol Mall North, the present primary office location of the Commission. As the fiscal year ended, it appeared that the Commission's Washington staff would continue to be located at their three separate area locations for the immediately forseeable future

## FINANCIAL MANAGEMENT

Total fees collected by the Commission in fiscal 1976 represented 52 percent of funds appropriated by the Congress for Commission operations. The Commission is requred by law to collect fees for (1) registration of securities issued, (2) qualifications of trust indentures; (3) registration of exchanges, (4) registration of brokers and dealers who are registered with the Commission but are not members of the NASD; and (5) certification of documents filed with the Commission. In addition, by fee schedule the Commission imposes fees for certain filings and services, such as the filing of annual reports and proxy material

The Securities Acts Amendments of 1975 increased the transaction fees to be paid by all national security exchanges to one three-hundredth of 1 per centum of the aggregate dollar amount of the sales of securities transacted during each preceding calendar year. The 1975 Amendments have also included under this fee requirement certain transactions by every registered broker and dealer which are not transacted on a national securities exchange, provided, however, that no payment will be required for any calendar year in which the fee would be less than $100

With reference to the fee schedule, the investment adviser assessment fee refunds originally announced in Commission release IA–486 have been almost completed. To date, approximately 2,750 refund checks have been mailed totaling slightly more than $607,000.

## NOTES TO PART 8

[1] See p 12, *supra*, and 41st Annual Report, p. 18.

[2] See page 20, *supra*.

[3] Securities Exchange Act Release No. 12528 (June 9, 1976), 9 SEC Docket 833.

# Part 9

# Statistics

# Part 9

# Statistics

## THE SECURITIES INDUSTRY

### Income, Expenses, and Selected Balance Sheet Items

On December 17, 1975, the Commission announced the adoption of the Financial and Operational Combined Uniform Single (FOCUS) Report and the amendment of other rules governing broker-dealer reporting of financial and operational information Among the changes were amendments to Rule 17a–10 and its associated Form X–17A–10, the Commission's source for industry financial information.

The amendment to Form X–17A–10 reduced considerably the reporting burden to broker-dealers and made available for the first time financial data for approximately 2,000 additional registered broker-dealers which previously filed only the Introduction of the original Form X–17A–10 As a consequence, securities industry financial information is more comprehensive than that previously collected

Registered broker-dealers reported total revenue of $7.3 billion for the year. The largest single source of revenue was securities commissions, which accounted for approximately 46 percent of total revenue. Trading and underwriting revenues were the second and third most important revenue contributors, accounting for 16.4 percent and 12 7 percent, respectively

Pre-tax income came to approximately $1 1 billion, bringing the industry profit margin to 15 2 percent for 1975. Industry assets stood at $31.1 billion at the end of the year with ownership equity closing the year at $4.5 billion

**Table 1**

**FINANCIAL INFORMATION FOR BROKER-DEALERS 1975**

(Millions of Dollars)

| | | 1975[p] |
|---|---|---|
| **A** | **Revenue and Expenses** | |
| 1 | Securities Commissions | $ 3,374 1 |
| 2 | Gain (Loss) In Trading | 1,201 1 |
| 3 | Gain (Loss) in Investments | 131 7 |
| 4 | Profit (Loss) From Underwriting and Selling Groups | 930 3 |
| 5 | Interest Income | 601 7 |
| 6 | Other Revenue Related to Securities Business | 697 5 |
| 7 | Revenue From All Other Sources | 394 3 |
| 8 | Total Revenue | 7,330 7 |
| 9 | Total Expenses* | 6,215 9 |
| 10 | Pre-tax Income | $ 1,114 8 |
| **B.** | **Assets, Liabilities and Capital** | |
| 11 | Total Assets | $31,181 1 |
| 12 | Liabilities | |
| | a Total liabilities (excluding subordinated debt) | 25,824 4 |
| | b Subordinated debt | 834 7 |
| | c Total liabilities (11a + 11b) | 26,659 1 |
| 13 | Ownership Equity | 4,522 0 |
| 14 | Total Liabilities and Ownership Equity | $31,181 1 |
| | Number of Firms | 4,015 |

[p] = preliminary
* Expenses include Partners Compensation
Source Form X–17A–10

## Historical Information—Income, Expense, and Balance Sheet Information of Broker-Dealers With Securities Related Revenue of $500,000 or More

Historically, broker-dealers receive a major portion of their revenue from four primary sources securities commissions, trading activities, underwriting, and interest income earned on loans to customers [1] Reflecting increased market activity, three of these revenue sources showed marked improvement during 1975 with only interest income falling below the previous year's level Coupled with increases from all other revenue components, 1975 total revenue was 38 percent above the depressed 1974 figure and 4 percent above the 1972 revenue level, the last previous peak

The surge in revenue in 1975 was reflected in the pre-tax income figure of $1041.7 million, more than 250 percent above that recorded for 1974. Due to the influence of positive economic conditions, total assets of broker-dealers (with $500,000 or more of securities related revenue) at the close of 1975 stood at $30 7 billion, up from the 1974 level of $23.8 billion Similarly, ownership equity surpassed the year-end 1974 figure by $1 2 billion, an increase of 44 percent. The year-end 1975 ownership figure of $3.9 billion almost equaled that recorded for 1972 even though 53 fewer firms were included in the 1975 figure.

[1] Because of aforementioned changes in reporting requirements, the most detailed income, expense, and balance sheet information is available for only registered broker-dealers with securities related revenue of $500,000 or more In order to provide as comparable information as possible, new financial information was developed for prior years For 1975, broker-dealers with securities related revenue of $500,000 or more held approximately 99 percent of industry assets and reported roughly 95 percent of industry revenue

## Table 2

## HISTORICAL REVENUE AND EXPENSES FOR BROKER-DEALERS WITH TOTAL REVENUE OF $500,000 OR MORE

(Millions of Dollars)

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975[p] |
|---|---|---|---|---|---|---|
| **A. Revenue and Expenses** | | | | | | |
| 1 Commissions | | | | | | |
| a Commissions earned on equity securities transactions executed on a national securities exchange | $1,904 1 | $2,727 2 | $2,747 3 | $2,385 2 | $2,081 1 | $2,599 3 |
| b Other commission revenue | 362 4 | 560 1 | 656 3 | 430 6 | 357 1 | 616 3 |
| c Total commissions | 2 266 5 | 3,287 3 | 3,403 6 | 2,815 8 | 2,438 2 | 3,215 6 |
| 2 Gain (Loss) on Firm Securities Trading and Investment Accounts | | | | | | |
| a Gain (loss) in trading | 823 5 | 1,056 0 | 994 2 | 590 2 | 722 4 | 1,136 6 |
| b Gain (loss) in investments | 74 9 | 242 5 | 208 6 | – 3 1 | 54 5 | 131 0 |
| c Total gain (loss) | 898 4 | 1,298 5 | 1,202 8 | 587 1 | 776 9 | 1 267 6 |
| 3 Profit (Loss) from Underwriting and Selling Groups | 601 3 | 957 0 | 915 6 | 493 5 | 496 3 | 912 7 |
| 4 Revenue From Sale of Investment Company Securities | | | | | | |
| a As Underwriter | N/A | N/A | N/A | N/A | N/A | 48 8 |
| b Other than as underwriter (retail transactions) | N/A | N/A | N/A | N/A | N/A | 70 9 |
| c Total revenue from sale of investment company securities | 184 2 | 195 5 | 151 0 | 148 8 | 78 8 | 119 7 |
| 5 Interest Income | 378 6 | 363 8 | 527 0 | 620 9 | 622 0 | 591 3 |
| 6 Fees for Account Supervision, Investment Advisory and Administrative Services | 63 6 | 82 3 | 98 6 | 82 8 | 84 6 | 154 5 |
| 7 Commodity Revenue | 88 2 | 98 3 | 124 6 | 177 5 | 168 2 | 186 6 |
| 8 Other Revenue Related to Securities Business | N/A | N/A | N/A | N/A | N/A | 381 3 |
| 9 Revenue From All Other Sources | 266 2 | 300 4 | 306 2 | 323 3 | 399 7 | 167 1 |
| 10 Total Revenue | $4,747 0 | $6,583 1 | $6,729 4 | $5,249 7 | $5,064 7 | $6 996 4 |
| **B Expense** | | | | | | |
| 11 Compensation to registered representatives | $ 777 7 | $1 139 0 | $1 198 0 | $ 937 4 | $ 949 4 | $ 1,274 5 |
| 12 Employee compensation and benefits | 1 085 7 | 1 299 7 | 1 392 2 | 1,184 2 | 1,096 6 | 1 375 5 |
| 13 Commissions paid to other brokers | 128 0 | 182 0 | 185 7 | 188 0 | 151 0 | 210 8 |
| 14 Interest | 539 9 | 519 8 | 633 7 | 795 7 | 749 7 | 580 0 |
| 15 Communications | 370 0 | 433 8 | 488 0 | 461 0 | 462 6 | 481 7 |
| 16 Occupancy and equipment rental | 348 7 | 412 8 | 459 6 | 433 4 | 439 7 | 463 0 |
| 17 Promotional | 156 8 | 187 7 | 214 0 | 185 7 | 172 1 | 156 8 |
| 18 All other operating expenses | 606 3 | 787 4 | 793 5 | 685 9 | 633 7 | 1,413 0 |
| 19 Total expenses[‡] | 4 013 1 | 4,962 2 | 5,364 7 | 4,871 3 | 4,654 8 | 5 955 3 |
| **C. Pre-Tax Income** | | | | | | |
| 20 Pre-tax income | $ 733 9 | $1,620 9 | $1,364 7 | $ 378 4 | $ 409 9 | $1 041 7 |
| Number of Firms | 655 | 788 | 817 | 652 | 609 | 764 |

[‡] Expenses include partners compensation

Source From X–17A–10

## Table 3

## HISTORICAL CONSOLIDATED BALANCE SHEET FOR BROKER-DEALERS WITH TOTAL REVENUES OF $500,000 OR MORE

(Millions of Dollars)

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975* |
|---|---|---|---|---|---|---|
| **A. Assets** | | | | | | |
| 1 Cash, clearing funds, and other deposits | $ 1,161 7 | $ 1,220 5 | $ 1,280 6 | $ 1,139 4 | $ 940 3 | $ 922 7 |
| 2 Receivables from brokers or dealers | | | | | | |
| a Securities failed to deliver | 2,318 9 | 2,230 3 | 2,567 9 | 1,843 6 | 1,219 9 | 1,446 1 |
| b Securities borrowed | 864 8 | 1,022 2 | 1,363 9 | 1,096 0 | 889 0 | 1,366 2 |
| c Other receivables | 197 7 | 295 1 | 382 2 | 330 0 | 905 2 | 1,069 7 |
| 3 Receivables from customers | 7,077 0 | 9,643 6 | 13,372 8 | 9,056 2 | 7,450 1 | 8,455 1 |
| 4 Market value or fair value of securities and commodities accounts | | | | | | |
| a Trading accounts | NA | NA | NA | NA | NA | 10,673 3 |
| b Other accounts | NA | NA | NA | NA | NA | 2,192 4 |
| c Total market value or fair value of securities and commodities accounts | 10,261 4 | 11,667 0 | 11,870 1 | 9,721 6 | 10,788 5 | 12,865 7 |
| 5 Memberships in exchanges (market value) | 210 2 | 200 1 | 207 9 | 123 0 | 100 5 | 117 7 |
| 6 Property, furniture, equipment, leasehold improvements and rights under lease agreements (net of depreciation)* | 228 6 | 278 1 | 306 7 | 279 9 | 268 5 | 255 4 |
| 7 Other assets | 1,163 8 | 1,368 1 | 1,397 5 | 1,599 0 | 1,224 8 | 4,276 4 |
| 8 Total assets | 23,484 1 | 27,925 0 | 32,749 6 | 25,188 7 | 23,786 8 | 30,775 0 |
| **B Liabilities** | | | | | | |
| 9 Money borrowed | | | | | | |
| a Secured by customer collateral | NA | NA | NA | NA | NA | 2,212 5 |
| b Secured by firm collateral | NA | NA | NA | NA | NA | 7,123 1 |
| c Unsecured | NA | NA | NA | NA | NA | 142 2 |
| d Total money borrowed | 8,994 1 | 11,285 7 | 14,398 4 | 9,878 1 | 10,421 0 | 9,477 8 |
| 10 Payables to brokers or dealers | | | | | | |
| a Securities failed to receive | 2,705 7 | 2,419 6 | 2,732 2 | 1,724 3 | 1,281 0 | 1,398 9 |
| b Securities borrowed | 835 5 | 983 6 | 1,284 3 | 846 9 | 579 2 | 1,063 1 |
| c Other payables to brokers or dealers | 197 8 | 345 2 | 354 2 | 364 7 | 1,058 5 | 1,084 3 |
| d Total payables to brokers or dealers | 3,739 0 | 3,748 4 | 4,370 7 | 2,935 9 | 2,918 7 | 3,546 3 |
| 11 Payables to customers | | | | | | |
| a Free credit balances | 2,125 5 | 2,103 8 | 2,149 8 | 2,184 4 | 1,732 5 | 1,732 9 |
| b All other payables to customers | 2,116 5 | 2,632 6 | 3,078 3 | 2,793 1 | 2,253 6 | 2,958 5 |
| c Total payables to customers | 4,242 0 | 4,736 4 | 5,228 1 | 4,977 5 | 3,986 1 | 4,691 4 |
| 12 Short positions in securities and commodities accounts | 707 4 | 906 8 | 1,525 1 | 1,158 3 | 1,038 2 | 1,163 8 |
| 13 Other liabilities | 2,343 0 | 2,858 7 | 2,505 4 | 2,549 7 | 2,098 5 | 7,195 8 |
| 14 Total liabilities excluding subordinated borrowings | 20,025 5 | 23 536 0 | 28,027 7 | 21,499 5 | 20,462 5 | 26,075 1 |
| 15 Subordinated borrowings | 641 0 | 728 1 | 773 9 | 642 2 | 593 5 | 767 0 |
| 16 Total liabilities | 20,666 5 | 24,264 1 | 28,801 6 | 22,141 7 | 21,056 0 | 26,842 1 |
| **C. Ownership Equity** | | | | | | |
| 17 Ownership equity | 2,817 6 | 3,660 9 | 3,948 0 | 3,047 0 | 2,730 8 | 3,932 9 |
| 18 Total liabilities and capital | $23,484 1 | $27,925 0 | $32,749 6 | $25,188 7 | $23,786 8 | $30,775 0 |
| Number of Firms | 655 | 788 | 817 | 652 | 609 | 764 |

* Item 6 not net of amortization
Source Form X-17A-10

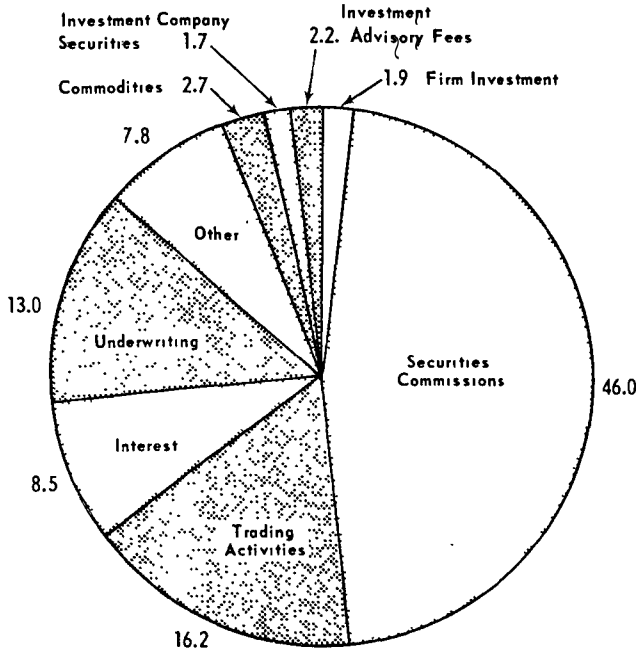
## Securities Industry Dollar

Of each dollar received by broker-dealers (with securities related revenue of $500,000 or more) in the calendar year 1975, a total of 46.0 cents was derived from the securities commission business, 16 2 cents from trading activities, 13.0 cents from the underwriting business and the remaining 24.8 cents from secondary sources of revenue such as commodities revenue, sale of investment company securities and gain or loss from firm investments.

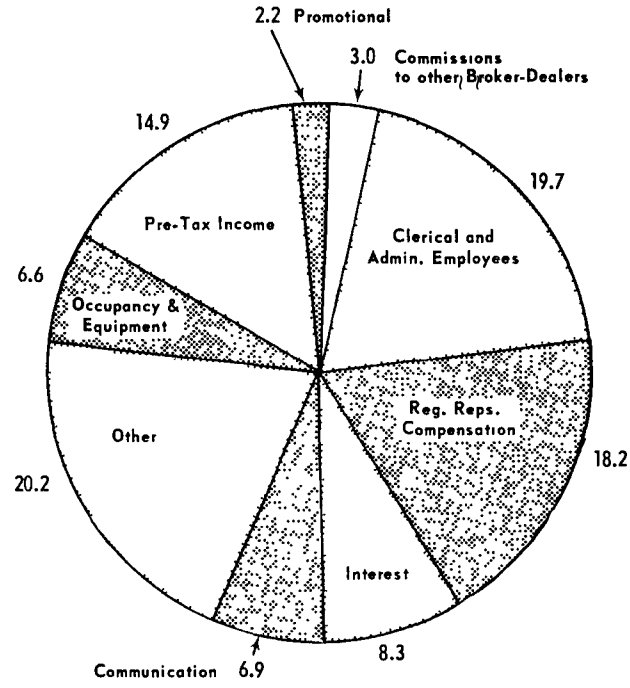
Total expenses amounted to 85.1 cents of each securities industry dollar. The largest proportion of broker-dealer expenses were associated with personnel costs. Administrative and employee cost and compensation to registered representatives amounted to 37.9 cents per industry dollar. Operating income after partners' compensation but before taxes accounted for 14.9 cents of the average securities industry dollar.

# SECURITIES INDUSTRY DOLLAR: 1975

## SOURCES OF REVENUE




## EXPENSES AND PRE-TAX INCOME




*NOTE Includes information for firms with securities related revenues of $500,000 or more in 1975.*

SOURCE X-17A-10 REPORTS

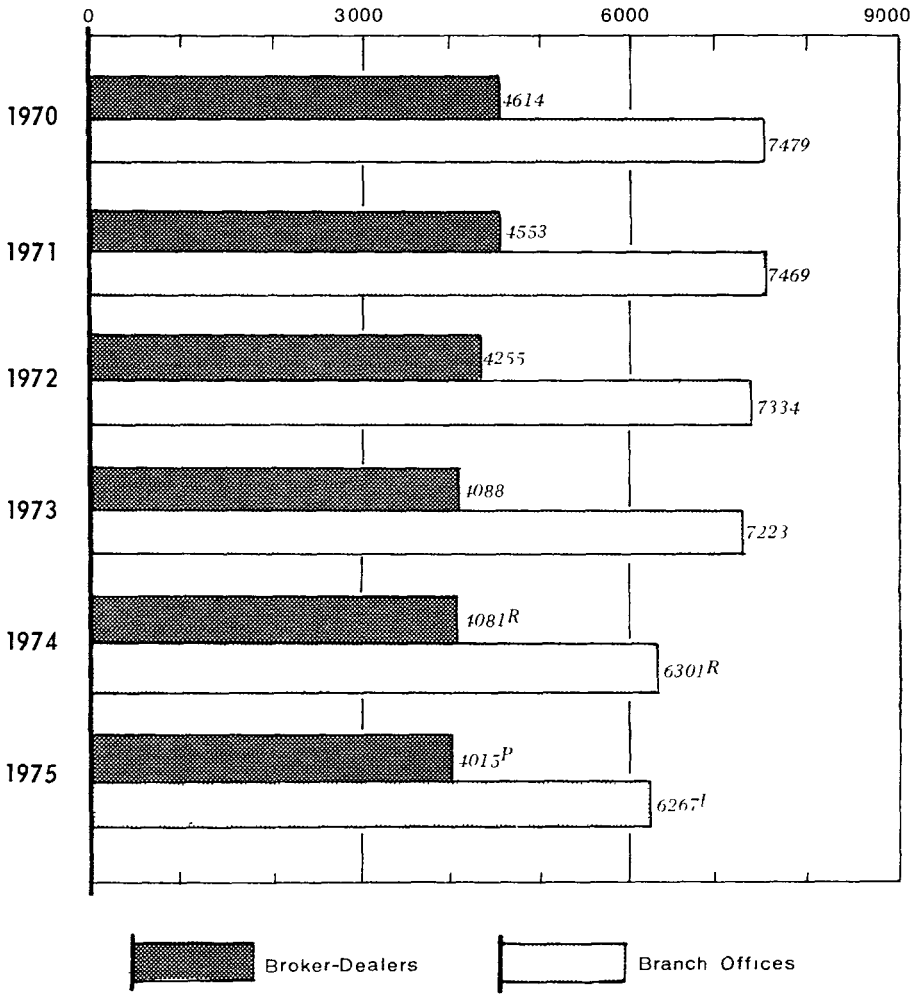
DS-5050

## Broker-Dealers, Branch Offices, Employees

The number of broker-dealers decreased in 1975, continuing a series of successive declines beginning in 1970 Following the trend in the number of broker-dealers, the number of branch offices operated by broker-dealers also continued its downward movement, ending the year at 6,267 offices.

