

SECURITIES AND EXCHANGE COMMISSION
AUTHORIZATIONS FOR FISCAL YEARS
1981, 1982, AND 1983

HEARING
BEFORE THE
SUBCOMMITTEE ON CONSUMER PROTECTION
AND FINANCE
OF THE
COMMITTEE ON
INTERSTATE AND FOREIGN COMMERCE
HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

H.R. 6830

A BILL TO AMEND THE SECURITIES EXCHANGE ACT OF 1934
TO AUTHORIZE APPROPRIATIONS FOR THE SECURITIES AND
EXCHANGE COMMISSION FOR FISCAL YEARS 1981 THROUGH
1983

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MARCH 20, 1980

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SECURITIES AND EXCHANGE COMMISSION AUTHORIZATIONS FOR FISCAL YEARS 1981, 1982, AND 1983

THURSDAY, MARCH 20, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE,
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
Washington, D.C.

The subcommittee met at 9:30 a.m., pursuant to notice, in room 2322, Rayburn House Office Building, Hon. James H. Scheuer (chairman) presiding.

Mr. SCHEUER. The subcommittee will please be in order.

Today the Subcommittee on Consumer Protection and Finance is holding hearings on H.R. 6830, the budget authorization request for the Securities and Exchange Commission for the fiscal years 1981, 1982, and 1983.

The amounts requested for these years are \$85.5 million, \$98 million, and \$108 million, respectively.

The Commission was created in 1934 to address market problems of such dimensions that they were eroding public confidence in the free enterprise system, and we all remember those days of shocks, scandals, bankruptcies, and members of the New York Stock Exchange tried, convicted, and going to jail.

Mr. OTTINGER. And jumping out of windows.

Mr. SCHEUER. Exactly right.

The Commission in those 45 years has performed not only well but magnificently.

Today, we have the strongest and fairest capital market system in the world, and nobody with any understanding of the marketplace seriously questions the value of the federally mandated disclosure system, administered by the Commission.

In the last 40 years, there have been enormous increases in the volume of shares traded, the number of reporting companies, registered investment companies, brokers/dealers, municipal securities dealers, investment advisers, and transfer agents.

Other Commission responsibilities have included the recent explosion in the options trading and the establishment of a national market system.

Nevertheless, with all of this activity under their jurisdiction, the Commission hardly fits the definition of a burgeoning bureaucracy.

As a matter of fact, the number of personnel has increased only 17 percent since 1941.

As my computer instructs me, this is 0.43-percent increase per year over that period of time, less than one-half of 1 percent increase per year. And in these days when Congress is taking a parsimonious look at regulatory agencies, surely this record of tightfistedness and hardnosed control deserves the Congressional Medal of Honor with oak leaves clusters and I hereby award such medal.

The proposed authorization of \$85.5 million is a modest amount for such a large task. The actual cost to the public is closer to half this amount because of fees and other charges that are assessed by the Commission

However, this is a time of austerity and Congress has the responsibility to insure that public funds will only be expended when they will yield generous returns.

Of course, there is a delicate balance between fiscal restraint and the need for continued effectiveness of an agency as vital to the workings of our capital market and our free enterprise system as the SEC.

I think in this environment, where slashes and cuts are almost expected of us, we ought not to forget that the Commission's primary function of protecting the investor and insuring the continued confidence in and the integrity and effectiveness of our capital markets is not unlike those of the bank regulatory agencies.

If in these times we would not consider paring back the essential regulatory and examination functions of our banking agencies, Congress should justify a different treatment for the Commission.

Without objection the text of H.R. 6830 will be placed at this point in the record.

[The text of H.R. 6830 follows:]

96TH CONGRESS
2D SESSION

H. R. 6830

To amend the Securities Exchange Act of 1934 to authorize appropriations for the Securities and Exchange Commission for fiscal years 1981 through 1983.

IN THE HOUSE OF REPRESENTATIVES

MARCH 17, 1980

Mr. STAGGERS (by request) introduced the following bill; which was referred to the Committee on Interstate and Foreign Commerce

A BILL

To amend the Securities Exchange Act of 1934 to authorize appropriations for the Securities and Exchange Commission for fiscal years 1981 through 1983.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 That section 35 of the Securities Exchange Act of 1934 (15
4 U.S.C. 78kk) is amended—

5 (1) in the first sentence thereof, by striking out
6 “and” immediately after “1979,”;

7 (2) by inserting immediately before the period at
8 the end of the first sentence thereof the following: “,

1 \$85,500,000 for the fiscal year ending September 30,
2 1981, \$98,000,000 for the fiscal year ending Septem-
3 ber 30, 1982, and \$108,000,000 for the fiscal year
4 ending September 30, 1983"; and

5 (3) in the last sentence thereof, by striking out
6 "“fiscal year 1980”" and inserting in lieu thereof "“fiscal
7 year 1983”".

Mr. SCHEUER. Without objection, the Chair wishes to place in the record as though read, the statement of Congressman Matthew J. Rinaldo of New Jersey.

[The statement of Congressman Matthew J. Rinaldo follows:]

STATEMENT OF HON. MATTHEW J. RINALDO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. RINALDO. Capitol Hill is awash with budget-cutting rhetoric, and for good reason. While economists can argue round the clock as to the causes of inflation, a trim Federal budget has at least symbolic importance. Painless formulas for balancing the budget and beating inflation are featured articles in newspapers and magazines on a daily basis. All seem to suggest that through a little accounting magic we can get through this mess.

Bottom-line economics tells a different story. We must make some painful decisions, soon. Federal Government has been operating in the red for too long. Elaborate charts, graphs, and tables demonstrating cost justification for pet projects may have to be scrapped in the face of certain stark economic realities. In the past it was always politically safe to rail about bloated budgets and huge deficits, then go on and give Government everything it wanted. Fiscal 1981 has to be different—we must speak in terms of a survival budget, and it will probably have to apply to the rest of the 1980's as well.

Given this context, I would like to sharpen the focus and direct some comments on the proposed market oversight and surveillance system (MOSS). First of all, the secretive way that the SEC has gone about the development of the MOSS system has fed industry anxiety about its true impact. Certainly, the development of MOSS has not been a model of industry-Government cooperation. Second, cost projections seem unsupportable. I believe that an overall figure of \$12 million is a sheer fantasy. Moreover, I don't want to get so committed to the system that when the real figures come out we will have spent so much that there will be no turning back. Third, no one knows what the system will cost to industry. Who will pay for hookup lines between marketmakers and the MOSS computer at SEC headquarters? Who will pay for the adaptation of data processing machinery located in brokers' offices? Ultimately, the cost will be borne by investors and taxpayers. Finally, what is the role of self-regulatory organizations? Is there unnecessary duplication?

In view of the state of the economy and in the era of deregulation, I do not believe that a long-range commitment to MOSS would be in the best public interest.

Thank you.

Mr. SCHEUER. We are very happy to welcome as our first witness the Chairman of SEC, the Honorable Harold M. Williams.

Of course, your testimony will be printed in the record in full.

We commend you on the fine job that you are doing and we look forward with pleasure to what you have to tell us.

STATEMENT OF HON. HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY BENJAMIN MILK, EXECUTIVE DIRECTOR, OFFICE OF THE EXECUTIVE DIRECTOR; GEORGE G. KUNDAHL, DEPUTY EXECUTIVE DIRECTOR, OFFICE OF THE EXECUTIVE DIRECTOR; AND SYDNEY H. MENDELSON, DIRECTOR, DIVISION OF INVESTMENT MANAGEMENT

Mr. WILLIAMS. Thank you, Mr. Chairman.

Mr. SCHEUER. Excuse me; my colleague from New York, which, of course, is the mother lode of which the New York Stock Exchange, and our economic life blood, has had a continuing concern for the economic viability of the securities markets and the well-being of our city and I welcome any remarks he would like to make.

Mr. OTTINGER. I would like to second what you said which I think you said very well.

I think there has been inadequate appreciation for the securities industry which is one of the largest businesses in New York, and is really vital to the health and vitality of the city and the State.

The SEC plays a key role in that. Also, I advise my colleague, the Congressional Medal of Honor is traditionally voted posthumously. We don't want to see that happen to the SEC.

I am concerned and talked to Mr. Williams today. In fact, perhaps the agency has been too conservative in keeping down its personnel in light of the additional responsibilities we have placed on the agency in which the tremendous growth in the industry has greatly complicated its task.

I understand Mr. Williams feels really to do the job properly there ought to be an additional assignment. I don't know if that is going to be feasible this year or not, but I think it is something we should address.

I would like to join the chairman in welcoming you and offering to be as much help as we can under current economic circumstances.

Mr. SCHEUER. Thank you very much.

All right; we are eager to hear what you have to tell us.

Mr. WILLIAMS. I am awfully tempted to say that concludes my opening statement. It would be hard to improve on both of your generous observations.

In light of those, let me summarize briefly for you the authorization requests for fiscal years 1981 through 1983.

Perhaps it is unusual, in fact it is indeed unusual, in the history of the Commission, perhaps in the history of most regulatory agencies, that a Chairman hangs around for a full 5 years.

With the background I bring to this position and with the nature of the 5-year commitment in a sense as background, we have undertaken a very comprehensive review both of the responsibilities of the agency and of the resources of the agency as designed to meet those responsibilities.

Our conclusion is that the resources available at this time to enable us to discharge our major responsibilities are seriously inadequate and it appears to us, in the context particularly of an authorization hearing, that it would be appropriate for us to focus first on the resource side and then, of course, expecting that to the

extent and the ability to fund those resources will be conditioned at least to some extent on overall congressional priorities and on the magnitude of the budget in its entirety.

As the chairman has indicated, the nature of the Commission's responsibilities has grown enormously over the past years. Indeed, obviously the numbers or the growth depend upon the base point.

We have tended to look at 1975 and years beyond as a major turning point in terms of the magnitude of growth of the Commission's responsibilities, in part brought about by the 1975 Securities Acts amendments and in part by the growing complexity of the marketplaces themselves.

Relating to everything from sheer expanded market activity to the increasing complexity of financial transactions, new financial projects all impacting on the marketplace, and some major changes in the complexion and makeup and financial condition of the community itself, resulting in part of the unfixing of Commission rates in 1975, resulting in much higher financial leverage resulting in combinations of firms.

The third area of major growth is in the investment adviser area where we see something on the order of a two-thirds growth in the last 5 years in the number of registered investment advisers.

In the mutual fund area, there is probably nearly a fivefold full growth in the money market funds as a new area of emerging growth in that industry.

In the tender offer area in the last 5 years something on the order of \$100 billion or more worth of successful tender offers, so-called unfriendly tenders, in addition of course to the money that we are not successful.

During this time, we have been charged with a number of new regulatory responsibilities, not the least of which is the obligation to facilitate the development of a national market system.

We also had the implementation and enforcement of the Foreign Corrupt Practices Act and the expectation on the part of Congress as well as ourselves, is that we achieve more effective oversight and self-regulation of the accounting profession.

On top of this, recent judicial developments have tended to severely restrict the scope of implied private rights of action. In the history of the Commission the ability of the private individual who has felt himself or herself worked in a matter involving the Federal securities laws had in many instances the opportunity to resort to judicial enforcement on their own.

This has been a very vital adjunct to the whole context of the presence and enforcement of Federal securities laws, but with recent judicial determinations and the reluctance of particularly the Supreme Court to recognize implied private rights, where the Congress has not been explicit, this very important deterrent is no longer available, which then places an even greater burden on the Commission itself.

Finally, in relooking the degree to which the Commission is discharging and has discharged its longer term and more traditional types of responsibilities, we must conclude that in some of the very traditional areas, particularly oversight and inspection of exchange, broker/dealers, investment companies, investment advisers, that the level of sophistication, the level of intensity, and the

frequency of and the presence, if you will, of the Commission in both its oversight inspection programs has in our judgment not been adequate, and this is an area where we are, in any event, providing some additional resources as a matter of internal reallocation.

Within my prepared testimony I have discussed in some detail, at least, the areas of greatest need. I will leave those to the record and to any questions you might have.

There are three points I should stress, however.

One, doubling back, is that we are requesting a 3-year authorization.

Two years ago this committee supported a 3-year authorization for the Commission, and we would request that support again this year.

Multiyear budgeting is important to us as a planning tool and, of course, both the Congressional Budget Office and OMB have also stressed its importance in their recommendations and procedures.

A 3-year authorization would enable us to engage in reasonable time horizon planning and to participate meaningfully in the administration's multiyear exercises.

I would suggest a 3-year authorization is particularly appropriate at this time. With my term due to expire in June of 1982, the request would enable me to do as good a job as I can in prioritizing and setting a direction for the Commission during the remainder of my term and allow a 1-year orientation before a new Chairman is required to come forward and present his or her plan to the Congress.

In addition to the specific needs and priorities that are set forth and needs that are personnel-oriented that are set forth in the authorization request and in my testimony, there are two other areas I would like to address specifically for a moment.

One is our request for resources to fund the first several years in the development of what we have called the market oversight surveillance system. In addition to adequate staff resources, the Commission needs the technological capability to conduct oversight and surveillance in the trading markets and over the self-regulatory organizations in order to keep pace with the increasing complexity and volume of activity of the securities market.

The Commission has undertaken to develop a market oversight and surveillance system, MOSS, that will enable us to administer effectively our oversight responsibility over the SRO's, to conduct more thorough and comprehensive inspections over broker/dealers, to monitor trends and developments in the marketplace, to better coordinate with the SRO's in the followup to specific trading aberrations and better evaluate rule proposals that have an impact on the marketplace and more effectively manage our own oversight and surveillance resources.

My view is that this program will complement the primary market system operated by the SRO's. It will do this in two basic ways.

It will provide crossmarket or intermarket surveillance, particularly in regard to dual-market trading in options and their underlying securities; and it will indicate market trading data with non-marketing data such as other materials filed with the Commission.

We view meaningful oversight as a key to effective self-regulation. The MOSS system is intended to bolster, indeed make effective, an existing Commission responsibility and not at all to usurp the traditional surveillance functions performed by the self-regulatory organizations.

The Commission still intends to rely very heavily on each SRO to be primarily responsible for surveillance of its own trading market, but, among other things, MOSS will enhance the Commission's ability to oversee the industry's surveillance of the marketplace and will strengthen the overall scheme of self-regulation.

In order to test whether the proposed design for MOSS lives up to expectations and to make necessary changes, the Commission is presently operating a pilot or prototype of the larger system, and the SRO's are playing an essential role in the pilot phase by providing us with the basic information from the trading and clearing process.

Finally, I would like to discuss with you the Commission's critical need for a consolidated Washington headquarters and our request for leasing authority to respond to that need.

I would like to submit for the record a staff memorandum which outlines the history of the Commission's efforts to obtain a consolidated headquarters. It describes the impact of operating from multiple locations and explores the reasons why the Commission is requesting leasing authority.

[Testimony resumes on p. 54.]

[The following report was received for the record:]

Economic
Analysis
of
**Dispersed
Office
Locations**

for the
U.S. Securities and
Exchange Commission

April 1980

EXPEDITERS



PLANNING & DEVELOPMENT STRATEGIES FOR BUSINESS & INDUSTRY

James F. Giegerich & Associates

979 ROLLINS AVENUE -- ROCKVILLE, MARYLAND 20852

PHONE: (301) 881-0590

April 14, 1980

Mr. Benjamin Milk
Executive Director
Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549

Dear Mr. Milk:

Enclosed is an analysis of the direct and indirect costs of dispersed office facilities for the Securities and Exchange Commission. The analysis was obtained by interviewing the directors of the offices within the SEC that have been directly affected by the dispersal of offices in multiple locations and through review of various materials available at the SEC.

The direct costs are more readily measurable and documentable. The indirect costs, while very real as an economic impact on the Commission, are less measurable. However, in utilizing the experiences of the managers and staff of SEC and assuming their prudent judgment on the effectiveness of their staff and the performance of work for SEC, reasonable indicators were developed to provide some measure of the economic impact of dispersed locations on SEC operations.

A factor which has not been explored thoroughly in the past has been the economic impact of dispersed locations on the public. This report also includes an analysis of these impacts and is based upon impressions by persons in the private sector doing business with SEC. While these costs do not fall within the budget of SEC, they are nevertheless an important impact and should be considered strongly in any analysis of office facilities for the Securities and Exchange Commission.

Mr. Benjamin Milk
Page Two
April 14, 1980

One of the major impressions I have received in my work on this project, is that there is a great deal of time pressure placed on the staff to respond fully and effectively within statutory time requirements. However, I have also observed that there is a great deal of energy spent in overcoming problems in split locations. Communicating between offices at split locations absorbs substantial energy and creates a corresponding reduction in the ability of the staff to direct their energies as fully in improving the management of their workload. The lack of clear and easy communications can be a discouragement of non-mandatory improvements to the system, especially when time is of the essence and the staffing complement is "lean." When an organization has limited staff to perform its duties, it is especially important that top efficiency and productivity be enhanced. It is clear from the analysis that a combination of direct and indirect costs far exceed any additional cost that might be incurred to provide the Commission with adequate and well designed space to perform its duties.

I was most impressed with the caliber of SEC staff and their willingness to perform under difficult space conditions. I especially appreciate their willing cooperation in responding to my inquiries, often on short notice.

Sincerely,



James F. Giegerich

Enclosure

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Executive Summary

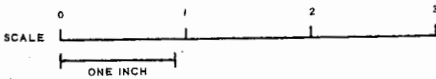
- Staffing during the past 15 years has been increased in response to substantially enlarged legislatively mandated programs.
- SEC staff has not been increased commensurate with the legislatively mandated workload, thereby creating higher staff performance requirements and greater selectivity in allocating scarce resources among the increased programs.
- The dispersal of staff to multiple locations has been required because of the limited space on North Capitol Street and the inability to obtain an enlarged consolidated building requested by the SEC from GSA since 1972.
- There are significant direct costs of dispersal of SEC in four office locations and two storage facilities. More than \$400,000 per year could be saved if the SEC were to be located in a consolidated building designed to help fulfill its mandated requirements.
- Two major categories of indirect costs are manifested in lowered productivity and employee turnover, which consume a conservatively estimated value of \$3,700,000 in budgeted resources. While these indirect costs are difficult to measure, they are important to consider because they have the affect of diminishing the effectiveness of the SEC and diluting the best utilization of its most important and costly resources, the SEC staff.
- The purpose of the SEC is to protect and serve the public in an effective manner, within timely restraints mandated by law. Issuers, investors and institutions under pressure of great economic risk depend on swift response to their requests. Fulfilling this objective is obviously jeopardized by limitation in the number of staff and the communication problems created by dispersal of SEC in multiple locations.

Introduction

Ballston Center Tower 3
(Arlington)
12,520 sq. ft.
54 employees



ONE INCH EQUALS APPROXIMATELY .51 MILES

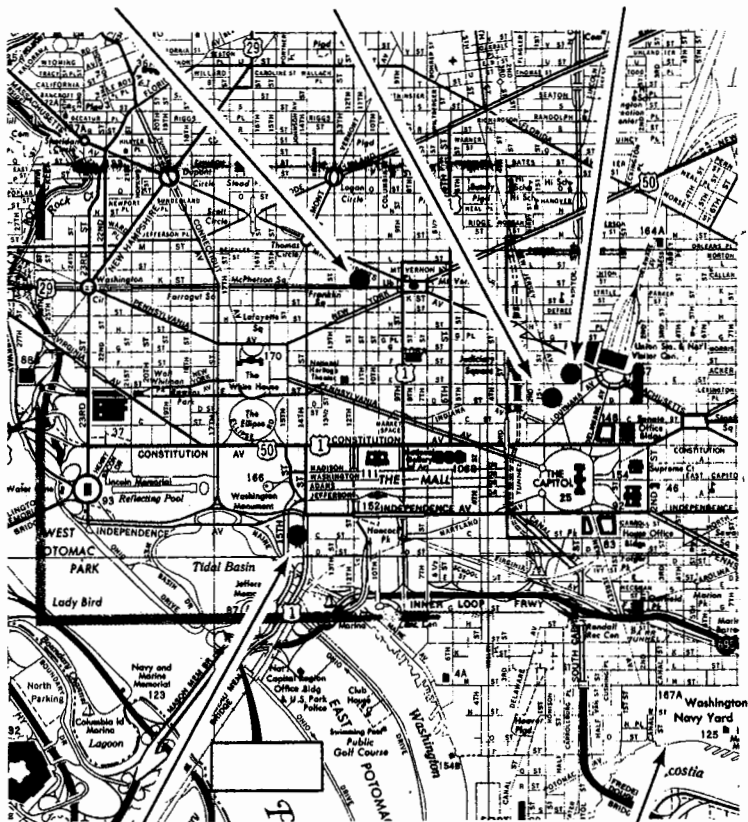


ALL PERSONNEL FIGURES FROM
 G.S.A. DRAFT PROSPECTUS.

1100 L St., N. W.
 72,272 sq. ft.
 225 employees

320 First St., N.W.
 31,920 sq. ft.
 150 employees

500 North Capitol St., N. W.
 170,405 sq. ft.
 925 employees

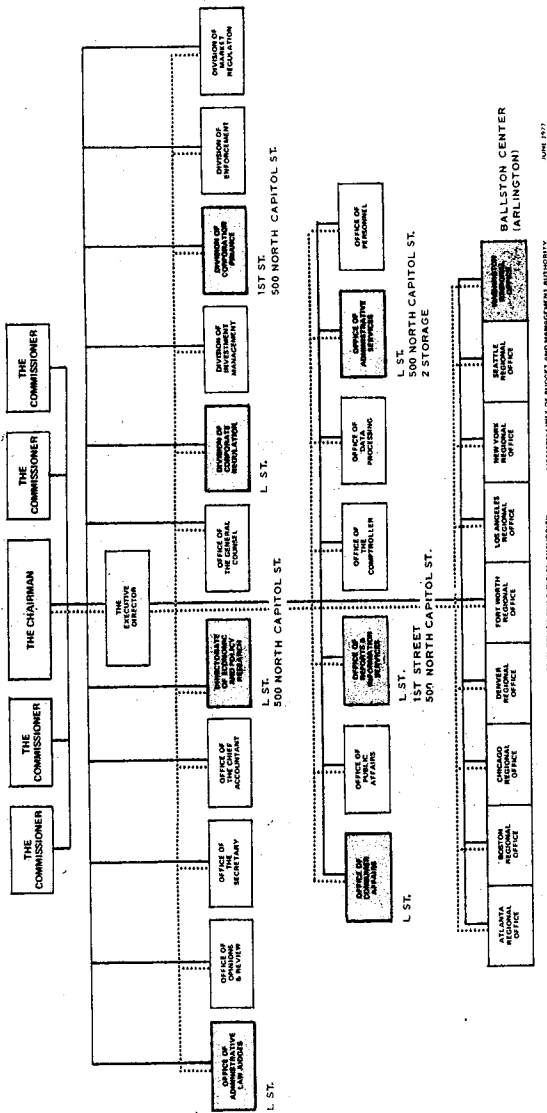


Auditors' Annex # 2
 3,610 sq. ft.
 0 employees

Navy Yard Annex 197
 4,520 sq. ft.
 0 employees

Dispersed Office Locations

SECURITIES AND EXCHANGE COMMISSION



JUNE 1977

UNITED STATES POLICE AND FIRE DEPARTMENT

UNITED STATES POLICE AND FIRE DEPARTMENT

The Securities and Exchange Commission moved into its present headquarters at 500 North Capitol Street in June of 1966. With a staff of 887, the 170,000 square feet at 500 North Capitol Street was adequate. There was however, no provision for additional staff.

The Washington Regional Office moved out of North Capitol Street to Arlington, Virginia in 1969. In 1971, the Commission began to outline for GSA its need for additional space. In 1972-1973 the Commission was able to secure an additional 96,000 square feet (including parking spaces) at 1100 L Street.

In 1977, an additional 30,000 square feet at 320 First Street was assigned to the Commission. The Commission was not able to move into the space until January 1978. This additional location provided the Commission with a total of 295,000 square feet of space. Today, the Commission has an authorized Washington staff of over 1,300 employees, with nearly 1,000 employees located at 500 North Capitol Street and 300 additional employees at three satellite locations. Using GSA standards, the Commission's space needs at present staff levels is 345,000 square feet, a full 50,000 square feet more than is presently leased for the Commission.

The Commission is a small, tightly knit agency with a highly specialized mission to protect investors and to ensure the integrity of our nation's capital markets. Unlike the situation found in many agencies, the Commission's divisions and offices are not free standing organizations or components. Rather, almost all Commission activity requires the coordination or participation of several offices and divisions. Additionally, the Commission's work requires extensive daily interaction in Washington with the corporate financial and legal communities and the investing public.

The Division of Corporation Finance has been split between 500 North Capitol Street and 320 First Street. The Directorate of Economic and Policy Research and the Office of Administrative Services have been split between 500 North Capitol Street and 1100 L Street. Additionally, several offices have been moved largely in their entirety from 500 North Capitol Street, such as the Division of Corporate Regulation, the Office of Reports and Information Services, and the Administrative Law Judges. Additionally, the Washington Regional Office of the Securities and Exchange Commission is located in a separate location in Arlington, Virginia.

The purpose of this study is to analyze the costs of dispersed office location and its impact on the Securities and Exchange Commission. This study addresses both the direct and indirect costs to the Commission as well as an analysis of the costs to the public which the Commission serves.

Direct Costs

There are a number of activities associated with operating offices in multiple locations that are directly measurable. Essentially, these are direct costs which are included in the Commission's budgetary requirements which would not be required if a building were provided to house the entire staff in a consolidated and integrated manner. Each of the principal divisions incurring direct costs through multiple locations were surveyed and a variety of direct costs were identified which can be saved in a consolidated location. These direct cost savings could amount to approximately \$400,000.

Staff Hours

Were the Commission's Washington Staff located in one location, a significant amount of time would be saved from commuting between buildings. While this would not be a reduction in budget, the time saved could be used productively towards the performance of the Commission's work. This is especially important because the Commission is in a position of having an increased workload without corresponding increase in staff. This will allow a corresponding increase in available staff time to perform Commission obligations.

Transportation

Currently there are three drivers traversing routes among the various SEC locations using a variety of vehicles performing delivery and shuttle service. These drivers would not be required if buildings were consolidated into one office facility. Direct savings could be achieved through reduction in costs of vehicles and corresponding fuel savings. Current vehicles used for delivery of people and materials among the buildings will not be required in a building in which staff could easily walk between offices.

Duplicate Facilities

Currently, because of the need for certain minimal services in each of the buildings, there is a duplication of copying rooms, library, and mail rooms. Accordingly, personnel and equipment are also required for these facilities.

It is estimated that \$67,000 could be achieved in a consolidated building by elimination of these duplicate facilities and equipment. The most important benefit, however, would be in improved ability to provide a more efficient and effective service to the Commission and the public it serves.

Overtime

The dispersal of office space and storage facilities makes it extremely difficult to perform the required moving of equipment and supplies within the normal work day. Due to the inefficiencies of multiple locations and overcrowding, there is a need to provide a substantial amount of overtime to move equipment and supplies where they are needed in order to provide the services required by the Commission. Similarly, the most important savings to the Commission is not necessarily in a direct cost of overtime, estimated at \$70,000, but in the handicap it poses to timely performance of Commission business.

