

**31st ANNUAL REPORT
of the
SECURITIES AND EXCHANGE COMMISSION**

For the Fiscal Year Ended June 30, 1965

SECURITIES AND EXCHANGE COMMISSION

Headquarters Office
425 Second Street NW.
Washington, D.C. 20549

COMMISSIONERS

MANUEL F. COHEN, Chairman
BYRON D. WOODSIDE
HUGH F. OWENS
HAMER H. BUDGE
FRANCIS M. WHEAT

ORVAL L. DuBOIS, Secretary

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C., January 10, 1966

SIR : On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Thirty-First Annual Report of the Commission covering the fiscal year July 1, 1964 to June 30, 1965, in accordance with the provisions of Section 23 (b) of the Securities Exchange Act of 1934, approved June 6, 1934; Section 23 of the Public Utility Holding Company Act of 1935, approved August 26, 1935; Section 46 (a) of the Investment Company Act of 1940, approved August 22, 1940; Section 216 of the

Investment Advisers Act of 1940, approved August 22, 1940; Section 3 of the Act of June 29, 1949, amending the Bretton Woods Agreement Act; and Section 11 (b) of the Inter-American Development Bank Act.

Respectfully,

MANUEL F. COHEN,
Chairman.

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

TABLE OF CONTENTS

Commissioners and staff officers

Regional and branch offices

Biographies of Commissioners

PART I

OPERATION OF THE SECURITIES ACTS AMENDMENTS OF 1964; IMPLEMENTATION OF SPECIAL STUDY RECOMMENDATIONS

Operation of 1964 amendments

Extension of disclosure requirements to over-the-counter securities

Exemptions from registration

Changes in prospectus delivery requirements

Enlargement of disciplinary authority as to broker-dealers.

Regulation of broker-dealers who are not members of registered securities association

Revision of retail quotations system

Summary suspension of over-the-counter trading

Implementation of Special Study recommendations

Minimum net capital

Supervision of selling practices

Research and investment advice

Financial responsibility

Specialists and floor traders

The "third market"

Over-the-counter markets and NASD organization

Level and structure of commission rate

Odd-lot differential

Automation of market facilities

PART II

LEGISLATIVE ACTIVITIES -

PART III

ADMINISTRATION OF THE SECURITIES ACT OF 1933

Description of the registration process

Registration statement and prospectus

Examination procedure

Time required to complete registration

Volume of securities registered

Registration statements filed

Stop order proceedings

Examinations and investigations

Exemption from registration of small issues

Exempt offerings under Regulation A

Reports of sales

Suspension of exemption

Exempt offerings under Regulation B

Reports of sales

Exempt offerings under Regulation E

Exempt offerings under Regulation F

Revision of rules, regulations and forms

Proposed amendment of Rule 485

Amendments to Forms S-1, S-8 and S-11-

PART IV

ADMINISTRATION OF THE SECURITIES EXCHANGE ACT OF 1934

Regulation of exchanges and exchange trading

Registration and exemption of exchanges

Commission inspections of the exchanges

Section 19 (a) (1) proceedings against San Francisco Mining Exchange

Exchange disciplinary action

Registration of securities on exchanges

Statistics relating to securities on exchanges

Number of issuers and securities

Market value of securities available for trading

Share and dollar volume of stocks traded

Foreign stocks on exchanges

Comparative exchange statistics

Delisting of securities from exchanges

Delisting proceedings under Section 19 (a) (2)

Unlisted trading privileges on exchanges

Applications for unlisted trading privileges

Block distributions reported by exchanges

Registration of over-the-counter securities

Manipulation and Stabilization

Manipulation; market surveillance

Stabilization

Insiders' security holdings and transactions

Ownership reports

Recovery of short-swing trading profits by issuer

Regulation of proxies

Scope of proxy regulation

Statistics relating to proxy statements

Stockholders' proposals

Ratio of soliciting to nonsoliciting companies

Proxy contests

Investigations with respect to reporting provisions

Regulation of broker-dealers and over-the-counter markets

Registration

Administrative proceedings

Decisions of particular interest

Suspension of registration pending final determination

Regulation of broker-dealers and over-the-counter markets

Net capital rule

Financial statements.

Broker-dealer inspections

Supervision of activities of National Association of Securities Dealers, Inc.

NASD disciplinary actions

Commission review of NASD disciplinary action

Commission review of NASD action on membership

Commission inspections of the NASD

Revision of rules, regulations and forms

Adoption of Rule 0-8

Amendments of Rules 10b-6 and 16b-3

Rescission of Rule 12f-5

Amendments to Rules 13a-15 and 15d-15

Amendments and proposed amendments to the proxy rules

Amendments of Rule 15b-2 and Form BD

Amendments of Rule 15b-9 under the Exchange Act and Rule 9 (b) under the Commission's Rules of Practice

Rescission of Rule 15c2-2

Amendment of Rule 15c3-1

Amendments of Rules 15ab-1 and 15ag-1

Amendment of Rule 16a-2

Adoption of Rule 16b-10

Proposed amendments of Rules 17a-3 and 17a-4

Proposed amendments to Form 8-K

Amendments to Forms 10 and 10-K

Adoption of Forms 12 and 12-K

Proposed amendments to Forms 16 and 16-K

PART V

ADMINISTRATION OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Composition of registered holding-company systems

Section 11 matters in registered holding-company systems

Exempt holding companies

Financing of active registered public-utility holding companies and their subsidiaries

Competitive bidding

Policy as to refundability of bonds

Other matters

PART VI

PARTICIPATION OF THE COMMISSION IN CORPORATE REORGANIZATIONS UNDER CHAPTER X OF THE BANKRUPTCY ACT

Summary of activities -

Jurisdictional, procedural and administrative matters

Trustee's investigation

Reports on plans of reorganization

Activities with regard to allowances

Intervention in Chapter XI proceedings

PART VII

ADMINISTRATION OF THE TRUST INDENTURE ACT OF 1939

Revision of rules, regulations and forms

Proposed Rule 7a-9

Proposed amendments to Forms T-1 and T-2

PART VIII

ADMINISTRATION OF THE INVESTMENT COMPANY ACT OF 1940

Companies registered under the Act

Growth of investment company assets

Inspection and investigation program

Revision of annual report form for management investment companies

Filings reviewed

Applications and proceedings.

Revision of rules, regulations and forms

Adoption of Rule 2a-4

PART IX
ADMINISTRATION OF THE INVESTMENT ADVISERS ACT OF 1940

Registration statistics

Inspection program

Administrative proceedings

PART X
OTHER ACTIVITIES OF THE COMMISSION

Civil litigation

Criminal proceedings

Complaints and investigations

Enforcement problems with respect to foreign securities

Foreign restricted list

Section of securities violations

Applications for nondisclosure of information

Activities of the Commission in accounting and auditing

International Bank for Reconstruction and Development

Inter-American Development Bank

Statistics and special studies

Issues registered under the Securities Act of 1933

New securities offerings

Individuals' savings

Private pension funds

Financial position of corporations

Plant and equipment expenditures

Directory of registered companies

Stock market data

Opinions of the Commission

Dissemination of information

Information available for public inspection

Publications

Organization

Personnel and financial management

New building and electronic data-processing equipment

COMMISSIONERS AND STAFF OFFICERS

Commissioners

MANUEL F. COHEN of Maryland, Chairman-Term expires June 5, 1968

BYRON D. WOODSIDE of Virginia-Term expires June 5, 1967

HUGH F. OWENS of Oklahoma-Term expires June 5, 1970

HAMER H. BUDGE of Idaho-Term expires June 5, 1969

FRANCIS M. WHEAT of California-Term expires June 5, 1966

Secretary: ORVAL L. DuBOIS

Executive Assistant to the Chairman: LEONARD M. LEIMAN

Staff Officers

EDMUND H. WORTHY, Director, Division of Corporation Finance.

ROBERT H. BAGLEY, Associate Director.

SOLOMON FREEDMAN, Director, Division of Corporate Regulation.
J. ARNOLD PINES, Associate Director.
HAROLD V. LESE, Associate Director.

LOUGHLIN MCHUGH, Chief Economist, Office of Policy Research.

IRVING M. POLLACK, Director, Division of Trading and Markets.

PHILIP A. LOOMIS, JR., General Counsel.
DAVID FERBER, Solicitor.
WALTER P. NORTH, Associate General Counsel.

ANDREW BARK, Chief Accountant.

LEONARD HELFENSTEIN, Director, Office of Opinions and Review.
W. VICTOR RODIN, Associate Director.

WILLIAM E. BECKER, Chief Management Analyst.

FRANK J. DONATY, Comptroller.

ERNEST L. DESSECKER, Records and Service Officer.

HARRY POLLACK, Director of Personnel.

REGIONAL AND BRANCH OFFICES

Regional Administrators

Region 1. New York, New Jersey.-Llewellyn P. Young, 225 Broadway, New York, N.Y., 10007

Region 2. Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine.- Philip E. Kendrick, Federal Building, Post Office Square, Boston, Mass., 02109

Region 3. Tennessee, Virgin Islands, Puerto Rico, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, that part of Louisiana lying east of the Atchafalaya River.-William Green, Suite 138, 1371 Peachtree Street, NE., Atlanta, Ga., 30309

Region 4. Illinois, Indiana, Iowa, Kansas City (Kansas), Kentucky, Michigan, Minnesota, Missouri, Ohio, Wisconsin.-Thomas B. Hart, U.S. Courthouse & Federal Bldg., 219 South Dearborn Street, Chicago, Ill., 60604

Region 5. Oklahoma, Arkansas, Texas, that part of Louisiana lying west of the Atchafalaya River, and Kansas (except Kansas City).- Oran H. Allred, United States Courthouse, Room 301, Tenth and Lamar Streets, Fort Worth, Texas, 76102

Region 6. Wyoming, Colorado, New Mexico, Nebraska, North Dakota, 'South Dakota, Utah.-Donald J. Stocking, Room 802, Midland Savings Building, 444 17th Street, Denver, Colo., 80202

Region 7. California, Nevada, Arizona, Hawaii, Guam,-Arthur E. Pennekamp, Federal Bldg., Box 36042, 450 Golden Gate Ave., 'San Francisco, Calif., 94102

Region 8. Washington, Oregon, Idaho, Montana, Alaska.-James E. Newton, 9th Floor, Hoge Bldg., 705 Second Ave., Seattle, Wash., 98104

Region 9. Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia.-Alexander J. Brown, Jr., Room 300, Courts Bldg., 310 Sixth Street NW., Washington, D.C., 20549

Branch Offices

Cleveland, Ohio, 44113.-Room 1628, Standard Building, 1370 Ontario Street.

Detroit, Michigan, 48226.-Room 1503, Washington Boulevard Building, 234 State Street.

Houston, Texas, 77002.-Room 2226, Federal Office and Courts Building, 515 Rusk Ave.

Los Angeles, Calif., 90028.-Room 309, Guaranty Building, 6331 Hollywood Blvd.

Miami, Fla., 33230.-Room 1504, 51 S.W., First Ave.

St. Louis, Mo., 63102.-Room 916, Federal Building, 208 North Broadway.

St. Paul, Minn., 55101.-Room 1027, Main Post Office and Customhouse, 180 East Kellogg Blvd.

Salt Lake City, Utah, 84111.-Room 8440, Federal Building, 125 South State Street.

COMMISSIONERS

Manuel F. Cohen, Chairman

Chairman Cohen was born in Brooklyn, N.Y., on October 9, 1912. He holds a B.S. degree in social science from Brooklyn College of the City of New York. He received an LL.B. degree, cum laude, from Brooklyn Law School of St. Lawrence University in 1936, and was elected to the Philonomic Council. He is a member of the District of Columbia and New York bars. In 1933-1934 he served as research associate in the Twentieth Century Fund studies of the securities markets. Chairman Cohen joined the Commission's staff as an attorney in 1942 after several years in private practice, serving first in the Investment Company Division and later in the Division of Corporation Finance, of which he was made Chief Counsel in 1953. He was named Adviser to the Commission in 1959 and in 1960 became Director of the Division of Corporation Finance. He was awarded a Rockefeller Public Service Award by the trustees of Princeton University in 1956 and for a period of 1 year studied the capital markets and the processes of capital formation and of government and other controls in the principal financial centers of Western Europe. In 1961, he was appointed a member of the Council of the Administrative Conference of the United States and received a Career Service Award of the National Civil Service League. From 1958 to 1962 he was lecturer in Securities Law and Regulation at the Law School of George Washington University and he is the author of a number of articles on securities regulation published in domestic and foreign professional journals. In 1962, he received an honorary LL.D. degree from Brooklyn Law School. He took office as a member of the Commission on October 11, 1961, for the term expiring June 5, 1963, and was reappointed for the term expiring June 5, 1968. He was designated Chairman of the Commission on August 20, 1964.

Byron D. Woodside

Commissioner Woodside was born in Oxford, Pa., in 1908, and is a resident of Haymarket, Va. He holds degrees of B.S. in economics from the University of Pennsylvania, A.M. from George Washington University, and LL.B. from Temple University. He is a member of the bar of the District of Columbia. In 1929 he joined the staff of the Federal Trade Commission, and in 1933, following the enactment of the Securities Act of 1933, was assigned to the Securities Division of that Commission which was charged with the administration of the Securities Act. Commissioner Woodside transferred to the Securities and Exchange Commission upon its establishment by the Securities Exchange Act of 1934. In 1940 he became Assistant Director and in 1952 Director of the Division (now Division of Corporation Finance) responsible for administering the registration and reporting provisions of the Securities Act, Securities Exchange Act, the Trust Indenture Act of 1939, and, in part, the Investment Company Act of 1940. For 14 months commencing in May 1948, he was on loan to the Department of the Army and assigned to duty in Japan as a member of a five-man board which reviewed reorganization plans of Japanese companies under the Occupation's decartelization program; and beginning in December 1950, he served 17 months with the National Security Resources Board and later with the Defense Production Administration as Assistant Deputy Administrator for Resources Expansion. He took office as a member of the Securities and Exchange Commission on July 15, 1960, for the term of office

expiring June 5, 1962, and was reappointed effective June 5, 1962, for the term expiring June 5, 1967.

Hugh F. Owens

Commissioner Owens was born in Muskogee, Oklahoma on October 15, 1909, and moved to Oklahoma City in 1918. He graduated from Georgetown Preparatory School, Washington, D.C., in 1927, and received his A.B. degree from the University of Illinois in 1931. In 1934, he received his LL.B. degree from the University of Oklahoma College of Law, and became associated with a Chicago law firm specializing in securities law. He returned to Oklahoma City in January 1936, to become associated with the firm of Rainey, Flynn, Green and Anderson. From 1940 to 1941, he was vice-president of the United States Junior Chamber of Commerce. During World War II he attained the rank of Lieutenant Commander U.S.N.R. and served as Executive Officer of a Pacific Fleet destroyer. In 1948, he became a partner in the firm of Hervey, May and Owens. From 1951 to 1953, he served as counsel for the Superior Oil Company in Midland, Texas, and thereafter returned to Oklahoma City, where he engaged in the general practice of law under his own name. He also served as a part-time faculty member of the School of Law of Oklahoma City University. In October 1959, he was appointed Administrator of the then newly enacted Oklahoma Securities Act and was active in the work of the North American Securities Administrators, serving as vice-president and a member of the executive committee of that Association. He took office as a member of the Securities and Exchange Commission on March 23, 1964, for the term expiring June 5, 1965, and was reappointed for the term expiring June 5, 1970.

Hamer H. Budge

Commissioner Budge was born in Pocatello, Idaho, on November 21, 1910. He attended the College of Idaho, Caldwell, Idaho, received an A.B. degree from Stanford University, Palo Alto, California, majoring in political science, and an LL.B. degree from the University of Idaho in Moscow, Idaho. He is admitted to practice before the Supreme Court of Idaho and the Supreme Court of the United States and practiced law in the city of Boise, Idaho, from 1936 to 1951, except for 3½ years in the United States Navy (1942-1945), with final discharge as Lieutenant Commander. Elected to the Idaho State Legislature, he served three sessions, two as assistant Republican floor leader and one as majority floor leader. First elected to Congress in November 1950, he represented Idaho's Second Congressional District in the United States House of Representatives during the 82d, 83d, 84th, 85th, and 86th Congresses. In the House he was a member of the Rules Committee, Appropriations Committee, and Interior Committee. During the period from 1961 until his appointment to the Commission he was District Judge in Boise. He took office as a member of the Securities and Exchange Commission on July 8, 1964, for the term of office expiring June 5, 1969.

Francis M. Wheat

Commissioner Wheat was born in Los Angeles, California, on February 4, 1921. He received an A.B. degree in 1942 from Pomona College, in Claremont, California, and an LL.B. degree in 1948 from the Harvard Law School. At the time of his appointment to the Commission, Commissioner Wheat was a member of the Los Angeles law firm of Gibson, Dunn & Crutcher, with which he became associated upon his graduation from law school. His practice was primarily in the field of corporation and business law, including the registration of securities for public offering under the Securities Act of 1933. He has been active in bar association work, including service as Chairman of the Committee on Corporations of the Los Angeles County Bar Association and Chairman of the Subcommittee on Investment Companies and Investment Advisers, Committee on Federal Regulation of Securities, American Bar Association (Banking and Business Law Section). He also has written or co-authored articles on various aspects of the securities business and its regulation, both under Federal and state law. He took office as a member of the Commission on October 2, 1964, for the term expiring June 5, 1966.

PART I

OPERATION OF THE SECURITIES ACTS AMENDMENTS OF 1964; IMPLEMENTATION OF SPECIAL STUDY RECOMMENDATIONS

OPERATION OF 1964 AMENDMENTS

Fiscal year 1965 marked the enactment and the beginning of the Commission's administration of the Securities Acts Amendments of 1964, the most significant statutory advance in Federal securities regulation and investor protection since 1940. The principal objectives of the 1964 amendments were to extend to investors in securities traded over the counter the same fundamental disclosure, and insider trading protections as were previously afforded by the Securities Exchange Act of 1934 to investors in listed securities, to strengthen the standards of entrance into the securities business, and to make more effective the disciplinary controls of the Commission and the rules of industry self-regulatory organizations over securities brokers and dealers and persons associated with them.

Obviously, the full impact of such far-reaching legislation could not be felt during the fiscal year. Aside from certain built-in delays in the statutory scheme, the Commission moved forward deliberately, well aware of the need of newly regulated companies for adequate time to prepare for bringing themselves into compliance and of the need for further study in some areas before taking definitive action. Nevertheless, the amendments have already had significant consequences and a substantial beginning has been made toward full incorporation of the new provisions into the fabric of securities regulation. In the course of the year, among other things, over-the-counter issuers filed a total of 1,508 registration statements pursuant to new Section 12 (g) of the Exchange Act, and thus took

the first step toward bringing themselves within the full panoply of the Exchange Act's disclosure and reporting requirements. The Commission, in addition to making the necessary internal preparations to meet its additional responsibilities, took steps to implement the legislation through the adoption or revision of various rules and forms. In a number of administrative proceedings against broker-dealers and persons associated with them, it imposed the new direct sanctions available against such associated persons. It made use in two instances of its new authority to suspend over-the-counter trading in specified securities. These matters and other action taken pursuant to the amendments are discussed in more detail in the following sections.

Extension of Disclosure Requirements to Over-the-Counter Securities

The 1964 amendments extended to a significant portion of the securities traded in the over-the-counter markets the registration, periodic reporting, proxy solicitation and insider reporting and trading provisions of the Exchange Act previously applicable to securities listed on the securities exchanges. The principal statutory mechanism for achieving this extension was the enactment of new Section 12 (g) which requires an issuer of securities traded in over-the-counter markets with total assets exceeding 1 million dollars and a class of non-exempt equity security held of record by 750 or more persons to register such security by filing a registration statement with the Commission within 120 days' after the last day of its first fiscal year ended after July 1, 1964, on which it meets the above standards. In order to provide a reasonable period for preparation of the required filing by the issuers involved and to permit gradual assumption by the Commission of its administrative burdens, the Commission postponed the required filing date until April 30, 1965, for those issuers which otherwise would have been required to file at an earlier date, except for companies required to file reports with the Commission under Section 13 or 15 (d) of the Act.

In an effort to bring the new legislation to the attention of companies which might be subject thereto, the Commission notified more than 7,000 companies not previously subject to the Commission's reporting requirements which, according to information obtained from over-the-counter quotation services and commercial financial reporting services, appeared possibly to be subject to Section 12 (g), of the applicability of that Section. Those companies which on the basis of responses to a questionnaire were apparently required to register securities with the Commission were provided with copies of the appropriate forms, rules and regulations.

The first registration statements under Section 12 (g) were filed in the second quarter of the fiscal year. From a total of 50 statements filed in that quarter, the number increased to 186 in the third quarter and to 1,272 in the final quarter. Thus, as has been noted, a total of 1,508 registration statements had been filed pursuant to Section 12 (g) by the end of the fiscal year. Two statements were withdrawn before the end of the year by the issuers when it was determined that they were not required to file under the Act, Of the total of

1,508 registration statements, 929 were filed on behalf of issuers already subject to the reporting requirements of Section 13 or 15 (d) of the Act.

During the fiscal year, requests by 180 issuers for extensions of time for filing were granted. A majority of these requests was based on the difficulties encountered by independent accountants in preparing certified financial statements within the prescribed time where prior financial statements had not been certified.

During the year the Commission adopted rules defining terms which are key factors in determining whether an issuer is required to register its securities. Pursuant to its authority under Section 3 (a) (11) of the Act to include within the term "equity security" securities it deems similar to those specified in that section, the Commission adopted Rule 3a11-1 which includes within that term a broad range of equity interests. Rules 12g5-1 and 12g5-2 define the terms "held of record" and "total assets." Generally speaking, Rule 12g5-1 includes as a separate holder each person identified on records maintained in accordance with accepted practice as the owner of the security. However, if the issuer knows or has reason to know that the form of holding securities of record is used primarily to circumvent the provisions of the Exchange Act, the rule as adopted provides that the beneficial owners shall be deemed to be the record holders thereof.

At the time of the adoption of Rule 12g5-1 the Commission indicated that it would continue to evaluate the rule to determine in the light of experience whether it may be necessary or appropriate, in order to prevent circumvention of the Act and to achieve the intended coverage on a uniform and acceptable basis, to count securities held in customers' accounts, but registered in the name of a broker, dealer or bank, as being "held of record" by the number of separate accounts for which they are held. The Commission also indicated it would give similar consideration to the necessity of including as record holders employees who have a direct beneficial interest in securities held by an employee plan.

Rule 12g5-2 defines "total assets" to mean the total assets as shown on the issuer's balance sheet or the balance sheet of the issuer and its subsidiaries consolidated, whichever is larger, prepared in accordance with the pertinent provisions of Regulation S-X.

As a result of the 1964 amendments, the date on which securities become "registered" pursuant to Section 12 assumes great importance. That date determines the applicability of the periodic reporting, proxy solicitation and insider reporting provisions of Sections 13, 14 and 16 of the Act. In addition, Section 15 (d) of the Act, as amended, provides that the obligation of an issuer to file periodic reports thereunder is suspended if and so long as the issuer has a class of security "registered" pursuant to Section 12. In order to resolve any uncertainty as to when a security is "registered," the Commission adopted Rule 12b-6 which provides that for the purposes of the above Sections and the rules and regulations thereunder, securities are not deemed to be registered pursuant to Section 12 until an

application for exchange registration or a registration statement filed with respect to over-the-counter securities has become effective.

The rules of the Commission adopted under Section 14 (a) of the Act governing the solicitation of proxies were redesignated as Regulation 14A and were amended to apply to solicitations with respect to securities registered pursuant to Section 12 (g) as well as securities registered on a national securities exchange. However, the amendment applies only to solicitations commenced on or after July 1, 1965, and the proxy rules therefore did not apply to over-the-counter securities registered during the fiscal year. [Footnote: Although not required, preliminary proxy statements of 17 such issuers were received and processed during the fiscal year.]

As a result of the extension of the proxy rules to over-the-counter securities, the Commission also amended Rule 14a-3, relating to the information to be furnished to security holders in connection with the solicitation of proxies. This rule previously provided, in part, that where the management of an issuer solicits proxies with respect to an annual meeting of security holders at which directors are to be elected, its proxy statement must be accompanied or preceded by an annual report to such security holders containing such financial statements for the last fiscal year as will in the opinion of management adequately reflect the financial position and operations of the issuer, and if such statements differ materially from those filed with the Commission, an explanation of the effect of the difference. As amended, the rule also requires an issuer which has not previously submitted to its security holders an annual report pursuant to the rules and regulations under Section 14 to include in its first such annual report such information as to its business operations during the past fiscal year as will, in the opinion of management, indicate the general nature and scope of the business of the issuer and its subsidiaries. In connection with the adoption of the amendment the Commission indicated that after it gained additional experience with respect to the reporting practices of unlisted companies, it would consider whether such companies should be required to include a description of their business in each annual report to security holders.

Section 14 (c) of the Exchange Act, which was added by the 1964 amendments, provides that issuers of registered securities shall, in accordance with rules and regulations prescribed by the Commission, transmit to security holders from whom proxies are not solicited in connection with meetings of security holders information comparable to that which would be furnished in proxy material. During the fiscal year, the Commission announced that it has under consideration a new Regulation 14C to implement Section 14 (c), and invited public comments. The proposed regulation would provide that in connection with every annual or other meeting of holders of a class of registered securities, the issuer shall transmit a written information statement containing substantially the same information as that which would be required in a proxy statement to every security holder who is entitled to vote in regard to any matter to be acted upon at the meeting and from whom a proxy is not solicited on behalf of the management. In the case of an annual meeting the issuer would also be required to transmit an annual report

including financial statements which with some exceptions would have to be certified by independent public or certified public accountants.