The number of full-time broker-dealer employees stood at 242 thousand at the end of 1975 There were approximately 72 thousand full-time registered representatives employed in the industry at the close of the year, 30 percent of industry total employment

# BROKER-DEALERS AND BRANCH OFFICES




P = Preliminary R = Revised E=Estimate

SOURCE X-17A-10 REPORTS DS-5051

## Table 4

## BROKERS AND DEALERS REGISTERED UNDER THE SECURITIES EXCHANGE ACT OF 1934—EFFECTIVE REGISTRATIONS AS OF JUNE 30, 1976 CLASSIFIED BY TYPE OF ORGANIZATION AND BY LOCATION OF PRINCIPAL OFFICES.

| Location of Principal Offices | Number of Registrants | | | | Number of Proprietors, Partners, Officers, etc [2,3] | | | |
|---|---|---|---|---|---|---|---|---|
| | Total | Sole proprietorships | Partnerships | Corporations[4] | Total | Sole proprietorships | Partnerships | Corporations[4] |
| ALABAMA | 23 | 2 | 1 | 20 | 125 | 2 | 3 | 120 |
| ALASKA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| ARIZONA | 28 | 4 | 1 | 23 | 105 | 4 | 9 | 92 |
| ARKANSAS | 22 | 2 | 0 | 20 | 106 | 2 | 0 | 104 |
| CALIFORNIA | 480 | 139 | 46 | 295 | 2 595 | 139 | 245 | 2,211 |
| COLORADO | 63 | 7 | 4 | 52 | 408 | 7 | 58 | 343 |
| CONNECTICUT | 62 | 8 | 10 | 44 | 465 | 8 | 117 | 340 |
| DELAWARE | 13 | 3 | 1 | 9 | 34 | 3 | 2 | 29 |
| DISTRICT OF COLUMBIA | 31 | 2 | 6 | 23 | 289 | 2 | 31 | 256 |
| FLORIDA | 112 | 10 | 5 | 97 | 481 | 10 | 10 | 461 |
| GEORGIA | 42 | 6 | 1 | 35 | 261 | 6 | 2 | 252 |
| HAWAII | 18 | 0 | 0 | 18 | 97 | 0 | 0 | 97 |
| IDAHO | 7 | 1 | 0 | 6 | 24 | 1 | 0 | 23 |
| ILLINOIS | 1,363 | 1,062 | 91 | 210 | 2,650 | 1,062 | 451 | 1,137 |
| INDIANA | 52 | 7 | 2 | 43 | 274 | 7 | 5 | 262 |
| IOWA | 37 | 2 | 1 | 34 | 225 | 2 | 6 | 217 |
| KANSAS | 27 | 2 | 2 | 23 | 282 | 2 | 9 | 271 |
| KENTUCKY | 11 | 2 | 1 | 8 | 71 | 2 | 3 | 66 |
| LOUISIANA | 10 | 4 | 0 | 6 | 35 | 4 | 0 | 31 |
| MAINE | 13 | 1 | 4 | 8 | 53 | 1 | 21 | 31 |
| MARYLAND | 37 | 4 | 4 | 29 | 235 | 4 | 72 | 159 |
| MASSACHUSETTS | 180 | 54 | 16 | 110 | 1 145 | 54 | 110 | 981 |
| MICHIGAN | 54 | 5 | 5 | 44 | 381 | 5 | 108 | 268 |
| MINNESOTA | 76 | 4 | 1 | 71 | 626 | 4 | 2 | 620 |
| MISSISSIPPI | 23 | 2 | 5 | 16 | 86 | 2 | 13 | 71 |
| MISSOURI | 67 | 4 | 6 | 57 | 766 | 4 | 144 | 618 |
| MONTANA | 3 | 1 | 0 | 2 | 20 | 1 | 0 | 19 |
| NEBRASKA | 16 | 0 | 0 | 16 | 112 | 0 | 0 | 112 |
| NEVADA | 3 | 1 | 0 | 2 | 8 | 1 | 0 | 7 |
| NEW HAMPSHIRE | 3 | 1 | 0 | 2 | 11 | 1 | 0 | 10 |
| NEW JERSEY | 179 | 39 | 26 | 114 | 609 | 39 | 77 | 493 |
| NEW MEXICO | 6 | 1 | 0 | 5 | 30 | 1 | 0 | 29 |
| NEW YORK (excluding New York City) | 280 | 108 | 20 | 152 | 647 | 108 | 59 | 480 |
| NORTH CAROLINA | 28 | 6 | 1 | 21 | 144 | 6 | 2 | 136 |
| NORTH DAKOTA | 5 | 0 | 0 | 5 | 27 | 0 | 0 | 27 |
| OHIO | 98 | 6 | 16 | 76 | 750 | 6 | 221 | 523 |
| OKLAHOMA | 22 | 4 | 1 | 17 | 110 | 4 | 2 | 104 |
| OREGON | 25 | 3 | 1 | 21 | 103 | 3 | 3 | 97 |
| PENNSYLVANIA | 192 | 26 | 40 | 126 | 1,122 | 26 | 213 | 883 |
| RHODE ISLAND | 20 | 5 | 2 | 13 | 48 | 5 | 8 | 35 |
| SOUTH CAROLINA | 12 | 1 | 2 | 9 | 55 | 1 | 9 | 45 |
| SOUTH DAKOTA | 2 | 1 | 0 | 1 | 12 | 1 | 0 | 11 |
| TENNESSEE | 49 | 3 | 2 | 44 | 278 | 3 | 29 | 246 |
| TEXAS | 152 | 26 | 5 | 121 | 899 | 26 | 23 | 850 |
| UTAH | 32 | 3 | 4 | 25 | 126 | 3 | 12 | 111 |
| VERMONT | 5 | 2 | 1 | 2 | 22 | 2 | 2 | 18 |
| VIRGINIA | 40 | 8 | 3 | 29 | 341 | 8 | 13 | 320 |
| WASHINGTON | 55 | 7 | 1 | 47 | 284 | 7 | 4 | 273 |
| WEST VIRGINIA | 5 | 1 | 0 | 4 | 17 | 1 | 0 | 16 |
| WISCONSIN | 34 | 3 | 0 | 31 | 339 | 3 | 0 | 336 |
| WYOMING | 7 | 2 | 0 | 5 | 24 | 2 | 0 | 22 |
| TOTAL (excluding New York City) | 4,124 | 1,595 | 338 | 2 191 | 17 956 | 1 595 | 2,098 | 14,263 |
| NEW YORK CITY | 1 160 | 398 | 249 | 513 | 4,923 | 398 | 2 571 | 1 954 |
| SUBTOTAL | 5,284 | 1 993 | 587 | 2 704 | 22 879 | 1,993 | 4,669 | 16 217 |
| FOREIGN[1] | 24 | 2 | 2 | 20 | 195 | 2 | 9 | 184 |
| GRAND TOTAL | 5,308 | 1,995 | 589 | 2 724 | 23,074 | 1,995 | 4,678 | 16,401 |

[1] Registrants whose principal offices are located in foreign countries or other jurisdictions not listed
[2] Includes directors, officers, trustees and all other persons occupying similar status or performing similar functions
[3] Allocations made on the basis of location of principal offices of registrants not actual locations of persons
[4] Includes all forms of organizations other than sole proprietorships and partnerships

## Table 5

## APPLICATIONS AND REGISTRATIONS OF BROKERS AND DEALERS

Fiscal Year 1976

| | | |
|---|---|---|
| **BROKER-DEALER APPLICATIONS** | | |
| Applications pending at close of preceding year | | 39 |
| Applications received during fiscal 1976 | | 2,601 |
| Total applications for disposition | | 2,640 |
| Disposition of Applications | | |
| Accepted for filing | 2,293 | |
| Returned | 224 | |
| Withdrawn | 22 | |
| Denied | 4 | |
| Total applications disposed of | | 2,543 |
| Applications pending as of June 30, 1976 | | 97 |
| **BROKER-DEALER REGISTRATIONS** | | |
| Effective registrations at close of preceding year | | 3,546 |
| Registrations effective during fiscal 1976 | | 2,265 |
| Total registrations | | 5,811 |
| Registrations terminated during fiscal 1976 | | |
| Withdrawn | 442 | |
| Revoked | 49 | |
| Cancelled | 12 | |
| Total registrations terminated | | 503 |
| Total registrations at end of fiscal 1976 | | 5,308 |
| **INVESTMENT ADVISER APPLICATIONS** | | |
| Applications pending at close of preceding year | | 63 |
| Applications received during fiscal 1976 | | 1,250 |
| Total applications for disposition | | 1,313 |
| Disposition of applications | | |
| Accepted for filing | 711 | |
| Returned | 495 | |
| Withdrawn | 3 | |
| Denied | 1 | |
| Total applications disposed of | | 1,210 |
| Applications pending as of June 30, 1976 | | 103 |
| **INVESTMENT ADVISER REGISTRATIONS** | | |
| Effective registrations at close of preceding year | | 3,420 |
| Registrations effective during fiscal 1976 | | 694 |
| Total registrations | | 4,114 |
| Registrations terminated during fiscal 1976 | | |
| Withdrawn | 238 | |
| Revoked | 9 | |
| Cancelled | 10 | |
| Total registrations terminated | | 257 |
| Total registrations at end of fiscal 1976 | | 3,857 |

## Table 6

## CONSOLIDATED REVENUES AND EXPENSES OF SELF-REGULATORY ORGANIZATIONS

(Thousands of Dollars)

| | 1972 | 1973 | 1974 | 1975 | 1976 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Jan | Feb | Mar | Apr | May | Jun |
| **Revenues** | | | | | | | | | | |
| Transaction Fees | $ 29,273 | $ 26,458 | $ 24,166 | $ 32,884 | $ 3,282 | $ 3,982 | $ 4,210 | $ 3,959 | $ 3,038 | $ 2,910 |
| Listing Fees | 26,441 | 26,490 | 25,434 | 31,726 | 3,140 | 2,284 | 2,868 | 3,245 | 4,289 | 3,977 |
| Communication Fees | 18,591 | 21,376 | 20,822 | 25,947 | 2,471 | 2,464 | 2,494 | 2,636 | 2,645 | 2,858 |
| Clearing Fees | 36,296 | 32,602 | 30,070 | 35,451 | 3,669 | 3,797 | 4,144 | 3,649 | 2,895 | 3,042 |
| Depository Fees | 19,469 | 23,586 | 22,696 | 27,792 | 3,041 | 3,054 | 3,593 | 2,908 | 2,632 | 2,843 |
| Tabulation services | 12,037 | 10,453 | 11,268 | 13,553 | 1,500 | 1,566 | 1,593 | 1,351 | 1,262 | 1,316 |
| All Other Revenues | 37,660 | 38,788 | 38,740 | 38,535 | 3,608 | 3,731 | 3,640 | 3,501 | 3,423 | 4,030 |
| Membership Dues | 9,937 | 11,103 | 11,156 | 11,313 | 1,051 | 1,044 | 1,047 | 1,052 | 1,053 | 1,049 |
| Registration Fees | 5,623 | 6,450 | 5,136 | 5,130 | 412 | 428 | 464 | 476 | 394 | 516 |
| Floor Usage Revenue | 4,685 | 4,777 | 4,860 | 6,972 | 723 | 508 | 594 | 614 | 603 | 966 |
| Corporate Finance Fees | 2,221 | 1,212 | 816 | 1,111 | 44 | 148 | 132 | 117 | 92 | 69 |
| Other | 15,194 | 15,246 | 16,772 | 14,009 | 1,377 | 1,512 | 1,402 | 1,241 | 1,281 | 1,430 |
| Total Revenues | $179,768 | $179,753 | $178,197 | $205,889 | $20,711 | $20,876 | $22,542 | $21,250 | $20,183 | $20,976 |
| **Expenses** | | | | | | | | | | |
| Employee Costs | $ 70,233 | $ 77,744 | $ 80,049 | $ 84,342 | $ 7,732 | $ 7,584 | $ 8,436 | $ 8,304 | $ 8,489 | $ 8,215 |
| Occupancy Costs | 7,954 | 10,663 | 12,750 | 12,910 | 1,156 | 1,163 | 1,218 | 1,222 | 1,171 | 1,227 |
| Equipment Costs | 1,734 | 1,916 | 2,487 | 3,510 | 299 | 314 | 415 | 403 | 381 | 360 |
| Professional and Legal Services | 7,343 | 8,627 | 5,757 | 8,006 | 615 | 684 | 633 | 654 | 689 | 885 |
| Depreciation and Amortization | 2,719 | 3,360 | 4,093 | 4,824 | 404 | 418 | 469 | 446 | 491 | 518 |
| Advertising, Printing and Postage | 4,194 | 5,391 | 4,882 | 3,342 | 259 | 315 | 284 | 248 | 411 | 404 |
| Communication, Data Processing and Collection | 49,840 | 54,837 | 52,504 | 58,854 | 5,448 | 5,682 | 5,864 | 5,891 | 5,791 | 6,369 |
| All Other Expenses | 16,814 | 15,028 | 11,746 | 15,858 | 1,435 | 1,380 | 1,899 | 1,529 | 1,445 | 1,437 |
| Total Expenses | $160,831 | $177,565 | $174,269 | $191,647 | $17,348 | $17,391 | $19,218 | $18,699 | $18,867 | $19,415 |
| **Pre-Tax Income** | $ 18,937 | $ 2,188 | $ 1,071 | $ 14,243 | $ 3,363 | $ 3,486 | $ 3,324 | $ 2,551 | $ 1,317 | $ 1,562 |

SOURCE Survey of Self-Regulatory Organizations and Subsidiaries
Directorate of Economic and Policy Research
Branch of Securities Industry and Self-Regulatory Economics

## Table 6—cont.

## CONSOLIDATED REVENUES AND EXPENSES OF SELF-REGULATORY ORGANIZATIONS

(Thousands of Dollars)

| | AMEX | | BSE | | CBOE | | CSE | | DSE[1] | | ISE | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1975 | Jan–Jun 1976 | 1975 | Jan–Jun 1976 | 1975 | Jan–Jun 1976 | 1975 | Jan–Jun 1976 | 1975 | Jan–Apr 1976 | 1975 | Jan–Jun 1976 |
| **Revenues** | | | | | | | | | | | | |
| Transaction Fees | $ 4,016 | $ 3,687 | $ 362 | $ 255 | $4,853 | $3,747 | $ 11 | $ 0 | $ 40 | $ 12 | $ 0 | $ 0 |
| Listing Fees | 4,898 | 2,765 | 90 | 31 | 0 | 0 | 10 | 6 | 17 | 5 | 4 | 3 |
| Communication Fees | 11,082 | 7,214 | 0 | 0 | 840 | 686 | 8 | 3 | 0 | 0 | 0 | 0 |
| Clearing Fees | 2,103 | 1,710 | 1,316 | 802 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Depository Fees | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Tabulation services | 36 | 0 | 676 | 453 | 0 | 0 | 3 | 2 | 0 | 0 | 0 | 0 |
| All Other Revenues | 2,431 | 1,406 | 845 | 525 | 2,464 | 1,782 | 98 | 38 | 63 | 18 | 23 | 11 |
| Membership Dues | 624 | 300 | 206 | 104 | 476 | 521 | 11 | 1 | 46 | 14 | 6 | 3 |
| Registration Fees | 151 | 62 | 7 | 5 | 427 | 171 | 7 | [2] | 0 | 0 | 0 | 0 |
| Floor Usage Revenue | 596 | 388 | 31 | 18 | 438 | 292 | 56 | 28 | 6 | 0 | 0 | 0 |
| Corporate Finance Fees | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| Other | 1,060 | 656 | 601 | 399 | 1,123 | 798 | 23 | 3 | 11 | 4 | 17 | 8 |
| Total Revenues | $24,566 | $16,782 | $3,289 | $2,066 | $8,157 | $6,215 | $130 | $49 | $120 | $36 | $27 | $13 |
| **Expenses** | | | | | | | | | | | | |
| Employee Costs | $ 8,584 | $ 4,829 | $1,565 | $ 905 | $2,780 | $2,020 | $36 | $18 | $67 | $13 | $10 | $ 5 |
| Occupancy Costs | 1,839 | 959 | 212 | 114 | 651 | 477 | 14 | 9 | 23 | 7 | 9 | 5 |
| Equipment Costs | 379 | 240 | 113 | 63 | 826 | 431 | 21 | 9 | 6 | 2 | 0 | 0 |
| Professional and Legal Services | 819 | 705 | 74 | 77 | 438 | 308 | 5 | 5 | 6 | 3 | 1 | 1 |
| Depreciation and Amortization | 1,057 | 527 | 100 | 55 | 429 | 477 | 0 | 0 | 2 | 0 | 0 | 0 |
| Advertising, Printing and Postage | 925 | 587 | 107 | 58 | 797 | 484 | 5 | 4 | 4 | 1 | 1 | 0 |
| Communication, Data Processing and Collection | 9,950 | 7,095 | 524 | 282 | 335 | 314 | 10 | 7 | 5 | 3 | 1 | 0 |
| All Other Expenses | 594 | 320 | 237 | 228 | 615 | 648 | 3 | 1 | 2 | 0 | 2 | 1 |
| Total Expenses | $24,147 | $15,262 | $2,933 | $1,782 | $6,872 | $5,158 | $94 | $52 | $114 | $31 | $23 | $13 |
| **Pre-Tax Income** | $ 419 | $ 1,520 | $ 356 | $ 285 | $1,286 | $1,057 | $35 | $ 3 | $ 5 | $ 4 | $ 4 | $ 1 |

[1] The Detroit Stock Exchange ceased operations on June 30, 1976

SOURCE Survey of Self-Regulatory Organizations and Subsidiaries
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Branch of Securities Industry and Self-Regulatory Economics