Alterations

There has been a consistent level of alterations required in the Commission's office facilities. While this has caused an important element of expense for the Commission, the alterations are conducted in a manner which is distracting and disruptive to the normal operations of the Commission. Dust, dirt and noise have impacted on the ability of the affected organizations to maintain a productive environment. Additionally, there normally are serious delays in performing and/or completing alterations after commitments have been made to achieve important improvements to the Commission operations. Alterations would not be required in a building specifically designed for SEC operations for at least a five-year period.

Guard Services

Direct savings of \$30,000 in guard services can be achieved in a consolidation of Commission offices. Supplemental guard services at the First Street and L Street offices would no longer be required and the corresponding savings achieved.

However, the more important impact would be that the guard services level of protection and security provided would be designed to adequately safeguard the materials and files in the Commission. Currently, the guard service at First Street and L Street is not provided at the minimum required level because it is under the control of other agencies whose level of security is not as stringent as that required by the SEC. As a result, there is a lack of confidence in the records and filing integrity, based on the Commission's actual experience with breaches in security resulting in loss of expensive equipment. Because of the inability to require certain minimum security measures in satellite locations, it is anticipated that such occurrences will continue. Therefore, the files and records under the custody of the Commission will continue to be jeopardized.

Computer Services

The use of the computer is essential to the work of the Securities and Exchange Commission. Because of the enormous number of files and records which come into the Commission each year ranging up to 120,000 per year, it is imperative that the very best kind of tracking system be available to ensure that records are not misplaced or misfiled and that a status report on each of the cases brought to the Commission each year be readily available. The Commission has experienced great difficulties in maintaining an effective computer operation due to the persistence of communications linkage problems between the buildings causing the computer to become dysfunctional. With the current dispersal of the Commission in a variety of locations, the

effectiveness of the computer is simply not able to reach its optimum level. Forty-two times in the last year the computer system was "down." This is especially significant when considering that each "outage" of the computer system creates a great degree of disruption to normal SEC operation. For example, if the computer is working for 15 minutes before going down, it is possible that all the materials that were entered into the computer may have been inadvertently eliminated by the outage.

During 1979, the effective down time and unreliability of the computer caused the system to be functionally unusable for almost two months. Since the air conditioning system used to cool the computer is marginal and provides no reserve or backup capacity, the computer system cannot be used during periods of air conditioning failure. Since some people are generally skeptical of reliance on the computer, credibility is called into the question along with attendant need to check accuracy and possible duplication of effort. A large backlog for the computer users has required extensive overtime and the acquisition of a separate mini-computer.

Additionally, the problems caused by a non-functioning computer create great inconvenience to the public. The public becomes dissatisfied when it is not able to get reasonably prompt answers as to the disposition of their cases and the location of file materials. Since the computer is so integral to the operations of the SEC, and since a great deal of time is lost when the system is not functioning, it lowers productivity at the various divisions of SEC and causes frustration on the part of staff and the public.

Another problem with computer services is that the space available to house the computer operation and personnel is overcrowded. The computer room is cramped and it is increasingly difficult to position facilities and equipment in order to get the maximum efficiency out of staff and computer operations.

Training

A major deficiency in the space of the Commission is that there is no place to perform training of personnel on a formal basis. There is inadequate room available for orientation of new staff and for training staff to improve their skills and effectiveness. There is no room for groups of people to assemble on a regular basis except for the Commission hearing room which is difficult to schedule for training and meeting purposes. Moreover, the Commission's staff requires a room with audio-visual facilities which can be used to video-tape headquarters training programs for new groups of employees and regional office personnel.

SEC Direct Costs of Dispersed Locations

Drivers (3 at \$15,000)	\$ 45,000
Vehicles	
Trucks (AVIS)	10,000
Car (3 at \$2,000)	6,000
Fuel	10,000
Duplicate Facilities	
Xerox rooms, personnel and equipment	28,000
Libraries	21,000
Mail rooms and personnel	18,000
Toll Charges and Direct Lines	5,000
Computer Services (e.g., Lexis)	4,000
Overtime for storage and pickup	70,000
Electronic communicator	1,000
Alterations	130,000
Additional ADP equipment required (annual cost)	30,000
Guard Services	<u>30,000</u>
 TOTAL	 \$408,000

Indirect Costs

There are a variety of costs which are not as easily measured but are equally as important to the effectiveness of the work of the Commission. Lowered efficiency robs the Commission's staff of an opportunity to perform a full measure of public benefit in accordance with legislative mandates. Due to budget restrictions, the Commission is unable to increase staff to compensate for inefficiency caused by the distribution of its offices at dispersed locations. Therefore, lowered efficiency either requires existing staff to work harder and longer, or for the level of service provided by the agency to be diminished. Based on a review of the Commission's operations, it appears that both of these impacts are being felt by the Commission.

It is difficult to measure the tangible cost of each of these factors of lowered efficiency. However, it is helpful to identify some of the factors that may result in lower productivity and output.

Internal Communications

Commission employees who have been relocated to satellite offices are out of the Commission mainstream of normal daily communication. It is more difficult, for example, to engage in informal communications which are necessary to improve the understanding of changes in emphasis in processing filings. The sense of being away from the "main" office has a subtle effect of undermining the teamwork orientation of the Commission headquarters. Since the Commission has indicated that it is understaffed to perform the requirements of law, an effectively working team environment is necessary to partially compensate for lack of an adequate level of staffing.

Commission staff have also experienced a decrease in the level of communication among the various divisions. Many issues cannot be resolved on the telephone and require small conferences among the staffs of several divisions. While meetings among individuals from various locations may resolve many issues, meetings among individuals from the various locations are difficult to arrange, and there is little incentive when commuting to and from the meeting may take substantially more time than the meeting itself.

Mail Problems

Dispersed locations also require interoffice mail to be shipped between buildings. Despite vigorous management efforts, a small amount of mail is inevitably lost between offices. Mail can take up to two days to be delivered between offices at dispersed locations. For rush mail, a special messenger must be used. However, many offices use clerical staff to hand carry mail between offices to ensure prompt and careful delivery. This reduces the amount of time clerical staff are situated in their offices and detracts from time available to perform normal assignments. On particularly important issues, professional staff may even carry mail between offices and different locations.

Lost Files

On the average, approximately 250 to 300 files per day presently travel between the Washington area buildings. That number increases greatly during the filing season at the end of March. In addition to the large amount of lost staff time waiting for files to arrive, an inordinate amount of time can be consumed when a file is misplaced or lost. This requires a

search by the staff to locate the file or to make a decision to obtain a replacement file. This incurs direct loss of time on the part of the staff and potentially on the part of the public.

Building Conditions

It may be worth noting that, apart from the problems associated with operating from split locations, the condition of the buildings varies substantially. However, in each location there are a number of problems which adversely affect the performance of staff and the productivity of their time.

Heat

The heat in the Capitol Street building and the First Street building is not balanced. This means that in the Capitol Street building, the ground floor can be 66 degrees while the eighth floor is 88 plus degrees. Since the heating and cooling cannot be balanced in the building, there can be no satisfactory solution to the maintenance of adequate temperature levels to accommodate for the differences in the heat within the building. In the summer time, the First Street building has been exceptionally overheated, too often creating heat in excess of 85°. While GSA has indicated they have repaired the system, there is great apprehension on the part of the staff as to whether or not this will be adequate to provide a reasonable working environment in the months ahead.

Overcrowding

Overcrowding is a major problem in the North Capitol Street office. Overcrowding is a factor which reduces productivity by placing too many people in uncomfortably close proximity to each other and adversely affecting their ability to concentrate and to work on confidential matters with a sense of privacy. The degree of overcrowding experienced at North Capitol Street creates distractions and annoyances which adversely affect work performance and may also be a factor in reducing the effective level of service to the public.

Condition

The general condition of the office space is not commensurate with the type of performance required by the highly complex work at SEC. The dignity and the importance of the mission of SEC is not reflected in the reasonable and minimal attractiveness of the office surroundings. Additionally, building alterations required to accommodate staff reorganizations is a lengthy process. This diminishes the effectiveness of the agency.

Also, construction employees often come to an office location and begin work without advance notice and without proper care and concern for the effect of construction on the operations of the office. This was particularly experienced in a recent renovation effort on First Street. Work was concluded and the renovated parts of the office space were left in an uncompleted or partly completed condition.

Split Offices

A number of divisions within the Commission are split among several locations. For example, Corporation Finance, Economic and Policy Research, and Administrative Services, are divided between two locations, while Reports and Information Services is divided among three locations.

The requirement for communication between offices is further exacerbated by an even more intense and important need to communicate within an office or division of the Commission. The need for very close team work within a subdivision of the Commission is frustrated when an office is divided among several locations. For example, in the Division of Corporation Finance nearly every task force is staffed by personnel working in two locations, which causes both timing and scheduling problems. Also, in the Administrative Services Office, the Graphics staff are located on L Street and the Printing staff with whom they work are located at North Capitol Street.

Waiting

There are enumerable situations in which a staff meeting is scheduled at the North Capitol Street office and staff come from various other offices on L Street and First Street. However, there may be an extension of a previous meeting and it is inopportune to advise all the participants in the meeting of a delay in a scheduled meeting. Consequently, not infrequently, staff arrive at North Capitol Street for a meeting and must wait until the meeting is to begin at a later than scheduled time. The alternative is to return to the office and come back at the right time. The inconvenience and loss of time in waiting is an important and significant time cost for the Commission staff.

Storage

Storage of supplies and materials for the SEC is in three separate locations in the city, with one location in the basement of the North Capitol Street building. In the North Capitol Street building, there is no loading dock, and the SEC utilizes space leased for parking by the SEC Recreation and Welfare Association, to

store skids of paper, carpeting, and other supplies. These items are stored behind vehicles, against the walls, and cannot be moved when the vehicles are parked. Therefore, to utilize any of the supplies/paper stored in the garage, they must be moved prior to or after working hours.

The location of storage outside the main operations of SEC is a problem. It requires truck transportation to the storage locations and time required to transport in between the locations. However, the most important factor is the condition of the storage space. The storage facilities at the Navy Yard are very poor and the layout of the space is in a long, narrow configuration. It is difficult to utilize a loading vehicle to traverse the entire length of the storage area. Therefore, materials that are in the back can only be obtained by moving aside all the materials in the front. However, there is no room to temporarily store the materials in the front while moving them to obtain access to the materials in the rear of the storage area. This requires a great deal of wasted and unnecessary moving time because of the difficulty of access.

It is exceedingly difficult to verify inventory because of the lack of access. Consequently, it is difficult to be fully informed of the material available in storage so that it can be made available for use as the Commission needs the material.

A second storage location on 14th Street is in even less usable condition. It is a maze of interconnected rooms with very difficult passage among the rooms and with structural support which

is insufficient to accommodate loading vehicles. Additionally, the doorway access to the storage space is not sufficiently wide to accommodate loading vehicles. Consequently, loading and unloading of supplies in this storage area is difficult.

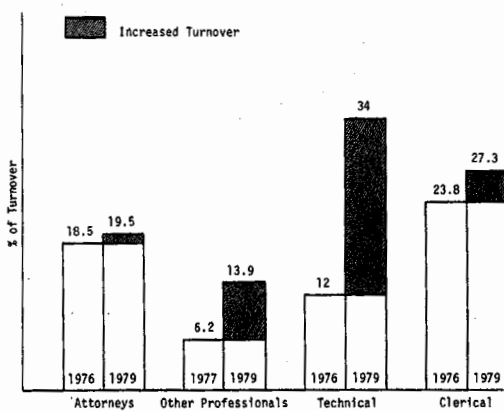
Storage in the 500 North Capitol Street location is limited. Consequently, hallways, showers and other inappropriate places are used for "temporary" storage for materials. It is a condition which does not appear safe and is apt to become worse if management acquiesces to the requests of staff joggers for access to the storage cabinet/showers.

Staff Turnover

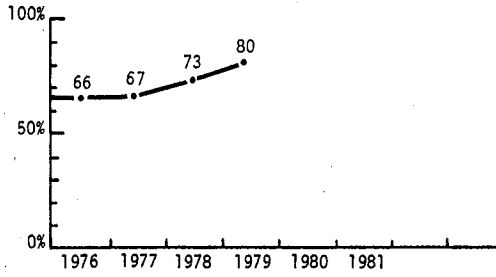
Many of the offices interviewed have identified lowered staff morale as a problem arising out of both the condition of the offices as well as the dispersal of offices away from the main headquarters of SEC. Attempt was made to understand whether there was a resulting higher degree of staff turnover which may be occurring at SEC due to lowered morale and poor working conditions in office environment.

The rate of staff turnover has gone up in every category and there has been a more than doubling of the non-attorney professional staff turnover and almost tripling of the turnover on the technical staff since 1976.

An analysis of the "reasons for departure" from Corporation Finance was conducted for the period between 1976 and 1979. This staff was divided between the First Street office and the North Capitol Street offices in 1978. Before

Comparison of Turnover for 1976 and 1979

**Percentage of Terminating Employees
Commenting on Need for Improved Office Environment**



CORPORATION FINANCE

Environmental Changes

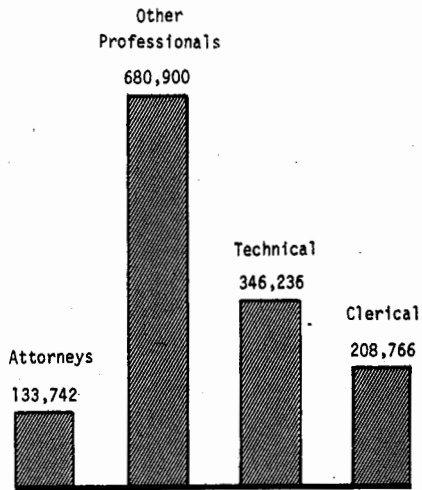
1976	No Change
1977	No Change
1978	Move to 1st Street
1979	Construction Alterations Excessive Heat

1978 approximately two-thirds of the employees commented on the work environment and the need for better facilities. However, since 1978 when the staff was separated in two locations the number of departing staff commenting on building conditions and work environment increased to 73 percent in 1978 and 80 percent of those departing in 1979. It can be reasonably deduced that greater pressure placed on the employees by their work environment is one of the factors leading to their decision to leave the Commission in increasing frequency.

The hiring and training of personnel is an important cost consideration. Commission records indicate that it costs approximately \$4,700 to advertise, interview and hire each new staff member by the Commission. Additionally, after an employee is hired, it takes time for an employee to become oriented with the specific work and responsibilities in his new position with the Commission. The average orientation time varies among the categories of employees. However, it is not unreasonable to say that it takes approximately one year to become oriented and fully productive in the Commission's employment.

When considering reduced productivity during the orientation period and the cost of each new hire, the investment in each new employee that must be rehired to fill a vacancy becomes very significant for the Commission. If the amount of turnover could be reduced by improvement in the facilities and consolidated operations of the Commission, the savings to the taxpayers would be substantial.

The following table represents some possibilities for potential savings to the Commission through the reduction of turnover to a level which was experienced in FY 1976 for the Commission.

Potential Savings by Reduced Turnover

TOTAL POTENTIAL SAVINGS: \$1,369,644

Productivity

The measurement of staff productivity is a judgment which can be made by individuals within an organization but is very difficult to specifically measure. However, the problems of the SEC staff in operating from four separate office locations and two storage locations is perceived to be great on the part of individuals interviewed. Even beyond the directly measurable time in communicating and commuting between offices, there is an inordinate amount of staff time diverted from the major concerns of the Commission to compensating actions to overcome space problems. For example, there is an inordinate amount of time spent in arranging for moves, conducting a move and adjusting to the new arrangement of people and offices after the move has been conducted. This higher degree of office moves is brought about because the Commission is beyond its reasonable office space capacity.

The offices of the SEC are very interdependent. Therefore meetings are very difficult to schedule and logistics become an important consideration. This concentration on logistics and overcoming the "friction" factor of difficult access to colleagues in a very interdependent organization often results in deferring or avoiding meetings when it is not absolutely essential. When this happens, there is a loss in effectiveness in the organization.

Because of the cramped and dispersed space, there is an inordinate amount of time and effort devoted to devising short term solutions to the problems created by the space situation. This absorbs important time and deflects focus from the organization's main objective.

After discussing the effects of the impact of the dispersal of space and the overcrowding in parts of the Commission, staff judgments were made as to the effective decrease in productivity above those that are identified as direct costs. That is, even after considering the time lost commuting between buildings and compensating for other inefficiencies associated with the

distribution of space in the Commission, there is a strong perception of lowered productivity. This is due to a combination of adverse office conditions arising from heat, noise and disruption, in addition to time devoted to moving and to post-adjustments along with numerous other elements described elsewhere in this report.

While it is difficult to specifically measure productivity decreases because time and motion studies are not realistic for the type of staff operating in the Securities and Exchange Commission, it is reasonable to prudently estimate some creditable amount of reduced productivity. The four major divisions which have split operations between various offices of the Commission were queried and prudent, best judgment estimates were prepared as to the reductions in productivity arising out of the dispersal and overcrowding of office facilities for the SEC.

Based on this analysis, it is not unreasonable to estimate that a productivity loss of approximately 20% or a personnel cost of \$2.3 million is a reasonable and prudent approximation of the amount of Commission energy consumed in the adjustment to the poor distribution and layout of space serving the Commission.

Industrial engineering is a science devoted to analysis of functional support to the primary productivity and efficiency of operations. Based on any reasonable, readily available standards, it is clear that the SEC space is not designed or arranged to support the maximum productivity on the part of the SEC staff. It is reasonable to assume that if space were designed to the specific needs of the Securities and Exchange Commission, an increase in effective productivity could be realized, and available to be put to use in the performance of the SEC's program requirements. While this estimate only includes four divisions within the SEC, and represents approximately one-third of the staff budget, it is actually considered to be a conservative estimate. Certainly, an office designed to specifically suit the needs of the SEC would have even additional productivity benefits to the balance of the SEC as well.

Estimated SEC Productivity Losses

Dispersed Office and Storage Location

	Personnel Budget	Productivity Losses
Economic & Policy Research	1,021,819	204,364
Corporate Finance	7,126,678	1,425,336
Administrative Services	932,437	186,487
Reports & Information Services	<u>2,602,323</u>	<u>520,465</u>
TOTAL	11,683,252	2,336,652
Total Washington Offices	33,210,145	

Public Cost

Meeting Rooms

Records

The SEC is an organization which deals principally with issuers, investors and institutions. The impact of inefficient operations on the public which it serves is a very important consideration. In this analysis, there are strong indications that the dispersal of SEC space throughout the city has an important effect by inconveniencing the public that SEC serves as well as imposing unnecessary economic risk, direct cost, and other significant burdens on the private sector. Generally, the Commission's present circumstances have resulted in hundreds of hours of lost time, delayed deliveries, excessive duplication of facilities and materials, as well as other inefficiencies.

While it is extremely difficult to completely cite the total cost of dispersed office space on the public, indicators of this problem and the dimensions of the problem will be identified in this section.

The information which was used as the basis of analysis in this section, was derived primarily from attorneys and other members of the public doing business with the Commission.

Credibility

In order to be most effective in fulfilling its requirements, the SEC must have credibility. Credibility is a difficult value to measure. Yet, it has its effect on the willingness of corporate entities to comply with SEC requirements. If credibility is reduced, the job of the SEC staff is correspondingly harder.

Several measures effecting credibility of the organization were mentioned during the interviewing of persons dealing with the SEC in a professional capacity.

When the public is required to come or voluntarily comes to the Commission to discuss matters with SEC staff, there is a major problem locating a place to meet with a reasonable degree of privacy. Typically there are no meeting rooms available. Five Hundred North Capitol Street with over 925 staff, has only two meeting rooms available which are in constant use. Consequently meetings will be held with the SEC staffer in his office. However, there are typically not sufficient chairs and a 5 to 10 minute search for chairs is a normal prerequisite to a meeting. The typical public comment is essentially that if the work of the SEC is important why can't the SEC staffer obtain use of a simple meeting room in order to conduct its business in a reasonable and professional manner?

Due to lack of storage space, files are packed throughout the SEC in all manner of locations including hallways. Legal representatives express some apprehension about the potential for loss of files and keeping track of important confidential material by the SEC. This translates into a reluctance to submit anything except copies of required information to the SEC. There is apprehension based on experience, that there is a reasonable possibility that materials will be misplaced and that additional copies will have to be transmitted to the SEC when time is of the essence.

Appearance

The work of the SEC involves enormous economic implications for the nation's economy. If the SEC work is not conducted in a proficient and effective manner, the viability of the securities industry and the confidence in the marketplace can be adversely effected. The offices of the SEC are not commensurate with that very important charge given to it. Elevators are very slow, freight is carried in passenger elevators, offices are cramped, most professionals share offices, and often share telephones. Visitors must walk through offices, interrupting work on their way towards an office in which they will be meeting, and decor is not given sufficient or adequate attention. Since the North Capitol Street and the First Street offices have very ineffective heating/cooling systems, it is not unusual for meetings with top management executives and leading attorneys to be held in an office with many distractions at a temperature which exceeds 85 degrees.

Offsetting these building conditions is an eager staff which is well educated and dedicated to the purposes of the SEC. The office space environment, while not the most important ingredient affecting credibility, presents an effective statement to the public which is frequently ready to believe less than the best of public employees to begin with.

Privacy

Much of the activity of the Commission requires a reasonable degree of confidential treatment and attention to the requirement for privacy in accordance with the tenets of the Privacy Act. Certainly, much of the work of the SEC entails information which should not be released prior to designated, scheduled times.

During discussions with SEC staff, there is generally insufficient provision for privacy. Too often, the public will not be meeting in a meeting room, the doors can't be closed for a variety of reasons. SEC staff may be walking through an office area during confidential discussions and other visiting public may be walking past a meeting in which confidential information is being discussed. There is insufficient space in which members of the public may come and engage in important discussions in a private and secure manner. This was an important reason for recently imposed changes in policy dealing with press access to SEC space.

Security

Guard service in the North Capitol Street Office is adequate. However, in the First Street Office and the L Street Office, individuals are not effectively screened prior to entry into the SEC areas. This is principally due to the lack of SEC control over the guard service because SEC is not the principal lessee of office space in those buildings. There is a basic expectation and strong desire that material filed with the SEC will be handled in a confidential manner and released for public information only at the appropriate time.

There have not been a large number of events in which security and privacy have been cited as being breached. However there is a pervasive and distracting sense of the lack of privacy and security with the care and handling of information yielded by the private sector to the SEC.

Business Costs

The SEC has a distinct economic impact on the public it serves. This impact involves direct costs as well as the element of risk dependent upon the effectiveness of SEC operations.

Risk Avoidance

The Commission receives well over 50,000 filings each year subject to evaluation by the Division of Corporation Finance. The bulk of these filings is received at 500 North Capitol Street, processed initially at that location and then shipped to the satellite location. In spite of vigorous management effort, and measurable improvements, there are inevitable misroutings and delays in this process. After consideration at the First Street location, filings requiring higher level review must be returned to 500 North Capitol.

Because of the dislocation of the Corporation Finance Division in two offices, and because of the extreme importance of registration filings and proxy filings, many are hand carried to the SEC by messenger service. However, in order to meet the very tight schedule for having registrations become effective in the required time, one of the problems created is the need to provide messenger service to both North Capitol Street and to First Street. This is a serious problem because mail service between North Capitol Street and First Street can take one to two days if a filing is submitted only to the North Capitol Street Office.

Many registrants, aware of the circumstances, incur additional costs and reproduce, voluntarily, non-official copies of their statement. Unfortunately, the staff cannot always use the unofficial copies and much time can be wasted locating the original document. In a situation of a registration statement where there is a large offering of common stock for underwriters which have worked strenuously to arrive at agreements, the economic impact may be substantial if the registration statement does not become effective between the opening of the SEC offices at 9 a.m. and the opening of the stock market at 10 a.m. on the same morning. Attorneys handling these registrations find it absolutely essential to incur the cost of quality messenger services to compensate for the two locations of the Corporation Finance Division.

Attorney Fees

Because of the importance of timing, it is not unusual for a group of attorneys who have worked to put together the necessary paperwork for a filing, to be waiting as a group for up to two hours or more while waiting to be assured that a registration has become effective within the time required. One law firm reported that this could mean up to \$2,400 an hour for several hours in situations in which there are some problems that might emerge with proper registration filings. This is a problem which has clearly been exacerbated by dispersal of offices in several buildings.

Lost Records

Lost records can be an important problem for the public. One lawyer serving the public says "it happens all the time." SEC staff indicates that there is some loss of records both within the Commission because of the inadequate storage and filing facilities as well as those that are misplaced in transit between the buildings. This requires staff effort to locate misplaced files consuming staff time. This also consumes valuable time on the part of the public while a search is undertaken to obtain a record.

Effectiveness

One of the major factors affecting the public's dealing with SEC is the time that it takes to communicate between buildings. As noted elsewhere, the work of the Commission is highly interrelated among the various divisions. Much of the business is complex and cannot be easily handled by phone. Internal communication within the SEC staff is also more difficult because of dispersed locations. The perception is that quality of effort on the part of the staff has been diminished because of this problem.

Another problem for the public is the difficulty in making reasonable presentations to Commission staff. This is experienced because a lawyer may arrive at North Capitol Street with time to spare for a meeting but may find that he has to go to another location, arriving there 10 or 20 minutes late for the meeting. This often represents a reduction in the amount of time available to meet with the staff. This reduced time puts more pressure on the staff to negotiate solutions to problems.

Another factor is that because of the physical arrangement and environment in which meetings take place, meetings often take longer due to disruptions and distractions. This is both an added cost for the staff of the SEC as well as for the public dealing with the SEC.

Another expressed concern is the amount of employee turnover. One lawyer indicated that in the course of one case, he had four consecutive sets of SEC staffers working on the case as a result of turnover within SEC. This creates a problem of continuity on the case and requires continuous reorientation of new employees. This both extends the time required to conclude work on a particular case and also adds significantly to the labor required to present the case adequately to SEC.

Confusion

Even with experienced lawyers, there is often confusion as to which office to see to deal with SEC matters. It is not unusual to arrive at North Capitol Street to find that the individual to be met is located on First Street. This issue is put into perspective and importance by the fact that over 70,000 investors, attorneys, accountants, registrants, and other members of the public conduct business at the Commission each year.