Section 16 (a) of the Act, as amended by the Securities Acts Amendments of 1964, requires the directors, officers and principal equity security holders of listed companies and companies registered pursuant to the new Section 12 (g) of the Act to file reports of their beneficial ownership of equity securities of their respective companies. The rules under this Section were amended during the fiscal year to make them applicable to the additional reports required by the amended section.

Section 16 (b) of the Act provides that profits realized by persons beneficially owning more than 10 percent of any class of equity security registered pursuant to Section 12, or any director or officer of the issuer of such security, from the purchase and sale, or sale and purchase, of any equity security of such issuer, whether or not registered, within a period of less than 6 months, inure to and are recoverable by or on behalf of the issuer. In interpreting this Section, the courts have indicated that recovery may be allowed of profits realized by a director or officer as a result of the purchase (sale) of an equity security before the effective date of the first registration of an equity security of the issuer under Section 12 and a sale (purchase) made subsequent to such effective date. In order to provide directors and officers of issuers registering under new Section 12 (g) with an opportunity to become familiar with the provisions of Section 16 (b), the Commission adopted Rule 12h-3 which exempts from the operation of Section 16 (b) any acquisition or disposition of an equity security by a director or officer of the issuer of such security made prior to the first registration of an equity security by the issuer under Section 12 (g). [Footnote: Securities Exchange Act Release No. 7598 (May 10, 1965). The rule makes no reference to transactions by persons beneficially owning more than 10 percent of a registered class of equity security because the exception in the last sentence of Section 16 (b) makes further exemption unnecessary.] The exemption is limited to transactions by directors or officers of issuers which first file a registration statement under Section 12 (g) on or prior to October 31, 1967. [Footnote: The 1964 amendments redesignated Section 16 (d) of the Act as Section 16 (e). Rule 16d-1, which relates to arbitrage transactions under Section 16, was re-designated as Rule 16e-1 and made applicable to securities registered pursuant to Section 12 (g).]

The revision of Section 15 (d) and the addition of Section 12 (g) necessitated certain amendments to Rule 12f-4, which provides exemptions from Sections 13, 14 and 16 of the Act for issuers having securities admitted only to unlisted trading privileges on a national securities exchange. Prior to the 1964 amendments, some companies exempt under that rule were required to file with the Commission certain annual and periodic reports pursuant to Section 15 (d). Since Section 12 (f) (6) of the Act provides that securities admitted to unlisted trading privileges are deemed to be "registered on a national securities exchange," the amendment to Section 15 (d) suspending the obligation to file reports if any security of the issuer is "registered pursuant to Section 12" had the effect of eliminating the need for issuers to file under that Section where they had a class

of securities admitted to unlisted trading privileges. The effect of the amendment to Rule 12f-4 is to subject such issuers to the reporting requirements of Section 13 if they would be subject to the equivalent requirements under Section 15 (d) but for the fact that they now are deemed to have a class of security "registered on a national securities exchange."

The General Rules and Regulations under the Exchange Act were amended to make them applicable to issuers required to register pursuant to Section 12 (g) of the Act. And various forms heretofore used for the registration of securities on a national securities exchange and for periodic reports by the issuers of such securities were amended or otherwise made available for the registration of securities pursuant to Section 12 (g) and for periodic reports by the issuers of such securities. Regulation 15D, containing certain special rules relating to the filing of periodic and other reports required by Section 15 (d), was amended to conform such rules to the provisions of Section 15 (d) as amended. In addition, Rule 15d-20, containing an exemption for certain closely held issuers from the reporting requirements of Section 15 (d), was rescinded as no longer necessary under the amended Section.

Section 12 (i) provides, in effect, that with respect to securities issued by banks, the functions and duties of administering and enforcing Sections 12, 13, 14 (a), 14 (c) and 16 are vested in the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation with respect to banks under their respective primary supervisory jurisdiction. The Commission understands that information regarding the operation of the Securities Acts Amendments of 1964 with respect to banks under the supervision of these agencies is discussed in their respective annual reports or is otherwise available from them.

Exemptions From Registration

Section 12 (h) of the Act authorizes the Commission, either by rules and regulations, or by order upon application of an interested person, to grant exemptions from the provisions of Section 12 (g) or Sections 13, 14, 15 (d) or 16, if it finds that such action is not inconsistent with the public interest or the protection of investors by reason of the number of public investors, the amount of trading interest in the securities, the nature and extent of the activities of the issuer, the income or assets of the issuer, or otherwise. Pursuant to this authorization, the Commission adopted Rule 12h-2 which exempts from registration pursuant to Section 12 (g) any interest or participation in an employee stock bonus, stock purchase, profit sharing, pension, retirement, incentive, thrift, savings or similar plan if the interest or participation is not transferable except in the event of death or mental incompetency, as well as any security which is issued solely to fund such plans. Other exemptions may be provided by rule as the Commission gains experience under the new requirements of the Act. In addition, 43 applications for complete or partial exemptions from the above provisions of the Act were filed during the fiscal year. Of these, 16 were granted, 3 were denied and the remainder were pending at the close of the fiscal year.

In addition to the broad exemptive authority conferred on the Commission by Section 12 (h) of the Exchange Act, Section 12 (g) (2) exempts various types of securities from the registration requirements of Section 12 (g), including securities issued by an insurance company if all of the following conditions are met: (1) the company is required to and does file an annual statement, conforming to that prescribed by the National Association of Insurance Commissioners ("NAIC"), with the insurance regulatory authority of its domiciliary state; (2) it is regulated in the solicitation of proxies as prescribed by the NAIC; and (3) after July 1, 1966, the purchase and sale of securities issued by such insurance company by beneficial owners, directors or officers of the company are subject to reporting and trading regulations by its domiciliary state in the manner provided by Section 16 of the Act.

The NAIC has prescribed a uniform annual reporting form which has been adopted in every state and the District of Columbia as the required annual report form for insurance companies. In addition, the NAIC, as part of that form, has developed a "stockholders' information supplement" which is designed to elicit whether the company's stockholders have been furnished information substantially equivalent to that which the Commission would require under its periodic reporting requirements and proxy rules. The Commissioners of each of the 50 states and the District of Columbia have stated that they would require insurance companies within their respective jurisdictions to file the supplement and any future revisions thereof and to comply with the proxy solicitation practices referred to therein. However, subsequent to the passage of the 1964 amendments, the insurance regulatory authorities of many states expressed the opinion that it may be necessary or desirable to receive express legislative authority to adopt the proxy regulations prescribed by the NAIC. In order to provide additional time for this purpose, the Commission adopted Rule 12h-1 granting insurance companies a temporary exemption from the registration requirements of Section 12 (g) for the calendar year 1965, even if they do not meet the condition relating to the regulation of proxies. As of August 15, 1965, 29 states had passed the necessary legislation. In some of the remaining states such legislation is not believed necessary and it is pending in the others and in the District of Columbia.

The NAIC has also undertaken a program to bring about enactment of a "model insider trading statute" in each state and the District of Columbia which would afford investor protections comparable to those provided in Section 16 of the Exchange Act. As of August 15, 1965, 40 states had passed such legislation and the remainder of the states and the District of Columbia have such legislation pending.

The NAIC expects that all jurisdictions will have complied with condition (3) by July 1, 1966, the date specified in the Act.

Section 12 (g) (3) specifically authorizes the Commission to exempt foreign securities and certificates of deposit issued against such securities from the registration

requirements if it finds that such action is in the public interest and is consistent with the protection of investors. Pursuant to this authority, the Commission has adopted Rule 12g3-1 which provides a temporary exemption from such requirements for foreign issuers until 120 days after their first fiscal year end following November 30, 1965. The adoption of Rule 12g3-1 was intended to give the Commission time to study the problems involved in the coverage of foreign securities. During the fiscal year, the Commission and its staff engaged in a study of these problems and, with the cooperation of various representatives of the foreign securities industry, extensive information relating to the various aspects of these problems has been collected. On the basis of this study, proposed rules will be formulated which will determine the extent to which various foreign issuers and their insiders will be subject to the disclosure requirements of the Exchange Act. Prior to the adoption of any rules, all interested persons-including foreign issuers, groups of foreign issuers, and American broker-dealers interested in foreign securities-will have an opportunity to present their comments.

The Commission believes that, to the extent practicable, American investors in foreign securities should be afforded the same protections as American investors in domestic securities. However, the Commission recognizes the practical problems of enforcement and compliance and of differing foreign laws. The Commission believes that it can administer the provisions of the 1964 amendments with respect to foreign securities in a manner that will provide the greatest practicable benefits for American investors, while at the same time not disrupting existing trading markets.

Changes in Prospectus Delivery Requirements

The effect of the dealers' transaction exemption, now contained in Section 4 (3) of the Securities Act of 1933, is to require all dealers, whether or not they participate in the initial distribution of a registered security, to deliver a prospectus for a designated period in connection with all transactions in such security in which the mails or facilities of interstate commerce are used, excepting only unsolicited brokers' transactions. Prospectuses must be delivered by an underwriter continuing to act as such and by a dealer effecting transactions in securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution so long as such underwriter or dealer is participating in a distribution, no matter how much time has elapsed since the commencement of the offering. In other situations, the period during which prospectus delivery was required prior to the Securities Acts Amendments of 1964, in the case of a security as to which a registration statement had been filed, expired 40 days after the effective date of such registration statement or the first date upon which the security was bona fide offered to the public by or through an underwriter after such effective date, whichever was later. In addition to renumbering the various provisions of Section 4 of the Act, the 1964 amendments made two substantive changes in the dealers' transaction exemption. First, the 40-day period was extended to 90 days if no securities of the issuer had previously been sold pursuant to an earlier effective registration statement-

so-called "first registered offerings." Second, the amendments give the Commission power to shorten the 40-day or 90-day period by rule, regulation or order.

In order that dealers will be apprised more readily of their obligation to deliver a prospectus, the Commission adopted a new Rule 425A, which requires a statement on the cover of a prospectus specifying the date on which, the relevant 40 or 90-day period will expire.

At the same time, the Commission also adopted Rule 174 which exempts offerings of certain types of securities from the prospectus-delivery requirements, establishes 40 days as the maximum period during which dealers must deliver a prospectus if the issuer has a class of securities listed and registered on a national securities exchange, and provides that where securities are to be offered at different times by one or more of several offerers, no new prospectus-delivery period will begin for dealers trading in the offering after the first 40- or 90-day prospectus-delivery period has expired following the initial offering of any of the registered securities for the accounts of any of the offerers. Other suitable relaxations of the dealers' exemption in Section 4 (3) may become apparent as the Commission and the financial community gain experience under the amended requirements of the Securities Act. In the meantime, the rule reserves to the Commission the power to modify the applicable period by order upon application or on its own motion in particular cases.

Enlargement of Disciplinary Authority as to Broker-Dealers

The 1964 amendments modified in important respects the provisions of Section 15 of the Exchange Act relating to disciplinary action against brokers and dealers and persons associated with them. For the first time, the Commission was authorized to proceed directly against individuals associated with broker-dealer firms and to impose sanctions on such individuals, including suspension or bar from being associated with a broker-dealer. The sanctions which the Commission may impose upon broker-dealers were expanded to include censure and suspension of registration for up to 12 months, and the statutory disqualifications from being registered as a broker-dealer or associated with a broker-dealer were expanded to include certain additional types of injunctions, convictions and violations.

The Commission has generally not applied these new provisions in any administrative proceeding commenced prior to August 20, 1964, the date when the Securities Acts Amendments were enacted. Since most of the administrative proceedings concluded during the fiscal year were commenced prior to that date, the operation of the amendments in this area was correspondingly limited. However, as a result of the consents of respondents in several such cases and the defaults or consents of respondents in a number of cases commenced subsequent to such date, 25 persons were barred during the fiscal year from association with any broker or dealer, three persons were suspended for varying periods from such association and one person was formally censured. In

addition, one broker-dealer firm was censured and the registration of another was suspended. One proceeding was instituted only against individuals and not against their employer firm.

Regulation of Broker-Dealers Who Are Not Members of Registered Securities Association

Prior to the passage of the 1964 amendments, broker-dealers registered with the Commission who were not members of the National Association of Securities Dealers, Inc. (NASD), or one of the principal exchanges, were not subject to any comprehensive regulation concerning qualifications, experience in the securities business, or fair business practices. A major objective of the amendments, according to the House Committee on Interstate and Foreign Commerce, was "to insure that the Commission has the necessary authority to provide regulation of non-member brokers and dealers comparable to that imposed by (self-regulatory) associations on their membership, including the requirement that these non-member brokers and dealers pay fees which will compensate the Commission for this additional regulation." [Footnote: House Report No. 1418, 88th Cong., 2d Sess., p. 12.]

In August 1964, the Commission, as contemplated by new subsections (8), (9), and (10) of Section 15 (b) of the Exchange Act, began to formulate a regulatory program for those broker-dealers who are not members of a registered securities association. The new provisions authorize the Commission to adopt rules and regulations prescribing standards of training, experience and other qualifications for such brokers and dealers and persons associated with them, and to adopt rules and regulations governing non-member broker-dealers designed to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and in general to protect investors and the public interest and to remove impediments to and perfect the mechanism of a free and open market.

In February and March 1965, the Commission prepared studies of non-NASD broker-dealers, based upon information obtained in replies to a questionnaire sent to all such firms. On the basis of these studies, and after conferences with securities industry representatives, the Commission published for comment proposed Rule 15b8-1, which proposed to establish qualification requirements and set fees for non-NASD broker-dealers who do an over-the-counter business, and for their principals, salesmen and other persons associated with them. Subsequent to the end of the fiscal year, the Commission adopted Rule 15b8-1 with revisions that took into account comments from broker-dealers, the NASD, state securities administrators and others. The rule includes a requirement that persons associated with non-member broker-dealers in certain capacities successfully complete a qualifications examination; that non-member broker-dealers file with the Commission a personnel form for each of their associated persons engaged in securities activities; and that they pay fees to defray the additional costs of regulation

incurred between August 20, 1964, the date of the enactment of the 1964 amendments, and June 30, 1965.

The rule exempts from its provisions broker-dealers who are members of a national securities exchange if they do not carry customers' accounts and if their annual gross income derived from over-the-counter business is no more than \$1,000. This exemption applies mainly to exchange specialists and other floor members who on occasion introduce accounts to other members.

The Commission is currently drafting rules under Section 15 (b) (10) relating to broker-dealers' business conduct, and under Sections 15 (b) (8) and (9) relating to a permanent fee schedule. In drafting these rules, the rules of the NASD and the principal stock exchanges are being carefully considered.

Revision of Retail Quotations System

One of the most significant recent developments in the regulation of trading in the over-the-counter markets occurred during the past year when the NASD adopted a revision of its retail quotations system. The Special Study had recommended that the existing system of providing the public with quotations be improved to reflect more accurately the best prevailing inter-dealer bid and asked quotations. In the 1964 amendments Congress added a new provision to the Exchange Act (Section 15A (b) (12)) which requires national securities associations to promulgate rules designed to produce fair and informative quotations.

Under the revised NASD system, which was adopted in response to the Congressional mandate and the Study recommendations, newspaper quotations for securities on the "National List" are now published on the basis of prevailing inter-dealer quotations as of a particular time and the masthead accompanying such published quotes states that the prices shown are subject to markups, markdowns or commissions in retail transactions. "Local List" securities are quoted as before but the masthead has been revised to provide a more accurate description of what the quotations purport to be. The NASD has engaged an outside management consulting firm to study the effects of the revised system and to determine the appropriateness of further changes in this and various related areas of the over-the-counter markets.

Summary Suspension of Over-the-Counter Trading

The 1964 amendments provide the Commission in new Section 15 (c) (5) with authority to summarily suspend over-the-counter trading in any security (except an exempted security) for periods of 10 days if, in its opinion, the public interest and protection of investors so require. Broker-dealers are prohibited from trading in any such security during the period of suspension. This provision is a counterpart to Section 19 (a) (4),

which provides for summary suspension of trading in securities listed on a national securities exchange.

During the 1965 fiscal year the Commission used this new authority in two instances. Trading in the stock of Empire Petroleum Company was suspended for a 5-day period to permit adequate dissemination of the company's annual report which contained adverse information, so that brokers and dealers as well as investors would be apprised of the facts before engaging in any further transactions in such stock. Trading in Idamont Oil and Mining Co. securities was suspended following the institution by the Commission of court action to enjoin violations of the Federal securities acts in the offer and sale of such securities. The suspension was later terminated following entry of a court order preliminarily enjoining the further offer and sale of such securities in violation of the Securities Act registration and anti-fraud provisions.

IMPLEMENTATION OF SPECIAL STUDY RECOMMENDATIONS

Aside from the enactment of the 1964 amendments and the implementation of that legislation as described above, further significant progress was made during the 1965 fiscal year in the implementation of recommendations of the Special Study Report.

Minimum Net Capital

The Special Study recommended the adoption of a minimum net capital requirement as one of several different approaches to assuring a broker-dealer community of principals and firms "reasonably qualified in terms of responsibility and commitment." Its Report commented that such requirement need not and should not be a uniform one for all firms but should be appropriately scaled to reflect the type and size of business engaged in.

Following extensive discussions with a number of industry groups and several statistical studies conducted by the Commission in an effort to arrive at a meaningful and workable proposal which would carry out the recommendation of the Special Study, the Commission adopted amendments to Rule 15c3-1 under the Exchange Act which provide for a minimum net capital requirement of \$5,000 for firms engaged in a general securities business and \$2,500 for firms solely engaged in transactions in shares of registered investment companies. These requirements are minimum figures and broker-dealers subject to the rule must also comply with the requirement that their ratio of aggregate indebtedness to net capital not exceed 2000 percent.

The Commission postponed the effectiveness of the minimum capital provisions until December 1, 1965, in order to provide broker-dealers with sufficient time to bring themselves into compliance. It stated that after the minimum net capital requirements had been in effect for a reasonable period the adequacy of such requirements would be given

further study to determine whether it is necessary for the protection of investors to modify such requirements and if so, to what extent.

In order to permit the Commission to exempt particular brokers or dealers from the provisions of the rule in unusual circumstances, a new paragraph (b) (3) provides that the Commission may, upon written application, exempt from the rule either unconditionally or on specified terms and conditions, a broker or dealer who satisfies the Commission that because of the special nature of his business, his financial position, and the safeguards he has established for the protection of customers' funds and securities it is not necessary in the public interest or for the protection of investors to subject him to the provisions of the rule. The Commission also adopted an amendment to paragraph (b) (1) of the rule which limits the scope of the exemption previously provided by that paragraph. The amended exemptive provision now applies only to a broker who is also licensed as an insurance agent, whose securities business is limited to selling variable annuity contracts as agent for the issuer, who promptly transmits all funds and delivers all variable annuity contracts, and who does not otherwise hold funds or securities for or owe money or securities to customers, and only if the issuer files with the Commission a satisfactory undertaking that it assumes responsibility for all valid claims arising out of the activities of the agent.

Supervision of Selling Practices

The Special Study pointed out serious inadequacies in the supervisory controls utilized by broker-dealers in their surveillance of the selling activities of salesmen and other employees and recommended the strengthening of such procedures and the adoption by the self-regulatory agencies of clearer standards and stronger enforcement procedures to assure more effective supervision by their member firms. In the 1964 amendments, Congress clearly recognized the importance of proper supervision by providing in new Section 15 (b) (5) (E) of the Exchange Act that failure to supervise properly which results in the violation of the securities acts or rules thereunder is a ground for disqualification from broker-dealer registration or from being a person associated with a broker-dealer.

During fiscal 1965, new rules establishing or clarifying standards of supervision were adopted in response to the Special Study recommendations by the American, Midwest, New York, and Pacific Coast Stock Exchanges. In addition, the New York Stock Exchange and the NASD continued the expansion and improvement of their existing branch office inspection programs. These inspection programs have as a primary function the surveillance of supervisory procedures executed at the branch office level.

A major step taken during the past year in this area was the adoption by the NASD of new rules which incorporate required standards of supervision by its members. These rules require the establishment and enforcement of written supervisory procedures and designation of a partner or officer as responsible for their execution. The internal procedures must include periodic review of customer accounts and at least an annual

inspection of each branch office. The rule governing discretionary accounts has also been amended to require written customer authorization and supervisory review and approval of activity in such accounts. The NASD also adopted a revised statement for inclusion in its Manual which enumerates many of the selling practices which violate members' responsibility for fair dealing. To aid in the implementation of these rules the Association has prepared and distributed to its members a comprehensive supervision manual which contains detailed guidelines and suggestions for effective supervisory procedures.

Research and Investment Advice

Significant progress has been made since the publication of the Special Study Report with respect to the upgrading of standards applicable to the research and investment advice disseminated by broker-dealers and investment advisers. The major self-regulatory agencies have amended their rules to include interpretations and statements of policy designed to meet important deficiencies. These rules now generally provide that recommendations must have a basis that can be substantiated as reasonable; firms must accurately describe their research facilities and staffs; and existing proprietary positions or other interests must be disclosed. With respect to the activities of investment advisers who are not subject to rules of a self-regulatory body, the Commission staff has prepared a draft rule under the Investment Advisers Act incorporating similar requirements. This rule is presently being circulated to affected industry groups for informal comment and discussions.

Financial Responsibility

In the area of financial responsibility and the protection of customers' funds and securities there have been several significant developments since the publication of the Special Study Report. As discussed in last year's annual report, the adoption of Rule 15c3-2 provides investors with meaningful information regarding the status and nature of free credit balances left with broker-dealers. Several of the self-regulatory organizations have revised their rules on the hypothecation and lending of securities to require that there be a "reasonable relationship" between the amount of each customer's securities that can be hypothecated or lent by a member broker-dealer and the amount of the customer's indebtedness. In addition, the NASD has revised its Rules of Fair Practice to require the segregation and identification of customers' free and excess margin securities.

As a result of the Ira Haupt & Co. insolvency, the New York Stock Exchange established a Special Trust Fund of \$25 million which can be utilized to satisfy the claims of customers in the event of the insolvency of any member organization of that Exchange. Furthermore, the NYSE and the other major exchanges have amended their rules to provide special adjustments and "haircuts" in the computation of members' net capital to reflect the commodities activities of their members. In the recent amendments to Rule 15c3-1 the Commission also provided that in computing net capital there should be

deducted from net worth an amount equal to 1 1/2 percent of the greater of customers' long or short commodities positions in each commodity.

Specialists and Floor Traders

Two of the areas which were studied in great depth by the Special Study were the activities and responsibilities of floor traders and specialists on the exchanges. The recommendations of the Special Study in these areas gave rise to extended discussions between members of the staff and of the New York and American Stock Exchanges culminating in the adoption on June 2, 1964, of Rule 11a-1 under the Exchange Act, regarding floor trading, and the adoption on November 23, 1964, of Rule 11b-12S respecting specialists. These rules were discussed at pages 3 and 4 of the Commission's 30th Annual Report and the plans filed by the New York and American Stock Exchanges pursuant to Rule 11a-1 were discussed at pages 13 and 14. Both exchanges have also adopted the necessary rule changes and additions required for compliance with Rule 11b-1.

The "Third Market"

The Special Study described a sharp increase in recent years in the volume of off-board trading in common stocks traded on the New York Stock Exchange and other national securities exchanges. To correct the deficiency of information concerning this growing market, which it described as the "third market," the Study recommended establishment of a system for identification of market makers and for reporting of trading activity. The adoption of Rule 17a-9 and related reporting forms X-17A-9 (1), X-17A-9 (2), and X-17A-9 (3) 29 implements this recommendation by providing a system for the identification of broker-dealers making off-board markets in common stocks traded on national securities exchanges and for the reporting of summaries of over-the-counter trading in common stocks traded on those national securities exchanges whose annual sales volume exceeds \$20 million.

Under the rule and the forms, brokers and dealers are required to report their trading over the counter and on exchanges in common stocks in which they are market makers, and to report certain off-board trading in common stocks traded on exchanges in which they do not make a market. Broker-dealers who are not market makers are also required to report certain third market transactions. It is expected that the Commission will regularly publish summaries of third market trading, as compiled from the reports filed under the rule. However, the reports of transactions filed by individual broker-dealers will not be made public.

The Commission plans periodically to conduct detailed transaction studies for the purpose of analyzing particular aspects of activities in the off-board market. The data to be obtained from the reports under Rule 17a-9 and from the transaction studies will

enable the Commission to evaluate the need for more detailed reporting and further regulation of this market.

Over-the-Counter Markets and NASD Organization

Reference has already been made to the very significant development in the regulation of trading in the over-the-counter markets that occurred during the past year—the revision by the NASD of its retail quotations system which was adopted in response to the Congressional mandate in new Section 15A (b) (12) of the 1934 Act and the recommendations of the Special Study. As noted, the NASD has engaged an outside management consulting firm to study the effects of the revised system. This study is also designed to determine the possible effects and appropriateness of the Study's recommendations regarding the prohibition of so-called "riskless" principal transactions and requiring certain disclosures to investors of prevailing inter-dealer quotations.

The NASD has taken further steps to improve its organizational structure and internal operations in response to certain criticisms in the Special Study Report. For example, during the year the NASD submitted to its membership for approval proposed revisions in its bylaws which are intended to expedite disciplinary actions and proceedings relating to employment of disqualified persons. The changes were approved by vote of the members after the end of the year. In addition, the Board of Governors has approved a new fee structure which will go into effect in 1966.