## Table 6—cont.

## CONSOLIDATED REVENUES AND EXPENSES OF SELF-REGULATORY ORGANIZATIONS

(Thousands of Dollars)

| | MSE | | NASD | | NYSE | | PSE | | PhilaSE | | SSE | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1975 | Jan–Jun 1976 | 1975 | Jan–Jun 1976 | 1975 | Jan–Jun 1976 | 1975 | Jan–Jun 1976 | 1975 | Jan–Jun 1976 | 1975 | Jan–Jun 1976 |
| **Revenues** | | | | | | | | | | | | |
| Transaction Fees | $ 1,437 | $ 933 | $ 0 | $ 0 | $ 20,518 | $11,376 | $ 991 | $ 739 | $ 656 | $ 631 | $ 0 | $ 0 |
| Listing Fees | 532 | 316 | 2,581 | 1,314 | 22,688 | 14,862 | 822 | 446 | 82 | 54 | 2 | 1 |
| Communication Fees | 3,474 | 1,876 | 0 | 0 | 10,543 | 5,761 | 0 | 12 | 0 | 16 | 0 | 0 |
| Clearing Fees | 2,646 | 1,438 | 8,166 | 4,889 | 16,023 | 9,523 | 3,012 | 1,630 | 2,184 | 1,204 | 0 | 0 |
| Depository Fees | 1,393 | 1,319 | 0 | 0 | 25,259 | 15,709 | 1,133 | 1,034 | 7 | 9 | 0 | 0 |
| Tabulation services | 9,197 | 5,799 | 0 | 0 | 0 | 0 | 3,642 | 2,333 | 0 | 0 | 0 | 1 |
| All Other Revenues | 3,787 | 2,165 | 10,748 | 5,884 | 14,918 | 8,240 | 2,274 | 1,414 | 867 | 440 | 18 | 9 |
| Membership Dues | 651 | 326 | 6,016 | 3,221 | 2,049 | 1,024 | 795 | 579 | 415 | 195 | 17 | 9 |
| Registration Fees | 1,012 | 634 | 2,407 | 1,183 | 1,047 | 580 | 12 | 23 | 59 | 29 | 0 | 0 |
| Floor Usage Revenue | 159 | 85 | 0 | 0 | 5,423 | 3,118 | 151 | 98 | 112 | 71 | 0 | 0 |
| Corporate Finance Fees | 0 | 0 | 1,110 | 602 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other | 1,964 | 1,120 | 1,215 | 878 | 6,399 | 3,518 | 1,316 | 714 | 280 | 146 | 2 | 0 |
| Total Revenues | $22,466 | $13,846 | $21,495 | $12,087 | $109,949 | $65,471 | $11,874 | $7,608 | $3,796 | $2,354 | $20 | $12 |
| **Expenses** | | | | | | | | | | | | |
| Employee Costs | $ 9,271 | $ 5,642 | $ 9,088 | $ 4,918 | $ 44,751 | $ 25,420 | $ 6,069 | $3,815 | $2,115 | $1,123 | $ 7 | $ 3 |
| Occupancy Costs | 1,468 | 797 | 1,098 | 590 | 6,836 | 3,714 | 573 | 338 | 182 | 145 | 3 | 2 |
| Equipment Costs | 76 | 63 | 0 | 0 | 437 | 296 | 1,552 | 1,017 | 98 | 50 | 2 | 1 |
| Professional and Legal Services | 507 | 290 | 732 | 352 | 5,029 | 2,117 | 284 | 198 | 111 | 54 | 1 | 1 |
| Depreciation and Amortization | 274 | 154 | 338 | 171 | 2,388 | 1,225 | 178 | 107 | 58 | 30 | 0 | 0 |
| Advertising, Printing and Postage | 43 | 37 | 24 | 24 | 994 | 443 | 316 | 221 | 123 | 58 | 4 | 3 |
| Communication, Data Processing and Collection | 7,667 | 4,045 | 6,478 | 3,907 | 31, 960 | 17,898 | 1,498 | 1,186 | 425 | 258 | 0 | 0 |
| All Other Expenses | 2,179 | 1,264 | 2,427 | 1,332 | 7,618 | 4,077 | 1,579 | 872 | 599 | 380 | 2 | 0 |
| Total Expenses | $21,484 | $12,291 | $20,185 | $11,294 | $100,014 | $55,191 | $12,049 | $7,754 | $3,712 | $2,099 | $20 | $11 |
| **Pre-Tax Income** | $ 982 | $ 1,555 | $ 1,310 | $ 793 | $ 9,935 | $10,280 | $ 175 | $ 146 | $ 84 | $ 256 | $ 0 | $ 1 |

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## Table 7

## HISTORICAL FINANCIAL INFORMATION FOR SELF-REGULATORY ORGANIZATIONS

(Thousands of Dollars)

| | AMEX | BSE | CBOE | CSE | DSE | ISE | MSE | NASD | NYSE | PSE | PhilaSE | SSE | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Revenues | | | | | | | | | | | | | |
| 1972 | $26,011 | $2,045 | $ 0 | $129 | $140 | $26 | $18,813 | $20,455 | $ 98,002 | $ 9,985 | $4,145 | $17 | $179,768 |
| 1973 | 22,436 | 2,252 | 1,178 | 109 | 152 | 28 | 19,131 | 21,329 | 99,129 | 10,079 | 3,911 | 20 | 179,753 |
| 1974 | 19,770 | 2,556 | 3,658 | 115 | 130 | 30 | 19,473 | 20,267 | 93,698 | 10,221 | 3,261 | 19 | 173,197 |
| 1975 | 24,566 | 3,289 | 8,157 | 130 | 120 | 27 | 22,466 | 21,495 | 109,949 | 11,874 | 3,796 | 20 | 205,889 |
| Transaction Fees | | | | | | | | | | | | | |
| 1972 | 5,986 | 207 | — | 20 | 43 | 11 | 1,404 | — | 19,474 | 1,492 | 647 | — | 29,273 |
| 1973 | 3,743 | 201 | 360 | 20 | 49 | — | 1,265 | — | 18,987 | 1,260 | 572 | — | 26,458 |
| 1974 | 2,302 | 187 | 2,109 | 16 | 40 | 1 | 1,127 | — | 17,026 | 896 | 463 | — | 24,166 |
| 1975 | 4,016 | 362 | 4,853 | 11 | 40 | — | 1,437 | — | 20,518 | 991 | 656 | — | 32,884 |
| Listing Fees | | | | | | | | | | | | | |
| 1972 | 5,181 | 65 | — | 3 | 17 | 4 | 422 | — | 20,053 | 623 | 71 | 3 | 26,441 |
| 1973 | 4,153 | 70 | — | 4 | 19 | 6 | 334 | — | 21,333 | 507 | 60 | 3 | 26,490 |
| 1974 | 4,142 | 80 | — | 12 | 16 | 4 | 330 | 1,275 | 18,938 | 535 | 101 | 3 | 25,434 |
| 1975 | 4,898 | 90 | — | 10 | 17 | 4 | 532 | 2,581 | 22,688 | 822 | 82 | 2 | 31,726 |
| Communication Fees | | | | | | | | | | | | | |
| 1972 | 8,981 | — | — | — | — | — | 1,211 | — | 8,399 | — | — | — | 18,591 |
| 1973 | 9,082 | — | 62 | — | — | — | 3,761 | — | 8,471 | — | — | — | 21,376 |
| 1974 | 9,304 | — | 110 | — | — | — | 3,553 | — | 7,855 | — | — | — | 20,822 |
| 1975 | 11,082 | — | 840 | 8 | — | — | 3,474 | — | 10,543 | — | — | — | 25,947 |
| Clearing Fees | | | | | | | | | | | | | |
| 1972 | 2,876 | 998 | — | 49 | — | — | 3,022 | 7,621 | 15,466 | 3,412 | 2,853 | — | 36,296 |
| 1973 | 2,279 | 1,011 | — | 28 | — | — | 1,714 | 8,298 | 18,578 | 3,004 | 2,689 | — | 32,602 |
| 1974 | 1,776 | 988 | — | — | — | — | 1,629 | 7,638 | 18,275 | 2,507 | 2,257 | — | 30,070 |
| 1975 | 2,103 | 1,316 | — | — | — | — | 2,646 | 8,166 | 18,023 | 3,012 | 2,184 | — | 35,451 |
| Depository Fees | | | | | | | | | | | | | |
| 1972 | — | — | — | — | — | — | — | — | 19,273 | 196 | — | — | 19,469 |
| 1973 | — | — | — | — | — | — | 137 | — | 22,601 | 848 | — | — | 23,586 |
| 1974 | — | — | — | — | — | — | 1,211 | — | 20,738 | 747 | — | — | 22,696 |
| 1975 | — | — | — | — | — | — | 1,393 | — | 25,259 | 1,133 | 7 | — | 27,792 |
| Tabulation Services | | | | | | | | | | | | | |
| 1972 | 18 | 71 | — | 3 | — | — | 9,130 | — | — | 2,815 | — | — | 12,037 |
| 1973 | 28 | 107 | — | 1 | — | — | 7,914 | — | — | 2,403 | — | — | 10,453 |
| 1974 | 13 | 454 | — | 4 | — | — | 8,347 | — | — | 2,450 | — | — | 11,268 |
| 1975 | 36 | 676 | — | 3 | — | — | 9,197 | — | — | 3,642 | — | — | 13,553 |
| All Other Revenues | | | | | | | | | | | | | |
| 1972 | 2,969 | 704 | — | 54 | 80 | 20 | 3,625 | 12,834 | 15,336 | 1,448 | 575 | 15 | 37,660 |
| 1973 | 3,151 | 863 | 756 | 55 | 84 | 21 | 4,005 | 13,031 | 14,158 | 2,058 | 589 | 17 | 38,788 |
| 1974 | 2,233 | 847 | 1,439 | 83 | 74 | 25 | 3,277 | 11,354 | 15,866 | 3,085 | 440 | 17 | 38,740 |
| 1975 | 2,431 | 845 | 2,464 | 98 | 63 | 23 | 3,787 | 10,748 | 14,918 | 2,274 | 867 | 18 | 38,535 |
| Total Expenses | | | | | | | | | | | | | |
| 1972 | 25,847 | 1,734 | — | 319 | 131 | 31 | 18,517 | 17,912 | 81,652 | 10,772 | 3,897 | 18 | 160,831 |
| 1973 | 23,132 | 1,996 | 1,694 | 86 | 138 | 27 | 18,997 | 21,616 | 93,819 | 12,202 | 3,839 | 20 | 177,565 |
| 1974 | 20,816 | 2,544 | 4,103 | 18 | 125 | 27 | 19,403 | 21,023 | 92,885 | 9,703 | 3,603 | 19 | 174,269 |
| 1975 | 24,147 | 2,933 | 6,872 | 94 | 114 | 23 | 21,484 | 20,185 | 100,014 | 12,049 | 3,712 | 20 | 191,647 |
| Pre-Tax Income | | | | | | | | | | | | | |
| 1972 | 164 | 311 | — | (191) | 9 | (5) | 296 | 2,543 | 16,350 | (787) | 248 | (1) | 18,937 |
| 1973 | (698) | 256 | (516) | 23 | 14 | 1 | 134 | (287) | 5,310 | (2,123) | 72 | (0) | 2,188 |
| 1974 | (1,046) | 11 | (445) | 97 | 5 | 3 | 70 | (756) | 813 | 517 | (341) | — | (1,071) |
| 1975 | 419 | 356 | 1,286 | 35 | 5 | 4 | 982 | 1,310 | 9,935 | (175) | 84 | — | 14,243 |

SOURCE Survey of Self-Regulatory Organizatinons and Subsidiaries
Directorate of Economic and Policy Research
Branch of Securities Industry and Self-Regulatory Economics

## FINANCIAL INSTITUTIONS

### Stock Transactions of Selected Financial Institutions

During 1975, private noninsured pension funds, open-end investment companies, life insurance companies, and property-liability insurance companies purchased $35.2 billion of common stock and sold $30.6 billion, resulting in net purchases of $4.7 billion. In 1974 purchases were $27.2 billion; sales were $24.4 billion; and net purchases were $2.8 billion. Their common stock activity rate was 23.0 percent as compared to 19.1 percent a year earlier.

**Table 8**

**COMMON STOCK TRANSACTIONS AND ACTIVITY RATES OF SELECTED FINANCIAL INSTITUTIONS**

(Millions of Dollars)

| | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|---|---|---|
| Private Noninsured Pension Funds[1] | | | | | | | | |
| Purchases | 12,286 | 15,231 | 13,957 | 21,684 | 23,222 | 20,324 | 11,758 | 17,560 |
| Sales | 7,815 | 10,271 | 9,370 | 12,800 | 15,651 | 14,790 | 9,346 | 11,846 |
| Net purchases (sales) | 4,471 | 4,960 | 4,587 | 8,884 | 7,571 | 5,534 | 2,412 | 5,714 |
| Activity rate | 18 7 | 21 3 | 20 5 | 22 1 | 19 7 | 17 3 | 14 1 | 18 3 |
| Open-End Investment Companies[2] | | | | | | | | |
| Purchases | 20,102 | 22,059 | 17,128 | 21,556 | 20,943 | 15,561 | 9,085 | 10,949 |
| Sales | 18,496 | 19,852 | 15,901 | 21,175 | 22,552 | 17,504 | 9,372 | 12,144 |
| Net purchases (sales) | 1,606 | 2,207 | 1,227 | 381 | (1,609) | (1,943) | (287) | (1,195) |
| Activity rate | 48 4 | 51 0 | 45 6 | 48 2 | 44 8 | 39 0 | 30 5 | 35 8 |
| Life Insurance Companies[3] | | | | | | | | |
| Purchases | 2,932 | 3,703 | 3,768 | 6,232 | 6,912 | 6,492 | 3,930 | 4,534 |
| Sales | 1,725 | 2,184 | 1,975 | 2,777 | 4,427 | 4,216 | 2,439 | 3,373 |
| Net purchases (sales) | 1,207 | 1,519 | 1,793 | 3,455 | 2,485 | 2,276 | 1,491 | 1,161 |
| Activity rate | 26 8 | 29 4 | 27 8 | 31 0 | 29 5 | 25 8 | 18 7 | 20 6 |
| Property-Liability Insurance Companies | | | | | | | | |
| Purchases | 2,243 | 3,781 | 3,613 | 4,171 | 5,128 | 4,519 | 2,400 | 2,193 |
| Sales | 1,644 | 2,879 | 2,722 | 1,944 | 2,738 | 2,856 | 3,223 | 3,196 |
| Net purchases (sales) | 599 | 902 | 891 | 2,227 | 2,390 | 1,663 | (823) | (1,003) |
| Activity rate | 16 0 | 26 7 | 28 1 | 23 2 | 23 8 | 20 8 | 21 3 | 23 8 |
| Total Selected Institutions | | | | | | | | |
| Purchases | 37,563 | 44,774 | 38,466 | 53,643 | 56,205 | 46,896 | 27,173 | 35,236 |
| Sales | 29,680 | 35,186 | 29,968 | 38,696 | 45,368 | 39,366 | 24,380 | 30,559 |
| Net purchases (sales) | 7,883 | 9,588 | 8,498 | 14,947 | 10,837 | 7,530 | 2,793 | 4,677 |
| Activity rate | 29 4 | 32 4 | 29 8 | 30 8 | 27 8 | 23 6 | 19 1 | 23 0 |
| Foreign Investors[4] | | | | | | | | |
| Purchases | 13,118 | 12,428 | 8,927 | 11,625 | 14,360 | 12,768 | 7,634 | 15,066 |
| Sales | 10,849 | 10,941 | 8,301 | 10,893 | 12,173 | 9,977 | 7,094 | 10,586 |
| Net purchases (sales) | 2,269 | 1,487 | 626 | 732 | 2,187 | 2,791 | 540 | 4,480 |

[1] Includes pension funds of corporations, unions, multi-employer groups, and nonprofit organizations, also includes deferred profit sharing funds

[2] Mutual funds reporting to the Investment Company Institute, a group whose assets constitute about ninety percent of the assets of all open-end investment companies

[3] Includes both general and separate accounts

[4] Transactions of foreign individuals and institutions in domestic common and preferred stocks Activity rates for foreign investors are not calculable

NOTE Activity rate is defined as the average of gross purchases and sales divided by the average market value of holdings

SOURCE Pension funds and property-liability insurance companies, SEC, investment companies, Investment Company Institute, life insurance companies, Institute of Life Insurance, foreign investors, Treasury Department

## STOCKHOLDINGS OF INSTITUTIONAL INVESTORS AND OTHERS

At year-end 1975, the institutional groups listed below held $328 2 billion of the corporate stock, both common and preferred, versus $245 4 billion a year earlier The resulting 33 7 percent increase in the value of the stockholdings of these eleven groups closely matched the 34 1 percent increase in the aggregate market value of all stock outstanding Thus, the 40.2 percent share of total stock outstanding that was held by these institutions at year-end 1975 remained nearly unchanged from their 40.3 percent share of a year earlier During the same period, however, the share held by other domestic investors, which consists of individuals and institutions not listed, declined slightly from 55.1 percent to 53 9 percent, while foreign investors absorbed this slack by increasing their share from 4 6 percent to 5.9 percent

**Table 9**

**MARKET VALUE OF STOCKHOLDINGS OF INSTITUTIONAL INVESTORS AND OTHERS**

(Billions of Dollars, End of Year)

| | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|---|---|---|
| 1 Private Noninsured Pension Funds | 61 5 | 61 4 | 67 1 | 88 7 | 115 2 | 90 5 | 63 3 | 88 6 |
| 2 Open-End Investment Companies | 50 9 | 45 0 | 43 9 | 52 6 | 58 0 | 43 3 | 30 3 | 38 7 |
| 3 Other Investment Companies | 8 3 | 6 3 | 6 2 | 6 9 | 7 4 | 6 6 | 4 7 | 6 0 |
| 4 Life Insurance Companies | 13 2 | 13 7 | 15 4 | 20 6 | 26 8 | 25 9 | 21 9 | 28 3 |
| 5 Property-Liability Insurance Companies[1] | 14 6 | 13 3 | 13 2 | 16 6 | 21 8 | 19 7 | 12 8 | 14 3 |
| 6 Common Trust Funds | 4 8 | 4 6 | 4 6 | 5 8 | 7 4 | 6 6 | 4 3 | 5 7 |
| 7 Personal Trust Funds | 83 6 | 79 6 | 78 6 | 94 1 | 110 2 | 94 7 | 67 7 | 92 8 |
| 8 Mutual Savings Banks | 2 4 | 2 5 | 2 8 | 3 5 | 4 5 | 4 2 | 3 7 | 4 4 |
| 9 State and Local Retirement Funds | 5 8 | 7 3 | 10 1 | 15 4 | 22 2 | 20 6 | 17 4 | 25 8 |
| 10 Foundations | 22 0 | 20 0 | 22 0 | 25 0 | 28 5 | 24 5 | 18 4 | 22 7 |
| 11 Educational Endowments | 8 5 | 7 6 | 7 8 | 9 0 | 10 7 | 9 6 | 6 7 | 8 7 |
| 12 Subtotal | 275 6 | 261 3 | 271 6 | 338 2 | 412 7 | 346 1 | 251 3 | 336 0 |
| 13 Less Institutional Holdings of Investment Company Shares | 3 4 | 4 0 | 4 9 | 5 8 | 6 5 | 6 3 | 5 8 | 7 8 |
| 14 Total Institutional Investors | 272 2 | 257 3 | 266 8 | 332 4 | 406 2 | 339 8 | 245 4 | 328 2 |
| 15 Foreign Investors[2] | 28 8 | 26 9 | 28 7 | 32 9 | 41 3 | 37 0 | 28 2 | 48 2 |
| 16 Other Domestic Investors[3] | 680 3 | 582 1 | 563 9 | 638 4 | 694 7 | 487 8 | 335 3 | 439 9 |
| 17 Total Stock Outstanding[4] | 981 4 | 866 3 | 859 4 | 1,003 7 | 1,142 3 | 864 6 | 608 9 | 816 3 |

[1] Excludes holdings of insurance company stock
[2] Includes estimate of stock held as direct investment
[3] Computed as residual (line 16=17–14–15) Includes both individuals and institutional groups not listed above
[4] Includes both common and preferred stock Excludes investment company shares but includes foreign issues outstanding in the U S

## Number and Assets of Registered Investment Companies

As of June 30, 1976, there were 1,286 active investment companies registered under the Investment Company Act, with assets having an aggregate market value of over $80 billion Those figures represent a decrease of 1 in the number of registered companies and an increase of $6 4 billion in the market value of assets since June 30, 1975