Conclusion

Annual Costs and Savings

Savings

DIRECT COSTS		\$ 408,000
INDIRECT COSTS		
- Increased Turnover Costs		
- Attorneys	133,742	
- Other professionals	670,900	
- Technical	346,236	
- Clerical	208,766	
		\$ 1,369,644
- Productivity Costs of Major Dispersed Offices		
- Economic & Policy Research	204,364	
- Corporation Finance	1,425,336	
- Administrative Services	186,487	
- Reports & Information Services	540,465	
		\$ 2,356,652
Total		\$ 4,114,296

Costs

Proposed Space at 1982 Cost	\$ 5,104,296
Present Space at 1982 Cost	\$ 3,835,685
Total - Additional Cost in 1982 of Proposed Consolidated Space Over Present Dispersed Space	\$ 1,268,611

Net Savings

Cost Savings Due to Consolidation	\$ 4,114,296
Additional Cost of Consolidated Space	\$ 1,268,611
Total Net Savings With Consolidation	\$ 2,845,685

Ratio

The Ratio of Cost Savings to Additional Costs			
<u>SAVINGS</u>	<u>4,114,296</u>	or	<u>3.24</u>
<u>COSTS</u>	<u>1,268,611</u>		<u>1</u>

The present distribution of office space for SEC is neither cost effective, nor does it permit the Commission to operate in a reasonably business like manner.

The savings in providing a consolidated facility for SEC operations by 1982 is over three times the additional cost that would be incurred. The savings in direct and indirect costs of \$4,114,296 far overshadow the added cost of \$1,268,611, and results in a total savings of \$2,845,685 arising from consolidation. Of these savings, \$408,000 would be direct savings in budgeted resources which would not be required to support consolidated operations for the Securities and Exchange Commission.

A more important impact of elimination of dispersed SEC facilities will be on the ability of the Commission to better perform its legislatively mandated responsibilities.

There are strong indications that the dispersal of SEC has the important effect of inconveniencing the public as well as imposing unnecessary economic risk and direct cost on them.

The condition of the space is not commensurate with the importance of the work and the expectations placed on the Commission. The present facilities, are crowded and unattractive and do not provide a business like environment in which to conduct sensitive and complex business involving high economic value and risk.

Due to the sensitivity and importance of the work of the Commission, especially in the requirement for timely responses, efficient organization of space and support facilities is essential. This analysis indicates that the current inefficiencies can be greatly ameliorated with savings far in excess of the costs of a consolidated facility.

Mr. WILLIAMS. It has been nearly a decade now since the Commission first sought to secure a consolidated headquarters that would adequately serve not only its staff but the over 70,000 investors, attorneys, accountants, registrants, and other members of the public who conduct business at the Commission each year.

It has been over 5 years since the Congress and OMB and GSA first supported such a consolidation, and yet over the years the Commission has expanded into three satellite locations to accommodate additional personnel needed to fulfill its expanded responsibilities.

The present split imposes large costs both direct and indirect on the Commission, its staff, the business community, and the investing public. In spite of our best management efforts, hundreds of hours of lost time, delayed deliveries, duplication of facilities and material have been the inevitable result.

The direct dollar cost to the Government is estimated at nearly half a million a year, much of which could be recovered if the Commission were housed in a single headquarters. The indirect costs, especially to business, are more difficult to quantify, but they derive from the costly inefficiencies which result from arbitrarily splitting the work of the Commission.

The Commission is a small integrated agency with a highly specialized mission to protect investors and insure the integrity of our Nation's capital market. Unlike the situation found in many Government agencies, the Commission's divisions and offices are not free-standing organizational components; rather, almost all Commission activities require the coordination or integration of several offices and divisions.

Historically, the Commission has attracted to its staff high quality lawyers, accountants, economists and other professionals, and the nature of the Commission's work requires a large number of such highly trained professionals.

Moreover, its work requires extensive daily interaction in Washington with the corporate, financial and legal communities, and with the investing public. Under these circumstances the present split of the Commission between four Washington area locations has a particularly serious impact on the Commission's productivity and places unwarranted burdens on the private sector.

In the face of contrained budget resources and minimal pay increases and increasing restrictions and demands on Commission employees, no single event could have a more positive impact on the productivity of the Commission staff than the resolution of the Commission's long-standing space needs through the acquisition of a suitable headquarters.

The most efficient and expeditious means of achieving that end in our judgment would be to provide the Commission with its own leasing authority.

Mr. SCHEUER. With its own leasing or purchase authority perhaps?

Mr. WILLIAMS. We would be delighted to explore both. Our sense was that leasing might be a little simpler, but we are end-oriented.

Mr. SCHEUER. Right.

Mr. WILLIAMS. Mr. Chairman, members of the committee, I have sought to provide a realistic assessment of the resource requirements of the Commission in the discharge of its responsibility.

As I noted at the outset, I am mindful of the economic climate, but I feel it is my responsibility to report to you accurately with respect to the Commission's needs.

Moreover, I believe the Commission has an important role to play in our economic recovery by insuring the continued integrity and stability of the Nation's capital markets which facilitate capital formation and contribute to confidence in the economic condition of the country.

This concludes my prepared remarks, and I would be pleased to respond to any questions you may have.

[Testimony resumes on p. 73.]

[Mr. Williams' prepared statement follows:]

STATEMENT OF THE HONORABLE HAROLD M. WILLIAMS
CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION,
BEFORE THE SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE
HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

March 20, 1980

Mr. Chairman and members of the Subcommittee, I am pleased to have the opportunity to testify on behalf of H.R. H.R. 6830, which authorizes appropriations for the Securities and Exchange Commission for the fiscal years 1981-1983. The Commission has submitted to the Subcommittee a detailed justification supporting the request contained in the Bill. I request that the document, entitled "Budget Authorization Request For Fiscal Years 1981, 1982, and 1983," be made a part of the record of this hearing. This morning I would like to highlight the rationale for the request and discuss the Commission's pressing need for a consolidated Washington headquarters.

The Commission is requesting \$85.5 million for fiscal 1981, \$98 million for fiscal 1982, and \$108 million for fiscal year 1983. In addition to anticipating increases in operating expenses, the request would allow the Commission to increase its staffing level from the present 2,100 to approximately 2,500, and would enable the Commission to fund its new Market Oversight Surveillance System.

We are acutely sensitive to -- and fully support -- the urgency of controlling inflation and the related need to

limit Federal spending. We are also well aware -- and fully support -- the strong desire of Congress to limit the size of the Federal regulatory presence. Regardless of its resource allocation level, the Commission and its staff will continue their commitment to fulfill their responsibilities with a professionalism and dedication which Congress and the investing public have come to expect.

At the same time, however, I believe that I would be remiss in my responsibilities to Congress, the Commission, and the public if I did not make clear to this subcommittee my judgment, based upon a career of management experience and almost three years heading the Securities and Exchange Commission, that the Commission's resources are not adequate to permit it to discharge its important responsibilities.

I recognize that Congress from year to year may be required to balance the resources needed to effect the public policies embodied in the Federal securities laws against other public concerns, such as the need for budgeting constraints. However, it is my suggestion that in the context of a multi-year authorization request, which provides the unique opportunity for the Commission's oversight committees to take a long-view of the Commission's programs and policies, the threshold inquiry should be on the resource levels necessary for the Commission to effectively carry out its mandate. Subsequently, Congress, of course, can reconsider these

resource levels on an annual basis according to the then-current budgetary conditions.

Before outlining the Commission resource needs, I would like to address the Commission's request for a three-year - authorization. Two years ago, this Committee supported a three-year authorization for the Commission. Today, the request for a three-year authorization is even more appropriate.

Multi-year budget planning is critical to the efficient management of the Commission. Both the Congressional Budget Office and the President's Office of Management and Budget have stressed its importance in their recommendations and procedures. The enactment of a three year authorization will strengthen the Commission's ability to engage in its own long-term planning and permit it to participate meaningfully in the Administration's multi-year planning exercises. A three-year authorization will constitute a clear expression of the activity level at which the Congress intends for the Commission to operate in the three years ahead. It will enable the Commission to refer to multi-year authorization as a blueprint for structuring resource requests to OMB and the President over the next three years.

From my perspective as a Chairman whose term will expire in June, 1982, the three year term is particularly appropriate. The request will enable me to chart effectively

the priorities for utilization of resources for the remainder of my term, and then allow a one-year orientation period before a new chairman will be required to formally present his or her program to the Congress.

With respect to the Commission's resource requirements, since 1975, during a period in which the Commission actually lost 44 staff positions, the Commission has experienced an explosion in the number and complexity of its regulatory responsibilities -- in large part, for two specific reasons. First, significant changes have occurred in the financial markets and the financial community -- including greatly expanded market activity, increasing complexity of financial transactions, the development of a new mix of financial products being offered to the public and the increasingly high financial leverage of the broker-dealer industry. As illustrations, since 1975, the number of shares annually traded in the NASDAQ system increased over 150 percent, the number of contracts for exchangetraded options increased 250 percent, the number of registered broker-dealers increased by almost 80 percent, the number of registered investment advisers increased by two-thirds, there were \$100 billion worth of successful tender offers, and in the last year alone the assets of money market funds increased almost five-fold.

Further, during the same five-year period, Congress charged the Commission with a range of new regulatory responsibilities and legal obligations. For example, in 1975 Congress directed the Commission to facilitate the establishment of a national market system for securities. The Commission has also been charged with implementing the Foreign Corrupt Practices Act and has undertaken a greater role to achieve more effective oversight and self-regulation of the accounting profession. Moreover, recent judicial developments, which have severely restricted the scope of implied private rights of action, mean that, in many cases, no party other than the Commission can seek judicial enforcement of the Federal securities laws. At the same time, the Commission is not unmindful of its obligation to initiate regulatory reforms by reviewing and rethinking its existing regulatory structure and by considering steps that might reduce regulatory burdens consistent with investor protection. The Commission has taken many steps in this direction, and will continue to do so.

In light of its increasing responsibilities and diminished staff, the Commission has sought to enhance the professionalism with which it manages its resources and has submitted existing management techniques and systems to searching review. For example, corporate filings which were previously subject to detailed staff review are now processed under an "audit

mode"; that is, only certain key filings are closely scrutinized, while less resources are devoted to reviewing more routine documents. The Commission similarly has had to be more selective in the enforcement cases it pursues and in determining when a case should be appealed or whether to appear in private litigation as an amicus. But, resource allocation judgments can accomplish only so much. Accordingly, the Commission has proposed in its authorization request to embark on a five-year program to increase its personnel resources to a level which will enable it to fulfill its statutory responsibilities. The current authorization request would move the Commission toward the goal of adding approximately 700 positions in incremental steps over the next five years.

The Commission's job, in its most essential terms is to foster investor confidence in the fairness, integrity, and efficiency of the securities marketplace. That confidence is necessary to the health and vitality of the capital formation process which fuels our economy. I believe that the agency, when measured against these critical responsibilities which the Congress has directed it to shoulder, is seriously understaffed and underfunded. Let me cite some of the areas of greatest need.

Full Disclosure. As discussed above, at current staffing levels, the Commission has found it necessary to adopt an "audit mode" system and to curtail the number of corporate

filings reviewed as well. Reductions in the number of filings reviewed could affect the Commission's efforts to maintain acceptable levels of investor protection through operation of the review process. The staffing increases projected for the early 1980's would permit the Commission to expand the "audit mode" review to include certain filings which now receive no review and increase the percentage of filings reviewed in each category. It would also accelerate the development of quality control and training programs.

Prevention and Suppression of Fraud. With the increasing activity in the nation's securities markets and with the increasing complexity in these markets, the Commission must continue to maintain an adequate enforcement presence. Because of the large sums of money involved and the very real opportunities for illicit gain, securities frauds often entail creative, novel and rapidly changing schemes. Indeed, the complexity of securities fraud is, in part, an outgrowth of the Commission's success in eradicating many of the less sophisticated improper practices prevalent in earlier years. As Commission oversight of the marketplace has become effective and widely recognized, the unscrupulous have turned to new, more esoteric and intricate devices. In turn, Commission investigations have become progressively more complicated and time consuming. In addition, there is a growing inclination throughout our society to litigate, and this propensity

to mount judicial challenges to government action of all kinds has had its effects on the Commission's fraud suppression program. Commission enforcement proceedings develop into protracted and complex litigation with increasing frequency. At the same time, a highly skilled and specialized private securities bar has evolved. Defendants in Commission litigation generally have the financial capability to retain first-rate counsel when they elect to contest Commission charges. Trial preparation and litigation, accordingly, impose very substantial demands on the Commission's enforcement staff. Likewise, the private bar is increasingly in a position to command extensive clerical and paralegal support services to assist in complex securities litigation. To remain on an equal footing in its representation of the public interest, the Commission must therefore enhance the support on which its legal staff may draw. The tendency for defendants to resort to litigation to test the sufficiency of Commission charges is, of course, not in itself undesirable. It does, however, mean that the Commission must increase its legal staff simply to assure that the investing public enjoys the same degree of protection which the Commission was previously able to provide with fewer resources.

In addition to this overall trend toward more complex and time-consuming investigations and enforcement proceedings, a number of developments in the marketplace will

place new demands on the Commission's investigative, surveillance, and enforcement capabilities.

For example, inflationary forces over the past several years have pushed short and long-term interest rates to record high levels. This has resulted in the rapid growth of money market funds, and, at the end of 1979, these entities had assets well over \$100 billion. The expansion of money market funds has engendered new concerns in areas such as portfolio valuation, disclosure, back office efficiency, and selling practices, which have demanded additional Commission resources. Additionally, there has been a significant increase in investigations of investment companies other than money market funds.

Corporate mergers and acquisitions by tender offers have also developed into one of the major areas of Commission concern. Due to the critical time pressures inherent in these transactions, the Commission must be able to conduct expedited investigations in order to ascertain whether violative conduct is occurring. The subject is one of increasing Congressional and public concern, and it is imperative that the Commission remain current in its program to monitor activity in this area.

Regulation of Securities Markets. Since passage of the Securities Act Amendments of 1975, new responsibilities and new classes of regulated entities have come under the

Commission's jurisdiction. In addition, the regulated population has grown significantly, and the nation's trading markets have experienced substantial increases in activity -- first, with the development and growth of exchange markets for standardized options contracts, and more recently, with unprecedented increases in the volumes of stock trading.

In 1979, the Commission undertook to enhance its examination program for broker-dealers. The number of broker-dealers registered with the Commission has grown from 3,524 in 1975 to over 6,300 in 1979, an increase of 79 percent. The increases in personnel programmed for the early eighties will permit the Commission to increase the number of broker-dealer examinations to reflect increases in the number of registrants, and to focus on those firms heavily engaged in trading new investment instruments such as options.

The expansion of the options market which will accompany lifting of the options moratorium in 1980 is expected to generate increased workload in processing rule filings and in oversight of option trading. In addition, implementation of recommendations made in the Report of the Special Study of the Options Markets will require significant staff resources over the next several years.

Progress towards the development of a national market system has been a primary focus of the Commission in the past and will continue to be a major goal. The health and

vitality of our capital markets is crucial to the continued strength of our economic system, and accordingly, the Commission recognizes that steps to restructure those markets must proceed in careful and thoughtful fashion with a full understanding of the consequences. Accordingly, the Commission will continue to devote significant staff resources to the complex and sensitive task Congress assigned to it in Section 11A of the Securities Exchange Act.

In addition to programs either already in process or in the planning stages, there are several new areas bearing on the regulation of the markets which the Commission feels require immediate attention. For example, the Commission's enforcement efforts have uncovered a number of abuses in the government-guaranteed securities markets. A major effort will be needed to develop an adequate regulatory system to deal with the increasing participation in these markets by investors less sophisticated and less capable of bearing the economic risks associated with such securities.

Public Utility Holding Company Regulation. One of the Commission's prime objectives in this program over the next three years will be to reduce the growing backlog of filings. In the past, the Division of Corporate Regulation had an excellent reputation for prompt and effective action on the large volume of applications required under the Public Utility Holding Company Act of 1935. Applications are filed at the

rate of almost one per day, and are becoming more complex. Unique and novel areas which Congress did not contemplate when it enacted the '35 Act, such as concern for the human environment, acquisitions of coal and uranium mines by holding companies, oil and gas exploration and a myriad of other ventures into the fuel area as a means of dealing with the energy crisis, are requiring that the Commission expand its expertise.

Investment Management Regulation. There is now over \$100 billion being managed by investment companies and over \$600 billion being controlled by registered investment advisers. The latter has been particularly troublesome in the past due to inadequate information and the lack of bank custodians. The Commission attempted to deal with this issue last year by adopting an expanded form for investment advisers and computerizing the input to more easily spot problem areas. The Commission has undertaken two initiatives which will influence the effective regulation of investment companies and investment advisers during the period 1981-1983. The first consists of a series of studies to review the Commission's rules under the Investment Company Act and the Investment Advisers Act. The impact of these efforts on the private sector and the Commission's workload will not be fully felt until the mid-1980s.

The second thrust in this program addresses the inspection program for investment companies and investment advisers. Our goal is to schedule inspections on a two year cycle. Inspection cycles are presently averaging one examination every 5.8 years for investment companies and one every 11.8 years for investment advisers. With additional staffing, the inspection cycle would approach the goal of an inspection every other year for each investment company and investment adviser.

Economic and Statistical Research. The Commission is seeking to ensure that adequate consideration is given to economic issues and the impact of Commission actions on the nation's securities markets and participants in those markets. In the years ahead, greater emphasis will be placed on the ongoing monitoring of regulations already enacted by the Commission, as well as on development of a capability to identify longer term trends expected to impact on the securities industry.

Market Oversight Surveillance System. As I have sought to illustrate, the Commission has present and anticipated responsibilities which are not being adequately addressed by current staff resources. However, in addition to adequate staff resources, the Commission needs the technological capability to conduct oversight and surveillance in the trading markets and the self-regulatory organizations in.

order to keep pace with the increasing complexity and activity of the securities markets.

To ensure that capability, the Commission has undertaken to develop a market oversight and surveillance system -- MOSS -- that will enable us to (1) administer effectively our oversight responsibilities over the SROs'; (2) conduct more thorough and comprehensive inspections of broker-dealers; (3) monitor for trends in developments in the marketplace in coordination with SRO surveillance; (4) better coordinate with the SROs in follow-up to specific trading aberrations; (5) better evaluate rule proposals that have an impact on the marketplace; and (6) more effectively manage our oversight and surveillance resources. MOSS will complement the primary market surveillance systems operated by the self-regulatory organizations. It would do this in two basic ways: (1) it will provide cross-market or inter-market surveillance, particularly in regard to dual-market trading in options and trading in options and their underlying securities; and (2) it will integrate market trading data with non-market information such as material filed with the Commission.

We view meaningful oversight as a key to effective self-regulation. The Commission's MOSS system is intended to bolster an existing Commission function rather than usurp the traditional surveillance functions performed by the self-regulatory organizations. The Commission still intends

to rely very heavily on each self-regulatory organization to be primarily responsible for surveillance of its own trading market. But among other things, MOSS will enhance the Commission's ability to oversee the industry's surveillance of the marketplace and by doing so, strengthen the overall scheme of self-regulation.

In order to test whether the proposed design for MOSS lives up to expectations and to make necessary changes, the Commission is presently operating a pilot or prototype of the larger system. The SROs are playing an essential role in this pilot phase by providing us with the basic information from the trading and clearing process.

Consolidated Headquarters. Finally, I would like to discuss with you the Commission's critical need for a consolidated Washington headquarters, and our request for leasing authority to respond to that need. I would like to submit for the record a staff memorandum which outlines the history of the Commission's efforts to obtain a consolidated headquarters, describes the impacts of operating from multiple locations and explores the reasons why the Commission is requesting leasing authority.

It has been nearly a decade since the Commission first sought to secure a consolidated headquarters that would adequately serve not only its staff but the over 70,000 investors, attorneys, accountants, registrants and other

members of the public who conduct business at the Commission each year. It has been over five years since the Congress, OMB and GSA first supported such a consolidation. Over the years, the Commission has expanded into three satellite locations to accommodate additional personnel needed to fulfill its expanded responsibilities.

The present split between four locations imposes large costs, both direct and indirect, on the Commission, its staff, the business community and the investing public. In spite of the Commission's best management efforts, hundreds of hours of lost time, delayed deliveries, and duplication of facilities and materials have been the inevitable result. The direct dollar cost to the government is estimated at nearly \$500,000 each year, much of which could be recovered if the Commission were housed in a single headquarters. The indirect costs, especially to business, are more difficult to quantify, but they derive from the costly inefficiencies which result from arbitrarily splitting the work of the Commission.

The Commission is a small, integrated agency with a highly specialized mission to protect investors and insure the integrity of our nation's capital market. Unlike the situation found in many government agencies, the Commission's divisions and offices are not free-standing organizational components; rather, almost all Commission activities require

the coordination or participation of several offices and divisions. Historically, the Commission has attracted to its staff high quality lawyers, accountants, economists and other professionals; and the nature of the Commission's work requires a large number of such highly trained professionals. Moreover, the Commission's work requires extensive daily interaction in Washington with the corporate, financial and legal communities and the investing public. Under these circumstances, the present split of the Commission between four Washington-area locations has a particularly serious impact on the Commission's productivity and places unwarranted burdens on the private sector.

In the face of constrained budget resources, minimal pay increases and increasing restrictions and demands on Commission employees, no single event could have a more positive impact on the productivity of the Commission staff than the resolution of the Commission's long-standing space needs through the acquisition of a suitable headquarters. The most efficient and expeditious means of achieving that end is to provide the Commission with leasing authority.

Conclusion.

I have sought to provide the Committee with a realistic assessment of the resource requirements of the Commission. As I noted at the outset, I am mindful of the economic climate, but I feel it is my responsibility to report to you

accurately with respect to the Commission's needs. Moreover, I believe the Commission has an important role in our economic recovery by insuring the integrity and stability of the nation's capital markets which facilitate capital formation and contribute to confidence in the economic condition of the country.

That concludes my prepared remarks. I would be pleased to respond to any questions members of the Subcommittee may have.

Mr. SCHEUER. Thank you very much.

I have a great number of questions to ask you, but in deference to my colleague from New York, who has a busy schedule this morning, I am going to yield to him for such time as he may use.

Mr. OTTINGER. Thank you, Mr. Chairman.

Let's explore the building for a moment.

Have you got any contemplation of what it would cost to lease or purchase a building adequate for your needs in Washington; what the net economics of that would be compared to your present situation and, I suppose, lastly, as I understand it from most Federal agencies, the GSA performs this function.

Why is it that GSA cannot perform this function adequately for you?

Mr. WILLIAMS. Mr. Ottinger, on the last part first, I would think they could, but whether they can or not they have not, and I am at a loss to understand why. It apparently has not been one of their priorities.

Mr. SCHEUER. Well, just as a followup on that, we have heard that there has been a sort of glitch.

There has been sort of a glitch over a continuous systematic series of glitches in our communications with GSA. We have heard that you were unable for a long time to even be able to scrutinize a copy of the GSA lease on the building that you are in, and we have heard reports that the GSA regional administrator does not return your phone calls.

Is there some kind of an attitude there that is a problem, an attitude toward the SEC that seems to be a problem?

Mr. WILLIAMS. Well, Mr. Chairman, I find that difficult to answer. I don't have any frame of reference to test it against. I don't know whether this kind of problem is peculiar to the SEC.

Mr. SCHEUER. Did you have a problem getting a copy of the lease on your building?

Mr. WILLIAMS. Yes, sir, we finally got it from the owner of the building.

Mr. SCHEUER. What efforts did you make to see a copy of the GSA lease on your building?

Mr. WILLIAMS. I will have Mr. Milk speak to that.

Mr. MILK. The Commission requested a copy of the lease from GSA on no less than three different occasions; and at one point GSA gave us an abbreviated portion of the lease but they declined to give us the lease in its entirety.

Mr. SCHEUER. Was there any correspondence or was this oral?

Mr. MILK. It was oral in two instances, and there have been one or more written requests as well, but I understand that it is fairly common practice for GSA to deny agencies access to their lease agreements.

Mr. SCHEUER. How about the question of the phone calls? Is it true, as we have heard, that the regional administrator does not return your phone calls?

Mr. WILLIAMS. I haven't tried to reach the regional administrator recently. I don't recall that well enough. There was an episode of this sort, but I would have to get back into the facts to recall it.

Mr. SCHEUER. I yield back my time.

Mr. OTTINGER. Give us now for the record what your estimated costs are and what the net economics would be.

Mr. WILLIAMS. Our estimate at this point is that—and it will be in the material that we are filing, or if it isn't we will submit it—we are talking about a cost of proposed space of some \$5.1 million which, after elimination of duplicative costs and the costs of the present space and the cost of the proposed rate increases to our present space, would result in a net cost of the consolidation of \$900,000 a year.

Mr. SCHEUER. Have you factored in the benefits from that in terms of increased efficiency and less hassle for the lawyers and private business people throughout the United States and abroad who come to you for counseling and assistance of one kind or another?

Mr. WILLIAMS. The only thing we have factored in are what are clearly hard duplicative costs.

We have not, for example, tried to factor in stafftime shuffling back between locations.

Mr. SCHEUER. That would be a further reduction of that cost, and you would have to say that the increased convenience to lawyers here and businessmen from abroad would also be a further reduction to that cost?

Mr. WILLIAMS. Mr. Chairman, in 1976 I had occasion after many years of having been at the Commission, and at the time I had no expectation of ever becoming Chairman, I had occasion to come to the Commission as chairman of an audit committee with two other lawyers to present our report to the Commission's staff.

I found myself sitting in an office that was perhaps large enough for one person with two lawyers in there, and we couldn't get enough chairs in for the three of us to sit down. While we were trying to have a meeting with one lawyer, the other lawyer behind us was trying to do some work.

That is not the way the Commission should present itself to people for whom it has an oversight or regulatory responsibility, No. 1. No. 2, I don't know how I ever got any work done during that time or how we could effectively function, and that has been alleviated some with the expansion into the old Federal Home

Loan Bank Building, but it still is largely true, so that I think the most important cost saving in many respects can be just sheer efficiency of people's ability to do their jobs, and lunch facilities at the building are bad enough to be irresponsible.

Again, we force people to spend time away from the building, and a proper environment would make an enormous difference.

Mr. OTTINGER. I think it would be very useful to have an economic analysis. Is that something that you can do, that you have the capability of doing?

Mr. WILLIAMS. Yes; I must say in all candor it gets iffy. How do I put a dollar cost on the kind of thing I have just described, and defend it?

I do know it is there and I do know it is significant.

Mr. SCHEUER. If my colleague will yield, it might be better if a third entity were to do it.

You might call in a management consultant firm and give them a contract to review the costs and benefits of making such a move and what the real cost would be after factoring in with all of those enhanced efficiencies, morale, more effective workplace, more productive environment, both for the internal work of the Commission as well as the convenience factors for people coming in from our own domestic business, as well as from abroad.

It seems to me if you went to a management consultant firm and gave them a contract to do a study for you, they would carry some objectivity and credibility, and would help you make your case. Frankly, I would encourage you to do that and submit their analysis for the record. I think it would be a very proper expenditure of your funds.

[Testimony resumes on p. 129.]

[The following report was received for the record:]

FUTURE OCCUPANCY COST ANALYSIS
SECURITIES AND EXCHANGE COMMISSION

May 1, 1980

By

Gladstone Associates
Economic Consultants
Washington, D.C.

Gladstone associates

Economic consultants

John R. Fletcher
Vice President

April 30, 1980

Mr. Benjamin Milk
Executive Director
Securities and Exchange Commission
500 North Capital Street
Suite 846
Washington, D.C. 20549

Dear Mr. Milk:

We are pleased to submit our final report examining occupancy costs of alternative space solutions for the Securities and Exchange Commission.