Other recommendations regarding the over-the-counter market have received attention in the past fiscal year. Rule 15c2-7 under the Exchange Act, which relates to the operation of the inter-dealer quotation systems, was adopted during fiscal 1965. The rule, which was proposed last year, was discussed in detail at pages 4, 16 and 17 of the Commission's 30th Annual Report. The staff has held several conferences with representatives of the NASD Trading Committee in an effort to develop appropriate standards and/or policy statements concerning a broker-dealer's obligation to provide his customer with the best execution and to furnish bonafide and firm price quotations. In addition, a special committee of the NASD has had under consideration a clarification of its standards with respect to members' pricing practices in transactions with the public.

Level and Structure of Commission Rate

In connection with staff research on the level of the commission rate, major efforts were directed to improving and expanding the income and expense reports of broker-dealer firms in cooperation with the staff of the New York Stock Exchange. Agreement was reached with the Exchange on a new Exchange rule that would make mandatory the filing of such reports by firms conducting a public commission business; and an understanding was reached that if studies now underway establish the feasibility of certain reports, all New York Stock Exchange firms may be required to report on a mandatory basis. This building-up of an inventory of financial information for securities firms is an essential

first step in the gauging of the reasonableness of the commission rate level. The Commission is also pursuing the development of reporting forms to provide detailed financial information regarding all broker-dealers and investment advisers. These reports would give the Commission a more complete picture of the economics of the securities industry and are expected to assist the Commission in the determination of many of the complex matters which are within its responsibilities.

In the last half of the fiscal year, the Commission staff engaged in a series of discussions with the New York Stock Exchange staff on the commission rate structure. These initial steps were directed towards gaining a fuller understanding of the various practices now in effect which permit arrangements allowing for deviation from the fixed minimum commission schedule established by the Exchange. Based partly on the results of these discussions, the Commission staff has been directed to develop proposals for submission to the Commission aimed at evaluating such current practices as "give-ups," reciprocal arrangements and the provision of special services, with a view to insuring a reasonable commission rate structure.

Odd-Lot Differential

The Commission staff has also undertaken a review of the odd-lot differential charged by New York Stock Exchange firms. The Special Study recommended that the Exchange, with the cooperation of the Commission, undertake a cost study of the odd-lot business. This study was begun by Price Waterhouse & Co. in fiscal 1964 and completed in fiscal 1965. During 1965 the Commission staff: (1) met with the Exchange Committee on odd-lots, (2) maintained a continuing oversight of the progress of the Price Waterhouse & Co. cost study, (3) analyzed the cost study report, and (4) began analysis of the odd-lot differential in anticipation of a report from the Exchange Committee on odd-lots.

Automation of Market Facilities

Throughout the past year the staff has met frequently with representatives of the various exchanges, the National Association of Securities Dealers, suppliers of stock market information and others, on the subject of automation of market facilities. The purpose of these meetings has been twofold. First, they have served to keep the Commission informed of the many developments in this field. Secondly, the meetings have enabled the Commission to make judgments on the direction in which these developments have been moving and to suggest changes, if necessary, for the protection of the public investor.

Discussions with the exchanges have dealt with the central bookkeeping systems, automating surveillance procedures, improving quotations, a central depository for securities, automation of the clearing operation, and the institution of procedures for automating the execution of odd-lot transactions.

Automation in the over-the-counter market has been discussed with the National Association of Securities Dealers and broker-dealers, as well as with vendors who hope to supply the equipment and related services for any such program.

PART II LEGISLATIVE ACTIVITIES

Early in the fiscal year the President signed Public Law 88-467, the Securities Acts Amendments of 1964. This legislation, amending the Securities Act of 1933 and the Securities Exchange Act of 1934, represented the most significant statutory advance in Federal securities regulation and investor protection since 1940. A summary of the amendments appeared in the 30th Annual Report, at pages 8 and 9.

In March 1965, the Commission submitted to the 89th Congress a proposed amendment to the Securities Act of 1933 to provide for an increase in the fees paid in connection with the filing of registration statements for securities offerings, in order to enable the Commission to recover to a greater extent the costs of administration of the Federal securities laws. Subsequent to the end of the fiscal year, the proposed amendment was enacted into law.

On July 23, 1964, then Acting Chairman Cohen testified before Subcommittee No. 1 on Foundations of the Select Committee to Conduct Studies and Investigations of the Problems of Small Business, House of Representatives, concerning the relation of the Commission's administration of the Federal securities laws to the Federal Government's supervision of tax-exempt foundations and charitable trusts. On June 2, 1965, Chairman Cohen also appeared before the Subcommittee on Domestic Finance of the Committee on Banking and Currency, House of Representatives, and testified with respect to H.R. 7372, a bill to amend the Bank Holding Company Act of 1956.

During the fiscal year the Commission and its staff analyzed or commented on 36 bills and other legislative matters referred to it by various committees of the Senate and House of Representatives, by individual members of Congress, and by the Bureau of the Budget.

PART III ADMINISTRATION OF THE SECURITIES ACT OF 1933

The Securities Act of 1933 is designed to provide disclosure to investors of material facts concerning securities publicly offered for sale by the use of the mails or instrumentalities of interstate commerce, either by an issuing company or by any person in a control relationship to such company, and to prevent misrepresentation, deceit, or other fraudulent practices in the sale of securities generally. Disclosure is obtained by requiring the issuer of such securities to file with the Commission a registration statement which

includes a prospectus containing significant financial and other information about the issuer and the offering. The registration statement is available for public inspection as soon as it is filed. Although the securities may be offered for sale as soon as the registration statement has been filed, actual sales may not be made until the registration statement has become "effective." A copy of the prospectus must be furnished to each purchaser at or before the sale or delivery of securities in order to provide him with an opportunity to evaluate such securities and make an informed investment decision. The issuer and the underwriter are basically responsible for the contents of the registration statement. The Commission has no authority to control the nature or quality of a security to be offered for public sale or to pass upon its merits or the terms of its distribution. Its action in permitting a registration statement to become effective does not constitute approval of the securities, and any representation to the contrary to a prospective purchaser is made unlawful by Section 23 of the Act.

DESCRIPTION OF THE REGISTRATION PROCESS

Registration Statement and Prospectus

Registration of any security proposed to be publicly offered may be effected by filing with the Commission a registration statement on the applicable form containing the prescribed disclosure. Generally speaking, a registration statement relating to securities issued by a corporation or other private issuer must contain the information specified in Schedule A of the Act, while a statement relating to securities issued by a foreign government must include the information specified in Schedule B. These schedules specify in considerable detail the items of information which must be disclosed in order to permit prospective investors to make a realistic appraisal of the issuer and the securities being offered. The Act empowers the Commission to classify issues, issuers and prospectuses, to prescribe appropriate forms, and to increase, or in certain instances vary or diminish, the particular items of information required to be disclosed as the Commission deems appropriate in the public interest or for the protection of investors. To facilitate the registration of securities by different types of issuing companies, the Commission has prepared special registration forms which vary in their disclosure requirements so as to provide maximum disclosure of the essential facts pertinent in a given type of case while at the same time minimizing the burden and expense of compliance with the law.

In general, the registration statement of an issuer other than a foreign government must disclose such matters as the names of persons who participate in the management or control of the issuer's business; the security holdings and remuneration of such persons; the general character of the business, its capital structure, past history and earnings; underwriters' commissions; payments to promoters made within 2 years or intended to be made; the interest of directors, officers and principal stockholders in material transactions; pending or threatened legal proceedings; and the purposes to which the

proceeds of the offering are to be applied, and must include financial statements certified by independent accountants. The registration statement of a foreign government must contain comparable information in regard to the underwriting and distribution of the securities being registered, the natural and industrial resources of the country, its revenues, obligations and expenses, a description of the securities being registered, and similar matters. The prospectus constitutes a part of the registration statement and presents the more important of the required disclosures.

Examination Procedure

Registration statements are examined for compliance with the standards of adequate and accurate disclosure by the Commission's staff. This examination is primarily the responsibility of the Division of Corporation Finance; however, as a result of a reallocation of functions during the fiscal year, statements filed by investment companies registered under the Investment Company Act of 1940 are now examined by the Division of Corporate Regulation. If it appears that a statement does not conform in material respects with the applicable requirements, the registrant is usually notified by an informal letter of comment and is afforded an opportunity to file correcting or clarifying amendments. In addition, the Commission has the power, after notice and opportunity for hearing, to issue an order suspending the effectiveness of a registration statement if it finds that material representations are misleading, inaccurate or incomplete. In certain instances, such as where the deficiencies in a registration statement appear to stem from careless disregard of applicable requirements or from a deliberate attempt to conceal or mislead, the letter of comment procedure is not used and the Commission either institutes an investigation to determine whether "stop-order" proceedings should be instituted or immediately institutes such proceedings. Information regarding the exercise of the "stop-order" power during fiscal year 1965 appears below under the heading "Stop-Order Proceedings."

Time Required to Complete Registration

The Commission's staff endeavors to complete its examination of registration statements in as short a time as possible. The Act provides that a registration statement shall become effective on the 20th day after it is filed (or on the 20th day after the filing of any amendment thereto). Since most registration statements require one or more amendments, they usually do not become effective until some time after the original 20-day period. The period between filing and effective date is intended to afford investors an opportunity to become familiar with the proposed offering through the dissemination of the preliminary form of prospectus. The Commission is empowered to accelerate the effective date so as to shorten the 20-day waiting period, taking into account the adequacy of the information respecting the issuer theretofore available to the public, the facility with which the facts about the offering can be understood, and the public interest and the protection of investors. The note to Rule 460 under the Act lists some of the more

common situations in which the Commission considers that the statute generally requires it to deny acceleration.

The median number of calendar days which elapsed from the date of original filing to the effective date with respect to the 1,097 registration statements that became effective during the 1965 fiscal year was 36, the identical figure as in the previous year when only 960 registration statements became effective. The corresponding figure for fiscal year 1963 was 52 days for 985 registration statements. The number of registration statements filed during fiscal year 1965 was 1,376, as compared with 1,192 and 1,159, respectively, in the 2 preceding years.

The following table shows by months during the 1965 fiscal year the number of calendar days elapsed during each of the three principal stages of the registration process for the median registration statement, the total elapsed time and the number of registration statements effective.

[table omitted]

VOLUME OF SECURITIES REGISTERED

A total of 1,266 statements registering securities in the amount of \$19.4 billion became effective under the Securities Act of 1933 during the fiscal year 1965. This was an increase of 13 percent in the number of statements, and an increase of 15 percent in the dollar amount of securities registered over the preceding fiscal year. The chart on page 26, shows the number and dollar amounts of registrations from 1935 to 1965.

The figures for 1965 cover all registrations which became effective, including secondary distributions and securities registered for other than cash sale, such as issues exchanged for other securities, and securities reserved for conversion. Of the dollar amount of securities registered in 1965, 75 percent was for the account of issuers for cash sale, 10 percent for the account of issuers for other than cash sale, and nearly 15 percent for the account of others, as shown below.

[table omitted]

The amount of securities offered for cash sale for the account of issuers, \$14.7 billion, was about the same as in the preceding fiscal year. Registration of new common stock issues aggregated \$10.6 billion, \$632 million more than in the 1964 fiscal period, largely reflecting increased registrations of investment company issues which totaled a record \$6.4 billion. Registration of new bonds, notes and debentures declined 19 percent from the previous year and accounted for \$3.7 billion of the 1965 volume. Preferred stock issues registered for the account of issuers amounted to \$307 million, an increase of 37 percent. Appendix Table 1 shows the number of statements which became effective and total amounts registered for each of the fiscal years 1935 through 1965, and contains a

classification by type of security of issues to be offered for cash sale on behalf of the issuer during those years.

Corporate issues to be offered immediately after effective registration amounted to \$5.3 billion, a decrease of \$1.2 billion from the previous year. Of the total, electric, gas and water companies registered \$1.7 billion of new issues, which was less than in 1964 and 1963. Issues of communication companies amounted to \$720 million, a sharp decline from \$2.2 billion of securities registered in the previous year which included the \$1.2 billion AT&T issue and the \$200 million Communications Satellite offering. Manufacturing company issues totaled \$1.5 billion, the largest amount since the 1962 fiscal period. Among the other industry groups, registration of financial and real estate issues declined slightly to \$922 million while issues classified in the "commercial and other" group were somewhat larger in amount than in 1964. Registrations of foreign government issues were almost three times larger than in the previous year, amounting to \$303 million.

The following table gives the distribution by industry of issues registered for the account of issuers to be offered for cash sale during the last 3 fiscal years:

[table omitted]

Registration of issues to be offered over an extended period amounted to \$9.0 billion compared with \$8.2 billion in 1964, an increase of 10.5 percent. These issues are classified below:

[table omitted]

Of the \$5.3 billion expected from the immediate cash sale of corporate securities for the account of issuers in 1965, 83 percent was designated for new money purposes, including plant, equipment and working capital, 3 percent for retirement of securities, and 14 percent for all other purposes including purchases of securities. As compared with the 1964 fiscal period, funds for new money purposes and retirement of securities declined slightly while funds for other purposes showed a moderate rise.

REGISTRATION STATEMENTS FILED

During the 1965 fiscal year, 1,376 registration statements were filed for offerings of securities aggregating \$19.1 billion, as compared with 1,192 registration statements filed during the 1964 fiscal year for offerings amounting to \$18.6 billion. This represents an increase of 15.4 percent in the number of statements filed and 3 percent in the dollar amount involved. Filings by companies that had not previously filed registration statements totaled 458, representing 33 percent of the total. Corresponding figures for the 1964 and 1963 fiscal years were 322, or 27 percent, and 357, or 31 percent, respectively.

Since the effective date of the Securities Act and through June 30, 1965, a total of 25,422 registration statements has been filed by 11,643 different issuers covering proposed offerings of securities aggregating over \$277 billion. Particulars regarding the disposition of these statements are summarized in the following table:

[table omitted]

During the 1965 fiscal year, 82 registration statements were withdrawn. The reasons assigned by the various registrants for requesting withdrawal are shown in the following table:

[table omitted]

STOP ORDER PROCEEDINGS

Section 8 (d) of the Act provides that, if it appears to the Commission at any time that a registration statement contains an untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, the Commission may institute proceedings to determine whether a stop order suspending the effectiveness of the registration statement should be issued. Where such an order is issued, the offering cannot lawfully be made, or continued if it has already begun, until the registration statement has been amended to cure the deficiencies and the Commission has lifted the stop order.

At the beginning of the 1965 fiscal year, four stop order proceedings were pending. Three additional proceedings were instituted during the year, six were terminated (four through issuance of stop orders, one through dismissal, subject to distribution of the Commission's opinion, and one through withdrawal of the registration statement pursuant to an offer of settlement, and one was pending at the end of the year. For the first time, stop orders were issued pursuant to delegated authority (by the Director of the Office of Opinions and Review) in those instances where the registrants concerned consented to the issuance of such orders.

Franchard Corporation (formerly Glickman Corporation) -- These proceedings raised issues as to the adequacy of three registration statements (all of which had become effective) filed by a large cash flow real estate company and of a series of post-effective amendments to one of those statements. The Commission found the registration statements materially false and misleading because of their failure to disclose that large sums had been transferred from registrant to its controlling stockholder and chief executive officer for use in his own business ventures and that such controlling person had pledged his holdings in registrant as collateral for high-interest loans from unconventional sources, which loans had placed him in a strained financial position, had

created a likelihood of a shift in control, and had also given rise to potential conflicts between his interests and those of the other shareholders. In its discussion of these matters the Commission pointed out that all of registrant's public offerings had been predicated on its controlling person's reputed expertise as an investor in and manager of real property. Although the diversion of registrant's funds was known only to the controlling person and one subordinate, the Commission held that regardless of the diligence which may have been exercised in the preparation of a registration statement, such statement was materially false and misleading whenever it failed—for whatever reason—to meet the statutory standard of disclosure.

In holding that the controlling person's pledges should have been disclosed, the Commission rejected registrant's contentions that such disclosure would have been an unwarranted intrusion into his personal affairs and was in any event not called for by the registration forms under the Securities Act. The Commission pointed out that an insider of a corporation that is asking the public for funds cannot keep private those of his personal affairs that impinge significantly on the affairs of the company. The Commission disposed of the second contention by observing that its registration forms are not exhaustive enumerations of every item that might possibly be material in the special circumstances of a particular offering and by pointing out that Rule 408 under the Securities Act requires the disclosure of all material information that may be necessary to keep the required statements from being misleading.

As to one important issue, however, the Commission agreed with the registrant and rejected the staff's charges. The staff contended that registrant's filings should have disclosed that its directors had failed to exercise the necessary diligence with respect to the day-to-day operations of the company. While noting that it had required disclosure concerning directors' performance where there was a virtual abdication of responsibility or where affirmative representations had been made regarding such performance, the Commission held that, in view of the diverse and uncertain standards applicable, "to generally require information in Securities Act prospectuses as to whether directors have performed their duties in accordance with the standards of responsibility required of them under state law would stretch disclosure beyond the limitations contemplated by the statutory scheme and necessitated by considerations of administrative practicality." [Footnote: In a decision rendered subsequent to the end of the fiscal year (Imperial Financial Services, Inc., Securities Exchange Act Release No. 7684 (August 26, 1965)), the Commission noted that while its decision in Franchard had rejected a standard of requiring on a routine basis in prospectuses an evaluation of directors' performances, it had recognized that there were areas where disclosure might be necessary as to activities of directors which do not comply with applicable standards. The Commission went on to hold that the prospectuses of an investment company which failed to disclose that unaffiliated directors were not informed of material transactions were materially misleading.]

The Commission considered the deficiencies in registrant's effective filings extremely serious, but did not issue a stop order. In its view the distribution of copies of its opinion to all of registrant's past and present stockholders, as registrant proposed, was sufficient under the circumstances to give adequate public notice of the deficiencies in the filings. Among the factors that led the Commission to this conclusion were the departure of the wrongdoing chief executive, the transfer of his controlling shares to a management that had made a substantial investment in registrant's securities, had made voluntary remedial disclosures to the Commission's staff and to registrant's stockholders, and had filed post-effective amendments which represented a bona fide effort to remedy the deficiencies in the effective filings, and the unusually extensive publicity that had already been given to such deficiencies.

The Commission refused however to declare the post-effective amendments effective. It found some of those amendments deficient because of their failure to state clearly that registrant's cash distributions to its stockholders would exceed the cash derived from its operations, and it found all of them deficient because of the absence of a lucid disclosure of the complex of risk elements peculiar to cash flow real estate securities. Among the risk elements that were in the Commission's view inadequately presented were: (1) the adverse leverage effect of the high ratio of debt to equity capital characteristic of cash flow real estate companies; (2) the ambiguity of the phrase "cash derived from operations," which should, the Commission held, be precisely defined so as to make it clear whether extraordinary non-recurring receipts were or were not included therein; and (3) the limited duration of the tax advantages derived from the cash flow system and their eventual transformation into tax disadvantages. The format of the post-effective amendments was also found objectionable. The Commission pointed out that each non-effective post-effective amendment consisted of a prospectus that had been rendered obsolete by lapse of time and by numerous material changes in registrant's affairs, and of a lengthy supplement thereto, concluded that this "obscure and uncoordinated presentation" was inadequate and misleading, and held that a thorough-going revision that would "give investors the clear, comprehensive picture of the registrant's business and affairs contemplated by the Securities Act" was necessary.

Clinton Engines Corporation 10-Here a registration statement that had become effective in 1960 was found seriously deficient because: (1) The unaudited financial material therein was materially deceptive by reason of a substantial inventory overstatement which led to material overstatements of earnings and assets, distorted the historical operating record, and "had the effect of presenting the financially straitened registrant in a wholly illusory picture of incipient prosperity"; (2) the discussion of the causes of registrant's low profit margins concealed significant adverse factors; and (3) a suggestion that significant improvements in efficiency could be effected by a program to be financed out of the registrant's future earnings was highly misleading since the prospectus failed to point out that such improvements would have required a massive program of capital investment that had not even been formulated and could not be financed without the sale of long-term debt or equity securities as to the successful flotation of which there was no

assurance. The Commission concluded that deficiencies of such seriousness required the issuance of a stop order. Registrant's assertion that the issuance of a stop order would have an adverse effect on it was held insufficient in view of the fact that registrant had never taken adequate steps to bring the deficiencies in its registration statement to the attention of investors and of the demonstrated effectiveness of stop orders in achieving that result.

EXAMINATIONS AND INVESTIGATIONS

The Commission is authorized by Section 8 (e) of the Act to make an examination in order to determine whether a stop order proceeding should be instituted under Section 8 (d), and in connection therewith is empowered to examine witnesses and require the production of pertinent documents. The Commission is also authorized by Section 20 (a) of the Act to make an investigation to determine whether any provision of the Act or any rule or regulation prescribed thereunder has been or is about to be violated. In appropriate cases, investigations are instituted under this Section as an expeditious means of determining whether a registration statement is false or misleading or omits to state any material fact. The following tabulation indicates the number of such examinations and investigations with which the Commission was concerned during the year:

[table omitted]

EXEMPTION FROM REGISTRATION OF SMALL ISSUES

The Commission is authorized under Section 3 (b) of the Securities Act to exempt, by its rules and regulations and subject to such terms and conditions as it may prescribe therein, any class of securities from registration under the Act, if it finds that the enforcement of the registration provisions of the Act with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering. The statute imposes a maximum limitation of \$300,000 upon the size of the issues which may thus be exempted.

Acting under this authority, the Commission has adopted the following exemptive rules and regulations:

Rule 234: Exemption of first lien notes.

Rule 235: Exemption of securities of cooperative housing corporations.

Rule 236: Exemption of shares offered in connection with certain transactions.

Regulation A: General exemption for United States and Canadian issues up to \$300,000.

Regulation B: Exemption for fractional undivided interests in oil or gas rights up to \$100,000.

Regulation F: Exemption for assessments on assessable stock and for assessable stock offered or sold to realize the amount of assessment thereon.

Under Section 3 (c) of the Securities Act, which was added by Section 307 (a) of the Small Business Investment Act of 1958, the Commission is authorized to adopt rules and regulations exempting securities issued by a company which is operating or proposes to operate as a small business investment company under the Small Business Investment Act. Acting pursuant to this authority, the Commission adopted Regulation E which exempts, subject to terms and conditions substantially similar to those contained in Regulation A, securities offerings not in excess of \$300,000 by any small business investment company which is registered under the Investment Company Act of 1940.

Exemption from registration under Section 3 (b) or 3 (c) of the Act does not carry with it any exemption from the provisions of the Act prohibiting fraudulent conduct in the offer or sale of securities and imposing civil liability or criminal responsibility for such conduct.

Exempt Offerings Under Regulation A

Regulation A permits a company to obtain needed capital not in excess of \$300,000 (including underwriting commissions) in any one year from a public offering of its securities without registration, provided specified conditions are met. These include the filing of a notification supplying basic information about the company with the Regional Office of the Commission in the region in which the company has its principal place of business and the filing and use in the offering of an offering circular. However, an offering circular need not be filed or used in connection with an offering not in excess of \$50,000 by a company with earnings in one of the last 2 years.

During the 1965 fiscal year, 397 notifications were filed under Regulation A, covering proposed offerings of \$77,367,235, compared with 462 notifications covering proposed offerings of \$89,317,615 in the 1964 fiscal year. Included in the 1965 total were 29 notifications covering stock offerings of \$3,298,877 by companies engaged in the exploratory oil and gas business, 12 notifications covering offerings of \$2,732,760 by mining companies and 14 notifications covering offerings of \$3,102,095 by companies featuring new inventions, products or processes.

The following table sets forth various features of the Regulation A offerings during the past 3 fiscal years:

[table omitted]

Reports of Sales

The Commission requires, within 30 days after the end of each 6-month period following the date of the original offering circular required by Rule 256, or the statement required by Rule 257, that the issuer or other person for whose account the securities are offered shall file a report containing specified information and that a final report shall be made upon completion or termination of the offering.

During the fiscal year 1965, 795 Reports of Sales were filed reporting an aggregate amount of sales of \$45,554,313.

Suspension of Exemption

Regulation A provides for the suspension of an exemption thereunder where, in general, the exemption is sought for securities for which the regulation provides no exemption or where the offering is not made in accordance with the terms and conditions of the regulation or with prescribed disclosure standards. Following the issuance of a temporary suspension order by the Commission, the respondents may request a hearing to determine whether the temporary suspension should be vacated or made permanent. If no hearing is requested within 30 days after the entry of the temporary suspension order and none is ordered by the Commission on its own motion, the temporary suspension order becomes permanent.

During the 1965 fiscal year, temporary suspension orders were issued in 23 cases, which, added to the 19 cases pending at the beginning of the fiscal year, resulted in a total of 42 cases for disposition. Of these, the temporary suspension order was vacated in 3 cases and became permanent in 32: in 14 by lapse of time, in 12 by withdrawal of the request for hearing, and in 6 after hearing. Thus, there were 7 cases pending at the end of the fiscal year.

Three of the cases disposed of during the year are summarized below to illustrate the type of misrepresentations and other noncompliance with the regulation which led to the issuance of suspension orders:

Isthmus Steamship & Salvage Co., Inc.--The issuer was organized in 1956, for the stated purposes of salvaging cargoes of sunken ships and engaging in the general steamship business. After filing a notification under Regulation A, the issuer in February 1958 commenced a public offering of 150,000 shares at \$2 per share. The efforts of three broker-dealers to sell the offering having been largely unsuccessful, Robert Edelstein was designated sole underwriter on a "best-efforts" basis in May 1959. On August 7, 1959, issuer filed a report of sales on Form 2-A stating that 148,088 shares had been sold and that the offering had been terminated as to the unsold shares.