## Table 10

## COMPANIES REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940 AS OF JUNE 30, 1976

| | Number of Registered Companies | | | Approximate Market Value of Assets of Active Companies (Millions) |
|---|---|---|---|---|
| | Active | Inactive[a] | Total | |
| Management open-end ("Mutual Funds") | 786 | 29 | 815 | 56,937 |
| Funds having no load | 250 | — | — | 11,268 |
| Variable annuity-separate accounts | 57 | — | — | 1,304 |
| Capital Leverage Companies | 2 | — | — | 32 |
| All other load funds | 470 | — | — | 44,333 |
| Management closed-end | 178 | 36 | 214 | 9,319 |
| Small business investment companies | 39 | — | — | 286 |
| Capital leverage companies | 7 | — | — | 335 |
| All other closed-end companies | 132 | — | — | 8,698 |
| Unit investment trusts | 315 | 22 | 337 | [b]13 218 |
| Variable annuity-separate accounts | 57 | — | — | 927 |
| All other unit investment trusts | 258 | — | — | 12,291 |
| Face-amount certificate companies | 7 | 3 | 10 | 1,091 |
| Total | 1,286 | 90 | 1,376 | 80,564 |

[a] "Inactive" refers to registered companies which as of June 30, 1976, were in the process of being liquidated or merged, or have filed an application pursuant to Section 8(f) of the Act for deregistration, or which have otherwise gone out of existence and remain registered only until such time as the Commission issues order under Section 8(f) terminating their registration

[b] Includes about $5 9 billion of assets of trusts which invest in securities of other investment companies, substantially all of them mutual funds

## Table 11

## COMPANIES REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940

| Fiscal year ended June 30 | Number of companies | | | | Approximate market value of assets of active companies (millions) |
|---|---|---|---|---|---|
| | Registered at beginning of year | Registered during year | Registration terminated during year | Registered at end of year | |
| 1941 | 0 | 450 | 14 | 436 | $ 2,500 |
| 1942 | 436 | 17 | 46 | 407 | 2,400 |
| 1943 | 407 | 14 | 31 | 390 | 2,300 |
| 1944 | 390 | 18 | 27 | 371 | 2,200 |
| 1945 | 371 | 14 | 19 | 366 | 3,250 |
| 1946 | 366 | 13 | 18 | 361 | 3,750 |
| 1947 | 361 | 12 | 21 | 352 | 3,600 |
| 1948 | 352 | 18 | 11 | 359 | 3,825 |
| 1949 | 359 | 12 | 13 | 358 | 3,700 |
| 1950 | 358 | 26 | 18 | 366 | 4,700 |
| 1951 | 366 | 12 | 10 | 368 | 5,600 |
| 1952 | 368 | 13 | 14 | 367 | 6,800 |
| 1953 | 367 | 17 | 15 | 369 | 7,000 |
| 1954 | 369 | 20 | 5 | 384 | 8,700 |
| 1955 | 384 | 37 | 34 | 387 | 12,000 |
| 1956 | 387 | 46 | 34 | 399 | 14,000 |
| 1957 | 399 | 49 | 16 | 432 | 15,000 |
| 1958 | 432 | 42 | 21 | 453 | 17,000 |
| 1959 | 453 | 70 | 11 | 512 | 20,000 |
| 1960 | 512 | 67 | 9 | 570 | 23,500 |
| 1961 | 570 | 118 | 25 | 663 | 29,000 |
| 1962 | 663 | 97 | 33 | 727 | 27,300 |
| 1963 | 727 | 48 | 48 | 727 | 36,000 |
| 1964 | 727 | 52 | 48 | 731 | 41,600 |
| 1965 | 731 | 50 | 54 | 727 | 44,600 |
| 1966 | 727 | 78 | 30 | 775 | 49,800 |
| 1967 | 775 | 108 | 41 | 842 | 58,197 |
| 1968 | 842 | 167 | 42 | 967 | 69,732 |
| 1969 | 967 | 222 | 22 | 1,167 | 72,465 |
| 1970 | 1,167 | 187 | 26 | 1,328 | 56,337 |
| 1971 | 1,328 | 121 | 98 | 1,351 | 78,109 |
| 1972 | 1,351 | 91 | 108 | 1,334 | 80,816 |
| 1973 | 1,334 | 91 | 64 | 1,361 | 73,149 |
| 1974 | 1,361 | 106 | 90 | 1,377 | 62,287 |
| 1975 | 1,377 | 88 | 66 | 1,399 | 74,192 |
| 1976 | 1,399 | 63 | 86 | 1,376 | 80,564 |

**Table 12**

**NEW INVESTMENT COMPANY REGISTRATIONS**

| | 1976 |
|---|---|
| Management open-end | |
| No-loads | 15 |
| Variable annuities | 3 |
| All others | 28 |
| Sub-total | 46 |
| Management closed-end | |
| SBIC's | 1 |
| All others | 2 |
| Sub-total | 3 |
| Unit investment trust | |
| Variable annuities | 3 |
| All others | 10 |
| Sub-total | 13 |
| Face amount certificates | 1 |
| Total Registered | 63 |

**Table 13**

**INVESTMENT COMPANY REGISTRATIONS TERMINATED**

| | 1976 |
|---|---|
| Management open-end | |
| No-loads | 23 |
| Variable annuities | 3 |
| All others | 39 |
| Sub-total | 65 |
| Management closed-end | |
| SBIC s | 4 |
| All others | 11 |
| Sub-total | 15 |
| Unit investment trust | |
| Variable annuities | 3 |
| All others | 3 |
| Sub-total | 6 |
| Face amount certificates | 0 |
| Total Terminated | 86 |

## Private Noninsured Pension Funds: Assets

The assets of private noninsured pension funds totaled $145.2 billion at book value and $145 6 billion at market value on December 31, 1975 A year earlier their comparable asset totals were $133 7 billion and $111 7 billion The book value of common stockholdings increased from $79 3 billion at the end of 1974 to $83.7 billion last year. At market value, holdings of common stock rose from $62 6 billion, or 56 0 percent of total assets, at the end of 1974 to $87 7 billion, or 60 2 percent of total assets, at the end of last year

## Table 14A

## ASSETS OF PRIVATE NONINSURED PENSION FUNDS

Book Value, End of Year

(Millions of Dollars)

| | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|---|---|---|
| Cash and Deposits | 1,592 | 1 619 | 1,804 | 1,641 | 1,857 | 2,336 | 4,286 | 2,962 |
| U S Government Securities | 2,756 | 2,792 | 3,029 | 2,732 | 3,689 | 4,404 | 5,533 | 10,764 |
| Corporate and Other Bonds | 27,000 | 27,613 | 29,666 | 29,013 | 28,207 | 30,334 | 35,029 | 37,809 |
| Preferred Stock | 1,332 | 1,757 | 1,736 | 1,767 | 1,481 | 1,258 | 1,129 | 1,188 |
| Common Stock | 41,740 | 47,862 | 51,744 | 62,780 | 74 585 | 80 593 | 79 319 | 83 654 |
| Own Company | 2,836 | 3,062 | 3,330 | 3,608 | 3,868 | 4 098 | 4 588 | N A |
| Other Companies | 38,904 | 44,800 | 48,414 | 59,172 | 70,717 | 76,495 | 74 731 | N A |
| Mortgages | 4,067 | 4,216 | 4,172 | 3,660 | 2,728 | 2 377 | 2,372 | 2,383 |
| Other Assets | 4,585 | 4,720 | 4,860 | 4,826 | 4,983 | 5,229 | 6,063 | 6,406 |
| Total Assets | 83,072 | 90,579 | 97,011 | 106,419 | 117,530 | 126 531 | 133,731 | 145 166 |

N A Not Available
NOTE Includes deferred profit sharing funds and pension funds of corporations, unions, multiemployer groups, and nonprofit organizations

## Table 14B

## ASSETS OF PRIVATE NONINSURED PENSION FUNDS

Market Value, End of Year

(Millions of Dollars)

| | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|---|---|---|
| Cash and Deposits | 1,592 | 1,619 | 1,804 | 1,641 | 1,857 | 2,336 | 4,286 | 2,962 |
| U S Government Securities | 2,615 | 2,568 | 2,998 | 2,772 | 3,700 | 4,474 | 5,582 | 11,097 |
| Corporate and Other Bonds | 22,437 | 21,262 | 24,919 | 26,111 | 26,232 | 27,664 | 30,825 | 34,519 |
| Preferred Stock | 1,351 | 1 598 | 1 631 | 2,014 | 1,869 | 985 | 703 | 892 |
| Common Stock | 60,105 | 59,827 | 65,456 | 86,636 | 113,369 | 89,538 | 62,582 | 87,669 |
| Own Company | 5,764 | 5,775 | 6,038 | 7,691 | 8,750 | 6,947 | 5,230 | N A |
| Other Companies | 54,341 | 54,052 | 59,418 | 78,945 | 104,619 | 82 591 | 57,352 | N A |
| Mortgages | 3,578 | 3,461 | 3,504 | 3,184 | 2,427 | 2,108 | 2,063 | 2,139 |
| Other Assets | 4,332 | 4 295 | 4,422 | 4,560 | 4,908 | 5,140 | 5,681 | 6,341 |
| Total Assets | 96,013 | 94,632 | 104 737 | 126,921 | 154,363 | 132 247 | 111,724 | 145,622 |

N A Not Available
NOTE Includes deferred profit sharing funds and pension funds of corporations, unions, multi-employer groups, and nonprofit organizations

## PRIVATE NONINSURED PENSION FUNDS: RECEIPTS AND DISBURSEMENTS

Information on the receipts and disbursements of private noninsured pension funds for 1975 is not yet available. In 1974, net receipts were $10.0 billion. Of the $21.1 billion in total receipts, $17.0 billion was contributed by employers and $1 5 billion by employees. Investment income (interest, dividends, and rent) and net loss on sale of assets were $6.0 billion and $3 5 billion, respectively Of the $11 0 billion in total disbursements, $10 7 billion was paid out to beneficiaries

## Table 15

### RECEIPTS AND DISBURSEMENTS OF PRIVATE NONINSURED PENSION FUNDS

(Millions of Dollars)

| | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|---|---|---|
| Total Receipts | 13,152 | 14,151 | 13,195 | 17,545 | 20,070 | 19,673 | 21,063 | N A |
| Employer Contributions | 7,702 | 8,487 | 9,717 | 11,324 | 12,745 | 14,368 | 16,971 | N A |
| Employee Contributions | 893 | 1,011 | 1,074 | 1,120 | 1,199 | 1,273 | 1,460 | N A |
| Investment Income | 3,193 | 3,549 | 3,866 | 4,102 | 4,302 | 4,843 | 5,982 | N A |
| Net Profit (Loss) on Sale of Assets | 1,265 | 991 | (1,592) | 904 | 1,723 | (924) | (3,477) | N A |
| Other Receipts | 99 | 113 | 130 | 95 | 101 | 113 | 127 | N A |
| Total Disbursements | 4,621 | 5,428 | 6,180 | 7,263 | 8,493 | 9,539 | 11,030 | N A |
| Benefits Paid Out | 4,503 | 5,290 | 6,030 | 7,083 | 8,297 | 9,313 | 10,740 | N A |
| Expenses and Other Disbursements | 118 | 138 | 150 | 180 | 196 | 226 | 290 | N A |
| Net Receipts | 8,531 | 8,723 | 7,015 | 10,282 | 11,577 | 10,134 | 10,033 | N A |

NOTE Includes deferred profit sharing funds and pension funds of corporations, unions, and multi-employer groups, and nonprofit organizations

## SECURITIES ON EXCHANGES

### Exchange Volume

Dollar Volume of all securities transactions on registered exchanges totaled $166 9 billion in 1975, up 33 percent from the $125.1 billion volume in 1974 Of this total, $157.3 billion represented stock trading, $9 3 billion bond trading, and the balance trading in rights and warrants The value of New York Stock Exchange transactions was $143.1 billion in 1975 This figure represents an increase of 36 percent from 1974. NYSE share volume increased 32 percent from the 1974 total. On the American Stock Exchange, value of shares traded increased 13 percent to $5 7 billion The AMEX volume of 541 million shares was up 14 percent from the 1974 figure. Share volume on regional exchanges increased 15 percent from the 1974 figure to 623 9 million shares, valued at $17.8 billion

Chicago Board Options Exchange began listed option trading April 23, 1973 The contract volume for the year ending 1975 was 14 4 million, up 153 percent from 5.7 million contracts in 1974. The value was $6.4 billion, an increase of 276 percent from $1.7 billion in 1974 The American Stock Exchange commenced listed option trading January 13, 1975 The volume was 3.5 million contracts in 1975 On June 27, 1975, Philadelphia Stock Exchange began listed option trading Their contract volume in 1975 was 279 thousand with a value of $27 5 million.

Detroit Stock Exchange ceased operations June 30, 1976.

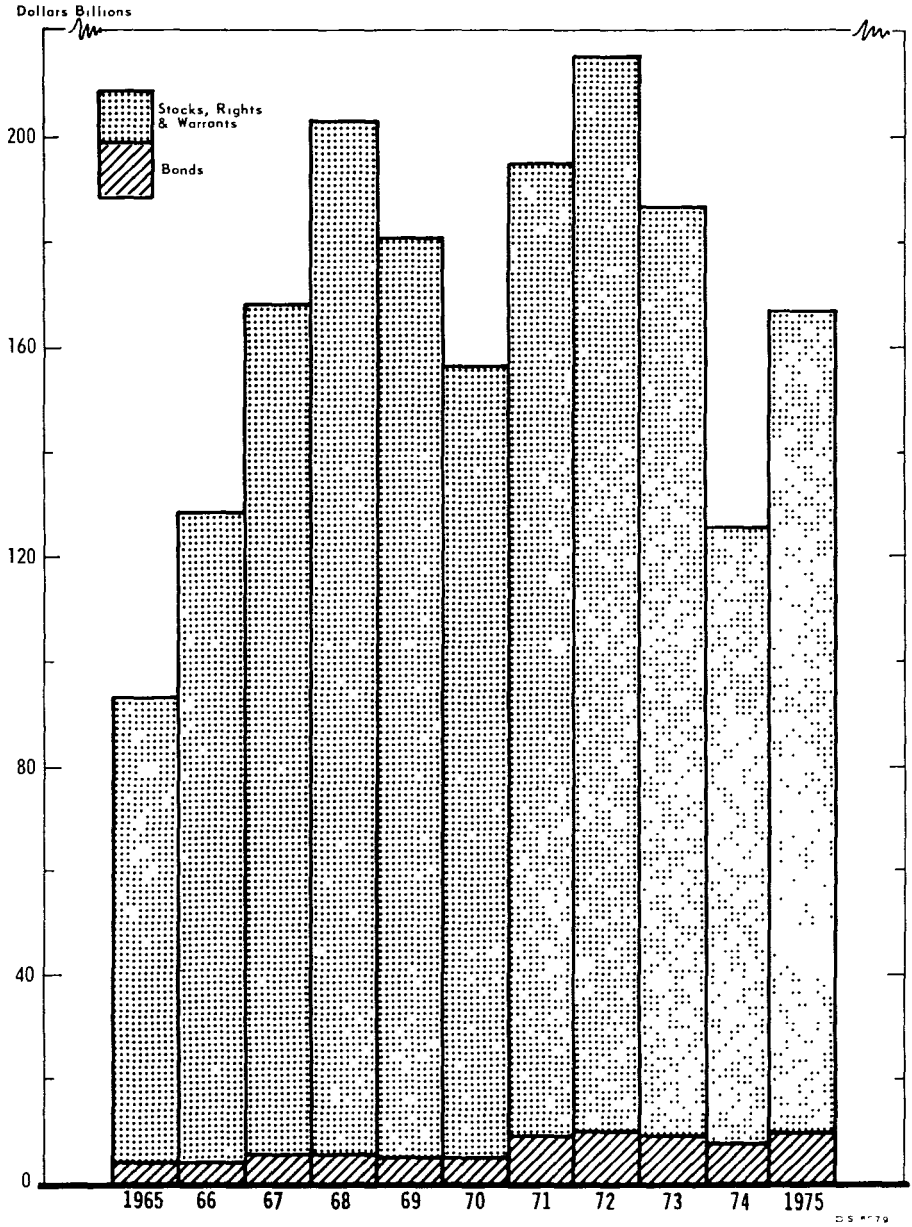
## Table 16

### EXCHANGE VOLUME: 1975

(Data in thousands)

| | Total dollar volume | Bonds | | Stocks | | Rights and warrants | |
|---|---|---|---|---|---|---|---|
| | | Dollar volume | Principal amounts | Dollar volume | Share amount | Dollar volume | Number of units |
| All Registered Exchanges | 166,900,444 | 9,345,608 | 10,706,861 | 157,259,952 | 6,231,323 | 294,884 | 150,153 |
| American | 5,980,826 | 204,193 | 303,672 | 5,678,028 | 540,944 | 98,605 | 31,180 |
| Boston | 1 871,126 | 0 | 0 | 1,870,995 | 54,177 | 131 | 65 |
| Chicago Board of Trade | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Cincinnati | 268,393 | 332 | 536 | 268,060 | 8,351 | 1 | 7 |
| Detroit | 196,661 | 0 | 0 | 196,660 | 7,356 | 1 | 5 |
| Midwest | 7,606,573 | 1,433 | 996 | 7,604,714 | 257,542 | 426 | 1,202 |
| National | 109 | 0 | 0 | 109 | 124 | 0 | 0 |
| New York | 143,066,148 | 9,079,083 | 10,313,772 | 133,818,551 | 5,056,450 | 168,514 | 107,745 |
| Pacific Coast | 5,182,746 | 60,132 | 87,423 | 5,096,042 | 198,867 | 26,572 | 9,137 |
| Philadelphia | 2,722,963 | 436 | 462 | 2,721,893 | 97,633 | 634 | 812 |
| Intermountain | 552 | 0 | 0 | 552 | 3,167 | 0 | 0 |
| Spokane | 4,457 | 0 | 0 | 4,457 | 6,836 | 0 | 0 |
| Exempted Exchanges—Honolulu | 524 | 0 | 0 | 524 | 69 | 0 | 0 |

# MARKET VALUE OF SECURITIES TRADED ON ALL U.S. STOCK EXCHANGES



## NASDAQ Volume

NASDAQ share volume and price information for over-the-counter trading has been reported on a daily basis since November 1, 1971. At the end of 1975, there were 2,598 issues in the NASDAQ system, an increase of 0.2 percent from the previous year-end figure. Volume for 1975 was 1.4 billion shares, up 17 percent from 1974. This trading volume reflects the number of shares bought and sold by market makers plus their net inventory changes.