The single most important finding of our analysis is that it is counter productive and more expensive to continue your leasing in multiple locations to solve your future space needs. When the penalty costs associated with the inefficiencies of multiple locations are considered, continuing in your present locations is the most expensive alternative. The least expensive is to own a consolidated facility, although this would require an outlay of some \$60 million dollars. Somewhat more costly in the long run would be leasing on the open market. However, this is vastly less costly, in the long run, than continuing in your present mode.

Should you have questions regarding this analysis, please do not hesitate to call.

Very truly yours,

GLADSTONE ASSOCIATES


Christopher Gladstone
Associate


John R. Fletcher

68-331 107

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SECTION I
EXECUTIVE SUMMARY

SECTION I
EXECUTIVE SUMMARY

Introduction

The Securities and Exchange Commission has been seeking a long term solution to its future space needs for almost a decade. To this end, the SEC has recently sought (1) to examine in more depth the penalty costs associated with the inefficiency and counter productiveness of having the Commission located in dispersed facilities, and (2) to examine and compare the occupancy costs of consolidation alternatives -- the focus of this report.

While the penalty costs are analyzed in a separate report, they are introduced in this comparative economic analysis as one component of future occupancy costs for continuing to lease in multiple locations.

Alternatives

While there are theoretically an infinite number of hypothetical alternatives that might be tested, they generally fall into the following categories:

- Status Quo. This alternative would continue the policy of leasing at multiple locations, increasing occupied space on the open market on an as-needed basis. The Status Quo alternative, as discussed above, is the only alternative to which special "penalty" costs are applied. These penalties result from inefficiencies and counter productiveness of being located in multiple facilities.

- Contract to Build/Own. This alternative assumes a major investment in new space, constructed to the specifications of the SEC.
- Acquire Existing Property. This alternative is similar to the Build/Own option except an existing property would be acquired.
- Lease New Building.
- Lease an Older Common Existing Property.

The combination of the above alternatives are many. There could be leases with options to purchase; construction of a building significantly larger than the immediate SEC needs requiring a leasing of excess space on the open market; many types of long term lease arrangements; and the like. It is not possible to evaluate all since each type of deal would be separately negotiated. However, the ones tested are reasonably representative.

General Assumptions

The essence of any financial modeling is in the assumptions. A more detailed explanation of assumptions is made in subsequent sections of this document. However, major assumptions are listed as follows:

- All alternative scenarios are hypothetical, except the Status Quo. None are based on any known deal but rather each is a composite based on Gladstone Associates' experience and research.
- The Securities and Exchange Commission has performed several recent analyses of its own space needs. Estimates have been made of employees by grade, special types of space requirements, etc. Gladstone Associates has reviewed these estimates,

and has used them as a basis for calculating usable, leasable, and gross square footage requirements in the future.

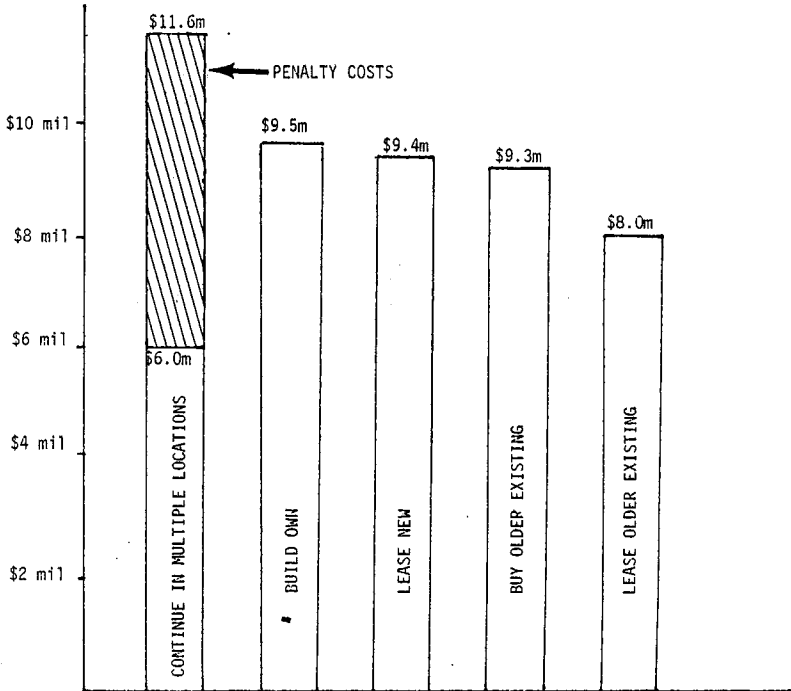
- Throughout the economic analysis, numerous assumptions were made regarding land and development costs, lease rates, rate of appreciation, inflation rates, etc. Some of these costs can vary widely. For example, land costs can vary by 100 percent from one block to the next. Lease rates, likewise, will vary by type of space, quality of space, location, age and condition of the building, etc. For purposes of this analysis, a mid point among ranges has been assumed. In hypothesizing alternative lease or own scenarios, neither the cheapest space nor the poorest locations were chosen, nor were prime commercial downtown costs assumed.
- In hypothesizing the construction of new space, General Services Administration (GSA) standards and costing techniques were used. In projecting lease rates on the open market, a Class B tenant finish level was assumed. In projecting a continuation of leasing in existing multiple locations, the GSA Standard Level User Charge (SLUC) system was used.
- For projecting the comparative costs of all alternatives, a thirty year period commencing in 1984 was assumed. The year 1984 is strictly hypothetical and represents a common starting point for all alternatives. It should not be misconstrued as the first possible date of initial occupancy for any alternative.

Key Findings

Penalty Costs

The single most important factor in cost comparisons among the alternatives is consideration of the penalty costs associated with

COMPARATIVE
INITIAL YEAR 1984 OCCUPANCY COSTS



lack of consolidation. For purposes of the comparative analysis, these penalty costs are considered equivalent to occupancy costs, since they are directly related to space problems and would be eliminated under a consolidation alternative.

● Penalty costs, estimated at \$4,115,000 in 1980, are projected to \$5,600,000 in 1984 (at an 8% annual increase). This nearly doubles the estimated 1984 occupancy costs of the Status Quo alternative. In other words, the penalties of extra direct costs, increased turnover, and reduction in operational productivity all resulting from multiple locations nearly equals the projected 1984 occupancy costs of \$6.0 million dollars.

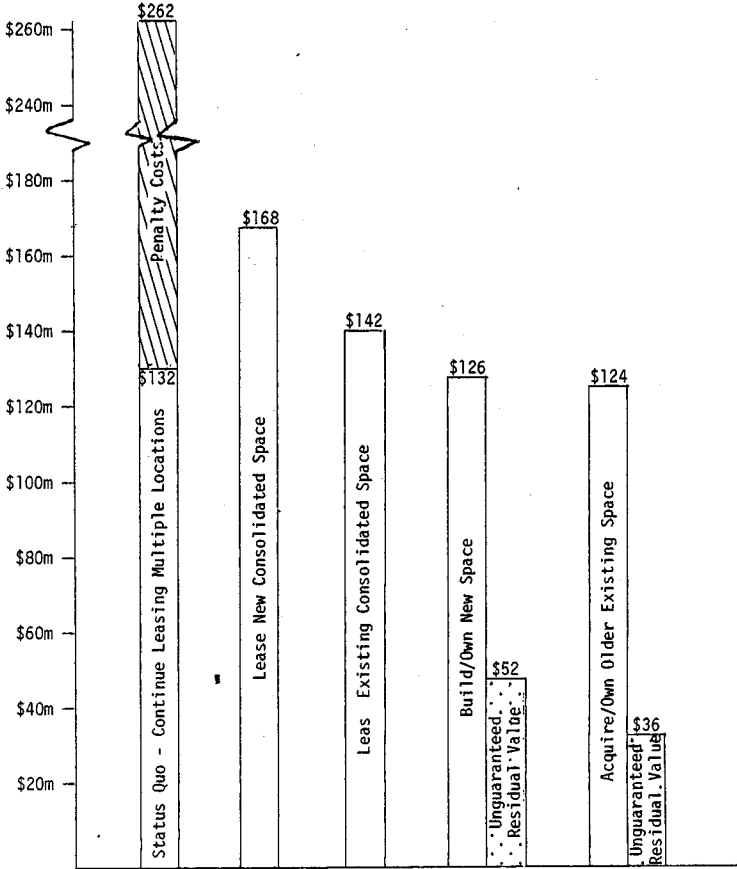
ESTIMATE OF PENALTY COSTS
ASSOCIATED WITH MULTIPLE LOCATIONS
SECURITIES AND EXCHANGE COMMISSION
1980, 1984

	<u>1980^{1/}</u>	<u>1984^{2/}</u>
<u>Direct Costs</u>	\$ 408,000	\$ 555,000
<u>Indirect Costs</u>		
Increased Turnover	\$1,370,000	\$1,864,000
Reduced Productivity	2,337,000	3,179,000
<u>Total</u>	<u>\$4,115,000</u>	<u>\$5,598,000</u>

^{1/} Source: James F. Giegerich & Associates
^{2/} Increased @ 8% per year, 1980 - 1984.

● With consideration of the penalty costs, the Status Quo alternative becomes, by far, the most costly long-term solution. In present value terms (1984 constant dollars), the

PRESENT VALUE COMPARISONS
OF 30 YEAR OCCUPANCY COSTS
AND RESIDUAL VALUES
(Millions)



Status Quo alternative costs \$262 million dollars, versus \$168 million dollars for the next most costly alternative. Likewise, occupancy costs for the first stabilized operating year -- 1984 -- show the Status Quo alternative to be over \$2 million dollars more costly than to lease a new consolidated facility.

● James F. Giegerich and Associates has evaluated the costs of the inefficiencies and the counter productivity -- both direct and indirect. Gladstone Associates has reviewed these estimates and believes them to be deliberative and responsible. The direct costs are most subject to estimation and we believe them to be conservative. The indirect costs are the most difficult to estimate as they are subject to judgment and interpretation. However, even if these indirect costs were reduced by 70 percent, the continuation of leasing at multiple locations would still be the most expensive long-term space solution in present value terms. Stated another way, even if indirect penalty costs were \$1.5 million versus the estimated \$5.0 initially, the Status Quo alternative would still be more expensive than leasing or acquiring consolidated space.

New Consolidated Space -- Own Versus Lease

On a strictly economic basis, without regard to Federal budgetary pressures, ownership of tangible real assets by the Federal Government appears advantageous compared with leasing on the open market. This is generally true during periods of expected relatively high inflation levels and in the Downtown Washington area where the commercial office leasing market is very tight, with lease rates escalating very rapidly. Major reasons for this conclusion are:

- Ownership averts continuing escalations in base rents based on percentage increases in the Consumer Price Index (CPI). These increases, now typical of most downtown standard leases, are in addition to "pass throughs" of operating expense increases.
- Likewise, ownership can avert stepped increases in base rents at renewal points -- usually at five to ten year junctures.
- The "cost of capital" of the Federal Government, assumed to be equivalent to long-term Treasury Bond Yields in this analysis, is somewhat less than the weighted average cost of capital in the private sector.
- There is an unguaranteed residual value to any property at the end of an assumed 30 year period. The precise value of that residual is highly uncertain, depending upon the cumulative impact of numerous assumptions on values over a 30 year period (i.e., impact of physical, functional, and economic depreciation factors). However, if the future 30 years were similar to the past period, the present value of future residuals would be similar to new construction values today, minus an allowance for improvements. This value, although not a certainty, still must be considered when comparing alternatives.
- At present, the Federal Government does not pay property taxes to the District of Columbia Government. Although

there is a payment in lieu of property taxes, there is no way of ascribing a fixed amount of new office building. Therefore, operating expenses in a leased private building would be higher than in a Government-owned building by the amount of the property taxes, all other factors being equal.

Having noted these cost advantages, there are several important disadvantages. First, ownership requires the outlay of approximately \$60 million during the 1981-1983 period. In a period of fiscal tightness, such an outlay may not be prudent. Further, ownership limits locational mobility somewhat. The flexibility to relocate without having to dispose of space may be an advantage sometime during the next 30 years.

● Comparing present values (1984 dollars) of future occupancy costs for new space over a 30 year period (1984-2013) ownership is \$42 million less expensive than leasing a new building before taking into consideration unguaranteed residual values estimated at \$50 million. As the accompanying chart illustrates, leasing of new space on the open market results in a \$168 million expenditure, in present value terms, vs. a \$126 million expenditure for the ownership case. This is true even though ownership is more costly during the first ten years of operation. (Likewise, leasing older consolidated space is approximately \$18 million more costly than purchasing older space, before considering residual values.)

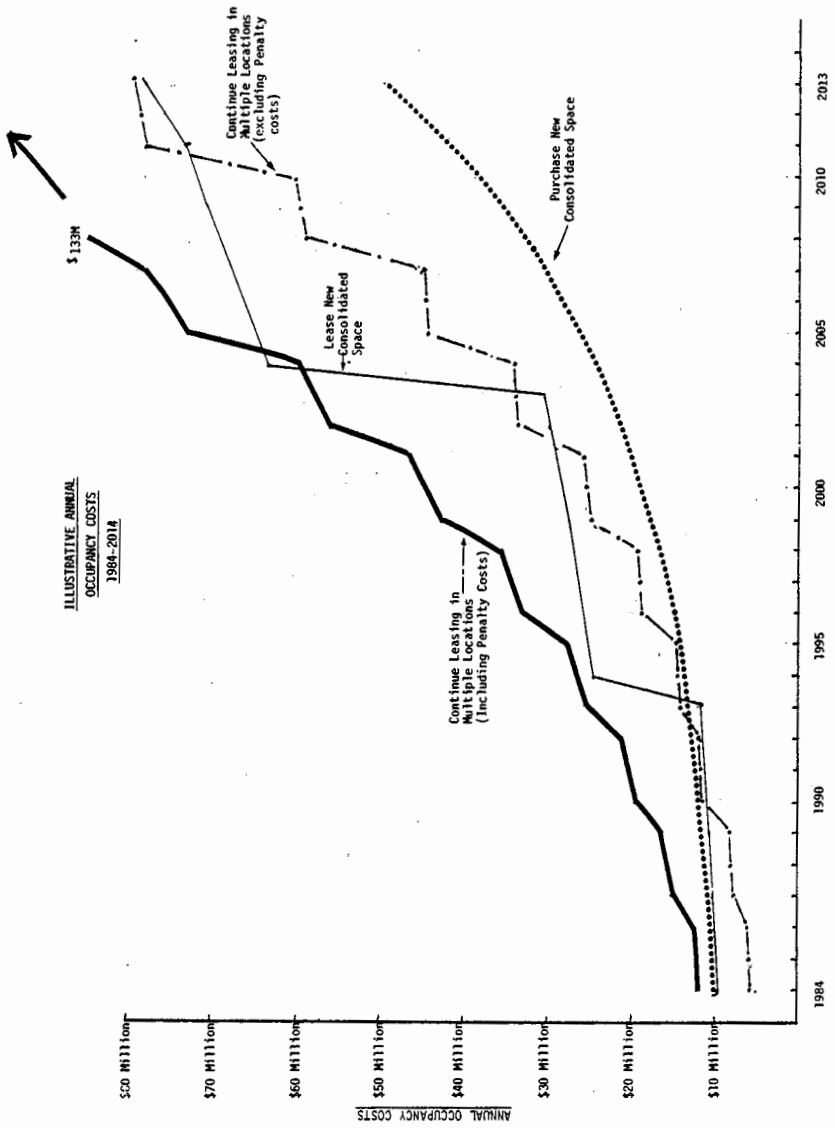
New Consolidated Space -- Lease New vs. Older Space

In tight office markets, well maintained older buildings in competitive locations command rents at nearly the same rates as those for newer buildings. For purposes of this analysis, we have assumed a rent differential of 15 percent between old and new. Illustratively, a \$20 per square foot rent for a new building would then compare to a \$17 per square foot rent in a comparable but older building.

- The net present value (1984 - dollars) of the savings over the assumed 30 year term is \$26 million (\$168 million for new vs. \$142 million for older).
- While this hypothetically offers a significant savings, it is highly unlikely that any privately owned building exists that has the requisite size, specifications, and locational characteristics to accommodate consolidation needs of the SEC. Even if such a building could be found, it would likely be subject to existing leasehold interests which would have to be purchased, increasing the cost substantially. This alternative, therefore, of leasing an existing building on the open market appears not to be a realistic option.

New Consolidated Space -- Build/Own vs. Buy Older Building

- In the current market place for private commercial buildings, prices for well maintained properties, say ten years old, are virtually identical to new construction costs. This is especially true for buildings in prime locations with solid



tenants and leases providing "pass throughs" of operating expenses and CPI escalators. In present value terms, therefore, purchasing an existing building is virtually identical in cost to the Build/Own alternative.

- Further, given the SEC size, locational, and special space needs, it is highly unlikely that a suitable existing building could be found -- especially one coming vacant during the next several years. For these reasons, therefore, purchasing an existing building on the private market to satisfy the SEC consolidation needs is not a realistic alternative.

Annual Occupancy Cost Patterns

Lump-sum present values and first year net occupancy costs have been presented thus far. The following chart illustrates the pattern of net occupancy costs over the 30 year period.

- In this illustration, continuing in the multifunctional mode, with penalty costs, is the most expensive alternative in virtually every year.
- Ownership, although it is more expensive during the first 10 years, becomes the least costly since it is not subject to periodic rent increases (before consideration of any residual values).

Other Consideration

The goal of the SEC is not, and should not be, to reduce occupancy costs to a bare minimum. Theoretically, the SEC could halve its present space allowance and continue to function through working shifts, shrinking

space even further, etc. This would, however, be counterproductive. Rather, the Commission's goal should be to optimize the balance between operational efficiency and occupancy costs. Sooner or later, in our judgment, this will require a long-term consolidation space solution.

* * *

The following sections provide detailed supporting documentation to the findings above. Section II addresses the SEC space needs and the occupancy costs of continuing the Status Quo. Sections III and IV address the economics of long-term ownership and leasing, respectively.

SECTION II

SPACE NEEDS: CONTINUATION OF STATUS QUO

SECTION II
SEC SPACE NEEDS
CONTINUATION OF STATUS QUO

As a basis of comparison with consolidation alternatives, this section provides a discussion of present and projected future SEC space requirements, followed by a projection of future occupancy costs of continuing in multiple locations. Subsequent sections provide detailed economic analysis of the two basic alternative approaches for meeting the SEC's long-term space needs.

1. Purchase a consolidated headquarters facility, either contracting to build and own or by acquiring an existing property;
2. Lease a consolidated headquarters facility, either in a new building or in an older, existing property.

Penalty costs associated with the inefficiencies and counter-productiveness of multiple locations are not considered in the remainder of this report. These estimates are contained in a separate document and are only addressed in the Executive Summary of this report.

Current Space Inventory and Annual Occupancy Costs. Before examining alternatives for the future, it is important to characterize the SEC's existing space inventory in physical and economic terms.

The SEC currently occupies a total of 333,213 square feet of usable space. While housed in eight separate facilities, most Commission offices are located in four buildings: 500 North Capitol Street, N.E., 1020 11th Street, N.W., 329 First Street, N.W., and 4015 Wilson Boulevard in Arlington, Virginia. When combined, SEC space in these buildings totals approximately 320,000 square feet of usable space.

The Commission currently leases all its Washington facilities from the General Services Administration. In accordance with standard procedure for all properties it controls, GSA charges the SEC a Standard Level Users Charge, or SLUC, for the space the Commission occupies. The SLUC rate is determined by GSA in the following fashion. An independent appraiser is hired who, upon analyzing a particular GSA controlled building, reports on the property's value. This value is determined in accordance with such factors as location, age of improvements, and overall condition of the property.

With the appraised value as a basis, GSA determines an appropriate SLUC rate. This rate includes not only a rent level commensurate with property value, but also includes all standard building operating costs such as utilities, cleaning, maintenance, security, etc. Once determined, the SLUC rate is levied for three years, at which time the property is reappraised and the SLUC rate adjusted accordingly.

The table on the following page details the SEC's current space inventory and SLUC rates by location and function. Added to these costs is the expense associated with all above SLUC level services. This expense principally results from extended SEC working hours and includes such expenses as extra utilities and guard service.

The Commission currently pays \$2,492,000 annually in SLUC fees. In addition, it spends \$294,614 to cover the cost of services above the standard SLUC level. In total, current annual occupancy cost for the SEC are \$2,787,134.

CURRENT SPACE INVENTORY AND ANNUAL OCCUPANCY COST

SEC. WASHINGTON OPERATIONS

AS OF 1/1/80

	320 1st St., N.W.	200 Constitution Ave. N.W.	14th & C Sts. N.W.	Navy Yard Annex #155	Navy Yard Annex #197	500 N. Cap St. N.E.	1020 11th St. N.W.	4015 Wilson Blvd.	Total
I. Working Area									
A. Office									
1. Square feet leased	31,920					148,795	70,285	11,920	262,920
2. Annual cost per s. f.	\$ 9.05					\$ 9.05	\$ 5.75	\$ 9.11	--
3. Total annual cost	\$ 288,676					\$ 1,346,695	\$ 404,158	\$ 108,591	\$ 2,140,201
B. Data Processing									
1. Square feet leased						2,380			2,380
2. Annual cost per s. f.						\$ 11.24			--
3. Total annual cost						\$ 26,751			\$ 26,751
C. Training/Conference									
1. Square feet leased						1,520		210	1,730
2. Annual cost per s. f.						\$ 10.19		\$ 10.25	--
3. Total annual cost						\$ 15,489		\$ 2,152	\$ 17,641
D. Light Industrial									
1. Square feet leased						5,495			5,495
2. Annual cost per square foot						\$ 6.86			--
3. Total annual cost						\$ 37,696			\$ 37,696
II. Non-Working Area									
A. Structurally Changed									
1. Square feet leased						3,020	390		3,410
2. Annual cost per s. f.						\$ 12.55	\$ 12.63		\$ 12.63
3. Total annual cost						\$ 37,901	\$ 4,926		\$ 42,827
B. Lab and Clinic									
1. Square feet leased					140	655			1,370
2. Annual cost per s. f.					\$ 13.17	\$ 15.61		\$ 9.84	--
3. Total annual cost					\$ 1,964	\$ 10,224		\$ 5,658	\$ 17,446
C. Food Service									
1. Square feet leased			2			1,995	1,412		3,409
2. Annual cost per square foot			\$ 10.46			\$ 14.95	\$ 8.24		--
3. Total annual cost			\$ 21			\$ 29,227	\$ 13,047		\$ 42,295
D. Storage									
1. Square feet leased			3,610		4,520	6,545			14,675
2. Annual cost per s. f.			\$ 4.85		\$ 4.65	\$ 6.42			--
3. Total annual cost			\$ 16,786		\$ 21,018	\$ 42,019			\$ 79,823
E. Parking									
1. Square feet leased	5,460	7,164				900	24,300		37,824
2. Annual cost per s. f.	\$ 2.26	\$ 2.36				\$ 1.92	\$ 1.91		--
3. Total annual cost	\$ 14,792	\$ 16,907				\$ 1,728	\$ 46,413		\$ 79,840
III. Annual Cost of above S.L.U.C. level services									
	\$ 16,726 ^{2/}					\$ 235,127	\$ 42,761		\$ 294,614
IV. Totals									
1. Total square feet leased	37,380	7,164	3,610	2	4,660	171,305	96,572	12,520	333,213
2. Total annual cost	\$ 303,668	\$ 16,907	\$ 16,786	\$ 21	\$ 22,582	\$ 1,547,830	\$ 469,257	\$ 115,669	\$ 2,456,550
3. Total cost of above S.L.U.C. level services	\$ 16,726					\$ 235,127	\$ 42,761		\$ 294,614
4. Total annual occupancy costs	\$ 320,394	\$ 16,907	\$ 16,786	\$ 21	\$ 22,582	\$ 1,782,757	\$ 512,018	\$ 115,669	\$ 2,707,134

1/ Includes costs of extra guard services and after-hour operations. Costs are for calendar year 1980.

2/ Estimated by GSA.

Source: General Services Administration Public Building Service; S.E.C.

Projected Space Needs. In the future, the Securities and Exchange Commission anticipates a moderate personnel expansion. In addition, the Commission requires enlargement of several of its public areas such as reference and meeting rooms. Any consideration of future space alternatives must take this projected growth into account.

The table below displays in detail SEC projected space needs by function. The Commission's long term space needs total 345,649 square feet of usable space, not including parking. If spaces for approximately 260 cars are provided, this total rises to 449,249 usable square feet.

<u>PROJECTED SPACE NEEDS</u>			
<u>NEW SEC HEADQUARTERS</u>			
	<u>Usable Square Feet^{1/}</u>	<u>Rentable Square Feet^{2/}</u>	<u>Gross Square Feet^{3/}</u>
<u>I. Working Areas</u>			
A. Office	299,630	353,400	384,100
B. Data Processing	4,600	5,400	5,900
C. Training/Conferences	7,000	8,300	9,000
D. Light Industrial	11,900	14,000	15,200
<u>II. Non-Working Areas</u>			
A. Structurally Changed	3,410	4,000	4,400
B. Labs and Clinics	1,700	2,000	2,200
C. Food Service	3,409	4,000	4,400
D. Storage	14,000	16,500	17,900
E. Parking	103,600	103,600	103,600
Total	449,249	511,200	546,700

^{1/} Source: S.E.C.

^{2/} Rentable square footage is calculated at 92% of gross, conforming with Washington Board of Realtors measurement standard averages.

^{3/} To derive gross square feet, GSA multiplies usable square feet by 1.28.

These projections are calculated by the SEC using standard GSA methodology. Usable square feet, however, as defined by GSA, excludes such items as common corridors, lobbies, bathrooms, and vertical shafts. For the purpose of examining alternatives to the present course of action, therefore, (i.e., purchasing or leasing a consolidated headquarters), the Commission's estimates are translated into both gross square feet and rentable square feet.

As the above table indicates, gross square feet is the amount of space necessary to build or purchase in order to provide the requisite quantity of usable square feet. Similarly, rentable square feet is the required amount of private space to lease on the open market, according to Washington Board of Realtors' measurement standards.

General Assumptions. With projections of future SEC space needs in place, the three basic alternative space solutions can be subjected to detailed analysis. In examining each of these alternatives, certain common assumptions are made.

1. For projecting the comparative costs of all alternatives, a 30-year period commencing in 1984 is assumed. All SLUC rates, lease rates, construction costs, operating expenses, etc., are increased to a 1984 level and projected from that point. 1984 is chosen because, in our view, this is the most likely date of initial occupancy under the Build/Own alternative.
2. For the purpose of projection, all SLUC rates are assumed to be recalculated in 1980. Thus, in accordance with historic GSA increases for the Washington, D.C., area, SLUC rates determined in 1977 are inflated by 9.3% to 1978, 12.6% to 1979, and 12.9% to 1980.
3. To project from 1980 to 1984, all costs, with the exception of SLUC rates and open-market rents, are estimated to increase by an average of 13% per year.