In consolidated Regulation A and broker-dealer proceedings, the Commission found that the offering circular used by the issuer was materially misleading in regard to the value of salvage rights which it stated the issuer owned in the sunken ship S.S. Bayard which had gone down off the Louisiana coast in 1942. The circular stated that the ship carried "copper wire, copper tubing, slab zinc, nickel, sheet brass and other salvageable materials" having an estimated "maximum delivered market value in excess of \$2 million." However, a certified copy of a 43-page manifest, filed in the New Orleans office of the Bureau of Customs the day before the ship had sunk, showed that the Bayard cargo consisted primarily of perishable goods and not the valuable and salvageable goods referred to in the offering circular.

The Commission stated in its Opinion that "while the truth of the statements contained in [the manifest] is not established by the fact that it was so filed, its very existence casts serious doubt upon the affirmative representations contained in the offering circular" and "this apparent conflict clearly should have been disclosed to prospective investors. . . ."

The Commission permanently suspended the issuer's exemption and revoked the broker-dealer registration of Edelstein's successor firm, finding among other things that Edelstein as underwriter failed to exercise reasonable care to satisfy himself as to the accuracy of the offering circular and made false and misleading statements in the sale of issuer's securities.

Marion Oil Company, Inc. -- The issuer, a Pennsylvania corporation, was organized in February 1963, to engage in the business of prospecting for, producing and selling petroleum and natural gas. Issuer filed a notification with the Commission on March 12, 1964, with respect to a proposed public offering under Regulation A of 100,000 shares of its Class B non-voting stock at \$3 per share.

On May 11, 1964, the exemption was temporarily suspended. On the basis of the record established at a hearing requested by the issuer, the Commission permanently suspended the exemption. It found that the issuer's offering circular was materially misleading in that it did not disclose the existence of a predecessor of the issuer of which the issuer's general manager and secretary had been president and secretary-treasurer, respectively, nor that such predecessor had undertaken production of oil on the same tract to be developed by Marion and had lost the lease to the tract through foreclosure because of a lack of operating funds. The offering circular was further deficient in failing to disclose the production history of the tract and unfavorable production information as to bordering properties which it characterized as "oil producing property."

The Commission also found that the offering circular was materially misleading in not adequately disclosing the immediate dilution of a purchaser's investment from \$3 per share to 45 cents per share if all the securities were sold. Issuer also failed to meet the requirements of Regulation A in not escrowing certain insider shares pursuant to Rule

253 (c), and consequently the filing involved an offering in excess of the \$300,000 limitation on Regulation A offerings.

Capitol Leasing Corporation -- An affiliate of the issuer, American Trailer Rental Company (ATR), had managed and rented a fleet of automobile-type utility trailers which it obtained through sale-leaseback arrangements. Some of the trailer owners were entitled to receive monthly a percentage of the cost of the trailer and others a percentage of the amount realized through the use of the trailer. ATE had sustained 3 years of substantial losses and was delinquent in its payments to trailer owners. ATE's directors realized that the company's financial position probably would deter trailer owners from exchanging their interests for an equity position in ATE, and therefore decided to form the issuer, which would acquire \$300,000 of trailers in exchange for its shares and would then make an additional public offering of \$6 million for the purpose of purchasing trailers, including those owned by ATE. When this plan was not successful, issuer offered its stock under Regulation A, primarily to ATE trailer owners, at \$2 per share, or alternatively for trailers at an exchange rate based on the retail cost of the trailers.

The Commission found that the issuer's offering circular was materially misleading in that it failed to disclose that the issuer was formed, and the proposed offering was designed, for the purpose of effecting a program of financial relief for ATE; that the offering was primarily being made to ATE trailer owners; that persons to whom the offer was made were merely being given an opportunity to exchange their rights under the ATE contracts for an equity interest in substantially the same enterprise; that ATE had never operated at a profit; that the subject offering was one step in a larger financing plan involving a much larger public offering; and that officers and directors of the issuer were also creditors and stockholders of ATE. The Commission permanently suspended the exemption, rejecting the issuer's argument that the proceedings should be dismissed because it had not been given an opportunity to correct the deficiencies in the offering circular.

Exempt Offerings Under Regulation B

During the fiscal year ended June 30, 1965, 173 offering sheets and 203 amendments thereto were filed pursuant to Regulation B and were examined by the Oil and Gas Section of the Commission's Division of Corporation Finance. During the 1964 and 1963 fiscal years, 242 and 231 offering sheets, respectively, were filed. The following table indicates the nature and number of Commission orders issued in connection with such filings during the fiscal years 1963-65. The balance of the offering sheets filed became effective without order.

[table omitted]

Reports of sales. -- The Commission requires persons who make offerings under Regulation B to file reports of the actual sales made pursuant to that regulation. The

purpose of these reports is to aid the Commission in determining whether violations of law have occurred in the marketing of such securities. The following table shows the number of sales reports filed under Regulation B during the past 3 fiscal years and the aggregate dollar amount of sales during each of such fiscal years.

[table omitted]

Exempt Offerings Under Regulation E

Regulation E provides a conditional exemption from registration under the Securities Act for securities of small business investment companies which are licensed under the Small Business Investment Act of 1958 or which have received the preliminary approval of the Small Business Administration and have been notified by the Administration that they may submit an application for such a license. As has been noted, the terms and conditions of the exemption are substantially similar to those provided by Regulation A. Two notifications were filed under Regulation E during the 1965 fiscal year. One was subsequently withdrawn and the other was pending at the close of the year.

Exempt Offerings Under Regulation F

Regulation F provides an exemption for assessments levied upon assessable stock and for delinquent assessment sales in amounts not exceeding \$300,000 in any one year. It requires the filing of a simple notification giving brief information with respect to the issuer, its management, principal security holders, recent and proposed assessments and other security issues. The regulation requires a company to send to its stockholders, or otherwise publish, a statement of the purposes for which the proceeds of the assessment are proposed to be used. Copies of any other sales literature used in connection with the assessment must be filed. Like Regulation A, Regulation F provides for the suspension of an exemption thereunder where the regulation provides no exemption or where the offering is not made in accordance with the terms and conditions of the regulation or in accordance with prescribed disclosure standards.

During the 1965 fiscal year, 19 notifications were filed under Regulation F, covering assessments of \$789,508. Underwriters were not employed in any of the Regulation F assessments. No Regulation F filings were suspended during the fiscal year.

REVISION OF RULES, REGULATIONS AND FORMS

In addition to the matters discussed below, two new rules (174 and 425A) were adopted during the fiscal year in implementation of the 1964 amendments to Section 4 of the Securities Act. The substance of these rules is discussed in Part I of this Report.

Proposed Amendment of Rule 485

During the fiscal year, the Commission invited comments on certain proposed amendments to Rule 485. This rule sets forth the procedure to be followed by a registrant in applying to the Commission for confidential treatment of a material contract or a portion of such a contract. The proposed amendments would have required that the registration statement indicate that the contract or a portion thereof has been omitted and filed separately with the Commission. A further amendment would have required applications pursuant to the rule to state whether or not the applicant would be willing to permit the disclosure of the contract or portion thereof to other agencies of the Federal Government.

Subsequent to the end of the fiscal year, the Commission, after further consideration of the matter in the light of the comments and suggestions received, determined not to adopt the proposed amendments and accordingly withdrew them.

Amendments to Forms S-1, S-8 and S-11

The amendments to the above forms adopted during the fiscal year are discussed at pp. 75-76, *infra*, in connection with the discussion of related amendments of Rules 10b-6 and 16b-3 under the Securities Exchange Act of 1934.

PART IV

ADMINISTRATION OF THE SECURITIES EXCHANGE ACT OF 1934

The Securities Exchange Act of 1934, as amended by the Securities Acts Amendments of 1964, provides for the registration and regulation of securities exchanges, the registration of securities listed on such exchanges and, under new Section 12 (g), the registration of securities traded over the counter where the issuers of such securities have total assets in excess of \$1 million and the securities constitute a class of equity securities held of record by at least 750 persons (after July 1, 1966, the number will be reduced to 500). It establishes, for issuers of securities registered under the Act, financial and other reporting requirements and regulation of proxy solicitations and, for directors, officers and principal security holders of such issuers, reporting requirements and restrictions on trading in the securities of their companies. The Act also provides for the registration and regulation of national securities associations and of brokers and dealers doing business in the over-the-counter markets, contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets and authorizes the Board of Governors of the Federal Reserve System to regulate the use of credit in securities transactions. The principal purpose of the various

statutory provisions is to ensure the maintenance of fair and honest markets in securities transactions on the organized exchanges and in the over-the-counter markets.

REGULATION OF EXCHANGES AND EXCHANGE TRADING

Registration and Exemption of Exchanges

As of June 30, 1965, 14 stock exchanges were registered under the Exchange Act as national securities exchanges:

- American Stock Exchange
- Boston Stock Exchange
- Chicago Board of Trade
- Cincinnati Stock Exchange
- Detroit Stock Exchange
- Midwest Stock Exchange
- National Stock Exchange
- New York Stock Exchange
- Pacific Coast Stock Exchange
- Philadelphia-Baltimore-Washington Stock Exchange
- Pittsburgh Stock Exchange
- Salt Lake Stock Exchange
- San Francisco Mining Exchange
- Spokane Stock Exchange

Three exchanges were exempted from registration by the Commission pursuant to Section 5 of the Act:

- Colorado Springs Stock Exchange
- Honolulu Stock Exchange
- Richmond Stock Exchange

The Wheeling Stock Exchange ceased activity and its exemption from registration as a national securities exchange was terminated effective April 30, 1965.

Commission Inspections of the Exchanges

One of the Commission's primary roles under the regulatory scheme of the Exchange Act is the oversight of the national securities exchanges in the performance of their self-regulatory activities. To facilitate this oversight the Office of Regulation in the Division of Trading and Markets conducts regular and periodic inspections of various phases of exchange activity. During the past year, 11 such inspections were made of the New York and American Stock Exchanges and general inspections were conducted of the

Cincinnati, Detroit, Honolulu, Pacific Coast and Salt Lake Exchanges. These periodic inspections enable the Commission to insure that the exchanges are complying with their self-regulatory responsibilities and to recommend improvements and refinements designed to increase the effectiveness of self-regulation.

The inspections conducted of the two New York exchanges covered such areas as procedures relating to the financial responsibility of member organizations, surveillance of registered traders, surveillance of specialists, procedures for handling public complaints, and practices and procedures regarding admission and qualification standards for members and registered representatives.

Where it appeared to the staff of the Commission that revisions in exchange procedures or policies were desirable in order to improve an exchange's performance, its views were communicated to the particular exchange and discussions were held between the Commission and exchange staffs to arrive at appropriate solutions. During the past year a number of significant improvements in exchange operations were accomplished as a result of the inspection program and the subsequent discussions.

Section 19 (a) (1) Proceedings Against San Francisco Mining Exchange

During the fiscal year further progress toward a final determination was made in the pending proceedings under Section 19 (a) (1) of the Act to determine whether the registration of the San Francisco Mining Exchange should be withdrawn for the protection of investors. The proceedings are based on allegations that the Exchange failed to require its members and issuers of securities registered on the Exchange to comply with the Act's reporting, proxy-soliciting, record-keeping and other requirements, that it permitted its facilities to be used in connection with unlawful securities distributions, and that it did not have adequate listing or delisting standards and was not properly organized to discharge the responsibilities of a national securities exchange under the Act. Following an evidentiary hearing, the hearing examiner filed a recommended decision in May 1965, in which he found the existence of a number of serious deficiencies but recommended that the Exchange be given a further opportunity to effect a thorough reorganization and change of management and that if such reorganization were not accomplished within a 90-day period the Exchange's registration be withdrawn. In July 1965, subsequent to the end of the fiscal year, the Commission heard oral argument. The Exchange urged acceptance of the hearing examiner's recommendations, while the Division of Trading and Markets urged that the registration of the Exchange be withdrawn.

Exchange Disciplinary Action

Each national securities exchange reports to the Commission disciplinary actions taken against its members, member firms or persons connected therewith for violation of any

rule of the exchange or of the Securities Exchange Act or any rule or regulation thereunder.

During the fiscal year, six exchanges reported 127 such actions, including impositions of fines in 23 cases ranging from \$25 to \$20,000, with total fines aggregating \$28,875, and the suspension from membership of 14 individuals and three member organizations. These exchanges also reported the imposition of various sanctions against 60 registered representatives and employees of member firms. In addition, a number of informal staff actions of a cautionary nature were reported by several exchanges.

REGISTRATION OF SECURITIES ON EXCHANGES

Unless a security is registered on a national securities exchange under the Securities Exchange Act or is exempt from such registration it is unlawful for a member of such exchange or any broker or dealer to effect any transaction in the security on the exchange. In general, the Act exempts from registration obligations issued or guaranteed by a state or the Federal Government or by certain subdivisions or agencies thereof and authorizes the Commission to adopt rules and regulations exempting such other securities as the Commission may find necessary or appropriate to exempt in the public interest or for the protection of investors. Under this authority the Commission has exempted securities of certain banks, certain securities secured by property or leasehold interests, certain warrants and, on a temporary basis, certain securities issued in substitution for or in addition to listed securities.

Pursuant to Section 12 of the Exchange Act, an issuer may register a class of securities on an exchange by filing with the Commission and the exchange an application which discloses pertinent information concerning the issuer and its affairs. Information must be furnished regarding the issuer's business, its capital structure, the terms of its securities, the persons who manage or control its affairs, the remuneration paid to its officers and directors, and the allotment of options, bonuses and profit-sharing plans, and financial statements certified by independent accountants must be filed as part of the application.

Form 10 is the form used for registration by most commercial and industrial companies. There are specialized forms for certain types of securities, such as voting trust certificates, certificates of deposit and securities of foreign governments. These forms are also used for the registration under new Section 12 (g) of securities traded in the over-the-counter markets.

Section 13 requires issuers having securities registered on an exchange to file periodic reports keeping current the information furnished in the application for registration. These periodic reports include annual reports, semi-annual reports, and current reports. The principal annual report form is Form 10-K which is designed to keep up-to-date the information furnished in applications filed on Form 10. Semi-annual reports required to

be filed on Form 9-K are devoted chiefly to furnishing mid-year financial data. Current reports on Form 8-K are required to be filed for each month in which any of certain specified events have occurred. A report on this form deals with matters such as changes in control of the registrant, important acquisitions or dispositions of assets, the institution or termination of important legal proceedings and important changes in the issuer's capital securities or in the amount thereof outstanding. The above requirements are now also applicable to issuers having securities registered under new Section 12 (g).

The following table shows the number of reports filed during the fiscal year pursuant to Section 13 of the Exchange Act and those filed under Section 15 (d) of the Act by issuers obligated to file reports by reason of having publicly offered securities registered under the Securities Act of 1933. As of June 30, 1965, there were 3,184 such issuers, including 315 that were also registered as investment companies under the Investment Company Act of 1940. The table also includes the number of annual reports, quarterly reports and reports to stockholders filed by issuers subject to the reporting requirements of Section 30 of the Investment Company Act.

[table omitted]

STATISTICS RELATING TO SECURITIES ON EXCHANGES

Number of Issuers and Securities

As of June 30, 1965, a total of 2,522 issuers had 4,127 classes of securities listed and registered on national securities exchanges, of which 2,913 were classified as stocks and 1,214 as bonds. Of these totals, 1,417 issuers had 1,625 stock issues and 1,118 bond issues listed and registered on the New York Stock Exchange. Thus, 56 percent of the issuers, 56 percent of the stock issues and 92 percent of the bond issues were on the New York Stock Exchange. Table 4 in the appendix to this report contains comprehensive statistics as to the number of securities issues admitted to exchange trading and the number of issuers involved, as of June 30, 1965.

During the 1965 fiscal year, 149 issuers listed and registered securities on a national securities exchange for the first time, while the registration of all securities of 94 issuers was terminated. A total of 279 applications for registration of securities on exchanges was filed during the year.

Market Value of Securities Available for Trading

The market value on December 31, 1964, of stocks and bonds, both listed and unlisted, admitted to trading on one or more stock exchanges in the United States was approximately \$636 billion.

The New York Stock Exchange and American Stock Exchange figures were reported by those exchanges. There was no duplication of issues between them. The figures for all other exchanges were for the net number of issues appearing only on such exchanges, excluding the many issues on them which were also traded on one or the other of the New York exchanges. The number and market value of issues as shown excluded those suspended from trading and a few others for which quotations were not available: The number and market value as of December 31, 1964, of preferred and common stocks separately was as follows:

[table omitted]

The 3,073 preferred and common stocks represented over 11.4 billion shares, of which over 10.9 billion were included in the 2,872 issues listed on registered exchanges.

The New York Stock Exchange has reported aggregate market values of all stocks listed thereon monthly since December 31, 1924, when the figure was \$27.1 billion. The American Stock Exchange has reported December 31 totals annually since 1936. Aggregates for stocks exclusively on the remaining exchanges have been compiled as of December 31 annually by the Commission since 1948. The available data since 1936 appear in Table 5 in the appendix of this Annual Report. It should be noted that changes in aggregate market values over the years reflect not only changes in prices of stocks but also such factors as new listings, mergers into listed companies, removals from listing and issuance of additional shares of a listed security.

Share and Dollar Volume of Stocks Traded

The following figures show the annual volume of shares actually traded on all exchanges during the years 1955 through 1964, and the first 6 months of 1965:

[table omitted]

These volume figures include shares, warrants and rights. Tables 6 and 7 in the appendix of this Annual Report contain comprehensive statistics on volumes, by exchanges.

Foreign Stocks on Exchanges

The market value on December 31, 1964, of all shares and certificates representing foreign stocks on U.S. stock exchanges was \$17 billion, of which \$14.1 billion represented Canadian and \$2.9 billion represented other foreign stocks. The market values of the entire Canadian stock issues were included in these aggregates. Most of the other foreign stocks were represented by American Depositary Receipts or American shares, only the outstanding amounts of which were used in determining market values.

[table omitted]

The number of foreign stocks on the exchanges has declined in recent years, owing principally to a reduction on the American Stock Exchange from 145 issues in 1960, to 102 in 1964. However, trading in foreign stocks represented 17.9 percent of the reported share volume on that Exchange in 1960, and 18.5 percent in 1964. Trading in foreign stocks on the New York Stock Exchange has declined from 2.7 percent of its reported share volume in 1960, to 2 percent in 1964. Reported trading volumes in foreign shares during 1964 consisted of about 44.7 million Canadian shares and 24.6 million other foreign shares on the American Stock Exchange and about 12.3 million Canadian shares and 11.7 million other foreign shares on the New York Stock Exchange. While the share volume on the American exceeded that on the New York Stock Exchange, it would appear that in view of higher average share prices, the latter exchange had a greater dollar volume in foreign shares.

Comparative Exchange Statistics

During fiscal year 1965, there was a moderate increase in the number of stocks listed on the New York Stock Exchange, consistent with the trend of recent years; the number listed on the American Stock Exchange also increased moderately-, representing the first gain since 1962; and the number of stocks available for trading exclusively on the other exchanges continued to decline.

[table omitted]

Since 1948, aggregate values of stocks listed on the New York Stock Exchange have generally represented an increasing proportion of total share values on all the exchanges.

[table omitted]

The ratio of share volume on the regional exchanges to the total on all exchanges has continued to decline over the years. However, the regional exchange percentage of dollar volume has increased slightly. In the following presentation, shares, warrants and rights are included.

[table omitted]

DELISTING OF SECURITIES FROM EXCHANGES

Application may be made to the Commission by exchanges to strike securities or by issuers to withdraw their securities from listing and registration on exchanges pursuant to Rule 12d2-2 under Section 12 (d) of the Securities Exchange Act. During the fiscal year ended June 30, 1965, the Commission granted applications by exchanges and issuers to remove 64 stock issues, representing 62 issuers, from listing and registration. Since 8

stocks were each delisted by two exchanges, there was a total of 72 stock removals, as follows:

[table omitted]

The two applications by issuers which were granted during the year removed from the Detroit and Pittsburgh Stock Exchanges securities whose principal exchange markets were on the New York Stock Exchange.

Revisions in the listing and delisting standards of the American and New York Stock Exchange became effective in February and April 1965, respectively. The Midwest Stock Exchange adopted a number of listing policy changes in 1964, and adopted delisting standards in January 1965.

Delisting Proceedings Under Section 19 (a) (2)

Section 19 (a) (2) authorizes the Commission to suspend for a period not exceeding 12 months, or to withdraw, the registration of a security on a national securities exchange if in its opinion such action is necessary or appropriate for the protection of investors and it finds, after notice and opportunity for hearing, that the issuer of the security has failed to comply with any provision of the Act or the rules and regulations thereunder. The one proceeding under this Section pending at the beginning of the fiscal year was terminated, and no additional proceedings were instituted during the year.

UNLISTED TRADING PRIVILEGES ON EXCHANGES

Stocks with unlisted trading privileges which are not also listed and registered on other exchanges continued to decline in number, from 140 on June 30, 1964, to 132 on June 30, 1965. The American Stock Exchange accounted for all the removals. The distribution of unlisted stocks and share volumes therein among the exchanges is shown in Appendix Table 9.

The statutory provisions regarding unlisted trading privileges were amended in several respects by the Securities Acts Amendments of 1964. Thus, the provision authorizing an exchange, with the approval of the Commission, to extend unlisted trading privileges to any security as to which the disclosure requirements and other duties and obligations of the issuer were substantially equivalent to those applicable to listed securities has been deleted. The Commission is now authorized to extend unlisted trading privileges only for securities listed and registered on another national securities exchange. In addition, the 1964 amendments broadened the standards by which the Commission must judge applications for unlisted trading privileges by deleting a requirement that an applicant exchange demonstrate the existence of widespread public distribution and trading activity in the security in the vicinity of the exchange. The Commission is now allowed to

consider all factors affecting the public interest or the protection of investors in extending, suspending or terminating unlisted trading.

During the calendar year 1964, the reported volume of trading on the exchanges in stocks with only unlisted trading privileges was about 24,521,000 shares or about 1.2 percent of the total share volume on all exchanges. About 96 percent of this volume was on the American Stock Exchange while four other exchanges contributed the remaining 4 percent. The share volume in these stocks on the American Stock Exchange represented 5.9 percent of the total share volume on that Exchange.

Unlisted trading privileges on exchanges in stocks listed and registered on other exchanges numbered 1,661 as of June 30, 1965. The volume of trading in these stocks for the calendar year 1964 was reported at about 67,927,000 shares. About 14 percent of this volume was on the American Stock Exchange in stocks listed on regional exchanges, and 86 percent was on regional exchanges in stocks listed on the New York or American Stock Exchange. While the 67,927,000 shares amounted to only 3.3 percent of the total share volume on all exchanges, they constituted substantial portions of the share volume of the leading regional exchanges, as reflected in the following approximate percentages: Boston 74 percent; Cincinnati 73 percent; Detroit 68 percent; Philadelphia-Baltimore-Washington 68 percent; Pittsburgh 52 percent; Midwest 32 percent; and Pacific Coast 30 percent.

Applications for Unlisted Trading Privileges

Applications by exchanges for unlisted trading privileges in stocks listed on other exchanges, filed pursuant to Rule 12f-1 under Section 12 (f) (1) (B) of the Securities Exchange Act, were granted by the Commission during the fiscal year ended June 30, 1965, as follows:

[table omitted]

BLOCK DISTRIBUTIONS REPORTED BY EXCHANGES

The usual method of distributing blocks of listed securities considered too large for the auction market on the floor of an exchange is to resort to "secondary distributions" over the counter after the close of exchange trading. Secondary distributions, as reported since 1942, reached a peak of \$926,514,000 during the calendar year 1961, and the total of \$909,821,000 during 1964 is close to this peak. During the first 6 months of 1965, there were 74 secondary distributions aggregating \$1,099,121,000, or more than the total for the entire year 1964. This record total includes two unusually large secondary distributions, one by Ford Motor Co. and one by General Motors Co., which together accounted for more than half of the total value.

In an effort to keep as much trading as possible on their floors, the leading exchanges adopted Special Offering Plans in 1942, and the somewhat more flexible Exchange Distribution Plans in 1953. Special offerings have disappeared in the last few years, while the number of exchange distributions has grown. The largest number of special offerings was 87 in 1944, with \$32,454,000 aggregate value. In 1962, there were only two offerings and in 1963 and 1964 there were none. Exchange distributions reached a record with 72 in 1963, compared with 68 in 1964; the value of such distributions was \$107,498,000 in 1963, compared with \$97,711,000 the following year.

[table omitted]

REGISTRATION OF OVER-THE-COUNTER SECURITIES

The provisions of Section 12 (g) of the Exchange Act requiring the registration of certain securities traded in the over-the-counter markets, which was added by the Securities Acts Amendments of 1964, the implementation of that Section and of Section 12 (h) (relating to exemptions from the requirements of Section 12 (g)) through the adoption or amendment of various rules and forms by the Commission, statistics regarding the number of registration statements filed during the fiscal year pursuant to Section 12 (g), and related matters are discussed in some detail in Part I of this Report.

MANIPULATION AND STABILIZATION

Manipulation; Market Surveillance

The Exchange Act describes and prohibits certain forms of manipulative activity in any security registered on a national securities exchange. The prohibited activities include wash sales and matched orders effected for the purpose of creating a false or misleading appearance of trading activity in, or with respect to the market for, any such security; a series of transactions in which the price of such security is raised or depressed, or in which actual or apparent active trading is created, for the purpose of inducing purchases or sales of such security by others; circulation by a broker, dealer, seller, or buyer, or by a person who receives consideration from a broker, dealer, seller or buyer, of information concerning market operations conducted for a rise or a decline in the price of such security; and the making of any false or misleading statement of material information by a broker, dealer, seller, or buyer regarding such security for the purpose of inducing purchases or sales. The Act also empowers the Commission to adopt rules and regulations to define and prohibit the use of these and other forms of manipulative activity in any security registered on an exchange or traded over the counter.