### Table 17

### SHARE VOLUME BY EXCHANGES[1]

| Year | Total Shares Volume (thousands) | In Percentage | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | NYSE | AMEX | MSE | PSE | PHLX | BSE | DSE | CSE | Other[2] |
| 1935 | 681,971 | 73 13 | 12 42 | 1 91 | 2 69 | 1 10 | 0 96 | 0 85 | 0 03 | 6 91 |
| 1940 | 377,897 | 75 44 | 13 20 | 2 11 | 2 78 | 1 33 | 1 19 | 0 82 | 0 08 | 3 05 |
| 1945 | 769,018 | 65 87 | 21 31 | 1 77 | 2 98 | 1 06 | 0 66 | 0 79 | 0 05 | 5 51 |
| 1950 | 893,320 | 76 32 | 13 54 | 2 16 | 3 11 | 0 97 | 0 65 | 0 55 | 0 09 | 2 61 |
| 1955 | 1,321,401 | 68 85 | 19 19 | 2 09 | 3 08 | 0 85 | 0 48 | 0 39 | 0 05 | 5 02 |
| 1960 | 1,428,552 | 69 08 | 22 46 | 2 22 | 3 14 | 0 89 | 0 39 | 0 34 | 0 04 | 1 41 |
| 1961 | 2,121,050 | 65 65 | 25 84 | 2 24 | 3 45 | 0 80 | 0 30 | 0 31 | 0 04 | 1 33 |
| 1962 | 1,699,346 | 71 84 | 20 26 | 2 36 | 2 97 | 0 87 | 0 31 | 0 36 | 0 04 | 0 95 |
| 1963 | 1,874,718 | 73 17 | 18 89 | 2 33 | 2 83 | 0 83 | 0 29 | 0 47 | 0 04 | 1 10 |
| 1964 | 2,118,326 | 72 81 | 19 42 | 2 43 | 2 65 | 0 93 | 0 29 | 0 54 | 0 03 | 0 86 |
| 1965 | 2,663,495 | 70 10 | 22 59 | 2 63 | 2 34 | 0 82 | 0 26 | 0 53 | 0 05 | 0 64 |
| 1966 | 3,306,386 | 69 54 | 22 89 | 2 57 | 2 68 | 0 86 | 0 40 | 0 45 | 0 05 | 0 51 |
| 1967 | 4,641,215 | 64 48 | 28 45 | 2 36 | 2 46 | 0 87 | 0 43 | 0 33 | 0 02 | 0 57 |
| 1968 | 5,406,582 | 62 00 | 29 74 | 2 63 | 2 65 | 0 89 | 0 78 | 0 31 | 0 01 | 0 95 |
| 1969 | 5,133,498 | 63 17 | 27 61 | 2 84 | 3 47 | 1 22 | 0 51 | 0 12 | 0 00 | 1 00 |
| 1970 | 4,835,222 | 71 27 | 19 02 | 3 16 | 3 68 | 1 63 | 0 51 | 0 10 | 0 02 | 0 57 |
| 1971 | 6,172,668 | 71 34 | 18 42 | 3 52 | 3 72 | 1 91 | 0 43 | 0 15 | 0 03 | 0 44 |
| 1972 | 6,518,132 | 70 47 | 18 22 | 3 71 | 4 13 | 2 21 | 0 59 | 0 15 | 0 03 | 0 45 |
| 1973 | 5,899,678 | 74 92 | 13 75 | 4 09 | 3 68 | 2 19 | 0 71 | 0 18 | 0 04 | 0 39 |
| 1974 | 4,950,833 | 78 47 | 10 27 | 4 39 | 3 48 | 1 82 | 0 86 | 0 19 | 0 04 | 0 44 |
| 1975 | 6,371,545 | 81 05 | 8 97 | 4 06 | 3 10 | 1 54 | 0 85 | 0 11 | 0 13 | 0 15 |

[1] Share Volume for Exchanges includes Stocks, Rights, and Warrants
[2] Others include Intermountain, Spokane, National, and Honolulu Stock Exchanges

### Table DOLLAR VOLUME BY EXCHANGES[1]

| Year | Total Dollar Volume (thousands) | In Percentage | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | NYSE | AMEX | MSE | PSE | PHLX | BSE | DSE | CSE | Other[2] |
| 1935 | 15,396,139 | 86 64 | 7 83 | 1 32 | 1 39 | 0 88 | 1 34 | 0 40 | 0 04 | 0 16 |
| 1940 | 8,419,772 | 85 17 | 7 68 | 2 07 | 1 52 | 1 11 | 1 91 | 0 36 | 0 09 | 0 09 |
| 1945 | 16,284,552 | 82 75 | 10 81 | 2 00 | 1 78 | 0 96 | 1 16 | 0 35 | 0 06 | 0 13 |
| 1950 | 21,808,284 | 85 91 | 6 85 | 2 35 | 2 19 | 1 03 | 1 12 | 0 39 | 0 11 | 0 05 |
| 1955 | 38,039,107 | 86 31 | 6 98 | 2 44 | 1 90 | 1 03 | 0 78 | 0 39 | 0 09 | 0 08 |
| 1960 | 45,276,616 | 83 86 | 9 35 | 2 72 | 1 95 | 1 04 | 0 60 | 0 34 | 0 07 | 0 03 |
| 1961 | 64,032,924 | 82 48 | 10 71 | 2 75 | 1 99 | 1 03 | 0 49 | 0 37 | 0 07 | 0 05 |
| 1962 | 54,823,153 | 86 37 | 6 81 | 2 75 | 2 00 | 1 05 | 0 46 | 0 41 | 0 07 | 0 04 |
| 1963 | 64,403,991 | 85 23 | 7 52 | 2 72 | 2 39 | 1 06 | 0 42 | 0 51 | 0 06 | 0 04 |
| 1964 | 72,415,297 | 83 54 | 8 46 | 3 15 | 2 48 | 1 14 | 0 42 | 0 66 | 0 06 | 0 04 |
| 1965 | 89,498,711 | 81 82 | 9 91 | 3 44 | 2 43 | 1 12 | 0 42 | 0 70 | 0 08 | 0 03 |
| 1966 | 123,643,475 | 79 81 | 11 84 | 3 14 | 2 85 | 1 10 | 0 56 | 0 57 | 0 07 | 0 02 |
| 1967 | 162,136,387 | 77 31 | 14 48 | 3 08 | 2 79 | 1 13 | 0 67 | 0 43 | 0 03 | 0 03 |
| 1968 | 197,061,776 | 73 57 | 18 00 | 3 12 | 2 66 | 1 13 | 1 04 | 0 35 | 0 01 | 0 08 |
| 1969 | 176,343,146 | 73 50 | 17 60 | 3 39 | 3 12 | 1 43 | 0 67 | 0 12 | 0 01 | 0 12 |
| 1970 | 131,707,946 | 78 44 | 11 11 | 3 76 | 3 81 | 1 99 | 0 67 | 0 11 | 0 03 | 0 04 |
| 1971 | 186,375,130 | 79 07 | 9 98 | 4 00 | 3 79 | 2 29 | 0 58 | 0 18 | 0 05 | 0 03 |
| 1972 | 205,956,263 | 77 77 | 10 37 | 4 29 | 3 94 | 2 56 | 0 75 | 0 17 | 0 05 | 0 05 |
| 1973 | 178,863,622 | 82 07 | 6 06 | 4 54 | 3 55 | 2 45 | 1 00 | 0 21 | 0 06 | 0 01 |
| 1974 | 118,828,272 | 83 62 | 4 39 | 4 89 | 3 50 | 2 02 | 1 23 | 0 22 | 0 06 | 0 01 |
| 1975 | 157,555,360 | 85 04 | 3 66 | 4 82 | 3 25 | 1 72 | 1 18 | 0 12 | 0 17 | 0 00 |

[1] Dollar Volume for Exchanges includes Stocks, Rights, and Warrants
[2] Others include Intermountain, Spokane, National, and Honolulu Stock Exchanges

## Special Block Distributions

In 1975, the total number of special block distributions declined 3 7 percent. The value of these distributions increased 808 percent to $1.4 billion from $157 million in 1974

Secondary distributions accounted for 64.6 percent of the total number of special block distributions in 1975 and 98.6 percent of the total value of these distributions

The special offering method was employed 14 times accounting for 17.7 percent of the total number of special block distributions in 1975, but with an aggregate value of $11.5 million, these offerings accounted for only 0.8 percent of the value of all special block distributions.

The exchange distribution method was employed 14 times in 1975 The value of exchange distributions was $8 3 million, representing an increase of 22 percent from the 1974 figure.

**Table 18**

**SPECIAL BLOCK DISTRIBUTIONS REPORTED BY EXCHANGES**

(Value in thousands)

| Year | Secondary distributions | | | Exchange distributions | | | Special offerings | | |
|---|---|---|---|---|---|---|---|---|---|
| | Number | Shares sold | Value | Number | Shares sold | Value | Number | Shares sold | Value |
| 1942 | 116 | 2,397,454 | 82,840 | | | | 79 | 812,390 | 22,694 |
| 1943 | 81 | 4,270,580 | 127,462 | | | | 80 | 1,097,338 | 31,054 |
| 1944 | 94 | 4,097,298 | 135,760 | | | | 87 | 1,053,667 | 32,454 |
| 1945 | 115 | 9,457,358 | 191,961 | | | | 79 | 947,231 | 29,878 |
| 1946 | 100 | 6,481,291 | 232,398 | | | | 23 | 308,134 | 11,002 |
| 1947 | 73 | 3,961,572 | 124,671 | | | | 24 | 314,270 | 9,133 |
| 1948 | 95 | 7,302,420 | 175,991 | | | | 21 | 238,879 | 5,466 |
| 1949 | 86 | 3,737,249 | 104,062 | | | | 32 | 500,211 | 10,956 |
| 1950 | 77 | 4,280,681 | 88,743 | | | | 20 | 150,308 | 4,940 |
| 1951 | 88 | 5,193,756 | 146,459 | | | | 27 | 323,013 | 10,751 |
| 1952 | 76 | 4,223,258 | 149,117 | | | | 22 | 357,897 | 9,931 |
| 1953 | 68 | 6,906,017 | 108,229 | | | | 17 | 380,680 | 10,486 |
| 1954 | 84 | 5,738,359 | 218,490 | 57 | 705,781 | 24,664 | 14 | 189,772 | 6,670 |
| 1955 | 116 | 6,756,767 | 344,871 | 19 | 258,348 | 10,211 | 9 | 161,850 | 7,223 |
| 1956 | 146 | 11,696,174 | 520,966 | 17 | 156,481 | 4,645 | 8 | 131,755 | 4,557 |
| 1957 | 99 | 9,324,599 | 339,062 | 33 | 390,832 | 15,855 | 5 | 63,408 | 1,845 |
| 1958 | 122 | 9,508,505 | 361,886 | 38 | 619,876 | 29,454 | 5 | 88,152 | 3,286 |
| 1959 | 148 | 17,330,941 | 822,336 | 28 | 545,038 | 26,491 | 3 | 33,500 | 3,730 |
| 1960 | 92 | 11,439,065 | 424,688 | 20 | 441,644 | 11,108 | 3 | 63,663 | 5,439 |
| 1961 | 130 | 19,910,013 | 926,514 | 33 | 1,127,266 | 58,072 | 2 | 35,000 | 1,504 |
| 1962 | 59 | 12,143,656 | 658,780 | 41 | 2,345,076 | 65,459 | 2 | 48,200 | 588 |
| 1963 | 100 | 18,937,935 | 814,984 | 72 | 2,892,233 | 107,498 | 0 | 0 | 0 |
| 1964 | 110 | 19,462,343 | 909,821 | 68 | 2,553,237 | 97,711 | 0 | 0 | 0 |
| 1965 | 142 | 31,153,319 | 1,603,107 | 57 | 2,334,277 | 86,479 | 0 | 0 | 0 |
| 1966 | 126 | 29,045,038 | 1,523,373 | 52 | 3,042,599 | 118,349 | 0 | 0 | 0 |
| 1967 | 143 | 30,783,604 | 1,154,479 | 51 | 3,452,856 | 125,404 | 0 | 0 | 0 |
| 1968 | 174 | 36,110,489 | 1,571,600 | 35 | 2,669,938 | 93,528 | 1 | 3,352 | 63 |
| 1969 | 142 | 38,224,799 | 1,244,186 | 32 | 1,706,572 | 52,198 | 0 | 0 | 0 |
| 1970 | 72 | 17,830,008 | 504,562 | 35 | 2,066,590 | 48,218 | 0 | 0 | 0 |
| 1971 | 204 | 72,801,243 | 2,007,517 | 30 | 2,595,104 | 65,765 | 0 | 0 | 0 |
| 1972 | 229 | 82,365,749 | 3,216,126 | 26 | 1,469,666 | 30,156 | 0 | 0 | 0 |
| 1973 | 120 | 30,825,890 | 1,151,087 | 19 | 802,322 | 9,140 | 91 | 6,662,111 | 79,889 |
| 1974 | 45 | 7,512,200 | 133,838 | 4 | 82,200 | 6,836 | 33 | 1,921,755 | 16,805 |
| 1975 | 51 | 34,149,069 | 1,409,933 | 14 | 483,846 | 8,300 | 14 | 1,252,925 | 11,521 |

## Value and Number of Securities Listed on Exchanges

The market value of stocks and bonds listed on U S Stock Exchanges at year-end 1975 was $1,038 billion, an increase of 31 percent from the previous year-end figure of $795 billion The total was comprised of $719 billion in stocks and $319 billion in bonds. The value of listed stocks increased by 34 percent in 1975 and the value of listed bonds increased 24 percent Stocks with primary listing on the New York Stock Exchange were valued at $685 billion and represented 95 percent of the common and preferred stock listed on all U.S stock exchanges. The value of NYSE listed stocks increased from their 1974 year-end total by $174 billion or 34 percent Stocks with primary listing on the AMEX accounted for 4 percent of the total and were valued at $29 4 billion The value of AMEX stocks increased $6 billion or 26 percent in 1975 Stocks with primary listing on all other exchanges were valued at $4.2 billion and increased 45 percent over the 1974 total.

The net number of stocks and bonds listed on exchanges increased by 139 issues or 2 percent in 1975. The largest gain was recorded on the NYSE, where listings increased by 283 issues.

**Table 19**

**SECURITIES LISTED ON EXCHANGES[1]**

(December 31, 1975

| Exchange | Common | | Preferred | | Bonds | | Total Securities | |
|---|---|---|---|---|---|---|---|---|
| | Number | Market Value (Millions) | Number | Market Value (Millions) | Number | Market Value (Millions) | Number | Market Value (Millions) |
| *Registered* | | | | | | | | |
| American | 1 181 | $ 27,937 | 86 | $ 1,429 | 197 | $ 2,999 | 1,464 | $ 32,365 |
| Boston | 88 | 268 | 3 | 2 | 1 | 1 | 92 | 271 |
| Cincinnati | 6 | 15 | 3 | 6 | 7 | 64 | 16 | 85 |
| Detroit (estimated) | 5 | 17 | 1 | * | 0 | 0 | 6 | 17 |
| Midwest | 27 | 324 | 8 | 79 | 1 | 1 | 36 | 404 |
| New York | 1,531 | 663,127 | 580 | 21,983 | 2,632 | 315,405 | 4,743 | 1,000,515 |
| Pacific | 55 | 1 691 | 9 | 606 | 21 | 396 | 85 | 2,693 |
| Philadelphia | 24 | 113 | 97 | 704 | 3 | 5 | 124 | 822 |
| Intermountain | 33 | 19 | 0 | 0 | 0 | 0 | 33 | 19 |
| Spokane | 27 | 2 | 0 | 0 | 0 | 0 | 27 | 2 |
| *Exempted* | | | | | | | | |
| Honolulu | 18 | 368 | 7 | 7 | 3 | 5 | 28 | 380 |
| Total | 2,995 | 693,881 | 794 | 24 816 | 2,865 | 318,876 | 6,654 | 1 037 573 |
| *Includes the following foreign stocks* | | | | | | | | |
| New York | 32 | 14 171 | 2 | 10 | 158 | 3,384 | 192 | 17 565 |
| American | 70 | 10 670 | 1 | 13 | 6 | N A | 77 | 10,683 |
| Pacific | 3 | 304 | 1 | 507 | 0 | 0 | 4 | 811 |
| Honolulu | 2 | 21 | 0 | 0 | 0 | 0 | 2 | 21 |
| Total | 107 | 25 166 | 4 | 530 | 164 | 3 384 | 275 | 29,080 |

[1] Excludes securities which were suspended from trading at the end of the year, and securities which because of inactivity had no available quotes

* Less than 5 million but greater than zero

## Table 20

## VALUE OF STOCKS LISTED ON EXCHANGES

(Dollars in billions)

| Dec 31 | New York Stock Exchange | American Stock Exchange | Exclusively on Other Exchanges | Total |
|---|---|---|---|---|
| 1936 | 59 9 | 14 8 | | 74 7 |
| 1937 | 38 9 | 10 2 | | 49 1 |
| 1938 | 47 5 | 10 8 | | 58 3 |
| 1939 | 46 5 | 10 1 | | 56 6 |
| 1940 | 41 9 | 8 6 | | 50 5 |
| 1941 | 35 8 | 7 4 | | 43 2 |
| 1942 | 38 8 | 7 8 | | 46 6 |
| 1943 | 47 6 | 9 9 | | 57 5 |
| 1944 | 55 5 | 11 2 | | 66 7 |
| 1945 | 73 8 | 14 4 | | 88 2 |
| 1946 | 68 6 | 13 2 | | 81 8 |
| 1947 | 68 3 | 12 1 | | 80 4 |
| 1948 | 67 0 | 11 9 | 3 0 | 81 9 |
| 1949 | 76 3 | 12 2 | 3 1 | 91 6 |
| 1950 | 93 8 | 13 9 | 3 3 | 111 0 |
| 1951 | 109 5 | 16 5 | 3 2 | 129 2 |
| 1952 | 120 5 | 16 9 | 3 1 | 140 5 |
| 1953 | 117 3 | 15 3 | 2 8 | 135 4 |
| 1954 | 169 1 | 22 1 | 3 6 | 194 8 |
| 1955 | 207 7 | 27 1 | 4 0 | 238 8 |
| 1956 | 219 2 | 31 0 | 3 8 | 254 0 |
| 1957 | 195 6 | 25 5 | 3 1 | 224 2 |
| 1958 | 276 7 | 31 7 | 4 3 | 312 7 |
| 1959 | 307 7 | 25 4 | 4 2 | 337 3 |
| 1960 | 307 0 | 24 2 | 4 1 | 335 3 |
| 1961 | 387 8 | 33 0 | 5 3 | 426 1 |
| 1962 | 345 8 | 24 4 | 4 0 | 374 2 |
| 1963 | 411 3 | 26 1 | 4 3 | 441 7 |
| 1964 | 474 3 | 28 2 | 4 3 | 506 8 |
| 1965 | 537 5 | 30 9 | 4 7 | 573 1 |
| 1966 | 482 5 | 27 9 | 4 0 | 514 4 |
| 1967 | 605 8 | 43 0 | 3 9 | 652 7 |
| 1968 | 692 3 | 61 2 | 6 0 | 759 5 |
| 1969 | 629 5 | 47 7 | 5 4 | 682 6 |
| 1970 | 636 4 | 39 5 | 4 8 | 680 7 |
| 1971 | 741 8 | 49 1 | 4 7 | 795 6 |
| 1972 | 871 5 | 55 6 | 5 6 | 932 7 |
| 1973 | 721 0 | 38 7 | 4 1 | 763 8 |
| 1974 | 511 1 | 23 3 | 2 9 | 537 3 |
| 1975 | 685 1 | 29 3 | 4 3 | 718 7 |

## Securities on Exchanges

As of June 30, 1976, a total of 6,764 securities, representing 3,377 issuers, were admitted to trading on securities exchanges in the United States. This compares with 6,559 issues, involving 3,404 issuers, a year earlier. Over 4,700 issues were listed and registered on the New York Stock Exchange, accounting for 55.2 percent of the stock issues and 90 percent of the bond issues. Data below on "Securities Traded on Exchanges" involves some duplication since it includes both solely and dually listed securities

**Table 21**

**SECURITIES TRADED ON EXCHANGES**

| | Issuers | Stocks | | | | Bonds[1] |
|---|---|---|---|---|---|---|
| | | Registered | Temporarily exempted | Unlisted | Total | |
| American | 1,257 | 1,269 | 1 | 43 | 1,313 | 205 |
| Boston | 848 | 145 | | 760 | 905 | 16 |
| Chicago Board Options | 1 | 1 | | | 1 | |
| Chicago Board of Trade | 3 | 1 | | 2 | 3 | |
| Cincinnati | 345 | 37 | | 320 | 357 | 14 |
| Detroit | 373 | 79 | | 315 | 394 | |
| Honolulu[2] | 35 | | | | 44 | 5 |
| Intermountain | 53 | 51 | | 2 | 53 | |
| Midwest | 626 | 361 | 1 | 347 | 709 | 28 |
| New York | 1,890 | 2,158 | 3 | | 2 161 | 2 574 |
| Pacific Coast | 855 | 849 | 1 | 179 | 1,029 | 92 |
| PBS | 946 | 308 | | 822 | 1,130 | 63 |
| Spokane | 37 | 35 | | 5 | 40 | |

[1] Issues exempted under Section 3(a)(12) of the Act, such as obligations of U S Government, the states, and cities, are not included in this table

[2] Exempted exchange had 38 listed stocks and 6 admitted to unlisted trading

**Table 22**

**UNDUPLICATED COUNT OF SECURITIES ON EXCHANGES**

(June 30, 1976)

| Registered exchanges | Stocks | Bonds | Total | Issuers involved |
|---|---|---|---|---|
| Registered and Listed | 3,840 | 2,833 | 6,673 | 3,324 |
| Temporarily exempted from registration | 3 | 2 | 5 | 2 |
| Admitted to unlisted trading privileges | 39 | 14 | 53 | 30 |
| Exempted exchanges | | | | |
| Listed | 22 | 5 | 27 | 15 |
| Admitted to unlisted trading privileges | 6 | 0 | 6 | 6 |
| Total | 3,910 | 2,854 | 6,764 | 3,377 |

## 1933 ACT REGISTRATIONS

### Effective Registrations Statements Filed

During fiscal year 1976, 2,813 securities registration statements valued at $88 billion became effective. While the number of effective registrations rose only one percent from fiscal 1975, the dollar value increased 13 percent.