4. Since SLUC rates are based on a market value determination, SLUC rates and open-market rents are assumed to move in tandem. From 1980 to 1984, SLUC rates and rent levels are projected to increase as follows: 15% to 1981, 15% to 1982, 11% to 1983, and 11% to 1984. The reasoning behind these estimates is that while rents do track inflation to a certain extent, they also vary in accordance with local supply and demand conditions. Based on our experience with the Washington market, we anticipate an excess of demand over supply through 1982, with an equalization and potential oversupply in 1983.
5. To project beyond 1984, a 10% rate of inflation in occupancy costs is assumed. Additionally, market rents are assumed to increase annually at 10%, conservatively below the historic rate of increase during the 1970's.

Costs of Continuing Status Quo. This alternative assumes that the SEC's long-term space needs are met by a continued policy of leasing at multiple locations, picking up expansion space on the open market on an as-needed basis. The process of calculating annual occupancy costs for this alternative entails a series of steps, each of which is described below.

First, the cost of all existing occupied space is brought to current (1980) dollars. Because the SEC has acquired its space on an as-needed basis, the Commission is currently paying SLUC charges established in 1977 for some space, 1978 for other space, and 1979 for still other space.

To simplify projections, the assumption is made that SLUC charges on all SEC space will expire this year, and thus be subject to reappraisal. To bring all space current to 1980 SLUC rates, current SLUC rates are therefore inflated to 1980 levels in accordance with historical GSA increases.

Once all SLUC charges for existing space are brought to current levels, they are projected to 1984 utilizing appreciation rates discussed above, with adjustments made for additional space requirements. Similarly, the costs of services above the standard SLUC level, passed through annually to the SEC on a current cost basis, are projected to 1984. Finally, each of these component costs is summed to yield a 1984 total occupancy cost figure, as indicated in the table on the next page.

PROJECTED SPACE INVENTORY AND ANNUAL OCCUPANCY COSTS

STATION 202

MULTIPLE LEASE ALTERNATIVES

SEC WASHINGTON OPERATIONS

1984

	220 1st St. N.W.	200 Constitution Ave., N.W.	14th & C Sts. N.W. Annex #159 Annex #197	Naval Yard	Naval Yard	500 N. Cap. St. N.E.	1020 11th St. N.W.	4015 Wilson Blvd.	Projected/ New Space Needs	Total
I. Working Areas										
A. Office										
1. Square feet leased	31,970					148,795	70,295	11,920	38,710	299,630
2. Annual cost per s. f.	\$ 18.68					\$ 18.64	\$ 13.02	\$ 18.77	\$ 15.78	\$ 18.68
3. Total annual cost	\$ 531,787					\$ 2,478,925	\$ 915,111	\$ 199,898	\$ 779,284	\$ 4,708,005
B. Data Processing										
1. Square feet leased						2,380			2,280	4,660
2. Annual cost per s. f.						\$ 20.69			\$ 20.69	\$ 20.69
3. Total annual cost						\$ 49,242			\$ 45,932	\$ 95,174
C. Training/Conference										
1. Square feet leased						1,820		210	6,270	7,000
2. Annual cost per s. f.						\$ 18.78		\$ 18.87	\$ 18.81	\$ 18.81
3. Total annual cost						\$ 28,515		\$ 3,963	\$ 99,124	\$ 131,602
D. Light Industrial										
1. Square feet leased						5,498			6,405	11,903
2. Annual cost per s. f.						\$ 12.64			\$ 12.64	\$ 12.64
3. Total annual cost						\$ 69,467			\$ 80,959	\$ 150,416
II. Non Working Areas										
A. Structurally Changed										
1. Square feet leased						3,000		380		3,410
2. Annual cost per s. f.						\$ 23.11		\$ 23.26		\$ 23.11
3. Total annual cost						\$ 69,782		\$ 9,064		\$ 78,856
B. Labs and Clinics										
1. Square feet leased					140	655	878		330	1,709
2. Annual cost per s. f.					\$ 20.87	\$ 28.75	\$ 22.28		\$ 23.87	\$ 23.87
3. Total annual cost					\$ 2,900	\$ 18,831	\$ 17,911		\$ 7,877	\$ 42,599
C. Food Service										
1. Square feet leased				2		1,995	1,412			3,409
2. Annual cost per s. f.				\$ 19.29		\$ 28.98	\$ 20.92			\$ 20.92
3. Total annual cost				\$ 39		\$ 57,825	\$ 29,539			\$ 87,363
D. Storage										
1. Square feet leased		3,610		4,820		6,545			(678)	14,000
2. Annual cost per s. f.		\$ 8.52		\$ 8.52		\$ 11.40			\$ 8.61	\$ 8.61
3. Total annual cost		\$ 30,757		\$ 41,110		\$ 74,721			(5,847)	\$ 140,011
E. Parking										
1. Square feet leased	5,440	7,164				980	24,300		65,778	102,600
2. Annual cost per s. f.	\$ 4.16	\$ 4.89				\$ 3.53	\$ 4.33		\$ 4.23	\$ 4.23
3. Total annual cost	\$ 22,714	\$ 35,032				\$ 3,477	\$ 105,219		\$ 278,230	\$ 444,374
II. Annual cost of above S.L.U.C. level services										
<hr/>										
IV. Totals										
1. Total square feet leased	37,380	7,164	3,610	2	4,660	171,305	86,372	12,620	116,022	649,249
2. Total annual cost	\$ 544,501	\$ 35,032	\$ 30,757	\$ 39.00	\$ 41,390	\$ 2,048,995	\$ 1,062,660	\$ 212,921	\$ 1,084,926	\$ 8,871,245
3. Total cost of above S.L.U.C. level services	\$ 24,934					\$ 363,928	\$ 63,745		\$ 79,815	\$ 552,522
4. Total annual occupancy costs	\$579,435	\$ 35,032	\$ 30,757	\$ 39.00	\$ 41,390	\$ 2,212,973	\$ 1,126,405	\$ 212,921	\$ 1,164,841	\$ 9,423,767

1/ All costs for new space needs are derived by averaging projected S.L.U.C. costs for existing space.

2/ Includes costs of extra guard services and after-hour operations. Costs are estimated based on calendar year 1980 experience.

3/ Assumes demand for above S.L.U.C. level services in new space equals demand for above S.L.U.C. level services in existing space.

Source: General Services Administration Public Building Services; S.E.C.

Once the cost of the Status Quo alternative is projected to 1984, annual occupancy costs for the next 30 years are calculated. Results of this analysis, presented in the table on the next page, are obtained in the following fashion.

The 1984 annual occupancy costs, indicated in the table above, are used as the starting point of the 30 year projection. For 1984, the costs of SLUC and above SLUC level services are totaled. Subtracted from this amount are all SLUC costs associated with parking. As of November, 1981, government employees will have to bear the full cost of parking. As a result, these costs are assumed to be passed on to employees and are therefore deducted from SEC operating costs.

Since GSA recalculates the SLUC rates every three years, the 1984 charge is held constant through 1985 and 1986, as is the amount subtracted for parking revenues. The cost of above SLUC level services, however, is passed directly through to the SEC by GSA on an annual basis. From 1984 on, therefore, this cost is increased annually by the rate of inflation, assumed to be 10%.

Beginning in 1987, and every subsequent third year, SLUC rates are inflated to market levels, assumed to increase at a rate equal to inflation. Illustratively, the amount of escalation necessary to keep SLUC rates current with market values for each 3 year period is $(1.1)^3$ or 33%, every three years. Parking revenues are adjusted accordingly.

ANNUAL OCCUPANCY COSTS
STATUS: Q00
MULTIPLE LOCATION LEASE
 1994-2014
 (Dollars in Thousands)

Calendar Year	Total Previous Year S.L.B.C.	Escalation of S.L.B.C. @ .35% /	Current Year S.L.B.C.	Previous Year's Cost of Above - S.L.B.C. - Level Services ⁽³⁾		Increase in Above - S.L.B.C. - Level Services ⁽⁴⁾		Current Year's Cost of Above S.L.B.C. - Level Services ⁽⁵⁾	Less Parking Expenses Received ⁽⁶⁾	Total Occupancy Costs ⁽⁷⁾
				(1)	(2)	(3)	(4)			
1994	-	0	5,871	553	-	55	600	444	-	5,900
1995	5,871	0	5,871	608	61	67	669	444	-	6,035
1996	5,871	1,937	7,808	669	74	81	736	591	-	6,096
1997	7,808	0	7,808	716	47	53	769	591	-	7,953
1998	7,808	0	7,808	810	94	86	896	591	-	8,027
1999	7,808	2,577	10,385	891	83	90	980	705	-	10,580
2000	10,385	0	10,385	900	96	108	1,078	705	-	10,678
2001	10,385	0	10,385	1,078	108	119	1,186	705	-	10,786
2002	10,385	3,427	13,812	1,186	119	126	1,305	1,045	-	14,072
2003	13,812	0	13,812	1,255	144	144	1,400	1,045	-	14,503
2004	13,812	0	13,812	1,345	144	158	1,503	1,045	-	14,503
2005	13,812	4,557	18,369	1,580	158	174	1,738	1,389	-	18,718
2006	18,369	0	18,369	1,738	174	191	1,912	1,389	-	18,892
2007	18,369	0	18,369	1,912	191	210	2,103	1,389	-	19,093
2008	18,369	6,062	24,431	2,103	210	231	2,313	1,818	-	24,896
2009	24,431	0	24,431	2,313	231	254	2,544	1,818	-	25,127
2010	24,431	0	24,431	2,544	254	280	2,828	1,818	-	26,466
2011	24,431	8,063	32,494	2,798	280	308	3,078	2,457	-	33,115
2012	32,494	0	32,494	3,078	308	339	3,366	2,457	-	33,423
2013	32,494	0	32,494	3,386	339	373	3,725	2,457	-	33,762
2014	32,494	10,723	43,217	3,725	373	410	4,098	3,268	-	44,047
2015	43,217	0	43,217	4,098	410	456	4,568	3,268	-	44,457
2016	43,217	0	43,217	4,568	456	506	5,074	3,268	-	44,866
2017	43,217	14,000	57,478	4,955	496	546	5,455	4,347	-	58,586
2018	57,478	0	57,478	5,455	546	600	6,001	4,347	-	59,132
2019	57,478	0	57,478	6,001	600	660	6,661	4,347	-	59,732
2020	57,478	18,968	76,446	6,661	660	726	7,281	5,782	-	77,925
2021	76,446	0	76,446	7,281	726	799	7,987	5,782	-	78,651
2022	76,446	0	76,446	7,987	799	876	8,766	5,782	-	79,450

Present value @ 11.75% discount rate is \$132,328,000

1/ S.L.B.C. rates are adjusted every three years to conform to market values. This analysis assumes that the value of GSA-controlled buildings keeps pace with the market; hence, S.L.B.C. rates are adjusted accordingly.
 2/ Assumed costs for above-S.L.B.C.-level services are passed on as incurred; hence, those costs are escalated at the projected annual inflation rate of 10%.
 3/ As of November, 1981 government employees will have to bear the full cost of parking. As a result, these costs are assumed to be passed on to employees and deducted for S.L.C. occupancy costs.

This combined annual cost escalation of above SLUC level services and tri-annual escalation of SLUC rates is projected for 30 years, to the year 2013. In this final year, total annual occupancy costs are estimated to equal \$79,450,000.

Once the stream of occupancy costs is generated for all 30 years, it is discounted to determine the present value of the Status Quo alternative. In this analysis, the discount rate selected is equal to the Federal Government's cost of long-term capital as raised through the sale of Treasury bonds. At the April 15, 1980 rate of 11.75% the present value of the future stream of occupancy costs over 30 years for the Status Quo alternative is \$132,328,000.

SECTION III

ECONOMICS OF OWNERSHIP

SECTION III
ECONOMICS OF BUILD/OWN OR PURCHASE
CONSOLIDATED FACILITY

As presented in Section I, long-term ownership appears to be the least costly to the Federal Government. However, ownership does entail the outlay of approximately \$60 million for development and could inhibit mobility and flexibility in the long run. This section addresses the derivation of the occupancy cost estimates -- for both the contract-to-build and own option, and the purchase on the open market option.

Purchasing an existing building is, in our judgment, an unlikely possibility. Very few buildings would have the requisite size, space, and locational characteristics necessary for a consolidated SEC facility. And given the very tight market conditions, it is unlikely that any suitable building could be made available for occupancy in the short run.

Contract to Build/Own. As indicated below, contracting to build space would likely delay initial occupancy until 1984. This assumes that an 18 month period would allow sufficient time to locate and acquire a building site, complete all engineering tests and architectural drawings, bid out the construction contract, and effect any demolition.

WORKING ASSUMPTIONS
NEW SEC HEADQUARTERS
BUILD/OWN ALTERNATIVE

Effective start of construction	▪ 1/1/82 ^{1/}
Construction period	▪ 1/1/82 - 5/31/84 ^{1/}
Date of occupancy	▪ 6/1/84

- ^{1/} Assumed lead time necessary to complete site search and acquisition, all engineering tests and architectural drawings, construction contract bidding, and any demolition.
- ^{2/} Typical construction period for projects of this size.

The table on the following page displays illustrative specifications for a new headquarters building adequate to accommodate the SEC's projected space needs. Such a building would provide above-grade space totaling 450,000 gross square feet, sufficient area for all functions except storage and parking. These would be located underground.

ILLUSTRATIVE BUILDING SPECIFICATIONS
NEW S.E.C. HEADQUARTERS
WASHINGTON, D.C.

<u>Floor</u> ^{1/}	<u>Above Grade Gross Area (Sq. Ft.)</u> ^{2/}	<u>Above Grade Usable - Sq. Ft.</u> ^{3/}		
		<u>Office and Ancillary</u>	<u>Storage</u> ^{5/}	<u>Parking</u>
10	45,000	35,100	-	-
9	45,000	35,100	-	-
8	45,000	35,100	-	-
7	45,000	35,100	-	-
6	45,000	35,100	-	-
5	45,000	35,100	-	-
4	45,000	35,100	-	-
3	45,000	35,100	-	-
2	45,000	35,100	-	-
1	<u>45,000</u>	<u>15,749</u> ^{7/}	-	-
Total	450,000	331,649	-	-

1/ Assumes building located in C-4 zone, hence 10.0 F.A.R. maximum permitted density and 110-foot permitted height.

2/ Derived by standard G.S.A. methodology.

3/ See separate schedule.

4/ Includes office, data processing, training/conference, light industrial, structurally changed, labs and clinics, and food service.

5/ Required 14,000 square feet of storage is assumed to be located underground.

6/ 103,600 square feet of parking is assumed to be located underground.

7/ Balance of area devoted to lobby functions.

Assuming ground breaking in early 1982, the following table illustrates the total development budget. Direct construction costs are broken into component uses and priced in accordance with the basic GSA estimating manual, Building Construction Data. Because this data is based on 1977 prices, all direct development costs are inflated to 1982 levels. In this fashion, direct construction costs are estimated to total \$32,011,000.

Added to these construction costs are certain "soft" costs. These "non-construction costs" include land, fees, interest payments, contingencies, etc. Land cost is estimated to be in the \$200 per square foot range, which assumes a location outside the prime downtown Washington commercial core, but proximate to Metro and Federal Government facilities located in and around Capitol Hill. This cost can vary widely, depending upon locational characteristics, quality of surrounding area, size and shape of the site, proximity to transportation, etc. The \$200 amount, or \$20 per square foot of building area, is considered a reasonable midpoint in a range of values.

To finance a new SEC building it is assumed that the government will borrow the private-market equivalent to a 30 year mortgage. Such an equivalent would be a long-term Treasury bond, yielding 11.75% at the time of this analysis. It is assumed that 100% of interim and long-term financing will be available at this rate, acknowledging that the Treasury rate will fluctuate over time. By using this methodology, the costs of financing construction and ownership are made comparable

for the public and private sector. Land and financing costs represent two-thirds of total non-construction costs. The balance -- fees and contingencies -- is derived using GSA formulations and standard contingencies and developer fees.

CAPITAL COST ANALYSIS
NEW SEC HEADQUARTERS
BUILD/OWN ALTERNATIVE
(1982 Dollars)

I. <u>Direct Construction Cost</u>	SF (1,000s) ^{1/}	Development Cost/S.F. ^{3/}	Total (1,000s)
<u>A. Component Uses</u>			
<u>Working Areas</u>			
Office ^{3/}	384.1	\$59.00	\$22,662
Data Processing ^{4/}	5.9	\$61.00	\$ 359
Training/Conferences ^{5/}	9.0	\$71.30	\$ 642
Light Industrial ^{7/}	15.2	\$61.00	\$ 927
<u>Non-Working Areas</u>			
Structurally Changed ^{4/}	4.4	\$61.00	\$ 268
Labs and Clinic ^{2/}	2.2	\$64.80	\$ 142
Food Service ^{5/}	4.4	\$69.40	\$ 305
Storage ^{5/}	17.9	\$23.20	\$ 415
Parking ^{5/}	103.6	\$28.00	\$ 2,901
Subtotal			
<u>B. Project-Wide</u>			
Subsurface Conditions ^{6/}	546.7	\$ 6.20	\$ 3,390
Subtotal			\$32,011
<u>II. Non-Construction Costs</u>			
A. Land @ \$200/sq.ft. ^{1/}			\$ 9,000
B. Architect @ 6.75 of Direct Costs ^{8/}			\$ 2,153
C. Engineers @ .875% of Direct Costs ^{9/}			\$ 281
D. Insurance @ 1.0% of Direct Costs ^{9/}			\$ 578
E. Interim Interest ^{9/}			\$ 9,445
F. General Contingency			\$ 3,229
G. Developer Overhead			\$ 3,229
Subtotal			\$27,915
<u>III. Total Capital Cost</u>			\$ 59,926

^{1/} See separate schedule.

^{2/} Assumes January 1, 1982, purchase. Source for all development costs is the basic GSA construction cost handbook -- Building Construction Data, Robert Snow Means Co., Inc., 1978, pp. 265-271. Since cost data is for 1977, figures were inflated for 1978 and 1979.

^{3/} Building Construction Data, inflated as indicated above. In accordance with the American Appraisal Company, Inc., "Boeckh Index for office buildings (See "Construction Review," U.S. Department of Commerce, Industry and Trade Administration, p. 17). For 1980 and 1981, costs were inflated on the assumption of 13% annual increase in construction costs.

^{4/} Building Construction Data, inflated as indicated above. Costs were assumed to be equal to office, except that live load design is equal to 200 lbs/sf rather than the standard office live load design of 160 lbs/sf.

^{5/} Building Construction Data, inflated as indicated above.

^{6/} Includes sitework, excavation, sneeting and shoring, underpinning, and dewatering.

^{7/} Based on recent area land sales.

^{8/} Building Construction Data.

^{9/} Assumes U.S. Government cost of capital is equal to cost of Federal borrowing through the bond market. On April 9, 1980, the interest rate for U.S. Government bonds due in 2010 was 11.75 percent. Also assumes that in the first twelve months of construction, 40% of total development funds are expended, in the second twelve months, 40%; in the final six months, 20%.

^{10/} Assumes developer responsible for all tasks associated with project management including design development and construction management.

A projection of initial year (1984) operating expenses is provided in the following table. These expenses are based on 1980 experience. Note that because the building is owned by the Federal Government no charge is made for real estate taxes or depreciation.

OPERATING EXPENSES
NEW SEC HEADQUARTERS
FULLY STABILIZED YEAR
(1984 Dollars)

	1980 Estimated Per Sq. Ft. 1/	1984 Projected Per Sq. Ft. 2/	391,100 Sq. Ft. Office and Ancillary Space 3/ 1984
Electricity	\$ 1.60	\$ 2.46	\$ 958,195
Cleaning 4/	\$.66	\$ 1.01	\$ 395,011
Management Fee 5/	\$.51	\$.78	\$ 305,058
Engineers' Salaries 6/	\$.28	\$.43	\$ 168,173
Insurance	\$.11	\$.16	\$ 62,576
Elevator Maintenance	\$.10	\$.15	\$ 58,665
Repairs, Maintenance, Supplies	\$.09	\$.13	\$ 50,843
Security 7/	\$.53	\$.81	\$ 316,791
Water and Sewer	\$.03	\$.04	\$ 15,644
Miscellaneous	\$.05	\$.07	\$ 27,377
Subtotal	\$3.96	\$6.03	\$2,358,333

1/ Based on local Washington, D.C. operating experience.

2/ Assumes 13% annual inflation in operating expenses.

3/ Total rentable square feet. Includes all fully serviced areas: office, data processing, training/conferences, light industrial, structurally changed, labs and clinic, and food service. Assumes storage facility has few or no service requirements.

4/ At this price, a good quality cleaning service is assumed. The cost may vary slightly depending on the level of service provided.

5/ Standard fee for Washington area.

6/ Salary and fringe benefits for full-time building engineer.

7/ Based on current S.E.C. experience at 500 North Capital Street, N.E.

Annualized 30 year occupancy costs are presented in the table on the following page. Capital cost remains constant throughout the period, while operating expenses increase at 10% annually. A further occupancy cost, is "add-on expenses" for extra security and utility costs incurred as a result of SEC functions which occur beyond normal building operating hours. Based on SEC estimates of current "add-on expenses," these costs have been projected to 1984 and inflated at 10% annually.

To obtain total annual occupancy costs, all expenses are summed. From this total, market rate parking revenues are subtracted, in accordance with the requirement that by November, 1981, government employees must bear the full cost of parking. For 1984, the net result of these calculations is a total annual occupancy cost of \$9,485,000.

ANNUAL OCCUPANCY COSTS
NEW SEC HEADQUARTERS
BUILD NEW CONSIDERED SPACE
1984 - 2014
(Dollars in Thousands)

Calendar Year	Cost of Capital @ 11.75% Constant 1/	Previous Year Operating Costs (2)	Increase in Operating Costs @ .10% (3)	Current Year Operating Costs (4)	Previous Year Add-On Expenses (5)	Increase in Add-On Expenses @ .10% (6)	Current Year Add-On Expenses (7)	Less Parking Revenues Received (8)	Total Occupancy Costs 2/
1984	7,041	7,358	236	2,358	-	40	396	310	\$ 9,405
1985	7,041	2,594	236	2,594	395	44	436	325	\$ 9,746
1986	7,041	2,653	285	2,653	436	44	480	341	\$10,033
1987	7,041	3,138	314	3,138	480	53	533	376	\$10,259
1988	7,041	3,452	345	3,797	528	58	586	395	\$11,092
1989	7,041	3,797	380	4,177	639	64	703	415	\$11,506
1990	7,041	4,177	418	4,595	703	70	773	436	\$11,973
1991	7,041	4,595	459	5,054	773	77	850	457	\$12,488
1992	7,041	5,054	505	5,559	850	85	935	480	\$13,055
1993	7,041	5,559	556	6,115	935	94	1,029	576	\$13,609
1994	7,041	6,115	611	6,726	1,029	103	1,132	605	\$14,294
1995	7,041	6,726	710	7,436	1,132	113	1,249	667	\$15,083
1996	7,041	7,436	760	8,196	1,249	117	1,366	720	\$15,875
1997	7,041	7,999	814	8,813	1,366	121	1,487	772	\$16,812
1998	7,041	8,139	895	9,033	1,487	151	1,638	810	\$17,876
1999	7,041	8,953	895	9,848	1,638	166	1,804	851	\$19,005
2000	7,041	9,848	965	10,813	1,824	182	2,006	883	\$20,153
2001	7,041	10,833	1,063	11,916	2,006	201	2,207	893	\$22,995
2002	7,041	11,916	1,192	13,108	2,207	221	2,428	910	\$24,501
2003	7,041	13,108	1,311	14,419	2,428	243	2,671	910	\$26,500
2004	7,041	14,419	1,442	15,861	2,671	267	2,938	910	\$28,283
2005	7,041	15,861	1,586	17,447	2,938	294	3,232	910	\$30,466
2006	7,041	17,447	1,745	19,192	3,232	323	3,555	910	\$32,871
2007	7,041	19,192	1,919	21,111	3,555	336	3,891	910	\$35,519
2008	7,041	21,111	2,111	23,222	3,891	343	4,234	910	\$38,355
2009	7,041	23,222	2,322	25,544	4,234	443	4,677	910	\$41,644
2010	7,041	25,544	2,554	28,098	4,677	473	5,150	910	\$45,182
2011	7,041	28,098	2,810	30,908	5,150	525	5,675	910	\$48,884
2012	7,041	30,908	3,091	33,999	5,675	573	6,248	910	\$52,726
2013	7,041	33,999	3,400	37,399	6,248	573	6,821	910	\$56,726

Present value @11.75% discount rate is \$126,249,000

1/ Current yield on long-term Treasury Bonds.

2/ 1 + 4 + 7 - 8.

For the ensuing 29-years, annual occupancy costs are projected in a straightforward fashion. Cost of capital remains a fixed charge. Operating expenses and add-on expenses are increased annually at the rate of inflation. Parking revenues, less responsive to inflationary pressures, are projected to increase at 5% per year for 10 years, jumping 20% every eleventh year.

The net present value of this stream of future occupancy costs, discounted at the assumed cost of capital rate of 11.75%, is \$126,249,000 in 1984 dollars. This figure, however, does not take into account the value of the SEC headquarters building after 30 years of use. Unlike the Status Quo solution where real property is leased, at the end of 30 years there is an unguaranteed residual value associated with an owned property. The table below calculates this value based on several assumptions.

Over the last 30 years, buildings constructed in 1950 have maintained a value approximately equal to the cost of reconstructing the building today minus depreciation. Assuming this trend continues, the residual value of the 1984 SEC building in constant dollars can be readily calculated. As indicated below, the net residual value in the year 2014 is projected to be \$52,000,000.

CALCULATION OF RESIDUAL VALUE
NEW SEC HEADQUARTERS
BUILD/OWN ALTERNATIVE
(1984 Dollars)

1. Development Budget - 1984	\$59,926,000
2. Rate of Construction cost increase 1967-1980; Washington, D.C. - Reinforced Concrete Construction	7½%
3. Rate of inflation 1967-1980 (Dollar deflator)	6½%
4. Difference in Rates 2. + 3.	3/4%
5. Assumed average annual real dollar increase in construction costs: 1984-2014	3/4%
6. Year 2014 residual value of property expressed in 1984 constant (real) dollars (excluding depreciation) equals (.75%) ³⁰ X \$59,926,000	\$74,984,000
7. Estimated depreciation @ 31.0% ^{1/}	\$23,245,000
8. Net 2014 residual value in 1984 constant dollars	\$51,739,000
	say \$52,000,000

^{1/} Depreciation based upon need to replace mechanical systems; verticle transportation systems; cosmetic exterior refinishing and total new interior tenant finish; roof finishing; and contingencies.

Buy/Own. An alternative to building a new SEC facility would be to acquire a suitable existing structure. The following table presents a calculation of what such a building, if it could be found, would cost in 1984. The standard method of valuation for sale is as follows. First, consolidated net operating income is derived. This figure is built up based on a projection of current market rental rates and operating expenses for 10-year old downtown buildings. Deducted from this net income figure is debt service, typically in the 8.625% range for buildings erected in 1974. In this fashion, a net cash flow is derived. In today's market, net cash flow is capitalized at a 6% rate. Based on the prototypical pro forma exhibit below, a 10-year old building suitable for SEC occupancy would cost approximately \$58,000,000 in 1984.