In August 1964, the Commission transferred to the headquarters office responsibility for overall surveillance of the securities markets. To implement a more effective and

expanded program of surveillance, designed to be integrated into the Commission's regulatory program, procedures were adopted whereby the activities of the Commission's market surveillance staff were closely coordinated with the stock-watching operations of the New York and American Stock Exchanges. Within this framework, the Commission's market surveillance staff reviews the daily and periodic stock watch reports prepared by these exchanges and on the basis of its analysis of the information developed by the exchanges and from other sources, determines the matters of interest, the apparent violations, if any, of applicable law and the appropriate action to be taken.

The Commission's market surveillance staff also observes the ticker-tape quotations of securities listed on the New York Stock Exchange and on the American Stock Exchange, the sales and quotation sheets of regional exchanges, and the bid and asked prices published by the National Daily Quotation Service for unlisted securities to observe any unusual or unexplained price variations or market activity. The financial news ticker, leading newspapers, and various financial publications and statistical services are also closely followed. Investigations are conducted if it appears that violations have occurred.

When securities are to be offered to the public, their markets are watched very closely to make sure that the price is not unlawfully raised prior to or during the distribution. During the fiscal year, such surveillance took place with respect to a total of 1,163 registered offerings, with a value of \$12.8 billion, and 397 offerings under the small issues exemption from registration (Regulation A under the Securities Act) with a value of \$77 million. In addition, 204 other offerings, such as secondary distributions and distributions of securities under special plans filed by the exchanges, having a total value of \$1,039 million, were also kept under surveillance.

Stabilization

Stabilization involves open-market purchases of securities to prevent or retard a decline in the market price in order to facilitate a distribution. It is permitted by the Exchange Act subject to the restrictions provided by the Commission's Rules 10b-6, 7 and 8. These rules are designed to confine stabilizing activity to that necessary for the above purpose, to require proper disclosure and to prevent unlawful manipulation.

During fiscal year 1965, stabilizing was effected in connection with stock offerings totaling 42,092,451 shares having an aggregate public offering price of \$1,634,723,254 and bond offerings having a total offering price of \$427,105,000. In these offerings, stabilizing transactions resulted in the purchase of 1,443,148 shares at a cost of \$52,005,854 and bonds at a cost of \$1,651,630. In connection with these stabilizing transactions, 6,418 stabilizing reports, showing purchases and sales of securities effected by persons conducting the distribution, were received and examined during the fiscal year.

INSIDERS' SECURITY HOLDINGS AND TRANSACTIONS

Corporate insiders, by virtue of their position, may have knowledge of a company's condition and prospects which is unavailable to the general public and may be able to use such information to their personal advantage in trading in the company's securities. Section 16 of the Exchange Act and corresponding provisions in Section 17 of the Public Utility Holding Company Act of 1935 and Section 30 (f) of the Investment Company Act of 1940 are designed to prevent the unfair use of such information by giving publicity to insiders' security transactions and holdings, and removing the profit incentive in short-term trading.

Ownership Reports

Prior to the 1965 fiscal year, Section 16 (a) of the Securities Exchange Act required every person who was a direct or indirect beneficial owner of more than 10' percent of any class of equity security which was registered on a national securities exchange, or who was a director or an officer of the issuer of any such security, to file statements with the Commission and the exchange disclosing his ownership of the issuer's equity securities and changes in such ownership. The Securities Acts Amendments of 1964 extended the reporting requirements of Section 16 (a) to the insiders of issuers of securities registered under Section 12 (g). Similar provisions applicable to insiders of registered public-utility holding companies and registered closed-end investment companies are contained in Section 17 (a) of the Holding Company Act and Section 30 (f) of the Investment Company Act, respectively. The administration of the insider reporting provisions of the three Acts is combined in one section in the Division of Corporation Finance.

During the fiscal year, 56,554 ownership reports (14,594 initial statements of ownership on Form 3 and 41,960 statements of changes in ownership on Form 4) were filed with the Commission. This represents an increase of 11,923 over the 44,631 reports (6,573 initial statements and 38,058 statements of changes) filed during the 1964 fiscal year. The bulk of the increase is attributable to the extension of the reporting requirements to insiders of issuers of over-the-counter securities registered under new Section 12 (g), although the majority of the initial statements of ownership by the insiders of the more than 1,500 companies affected was not filed until after the close of the fiscal year.

All ownership reports are made available for public inspection as soon as they are filed at the Commission's office in Washington and at the exchanges where copies are filed. In addition, the information contained in reports filed with the Commission is summarized and published in the monthly "Official Summary of Security Transactions and Holdings," which is distributed by the Government Printing Office on a subscription basis to more than 20,000 persons.

Recovery of Short-Swing Trading Profits by Issuer

In order to prevent insiders from making unfair use of information which may have been obtained by reason of their relationship with a company, Section 16 (b) of the Exchange Act, Section 17 (b) of the Holding Company Act, and Section 30 (f) of the Investment Company Act provide for the recovery by or on behalf of the issuer of any profit realized by insiders in the categories described under "Ownership Reports" from certain purchases and sales, or sales and purchases, of securities of the company within any period of less than 6 months. The Commission has certain exemptive powers with respect to transactions not comprehended within the purpose of these provisions, but is not charged with the enforcement of the civil remedies created thereby.

REGULATION OF PROXIES

Scope of Proxy Regulation

Under Sections 14 (a) of the Securities Exchange Act, 12 (e) of the Public Utility Holding Company Act of 1935, and 20 (a) of the Investment Company Act of 1940, the Commission has adopted Regulation 14A requiring the disclosure in a proxy statement of pertinent information in connection with the solicitation of proxies, consents and authorizations in respect of securities subject to those provisions, in order to enable holders of such securities to act intelligently on the matters involved. The regulation also provides, among other things, that when the management is soliciting proxies, any security holder desiring to communicate with other security holders for a proper purpose may require the management to furnish him with a list of all security holders or to mail his communication to security holders for him. A security holder may also, subject to reasonable prescribed limitations, require the management to include in its proxy material any appropriate proposal which such security holder desires to submit to a vote of security holders. Any security holder or group of security holders may at any time make an independent proxy solicitation upon compliance with the proxy rules, whether or not the management is making a solicitation. Certain additional provisions of the regulation are applicable where a contest for control of the management of an issuer or representation on the board is involved.

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

The Securities Acts Amendments of 1964 extended the proxy solicitation requirements to those over-the-counter securities which are registered under Section 12 (g) of the Act. As previously noted, Regulation 14A is applicable to solicitations of proxies with respect to such securities where the solicitation is commenced on or after July 1, 1965. The amendments also authorize the Commission to promulgate rules and regulations requiring

an issuer to send information to security holders even though a proxy solicitation is not made, and requiring broker-dealers to transmit proxy material to customers. Proposed Regulation 14C to implement the former provision is discussed in Part I of this report.

Statistics Relating to Proxy Statements

During the 1965 fiscal year, 2,661 proxy statements in definitive form were filed under the Commission's Regulation 14A for the solicitation of proxies of security holders; 2,639 of these were filed by management and 22 by non-management groups or individual stockholders. These 2,661 solicitations related to 2,433 companies, 228 of which had more than one solicitation during the year, generally for a special meeting not involving the election of directors. There were 2,391 solicitations of proxies for the election of directors, 248 for special meetings not involving the election of directors, and 22 for other assents and authorizations.

During fiscal year 1965, the votes of security holders were solicited with respect to the following types of matters, other than the election of directors:

[table omitted]

Stockholders' Proposals

During the 1965 fiscal year, 191 proposals submitted by 42 stockholders were included in the proxy statements of 132 companies under Rule 14a-8 of Regulation 14A.

Typical of such stockholder proposals submitted to a vote of security holders were resolutions relating to amendments to charters or by-laws to provide for cumulative voting for the election of directors, limitations on the grant of stock options to and their exercise by key employees and management groups, the sending of a post-meeting report to all stockholders, a change of the place of the annual stockholders' meeting, and the approval by stockholders of management's selection of independent auditors.

A total of 54 additional proposals submitted by 38 stockholders was omitted from the proxy statements of 29 companies in accordance with Rule 14a-8. The principal reasons for such omissions and the number of times each such reason was involved (counting only one reason for omission for each proposal even though it may have been omitted under more than one provision of Rule 14a-8) were as follows:

[table omitted]

Ratio of Soliciting to Nonsoliciting Companies

Of the 2,522 issuers that had securities listed and registered on national securities exchanges as of June 30, 1965, 2,338 had voting securities so listed and registered. Of

these 2,338 issuers, 3 listed and registered voting securities for the first time after their annual stockholders' meeting in fiscal 1965; of the remaining 2,335 issuers with voting securities, 1,999, or 85.6 percent, solicited proxies under the Commission's proxy rules during the 1965 fiscal year for the election of directors.

Proxy Contests

During the 1965 fiscal year, 26 companies were involved in proxy contests for the election of directors. A total of 400 persons, both management and non-management, filed detailed statements as participants under the requirements of Rule 14a-11. Proxy statements in 16 cases involved contests for control of the board of directors and those in 10 cases involved contests for representation on the board.

Management retained control in 7 of the 16 contests for control of the board of directors, 4 were settled by negotiation, non-management persons won 3 and 2 were pending as of June 30, 1965. Of the 10 cases where representation on the board of directors was involved, management retained all places on the board in 6 contests, opposition candidates won places on the board in 2 cases, 1 was settled by negotiation and in 1 contest a representative of certain shareholders won a seat.

INVESTIGATIONS WITH RESPECT TO REPORTING PROVISIONS

Section 21 (a) of the Act authorizes the Commission to make such investigations as it deems necessary to determine whether any person has violated or is about to violate any provision of the Act or any rule or regulation thereunder. The Commission is authorized, for this purpose, to administer oaths, subpoena witnesses, compel their attendance, take evidence and require the production of records. In addition to the investigations undertaken in enforcing the anti-fraud, broker-dealer registration, and other regulatory provisions of the Act, which are discussed in Part X of this report under "Complaints and Investigations," the following investigations were undertaken in connection with the enforcement of the reporting provisions of Sections 12, 13, 14 and 15 (d) of the Act and the rules thereunder, particularly those provisions relating to the filing of annual and other periodic reports and proxy material:

[table omitted]

REGULATION OF BROKER-DEALERS AND OVER-THE-COUNTER MARKETS

Registration

Section 15 (a) of the Securities Exchange Act requires the registration of all brokers and dealers who use the mails or instrumentalities of interstate commerce to effect or induce transactions in securities in the over-the-counter market. Brokers and dealers conducting an exclusively intrastate business or dealing only in exempted securities, commercial paper, commercial bills or bankers' acceptances are exempt from registration. The 1964 amendments added Section 15 (a) (2) which permits the Commission to exempt broker-dealers or classes of broker-dealers, either unconditionally or upon specified terms or conditions, from the requirement of registration.

The following tabulation reflects certain data with respect to registrations of brokers and dealers during the fiscal year ended June 30, 1965.

[table omitted]

Administrative Proceedings

The scope of the administrative sanctions which the Commission may impose against brokers and dealers and persons associated with a broker or dealer, pursuant to Sections 15 (b) and 15A of the Exchange Act, was enlarged in significant respects by the Securities Acts Amendments of 1964. Thus, in addition to the previously available sanctions against a broker-dealer of denial or revocation of registration and expulsion or suspension from a registered securities association or national securities exchange, the Commission may now suspend a broker-dealer's registration for a period not to exceed 12 months and may impose censure. Under prior law the Commission could not proceed directly against individuals associated with a broker-dealer firm, although incidental to a proceeding against the firm it could make findings with respect to such individuals which had the effect of disqualifying them from employment in the securities industry. The Act, as amended, permits direct action against associated persons, with or without joining the firm. The Commission may censure an associated person, may suspend or bar him from being associated with a broker or dealer, and may suspend or bar him from being associated with a member of a registered securities association. Under Section 15 (b), a sanction of revocation, denial or suspension of registration, or censure may be imposed upon a broker-dealer if, after notice and opportunity for hearing, the Commission finds that such sanction is in the public interest and that the broker-dealer, or any person associated with such broker-dealer, is subject to one or more of the specified statutory disqualifications. The Commission may censure, or bar or suspend from association with a broker-dealer, an associated person where it finds that such action is in the public interest and that such person has committed or omitted any act or omission which would be a basis for the imposition of a sanction if such person were a broker-dealer. The statutory disqualifications, which have been enlarged by the 1964 amendments, include the following:

(1) wilfully false or misleading statements in an application for registration or other report required to be filed under the Exchange Act;

(2) conviction within the previous 10 years of a felony or misdemeanor which involved the purchase or sale of securities; arose out of the conduct of business as a broker-dealer or investment adviser; involved embezzlement, fraudulent conversion, or misappropriation of funds or securities; or involved violation of the provisions of the United States Code dealing with various frauds and swindles committed by use of the mails, telephone, telegraph, radio or television;

(3) injunction by a court of competent jurisdiction against engaging in certain practices related to the securities business;

(4) wilful violation of any provision of the Securities Act of 1933, the Exchange Act, the Investment Advisers Act of 1940 or the Investment Company Act of 1940 or any of the Commission's rules or regulations thereunder;

(5) wilfully aiding or abetting another person in a violation of the Federal securities laws or rules and regulations thereunder or failing reasonably to supervise other persons who commit such violations; and

(6) employing a person barred or suspended from being associated with a broker-dealer.

Section 15A of the Exchange Act as amended empowers the Commission to suspend or expel a broker-dealer from membership in a registered securities association or to suspend or bar any person from being associated with a member, upon a finding of violation of the Federal securities laws or any rule or regulation thereunder. The National Association of Securities Dealers, Inc. ("NASD") is the only such association. Section 19 (a) (3) of the Act gives the Commission power to take similar action against members of national securities exchanges.

Set forth below are statistics with respect to administrative proceedings pursuant to Sections 15 (b) and 15A of the Securities Exchange Act which were pending during fiscal year 1965:

[table omitted]

Decisions of Particular Interest

The physical limitations imposed upon this report preclude an extensive review of the many decisions rendered by the Commission during the 1965 fiscal year in administrative proceedings with respect to brokers and dealers. However, a few cases of unusual interest or significance are set forth in some detail in the following paragraphs:

In Axe Securities Corporation the Commission censured Axe Securities Corporation, a registered broker-dealer, E. W. Axe & Co., a registered investment adviser, and a

principal of both firms on the basis of findings that they had wilfully violated the anti-fraud provisions of the Securities Act and the Investment Advisers Act.

The violations resulted from the publication by respondents of an article, "Your Investment Program" in a book entitled To the Bride. The book, which also contained recipes, household hints and recommendations of various products and was distributed to prospective brides by about 96 department stores, urged brides to initiate an investment program by purchasing shares in a mutual fund. It stated that E. W. Axe & Co. was "one of the outstanding nationally recognized investment counsels" whose "proven ability in economic research and evaluation, and their record in economic and market analysis, had led many financial institutions to retain them."

The article was paid for by Axe Securities and E. W. Axe & Co. and described, analyzed and recommended a group of mutual funds of which the registrants were the underwriter and investment adviser, respectively. The book contained no statement of the receipt and amount of the consideration paid by the registrants for the recommendations made.

The Commission found that the article may have carried to unwary readers the implication of an objective unpaid endorsement of the funds by the publisher, and that its publication violated the anti-fraud provisions. The Commission also found that other provisions of the Federal securities statutes were violated, including those relating to transmission of prospectuses. Because of certain mitigating factors, including cooperation with the Commission's staff in its investigation, rescission offers to recipients of the books who purchased the funds and adoption of internal procedures with respect to the distribution of sales materials, the Commission found that the public interest did not require a more severe sanction than censure.

In Capital Funds, Inc., the Commission denied broker-dealer registration to the firm and found its principals each a cause of the denial on the basis of a finding, among others, that respondents wilfully violated the registration provisions of the Securities Act of 1933 in the sale of stock of Peoples Loan & Investment Co. Inc., an Arkansas corporation.

Capital Funds was the underwriter of a public offering of stock of Peoples, assertedly limited to residents of Arkansas. One thousand shares of stock, however, were sold to two residents of Oklahoma. Respondents claimed the transactions in fact represented sales by one of the firm's salesmen of stock which he had previously purchased from the firm. The Commission rejected this contention, however, finding that the salesman had not become the bona fide owner of the shares or, even if he had, that under all the circumstances such shares had not come to rest in the hands of a resident before being sold to non-residents.

The Commission accordingly concluded that no intrastate exemption under Section 3 (a) (11) of the Securities Act was available for the respondents' offering of Peoples stock and pointed out that it is incumbent upon an underwriter and others connected with a public

offering in reliance on that exemption to make certain that the offering does not in fact become interstate in character.

The Commission also rejected the further contention that the securities of Peoples were exempt from registration under Section 3 (a) (2) of the Securities Act as securities issued by a banking institution, finding that Peoples was an industrial loan institution rather than a banking institution.

Early in the fiscal year, the Commission, pursuant to an offer of settlement, entered an order with respect to J. H. Goddard & Co., Inc. suspending registrant from membership in the National Association of Securities Dealers, Inc. for a period of 45 days and, upon termination of such suspension, from membership in the Boston Stock Exchange for 90 days. Subsequently, the Commission issued its Findings and Opinion. It found that registrant sold shares of unregistered stock of United Security Life Insurance Co. at increasing prices resulting from its manipulative market activities accompanied by the dissemination of false and misleading market letters. It further found that, in entering bids in the "pink" sheets and purchasing such securities while engaged in their distribution, registrant violated Rule 10b-6 under Section 10 (b) of the Exchange Act.

In Sidney Tager, doing business as The Tager Company,⁸ the Commission revoked the broker-dealer registrations of Tager and Darius Incorporated, expelled Tager from membership in the NASD, suspended Englander & Co., Inc. from NASD membership for a period of 15 days, and found certain individual respondents to be causes of the sanctions imposed on their firms. The Commission found that Tager, together with or aided and abetted by the other respondents, wilfully violated the anti-fraud provisions of the securities acts, including Rule 10b-6.

Tager, while engaged as underwriter in distributing stock of Diversified Collateral Corporation, induced Darius to enter quotations for the stock in the National Quotation Bureau sheets at prices suggested by Tager. Englander also entered quotations in the sheets during the same period. Both were told by Tager that the stock was free for trading. The Commission pointed out that under Rule 10b-6 it is a manipulative or deceptive device for an underwriter engaged in a distribution of a security to bid for or purchase such security for any account in which he has a beneficial interest or to attempt to induce any person to purchase any such security. It held that Tager wilfully violated the rule since he attempted to induce purchases by others by causing Darius and Englander to make a market in the stock and insert quotations in the sheets while he was still engaged in the distribution of the stock. The Commission further held that the participation of Darius and Englander and the individual respondents in Tager's violations was wilful since they failed to take reasonable precautions to satisfy themselves that the distribution was over instead of merely accepting Tager's self-serving assertion that it was, before making a market in the security.

The Commission added that its findings and conclusions did not mean that a dealer is not free to trade in a stock being distributed by another dealer. The gravamen of the violations here was that these respondents joined with Tager in activities designed to stimulate purchases and maintain or increase the price of Diversified stock at a time when Tager was engaged in a distribution which they knew or should have known was not yet terminated.

In Albert J. DiGiacomo, doing business as Albert James Co., the Commission, pursuant to an offer of settlement submitted by respondent, and based on findings that he had wilfully violated the registration and anti-fraud provisions of the securities acts in the sale of unregistered shares of J-F Machine, Diesel and Electronics, Inc. through the use of a false and misleading offering circular, and had wilfully violated the record-keeping requirements under the Exchange Act, suspended his broker-dealer registration for 120 days subject to the conditions that he would withdraw his registration at the end of the suspension period and that the findings and order of themselves would not be a bar after the termination of the suspension to his future employment in the securities business upon a showing that he would be employed under appropriate supervision. The case is of interest in that it is the first instance in which the Commission, as newly empowered under Section 15 (b) of the Exchange Act, imposed a suspension of broker-dealer registration for a specified period.

In Victor R. Redstone the Commission found registrant responsible for wilful violations of the Federal securities laws committed by persons whom he permitted to conduct a securities business under his trade name and revoked his registration as a broker-dealer.

It was found that registrant, a sole proprietor, doing business as Vanguard Investment Company, had agreed with two other persons to form a corporation, also to be known as Vanguard Investment Company, to engage in the securities business at a time when his securities business was dormant and he was engaged in the insurance business. The other two parties to the agreement opened an office and engaged in the securities business under registrant's trade name. Thereafter, these two individuals sold unregistered securities by means of false and misleading statements in wilful violation of the Federal securities statutes.

The Commission rejected registrant's claim that he was unaware that securities were being sold under his trade name, citing several instances evidencing his knowledge of such fact. It stated that registrant was under a duty to exercise control and supervision over the securities activities being conducted under his trade name, and since he failed to do so, must be held responsible for the violations which such activities entailed.

The Commission revoked the broker-dealer registration of Financial Counsellors Inc., and found Ernest F. Boruski, Jr. a cause of such action, on the basis of findings that the registrant failed to disclose in its application for registration, and amendments thereto, that Boruski controlled its business. The Commission found that Boruski, a registered

broker-dealer specializing in the retail sale of mutual fund shares, conceived the idea of forming the registrant after revocation proceedings were instituted against him, in order to protect future concessions on sales of mutual fund shares previously effected. The record showed that the registrant was entirely under his control, domination and management, In considering the question of what remedial action was required in the public interest, the Commission took into account the "intentional concealment and evasion," and emphasized the importance of the application for registration to the performance of its enforcement functions.

Subsequently, the Commission revoked Boruski's broker-dealer registration and expelled him from membership in the NASD on the basis of his wilful violations of Section 17 (a) of the Exchange Act and Rule 17a-5 thereunder. The Commission found that for several years Boruski had submitted reports of financial condition which were not certified, as required by the rule, despite the fact that no exemption from certification was available. Following each submission he was advised by the Commission's staff that the uncertified reports did not qualify as a filing under the rule and that in order to avoid a violation it would be necessary for him to file a proper report. Boruski contended that he was unable to find an accountant to certify his reports and that the certification requirement was illegal since he could not compel an accountant to do so.

The Commission rejected this argument, stating that the certification requirement contemplates a thorough review of a broker-dealer's accounts and financial affairs for the purpose of safeguarding funds and securities of customers and to give the public the protection which an audit is designed to achieve, including the detached objectivity of a disinterested person. The Commission stated that a broker-dealer who submits a financial report which is not certified, whether because he chose not to have it certified or because he submitted it to an accountant for certification in a form or under circumstances which caused the accountant to refuse to certify it, is not complying with its reporting requirements.

The Commission at the same time denied Boruski's application for registration as an investment adviser, on the basis of its findings in the Boruski and Financial Counsellors broker-dealer proceedings.

Indicative of the fact that "boiler-rooms" present a continuing problem are the decisions during the fiscal year in Albion Securities Company, Inc., Wright, Myers & Bessell, Inc., William Glanzman & Co., Inc., and Fabrikant Securities Corporation. The Commission, finding wilful violations of the anti-fraud provisions of the Federal securities acts by principals and salesmen of each of these firms, revoked their broker-dealer registrations and in the Fabrikant Securities case barred 12 individuals, most of them salesmen, from being associated with any broker or dealer.

In all these proceedings the Commission found that the respondents had engaged in the sale of securities by the use of high pressure telephone selling techniques, including the

use of false and misleading statements concerning the securities being sold and their issuers. As is typical of "boiler-room" activities, the securities involved were unseasoned and speculative and were generally sold to persons with whom the respondents were not acquainted and whose financial needs, objectives and circumstances were unknown to them.

Suspension of Registration Pending Final Determination

Section 15 (b) of the Securities Exchange Act authorizes the Commission to suspend a broker-dealer's registration pending final determination as to whether registration should be revoked. In order to suspend registration, the Commission must find, after notice and opportunity for hearing, that suspension is necessary or appropriate in the public interest or for the protection of investors. The registrations of two broker-dealers were suspended during the past fiscal year on the basis of such findings. The entry of a suspension order is of course not determinative of the ultimate issue whether registration should be revoked.

Net Capital Rule

As previously noted, Rule 15c3-1 under the Exchange Act, commonly known as the net capital rule, was amended during the fiscal year to impose minimum net capital requirements on brokers and dealers (effective December 1, 1965) and in certain other respects. The amendments do not affect the previously existing requirement which limits the amount of indebtedness which may be incurred by a broker-dealer in relation to its capital, by providing that the "aggregate indebtedness" of a broker-dealer may not exceed 20 times the amount of its "net capital" as computed under the rule. During the past fiscal year, violations of the net capital rule were charged in 11 injunctive actions and in 16 administrative proceedings instituted against broker-dealers.

Registered broker-dealers who participate in "firm commitment" underwritings must have sufficient capital to permit the participation provided by the underwriting contract without impairing the capital-debt ratio or minimum net capital prescribed by the rule. If a broker-dealer is unable to meet such requirements, he must decrease his "firm commitment" until compliance with the rule is reached. If necessary he may have to withdraw from the underwriting or participate on a "best efforts" basis only.

Financial Statements

Rule 17a-5 under Section 17 (a) of the Exchange Act requires registered broker-dealers to file annual reports of financial condition with the Commission. Such reports must be certified by a certified public accountant or public accountant who is in fact independent, with certain limited exemptions applicable to situations where certification does not appear necessary for customer protection. A broker-dealer's first report must reflect his financial condition as of a date between the end of the 1st and 5th months after the

effective date of registration. All reports must be filed within 45 days after the date as of which the report speaks.