Although there were 2,976 registration statements filed in fiscal 1976 as compared with 2,912 filed in the previous year—a slight rise of 2 percent—the dollar value rose from $80 billion to $86 billion. Among these statements, there were 540 first-time registrants in fiscal 1976 as compared with 507 in fiscal 1975.

### Purpose of Registration

Effective registrations for cash sale for the account of issuers amounted to $70 billion, remaining at the same level as the previous

year In this category there were substantial differences in distribution as between equity and debt offerings; i e , equity offerings increased from $33 billion to $40 billion in fiscal 1976—a 23 percent rise—and debt offerings declined from $38 billion to $29 billion—a 22 percent decline

Among the securities registered for cash sale, almost all debt issues were for immediate offerings, whereas nearly three-fourths of the equity registrations were for extended cash sale. Registration of extended offerings totaled $28 9 billion with investment companies accounting for $18.8 billion and employee plans $9 1 billion Corporate equity registrations accounted for 29 percent of immediate cash sale registrations, up 39 percent from fiscal 1975

Securities registered for the account of the issuer for other than cash sale are primarily common stock issues relating to exchange offers, mergers and consolidations In fiscal 1976 common stock effectively registered for this purpose totaled $11 billion, an increase of nearly three and one half times over the previous year

Registrations for the purpose of secondary offerings (proceeds going to selling security holders) typically concern sales of common stock In fiscal 1976 these registrations amounted to $2 1 billion, representing a 64 percent increase from fiscal 1975

**Table 23**

**EFFECTIVE REGISTRATIONS**

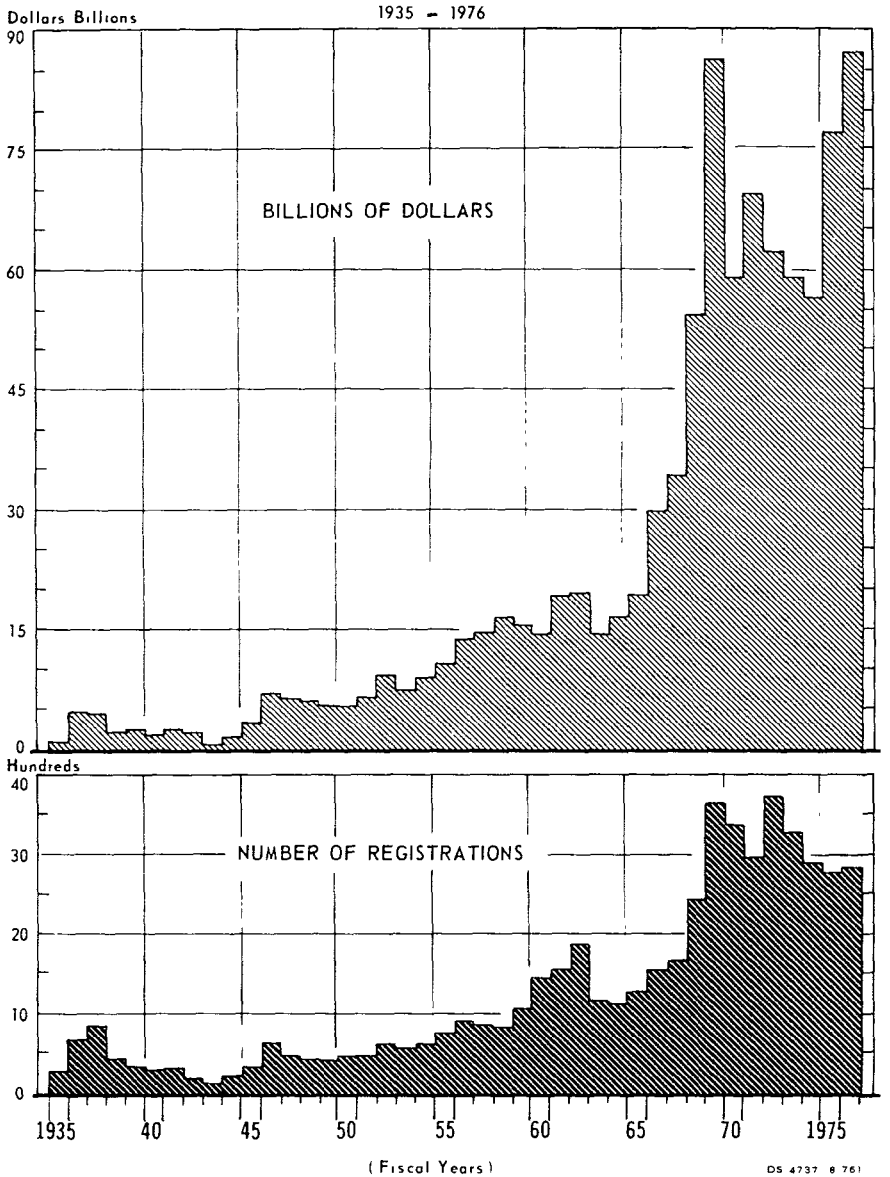
(Dollars in millions)

| Fiscal year ended June 30 | Total | | Cash sale for account of issuers | | | |
|---|---|---|---|---|---|---|
| | Number | Value | Common stock | Bonds, debentures, and notes | Preferred stock | Total |
| 1935[1] | 284 | $ 913 | $ 168 | $ 490 | $ 28 | $ 686 |
| 1936 | 689 | 4,835 | 531 | 3,153 | 252 | 3,936 |
| 1937 | 840 | 4,851 | 802 | 2 426 | 406 | 3 635 |
| 1938 | 412 | 2 101 | 474 | 666 | 209 | 1,349 |
| 1939 | 344 | 2,579 | 318 | 1,593 | 109 | 2 020 |
| 1940 | 306 | 1 787 | 210 | 1,112 | 110 | 1,433 |
| 1941 | 313 | 2,611 | 196 | 1,721 | 164 | 2,081 |
| 1942 | 193 | 2 003 | 263 | 1,041 | 162 | 1,465 |
| 1943 | 123 | 659 | 137 | 316 | 32 | 486 |
| 1944 | 221 | 1 760 | 272 | 732 | 343 | 1,347 |
| 1945 | 340 | 3,225 | 456 | 1,851 | 407 | 2,715 |
| 1946 | 661 | 7,073 | 1,331 | 3,102 | 991 | 5,424 |
| 1947 | 493 | 6,732 | 1,150 | 2,937 | 787 | 4,874 |
| 1948 | 435 | 6,405 | 1 678 | 2 817 | 537 | 5 032 |
| 1949 | 429 | 5,333 | 1 083 | 2 795 | 326 | 4,204 |
| 1950 | 487 | 5 307 | 1 786 | 2 127 | 468 | 4,381 |
| 1951 | 487 | 6 459 | 1,904 | 2,838 | 427 | 5 169 |
| 1952 | 635 | 9 500 | 3,332 | 3 346 | 851 | 7,529 |
| 1953 | 593 | 7,507 | 2,808 | 3,093 | 424 | 6 326 |
| 1954 | 631 | 9 174 | 2,610 | 6,240 | 531 | 7 381 |
| 1955 | 779 | 10 960 | 3,864 | 3 951 | 462 | 8 277 |
| 1956 | 906 | 13,096 | 4,544 | 4,123 | 539 | 9 206 |
| 1957 | 876 | 14,624 | 5,858 | 5,689 | 472 | 12 019 |
| 1958 | 813 | 16 490 | 5,998 | 6,857 | 427 | 13 281 |
| 1959 | 1 070 | 15 657 | 6,387 | 5 265 | 443 | 12 095 |
| 1960 | 1,426 | 14,367 | 7,260 | 4,224 | 253 | 11 738 |
| 1961 | 1,550 | 19 070 | 9,850 | 6,162 | 248 | 16,260 |
| 1962 | 1,844 | 19,547 | 11,521 | 4,512 | 253 | 16 286 |
| 1963 | 1 157 | 14,790 | 7,227 | 4,372 | 270 | 11,869 |
| 1964 | 1,121 | 16 860 | 10,006 | 4,554 | 224 | 14,784 |
| 1965 | 1,266 | 19 437 | 10,638 | 3 710 | 307 | 14,656 |
| 1966 | 1 523 | 30 109 | 18,218 | 7 061 | 444 | 25,723 |
| 1967 | 1,649 | 34,218 | 15 083 | 12,309 | 558 | 27,950 |
| 1968 | [2]2,417 | [2]54 076 | 22,092 | 14 036 | 1 140 | 37,269 |
| 1969 | [2]3 645 | [2]86,810 | 39,614 | 11 674 | 751 | 52,039 |
| 1970 | [2]3 389 | [2]59 137 | 28,939 | 18,436 | 823 | 48 198 |
| 1971 | [2]2 989 | [2]69,562 | 27 455 | 27 637 | 3 360 | 58,452 |
| 1972 | 3 712 | 62,487 | 26,518 | 20,127 | 3 237 | 49 882 |
| 1973 | 3 285 | 59,310 | 26,615 | 14,841 | 2 578 | 44 034 |
| 1974 | 2 890 | 56,924 | 19,811 | 20,997 | 2 274 | 43,082 |
| 1975 | 2 780 | 77 457 | 30,502 | 37,557 | 2,201 | 70 260 |
| 1976 | [2]2 813 | [2]87 733 | 37 115 | 29,373 | 3 013 | 69,502 |
| Cumulative total | 52,816 | 943 535 | 396 624 | 309,863 | 31,841 | 738 335 |

[1] For 10 months ended June 30, 1935

[2] Includes registered lease obligations related to industrial revenue bonds

## SECURITIES EFFECTIVELY REGISTERED WITH S.E.C.



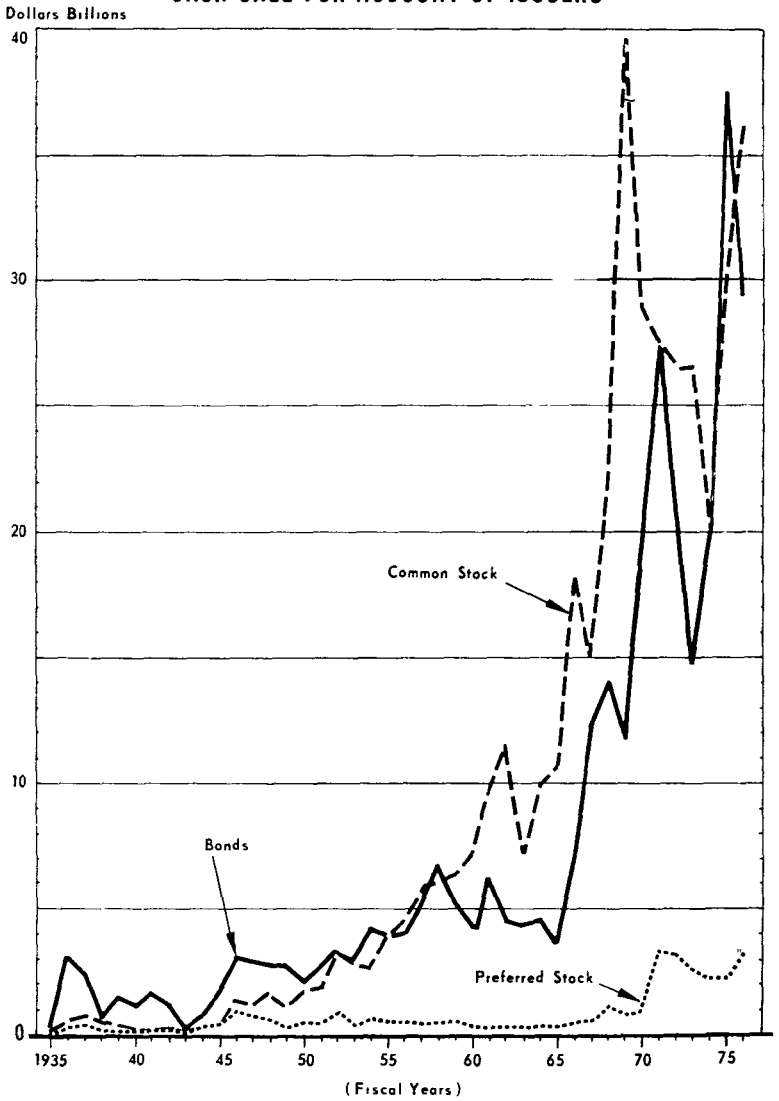
## Table 24

## EFFECTIVE REGISTRATIONS BY PURPOSE AND TYPE OF SECURITY: FISCAL 1976

(Dollars in millions)

| Purpose of registrations | Total | Type of securitl | | |
|---|---|---|---|---|
| | | Bonds, debentures, and notes | Preferred stock | Common stock |
| All registrations (estimated value) | 87,726 | 30,954 | 3,573 | 53,200 |
| For account of issuer for cash sales | 69,502 | 29,373 | 3,013 | 37 115 |
| Immediate offering | 40,522 | 28,969 | 3,010 | 8,543 |
| Corporate | 36,949 | 25,396 | 3,010 | 8,543 |
| Offered to | | | | |
| General public | 36,284 | 25,388 | 2,965 | 7,932 |
| Security holders | 664 | 8 | 45 | 611 |
| Foreign governments | 3,573 | 3,573 | 0 | 0 |
| Extended cash sale and other issues | 28,980 | 404 | 4 | 28,572 |
| For account of issuer for other than cash sale | 16,136 | 1 510 | 547 | 14,079 |
| Secondary offerings | 2,089 | 71 | 12 | 2,006 |
| Cash sale | 973 | 30 | 0 | 943 |
| Other | 1,116 | 40 | 12 | 1,063 |

## EFFECTIVE REGISTRATIONS
## CASH SALE FOR ACCOUNT OF ISSUERS



## Regulation & Offerings

During fiscal year 1976, 240 notifications were filed for proposed offerings under Regulation A Issues between $400.00 and $500 00 in size predominated

**Table 25**

**OFFERINGS UNDER REGULATION A**

| | Fiscal Year | | |
|---|---|---|---|
| | 1976 | 1975 | 1974 |
| Size | | | |
| $100,000 or less | 24 | 28 | 40 |
| $100,000–$200,000 | 36 | 42 | 79 |
| $200,000–$300,000 | 27 | 39 | 66 |
| $300,000–$400,000 | 39 | 24 | 39 |
| $400,000–$500,000 | 114 | 132 | 214 |
| Total | 240 | 265 | 438 |
| Underwriters | | | |
| Used | 37 | 44 | 115 |
| Not Used | 203 | 221 | 323 |
| Total | 240 | 265 | 438 |
| Offerors | | | |
| Issuing companies | 222 | 227 | 394 |
| Stockholders | 12 | 7 | 34 |
| Issuers and Stockholders jointly | 6 | 31 | 10 |
| Total | 240 | 265 | 438 |

# ENFORCEMENT

## Types of Proceedings

As the table below reflects, the securities laws provide for a wide range of enforcement actions by the Commission. The most common types of actions are injunctive proceedings instituted in the Federal district courts to enjoin continued or threatened securities law violators, and administrative proceedings pertaining to broker-dealer firms and/or individuals associated with such firms which may lead to various remedial sanctions as required in the public interest. When an injunction is entered by a court, violation of the court's decree is a basis for criminal contempt action against the violator

## Table 26

## TYPES OF PROCEEDINGS

I ADMINISTRATIVE PROCEEDINGS

| Basis for enforcement action | Sanction or relief |
|---|---|
| **Broker-dealer, investment adviser or associated person** | |
| Willful violation of securities acts provision or rule, aiding or abetting of such violation, failure reasonably to supervise others, willful misstatement in filing with Commission, conviction of or injunction against certain securities, or securities-related, violations | Revocation, suspension, or denial of broker-dealer or investment adviser registration, or censure of broker-dealer or investment adviser (1934 act, sec 15(b)(5), Advisers Act, sec 203(d)) |
| **Member of registered securities association** | |
| Violation of 1934 Act or rule thereunder, willful violation of 1933 act or rule thereunder | Expulsion or suspension from association (1934 act, sec 15A(1)(2)) |
| **Member of national securities exchange** | |
| Violation of 1934 act or rule thereunder | Expulsion or suspension from exchange (1934 act, sec 19(a)(3)) |
| **Any person** | |
| Same as first item | Bar or suspension from association with a broker-dealer or investment adviser, or censure (1934 act, sec 15(b)(7), Adviser Act, sec 203(f)) |
| Violation of 1934 act or rule thereunder, willful violation of 1933 act or rule thereunder | Bar or suspension from association with member of registered securities association (1934 act, sec 15A(1)(2)) |
| Willful violation of securities acts provision or rule aiding or abetting of such violation, willful misstatement in filing with Commission | Prohibition, permanently or temporarily, from serving in certain capacities for a registered investment company (Investment Co Act, sec 9(b)) |
| **Principal of broker-dealer** | |
| Appointment of SIPC trustee for broker-dealer | Bar or suspension from association with a broker-dealer (Securities Investor Protection Act, sec 10(b)) |
| **Registered securities association** | |
| Rules do not conform to statutory requirements | Suspension of registration (1934 act, sec 15A(b)) |
| Violation of 1934 act or rule thereunder, failure to enforce compliance with own rules, engaging in activity tending to defeat purposes of provision of 1934 act authorizing national securities associations | Revocation or suspension of registration (1934 act, sec 15A(1)(1)) |
| **National securities exchange** | |
| Violation of 1934 act or rule thereunder, failure to enforce compliance therewith by member of | Withdrawal or suspension of registration (1934 act, sec 19(a)(1)) |
| **Officer or director of registered securities association** | |
| Willful failure to enforce association rules or willful abuse of authority | Removal from office (1934 act, sec 15(A)(1)(3)) |
| **Officer of national securities exchange** | |
| Violation of 1934 act or rule thereunder | Expulsion or suspension from exchange (1934 act, sec 19(a)(3)) |
| **1933 Act registration statement** | |
| Statement materially inaccurate or incomplete | Stop order suspending effectiveness (1933 act, sec 8(d)) |
| Investment company has not attained $100,000 net worth 90 days after statement became effective | Stop order (Investment Co Act, sec 14(a)) |
| **1934 Act reporting requirements** | |
| Material noncompliance | Order directing compliance (1934 act, sec 15(c)(4)) |
| **Securities issue** | |
| Noncompliance by issuer with 1934 act or rules thereunder | Denial, suspension of effective date, suspension or withdrawal of registration on national securities exchange (1934 act, sec 19(a)(2)) |
| Public interest requires trading suspension | Summary suspension of over-the-counter or exchange trading (1934 act, secs 15(c)(5) and 19(a)(4)) |