PROTOTYPICAL PRO FORMA^{1/}
TEN-YEAR OLD DOWNTOWN OFFICE BUILDING
WASHINGTON, D.C.
1984

I. <u>Parking</u>		
	103,600 sq. ft. @ \$3.40/sq. ft. Net Revenue	\$ 392,240
II. <u>Office and Ancillary Areas</u>		
	331,680 sq. ft. @ \$23.00/sq. ft.	\$ 7,627,950
	Less operating expenses -	
	331,680 sq. ft. @ \$7.70/sq. ft.	(\$ 2,553,705)
	Total Office Net Revenue	<u>\$ 3,074,245</u>
III. <u>Storage</u>		
	14,000 sq. ft. @ \$6.70/sq. ft. Net Revenue	\$ 93,800
IV. <u>Consolidated Net Operating Income</u>		<u>\$ 5,520,285</u>
V. <u>Cash Flow</u>		
A.	Consolidated Net Operating Income	\$ 5,520,285
B.	Debt Service - \$23,697,000 @ 8.625% constant ^{2/}	(\$ 2,043,866)
C.	Net Cash Flow	<u>\$ 3,476,419</u>
V. <u>Economic Value</u>		
	\$3,476,419 @ 6% cap rate ^{3/}	<u>\$57,940,317</u>

^{1/} Based on local experience.

^{2/} Assumes financing equal to 80% of total development costs in 1974.

^{3/} Current market rate for determining economic value.

In a manner precisely parallel to the contract to Build/Own alternative, total occupancy costs are projected over a 30-year period for the option of purchasing an existing building. The results of this analysis are presented in the following table. When discounted back at the 11.75% rate, the present value of costs for this alternative are estimated to be \$124,112,000.

ANNUAL OCCUPANCY COSTS
 NEW SEC HEADQUARTERS
 BUY OLDER EXISTING BUILDING
 1984 - 2014
 (Dollars in Thousands)

Calendar Year	Cost of Capital @ 11.75% Constant 1/	Previous Year Operating Costs (2)	Increase in Operating Costs @ 10% (3)	Current Year Operating Costs (4)	Previous Year Add-On Expenses (5)	Increase in Add-On Expenses @ 10% (6)	Current Year Add-On Expenses (7)	Less Parking Revenues Received (8)	Total Occupancy Costs 2/ (9)
1984	\$ 6,808	\$ 2,358	\$ 236	\$ 2,358	\$ 396	\$ 40	\$ 396	\$ (310)	\$ 9,252
1985	\$ 6,808	\$ 2,594	\$ 259	\$ 2,594	\$ 436	\$ 44	\$ 436	\$ (325)	\$ 9,513
1986	\$ 6,808	\$ 2,853	\$ 285	\$ 2,853	\$ 480	\$ 48	\$ 480	\$ (341)	\$ 9,800
1987	\$ 6,808	\$ 3,138	\$ 314	\$ 3,138	\$ 528	\$ 53	\$ 528	\$ (358)	\$ 10,116
1988	\$ 6,808	\$ 3,452	\$ 345	\$ 3,452	\$ 581	\$ 58	\$ 581	\$ (376)	\$ 10,549
1989	\$ 6,808	\$ 3,797	\$ 385	\$ 3,797	\$ 634	\$ 64	\$ 634	\$ (395)	\$ 11,003
1990	\$ 6,808	\$ 4,177	\$ 418	\$ 4,177	\$ 703	\$ 70	\$ 703	\$ (415)	\$ 11,273
1991	\$ 6,808	\$ 4,595	\$ 459	\$ 4,595	\$ 773	\$ 77	\$ 773	\$ (436)	\$ 11,740
1992	\$ 6,808	\$ 5,054	\$ 505	\$ 5,054	\$ 850	\$ 85	\$ 850	\$ (457)	\$ 12,255
1993	\$ 6,808	\$ 5,559	\$ 556	\$ 5,559	\$ 935	\$ 94	\$ 935	\$ (480)	\$ 12,822
1994	\$ 6,808	\$ 6,115	\$ 611	\$ 6,115	\$ 1,029	\$ 103	\$ 1,029	\$ (516)	\$ 13,376
1995	\$ 6,808	\$ 6,726	\$ 673	\$ 6,726	\$ 1,132	\$ 113	\$ 1,132	\$ (565)	\$ 14,061
1996	\$ 6,808	\$ 7,399	\$ 740	\$ 7,399	\$ 1,245	\$ 125	\$ 1,245	\$ (635)	\$ 14,817
1997	\$ 6,808	\$ 8,139	\$ 805	\$ 8,139	\$ 1,370	\$ 137	\$ 1,370	\$ (700)	\$ 15,658
1998	\$ 6,808	\$ 8,953	\$ 885	\$ 8,953	\$ 1,507	\$ 151	\$ 1,507	\$ (735)	\$ 16,579
1999	\$ 6,808	\$ 9,848	\$ 985	\$ 9,848	\$ 1,658	\$ 166	\$ 1,658	\$ (772)	\$ 17,693
2000	\$ 6,808	\$ 10,833	\$ 1,083	\$ 10,833	\$ 1,824	\$ 182	\$ 1,824	\$ (810)	\$ 18,970
2001	\$ 6,808	\$ 11,916	\$ 1,192	\$ 11,916	\$ 2,006	\$ 201	\$ 2,006	\$ (851)	\$ 21,272
2002	\$ 6,808	\$ 13,108	\$ 1,311	\$ 13,108	\$ 2,207	\$ 221	\$ 2,207	\$ (893)	\$ 22,762
2003	\$ 6,808	\$ 14,419	\$ 1,442	\$ 14,419	\$ 2,428	\$ 243	\$ 2,428	\$ (937)	\$ 24,268
2004	\$ 6,808	\$ 15,861	\$ 1,586	\$ 15,861	\$ 2,671	\$ 267	\$ 2,671	\$ (972)	\$ 25,957
2005	\$ 6,808	\$ 17,447	\$ 1,745	\$ 17,447	\$ 2,935	\$ 287	\$ 2,935	\$ (1,016)	\$ 28,050
2006	\$ 6,808	\$ 19,177	\$ 1,915	\$ 19,177	\$ 3,220	\$ 313	\$ 3,220	\$ (1,052)	\$ 30,348
2007	\$ 6,808	\$ 21,171	\$ 2,111	\$ 21,171	\$ 3,525	\$ 343	\$ 3,525	\$ (1,091)	\$ 32,805
2008	\$ 6,808	\$ 23,222	\$ 2,322	\$ 23,222	\$ 3,855	\$ 373	\$ 3,855	\$ (1,131)	\$ 35,286
2009	\$ 6,808	\$ 25,544	\$ 2,544	\$ 25,544	\$ 4,202	\$ 401	\$ 4,202	\$ (1,172)	\$ 37,980
2010	\$ 6,808	\$ 28,098	\$ 2,810	\$ 28,098	\$ 4,573	\$ 430	\$ 4,573	\$ (1,215)	\$ 40,816
2011	\$ 6,808	\$ 30,908	\$ 3,091	\$ 30,908	\$ 5,205	\$ 521	\$ 5,205	\$ (1,260)	\$ 43,854
2012	\$ 6,808	\$ 33,999	\$ 3,400	\$ 33,999	\$ 5,726	\$ 573	\$ 5,726	\$ (1,307)	\$ 47,020
2013	\$ 6,808	\$ 37,399	\$ 3,400	\$ 37,399	\$ 5,726	\$ 573	\$ 5,726	\$ (1,356)	\$ 50,367

Present value @ 11.75% discount rate is \$124,112,000

1/ Current yield on long-term Treasury bonds.

2/ 1 + 4 + 7 - 8.

Once again, this figure is before the benefit of residual value. As shown in the table below, this value is calculated much the same way as that of the contract to Build/Own alternative, except, since the building was 10 years old when purchased, the charge for depreciation is greater. As the table indicates, the year 2014 residual value, in 1984 constant dollars, is projected to be \$36,287,000.

CALCULATION OF RESIDUAL VALUE

NEW SEC HEADQUARTERS

101 YEAR OLD BUILDING

PURCHASE/OWN ALTERNATIVE
(1984 Dollars)

1. Acquisition Cost - 1984	\$58,000,000
2. Assumed rate of real dollar increase, 1984-2014, excluding depreciation ^{1/}	3/45
3. Year 2014 residual value of property expressed in 1984 constant (real) dollars (excluding depreciation) equals (.75) ^{2/} x \$58,000,000	\$72,574,000
4. Estimated depreciation @ 40 year age equals 50% ^{2/}	\$36,287,000
5. Net 2014 residual value in 1984 constant dollars	\$36,287,000

^{1/} Based upon the difference between the overall rate of inflation (dollar deflator) and the inflation in Washington, D.C. construction costs for reinforced concrete construction during the period 1967-1980. It is assumed that the real dollar increase in value of an office building will increase at the rate of .75% per annum for 30 years.

^{2/} Without major improvements during the 40 year period the building would have, by that time, reached the effective end of its useful life. The 50% improvements reflect major improvements to the property to restore its useful life.

An important conclusion resulting from this analysis is that purchasing a well maintained, ten year old building is virtually as expensive as building a brand new structure. Investor purchasers in downtown Washington are willing to accept extraordinarily low current yields for the opportunity to participate in gradually increasing rents in the future. Therefore, even if a suitable building could be located, it would, in all likelihood, cost as much as a newly constructed facility "custom-built" to SEC specifications.

SECTION IV
ECONOMICS OF LEASING

SECTION IV
ECONOMICS OF LEASING
CONSOLIDATED FACILITY

This section analyzes the economics associated with leasing a consolidated headquarters facility in a privately owned building. The costs of leasing differ substantially from those of ownership due to several important factors.

In the initial year of occupancy (1984), cost disparities are primarily explained by differences in the cost of capital for the public and private sector. As indicated in the Buy/Own option above, the cost of servicing capital for the Federal Government is assumed to be 11.75%. This comparatively low rate is due to the fact that the government is essentially a risk-free borrower.

Considerably more risk, however, is entailed in lending to a private developer. As a result, capital used to finance private real estate ventures requires a relatively high rate of return. Increased cost of capital translates into higher rents, raising occupancy expenses accordingly.

An additional factor in higher first-year occupancy costs is real estate taxes. While the Federal Government pays no local property taxes, a private developer must bear this cost. In Washington, this difference typically raises private market rents by \$1.00 - \$1.30 per square foot and more.

Beyond the initial year of occupancy, the increased cost of open market leasing is compounded by high inflation and Washington office market conditions. As explained above, strong local demand has consistently permitted increases in rents in older buildings at a level equal to or above the rate of inflation. Were the SEC to lease from a private developer, therefore, its occupancy costs would rise as least as fast as inflation.

Lease New Building. Before proceeding with the analysis of this alternative, a note of caution is in order on projected rent levels. Based on a survey of new buildings appropriate for SEC occupancy, we project 1981 office rent levels to be in the \$16.00 range. Such a rent, however, will vary depending upon many factors, including:

1. The specific quality and cost of construction.
2. Location.
3. The lease terms and conditions to which the SEC would be willing to commit. If a long-term lease negotiated a developer would probably finance the project based on tenant strength, in which case the cost of capital and equity requirement could be substantially reduced. This would provide the SEC with meaningful negotiating leverage.
4. The developer's expectation of future (1984) office markets. If he believes the market will be very tight, he will have an incentive to "hold out," waiting for higher future rents.

The following table details the specific cost assumptions used in analyzing the lease consolidated new space alternative. A survey of projects of appropriate location and character revealed 1981 market rates averaging \$16.00 per leasable square foot for office space, \$7.00 per square foot for storage space, and \$2.10 per square foot for parking.

CALCULATION OF BASE YEAR 1984 RENTS
NEW SEC HEADQUARTERS
LEASE NEW SPACE ON OPEN MARKET
1984

I. Estimate of Net Leasable Area^{1/}

	<u>Gross Sq. Ft.</u>	<u>Bldg. Efficiency Factor</u>	<u>Leasable Square Feet</u>
Office Type Area	425,200	.92	391,100
Storage Type Area	17,900	.92	16,500
Parking	103,600	1.00	103,600

II. 1981 Market Rents per Sq. Ft.^{2/} and Total

Office	\$16.00	x	391,100 s.f. =	\$6,257,600
Storage	\$ 7.00	x	16,500 s.f. =	\$ 115,500
Parking	\$ 2.10	x	103,600 s.f. =	\$ 217,600
<u>Total 1981 Rents</u>				<u>\$6,590,700</u>

III. Total Rents Projected to 1984^{3/}

<u>Period</u>	<u>Increase in Market Rents</u>
1981 - 82	15%
1982 - 83	11%
1983 - 84	11%
1984 Base Year Rents:	<u>\$9,338,000</u>

IV. Operating Expenses Required Above Building Standard

Security 1980 ^{4/} \$90,800 increased by 1984 by 1.46	\$133,000
Extra Utilities ^{5/} equals 1,756 hours per year x \$150 per hour	<u>\$263,000</u>
Total Extra Operating Expenses Above Building Standard	<u>\$396,000</u>

^{1/} See separate table for usable and gross square foot space needs.^{2/} See separate table for 1981 rent rate assumptions.^{3/} Rate of increase 1981-1984 based upon knowledge of current 1980 and 1981 tightness in market; delaying of project for delivery in 1982; and likely easing of tightness in the 1983-1984 period.^{4/} 500 N. Capital St. security cost.^{5/} Extra hours: 13 on weekends, 4 on weeknights, and 8 on holidays. Assumes 2 floors require extra utility servicing in new consolidated headquarters @ \$75 per hour per floor.

With these 1981 rates established, rents are increased to 1984 levels in accordance with projected market increases. In this fashion, 1984 "base rents" are derived. In addition to base rents, above-building standard operating expenses are quantified for such expenses as extra guard service and utilities for after hour operations. The basis for security cost estimates is current above SLUC level security expenses at the 500 North Capitol Street, N.W. location. For the purposes of this analysis, it is assumed that this current cost accurately reflects the expenses of guarding a single building. Increased at the rate of inflation, annual security costs are projected to be \$133,000 by 1984.

Also projected are costs for extra utility consumption during after-hour SEC operations. Current after-hour usage is estimated to require that two full floors of office space be serviced an extra 1,756 hours per year. At \$75 per hour per floor, total extra utility costs are projected to be \$263,000 in 1984.

For an open market lease, the following terms are assumed for an occupancy.

- SEC
1. A 10 year primary lease term, with two additional renewal periods.
 2. At each renewal point, base rent would be renegotiated to establish a new base rate at "fair market value," as independently determined. For the purposes of this analysis, it is assumed that this value would keep pace with inflation, increasing 10% annually. Therefore, when adjustments are made in base rents at the 10-year renegotiation point, new base rents would be determined by multiplying old base rents by a factor of $(1.10)^{10}$, or 2.59.
 3. For each 10-year term, a base rent would be initially established. In accordance with current Washington practice, this base rent would be increased at a rate equal to 20% of the annual increase in the C.P.I. The annual increase in the C.P.I. is projected at 10% throughout the 30-year period; therefore, the base rent would increase 2% per year throughout each 10-year term.
 4. In accordance with current Washington standard practice, the lease would provide for a pass-through to the tenant of all increases in operating expenses after the initial base year. Increases in operating expenses are projected at 10% per year throughout the 30-year term.
 5. Finally, all add-on expenses -- above building standard -- are assumed to be passed directly on to the tenant on an annual basis.

The following table presents the results of the 30-year calculation of annual occupancy costs with these lease assumptions. As the table indicates, total occupancy costs climb from \$9,426,000 in 1984 to \$77,891,000 in the year 2013. When all 30 years of occupancy costs are discounted at 11.75%, the total present value of all costs for this alternative is projected to be \$168,217,000.

ANNUAL OCCUPANCY COSTS
 NEW SEC HEADQUARTERS
 LEASE NEW CONGR LIMITED SPACE
 1984 - 2014
 (Dollars in thousands)

Calendar Year	Previous Year Base Rent (1)	Escalation of Base Rent % (2)	Current Year Base Rent (3)	Previous Year's Operating Expenses and Add-ons \$/ (4)	Increase in Operating Expenses and Add-ons % (5)	Current Year's Operating Expenses (6)	Less Parking Revenues Received \$/ (7)	Total Occupancy Costs \$/ (8)
1984			9,338 Z/	396 A/			308	9,426
1985	9,338	187	9,525	3,670	367	4,037	314	9,578
1986	9,525	190	9,742	4,017	404	4,441	320	9,799
1987	9,742	192	9,982	4,414	432	4,846	326	9,994
1988	9,982	198	10,107	4,885	489	5,374	333	10,263
1989	10,107	202	10,309	5,374	531	5,911	341	10,505
1990	10,309	206	10,515	5,911	591	6,502	347	10,759
1991	10,515	210	10,723	6,502	651	7,153	354	11,011
1992	10,723	214	10,933	7,153	715	7,868	361	11,291
1993	10,933	219	11,148	7,868	787	8,654	368	11,567
1994 J/			24,220	8,654	865	9,519	799	24,286
1995	24,220	484	24,704	9,519	952	10,471	815	24,841
1996	24,704	500	25,188	10,471	1,048	11,519	828	25,362
1997	25,188	504	25,682	11,519	1,152	12,670	848	25,962
1998	25,682	514	26,203	12,670	1,267	13,937	865	26,605
1999	26,203	524	26,727	13,937	1,394	15,331	882	27,239
2000	26,727	535	27,262	15,331	1,533	16,864	900	27,895
2001	27,262	546	27,808	16,864	1,686	18,490	918	28,582
2002	27,808	556	28,363	18,490	1,855	20,405	936	29,282
2003	28,363	567	28,930	20,405	2,040	22,445	955	30,015
2004 J/			62,820	22,445	2,245	24,690	2,072	62,993
2005	62,820	1,286	64,078	24,690	2,469	27,159	2,113	64,432
2006	64,078	1,302	65,380	27,159	2,716	29,875	2,154	66,005
2007	65,380	1,307	66,685	29,875	2,988	32,863	2,199	67,454
2008	66,685	1,313	67,998	32,863	3,286	36,149	2,243	69,041
2009	67,998	1,360	69,358	36,149	3,615	39,764	2,288	70,685
2010	69,358	1,407	70,765	39,764	3,976	43,740	2,333	72,388
2011	70,765	1,443	72,189	43,740	4,378	48,118	2,378	74,184
2012	72,189	1,443	73,603	48,114	4,811	52,925	2,420	75,966
2013	73,603	1,472	75,075	52,925	5,292	59,217	2,476	77,891

Present value @ 11.75% discount rate is \$168,217,000.

J/ Based upon a lease providing for an escalation in base rents based upon 20% of the CPI increase. The annual CPI increase is assumed at 10% annually 1984 - 2014.

Z/ See separate schedule.

A/ Based upon a lease providing for full "pass through" of all increases in operating expenses.

B/ 1984 "Add-ons" for extra utilities and security.

C/ Assumes full payment of cost to lease parking spaces by individual employees. Payments increase saw at base rent - 2%.

D/ 3 + 5 - 7.

E/ Rents assumed adjusted after each 10-year term to reflect current market value. Current market value assumed to be equal to the 1984 base level increased annually to 1994 by 10%, then to 2004 by 10%.

Lease Older Existing Building. An alternative to leasing in a brand new building would be to rent space in an older building, assuming an appropriate structure with adequate space available could be found. As explained above, in a tight office market such as downtown Washington's, older, well-maintained, desirable buildings achieve rent levels and lease provisions nearly identical to those in new buildings. Consequently, the 30-year occupancy cost analysis for an older building assumes lease provisions identical to a new building and base rents at 85% of those charged for new space.

Due to this differing rent level, 30-year occupancy costs in an older building are lower than those for a new structure. As indicated in the following table, leasing in a 10-year old building for thirty years yields a net present value savings of approximately \$26,000,000.

ANNUAL OCCUPANCY COSTS
LEASE EXISTING 10-YEAR OLD SPACE
1984-2014
(Dollars in Thousands)

	<u>Total Occupancy Cost - New Building</u>	<u>85% of New Space Occupancy Cost</u>
1984	\$ 9,426	\$ 8,012
1985	\$ 9,578	\$ 8,141
1986	\$ 9,799	\$ 8,329
1987	\$10,026	\$ 8,522
1988	\$10,263	\$ 8,724
1989	\$10,505	\$ 8,929
1990	\$10,759	\$ 9,145
1991	\$11,011	\$ 9,359
1992	\$11,283	\$ 9,591
1993	\$11,567	\$ 9,832
1994	\$24,286	\$20,643
1995	\$24,841	\$21,114
1996	\$25,405	\$21,594
1997	\$25,996	\$22,097
1998	\$26,605	\$22,614
1999	\$27,239	\$23,153
2000	\$27,895	\$23,711
2001	\$28,575	\$24,289
2002	\$29,282	\$24,890
2003	\$30,015	\$25,513
2004	\$62,993	\$53,544
2005	\$64,432	\$54,767
2006	\$65,919	\$56,031
2007	\$67,454	\$57,336
2008	\$69,041	\$58,685
2009	\$70,685	\$60,082
2010	\$72,388	\$61,530
2011	\$74,154	\$63,031
2012	\$75,986	\$64,588
2013	\$77,891	\$66,207

Present value @ 11.75% discount rate is \$142,421,000.

Mr. OTTINGER. It is certainly much easier for us if we have a firm idea of what the cost benefits were to be before going to Congress to authorize this.

I would also like to suggest, Mr. Chairman, if we have time, that we bring up the GSA and find out what the problems are.

Mr. SCHEUER. I totally agree with you, and what I thought we might do is actually meet with the top GSA people and the Chairman of the SEC.

Just take this subcommittee down there to the headquarters and let the Chairman show us around and presumably bring the top decisionmaker of GSA to make an onsite inspection, so we all see together.

Mr. WILLIAMS. I think we can find room for you all.

Mr. SCHEUER. Well, we will try.

Mr. OTTINGER. If GSA has been as much of a problem as indicated, it would be well to get them on record as to what they intend to do about it, what their problems are in doing anything about it, why they have not been more cooperative in a very inefficient situation and if we have time I would like to do that.

Let me ask one more question. I am somewhat concerned about the ability under the national market situation, with the new instruments out, and so forth, that have become prevalent, of the ability to manipulate markets by arrangements that are made of the market today, with large volume trades.

I am also concerned about the lack of regulation of the curb market, the over-the-counter market in this respect, increasing volumes, moneys being handled without scrutiny.

I wonder if you might address that question, both the ability to do that through the exchange and the ability to do that through the over-the-counter market today, and what address you think is needed in that area.

Mr. WILLIAMS. Well, certainly the rules of the SRO's and the Commission, I believe, are adequate to address the problem. The question then is, are the rules being complied with and how do we know?

In that regard, I would have to say that to the best of our knowledge the rules are being generally adhered to. We don't encounter many instances that one would describe as manipulative conduct.

The opportunity clearly does exist; the more dispersed the market becomes the greater the opportunity, both in relation to their being a number of different places, and it is hard to say. The more places, the harder it is to keep your eye on all of them.

Second, the ability to engage in activity between markets provides further opportunity. It is those kinds of concerns, among others, that have led us to feel that we have to have a greater oversight capacity and, indeed, a greater presence and a greater activity in that area than we have had, so that we can have the level of confidence that we need, that we are discharging our responsibility, and that the SRO's are discharging theirs.

It is part of the thinking that gives rise to the MOSS project as well which is designed to provide a data flow to be sure that, one, the system in its entirety which includes the work of the SRO's is

adequate to track the opportunities that exist, and as in other areas it is presence that is the No. 1 deterrent.

If people know that the cop may be coming by the temptation to influence corrupt activity or other types of activities is discouraged. If they know we are not going to be around more than once in 11 years, as we are now with investment advisers, it is not much of a deterrent.

I can't bring you a number of horror stories that would suggest that there is rampant activity out there that I think we can have good confidence, a high level of confidence in the integrity of the markets; but there are always a certain number of people around who would like to take advantage of a situation.

Mr. OTTINGER. Do you think there is any greater hope for SEC surveillance in the over-the-counter markets?

Mr. WILLIAMS. I would have to say to you the oversight of the over-the-counter markets is a much more difficult oversight because it does involve market making in a number of different locations, and it does involve a less disciplined data stream than exists on the floors.

I can't answer you fully, but I would say that it does call for a greater Commission presence than we have now, and it calls for us to have a level of confidence in the quality of the ongoing work and have the increasing technology and systems and people development of the NASD, National Association of Securities Dealers, who in turn are experiencing a greater presence on the part of the Commission in its oversight role in the last year, so I am not prepared to say that there ought to be any major changes in the oversight of the over-the-counter markets.

Now, there are some changes that are happening, such as the inside quote requirement that the representative didn't ask about that will go into effect shortly. There are all kinds of speculations as to what difference that will make in terms of the way markets are made or in terms of the price the customers pay but, as I say, the general tenor of the speculation is that it will make a difference.

I would say that over time I would expect that there will be much more in the way of real time reporting in the over-the-counter markets, at least probably among the NASAQ securities, both in terms of transaction reporting and in terms of quotations, and that whole process will bring a greater degree of what you might call visibility and discipline to that market.

Mr. OTTINGER. I thank you very much for your indulgence, Mr. Chairman.

I have used more than my time.

Mr. SCHEUER. I appreciate my colleague's involvement in this matter. He is a very thoughtful, sophisticated, knowledgeable Member of Congress who understands the problems of our cities and understands the securities market to a very high degree, and we appreciate his contribution.

Congressman Luken, our colleague from Ohio.

Mr. LUKEN. Going from the sophisticated to the other end of the scale—

Mr. SCHEUER. Not so.

Mr. LUKEN. In any event, this country boy has not had much time, and it is nobody's fault in particular, I have not had a chance to go over your testimony and to consider the issues to any extent at all, so I have just a few questions here that I and my staff have come up with.

I would like to ask some questions about the MOSS program.

This is devised, of course, to fulfill your role of oversight, and I believe you said that you recognize the responsibility of other SRO's as self-regulating bodies; is that right?

Mr. WILLIAMS. Yes, sir.

Mr. LUKEN. So the MOSS program is to complement the SRO's?

Mr. WILLIAMS. That is right.

Mr. LUKEN. Obviously, as the memo from staff indicates, this has generated some controversy because perhaps some of the SRO's do not agree fully that it is intended to be complementary and questions have come up about the coordination with the SRO's.

Do you first want to comment generally on the controversy that has arisen and whether or not your SEC has coordinated with the SRO's in developing those specifications and developing this program?

Mr. WILLIAMS. Mr. Luken, let me give you some background.

Now, we have not coordinated with the SRO's in the development of the program itself.

Let me back up. The structure of the Securities Act Exchange calls very explicitly, and the whole contention of securities regulations is built on the concept of self-regulation. It is unique in the sense it is a unique regulatory concept as applied to the Federal Government.