Through these reports the Commission and the public may evaluate the financial position and responsibility of broker-dealers. The financial report is one means by which the staff of the Commission determines whether the registrant is in compliance with the net capital rule. Failure to file the required reports may result in the institution of revocation proceedings.

During the fiscal year 4,317 reports of financial condition were filed with the Commission, compared to the 1964 total of 4,503.

Broker-Dealer Inspections

Section 17 (a) of the Exchange Act provides for regular and periodic inspections of registered broker-dealers. During the fiscal year a total of 1,392 such inspections was conducted. Inspections provide one of the most useful means available to the Commission for the protection of investors. Among other things, the inspection determines a broker-dealer's financial condition, reviews his pricing practices, evaluates the safeguards employed in handling customers' funds and securities, and determines whether adequate and accurate disclosures are made to customers.

The Commission's inspectors also determine whether brokers and dealers are keeping books and records as required by the Exchange Act and the Commission's rules thereunder and are conforming to the margin and other requirements of Regulation T of the Board of Governors of the Federal Reserve System. Inspectors also look for excessive trading or switching in customers' accounts. They frequently find evidence of the sale of unregistered securities or of fraudulent practices such as use of improper sales literature or sales techniques.

When an inspection reveals that a broker-dealer is in violation of applicable statutory provisions or rules, the action taken depends on the type of violation and its effect on the public. The Commission does not take formal action as a result of every infraction discovered. However, if the violation appears to be wilful and the public interest is best served by formal action against the broker-dealer, the Commission promptly institutes appropriate proceedings.

The table below shows the types of infractions uncovered by the inspection program during the fiscal year:

[table omitted]

The National Association of Securities Dealers, Inc. and the principal stock exchanges also conduct inspections of their members, and some states have inspection programs.

Each inspecting agency conducts inspections in accordance with its own procedures and with particular reference to its own regulations and jurisdiction. Inspections by the Commission are primarily concerned with the detection of violations of the Federal securities laws and the Commission's rules and regulations. The inspection programs of the self-regulatory agencies and of the states afford added protection to the public. The Commission and certain other inspecting agencies coordinate their inspections to avoid duplication and to obtain the widest possible coverage of brokers and dealers. Agencies now participating in this coordination program include the New York Stock Exchange, the American Stock Exchange, the Boston Stock Exchange, the Midwest Stock Exchange, the Pacific Coast Stock Exchange, the Philadelphia-Baltimore-Washington Stock Exchange, the Pittsburgh Stock Exchange, and the National Association of Securities Dealers, Inc. It is hoped that even closer coordination may become possible in the future as recommended by the Special Study of Securities Markets. This coordination, however, does not preclude the Commission from inspecting any broker-dealer that has also been inspected by another agency, and such inspections are made whenever reason therefor exists.

SUPERVISION OF ACTIVITIES OF NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Section 15A of the Exchange Act provides for the registration with the Commission of national securities associations and establishes standards and requirements for such associations. The Act contemplates that such associations will serve as a medium for self-regulation by over-the-counter brokers and dealers. Their rules must be designed to protect investors and the public interest, to promote just and equitable principles of trade, and to meet other statutory requirements. They are to operate under the general supervision of the Commission, which is authorized to review disciplinary actions taken by them and to consider all changes in their rules. The National Association of Securities Dealers, Inc. (NASD) is the only association registered under the Act.

The Securities Acts Amendments of 1964 significantly changed several statutory provisions regarding registered securities associations. Such associations are now required to adopt appropriate standards regarding the training, experience and other qualifications of members and persons associated with members and to have rules designed to produce fair and informative quotations of over-the-counter securities. In addition, they may now bring disciplinary action directly against individuals associated with members. The revision by the NASD of its retail quotations system during the fiscal year is discussed in Part I of this Report.

In adopting legislation permitting the formation and registration of national securities associations, Congress provided an incentive to membership by permitting such associations to adopt rules which preclude a member from dealing with a non-member except on the same terms and conditions as the member affords the investing public. The

NASD has adopted such rules. Accordingly, membership is necessary to the profitable participation in underwritings since members may properly grant price concessions, discounts and similar allowances only to other members. Loss or denial of membership due to expulsion or suspension or other ineligibility due to a statutory disqualification, or the failure to meet standards of qualification established in NASD rules, may thus impose a severe economic sanction.

At the close of the fiscal year the NASD had 3,865 members, reflecting a net decrease of 292 members during the year. This decrease was the net result of 193 admissions to and 486 terminations of membership. During the year the registered representative population, which generally includes all partners, officers, traders, salesmen and other persons employed by or affiliated with member firms in capacities which involve their doing business directly with the public, declined by 992 to stand at 76,843 as of June 30, 1965. This decline was the net result of 9,836 initial registrations, 10,288 re-registrations and 21,116 terminations of registrations during the year.

NASD Disciplinary Actions

The Commission receives from the NASD copies of its decisions in all disciplinary actions against members and registered representatives. In general, such actions are based on allegations that the respondents violated specified provisions of the NASD's Rules of Fair Practice. Where violations are found the NASD may impose one or more sanctions upon a member, including expulsion, suspension, fine or censure. If an individual is involved his registration as a representative may be suspended or revoked, he may be suspended or barred from being associated with all members, and he may be fined or censured. Under Section 15 A (b) (4) of the Exchange Act and the NASD's by-laws, no broker-dealer may be admitted to or continued in NASD membership without Commission approval if he has been suspended or expelled from membership in the NASD or a national securities exchange; is barred or suspended from association with a broker or dealer or with all members of the NASD or an exchange; his registration as a broker-dealer has been denied, suspended or revoked; he has been found to be a cause of certain sanctions imposed by the Commission, the NASD or an exchange; or he has associated with him any person subject to one of the above disqualifications.

During the past fiscal year the Association reported to the Commission its final disposition of disciplinary complaint actions against 294 member firms and 266 individuals associated with them. [Footnote: Some members were involved in more than one action and some decisions covered more than a single complaint. Thus, two members were each expelled in two disciplinary actions reported in separate decisions. On the other hand, three decisions each related to four complaints which had been consolidated for purposes of hearing and decision.] With respect to 80 members, complaints were dismissed as a result of findings that the allegations of violations had not been sustained. [Footnote: The majority of the cases where allegations against members were dismissed involved misuse of customers' and/or firm securities or funds by a representative under

such circumstances that the member could not have known of or prevented such impropriety. Association procedures did not, in this period, permit disciplinary action solely against a registered representative 'but required the naming of the member as a respondent even though it was clear that the member was blameless. The Securities Acts Amendments of 1964 in effect authorized registered securities associations to take disciplinary action directly against individuals associated with members. The NASD has amended its rules to provide for such action.] In the remaining cases, violations were found and penalties were imposed on 214 members and 186 registered representatives or other individuals. The maximum penalty of expulsion from membership was imposed against 43 members, and 20 members were suspended from membership for periods ranging from 1 day to 2 years. In many of these cases, substantial fines were also imposed. In another 124 cases, members were fined amounts ranging from \$50 to \$20,000. In 27 other cases, the only sanction imposed was censure, although censure was usually a secondary penalty where a more severe penalty was also imposed.

Various penalties were also imposed on registered representatives found in violation of NASD rule's. The registrations of 86 representatives were revoked and 45 had their registrations suspended for periods ranging from 2 weeks to 3 years. [Footnote: As has been noted, a person found a cause of the expulsion or suspension of a member is disqualified from association with a member. The cause finding is therefore often used where an individual found to have violated Association rules should have been but was not registered as a registered representative. The numbers used in the text include unregistered individuals found to have been a cause of the expulsion or suspension of a member with registered representatives whose registrations were revoked or suspended, since this is the practical consequence of a cause finding.] Fines in various amounts were also imposed against many revoked or suspended representatives. In addition, 40 other representatives were fined amounts ranging from \$50 to \$3,000. Allegations of violations against 80 representatives were dismissed on findings that no violations had been established.

Commission Review of NASD Disciplinary Action

Section 15A (g) of the Act, as amended, provides that disciplinary actions by the NASD are subject to review by the Commission on its own motion or on the timely application of any aggrieved person. This Section also provides that upon application for review or institution of review by the Commission the effectiveness of any penalty imposed by the NASD is automatically stayed pending Commission review, unless the Commission otherwise orders after notice and opportunity for hearing. Section 15A (h) of the Act defines the scope of the Commission's review. If the Commission finds that the disciplined party engaged in or omitted such acts or practices as were found by the NASD, that such acts, practices, or omissions to act are in violation of such rules of the Association as have been designated in the determination, and that such conduct was inconsistent with just and equitable principles of trade, the Commission must dismiss the review proceedings unless it finds that the penalties imposed are excessive or oppressive,

having due regard to the public interest, in which case it must cancel or reduce such penalties.

At the start of the fiscal year, 19 NASD disciplinary decisions were pending before the Commission on review. During the year 18 additional cases were brought up for review as a result of timely petitions by aggrieved parties. Two review petitions were withdrawn prior to determination and 16 cases were disposed of by the Commission. In 7 of these cases, the Commission sustained the disciplinary action taken by the NASD, in 4 it set aside the Association action, and in the remaining 5 cases the Commission reduced the penalties imposed by the Association. Nineteen cases were pending as of the end of the year.

In a significant decision reversing an NASD decision adverse to Southern Brokerage Co., Inc., the Commission found that the failure of the firm to consummate a stock-purchase contract resulted from the firm's good faith belief that the transaction was part of a manipulative and fraudulent scheme. The Commission concluded that under these circumstances the firm's action did not violate an NASD rule requiring the observance of "high standards of commercial honor and just and equitable principles of trade," and it set aside the penalties imposed by the NASD of censure, a \$1,000 fine and a 30-day suspension of the firm from NASD membership.

Southern Brokerage had failed to accept delivery of and pay for 400 shares of Jerome, Richard & Co., Inc., a New York broker-dealer firm, in July 1963. According to the Commission's decision, the firm refused to consummate the transaction after it learned that Commission employees were investigating transactions in Jerome stock, that one of the firms to which it was supposed to deliver Jerome stock had refused to pay a draft and another had turned out to be non-existent, and that the only persons with whom it had had any personal dealings in Jerome stock had suddenly left their employment and were unavailable. For these and other reasons, the Commission concluded that the firm "honestly and with reasonable basis" believed that its transaction with the complainant was part of a fraudulent scheme, and that its refusal to carry out the transaction "did not constitute unethical or dishonorable conduct" in violation of the NASD rule.

In another opinion issued on the same day, the Commission sustained NASD disciplinary action against Nassau Securities Service for its failure to pay the \$325 balance arising out of a "buy-in." Such failure had been found by the NASD to violate its rules and it had censured the firm and fined it \$1,000.

According to the Commission's decision, the Nassau firm made a short sale of 100 shares of stock of Cryplex Industries, Inc., at \$6.75 per share for delivery October 31st (later extended). The purchaser (complainant), in a separate transaction, sold 100 shares of Cryplex stock to a third firm, which later executed a buy-in against the complainant by purchasing Cryplex shares at \$10 per share. The complainant then notified Nassau that the buy-in was being treated as a close-out of Nassau's transaction with the complainant.

In the meantime, Nassau had purchased 100 Cryplex shares at \$8.25 per share, but by reason of late delivery the tender of these shares to complainant was not made until a day after the November 13th deadline fixed by complainant, and was refused as too late. Complainant paid the balance owed by it to the third firm, but Nassau did not pay complainant the \$325 difference between its contract price and the buy-in price.

Nassau defended its action by claiming that the market for Cryplex stock was being manipulated and that the buy-in procedure was being used as a part of the manipulation scheme. However, according to the Commission's decision, Nassau participated (with some 16 other firms) in the making of a market in Cryplex when it was aware of most of the factors which it was claiming suggested a manipulation. Furthermore, when bought-in by complainant, Nassau did not communicate its asserted suspicions of fraud to complainant but, instead, sought a further extension for delivery of the Cryplex shares. Although Nassau offered to put the \$325 in escrow pending an investigation of the Cryplex market, it only made this offer to the NASD, not to complainant. The Commission concluded that applicant was not justified in resorting to non-payment of an obligation owed a fellow NASD member as a lever to secure an investigation, that in view of all the circumstances Nassau "had no equitable justification for its refusal to honor its obligation to complainant," and that its conduct therefore violated NASD rules.

The Commission also sustained action by the NASD revoking the registration of Hugh M. Casper, president and a registered representative of an NASD member.

The sole issue was whether the penalty, which was imposed as a result of Casper's admittedly taking, on behalf of a trainee of the member, an NASD qualification examination for registered representatives, was excessive. Casper urged in mitigation that he was a close friend of and had a deep personal interest in the trainee, that his decision to take the examination for the trainee, at the latter's request, was made on the spur of the moment, and that it involved no personal profit or gain and was motivated by kindness and charity for the trainee who was beset by financial, health and other problems.

The Commission, in its decision, concluded that the record failed to provide an adequate basis for leniency. After stressing the importance of examinations in upgrading the level of competence in the securities business, the Commission's decision stated, "we regard a deception in connection with the taking of those examinations, particularly as was practiced in this case, to be so grave that we would not find the extreme sanction of revocation or expulsion to be excessive or oppressive unless the most extraordinary mitigative facts were shown." The Commission regarded Casper's conduct as "particularly reprehensible" because he agreed to take the examination for the trainee even though, as president of the member, he had previously certified as to the trainee's good character and competence in the application for registration of the trainee submitted to the NASD by the member.

Commission Review of NASD Action on Membership

As previously noted, Section 15A (b) (4) of the Act and the by-laws of the NASD provide that, except where the Commission finds it appropriate in the public interest to approve or direct to the contrary, no broker or dealer may be admitted to or continued in membership if he, or any person associated with him, is under any of the several disabilities specified in the statute or the by-laws. A Commission order approving or directing admission to or continuance in Association membership, notwithstanding a disqualification under Section 15A (b) (4) of the Act, or under an effective Association rule adopted under that Section or Section 15A (b) (3), is generally entered only after the matter has been, submitted initially to the Association by the member or applicant for membership. The Association in its discretion may then file an application with the Commission on behalf of the petitioner. If the Association refuses to sponsor such an application the broker or dealer may apply directly to the Commission for an order directing the Association to admit or continue him in membership. At the beginning of the fiscal year, two applications for approval of admission to or continuance in membership were pending. During the year four additional applications were filed, four were approved, and one was denied, leaving one application pending at the year's end.

Commission Inspections of the NASD

Under the regulatory scheme of the Exchange Act the Commission is also charged with general oversight of national securities associations in the performance of their self-regulatory activities. In carrying out this responsibility the Commission staff conducts periodic inspections of various phases of NASD activity. These inspections assist the Commission in insuring that the NASD is complying with its self-regulatory responsibilities and enable the Commission to recommend improvements designed to increase the effectiveness of such self-regulation.

During the past fiscal year, inspections were made of the operations of the Association's district offices in San Francisco, Los Angeles and Atlanta, and of the programs of the NASD's national office for supervising the enforcement activities of all of the district offices and for the review of members' advertising and securities sales literature pursuant to the recently adopted NASD statement of policy with respect to such literature. Where it appeared to the staff of the Commission that modifications of NASD procedures or policies were desirable in order to improve the Association's performance, the staff's views were communicated to the Association and conferences were held to arrive at appropriate solutions. During the year the NASD took steps to upgrade its regulatory performance in several areas as a result of the inspection program and these discussions.

REVISION OF RULES, REGULATIONS AND FORMS

Part I of this Report discusses a number of new rules and forms, and amendments to existing rules and forms, which were adopted or proposed during the fiscal year in

connection with the implementation of the Securities Acts Amendments of 1964 and the Report of the Special Study of Securities Markets. Additional revisions are summarized below.

Adoption of Rule 0-8

Section 15 (b) (4) of the Exchange Act, as amended in 1964, provides that any section of that Act (other than Section 5 and subsection (a) of Section 15) which prohibits any act, practice, or course of business if the mails or any means or instrumentality of interstate commerce are used in connection therewith, shall also prohibit any such act, practice, or course of business by any broker-dealer registered under Section 15 (b) or by any persons acting on behalf of such broker or dealer irrespective of any use of the mails or interstate facilities. In order to conform those rules and regulations under the Act which refer to the use of the mails or interstate facilities, the Commission during the fiscal year adopted Rule 0-8 which is in the terms of the statutory provision.

Amendments of Rules 10b-6 and 16b-3

During the fiscal year the Commission extended the exemptive provisions of Rule 16b-3 and paragraph (e) of Rule 10b-6 to options which meet the conditions set forth in Section 424 (b) of the Internal Revenue Code for "restricted stock options" except for the fact that they were granted after January 1, 1964.

Rule 10b-6 makes it unlawful for participants in a distribution of securities, including the issuer of the securities, to purchase any such security, or any security of the same class or series, until completion of their participation in the distribution, subject to specified exceptions. Paragraph (e) of Rule 10b-6 provides that the prohibitions of the rule do not apply, inter alia, to any distribution of securities by an issuer to its employees, or to employees of its subsidiaries, or to a trustee or other person acquiring securities for the account of such employees, pursuant to a stock option plan involving only "qualified stock options" or "restricted stock options" or qualifying as an "employee stock purchase plan." Previously these terms were defined only by reference to Sections 422 through 424 of the Internal Revenue Code of 1954, as amended.

Rule 16b-3 provides an exemption from Section 16 (b) for shares of stock (other than stock acquired upon the exercise of an option, warrant, or right) acquired by an officer or director pursuant to a stock bonus, profit sharing, retirement, incentive, thrift, savings or similar plan meeting specified conditions. The rule also exempts the acquisition of a "qualified" or a "restricted" stock option pursuant to a qualified or a restricted stock option plan, or a stock option pursuant to an "employee stock purchase plan." As with Rule 10b-6 (e), the terms "qualified stock option," "restricted stock option" and "employee stock purchase plan" previously were defined only by reference to Sections 422 through 424 of the Internal Revenue Code, as amended.

On August 27, 1964, the Commission adopted certain amendments to Rules 10b-6 and 16b-3 and Form 10 under the Exchange Act and Forms S-1, S-8, and S-11 under the Securities Act with respect to stock options which are eligible for special tax benefits.³³ These amendments were designed to make the Commission's forms and rules consistent with the Internal Revenue Code, as amended by the Revenue Act of 1964, i.e., to provide all tax-favored options the same exemptive or favorable treatment as had been extended to the previous tax-favored options. Thereafter, it was brought to the attention of the Commission that certain companies desired to continue to grant options which met the former requirements for "restricted stock options" but which were not eligible for special tax benefits as a result of the amendments to the Internal Revenue Code. The effect of the further amendments of Rules 10b-6 and 16b-3 is to make the exemptive provisions of those rules applicable to such options if they meet the requirements of Section 424 (b) for "restricted stock options" except for the fact that they were granted after January 1, 1964. At the same time, the Commission amended Form S-8 to authorize its use for the registration of stock to be offered pursuant to such options.

An additional amendment to Rule 16b-3 adopted during the fiscal year extended the exemption to certain plans which could not previously meet the conditions of the rule.³⁵ One of the conditions of the exemption is that the plan must have been approved by the holders of a majority of the securities of the issuer present, or represented, and entitled to vote at a meeting of shareholders, or by the written consent of the holders of a majority of the securities of the issuer entitled to vote.

Prior to the amendment, the rule required that the security holders' vote or written consent must have been solicited substantially in accordance with the rules and regulations in effect under Section 14 (a) of the Act at the time of such vote, whether or not such rules and regulations were applicable to the solicitation. In order to extend the benefits of the exemption to plans approved, prior to registration of securities under Section 12 of the Act, by the vote or written consent of shareholders not solicited substantially in accordance with the rules and regulations under Section 14 (a) because such rules were not then applicable, the rule as amended requires only, subject to certain conditions, that such vote or written consent have been obtained in accordance with the applicable laws of the state or other jurisdiction in which the issuer was incorporated.

Rescission of Rule 12f-5

The 1964 amendments deleted from Section 12 (f) of the Exchange Act the provision requiring "any national securities exchange" or "any person directly or indirectly controlled by such exchange" to differentiate, in the publication of quotations or transactions, between listed securities and securities to which unlisted trading privileges have been extended. Rule 12f-5 which provided for the manner in which quotations or transactions should be differentiated was therefore rescinded.

Amendments to Rules 13a-1S and 15d-15

During the fiscal year, the Commission on two occasions adopted amendments to Rules 13a-15 and 15d-15 which require the filing of quarterly reports by certain real estate companies. Rule 13a-15 relates to real estate companies having securities registered on a national securities exchange pursuant to Section 12 (b) of the Act and to over-the-counter real estate companies having securities registered with the Commission pursuant to the new Section 12 (g) of the Act. Rule 15d-15 relates to real estate companies which have registered securities under the Securities Act of 1933 and are required to file reports with the Commission pursuant to Section 15 (d) of the Securities Exchange Act. The first amendments adapted the rules to the Securities Acts Amendments of 1964. The subsequent amendments made some language corrections in the rules.

Amendments and Proposed Amendments to the Proxy Rules

As previously noted, the Commission amended the proxy rules during the fiscal year to make them applicable to solicitations, commenced on or after July 1, 1965, with respect to securities registered pursuant to the new Section 12 (g). In addition, the proxy rules, which were adopted pursuant to Section 14 (a) of the Act and were previously designated "Regulation 14," were redesignated "Regulation 14A" in order to differentiate them from other rules which the Commission may adopt pursuant to Sections 14 (b) and (c) of the Act. The Commission also amended Rule 14a-6 of Regulation 14A, which requires the filing of proxy material with the Commission and with any exchange on which the issuer has securities listed and registered. The amendment increased from four to eight the number of definitive copies of the proxy statement, form of proxy and other soliciting material required to be filed with the Commission. Four copies will be kept in the Commission's principal office for the use of the staff and for public inspection. The additional copies will be placed in the principal regional offices of the Commission and in the regional office for the region in which the registrant has its principal office. This is intended to make the information contained in such material more readily available to interested persons, in line with the recommendations of the Special Study of Securities Markets.

Prior to the adoption of the foregoing amendments, the Commission invited public comments on a number of proposed amendments to the proxy rules which would clarify the existing rules and embody in the rules certain long-standing practices of the Commission. A limited number of substantive changes in the rules were also proposed. For example, a proposed amendment to Rule 14a-4 would require that, in certain instances, the form of proxy contain a provision whereby a security holder may grant or withhold authority to vote for elections to offices where other specified matters are being voted upon. In addition, the scope of Item 7 (f) of Schedule 14A, calling for a description of any material interest of certain persons in transactions with the issuer, would be clarified and extended. A detailed description of all of the proposed amendments is contained in Securities Exchange Act Release No. 7481 (December 7, 1964).

Consideration of the amendments has not been completed and the matter was pending at the close of the fiscal year.

As has been noted, the 1964 amendments to Section 15 (b) of the Exchange Act expanded the grounds on which the Commission is empowered to deny broker-dealer registration or to impose a sanction on a registered broker-dealer. Although consideration is being given to substantive amendments to Form BD (the form used for applications for registration as a broker-dealer and for amendments to such applications) and applicable rules, it was deemed necessary in the meantime to amend Form BD to include reference to the new disqualifications. At the same time the Commission also amended Rule 15b-2 which requires the filing of amendments to applications for broker-dealer registration when pertinent facts have changed, to delete certain archaic provisions and to provide that every amendment filed pursuant to the rule shall constitute a "report" within the meaning of all applicable provisions of the Act, as amended.

Amendments of Rule 15b-9 under the Exchange Act and Rule 9 (b) under the Commission's Rules of Practice

The procedures relating to the participation of associated persons in broker-dealer proceedings are prescribed by Rule 15b-9 under the Exchange Act and Rule 9 (b) of the Commission's Rules of Practice. In order to implement the amendments to the Exchange Act which permit direct action against such persons, the Commission amended these rules during the fiscal year to provide that unless the Commission otherwise directs, such rules shall apply only to proceedings instituted prior to August 20, 1964, the date of the enactment of the Securities Acts Amendments of 1964.

Rescission of Rule 15c2-2

Section 15 (c) (5) which was added to the Exchange Act by the Securities Acts Amendments of 1964, authorizes the Commission summarily to suspend over-the-counter trading in any non-exempt security for a period not exceeding 10 days. It also prohibits any broker or dealer from effecting any transaction in, or inducing the purchase or sale of, any security in which trading is suspended. This Section eliminated the need for Rule 15c2-2 which prohibited a broker or dealer from effecting transactions in, or inducing the purchase or sale of, a security in which trading was suspended pursuant to Section 19 (a) (4) and that rule was therefore rescinded.

Amendment of Rule 15c3-1

The amendments of Rule 15c3-1, the net capital rule, have already been discussed in some detail. Among the amendments, in addition to one providing for minimum net capital requirements, was one requiring broker-dealers not subject to exchange rules to make appropriate adjustments in computing net capital if they carry futures commodities contracts for customers. The New York Stock Exchange and other national securities

exchanges whose members handle the great majority of commodities futures transactions have imposed additional capital requirements on those members who conduct such a business. These changes resulted from a recognition that there are situations in which, either because of the nature of trading in commodities futures or the limited amount of margin required to be obtained from customers under the rules of various commodity exchanges, brokers who effect futures commodities transactions for customers may incur liabilities which create additional risks for the funds and securities of securities customers. Additional amendments relate to the circumstances under which subordinated loans may be excluded from "aggregate indebtedness" and to the exemptions from the requirements of the rule.