## Table 25—Continued

| Basis for enforcement action | Sanction or relief |
|---|---|
| **Registered investment company** | |
| Failure to file 1940 act registration statement or required report, filing materially incomplete or misleading statement or report | Revocation or suspension of registration (Investment Co Act, sec 8(e)) |
| Company has not attained $100,000 net worth 90 days after 1933 act registration statement became effective | Revocation or suspension of registration (Investment Co Act, sec 14(a)) |
| Name of company, or of security issued by it, deceptive or misleading | Prohibition of adoption of such name (Investment Co Act, sec 35(d)) |
| **Attorney, accountant, or other professional or expert** | |
| Lack of requisite qualifications to represent others, lacking in character or integrity, unethical or improper professional conduct, willful violation of securities laws or rules, or aiding and abetting of such violation | Permanent or temporary denial of privilege to appear or practice before Commission (Rules of Practice, Rule 2(e)(1)) |
| Attorney suspended or disbarred by court, expert's license revoked or suspended conviction of felony or misdemeanor involving moral turpitude | Automatic suspension from appearance or practice before Commission (Rules of Practice, Rule 2(e)(2)) |
| Permanent injunction or finding of violation in Commission—instituted action, finding of violation by Commission in administrative proceeding | Temporary suspension from appearance or practice before Commission (Rules of Practice, Rule 2(e)(3)) |

## Table 25—Continued

II CIVIL PROCEEDINGS IN FEDERAL DISTRICT COURTS

| Basis for enforcement action | Sanction or relief |
|---|---|
| **Any person** | |
| Person engaging or about to engage in acts or practices violating securities acts or rules thereunder | Injunction against acts or practices which constitute or would constitute violations (plus ancillary relief under court's general equity powers) (1933 act, sec 20(b), 1934 act, sec 21(e), 1935 act, sec 18(f), Investment Co Act, sec 42(e), Advisers Act, sec 209(e)) |
| Noncompliance with provisions of law, rule, or regulation under 1935 act, order issued by Commission, or undertaking in a registration statement | Writ of mandamus directing compliance (1933 act, sec 20(c), 1934 act, sec 21(f), 1935 act, sec 18(g)) |
| **Issuer subject to reporting requirements** | |
| Failure to file reports required under section 15(d) of 1934 act | Forfeiture of $100 per day (1934 act, sec 32(b)) |
| **Registered investment company or affiliate** | |
| Name of company or of security issued by it deceptive or misleading | Injunction against use of name (Investment Co Act, sec 35(d)) |
| Officer, director, adviser, or underwriter engaging or about to engage in act or practice constituting breach of fiduciary duty involving personal misconduct | Injunction against acting in certain capacities for investment company (Investment Co Act, sec 36(a)) |
| Breach of fiduciary duty respecting receipt of compensation from investment company, by any person having such duty | Award of damages (Investment Co Act, sec 36(b) |

III REFERRAL TO ATTORNEY GENERAL FOR CRIMINAL PROSECUTION

| Basis for enforcement action | Sanction or relief |
|---|---|
| **Any person** | |
| Willful violation of securities acts or rules thereunder | Maximum penalties $5,000 fine and 5 years' imprisonment under 1933 and 1939 acts, $10,000 fine and 2 years' imprisonment under other acts An exchange may be fined up to $500,000, a public-utility holding company up to $200,000 (1933 act, secs 20(b), 24, 1934 act, secs 21(e), 32(a), 1935 act, secs 18(f), 29, 1939 act, sec 325, Investment Co Act, secs 42(e), 49, Advisers Act, secs 209(e), 217 ) |

**Table 27**

**INVESTIGATIONS OF POSSIBLE VIOLATIONS OF THE ACTS ADMINISTERED BY THE COMMISSION**

| | |
|---|---|
| Pending June 30, 1975 | 1,288 |
| Opened | 413 |
| Total for Distribution | 1,701 |
| Closed | 447 |
| Pending June 30, 1976 | 1,254 |

During the fiscal year ending June 30, 1976, 273 formal orders were issued by the Commission upon recommendation of the Division of Enforcement

**Table 28**

**ADMINISTRATIVE PROCEEDINGS INSTITUTED DURING FISCAL YEAR ENDING JUNE 30, 1976**

| | |
|---|---|
| Broker Dealer Proceedings | 77 |
| Investment Adviser Proceedings | 17 |
| Stop Order, Reg A Suspension and Other Discloseure Cases | 35 |

## Injunctive Actions. 1975–1976

During fiscal 1976, 158 suits for injuctions and 17 miscellaneous actions were instituted in the United States district courts by the Commission, and 14 district court proceedings were brought against the Commission Eighteen appellate cases involving petitions for review of Commission decisions, 10 appeals in reorganization matters and 61 appeals in injunction and miscellaneous cases were filed SEC participated as Intervenor in 1 case and filed 11 amicus curiae briefs in 11 cases

During fiscal 1976, the Commission referred to the Department of Justice 116 criminal reference reports (This figure includes 7 criminal contempt actions )

**Table 29**

**INJUNCTIVE ACTIONS**

| Fiscal Year | Cases instituted | Injunctions ordered | Defendants enjoined |
|---|---|---|---|
| 1967 | 68 | 56 | 189 |
| 1968 | 93 | 98 | 384 |
| 1969 | 94 | 102 | 509 |
| 1970 | 111 | 97 | 448 |
| 1971 | 140 | 114 | 495 |
| 1972 | 119 | 113 | 511 |
| 1973 | 178 | 145 | 654 |
| 1974 | 148 | 289 | 613 |
| 1975 | 174 | 453 | 749 |
| 1976 | 158 | 435 | 722 |

## Criminal Proceedings

During the past fiscal year 116 cases were referred to the Department of Justice for prosecution (This figure includes 7 criminal contempt actions.) As a result of these and prior referrals, 23 indictments were returned against 118 defendants during the fiscal year There were also 97 convictions in 24 cases Convictions were affirmed in 17 cases that had been appealed, and appeals were still pending in 10 other criminal cases at the close of the period Of 24 defendants in 21 criminal contempt cases handled during the year, 6 defendants were convicted, prosecution was declined as to 2 defendants, and 8 defendants in 8 cases are still pending Eighteen cases are pending in a Suspense Category (This figure includes 1 criminal contempt case )

**Table 30**

**CRIMINAL CASES**

| Fiscal year | Number of cases referred to justice Dept | Number of indictments | Defendants indicted | Convictions |
|---|---|---|---|---|
| 1967 | 44 | 53 | 213 | 127 |
| 1968 | 40 | 42 | 123 | 84 |
| 1969 | 37 | 64 | 213 | 83 |
| 1970 | 35 | 36 | 102 | 55 |
| 1971 | 22 | 16 | 83 | 89 |
| 1972 | 38 | 28 | 67 | 75 |
| 1973 | 49 | 40 | 178 | 83 |
| 1974 | 67 | 40 | 169 | 81 |
| 1975 | 88 | 53 | 199 | 116 |
| 1976 | 116 | 23 | 118 | 97 |

## List of All Foreign Corporations on the Foreign Restricted List

The complete list of all foreign corporations and other foreign entities on the Foreign Restricted List on June 30, 1975, is as follows.

Aguacate Consolidated Mines, Incorporated (Costa Rica)
Alan MacTavish, Ltd. (England)
Allegheny Mining and Exploration Company, Ltd (Canada)
Allied Fund for Capital Appreciation (AFCA, S. A.) (Panama)
Amalgamated Rare Earth Mines, Ltd (Canada)
American Industrial Research S A., also known as Investigacion Industrial Americana, S A. (Mexico)
American International Mining (Bahamas)
American Mobile Telephone and Tape Co , Ltd (Canada)
Antel International Corporation, Ltd (Canada)
Antoine Silver Mines, Ltd (Canada)
ASCA Enterprisers Limited (Hong Kong)
Atholl Brose (Exports) Ltd (England)
Atholl Brose, Ltd (England)
Atlantic and Pacific Bank and Trust Co , Ltd (Bahamas)
Banco de Guadalajara (Mexico)
Bank of Sark (United Kingdom)
Briar Court Mines, Ltd (Canada)
British Overseas Mutual Fund Corporation Ltd (Canada)
California & Caracas Mining Corp , Ltd (Canada)
Canterra Development Corporation, Ltd (Canada)
Cardwell Oil Corporation, Ltd (Canada)
Caribbean Empire Company, Ltd (British Honduras)
Caye Chapel Club, Ltd (British Honduras)
Central and Southern Industries Corp (Panama)
Cerro Azul Coffee Plantation (Panama)
Cia Rio Banano, S.A (Costa Rica)
City Bank A S (Denmark)
Claw Lake Holybdenum Mines, Ltd (Canada)
Claravella Corporation (Costa Rica)
Compressed Air Corporation, Limited (Bahamas)
Continental and Southern Industries, S.A (Panama)
Credito Mineroy Mercantil (Mexico)
Crossroads Corporation, S A. (Panama)
Darien Exploration Company, S.A (Panama)
Derkglen, Ltd (England)
De Veers Consolidated Mining Corporation, S A (Panama)
Doncannon Spirits, Ltd (Bahamas)
Durman, Ltd , formerly known as Bankers International Investment Corporation (Bahamas)
Ethel Copper Mines, Ltd (Canada)
Euroforeign Banking Corporation, Ltd (Panama)
Financiera Comermex (Mexico)
Financiera de Eomento Industrial (Mexico)
Financiera Metropolitana (Mexico)
Finansbanken a/s (Denmark)
First Liberty Fund, Ltd. (Bahamas)
Global Explorations, Inc (Panama)
Global Insurance Company, Limited (British West Indies)
Globus Anlage-Vermittlungsgesellschaft MBH (Germany)

Golden Age Mines, Ltd (Canada)
Hebilla Mining Corporation (Costa Rica)
Hemisphere Land Corporation Limited (Bahamas)
Henry Ost & Son, Ltd (England)
International Communications Corporation (British West Indies)
Ironco Mining & Smelting Company, Ltd (Canada)
James G Allan & Sons (Scotland)
J P Morgan & Company, Ltd., of London, England (not to be confused with J P Morgan & Co , Incorporated, New York)
Jupiter Explorations, Ltd (Canada)
Kenilworth Mines, Ltd. (Canada)
Klondike Yukon Mining Company (Canada)
Kokanee Moly Mines, Ltd. (Canada)
Land Sales Corporation (Canada)
Los Dos Hermanos, S A (Spain)
Lynbar Mining Corp., Ltd (Canada)
Norart Minerals Limited (Canada)
Normandie Trust Company, S.A (Panama)
Northern Survey (Canada)
Northern Trust Company, S.A (Switzerland)
Northland Minerals, Ltd. (Canada)
Obsco Corporation, Ltd (Canada)
Pacific Northwest Developments, Ltd (Canada)
Panamerican Bank & Trust Company (Panama)
Paulpic Gold Mines, Ltd (Canada)
Pyrotex Mining and Exploration Co , Ltd (Canada)
Radio Hill Mines Co , Ltd (Canada)
Rodney Gold Mines Limited (Canada)
Royal Greyhound and Turf Holdings Limited (South Africa)
S A Valles & Co , Inc (Phillipines)
San Salvador Savings & Loan Co , Ltd (Bahamas)
Santack Mines Limited (Canada)
Security Capital Fiscal & Guaranty Corporation, S A. (Panama)
Silver Stack Mines, Ltd. (Canada)
Societe Anonyme de Refinancement (Switzerland)
Strathmore Distillery Company, Ltd (Scotland)
Strathross Blending Company Limited (England)
Swiss Caribbean Development & Finance Corporation (Switzerland)
Tam O'Shanter, Ltd (Switzerland)
Timberland (Canada)
Trans-American Investments, Limited (Canada)
Trihope Resources, Ltd (Canada)
Trust Company of Jamaica, Ltd. (West Indies)
United Mining and Milling Corporation (Bahamas)
Unitrust Limited (Ireland)
Vactionland (Canada)
Valores de Inversion, S.A. (Mexico)
Victoria Oriente, Inc. (Panama)
Warden Walker Worldwide Investment Co. (England)
Wee Gee Uranium Mines, Ltd. (Canada)
Western International Explorations, Ltd (Bahamas)
Yukon Wolverine Mining Company (Canada)

## PUBLIC UTILITY HOLDING COMPANIES

### Assets

At fiscal year end there were 18 active holding comapnies registered under the 1935 Public Utility Holding Company Act. The 15 Active holding company systems in which those companies are included represent a total of 165 companies. Aggregate consolidated assets, less valuation reserves, approximated $38 4 billion at December 31, 1975

## Table 31

## PUBLIC-UTILITY HOLDING COMPANY SYSTEMS

| | Solely Registered Holding Companies | Registered Holding Operating Companies | Electric &/or Gas Utility Subsidiaries | Non-utility Subsidiaries | Inactive Companies | Total Companies | Aggregate System Assets, Less Valuation Reserves, at December 31, 1975* |
|---|---|---|---|---|---|---|---|
| Allegheny Power System, Inc | 1 | 2 | 1 | 4 | 0 | 8 | $1,903 054,000 |
| American Electric Power Company, Inc | 1 | 0 | 9 | 17 | 2 | 29 | 6,408,281,000 |
| Central & Southwest Corporation | 1 | 1 | 3 | 2 | 1 | 8 | 1,982,294,000 |
| Columbia Gas System, Inc , The | 1 | 0 | 8 | 11 | 0 | 20 | 3,202,660,000 |
| Consolidated Natural Gas Company | 1 | 0 | 5 | 5 | 0 | 11 | 1,798,353,000 |
| Delmarva Power & Light Company | 0 | 1 | 2 | 1 | 0 | 4 | 934,724,000 |
| Eastern Utilities Associates | 1 | 0 | 4 | 1 | 2 | 8 | 279,776,000 |
| General Public Utilities Corporation | 1 | 0 | 5 | 3 | 1 | 10 | 3,631,979,000 |
| Middle South Utilities, Inc | 1 | 0 | 6 | 4 | 3 | 14 | 3,634,623,000 |
| National Fuel Gas Company | 1 | 0 | 1 | 3 | 0 | 5 | 448,000,000 |
| New England Electric System | 1 | 0 | 4 | 2 | 0 | 7 | 1,640,387,000 |
| Northeast Utilities | 1 | 0 | 5 | 8 | 6 | 20 | 2,741,950,000 |
| Ohio Edison Company | 0 | 1 | 1 | 0 | 0 | 2 | 2,048,144,000 |
| Philadelphia Electric Power Company | 0 | 1 | 1 | 0 | 1 | 3 | 58,379,000 |
| Southern Company, The | 1 | 0 | 5 | 2 | 0 | 8 | 7,237,003,000 |
| Subtotals | 12 | 6 | 60 | 63 | 16 | 157 | $37,949,607,000 |
| Adjustments (a) to take account of jointly-owned companies, (b) to add net assets of eight jointly-owned companies not included above** | 0 | 0 | (a)+8 | 0 | 0 | (a)+8 | 429,438,000 |
| Total companies and assets in active systems | 12 | 6 | 68 | 63 | 16 | 165 | $38,379,045,000 |

* Represents the consolidated assets, less valuation reserves, of each of system as reported to the Commission on Form U5S for the year 1975 The figures for National Fuel Gas Company are as at September 30, 1975

** These eight companies are Beechbottom Power Company, Inc which is an indirect subsidiary of American Electric Power Company, Inc and Allegheny Power System, Inc , Ohio Valley Electric Corporation and its subsidiary, Indiana-Kentucky Electric Corporation, which are owned 37 8 percent by American Electric Power Company, Inc , 16 5 percent by Ohio Edison Company, 12 5 percent by Alleghany Power System, Inc , and 33 2 percent by other companies, The Arklahoma Corporation, which is owned 32 percent by Central & Southwest Corporation system, 34 percent by Middle South Utilities, Inc system, and 34 percent by an electric utility company not associated with a registered system, Yankee Atomic Electric Company, Connecticut Yankee Atomic Power Company, Vermont Yankee Nuclear Power Corporation, and Maine Yankee Atomic Power Company, which are statutory utility subsidiaries of Northeast Utilities, New England Electric System, Eastern Utilities Associates and other electric utilities not associated with a registered system

## Table 32

## FINANCING OF HOLDING-COMPANY SYSTEMS [1]

(Fiscal 1976)

| | In Millions of Dollars [2] | | | |
|---|---|---|---|---|
| | Bonds | Debentures | Preferred Stock | Common [3] Stock |
| Alleghany Power Systems Inc | $ | $ | $ | $68 3 |
| Potomac Edison Co | [4] 54 8 | | 15 0 | |
| American Electric Power Co | | | | 196 0 |
| Appalachian Power Co | [4] 119 8 | | | |
| Indiana & Michigan Power Co | 73 6 | | | |
| Indiana & Michigan Electric Co | 59 6 | | 30 0 | |
| Ohio Power Co | [4] 104 0 | | | |
| Ohio Electric Co | 74 3 | | | |
| Central and South West Corp | | | | |
| Public Service of Oklahoma | | | 25 0 | |
| Southwestern Electric Power Co | [4] 84 5 | | | |
| Columbia Gas Co | | 148 0 | | |
| Eastern Utilities Associates | | | | [4,5] 12 3 |
| Brockton Edison Co | 20 0 | | 6 3 | |
| General Public Utilities Corp | | | | [4,5,6] 151 5 |
| Jersey Central Power & Light Co | [4] 128 5 | | | |
| Metropolitan Edison Co | [4] 93 5 | | | |
| Pennsylvania Electric Co | [4] 103 8 | | [4] 67 0 | |
| Middle South Utilities | | | | 121 9 |
| Arkansas Power & Light Co | 40 2 | | [4] 75 6 | |
| Louisiana Power & Light Co | 50 2 | | | |
| Mississippi Power & Light Co | 25 1 | | | |
| National Fuel Gas Co | | | [5] 30 0 | |
| New England Electric System | | | | |
| Massachusetts Electric Co | 40 0 | | | |
| New England Power Co | | | 26 3 | |
| Northeast Utilities | | [5,6] 50 0 | | [6] 67 1 |
| Connecticut Light & Power Co | 49 8 | | 20 0 | |
| Hartford Electric Light Co | 29 7 | | 10 0 | |
| Ohio Edison Co | | | 40 0 | 56 5 |
| Pennsylvania Power Co | 24 8 | | 8 0 | [7] 177 6 |
| Southern Company, The | | [5,6] 125 0 | | |
| Alabama Power Co | [4] 182 8 | | 50 0 | |
| Georgia Power Co | [4] 246 3 | | [4,5] 150 0 | |
| Gulf Power Co | | | 15 0 | |
| Mississippi Power Co | 25 1 | | 15 0 | |
| Total | $1,630 4 | $323 0 | $583 2 | $851 2 |

[1] The table does not include securities issued and sold by subsidiaries to their parent holding companies, short-term notes sold to banks, portfolio sales by any of the system companies, or securities issued for stock or assets of nonaffiliated companies Transactions of this nature also require authorization by the Commission, except, as provided by Sec 6(b) of the Act, the issuance of notes having a maturity of 9 months or less where the aggregate amount does not exceed 5 percent of the principal amount and par value of the other securities of the issuer then outstanding

[2] Debt securities are computed at price to company, preferred stock at offering price, common stock at offering or subscription price

[3] Common stock includes shares issued by dividend reinvestment plan

[4] Two or more issues

[5] Private placement

[6] At least one issue negotiated

# CORPORATE REORGANIZATIONS

## Commission Participation

During fiscal year 1976, the Commission entered 4 new Chapter X proceedings involving companies with aggregate stated assets of approximately $765 million and aggregate indebtedness of approximately $684 million. Including the new proceedings, the Commission was a party in a total of 124 reorganization proceedings during the fiscal year During the year, 9 proceedings were closed, leaving 115 pending.