I have been a strong advocate of the concept. It ought to be used more. I believe in it, and I have great interest in encouraging and protecting it as a concept.

For it to work most effectively, it does call for oversight on the part of the SEC, and for any self-regulatory process to work it ought to have effective oversight. We were called to task by the Congress in 1976 and 1977 in relation to the accounting profession.

They were critical of the profession for what it had done, what it had not done, and justifiably critical of the Commission for its breakdown in terms of its oversight of the profession.

In my judgment, the Commission is subject to criticism today for the degree and quality of the oversight of its SRO's and has been.

With the complexity of the markets as they are and as they are increasingly becoming, the Commission is unable to provide any effective oversight of the marketplace itself with its present methodologies and its present systems. It is with that background that we come to MOSS.

The genesis of MOSS is the Commission's effort to say what we need to be able to do to discharge our oversight responsibility, and the project was developed with that in mind, so that indeed it was not developed initially with the cooperation or coordination with the SRO's.

Mr. LUKEN. You say initially it was not?

Mr. WILLIAMS. It was not.

Mr. LUKEN. How about subsequently?

Mr. WILLIAMS. I met with the heads of the SRO's at the beginning of December and I told them at that time the project was now at a point where we had, with the benefit of our consultants, we had a pretty good concept of what we felt it ought to do and we were ready to start trying to shake it down and it was now time that we wanted to bring them into it and have some understanding of what it is that we were trying to do, what it is that MOSS would do for us and do for them and what would be expected of them in connection with it.

Mr. LUKEN. Did you provide them with the information you obtained from the consultants so they would have the benefit of knowing what you know about your findings?

Mr. WILLIAMS. Not entirely, no, sir, and we wouldn't because part of the whole purpose of the system is that we are looking for is what I call, in layman's language, a computer based exception-oriented program that will kick out certain types of disparities, if you will, that should be looked at further.

Mr. LUKEN. You mean certain things that the SRO's need not know or that you don't want them to know about your procedures?

Mr. WILLIAMS. That is right.

Mr. LUKEN. Do you want us to know about them?

That creates a problem. If we find out about them it is public information.

Mr. WILLIAMS. We may be overstating this part of it.

Mr. LUKEN. You have stated it.

Mr. WILLIAMS. All right; what I am saying is how the system will work to kick out irregularities that should be looked at further either by the SRO's or by the Commission itself.

The confidential so that they cannot be anticipated by someone who would wish to avoid such scrutiny.

Mr. SCHEUER. If my colleague will yield, that is a technically sound answer, but it does not respond to the general feeling we get from the industry that they have a queasy feeling about the cost of MOSS about how MOSS will interface with them, and about how MOSS will affect the traditional role of the SRO's. They have a general feeling that it is a threat to them, that it might create a capability of MOSS becoming in effect an electronic marketplace that would threaten them.

They allege that they have not been consulted about what the interface is going to be, the cost, and how much the existence of MOSS is going to erode their role. It seems to me that while there may be some knowledge base that you don't want to share with them, there is probably a great deal of knowledge base that you could share with them, and this informal communication process has to be corrected.

Mr. WILLIAMS. Let me discuss what has happened. I met with the heads of the SRO's at the end of November, early December.

Mr. LUKEN. If I could interject so you can answer both questions, I am not sure I understand why it is necessary for certain information, certain procedures that you are operating under to be secret and not available to the industry generally, but there may be a lack of understanding on my part which I recognize.

Could I ask this question?

Mr. WILLIAMS. Sure.

Mr. LUKEN. Do the SRO's agree, not that their answer is final in any way, but do they agree that these procedures, this information you have from the consultants should not be available to them, that in the proper surveillance role that you are carrying out that you should retain that information exclusively?

Mr. WILLIAMS. We haven't asked them.

Mr. LUKEN. I did yield. Go ahead.

Mr. SCHEUER. If the gentleman would answer my question about the general feeling of the lack of communication and anxiety about the threat that MOSS presents to the traditional role of the SRO's and the threat of the image they conjure up of MOSS being sort of an electronic marketplace that might displace them and anxiety about the cost and their general feeling they have not been involved in informal communication and their questions have not been answered.

We would like to hear something, and I yield back my time.

After we have gotten back to Mr. Luken, I do want to recognize the gentleman from New Jersey, who is very much interested in this matter and also has some questions for you.

Mr. WILLIAMS. I am still back at my meeting with the SRO's last November, at which time I told them very briefly about the project and that I felt we were at a place where we wanted to bring them into the process of understanding how the system would work and what was involved in it and what role they would be expected to play in it.

We had an initial meeting with the SRO's in January which was essentially just a introductory meeting to begin to give them some flavor of it and an overview of what was involved in it.

We have since sent them, well, they would at this point have received I guess one briefing document which was a functional description, and the second which has now gone out. I don't know if they have received it yet or not, which is a technical overview of the system itself.

The members of the Commission's staff have made trips to various SRO's or met with them or at this point have plans to meet with them to answer their questions.

Except for the one narrow aspect of it which perhaps the way I presented it becomes an overfocus, there is no big element of secrecy to the project as a whole. There is no conceivable way that anything like MOSS could become an electronic marketplace. I am sure in some way we have contributed to it and perhaps by not bringing the people in earlier, although I don't think we should have, but I sense a degree of paranoia that I am hard put to understand.

Mr. LUKEN. This is my time.

Mr. SCHEUER. Excuse me. We paranoids have a statement.

Just because we are paranoid doesn't mean they are out to get us. The question is, is anybody out to get them?

I yield back my time.

Mr. LUKEN. I would like to get back to this. I think we are getting down to at least the heart of the matter.

You have just stated that you don't think it conceivably could develop into an electronic marketplace?

Mr. WILLIAMS. It cannot.

Mr. LUKEN. Obviously, the SRO's are suspicious that that is the direction you are going; isn't that right?

Mr. WILLIAMS. I don't think that is obvious. I haven't heard it from the SRO's and I don't know how they could think that.

Mr. LUKEN. Perhaps in their paranoia—

Mr. RINALDO. Will the gentleman yield?

Mr. LUKEN. I yield my time.

Mr. RINALDO. My conversations with many of the people indicate that they don't understand what you are trying to do, why it is necessary, whether or not it is duplicative, or what it is intended to accomplish. You can't hear from them under those conditions.

Let me read a letter that I received just in the past week from a constituent of mine who is very very active in the area.

He started out by saying the SEC proposal for a \$12 million surveillance computer system is ridiculous. The New York Stock Exchange has the most modern system available at the present time. It has been offered to others for their use and it costs a great deal more than the SEC is asking for. In addition, the SEC will need to hire additional personnel to man their new computer.

It will create additional expenses. It is a clear move by big government into private business. Quite frankly, if we are going to balance the budget, if we are going to do what the President wants, I think we have to attack inflation and unnecessary costs at every avenue. I would hope this morning you could at least give to the committee and to myself the justification for this, the reasons for it, and the objectives.

Also, if you can, elaborate on the proposed costs, not the initial costs, because I have learned in my few years here that regardless the cost in the initial year, 5 years later the costs are 10 or 20 times what you start out with.

Mr. SCHEUER. Just like in the private sector.

Mr. RINALDO. Worse. The MOSS system is described as not to replace or diminish the existing regulatory responsibility of the various self-regulatory organizations, but rather to integrate existing trading information from the various markets in one location so that the Commission may better monitor trading practices for oversight and enforcement purposes.

Now, to me this type of system creates substantial redundancy as far as the functions that are performed by self-regulatory organizations today. Quite frankly, I think the SRO's make a good point when they wonder why this is needed. I question whether or not the same thing can be done by the SRO's themselves, whether or not they can get the information to you, why we need what seems to me to be a duplicative and unnecessary system. I would hope that you can justify the entire thing and explain it in a little more detail and give us a good idea of the projected costs, additional personnel, and what you think the people of the United States, the taxpayers, are going to get out of this.

Mr. LUKEN. I have never yielded to a gentleman for a brief question and got such a full response.

I don't know what questions are left, but thank you, Mr. Rinaldo.

Mr. WILLIAMS. I am trying to figure out how to present this to you in this kind of a setting in an adequate kind of detail to answer everything you want, I will try.

The first document that we submitted to the SRO's and, incidentally, I think the thing your committee also had, set out our cost estimates for the 5-year period, both in terms of the one-time capital costs, installation costs, software development, training of personnel, and the annual operating costs that are involved.

Mr. RINALDO. Can you give the dates of those items as you go along please?

When was it sent to the SRO's?

Mr. KUNDAHL. This was sent in early February and the document is not dated. Its title is Market Oversight Surveillance System Description and Justification.

Mr. RINALDO. A little over a month ago?

Mr. KUNDAHL. Yes.

Mr. SCHEUER. Have there been any formal conferences or seminars or briefing sessions?

Mr. WILLIAMS. They are still going on. The staff met yesterday afternoon with a representative from the New York Stock Exchange.

There is a meeting scheduled for Friday with the American Stock Exchange.

Mr. SCHEUER. You might want to submit whatever you have for the record and we can all study it.

Mr. RINALDO. Excuse me, Mr. Chairman; I think we need the information now. We need it prior to the date when we meet to mark up the bill.

As far as I am concerned, if there isn't adequate substantiation for it, maybe we should defer it and not put it into this authorization bill.

What would you think of that?

Mr. WILLIAMS. I would be very opposed to that, but that is your right.

Mr. SCHEUER. Mr. Chairman, we will have some kind of a markup schedule after we return from the Easter recess, and that is 30 days from now roughly. Maybe you could get us something.

Mr. WILLIAMS. The technical overview, as I indicated, I would expect to file today. This is the document of some 30 pages which is an effort to describe the plan.

Mr. RINALDO. Have you made this information generally available?

Mr. WILLIAMS. Generally, no, sir. This information—

Mr. SCHEUER. Is it available in the SRO's where the concern is?

Mr. WILLIAMS. This document is in the hands of the SRO's [indicating green booklet]; this document [indicating blue booklet] is on its way to the SRO's.

Mr. RINALDO. It is my understanding you did not answer freedom of information requests submitted by SIA.

Mr. LUKEN. Will the gentleman yield?

Obviously the gentleman has taken over the questioning. I do not want to continue the confusion, I would simply ask that we obtain a memorandum, a brief from the Chairman, on the justification of the secrecy which the Chairman has described in his testimony here, the secrecy in dealing with the SRO's in the preparation of this program.

Mr. WILLIAMS. I believe that is an overstatement, but I will be responsive to it.

Mr. LUKEN. That is not an overstatement.

Mr. WILLIAMS. We have not dealt with the SRO's in a general climate of secrecy.

Mr. LUKEN. The secrecy which the Chairman has described in the testimony here today. You need not go any further than that. Go to the testimony and find a couple of answers that you gave which I would conclude involved secrecy.

Mr. KUNDAHL. May I inject—

Mr. LUKEN. No, the gentlemen want to take the time, so they can take the time.

Mr. SCHEUER. Will you take the mike, please.

Mr. KUNDAHL. MOSS has applications well beyond the investigation application. The system is intended to assist the Market Regulation Division in overseeing the self-regulatory organizations and analyzing their rules and assisting them in doing their job. It is intended to help the Investment Management Division, which is responsible for, among other things, inspecting investment companies and investment advisors. It will be used by our Division of Corporation Finance in reviewing filings submitted to the Commission.

In the area of enforcement, there is a narrow portion of the system that will include parameters which constitute a formula to help us to detect trades which are worthy of our further investigation. I think in some ways it is analogous to the IRS system, which has certain parameters which allow them to identify tax forms that may have problems in them. Our whole effort in working with the SRO's is to describe the system as a whole, to talk about its purposes and uses. We have given them examples of the kinds of parameters we may employ. But they are a very small segment of the system, specifically, the parameters that we have gotten locked in on today as a secret part of the system. To be honest, we do not know what those parameters are today. Our effort to date has been to explain the concept of MOSS to Congress and the SRO's. We have submitted a cost-benefit study, prepared by an outside consultant which goes into considerable additional detail as to the benefits we will receive, as compared to the cost, I think that a useful explanation of the system, and we have provided and will provide additional copies of the description and justification to this committee.

As we move downstream over the 5-year implementation of MOSS, we will learn more about the system and continue to share our improved understanding with Congress and the SRO's.

Mr. LUKEN. All I can say is, I hope your memorandum has a more direct answer than that which you have just given us.

Mr. SCHEUER. If there is no objection, we will include that study.

[The information requested was not available to the subcommittee at the time of printing.]

Mr. SCHEUER. No Government organization could possibly do an adequate monitoring job on the order of activity you are charged with managing without coming into the 20th century and using the most advanced technology. It is demonstrably impossible for you to manage and cope with the volume of trading and activity without

some kind of sophisticated computer capability. I do not think there is any corporation in the country of a significant size that does not have a computer capability in carrying on its normal activities. Having said that, I get the general impression that there has been a communications gap. It may be you are just in the process in the last few weeks or month of closing that gap and that the documents that have gone out and which are about to go out, will go some distance in creating a more serene climate out there, where there is a lot of anxiety as to the system, not just the questionable secret area of your operation, but how this generally will affect them. I urge you to continue that quickly. We will be starting to mark up this bill shortly after we get back from the Easter recess.

Mr. WILLIAMS. Mr. Chairman, to the extent there is an unease that comes from a communications gap, we have the responsibility to close that gap; there is no question about that. I would hope we would be able to deal with this system on its merits, because I believe it is essential for us and essential for the Commission to discharge its oversight responsibility. I must say to you that I really do not expect the SRO's to applaud greater oversight. So I do not really expect a unanimous and resounding vote of approval for the system, because there is no question in my mind that tighter oversight, which I think the market calls for and which the Commission is responsible for providing, will cause some shoe-pinching.

Mr. SCHEUER. Some what?

Mr. WILLIAMS. Shoe-pinching.

Mr. LUKEN. Will the gentleman yield?

Mr. SCHEUER. It is your time.

Mr. LUKEN. I have withdrawn because of the confusion caused by the disruption. But I would like to point out, the communication gap which has been described here, when we talk about a communication gap, we generally mean something that is inadvertent. But the testimony here has been that there was a deliberate purposeful withholding of information and that is what I want a justification for—how a deliberate, purposeful withholding of information on procedures can be justified. Maybe it can.

Mr. WILLIAMS. There has been no—

Mr. LUKEN. You said there was, in answer to my question.

Mr. WILLIAMS. You asked me if they were brought into planning, and I said no, we had to take into consideration what our responsibility was—

Mr. LUKEN. Your associate here also said the reason you had not consulted them was because of the same reasons the IRS—

Mr. WILLIAMS. No, sir, I said there was one small part of this thing, that relates to the parameters, that we have not made public and we do not intend to make public. That is a small segment of a very large project. It is my fault I referred to that early on but I am overbuilding it and you are, too, sir.

Mr. LUKEN. Well, I heard the testimony, and perhaps you can set it forth in a clear memorandum as to just exactly what that is. If there is no secrecy, maybe you can set the whole thing forth. If there is, tell us what was withheld. But it is not a communication gap if it was intentional, and at least that little part was intentional on your part.

Mr. WILLIAMS. Yes, sir, but there is no cloud of secrecy over the project.

Mr. LUKEN. That is a conclusion. I want to get it straight because communication gap is inadvertent and that which you describe is very purposeful.

Mr. SCHEUER. What is the opposite of inadvertent?

Mr. LUKEN. Advertent.

Mr. SCHEUER. My colleague from New Jersey.

Mr. RINALDO. I think the chairman has a good idea of the questions I would like to have answered so I can vote intelligently during the markup.

I think if anything, the hearing thus far has brought out that perhaps in the implementation of a project of this sort there should be more cooperation and understanding between the SEC and SRO's. For my own part, I would like a number of other questions answered for the record, not necessarily today, so we have the answers prior to markup.

I asked earlier whether or not there was any unnecessary duplication of effort. I would like to know what costs you have projected that would have to be borne by the securities industry or by the consumer to whom they might pass on such costs during the development and implementation of this project. I would like to know whether or not your request for authorization, to add nine new personnel for this project effectively adds an additional \$3 million to the proposed one-time cost of \$12 million over a 5-year period.

I am concerned also, because, as recently as the 1975 Securities Reform Act, Congress endorsed the principle that the securities industry should be primarily self-regulated by the SRO's, and SEC should act in a limited oversight position insuring the effectiveness of the SRO's in this area. I would like to know why this additional effort is necessary.

Also, on the question of openness, I was in error before. I said it was the SIA, but I believe that the Freedom of Information request that was denied was made by McGraw-Hill; is that correct?

Mr. WILLIAMS. I would have to verify that; I do not know.

Mr. RINALDO. If we are going to be open about the MOSS system, if we are going to give everybody an opportunity to understand it, if we are going to give everybody an opportunity to evaluate it, I would hope any additional Freedom of Information requests and this one in particular would not be denied.

Mr. WILLIAMS. I would have to see what the request was. I cannot respond to that directly at this time.

Mr. RINALDO. I would hope in the spirit of cooperativeness not only with the SRO's, but also with this committee, this information would be forthcoming so we can effectively determine whether or not this additional expense is justified.

Mr. WILLIAMS. No problem.

Mr. SCHEUER. All right. Let us talk about the money market funds for a moment, the \$60 billion of them, involving more than 3 million investors.

The question we have is, the money market funds have grown enormously in the very recent past. To what extent do you feel you are able, properly, to police these money market funds and perhaps in a fashion similar to bank examiners?

It is my understanding the industry has urged that more Commission resources be devoted to this function in order to preclude events that could shake public confidence reminiscent of the late 1920's. Have you any concern as to your ability to scrutinize and regulate the money market funds?

Mr. WILLIAMS. Syd Mendelsohn will answer.

Mr. SCHEUER. I understand these are inspected on a 5.6 cycle. What should the cycle be? Does that represent a potential for abuse, 5.6?

Mr. MENDELSON. We have been able to marshal our forces and put them where we think the problem is. For example, in the last several months, we have inspected every money-market fund. We have looked for such things as quality of investments, back office and valuation. We have found three or four instances of errors in the way the securities were valued. We found nobody with their hand in the till.

As far as I am concerned, I am worried about the potential of the whole industry visiting on an average of 5.6—of one every 5.6 years.

What I am saying is, the emphasis we put on the money-market funds means we are deemphasizing other areas of the investment industry which conceivably need the attention we would give. But fortunately, we have had the ability to put the people where the problem is in this instance.

Mr. SCHEUER. So you do not feel there is any lack of inspection capacity or surveillance capacity that should be enhanced. You feel comfortable with the handle you have.

Mr. MENDELSON. I feel confident we can inspect in limited areas. I doubt we can in the whole investment industry.

Mr. SCHEUER. Do you feel there is a need there or do you feel it is being taken care of?

Mr. MENDELSON. We ought to have a "cop on the beat" sort of thing. The ideal thing would be an inspection of each company every 2 years. In that way, one could inspect in a short order and feel they have the whole company under surveillance.

Mr. SCHEUER. Would that "cop on the beat" be an electronic capability or more manpower or what? If your current cycle is 5.6 years, would it mean you would have to have more than double your present manpower devoted to that function or could that be accomplished by sophisticated electronic equipment?

Mr. MENDELSON. I think the presence of the inspector is the most important thing. Our computers could kick out areas or problems we could go to, but it cannot do the inspection for us.

Our inspection has to do with inside dealings, inside opportunities that the investment adviser or affiliated persons would have.

Mr. SCHEUER. The computer could not send up an early warning signal that individuals inside might be involved in trading irregularities? I seems to me that is the kind of thing a computer could spit out.

Mr. MENDELSON. Assuming the reporting requirements are such that we would get that information.

Mr. SCHEUER. If they are not, it seems as though there is something wrong with your reporting requirements.

Mr. MENDELSON. People who are attempting to take advantage of investment companies or any company are not necessarily the type of people who are going to report their activities. For example, joint transactions with the investment company, selling shares to the investment company, or selling property to the investment company, getting bribes under the table from people who want to deal with the investment company. These are not going to be reported in such a way that they can be shot out from a computer. You have to go in, look at the books, and you have to have an imaginative inspector to project from the facts he sees what he thinks the facts really are.

In this area, there is a limitation. The computer can show us general areas of problems. For example, they can show us trading by investment companies. We can go in and see if that trading is proper or whether anybody is taking advantage. But for the things that people do not realize that there are violations, the transactions a manager can do are very difficult to ascertain.

Mr. SCHEUER. Mr. Chairman.

Mr. WILLIAMS. The Commission is only beginning to scratch the surface in its ability to use computers set with certain parameters to evaluate certain information and kick out those matters where it seems as though a further look is called for. The things we are trying to do by hand today are much too slow and much too imprecise. I agree with Mr. Mendelsohn, in the area you were specifically talking about, it would be difficult to get that out of a computer. But there are a number of other areas where it would be extremely helpful.

Mr. SCHEUER. Turning to another subject, last Saturday the Fed announced the imposition of the 15-percent requirement on money-market funds. Some have stopped selling.

What are the practical problems that the funds are encountering? And does the situation in general discriminate against the small investor or against the large investor who has the opportunity to purchase CDs, or whatever, without reserve requirements?

Mr. WILLIAMS. Clearly, the impact of the imposition of the Credit Control Act on money-market funds will be to have a negative impact on yields—

Mr. SCHEUER. Does this in turn discriminate against certain kinds of money-market fund, against new funds, against small funds?

Mr. WILLIAMS. It is only on the increment. In effect, it puts a penalty on new money coming in. As far as existing funds are concerned, it does raise a question of whether they can appropriately bring more money in because the additional reserve requirement, the yield impact would have to be spread over all the money in the fund.

Mr. SCHEUER. Does this discriminate against money-market funds and in favor of banks, for example?

Mr. WILLIAMS. It reduces the differential. It certainly would reduce some of the attractiveness of money-market funds competitively to bank instruments. But I do not know whether I could characterize that as being discriminatory. It might take away an advantage that has been there.

Mr. SCHEUER. I would think that is discriminatory.

Mr. WILLIAMS. I suspect that banks previously felt the absence of reserve requirements on money-market funds was discriminatory in favor of money-market funds.

Syd, do you want to add anything to that?

Mr. MENDELSON. In answer to your question, let me tell you how I think the funds are going to cope with it.

We have been discussing with the industry the organization of what they call "clone" funds.

Mr. SCHEUER. Clone?

Mr. MENDELSON. Clone funds, identical funds. They will take the new money in, say "X" Fund No. 2, the original being "X" No. 1, they will take the new money in. The old company will cease selling to the public. However, they will queue up shareholders of the new company so as people redeem from the original company, the new investors will move into that company and thereby enjoy a minimum amount of reserve.

All companies will have a reserve requirement as I understand it, in that accrued interest makes a company grow, and will be subject to the reserve requirement. But there will be a minimum reserve requirement in the original companies that will not sell to the public.

The clone company will be the one that will be selling to the public and will be in effect, being charged the full impact of the reserve which is 15 percent as you know.

We figured it out at about 14-percent interest, the current yield. That would reduce the yield by about 2 percent. So in this way, the fiduciary responsibility of the management to segregate the impact of the shareholders seems to be the best way. Obviously a fund sold into this reserve requirement, all shareholders would be subject to a 7½-percent, what would be taken tantamount to a 7½-percent reserve. It would be punishing the existing shareholders to increase the fund and thereby conceivably increase the fee of the investment adviser. In order to avoid that they have come up with this second fund.

Mr. SCHEUER. In general, we sense a problem in the ability of small business to aggregate capital. We have heard persistent reports that small businessmen have been attracted and undoubtedly the tax laws and general state of the economy are a problem as reflected in the need for the Fed to raise the requirements to 15 percent. But the SEC statutes and the regulatory processes and this general posture have been consistently complained about by small business as being unduly burdensome.

I have the feeling that you have done much in the last couple of years to improve this situation and your establishment of the Office of Small Business Policy is an effort to face up to this issue directly. But the Commission and the securities laws and the general way they are being administered continue to come under this drumfire of criticism. We hear it from every spectrum of the small investor and small business, especially the failure to provide sufficient flexibility to meet the needs of corporations. The large businessmen have all orders of advantage that the small venture capitalists do not have.

What plans are there for small business to raise venture capital, and are there any plans to help encourage small venture capital enterprise?

Mr. MENDELSON. We have done several things, and several things are being contemplated.

One, we have proposed a rule to exempt investment advisers of venture capital companies from the impact of section 205 of the Advisers Act. Section 205 of the Advisers Act in effect prohibits an incentive fee under most conditions. We have a proposed rule. We have had it out for comment, we are about to resubmit it to the Commission, that would exempt small venture capital investment advisers from the impact of this so they could operate with an incentive of say getting 20 percent of the profits of the venture capital business. This will encourage, we feel, people who are not in the venture capital business to go into it. The conditions we put on it were that the minimum investment would be \$150,000, for example. We have defined a venture capital company fairly narrowly. We have called it a development company because we really could not figure out what a venture capital company is and we have had very little help from anybody. Everybody has their own definition of a venture capital company. So we call it a development company and have made our own definition.

We think this should draw more registered investment advisers with potential capital into the process.

Second, we put forth a rule under section 3(c) of the act not to count shareholders of institutions as a part of the hundred people that make registration a requirement. We have a rule which in effect allows institutions to go into a venture capital company and only be counted as one, whereas previously, all the shareholders of that institution could be counted to make up the hundred. So, we have narrowed the gap. We have done this simply because we felt when sophisticated capital goes into these venture capital companies, the need for the 1940 act protection is minimized. People know what they are doing and they can cope for themselves.

Mr. SCHEUER. There is the feeling abroad that you are overprotecting these very sophisticated, knowledgeable investors.

Mr. MENDELSON. As I said before, Mr. Chairman, in the investment company area, people do not know when they are getting gypped, no matter how sophisticated they are. In an ordinary transaction where a broker or person selling securities says the company has x and it does not or says it has a potential and it does not, sophisticated people can recognize this violation—

Mr. SCHEUER. It is hardly a violation if a company claims it has a potential. Is it a violation when a Congressman says he will be dedicated full time, et cetera. Everybody who comes into the capital market has to tell what his potential is and even an unsophisticated investor has the responsibility to check out what there is true.

Mr. MENDELSON. Suppose he says he has x number of oil deposits under his land—

Mr. SCHEUER. Well, if that is not potential.

Mr. MENDELSON. Where a particular investment or affiliate is taking a bribe to put it in a certain venture capital, there is no knowledge that can ferret that out by a sophisticated investor.

Mr. SCHEUER. That is a whole other bag, I agree with you.

Mr. MENDELSON. When an investment adviser says to a venture capital company, when you get into this, conceivably you take the equity, the risk, or better still, the investment company ends up lending the money in a very, very risky situation and under the table, there is an arrangement where the investment adviser pays a good portion of the stock of the company. So it ends up as a heads I win, tails you lose situation. It is very difficult for a sophisticated investor to know he has been taken advantage of.

You know, there is a lot of mystique about the Investment Company Act. The guts of the Investment Company Act says that an affiliated person should not sell to or buy from an investment company unless he gets an order from the Commission. This is fraught with a conflict of interest. It says in effect he should not take any bribes with respect to the purchase or sales of securities. It says that the capital system should not be such that the company is taking a tremendously undue risk by leveraging excessively. It talks in terms of joint transactions that an investment company and an affiliated person should not go into joint transactions.