Amendments of Rules 15ab-1 and 15ag-1

In implementation of the 1964 amendments to Section 15A expanding the conditions under which a person may be ineligible for membership in a national securities association or for association with a member thereof, and reducing from 60 days to 30 days the time within which an application for review of association disciplinary action must be filed, the Commission amended Rule 15ab-1 (procedures for applying for relief from statutory disqualification) and Rule 15ag-1 (procedures for applying for review of disciplinary action or denial of membership by a registered securities association) to conform their provisions to the amended statutory provisions.

Amendment of Rule 16a-2

During the fiscal year the Commission invited public comments on a proposed amendment of Rule 16a-2 relating to the method of computing percentage ownership under Section 16 (a) of the Act, and, shortly after the close of the fiscal year, the rule was amended.

As amended, Rule 16a-2 provides in general that for the purposes of computation under Section 16 (a) of the Act the amount of a class of equity securities shall be deemed to consist of the total amount of securities outstanding of the class, exclusive of any securities of the class held by or for the account of the issuer. Previously, the rule provided that such computations should be based on the amount of the class issued, whether or not any portion of the class was held by or for the account of the issuer.

The amended rule provides that a person acting in good faith may rely on information with respect to the amount of securities outstanding of a class contained in the issuer's latest consolidated financial statement in a registration statement or annual report (e.g., Form 10-K or 12-K) filed with the Commission, under the Exchange Act.

Adoption of Rule 16b-10

The Commission adopted a new Rule 16b-10 which exempts from the operation of Section 16 (b) of the Exchange Act (providing for the recovery of "short swing" profits realized by insiders) certain acquisitions of securities from the issuer made in exchange for other securities by a railroad or other person subject to Part I of the Interstate Commerce Act.

Proposed Amendments of Rules 17a-3 and 17a-4

During the fiscal year the Commission announced that it had under consideration a proposal to amend Rules 17a-3 and 17a-4. The proposed amendments would require certain members of national securities exchanges and other broker-dealers to prepare a record of computation of the ratio of aggregate indebtedness to net capital as of the date of the trial balance they are now required to make at least once a month and to preserve such computation for not less than 3 years. One purpose of the proposed requirement is to assist members, brokers and dealers to keep currently informed of their capital positions under Rule 15c3-1.

The proposed amendments were still under consideration at the close of the fiscal year.

Proposed Amendments to Form 8-K

Form 8-K is prescribed for current reports filed pursuant to Sections 13 and 15 (d) of the Securities Exchange Act. During the fiscal year, the Commission announced that it has under consideration certain proposed amendments to Form 8-K and invited public comments. Proposed amendments to Form 8-K have been published on two previous occasions. The comments and suggestions received in response to those proposals were carefully considered in the preparation of the current proposals.

Prompt public disclosure of significant developments in the business and financial affairs of a company is of the utmost importance to insure fair dealing in the company's securities. This fact has received increasing recognition. To a growing extent the national securities exchanges have supplemented the basic disclosure requirements of the Commission (as set forth in Form 8-K) with provisions in their listing agreement forms, and with other policies under which listed companies must make immediate public disclosure of a variety of material developments which might significantly affect the market for their securities and the interests of investors.

The proposed amendments are largely of a clarifying nature. In some instances they operate to make explicit certain long-standing administrative interpretations. In addition, certain new requirements have been added to elicit information which experience has shown to be of significance to investors. The principal changes proposed involve the reporting of timely information in connection with the pledging of securities which may result in a change in control if there is a default under the pledge agreement, the acquisition or disposition of a significant amount of assets otherwise than in the ordinary

course of business, the interest of management and others in certain transactions and the issuance of debt securities by subsidiaries.

These amendments were still under consideration at the close of the fiscal year.

Amendments to Forms 10 and 10-K

Form 10 is a general form for registration of securities on a national securities exchange or pursuant to Section 12 (g) of the Securities Exchange Act. Form 10-K is a general form for annual reports of issuers having securities registered on a national securities exchange, issuers required to file reports pursuant to Section 15 (d) of the Act, and issuers of securities registered under Section 12 (g) of the Act. As previously noted, Forms 10 and 10-K were amended during the fiscal year for the principal purpose of making them available for registration of securities pursuant to Section 12 (g) and for annual reports of issuers of such securities.

Adoption of Forms 12 and 12-K

During the fiscal year, the Commission adopted new special forms under the Securities Exchange Act for registration of securities, and for annual reports, of certain issuers which file reports with the Federal Power Commission, the Interstate Commerce Commission or the Federal Communications Commission.

Form 12 may be used by such issuers for the registration of securities on a national securities exchange pursuant to Section 12 (b) or for the registration of equity securities pursuant to Section 12 (g). Registration statements on the new form consist largely of copies of the annual reports of such issuers to the other Federal agencies together with certain other exhibits, including copies of material contracts. Use of the form is optional and any issuer may use Form 10 if it desires to do so.

Form 12-K may be used for annual reports of such issuers pursuant to Section 13 or 15 (d) of the Act. Annual reports on the new form consist largely of copies of the annual reports of such issuers to the other Federal agencies together with certain other exhibits. Use of the form is optional and any issuer may use Form 10-K if it so desires.

Proposed Amendments to Forms 16 and 16-K

During the fiscal year, the Commission announced that it has under consideration proposed revisions of Forms 16 and 16-K under the Securities Exchange Act and invited public comments.

Form 16 is prescribed for the registration of voting trust certificates on a national securities exchange. The revised form would be prescribed for that purpose and also for registration of voting trust certificates pursuant to Section 12 (g) of the Act.

Form 16-K is now prescribed for annual reports relating to voting trust certificates which are registered on a national securities exchange. The revised form would also be used for annual reports relating to voting trust certificates registered pursuant to Section 12 (g) of the Act and for annual reports filed pursuant to Section 15 (d) of the Act relating to voting trust certificates registered under the Securities Act of 1933. Reports pursuant to Section 15 (d) are now filed on Form 3-MD, which would be rescinded.

The format of the revised forms would, in general, follow that of the Commission's more recently adopted forms. The separate instruction books would be abolished and the necessary instructions contained therein would be incorporated in the forms proper in accordance with current practice. Some of the general instructions, including certain definitions which are now contained in the General Rules and Regulations, would be dropped from the forms to avoid duplication. Appropriate references to the General Rules and Regulations would be contained in the revised forms.

Certain additional items would be added to Form 16-K to require disclosure with respect to matters such as the amounts of securities deposited and withdrawn during the year and the exercise of voting and other powers by the voting trustees.

PART V ADMINISTRATION OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

In administering the Public Utility Holding Company Act of 1935 the Commission regulates interstate public-utility holding-company systems engaged in the electric utility business and/or in the retail distribution of gas. The Commission's jurisdiction also extends to natural gas pipeline companies and other non-utility companies which are subsidiaries of registered holding companies. Although the matters under the Act dealt with by the Commission and its staff embrace a variety of intricate and complex questions of law and fact generally involving more than one area of regulation, briefly there are three principal regulatory areas. The first covers those provisions of the Act, contained principally in Section 11 (b) (1), which require the physical integration of public-utility companies and functionally related properties of holding-company systems and those provisions, contained principally in Section 11 (b) (2), which require the simplification of intercorporate relationships and financial structures of holding company systems. The second covers the financing operations of registered holding companies and their subsidiaries, the acquisition and disposition of securities and properties, and certain accounting practices, servicing arrangements and intercompany transactions. The third includes the exemptive provisions of the Act, the provisions covering the status under the Act of persons and companies, and those regulating the right of a person affiliated with a public-utility company to acquire securities resulting in a second such affiliation. Matters

embraced within this last area of regulation come before the Commission and its staff frequently. Many such matters do not result in formal proceedings and others are reflected in such proceedings only in an indirect manner when they are related to issues principally under one of the other areas of regulation.

The Branch of Public Utility Regulation of the Commission's Division of Corporate Regulation performs the principal functions under the Act. It observes and examines problems which arise in connection with transactions which are or may be subject to regulation under the Act and discusses such problems with interested persons and companies and advises them as to the applicable sections of the Act, the rules thereunder and Commission policy with respect thereto. Questions are raised with and problems presented to the staff daily. These include questions raised by security holders and problems presented by companies contemplating transactions which require the filing of an application or declaration, particularly financing operations and the acquisition and disposition of securities and properties. This day-to-day activity includes pre-filing discussions and conferences, in person and by telephone, with company representatives and with other persons where the matter under consideration affects their interests. In those instances where formal proceedings are held, members of the staff actively participate in hearings and often aid the Commission in the preparation of its decision on a particular matter. The staff continually re-examines the status of exempt companies, examines the annual reports filed with the Commission and those sent to stockholders and must keep abreast of new technical developments in the electric and gas industry, including the use of atomic energy as a source of power.

COMPOSITION OF REGISTERED HOLDING-COMPANY SYSTEMS

At the close of the fiscal year there were 23 holding companies registered under the Act. Of these, 18 are included in the 16 remaining holding-company systems which are herein classified as "active registered holding-company systems," 2 of the 18 being subholding companies in these active systems. [Footnote: The two subholding companies are The Potomac Edison Co., a subsidiary of Allegheny Power System, Inc., and Southwestern Electric Power Co., a subsidiary of Central and South West Corp.] The remaining 5 registered holding companies are of relatively small size and are excluded from the active holding-company systems. [Footnote: These holding companies are American Gas Co.; British American Utilities Corp.; Kinzua Oil & Gas Corp., and its subholding company, Northwestern Pennsylvania Gas Corp.; and Standard Gas & Electric Co., which is in process of dissolution.] In the 16 active systems there are 86 electric and/or gas utility subsidiaries, 42 non-utility subsidiaries, 9 inactive companies, or a total, including the 18 parent holding companies, of 155 system companies. The following table shows the number of holding companies and the number of subsidiaries (classified as utility, nonutility, and inactive) in each of the active systems as of June 30, 1965, and the aggregate assets of these systems, less valuation reserves, as of December 31, 1964:

[table omitted]

SECTION 11 MATTERS IN REGISTERED HOLDING-COMPANY SYSTEMS

On March 19, 1964, the Commission issued its Findings, Opinion and Order directing New England Electric System to divest itself of its gas properties. The Commission found that these properties were not retainable as an additional integrated public-utility system under clause (A) of Section 11 (b) (1), which requires as a basis of retention a finding that divestment would result in a "loss of substantial economies". The Commission in this case, as in prior cases (some of which had been affirmed on review), had interpreted this provision to mean a loss of such a nature that the additional system, if separated from the principal system, would be incapable of independent economic operation. On review, the Court of Appeals for the First Circuit reversed the Commission's order and remanded the case to the Commission for further proceedings, primarily because, in the Court's view, "substantial economies" means "economies which in ordinary business parlance and by ordinary business standards are of a substantial nature, considering, of course, the size of the companies to which the economies relate."

The Commission's Order approving Step 2 of a plan filed by Eastern Utilities Associates ("ETTA") pursuant to Section 11 (e), providing for the sale of all the outstanding common stock of Valley Gas Co., was enforced by the district court. On November 23, 1964, the Commission issued a supplemental order approving the proposed subscription price for the Valley Gas Co. common stock, and the sale was consummated in December 1964. The consummation of Step 2 completed disposition by the EUA system of its interests in all its gas utility properties pursuant to the provisions of Section 11 (b) (1).

A Section 11 (b) (1) problem still exists as to whether Middle South Utilities, Inc. may, through its subsidiary company, New Orleans Public Service Inc., retain its interest in the gas and transportation properties of that subsidiary company together with the system's electric properties. The latter properties have heretofore been found by the Commission to constitute a single integrated public-utility system. Since 1962 a bill has been introduced in each Congress providing, in effect, that New Orleans Public Service Inc. shall not be required to dispose of its gas and transportation properties pursuant to any provision of the Holding Company Act. The House Committee on Interstate and Foreign Commerce, to which these bills have been referred, took no action on any of the prior bills and, as of the close of the fiscal year, had taken no action on the present bill, and no proceedings have been instituted by the Commission.

In appropriate proceedings under Section 11 (b) (2) of the Act, the Commission has heretofore ordered the elimination of public minority interests in most of the registered holding-company systems, but the problem remains in several others. On November 13, 1964, the Commission approved a plan filed by Allegheny Power System pursuant to Section 11 (e) of the Act, providing for the elimination of a 4.8 percent public minority

interest in the common stock of its subsidiary company, West Penn Power Company, through the exchange of 3.4 shares of Allegheny's \$2.50 par value common stock for each share of publicly-held West Penn common stock. The plan was enforced by order of the District Court.

On December 31, 1964, the Commission approved a plan filed by American Electric Power Company, Inc. pursuant to Section 11 (e), providing for the elimination of outstanding publicly-held scrip for fractional shares of American Electric's common stock. The plan provided for the distribution of approximately 1,590 full shares of American Electric common stock and/or cash in exchange for the scrip. Thereafter, the plan was enforced in the district court.

On February 3, 1965, the Commission entered an order approving a plan filed by Genesee Valley Gas Company, Inc., pursuant to Section 11 (e), providing for the pro rata distribution to Genesee's stockholders of the common stock of Pavilion Natural Gas Company, Genesee's sole direct public-utility subsidiary company. Subsequently, upon application by Genesee, the Commission on June 1, 1965, entered an order, pursuant to Section 5 (d), declaring Genesee to be no longer a holding company.

EXEMPT HOLDING COMPANIES

A "holding company" is defined by Section 2 (a) (7) (A) of the Act to mean any company which owns or controls 10 percent or more of the outstanding voting securities of an electric or gas public-utility company. Section 3 (a) of the Act provides that the Commission shall exempt any holding company (and its subsidiary companies, as such) from the duties and obligations of the Act if the company meets one or more of the exemptive standards set forth in that section, unless the Commission finds that the exemption would be detrimental to the public interest. An exemption may be granted by the Commission by order upon application, or (as to certain types of exemption) may be claimed by the holding company by the filing in "good faith" of a statement pursuant to Rule 2 promulgated by the Commission under Section 3. During the fiscal year, the Commission issued orders granting three applications for exemption under Section 3 (a). At the close of the fiscal year there were on file with the Commission exemption statements under Rule 2 submitted by a total of 58 companies. Each initial Rule 2 statement filed and each annual statement renewing the claimed exemption is carefully reviewed by the Commission's Division of Corporate Regulation to ensure that the claimant holding company is entitled to its asserted exempt status.

Exempt holding companies are nevertheless subject to the provisions of Section 9 (a) (2) of the Act, which prohibits them from acquiring 5 percent or more of the voting stock of any other public-utility company unless the acquisition has been approved by the Commission under Section 10. During the fiscal year two exempt holding companies applied for and were granted authority to acquire controlling interests in additional

public-utility companies; and at the close of the fiscal year another such application, was pending before the Commission.

When an exempt holding company proposes to acquire 10 percent or more of the voting securities of a public-utility company, there invariably arises the question whether as a consequence of the acquisition the exemption from the Act will continue to be available. The same question is presented in the case of such acquisition by a company which at present is not a holding company as defined in the Act. Generally these matters are explored informally with the staff of the Division. In some instances, the proposed acquisition, although satisfying the requirements of Section 10, has been abandoned when it appeared that no exemption from the Act would be available for the acquiring company.

FINANCING OF ACTIVE REGISTERED PUBLIC-UTILITY HOLDING COMPANIES AND THEIR SUBSIDIARIES

During the fiscal year 1965, 9 active registered holding-company systems sold to the public and financial institutions for cash 21 issues of long-term debt and capital stocks aggregating \$386 million, pursuant to authorizations granted by the Commission under Sections 6 and 7 of the Act. All but one of these issues were sold for the purpose of raising new capital. The one exception was an issue by Arkansas Power & Light Company, a subsidiary of Middle South Utilities, Inc., of 75,000 shares of preferred stock of \$100 par value for the purpose of refunding preferred stock of the same par value carrying a higher dividend rate.

The following table presents the amounts and types of securities issued and sold for cash by registered holding companies and their subsidiaries during fiscal 1965:

[table omitted]

The table does not include securities issued and sold by subsidiaries to their respective parent holding companies, short-term notes sold to banks, portfolio sales by any of the system companies, or securities issued for stock or assets of non-affiliated companies. These issuances and sales also require authorization by the Commission except (under Section 6 (b) of the Act) the issuance of notes having a maturity of 9 months or less where the aggregate amount does not exceed 5 percent of the principal amount and par value of the other securities of the company.

Competitive Bidding

All of the 21 issues of securities sold for cash in fiscal 1965, as shown in the preceding table, were offered for competitive bidding pursuant to the requirements of Rule 50 promulgated under the Act.

During the period from May 7, 1941, the effective date of Rule 50, to June 30, 1965, a total of 905 issues of securities with an aggregate value of \$13,513 million were sold at competitive bidding under the rule. These totals compare with 231 issues of securities with an aggregate value of \$2,371 million which have been sold pursuant to orders of the Commission granting exceptions from the competitive bidding requirements of the rule under paragraph (a) (5) thereof. Of the total amount of securities sold pursuant to such orders, 126 issues with a total value of \$1,888 million were sold by the issuers and the balance of 105 issues with a dollar value of \$483 million were portfolio sales. Of the 126 issues sold by the issuers, 70 were in amount from \$1 to \$5 million and 2 bond issues were in excess of \$100 million each.

POLICY AS TO REFUNDABILITY OF BONDS

In accordance with its long-standing policy under the Act, the Commission has continued to require that bonds and preferred stock sold by registered holding companies and their subsidiaries be fully refundable at the option of the issuer upon reasonable notice and that any redemption premium be reasonable in amount. During fiscal year 1965 one issuer subject to the Act took advantage of the refunding privilege and of prevailing favorable market conditions to refund a preferred stock issue at a lower dividend rate. The annual dividend savings on this issue were \$42,300.

Continuing studies made by the Commission's staff for fiscal year 1965 with respect to electric and gas utility bond issues sold at competitive bidding, whether or not subject to the Act, indicated that the presence or absence of a restriction on free refundability has not affected the number of bids received by an issuer at competitive bidding. With respect to the ability of the winning bidder to market the bonds, the data for fiscal year 1965 are at some variance with the data for the previous fiscal year and for all but one of the prior fiscal years covered in the staff's study. The 30th Annual Report, at pages 95-96, contains a summary of the results of an examination of all electric and gas utility bond issues (including debentures) sold at competitive bidding between May 14, 1957, and June 30, 1964, by companies subject to the Act as well as those not so subject. This study was extended to include fiscal year 1965.

During the period from May 14, 1957, to June 30, 1965, a total of 512 electric and gas utility bond issues, aggregating \$11,550.9 million principal amount, was offered at competitive bidding. The refundable issues numbered 379 and accounted for a total of \$7,280.5 million, while the non-refundable issues—all being non-refundable for a period of 5 years, except one which was non-refundable for a period of 7 years—numbered 133 and totaled \$4,270.4 million principal amount. The number of refundable issues thus represented 74.0 percent of the total number of issues, while, in terms of principal amount, the refundable issues accounted for 63.0 percent.

The weighted average number of bids received on the refundable issues for the period was 4.77, while on the nonrefundable issues it was 4.30. The median number of bids was 5 on the refundable and 4 on the non-refundable issues. With respect to the success of the marketing of the bond issues, an issue was considered to have been successfully marketed if at least 95 percent of the issue was sold at the syndicate price up to the date of termination of the syndicate. On this basis, 67.0 percent of the refundable issues were successful, while 63.9 percent of the non-refundable ones were successful. In terms of principal amount, 63.5 percent of the refundable issues were successful, while 61.5 percent of the nonrefundable ones were successful. Extension of the comparison to include the aggregate principal amounts of all issues which were sold at the applicable syndicate prices up to the termination of the respective syndicates, regardless of whether a particular issue met the definition of a successful marketing, indicates that 84.1 percent of the combined principal amount of all the refundable issues were so sold, as compared with 81.8 percent for the non-refundable issues. While the statistics for the total period from May 14, 1957, to June 30, 1965, developed in respect of the two groups of bond issues support the Commission's policy of requiring free refundability of utility bond issues subject to the Act, the Commission's staff will continue its studies of refundability provisions, particularly in light of the inconsistent marketing results in fiscal year 1965.

OTHER MATTERS

The Southern Company and its four electric utility subsidiary companies, including Alabama Power Company, filed an application-declaration with the Commission, pursuant to Section 6 (b), proposing, among other things, the issue and sale to Southern of \$14 million aggregate par value of common stock by Alabama Power. That company proposed to use these and other funds for the construction of electric facilities within the State of Alabama where it was organized and carries on its public-utility business. The Alabama Electric Cooperative, Inc. requested leave to intervene and a hearing on the asserted ground that certain of the proposed electric facilities would duplicate the Cooperative's facilities, would invade the service area of the Cooperative, and were consequently unnecessary and not in the public interest or the interest of investors or consumers. On June 1, 1965, the Commission issued its Findings, Opinion and Order, authorizing Alabama Power's proposed financing and denying the Cooperative's petition. The Commission found, among other things, that the proposed financing had been expressly approved by the Alabama Public Service Commission (before which the Cooperative had also appeared in opposition to the company's proposals) and that the issues raised and contentions advanced by the Cooperative were exclusively within the jurisdiction of the State authorities. The Cooperative filed a petition for review in the Court of Appeals for the District of Columbia Circuit.

As reported previously, on March 3, 1964, the Commission issued an interim ruling that Pacific Northwest Power Company would not become an electric utility company as defined in Section 2 (a) (3) at least prior to the time at which the grant of a license by the

Federal Power Commission for the construction and operation of a hydroelectric plant had become final, either by the expiration of the appeal period or by a final determination of the appellate courts affirming the grant. Three appeals from the grant of the license have been filed in the Court of Appeals for the District of Columbia Circuit, but as of the close of the fiscal year no decision had been rendered.

PART VI PARTICIPATION OF THE COMMISSION IN CORPORATE REORGANIZATIONS UNDER CHAPTER X OF THE BANKRUPTCY ACT

The Commission's role under Chapter X of the Bankruptcy Act, which provides a procedure for reorganizing corporations in the U.S. district courts, differs from that under the various other statutes which it administers. The Commission does not initiate Chapter X proceedings or hold its own hearings, and it has no authority to determine any of the issues in such proceedings. The Commission participates in proceedings under Chapter X in order to provide independent, expert assistance to the courts, the participants, and investors in a highly complex area of corporate law and finance. It pays special attention to the interests of public security holders who may not otherwise be represented effectively.

Where the scheduled indebtedness of a debtor corporation exceeds \$3 million, Section 172 of Chapter X requires the judge, before approving any plan of reorganization, to submit it to the Commission for its examination and report. If the indebtedness does not exceed \$3 million, the judge may, if he deems it advisable to do so, submit the plan to the Commission before deciding whether to approve it. Where the Commission files a report, copies or a summary must be sent to all security holders and creditors when they are asked to vote on the plan. The Commission has no authority to veto or to require the adoption of a plan of reorganization.

The Commission has not considered it necessary or appropriate to participate in every Chapter X case. Apart from the excessive administrative burden, many of the cases involve only trade or bank creditors and few public investors. The Commission seeks to participate principally in those proceedings in which a substantial public investor interest is involved. However, the Commission may also participate because an unfair plan has been or is about to be proposed, public security holders are not represented adequately, the reorganization proceedings are being conducted in violation of important provisions of the Act, the facts indicate that the Commission can perform a useful service, or the judge requests the Commission's participation.

The Commission has lawyers, accountants and financial analysts in its New York, Chicago and San Francisco regional offices who are engaged actively in Chapter X cases in which the Commission has filed its appearance. Supervision and review of the regional

offices' Chapter X work is the responsibility of the Division of Corporate Regulation of the Commission, which, through its Branch of Reorganization, also serves as a field office in cases arising in the Atlanta and Washington, D.C. regional areas.

SUMMARY OF ACTIVITIES

In fiscal year 1965, the Commission continued to maintain a high level of activity under Chapter X. During the year, the Commission entered its appearance in 17 new proceedings involving companies with aggregate stated assets of \$168 million and aggregate indebtedness of approximately \$150 million. These proceedings involved the rehabilitation of corporations engaged in various businesses including, among others, heavy manufacturing, real estate and mortgage investments, operation of hospitals and motels, the manufacture of mechanical and electronic components, the manufacture and distribution of chemicals and motor freighting.

During the year the Commission was a party in a total of 104 reorganization proceedings, including the new proceedings. The stated assets of the companies involved in these proceedings totaled approximately \$963 million and their indebtedness approximately \$899 million. The proceedings were scattered among district courts in 32 states and the District of Columbia, as follows: 15 in New York; 11 in Florida; 9 in California; 6 in Illinois; 5 each in Kentucky and Michigan; 4 each in New Jersey and North Carolina; 3 each in Arizona, Iowa, Nevada, Oklahoma, Texas, Pennsylvania and Washington; 2 each in Colorado, Kansas, Louisiana, Maryland, Montana and Ohio; and 1 each in the District of Columbia, Arkansas, Connecticut, Idaho, Massachusetts, New Mexico, South Dakota, Tennessee, Utah, Wyoming, West Virginia and Virginia. Proceedings involving 15 principal debtor corporations were closed during the year. Thus, at the end of the year the Commission was participating in 89 reorganization proceedings.

JURISDICTIONAL, PROCEDURAL AND ADMINISTRATIVE MATTERS

In Chapter X proceedings in which it participates, the Commission seeks to have the courts apply the procedural and substantive safeguards to which all parties are entitled. The Commission also attempts to secure judicial uniformity in the construction of Chapter X and the procedures thereunder.

In Muskegon Motor Specialties Co. the debtor was found insolvent, the confirmed plan of reorganization did not accord the stockholders any participation, and the preferred stockholders committee appealed.