## Table 33

## REORGANIZATION PROCEEDINGS UNDER CHAPTER X OF THE BANKRUPTCY ACT IN WHICH THE COMMISSION PARTICIPATED

Fiscal Year 1976

| Debtor | District Court | Petition Filed | SEC Notice of Appearance Filed |
|---|---|---|---|
| Air Industrial Research, Inc | N D Cal | March 14, 1974 | May 6, 1974 |
| Aldersgate Foundation, Inc | M D Fla | Sept 12, 1974 | Oct 3, 1974 |
| American Associated Systems, Inc | E D Ky | Dec 24, 1970 | Feb 26, 1971 |
| American Land Corporation | S D Ohio | Aug 8, 1973 | Sept 25, 1973 |
| American Loan & Finance Co | E D Va | July 31, 1972 | Aug 30, 1972 |
| American Mortgage & Investment Co | D S C | Dec 13, 1974 | Feb 6, 1975 |
| Arizona Lutheran Hospital | D Ariz | May 11, 1970 | May 25, 1970 |
| Arlan's Dept Stores, Inc | S D N Y | March 8, 1974 | March 8, 1974 |
| Atlanta International Raceway, Inc | N D Ga | Jan 18, 1971 | Feb 3, 1971 |
| Bankers Trust[3] | S D Ind | Oct 7, 1966 | Nov 1, 1966 |
| Beck Industries, Inc | S D N Y | May 27, 1971 | July 30, 1971 |
| Bermec Corp | S D N Y | April 16, 1971 | April 19, 1971 |
| Beverly Hills Bancorp | C D Cal | April 11, 1974 | May 14, 1974 |
| Bubble Up Delaware, Inc | C D Cal | Aug 31, 1970 | Oct 19, 1970 |
| BXP Construction Corp | S D N Y | Jan 15, 1974 | June 10, 1974 |
| C I P Corp | S D Ohio | May 23, 1975 | June 26, 1975 |
| Calvin Christian Retirement Home, Inc | W D Mich | Aug 8, 1974 | Nov 4, 1974 |
| Carolina Caribbean Corp | W D N C | Feb 28, 1975 | April 17, 1975 |
| Coast Investors, Inc [3] | W D Wash | April 1, 1964 | June 10, 1964 |
| Coffeyville Loan & Investment[3] | D Kans | July 17, 1959 | Aug 10, 1959 |
| Combined Metals Reduction Co | D Nev | Sept 30, 1970 | Sept 7, 1972 |
| Commonwealth Corp | N D Fla | June 28, 1974 | July 17, 1974 |
| Commonwealth Financial Corp [3] | E D Pa | Dec 4, 1967 | Dec 13, 1967 |
| Community Business Services, Inc | E D Cal | June 8, 1972 | April 30, 1973 |
| Continental Land Development One, Inc [2] | S D Fla | Nov 27, 1974 | May 8, 1975 |
| Continental Vending Machine Corp | E D N Y | July 10, 1963 | Aug 7, 1963 |
| Cosmo Capital Inc [3] | N D Ill | July 22, 1963 | April 22, 1963 |
| Davenport Hotel, Inc | E D Wash | Dec 20, 1972 | Jan 26, 1973 |
| Diversified Mountaineer Corp | S D W Va | Feb 8, 1974 | April 24, 1974 |
| Dumont-Airplane & Marine[3] | S D N Y | Oct 22, 1958 | Nov 10, 1958 |
| E T & T Leasing, Inc | D Md | Dec 20, 1974 | June 5, 1975 |
| Eastern Credit Corp [2] | E D Va | March 4, 1974 | April 22, 1974 |
| Educational Computer Systems, Inc | D Ariz | April 26, 1972 | Nov 3, 1972 |
| Eichler Corp [3] | N D Cal | Oct 11, 1967 | Oct 11, 1967 |
| Equitable Mortgage Investment Corp [1] | S D Iowa | July 10, 1975 | July 10, 1975 |
| Equitable Plan Co [3] | S D Cal | March 17, 1958 | March 24, 1958 |
| Equity Funding Corp of America | C D Cal | April 5, 1973 | April 9, 1973 |
| Farrington Manufacturing Co | E D Va | Dec 22, 1970 | Jan 14, 1971 |
| First Baptist Church, Inc of Margate, Fla | S D Fla | Sept 10, 1973 | Oct 1, 1973 |
| First Home Investment Corp of Kansas, Inc | D Kan | April 24, 1973 | April 24, 1973 |
| First Research Corp | S D Fla | March 2, 1970 | April 14, 1970 |
| GAC Corp [1] | S D Fla | June 14, 1976 | June 14, 1976 |
| Wm Gluckin Co , Ltd | S D N Y | Feb 22, 1973 | March 6, 1973 |
| Gro-Plant Industries, Inc [3] | N D Fla | Aug 30, 1972 | Sept 13, 1972 |
| Gulfco Investment Corp | W D Okla | March 22, 1974 | March 28, 1974 |
| Gulf Union Corp | M D La | Aug 29, 1974 | Nov 5, 1974 |
| Harmony Loan, Inc | E D Ky | Jan 31, 1973 | Jan 31, 1973 |
| Hawkeye Land, Ltd | S D Iowa | Dec 19, 1973 | Jan 21, 1974 |
| R Hoe & Co , Inc | S D N Y | July 7, 1969 | July 14, 1969 |
| Home-Stake Production Co | N D Okla | Sept 20, 1973 | Oct 2, 1973 |
| Houston Educational Foundation, Inc | S D Tex | Feb 16, 1971 | March 2, 1971 |
| Human Relations Research Foundation[3] | S D Cal | Jan 31, 1964 | Feb 14, 1964 |
| Imperial-American Resources Fund, Inc | D Colo | Feb 25, 1972 | March 6, 1972 |
| Imperial '400' National, Inc | D N J | Feb 18, 1966 | Feb 23, 1966 |
| Indiana Business & Investment Trust | S D Ind | Oct 10, 1966 | Nov 4, 1966 |
| Interstate Stores, Inc | S D N Y | June 13, 1974 | June 13, 1974 |
| Investors Associated, Inc [3] | W D Wash | March 3, 1965 | March 17, 1965 |
| Investors Funding Corp of New York | S D N Y | Oct 21, 1974 | Oct 22, 1974 |
| Jade Oil & Gas Co [3] | C D Cal | June 28, 1967 | Aug 16, 1967 |
| J D Jewell, Inc | N D Ga | Oct 20, 1972 | Nov 7, 1972 |
| King Resources Co | D Colo | Aug 16, 1971 | Oct 19, 1971 |
| Kirchofer & Arnold[3] | E D N C | Nov 9, 1959 | Nov 12, 1959 |
| Lake Winnebago Development Co , Inc | W D Mo | Oct 14, 1970 | Oct 26, 1970 |
| Little Missouri Minerals Assn , Inc | D N D | July 18, 1966 | Jan 29, 1968 |
| Los Angeles Land & Investments, Ltd | D Hawaii | Oct 24, 1967 | Nov 28, 1967 |
| Louisiana Loan & Thrift, Inc | E D La | Oct 8, 1968 | Oct 8, 1968 |
| Lusk Corp | D Ariz | Oct 28, 1965 | Nov 15 1965 |

See footnote at end of table

## Table 33

## REORGANIZATION PROCEEDINGS UNDER CHAPTER X OF THE BANKRUPTCY ACT IN WHICH THE COMMISSION PARTICIPATED

Fiscal Year 1976

| Debtor | District Court | Petition Filed | SEC Notice of Appearance Filed |
|---|---|---|---|
| Lyntex Corp | S D N Y | April 15, 1974 | Jan 28, 1974 |
| Dolly Madison Industries, Inc | E D Pa | June 23, 1970 | July 6, 1970 |
| Magnolia Funds, Inc | E D La | Nov 18, 1968 | May 26, 1969 |
| Mammoth Mountain Inn Corp [2] | C D Cal | Nov 9, 1969 | Feb 6, 1970 |
| Manufacturer's Credit Corp [3] | D N J | Aug 1, 1967 | July 30, 1968 |
| Maryvale Community Hospital [3] | D Ariz | Aug 1, 1963 | Sept 11, 1963 |
| Mayer Central Building [2] | D Ariz | July 15, 1965 | Jan 19, 1966 |
| Mid-City Baptist Church | E D La | July 30, 1968 | Oct 23, 1968 |
| Morehead City Shipbuilding [3] | E D N C | Nov 9, 1959 | Nov 12, 1959 |
| Mount Everest Corp [3] | E D Pa | May 29, 1974 | June 28, 1974 |
| Nevada Industrial Guaranty Co | D Nev | May 7, 1963 | July 2, 1963 |
| North American Acceptance Corp | N D Ga | March 5, 1974 | March 28, 1974 |
| North Western Mortgage Investors Corp | W D Wash | Dec 12, 1973 | Dec 12, 1973 |
| Omega-Alpha, Inc | N D Tex | Jan 10, 1975 | Jan 10, 1975 |
| Pan American Financial Corp | D Hawaii | Oct 2, 1972 | Jan 9, 1973 |
| Parkview Gem, Inc | W D Mo | Dec 18, 1973 | Dec 28, 1973 |
| Pocono Downs, Inc [1] | M D Pa | Aug 20, 1975 | Aug 20, 1975 |
| RIC International Industries, Inc | N D Tex | Sept 16, 1970 | Sept 23, 1970 |
| John Rich Enterprises, Inc [3] | D Utah | Jan 16, 1970 | Feb 6, 1970 |
| Riker Delaware Corp [3] | D N J | April 21, 1967 | May 23, 1967 |
| Roberts Company [2] | M D N C | Feb 12, 1970 | March 23, 1970 |
| Royal Inns of America, Inc | S D Cal | April 24, 1975 | June 24, 1975 |
| Scranton Corp [3] | M D Pa | April 3, 1959 | April 15, 1959 |
| Sequoyah Industries, Inc | W D Okla | Jan 21, 1974 | Jan 30, 1974 |
| Edward N Siegler & Co [3] | N D Ohio | May 23, 1966 | June 7, 1966 |
| Sierra Trading Corp [3] | D Colo | July 7, 1970 | July 22, 1970 |
| Sound Mortgage Co , Inc [3] | W D Wash | July 27, 1965 | Aug 31, 1965 |
| Southern Land Title Corp | E D La | Dec 7, 1966 | Dec 31, 1966 |
| Stanndco Developers, Inc | W D N Y | Feb 5, 1974 | March 7, 1974 |
| Stirling Homex Corp | W D N Y | July 11, 1972 | July 24, 1972 |
| Sunset International Petroleum Corp [3] | N D Tex | May 27, 1970 | June 10, 1970 |
| TMT Trailer Ferry, Inc [3] | S D Fla | June 27, 1957 | Nov 22, 1957 |
| Tele Tronics Co [2] | E D Pa | July 26, 1962 | Sept 12, 1962 |
| Texas Independent Coffer Organization [3] | S D Tex | Jan 5, 1965 | Jan 13, 1965 |
| Tilco, Inc | D, Kans | Feb 7, 1973 | Feb 22, 1973 |
| Tower Credit Corp [3] | M D Fla | April 13, 1966 | Sept 6, 1966 |
| Traders Compress Co | W D Okla | May 12, 1972 | June 6, 1972 |
| Trans-East Air Inc | D Me | Aug 29, 1972 | Feb 22, 1973 |
| Trans-International Computer Investment | N D Cal | March 22, 1971 | July 26, 1971 |
| Trustors Corp [3] | C D Cal | Sept 13, 1961 | Oct 9, 1961 |
| "U " Distnct Building Corp | W D Wash | Dec 9, 1974 | Dec 9, 1974 |
| U S Financial, Inc [1] | S D Cal | Sept 23, 1975 | Nov 3, 1975 |
| Uniservices, Inc [2] | S D Ind | Dec 4, 1970 | Jan 28, 1971 |
| Viatron Computer Systems Corp | D Mass | April 29, 1971 | April 29, 1971 |
| Vinco Corp [3] | E D Mich | March 29, 1963 | April 9, 1963 |
| Virgin Island Properties, Inc [3] | D V I | Oct 22, 1971 | April 11, 1972 |
| Waltham Industries Corp | C D Cal | July 14, 1971 | Aug 19, 1971 |
| Webb & Knapp, Inc [3] | S D N Y | May 7, 1965 | May 11, 1965 |
| H R Weissberg Corp [3] | N D Ill | March 5, 1968 | April 3, 1968 |
| Westec Corp | S D Texas | Sept 26, 1966 | Oct 4, 1966 |
| Western Growth Capital Corp | D Ariz | Feb 10, 1967 | May 16, 1968 |
| Western National Investment Corp [3] | D Utah | Jan 4, 1968 | March 11, 1968 |
| Westgate-California Corp | S D Cal | Feb 26, 1974 | March 8, 1974 |
| Wonderbowl, Inc | C D Cal | March 10, 1967 | June 7, 1967 |
| Woodmoor Corp [2] | D Colo | Feb 25, 1974 | March 25, 1974 |
| Yale Express System Inc [3] | S D N Y | May 24, 1965 | May 28, 1965 |

[1] Commission filed notice of appearance in fiscal year 1976
[2] Reorganization proceedings closed during fiscal year 1976
[3] Plan has been substantially consummated but no final decree has been entered because of pending matters

## SEC OPERATIONS

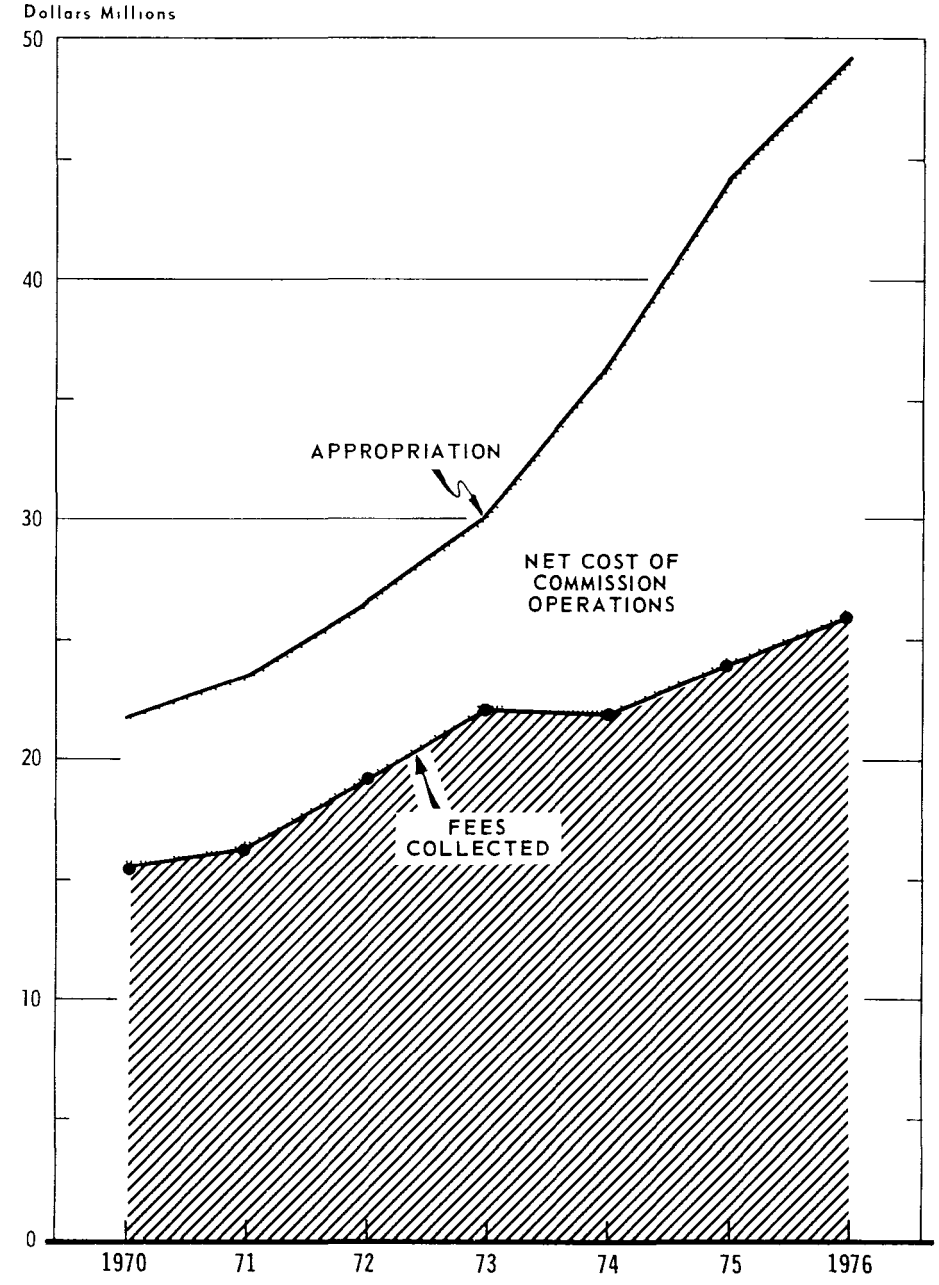
### Net Cost

Total fees collected by the Commission in fiscal 1976 represented 52 percent of funds appropriated by the Congress for Commission operations. The Commission is required by law to collect fees for (1) registration of securities issued; (2) qualification of trust indentures; (3) registration of exchanges, (4) registration of brokers and dealers who are registered with the Commission but are not members of the NASD; and (5) certification of documents filed with the Commission. In addition, by fee schedule the Commission imposes fees for certain filings and services, such as the filing of annual reports and proxy material

The Securities Acts Amendments of 1975 increased the transaction fees to be paid by all national security exchanges to one three-hundredth of 1 per centum of the aggregate dollar amount of the sales of securities transacted during each preceding calendar year. The 1975 Amendments have also included under this fee requirement certain transactions by every registered broker and dealer which are not transacted on a national securities exchange, provided, however, that no payment will be required for any calendar year in which the fee would be less than $100.

With reference to the fee schedule, the investment adviser assessment fee refunds originally announced in Commission release IA-486 have been almost completed. To date, approximately 2,750 refund checks have been mailed totaling slightly more than $607,000

# APPROPRIATED FUNDS vs FEES COLLECTED



## Table 34

## BUDGET ESTIMATES AND APPROPRIATION

| Action | Fiscal 1972 | | Fiscal 1973 | | Fiscal 1974 | | Fiscal 1975 | | Fiscal 1976 | | Transitional Quarter | | Fiscal 1977 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Positions | Money | Positions | Money | Positions | Money | Positions | Money | Positions | Money | Positions | Money | Positions | Money |
| Estimate submitted to the Office of Management and Budget | 1,875 | $28,728,000 | 1,939 | $33,691,000 | 1,919 | $34,027,000 | 2,219 | $43,674,000 | 2,294 | $54,577,000 | 2,081 | 12,500,000 | 2,400 | $56,162,000 |
| Action by the Office of Management and Budget | 313 | 2,411,000 | 283 | 3,930,000 | 204 | 2,817,000 | 225 | 1,543,000 | 276 | 7,390,000 | | | 262 | 3,064,000 |
| Amount allowed by the Office of Management and Budget | 1,562 | 26,317,000 | 1,656 | 29,761,000 | 1,715 | 31,210,000 | 1,994 | 42,131,000 | 2,018 | 47,187,000 | 2,081 | 12,500,000 | 2,138 | 53,098,000 |
| Action by the House of Representatives | | | | | + 204 | + 2,817,000 | + 150 | + 946 000 | | 302 000 | | 75,000 | | 98,000 |
| Sub-total | 1,562 | 26,317,000 | 1,656 | 29,761,000 | 1,919 | 34,027,000 | 2,144 | 43,077 000 | 2,018 | 46,885,000 | 2,081 | 12,425,000 | 2,138 | 53,000,000 |
| Action by conferees | | | | | | | | | - 63 | - 1,000,000 | | | | |
| Action by Senate | | | | | | | | | + 126 | + 2,000,000 | | + 250,000 | | |
| Sub-total | 1,562 | 26,317,000 | 1,656 | 29 761,000 | 1,919 | 34 027,000 | 2,144 | 43,077,000 | 2,144 | 48,885,000 | 2,081 | 12,675,000 | | |
| Annual appropriation | 1,562 | 26,317,000 | 1,656 | 29,761,000 | 1,919 | 34,027,000 | 2,144 | 43,077,000 | 2,081 | 47,885 000 | 2,081 | 12,675,000 | | |
| *Supplemental appropriation for statutory pay increase* | | 500,000 | | 532,000 | | 2,200,000 | | 1,350,000 | | 1,406,000 | | 502,000 | | |
| Total appropriation | 1,562 | 26,817,000 | 1,656 | 30,293,000 | 1,919 | 36,227,000 | 2 144 | 44,427,000 | 2,081 | 49,291,000 | 2,081 | 13,177,000 | | |