Now it seems to me there are very few people who say this should not be looked at, that this is overregulation. We are dealing with fungible assets and it seems to me, if it is wrong in the case of a venture capital company, then the act seems to be wrong with respect to almost any type of investment company operation. It seems to me, our current investment company study has been trying to develop rules to throw the burden on the directors of companies and letting them set up a system of their own protection and then letting us inspect that protection device that they have set up as a result of our rules. It seems to me that our whole emphasis from day-to-day regulation to regulation by the board of directors, the disinterested board, is a step in the right direction, not only for venture capital companies but for the whole investment company industry.

Mr. SCHEUER. Let me get on to another question, and your answers were very responsive and very well informed, we appreciate them.

The question of the right of privacy provisions of the Financial Institutions Reform Act of 1978. I am sure you are very well aware of the problem. They take effect in October of this year.

How do you perceive of them in terms of affecting your ability to police the market?

Mr. WILLIAMS. Mr. Chairman, we have had a 2-year exemption which expires this year.

Mr. SCHEUER. That is correct.

Mr. WILLIAMS. Our concern at the time, and it continues, is that since a very large part of our activity deals with financial instruments and a large part of our investigatory operation includes the ability to receive and examine bank records and as a result, the act would have an unusual effect in terms of the operation of the Commission. I recognize we are balancing two public interests here, the one articulated by the act itself, and the other in the interest of effective enforcement of the securities laws.

In general, we are concerned that the effect of the act on us would be to cause an enormous amount of delay. More specifically,

in a number of areas, we would be concerned that having the act to in a sense fall back on would enable individuals who wanted to implement their action that way with ways to delay and draw out both the actions in the courts and in other ways hinder our ability to get things done.

Mr. SCHEUER. This would impact on your staff needs?

Mr. WILLIAMS. Yes; enormously. We are spending an enormous amount of time in court on subpoena enforcement, which is required in response to new tactics to delay and wear us out. I would expect in the next day or so we will have a proposal that I hope will meet with favor in Congress to continue on a specific and narrow basis the treatment of the Commission.

Mr. SCHEUER. Mr. Luken, have you any questions you wish to ask?

Mr. LUKEN. Not at the present time. Thank you.

Mr. SCHEUER. Continue.

Mr. WILLIAMS. We will have a proposal to continue the present exemption for the Commission, but I feel there is a responsible effort to balance the two public policies involved.

Mr. SCHEUER. If you feel that the magnitude of the problem justifies a legislative remedy, I would advise you to get in touch with us.

Mr. WILLIAMS. We have not talked with your staff about it.

Mr. SCHEUER. Our counsel has a question, our very distinguished and extremely knowledgeable counsel.

Mr. OPPER. In connection with the clone funds that are being created to alleviate the problems that the money-market funds have with the reserve requirements of the Federal Reserve, one of the concerns expressed by the industry is that their application for these new funds be expedited. Is the Commission and your division making every effort to assure that these applications are processed expeditiously?

Mr. MENDELSON. We are. We have instructed the staff and we have told the industry we are giving top priority to these filings. We have instructed the industry how to file so as to complete the process with the least amount of delay.

Mr. OPPER. Thank you.

Mr. SCHEUER. Our counsel, Consuela Washington, has a question.

Ms. WASHINGTON. It is a general question of what if anything the Commission has done in the area of regulatory reform. You know that is an important issue up here, especially with us being asked to seriously cut budget.

While most of us applaud the Commission for what it has done with its resources, there are many singing a different song with a different set of lyrics accusing you of overenforcement.

What have you done, what has the Commission done in the area of regulatory reform?

Mr. WILLIAMS. I could give you a very long answer, but I will try to keep it brief.

There have been a number of efforts in a number of areas at the Commission. Particularly to me, they have several characteristics: One, they are very substantive; two, they look not only to kind of simplistic things that might impact on the agency, but much more fundamentally, what is the impact on the private sector where so

much of the burden of regulation lies; three, a very large part of this began long before issues like assisting small business and regulatory reform became as popular words as they are.

One area which the Chairman touched on was venture capital funds. Hearings are beginning on small business, to sort out what the SEC's impact is. We did establish an Office of Small Business Policy to focus on the problems of small business. We adopted several different approaches that reduced the burden. We adopted form S-18 to simplify reporting and, apropos to that, we have published our first report that tracks the impact of S-18. I believe a copy has been supplied to the staff. If not, we will get it to you promptly. We do know S-18 is achieving the purposes for which it was intended.

We adopted rule 242, to permit sales up to \$2 million, a more simplified way of raising capital. Again we are tracking on how 242 is used and whether it serves the purpose for which we intended.

There have been other things such as easing up on rule 144 which has to do with securities being sold after investment.

In the broader area not related generically to small business, we are engaged in a comprehensive review of the 1933 and 1934 acts. In effect, we are beginning a total relook at all those requirements. We have now proposed for consideration and we have out for comment, a major effort to integrate the 1933 and 1934 acts and the filings under those acts to reduce duplication, to eliminate a lot of the conflict or inconsistency between those two. As a result or consequence of that process, we hope to facilitate the registration of new issues both in terms of timing and in terms of content, when a company wants to come to market for additional financing, whether it is debt, equity, whether a large or small company.

As we have adopted rules relaxing the proxy disclosure requirements, we are requesting comments on how those rules are working, the kinds of problems raised by them, et cetera.

In the 1940 act area, we are going back through the entire act and our implementation of it to determine what we can do to deregulate. We have withdrawn the investment policy. We have adopted advertising restrictions and begun to get the Commission out of areas it was in before but should be the responsibility of the mutual fund, their advisers and boards of directors.

We have built up economic and policy research to implement proposed rules and to track and to have a better economic understanding of the industry, so we have a better sense of how to be responsible ourselves in regulation and to be able to better serve and assure the quality and integrity of the capital markets.

The development of a national market system is reducing and eliminating a lot of duplication, and we are trying to develop more efficiency within the marketplace and within the Commission in addressing the marketplace.

Our Office of Consumer Affairs gives us again, a better feel of when and where our regulations work well and what should be done where and what should be eliminated. We have done an awful lot in modernization of our own in-house information systems and to try to improve our own personnel management, both of which Government agencies are not notoriously well known for, but we are trying to make progress in that area as well.

That is the short explanation.

Ms. WASHINGTON. Then it is your view that you possess sufficient objectivity and staff resources to do an adequate job of regulatory reform, without anything congressionally imposed, such as legislative vetoes, sunset?

Mr. WILLIAMS. I spoke last fall before the National Press Club and expressed my views on regulatory reform.

It is very difficult for any organization to have adequate objectivity on its own. I brought a good bit of objectivity with me several years ago; I do not know how much is left. I try hard to be objective, and we all do at the agency. Objectivity can be enhanced by listening, encouraging comment; that is one of the importance of some of the exchange on MOSS although I would say that comment comes indirectly to the Commission rather than directly so we can deal with it more directly and on the merits. Of course, efforts such as congressional oversight are important to assure the Commission is responsible.

My concern about most of the regulatory reform measures is that they assume—I can be chauvinistic for a moment—that every male wears a 42-long. It fits me, but not everybody, and that is the problem with regulatory reforms. They are not well dealt with by one-House veto or by expansive judicial reviews or by executive veto, either. At the same time, they are very real problems and can go on. I am not opposed to regulatory reform and, I agree there is a need for it, but it takes a more fundamental prescription than most of the proposals I have seen.

Mr. SCHEUER. Our minority counsel, Jim McMahon, on behalf of Congressman Rinaldo.

Mr. McMAHON. Earlier this month, Mr. Rinaldo and Mr. Broyhill introduced legislation, H.R. 6723. It responds to some of the criticisms that SEC lodged against an earlier version of the bill.

The new bill also embodies some of the concepts embodied in the Senate bill which you have also been working on.

At your earliest convenience, would you provide for Mr. Broyhill or this particular committee, comments?

Mr. WILLIAMS. That is in process; yes, sir.

Mr. McMAHON. The second question is directed to the relief you are seeking from the Right to Financial Policy Act and without letting the cat out of the bag, do you intend to seek relief from this committee or the Senate committee.

Mr. WILLIAMS. We will be approaching both committees, but we have a specific proposal for this committee.

[The following letter was received for the record:]



SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

REC'D CP&F SUB.

APR 21 1980

April 15, 1980

The Honorable James H. Scheuer
Chairman
Subcommittee on Consumer Protection and
Finance
Committee on Interstate and Foreign
Commerce
2402 Rayburn House Office Building
House of Representatives
Washington, D. C. 20515

Dear Chairman Scheuer:

Recently I appeared before the House Subcommittee on Consumer Protection and Finance in connection with the Commission's pending request for budget authorization for a three-year period beginning with fiscal 1981. During the course of those hearings, several questions arose regarding the implementation of a computerized Market Oversight Surveillance System ("MOSS"), one of the the most important elements of the Commission's authorization package. The purpose of this letter is to respond to those questions by amplifying on the Commission's need for MOSS and clarifying any misconceptions concerning the purpose of the system and its relationship to the securities industry and the self-regulatory organizations.

The Framework of Self-Regulation

In order to evaluate the need for the proposed MOSS project, it is important to recognize the respective market surveillance roles which Congress has assigned to the Commission and the SROs. In this regard, self-regulation -- rather than direct government control -- is a central theme of the Securities Exchange Act of 1934, and for over 40 years, the Commission has worked to implement and refine that unique concept. ^{1/} In fact, a significant part of the Commission's effectiveness is, in my judgment, a consequence of our success

^{1/} The scheme of self-regulation is dealt with by various sections of the Securities Exchange Act of 1934, particularly in Sections 6, 15A, 17A and 19, 15 U.S.C. 78f, 78o-3, 78q, and 78s.

in attaining through self-regulation the various goals which Congress articulated in the federal securities laws. While reliance on the private sector is the key to self-regulation, effective government oversight is necessary to ensure that each self-regulator is fully discharging its responsibilities. The problem is essentially one of balance. Inadequate oversight can result in self-regulation's becoming lax; excessive oversight, on the other hand, can pre-empt the self-regulatory process.

Effective self-regulation also requires that the relationship between the Commission and the industry reflect the unique and difficult role of the SROs. A stock exchange or other self-regulatory organization is expected to perform what are sometimes two mutually inconsistent roles. As a marketplace, it competes for business and depends upon the support of its members for economic survival, while at the same time regulating the conduct of those members. Obviously, there are times when the self-regulators may have difficulty in balancing the interests of their members against their duties and responsibilities under the 1934 Act. It is the Commission's responsibility, in performing its oversight role to ensure that each self-regulator is indeed striking that balance appropriately.

An alternative approach to this current system of individualized SRO surveillance would be to establish a "sole self-regulator" with the exclusive responsibility for monitoring the activities of all professionals in all marketplaces. In my judgment, however, efforts to establish such a body at this time would divert resources from other Commission and industry efforts aimed at enhancing the quality of the securities markets and implementing the Securities Acts Amendments of 1975. Moreover, even if an effective surveillance self-regulator were successfully created, the Commission, in order to discharge its statutory responsibilities, would still have to perform an oversight function with respect to the activities of that body. In addition, the federal securities laws charge the Commission with primary responsibility for a number of market-related activities. For example, the Commission directly regulates broker-dealers which are not members of any SRO and is the only body with enforcement authority as to other entities, such as private investors, who are outside the jurisdiction of SROs. Accordingly, I doubt that this alternative would entail any advantages over the proposed MOSS system.

The Need for MOSS

Within this self-regulatory framework, the need for MOSS is a consequence of changes during the past decade in the marketplace and the financial community -- including greatly expanded market activity, increasing complexity of financial transactions, and the development of a new mix of financial products being offered to the public. For example, the volume of trading in New York Stock Exchange-listed securities on the composite tape, American Stock Exchange-listed and over-the-counter traded securities for the month of January, 1980, totaled 2.165 billion shares. Only a year earlier, in January, 1979, the figure was 1.017 billion shares -- less than half the 1980 figure. Two years ago, in January, 1978, only 743 million shares traded -- about one-third of this year's figure. Since 1975, the number of shares annually traded in the NASDAQ system increased more than 150 percent; the number of contracts for exchange-traded options increased 250 percent; the number of registered broker-dealers increased by almost 80 percent; the number of registered investment advisers increased by two-thirds; \$100 billion worth of successful tender offers occurred; and, in the last year alone, the assets of money market funds increased almost five-fold. During this same five-year period, Congress charged the Commission with a broad range of new regulatory responsibilities and legal obligations. By comparison, the Commission's personnel resources have remained relatively fixed during this period.

In addition to strengthening the Commission's ability to deal with the tremendous growth in the marketplace activities it oversees, MOSS will contribute to other important Commission functions. It will enable the Commission to discharge its oversight responsibilities for transfer agents, clearing corporations and securities information processors more effectively. ^{2/} It will also generate information essential to a meaningful inspection program for broker-dealers and the regulation of SECO broker-dealers, investment advisors and investment companies, provide the Commission with the capability to develop an enhanced understanding of the marketplace generally, and will make available to the Commission information valuable to thoughtful and well-disciplined rule-making and cost-benefit analyses.

^{2/} A flow chart of SEC statutory responsibilities and regulated entities is attached for your information.

Similarly, MOSS will facilitate more timely and less costly investigations of market-related activities such as tender offers and insider trading, since it will, for the first time, permit the Commission to review trading activity in conjunction with other information, such as public filings and news releases. Finally, MOSS will provide the Commission with an ability, not currently available within government or without, to analyze a composite of trading activity in all markets.

In assessing these benefits of the proposed system, it is useful to compare MOSS to the tools currently available to the Commission. Traditionally, the Commission's oversight of the activities of the self-regulators has been confined to relatively infrequent on-site inspections of the various self-regulatory organizations and to periodic telephone contact with the self-regulatory staffs concerning unusual marketplace events. In the sophisticated trading environment which characterizes the contemporary capital markets, this process is inadequate. The Commission is almost totally dependent upon the SROs to identify significant trading violations in their marketplaces, and we lack adequate independent means to evaluate the effectiveness and thoroughness of the SROs in dealing with such violations on a routine basis. With such limited information available, it has been impossible for the Commission to perform effectively its statutory oversight responsibilities.

Two examples illustrate the consequences of the Commission's reliance on its existing informal surveillance mechanisms. In July of 1977, the Commission imposed a moratorium on expansion of the options markets, in part because the Commission recognized that it lacked sufficient information concerning the operations of those markets and the capacity of the options self-regulators to deal with the novel regulatory and surveillance problems which options trading poses. Although many of the concerns raised by the Commission in its October, 1977, release proposing an options "moratorium" were eventually substantiated by the work of the Special Study of the Options Markets, 3/ the imposition of the options moratorium might not have been necessary if an informed and thorough oversight capability, such as MOSS will provide, had been available to the Commission during the initial stages of standardized options trading and at the time that the Commission was faced with its initial moratorium decision.

3/ See Report of the Special Study of the Options Markets, 96th Cong., 1st Session, (Comm. Print 96-IFC3, 1979).

Similarly, the Commission's experience in overseeing the regulation of the over-the-counter markets provides another illustration of the need for MOSS. On October 5, 1978, the General Accounting Office issued a report highly critical of the Commission's performance of its oversight responsibilities with respect to the activities of the National Association of Securities Dealers, Inc., the principal self-regulator for the OTC markets. 4/ The report noted that the Commission was particularly deficient in conducting oversight of NASD member firm trading and selling activities. MOSS will substantially address these concerns.

Finally, the Commission's inspection activities have provided additional evidence of the need for the more sophisticated capabilities which MOSS will provide. Over the past year, the Commission has enhanced its inspection programs, and, as a result, has discovered inadequacies in SRO surveillance efforts. These inadequacies can be separated into two general categories. First, some of the SROs do not adequately monitor their markets for certain common types of trading violations; and, second, when trading violations are detected, some SROs fail to enforce their rules vigorously against the offending member. 5/ Although the Commission's enhanced inspection effort has been useful in uncovering these weaknesses, we cannot rely on it exclusively to prevent their repetition. Under the current inspection cycle, the Commission only inspects a principal SRO approximately every nine months. These inspections, moreover, can only evaluate the performance of the SRO at a particular point in time. No ongoing statistically valid oversight of SRO performance is possible through this method, and inspections do not give the Commission the ability to detect, and the option to act upon, unusually significant trading violations, operational difficulties, or other serious market anomalies as they are occurring. MOSS, on the other hand, will both make the inspection process more effective and provide a supplementary oversight tool.

4/ See Comptroller General of the United States, Report: "Securities and Exchange Commission Should Strengthen Its Inspection Oversight of the National Association of Securities Dealers" (October 5, 1978).

5/ In fact, it was necessary recently for the Commission to take direct enforcement action against an SRO for non-performance of its regulatory responsibilities. In the Matter of the Philadelphia Stock Exchange Inc., Adm'n. Proc. No. 3-5890, (SEA Rel. No. 16648/March 13, 1980).

These three concerns -- increased marketplace volume and complexity, inadequacy of existing surveillance tools, and SRO weaknesses identified in the inspections programs -- gave birth to MOSS. MOSS represents, I believe, the most responsible, cost effective, and pragmatic solution to these inadequacies in our current oversight capabilities -- inadequacies that must be resolved if the Commission is to perform its responsibilities under the 1934 Act effectively. Moreover, MOSS reaffirms our commitment to the concept of self-regulation. I firmly believe that assertions to the contrary voiced by some members of the securities industry result from misunderstandings of the nature of MOSS and its use. These misunderstandings may be the result of the complex and technical nature of the proposal, or they may be the result of our having failed to communicate effectively our purposes and goals for MOSS. Whatever the cause, however, it is crucial to the continued maintenance of fair and orderly markets and to the Commission's ability to discharge its statutory responsibilities that these misunderstandings be clarified and that MOSS be allowed to proceed.

MOSS and the Existing SROs

At bottom, the objections to MOSS are predicated chiefly on the assumption that it will somehow duplicate or supplant existing SRO surveillance. On the contrary, however, although MOSS will enhance the Commission's capability to oversee the surveillance efforts of the SROs, the proposed system is not "redundant" of the existing SRO surveillance systems. While MOSS will process the same raw data as do the SROs, some on a daily basis, and some on a delayed basis, this information will be used for a different purpose. The Commission's objective is to ensure, on an exception basis, that the SROs routinely perform their statutory duties. The use of the underlying data for direct regulatory purposes, such as through disciplinary and other proceedings against SRO members, is largely the province of the SROs themselves.

The Commission is committed to maintaining this relationship, and MOSS is consistent with it. After MOSS is implemented, although the Commission staff will have a considerably greater and more timely ability to oversee the activities and performance of the SROs, we will not

alter the scope of our inquiries into market anomalies. The SROs will continue to have the primary responsibility for regulating their marketplaces and disciplining their members. The Commission's staff will retain its existing flexibility to take appropriate action when conditions in the marketplace so require.

In addition, MOSS has been structured to be flexible to changes in the SROs' capabilities. Although the Commission has developed a comprehensive blueprint for MOSS, the system is an evolving one. Only the first three years are now feasible for implementation, and the system will undergo constant revision as new data sources become available, as SRO information systems evolve, and as the nature of the changing marketplace dictates that new matters be monitored or others dropped. In order to adapt to a changing market and to accommodate to the availability of information at various stages of development, MOSS has been designed in modules which are independently self-sustaining and cost effective. Presently, the Commission is operating a pilot to test portions of the design for the entire system. Through the operation of the pilot, both the Commission and the SROs will have an opportunity to evaluate the impact of MOSS on their respective operations.

The Cost of the Proposed System

The Commission is very sensitive to the financial and administrative burdens which the establishment of MOSS might impose upon the self-regulators and the taxpayers, although it is difficult to quantify these burdens in detail at this point. First, with respect to the costs which MOSS will impose on the industry, two of the principles on which the system is based are minimization of private sector costs and utilization only of data otherwise necessary to SRO or Commission purposes. The principal consultant on the project has assured us that the MOSS proposal currently before the Congress is faithful to these precepts. For example, all of the data requested from the SROs as part of the pilot project is currently available in the securities industry and collected routinely in some form by the SROs. Moreover,

we are already in the process of beginning to collect most of the trading and clearing information which will be necessary for the full project from the various SROs, and this activity has imposed no unreasonable financial or other burden of which we are aware.

Burdens on the SROs and the industry will also be minimized because MOSS will not be linked with SRO information systems in a real-time mode. That is, real-time transaction and quotation information will be obtained from commercial vendors and all other SRO data will be submitted to MOSS at the end of each day and processed the following day. Further, with respect to broker-dealers, MOSS will not collect data from them directly and, with respect to the securities industry in general, additional "standardization" ^{6/} of trading and clearing information is not required for the effective operation of MOSS. Questions of "format" for such information are also being resolved with each SRO, depending on ease of access to particular data bases, prior to obtaining such information from the SROs. To the extent that an SRO can conveniently reformat information to meet our needs in the transmission process to MOSS, we have asked the SRO to do so. However, where it is more convenient to reformat the information within MOSS, that procedure is followed.

In addition, in evaluating the cost impact of MOSS, it is important to recognize that MOSS derives only a portion of its data base directly from the securities industry. Of the 69 data files that comprise MOSS' data base, 14 files will be composed of information which is derived, in whole or part, directly from the exchanges; seven will be composed, in whole or part, of information derived from the clearing corporations; and the remainder will be composed of information from commercial vendors and the Commission's own data sources. Over half of the data required to establish the data base in the full system

^{6/} Standardization refers to requiring all SROs to produce exactly the same types of trading information in precisely the same form. Currently, most data elements required for the efficient operation of MOSS have already been standardized by the industry itself.

has already been assembled as part of the implementation of the MOSS pilot project with little or no interruption or interference with the operations of the various SROs. 7/

Second, with respect to total procurement costs of the program to the Commission, MOSS will account for \$1.7 million in 1981 and approximately \$12 million over five years in total development costs. We have confidence in the accuracy of this figure. Our contractor has performed a very significant amount of computer systems work for both self-regulatory organizations and major broker-dealers, and has the experience and expertise to make such cost evaluations. Our cost estimate reflects a projected inflation rate of 9 percent during each year of the development of MOSS. To the extent that the general rate of inflation differs -- a factor obviously beyond the Commission's control -- the total cost of MOSS may rise or fall marginally.

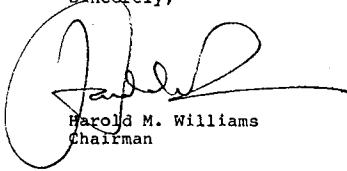
In addition, questions have arisen concerning the personnel costs associated with MOSS. The implementation of MOSS will require some additional Commission staff. Approximately 50 to 60 persons will be required to operate the various parts of the system and to deal with the various SROs on a periodic basis. We estimate, however, that fully half of these positions can be reallocated from existing Commission resources, leaving a net increase in Commission staffing levels due to MOSS of only 25 to 30 persons over a five-year period. Moreover, the implementation of MOSS should be viewed as an alternative to adding far greater numbers of Commission staff in order to perform our oversight role if MOSS is not built. In short, through implementing the MOSS system, we are taking advantage of the efficiencies of modern automated data processing techniques and statistical sampling methodologies to avoid adding substantially greater numbers of investigative and analytical employees to the Commission's payroll in response to a rapidly evolving market environment.

* * *

7/ While we have not found it necessary to invoke it, there is no question regarding the Commission's legal authority to request and receive such information promptly from the SROs or other regulated persons pursuant to Section 17 of the Securities Exchange Act, 15 U.S.C. 78q.

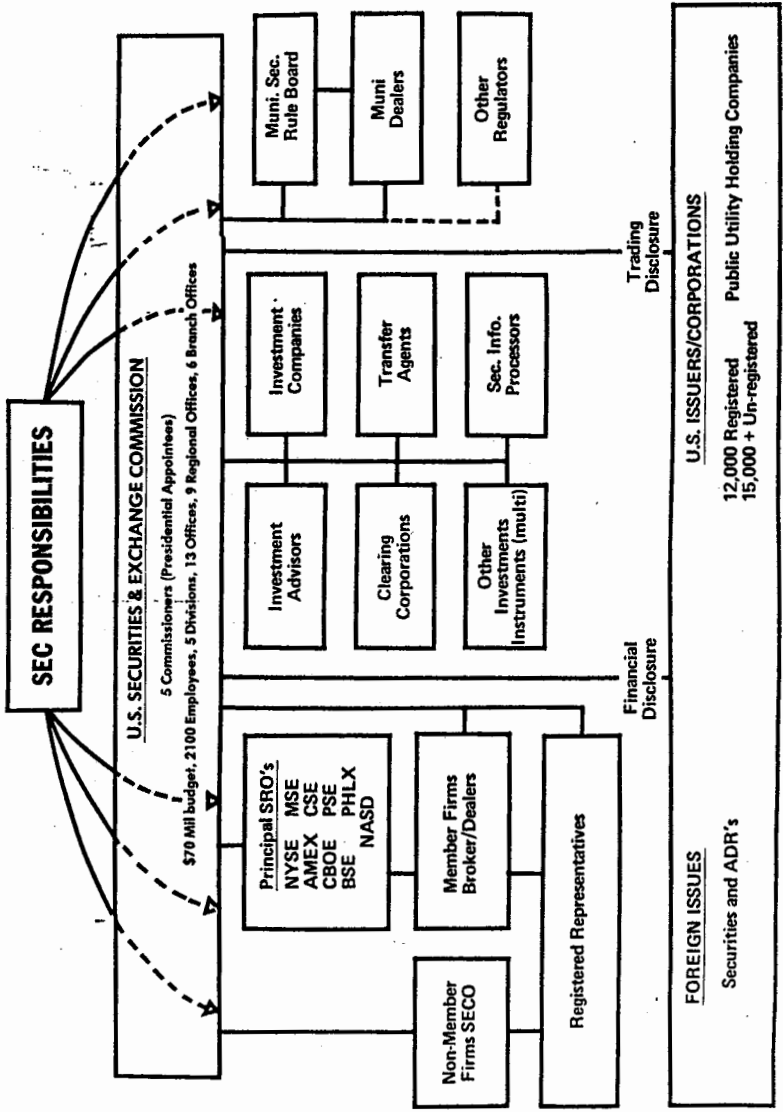
In summary, I believe that, without the implementation of MOSS, the Commission cannot perform its oversight of the nation's securities markets in the manner Congress expects of us. I look forward to discussing this urgent matter further with you to answer any additional questions regarding MOSS or the importance which we attach to its prompt implementation.

Sincerely,

A handwritten signature in black ink, appearing to read "Harold M. Williams", with a long horizontal flourish extending to the right.

Harold M. Williams
Chairman

Attachment



Mr. McMAHON. Thank you very much.

Mr. SCHEUER. We appreciate your testimony, Mr. Chairman. This completes our questioning. I will leave the record open in the event my colleagues have other questions which we will submit to you.

The hearing is adjourned.

[Whereupon, at 11:40 a.m., the subcommittee was adjourned.]

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