Subsequently, the Commission moved to vacate the order of confirmation on the ground that, because of a substantial increase in earnings since confirmation and other developments, the debtor may be solvent. In view of the pendency of the appeal, the

district judge prepared an order vacating the order of confirmation, and this proposed order was presented to the court of appeals as the basis for a motion to remand. In the interim, the purchasers under the plan filed in the district court a motion for rehearing of the Commission's motion to vacate. The court of appeals continued the hearing on the motion to remand, stating that it would grant the motion if the district court denied the motion for rehearing.

Certain stockholders of the debtor appealed from a district court order in Shawano Development Corporation, which adjudicated the debtor a bankrupt and thereby precluded the Chapter X trustee from proceeding with pending suits against former members of management and others. The court of appeals agreed with the Commission's view that a proceeding under Chapter X rather than in bankruptcy is a preferable forum for the prosecution of a debtor's lawsuits where such suits are financed, in part, by the stockholders. However, the court held, inter alia, that the district court did not abuse its discretion in adjudicating the debtor a bankrupt and that appellants had failed to appeal from an earlier order refusing approval of a proposed plan of liquidation which included a provision for the prosecution of these lawsuits.

In Texas Independent Coffee Organization the Commission objected to the trustee's petition to cancel all delinquent investment contracts held by the public and to forfeit the installments paid thereon. The Commission urged that the bankruptcy court, as a court of equity, should not countenance forfeitures, especially where, as in this case, there was no assurance that investors would receive in value that for which they had contracted. It was also urged that investors should not be required to make payments, under penalty of forfeiture, on contracts which had been sold in violation of the registration provisions of the Securities Act of 1933. The court agreed with the Commission and denied the trustee's petition.

In Investors Associated, Inc. the debtor contested an involuntary Chapter X petition on the ground that it was not insolvent as alleged in the petition. The debtor had issued and sold over \$1 million principal amount of subordinated debentures, \$691,000 of which had been exchanged for common stock. The Commission, appearing at the request of the district judge, supported the petition, urging that the stockholders who had acquired stock in this manner be treated as creditors for the purpose of determining insolvency since they had been induced to convert their debentures into common stock by the fraudulent assertions of management. Prior to the filing of the Chapter X petition, the Commission had obtained an order against the debtor, its officers, directors, and others enjoining violations of the registration and anti-fraud provisions of the securities laws in the sale of securities of the debtor. The special master's report adopted the Commission's views and the district judge approved the petition.

As reported previously, in Joe Newcomer Finance Company a debenture-holders committee was enjoined, on motion of the Commission, from further soliciting contributions from public investors, and the funds already collected were ordered held in

escrow pending a ruling on their disposition. The court subsequently required the return of the funds to the contributors and refused to allow committee members reimbursement of expenses from these funds.

In *Trans-United Industries, Inc.* the Chapter X court in Connecticut held that it had jurisdiction to determine the validity of tax assessments levied against the debtor's property in Philadelphia by the City of Philadelphia, and disallowed the claim.

TRUSTEE'S INVESTIGATION

A complete accounting for the stewardship of corporate affairs by the old management is a requisite under Chapter X. One of the primary duties of the trustee is to make a thorough study of the debtor to assure the discovery and collection of all assets of the estate, including claims against officers, directors, or controlling persons who may have mismanaged the debtor's affairs. The staff of the Commission often aids the trustee in his investigation.

In *Automatic Washer Co.*, reported previously, the court of appeals affirmed the order of the district court which held that the stock interests of Bankers Life & Casualty Company and of Bellanca Corporation (now Olson Brothers, Inc.) should be subordinated to the publicly held stock of the debtor to the extent of \$1.50 per share. As the Commission urged, the court held that subordination was not precluded because of a money judgment for fraud obtained by the trustee against Bankers, nor because the plan of reorganization was one of liquidation. The subordination nearly doubled the distribution to the public stockholders, and, since the per share distribution to them was substantially less than \$1.50, was tantamount to a disallowance of the stock interests of Bankers and Bellanca.

In *Swan-Finch Oil Corporation*, the trustee settled an action against the American Stock Exchange and Josephthal & Co. for \$150,000 and \$300,000, respectively. The action had been based upon alleged violations of the securities laws in the sale, through dummy accounts at Josephthal & Co., of 578,000 shares of unregistered Swan-Finch common stock in a rigged market and by use of the facilities of the Exchange. The trustee had also alleged that the Exchange did not carry out its responsibilities under the Securities Exchange Act of 1934. The proceeds of the settlement will enhance the distribution to creditors and stockholders under the proposed plan of liquidation. Substantially all of the facts alleged in the trustee's complaint were derived from an investigation conducted by the Commission's staff.

The court, in *The Sire Plan, Inc.*, authorized the trustees to accept \$20,000 in settlement of an action against two attorneys. The trustees had alleged, *inter alia*, that, within 1 year prior to the filing of the reorganization petition, at a time when the debtor corporations were insolvent, they transferred funds to the attorneys without fair consideration.

In Dilbert's Quality Supermarkets, Inc., the court authorized the trustee to settle for \$60,000 a suit against a supplier and its directors for monies allegedly paid as a commercial bribe to a former officer of the debtor. In Equitable Plan Co., the court authorized the trustee to settle a suit against Doeskin Products, Inc., based upon allegedly fraudulent acts committed by Lowell M. Birrell when he controlled Doeskin. Under the settlement, Doeskin recognized as validly issued 150,000 shares of the 194,000 shares of its stock held by the trustee. The 150,000 shares had a market value of about \$450,000 at the time of settlement.

REPORTS ON PLANS OF REORGANIZATION

Generally, the Commission files a formal advisory report only in a case involving a substantial public investor interest and presenting significant problems. When no such formal report is filed, the Commission may state its views briefly by letter, and authorize its counsel to make an oral or written presentation to amplify the Commission's views. During this fiscal year the Commission published two formal advisory reports. The Commission conveyed its views to the court on 14 other plans, on some by oral statement of its counsel at the hearing, and on the others by letter and supporting memoranda.

In TMT Trailer Ferry, Inc., the district court, on remand by the court of appeals, held further hearings on the internal plan of reorganization, which gives no recognition to the interests or claims of the debtor's public common stockholders. For reasons previously stated to the court, the Commission's report concluded that the plan was not fair and equitable because the evidence as to insolvency was not adequate and because of the failure to treat as creditors public stockholders who, as urged by the stockholders committee, had claims against the debtor based upon the sale to them of the debtor's stock in alleged violation of the Federal securities laws. The district court confirmed the plan and the stockholders committee appealed. After the close of the fiscal year, the court of appeals denied the Commission's motion for a stay pending appeal, and reserved decision on the trustee's motion to dismiss the appeal or to affirm summarily.

In Tuba Consolidated Industries, Inc., the plan provided for the internal reorganization of Yuba, which will continue in the steel fabrication and industrial engineering business through two divisions and two subsidiaries, with other properties to be liquidated. The plan's principal provisions relate to the treatment of the three classes of unsecured creditors, including the debenture holders whose claims are subordinated to creditor claims which arose after the issuance of the debentures. The plan provided for a distribution to the unsecured creditors of a minimum of \$1,050,000 in cash, a maximum of 550,000 shares of \$10 par value preferred stock and a like or greater number of shares of \$10 par value common stock, the total of all of which to equal Yuba's reorganization value as determined by the court. The creditors whose claims predated the debenture issue would receive their proportionate amount of the cash and of the preferred and common stocks. The creditors to whom the debentures are subordinated would receive

the remaining cash and preferred stock and, depending upon Yuba's reorganization value, all or part of the remaining common stock, but not exceeding in aggregate par value an amount which, together with the cash and par value of the preferred stock, would equal the dollar amount of their claim. The debenture holders would receive such amount of any remaining common stock as was not required for the purpose of satisfying the claims of the creditors, to whom the debenture holders are subordinated.

The court determined the value of the debtor's assets to be \$12,536,000, which included the capitalized value of prospective earnings, excess working capital, and the present value of the tax loss carry forward and of the earnings and sales proceeds of the liquidating properties. In its report the Commission had recommended a value of \$13,398,000. The court agreed with the Commission's conclusion that the proposed distribution under the plan provided fair and equitable treatment among the three classes of creditors since it accorded appropriate recognition to their status and priority *inter se*. As was suggested in the Commission's report, the plan was amended to provide for the issuance of no par value common stock and to permit the reorganized company, at its option after a specified date, to redeem the preferred stock at par plus a premium and accrued dividends. In its supplemental advisory report, the Commission concluded that the plan, as amended, was fair and equitable and feasible, and the plan, as amended, has been approved.

In General Economics Corporation, the court confirmed a plan of reorganization for a subsidiary, General Economics Syndicate, Inc. ("Syndicate"), which provided that the proceeds of \$200,000 from the sale by the parent of its majority stockholdings in Syndicate, which were claimed by both the parent and the subsidiary, should be held in escrow pending a ruling on their disposition. The Commission urged that since it had been established that the parent, as a majority stockholder, had breached its fiduciary obligation by defrauding the subsidiary and its public shareholders of over \$900,000, the parent should be divested of any interest in the stock or in the proceeds of its sale, and the court awarded the sales proceeds to the subsidiary.

ACTIVITIES WITH REGARD TO ALLOWANCES

Every reorganization case ultimately presents the difficult problem of determining the allowance of compensation to be paid to the various parties for services rendered and for expenses incurred in the proceeding. The Commission, which under Section 242 of the Bankruptcy Act may not receive any allowance for the services it renders, has sought to assist the courts in assuring economy of administration and in allocating compensation equitably on the basis of the claimants' contributions to the administration of estates and the formulation of plans. During the fiscal year 350 applications for compensation totaling about \$9.5 million were reviewed.

In *Bevis Shell Homes, Inc.*, a partner of the attorney representing the debenture holders protective committee sold, at a loss, 500 shares of the debtor's stock during the Chapter X proceeding. It was represented to the court that the selling partner had no knowledge of the proceeding other than that disseminated by the trustee to all of the stockholders, and that the partner representing the committee had no knowledge that his partner owned and then sold this stock until after the firm filed its application for a final allowance. The firm then filed a petition requesting the court to approve the sale and, in its discretion, to award an allowance. The district court, as urged by the Commission, ruled that, although the services performed were meritorious and contributed to the confirmed plan, Section 249 was an absolute bar to the award of any compensation.

In *Hudson & Manhattan Railroad Company*, the court of appeals, agreeing with the Commission, increased the final allowance to special counsel to the trustee. The court said that "the district judge erred in giving weight to the fact that the firm on six occasions did not seek the maximum interim allowance; this only encourages firms to apply for the maximum allowance regardless of the value of the services rendered." Counsel had requested a total allowance of \$107,350, the Commission recommended \$75,000, the district court allowed \$50,000, and the court of appeals increased the allowance to \$65,000. In this connection, the court noted that counsel had not kept accurate time records and emphasized that "any attorney who hopes to obtain an allowance from the court should keep accurate and current records of work done and time spent. . . . There is no excuse for an established law firm to rely on estimates made on the eve of payment and almost entirely unsupported by daily records or for it to expect a court to do so."

In the same decision the court of appeals ruled that the district judge erroneously denied any allowance to a law firm which represented a bondholder who made continued purchases and one sale of the debtor's bonds. The court held that Section 249 did not bar the law firm which did not trade and whose appearance for its client did not facilitate trading. It stated, "as the Commission points out 'the record indicates no problems of shifting interests and contains no indication that knowledge gained by the applicant was used to assist [the client's] trading.' We agree with the Commission that, where a client has traded in the debtor's securities, weight must be given to the purpose for which the attorney appeared in the proceeding."

Walco Building Corporation, the debtor, operated an office building constructed on land leased from the fee owners. The Chapter X proceeding was dismissed, and bondholders appealed. The appeal was thereafter dismissed under the terms of a settlement with the fee owners who advanced \$25,000 to the indenture trustee to be paid as compensation to the bondholders' attorneys. The court agreed with the Commission that, since the services of counsel were rendered in connection with the Chapter X proceeding, the district court had exclusive jurisdiction to review and determine their compensation, even though such compensation was not to be paid by the estate.

INTERVENTION IN CHAPTER XI PROCEEDINGS

Chapter XI of the Bankruptcy Act provides a procedure by which debtors can effect arrangements with respect to their unsecured debts under court supervision. Where a proceeding is brought under that chapter but the facts indicate that it should have been brought under Chapter X, Section 328 of Chapter XI authorizes the Commission or any other party in interest to make application to the court to dismiss the Chapter XI proceeding unless the debtor's petition is amended to comply with the requirements of Chapter X, or a creditors' petition under Chapter X is filed.

In *American Trailer Rentals Company*, reported previously, the Supreme Court reversed the court of appeals which had affirmed the district court's order denying the Commission's motion under Section 328. The Supreme Court held that ". . . although there is no absolute rule requiring that Chapter X be utilized in every case in which the debtor is publicly owned, or even, where publicly held debt is adjusted, as a general rule Chapter X is the appropriate proceeding for adjustment of publicly held debt." The Court indicated that there were ".. narrow limits within which there are exceptions to this general rule . . . for example, where the public investors are few in number and familiar with the operations of the debtor, or where, although the public investors are greater in number, the adjustment of their debt is relatively minor, consisting, for example, of a short extension of time for payment."

The Commission's motion under Section 328 was granted by the district court, with the debtor's consent, in *Liberty Mortgage Corporation*. The debtor then filed an amendment petition under Chapter X, but the petition was dismissed for lack of good faith, the court having found that rehabilitation of the debtor as a going concern was not possible and that there was no alternative but to liquidate the debtor. Referring to the decision in *American Trailer Rentals*, the district court stated that, while the granting of a motion under Section 328 will be determinative of one of the elements of good faith specifically stated in Section 146 (2) -- that adequate relief is not obtainable under Chapter XI -- the court must still determine whether it is reasonable to expect that a plan of reorganization can be effected. In *S.E.C. v. Crumpton Builders, Inc.*, decided before *American Trailer Rentals*, the court of appeals reversed the district court's denial of the Commission's Section 328 motion. On remand, the district court dismissed the debtor's amended petition under Chapter X, since it appeared that a successful reorganization under Chapter X was not feasible.

In *Canandaigua Enterprises Corp.*, reported previously, the court of appeals, prior to the *American Trailer Rentals* decision, reversed the order of the district court denying the Commission's Section 328 motion to dismiss the Chapter XI petition. The court stated that ". . . the need for a readjustment of publicly held debt creates a presumption in favor of Chapter X, whereas a case calling only for modification of the claims of trade creditors

or others who have had private dealings with the debtor is presumptively to be handled under Chapter XI."

In American Guaranty Corporation the Commission appealed from the order denying its motion under Section 328, While the appeal was pending, the Commission filed a motion to remand the case to the district court for further consideration in the light of the Supreme Court's decision in American Trailer Rentals and the substantial debt reduction during the pendency of the appeal. The Commission's motion was granted, the district court heard oral argument, and the case was pending for decision at the end of the fiscal year.

In Strouse, Inc. the Commission moved under Section 328 to dismiss the Chapter XI petition, but from subsequent developments it appeared that the motion was no longer appropriate and, by leave of court, the Commission withdrew its motion. In United Star Companies, Inc., reported previously, the court of appeals granted the Commission's unopposed motion for an order remanding the case to the district court with a direction to vacate as moot the district court's order denying the Commission's Section 328 motion to dismiss the debtor's Chapter XI petition. The motion for a remand was predicated on the ground that during the pendency of the Commission's appeal the debtor was adjudicated a bankrupt.

PART VII ADMINISTRATION OF THE TRUST INDENTURE ACT OF 1939

The Trust Indenture Act of 1939 requires that bonds, notes, debentures and similar securities publicly offered for sale, except as specifically exempted by the Act, be issued under an indenture which meets the requirements of the Act and has been duly qualified with the Commission. The Act requires that indentures to be qualified include specified provisions which provide means by which the rights of holders of securities issued under such indentures may be protected and enforced. These provisions relate to designated standards of eligibility and qualification of the corporate trustee to provide reasonable financial responsibility and to minimize conflicting interests. The Act outlaws exculpatory provisions formerly used to eliminate all liability of the indenture trustee and imposes on the trustee, after default, the duty to use the same degree of care and skill in the exercise of the rights and powers vested in it by the indenture as a prudent man would use in the conduct of his own affairs.

The provisions of the Trust Indenture Act are closely integrated with the requirements of the Securities Act. Registration pursuant to the Securities Act of securities to be issued under a trust indenture subject to the Trust Indenture Act is not permitted to become

effective unless the indenture conforms to the requirements of the latter Act, and necessary information as to the trustee and the indenture must be contained in the registration statement. In the case of securities issued in exchange for other securities of the same issuer and securities issued under a plan approved by a court or other proper authority which, although exempted from the registration requirements of the Securities Act, are not exempted from the requirements of the Trust Indenture Act, the obligor must file an application for the qualification of the indenture, including a statement of the required information concerning the eligibility and qualification of the trustee.

[table omitted]

REVISION OF RULES, REGULATIONS AND FORMS

Proposed Rule 7a-9

Public comments were invited during the fiscal year on a proposed new rule, to be designated Rule 7a-9, under the Trust Indenture Act. The new rule would provide for the filing with an application for the qualification of an indenture under the Act, or as an amendment to such an application which has not become effective, of an amendment which would delay the effectiveness of the application until a further amendment superseding the delaying amendment is filed, or until the Commission accelerates the effective date upon request of the obligor. Applications for qualification of an indenture are required to be filed in those cases, not otherwise exempt, where the securities to be issued under the indenture are not required to be registered under the Securities Act of 1933. Rule 473 under the Securities Act makes similar provision for the filing of delaying amendments to registration statements under that Act.

This matter was pending at the close of the fiscal year.

Proposed Amendments to Forms T-1 and T-2

During the fiscal year, the Commission invited public comments on proposed amendments to Forms T-1 and T-2 under the Trust Indenture Act. Form T-1 is prescribed for statements of eligibility and qualification of corporations designated to act as trustees under indentures qualified under the Act. Form T-2 is prescribed for statements of eligibility and qualification of individuals designated to act as trustees under such indentures. The proposed amendments would clarify and simplify the forms in certain respects, would delete certain required information deemed not essential to a determination of the eligibility and qualifications of the trustee, would require certain additional information deemed significant in such determination, and would bring the forms in line with the format of the Commission's more recently adopted forms under other acts.

PART VIII

ADMINISTRATION OF THE INVESTMENT COMPANY ACT OF 1940

The Investment Company Act of 1940 provides for the registration and regulation of companies primarily engaged in the business of investing, reinvesting, owning, holding, or trading in securities. The Act, among other things, requires disclosure of the financial and investment policies of such companies; prohibits changing the nature of their business or their investment policies without shareholder approval; regulates the means of custody of the companies' assets; requires management contracts to be submitted to security holders for approval; prohibits underwriters, investment bankers, and brokers from constituting more than a minority of the directors of such companies; and prohibits transactions between such companies and their officers, directors, and affiliates except with approval of the Commission. The Act also regulates the issuance of senior securities and requires face-amount certificate companies to maintain reserves adequate to meet maturity payments upon the certificates.

The securities of investment companies which are offered to the public are also required to be registered under the Securities Act of 1933 and the companies must file periodic reports. Such companies are also subject to the Commission's proxy rules and certain "insiders" of closed-end companies are subject to reporting and "short swing" trading rules. In November 1964, certain functions relating to investment companies were reallocated from the Division of Corporation Finance to the Division of Corporate Regulation, including the administration of the disclosure requirements with respect to registration statements filed by such companies under the Securities Act of 1933 and the administration of the periodic reporting, proxy solicitation, and other provisions of the Securities Exchange Act of 1934 with respect to registered investment companies. On the basis of the experience since the transfer of functions, the resulting concentration of responsibility in the Division of Corporate Regulation for the administration of the securities laws as they apply to investment companies has been of material convenience to registrants and other persons concerned with investment companies.

COMPANIES REGISTERED UNDER THE ACT

As of June 30, 1965, there were 727 investment companies registered under the Act, including 69 small business investment companies. Of this total, 616 were "active" companies, whose assets had an aggregate market value of approximately \$44.6 billion. Compared with the corresponding totals at June 30, 1964, these figures represent an overall increase of approximately \$3 billion in the market value of assets, while the number of registered companies decreased by four. The classification of the registered companies and the approximate market value of the assets in each category as of June 30, 1965, are shown in the following table:

[table omitted]

The approximately \$3.3 billion of assets of the "active" registered unit investment trusts includes approximately \$2.8 billion of assets of registered unit investment trusts which invest in securities of other registered investment companies, substantially all of them management open-end companies.

During the fiscal year, 50 new companies, including 3 small business investment companies, registered under the Act while the registrations of 54 companies, including 7 small business investment companies, were terminated. The classification of these companies is as follows:

[table omitted]

GROWTH OF INVESTMENT COMPANY ASSETS

The following table illustrates the striking growth of assets of investment companies over the years since the enactment of the Investment Company Act:

[table omitted]

INSPECTION AND INVESTIGATION PROGRAM

During fiscal year 1965, a total of 146 investment company inspections was completed pursuant to the statutory authority conferred on the Commission by Section 31 (b) of the Investment Company Act. A large number of the inspections disclosed violations not only of the Investment Company Act but also of other statutes administered by the Commission. A number of the violations uncovered during the course of routine inspections were serious in character. These included inadequate arrangements for safekeeping of the investment company's portfolio securities or failure to observe the safekeeping procedures which had been established. The inspections also disclosed several situations in which the procedures for pricing shares for purposes of purchase or redemption were not in conformity with the statute or the investment company's prospectus. Several instances were found in which the investment company failed to redeem shares within the required statutory period. The inspections further uncovered a number of instances in which transactions violating Section 17 of the Act had been effected by affiliated persons.

Largely as an outgrowth of information obtained during these inspections, 23 private investigations were commenced during the fiscal year. On the basis of the facts obtained in the investigations, two civil actions were instituted by the Commission. One of the

actions (S.E.C. v. Capital Funds, Inc., et al.) sought to enforce compliance with the proxy solicitation requirements of the Investment Company Act and the Securities Exchange Act of 1934 in connection with a proxy solicitation of shareholders of Modern American Mortgage Corporation, a then registered investment company. In that civil action, the Commission also sought to enjoin the defendants from offering to purchase the securities of Modern American Mortgage Corporation by means of allegedly fraudulent statements concerning, among other things, the net worth, earnings, assets and future market value of the securities of that company.

As a result of the Commission's inspection and investigation program, a total of \$1,541,000 was returned during fiscal 1965 to investment companies for the benefit of shareholders or to the shareholders directly. Following one inspection, a court-ordered liquidation of an unregistered investment company resulted in a distribution of assets totalling \$1,287,170 to that company's shareholders. In another instance, the Commission's staff, during a routine examination, discovered that an investment company officer had been converting funds by causing the company to purchase worthless short-term notes of a fictitious enterprise. Following this discovery, the investment company was fully indemnified for its losses, which aggregated \$195,000. In a third instance, through the efforts of the Commission's staff, \$39,441 was returned to an investment company in settlement of that company's claims against an affiliated broker-dealer firm arising from excessive brokerage commissions and trading profits and from the broker-dealer's activities in causing the company to engage in certain unauthorized principal trades with another affiliated business entity.

REVISION OF ANNUAL REPORT FORM FOR MANAGEMENT INVESTMENT COMPANIES

Even under an expanded inspection program, such as has been pursued by the Division of Corporate Regulation in the past few years, certain investment companies inevitably require closer or prompter scrutiny. Because of this and the continued growth in the number and size of investment companies, the Commission considered that the public interest and the protection of investors would be served by strengthening the annual report filed by investment companies, and adopted a revised form, captioned Form N-1R, effective for all fiscal years ending on and after December 31, 1964.

In adopting Form N-1R the Commission determined to amend the reporting requirements in two major respects. First, the previous form was revised to provide for additional information in the public reports filed by registered management investment companies. Second, a new nonpublic report is provided as a part of the form. The data in both reports will materially assist the Commission in its inspection program. In addition, the reports will serve the purpose of bringing to the attention of the persons responsible for the management and operations of investment companies information which will assist them to determine more readily whether the statutory standards and requirements are, in fact,

being complied with, and thus contribute to the achievement of a substantial degree of self-inspection.

FILINGS REVIEWED

Investment companies offering their shares for sale to the public must file a registration statement for their securities under the Securities Act of 1933 as well as register under the Investment Company Act. The registration statements and revised prospectuses of investment companies filed pursuant to the Securities Act are reviewed for compliance with that Act and the Investment Company Act. The Commission's rules promulgated under the Investment Company Act generally require that the basic information contained in notifications of registration and in registration statements of investment companies be kept current through periodic and other reports. In addition, proxy soliciting material filed by investment companies is reviewed for compliance with the Commission's proxy rules. The following table sets forth the volume of filings processed during the past fiscal year:

[table omitted]

APPLICATIONS AND PROCEEDINGS

Under Section 6 (c) of the Act, the Commission, by rules and regulations, upon its own motion or by order upon application, may exempt any person, security, or transaction from any provision of the Act if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Other Sections, such as 6 (d), 9 (b), 10 (f), 17 (b), 17 (d), and 23 (c), contain specific provisions and standards pursuant to which the Commission may grant exemptions from particular sections of the Act or may approve certain types of transactions. Also, under certain provisions of Sections 2, 3, and 8 the Commission may determine the status of persons and companies under the Act. One of the principal activities of the Commission in its regulation of investment companies is the consideration of applications for orders under the sections referred to.

During the fiscal year, 260 applications filed under various sections of the Investment Company Act were before the Commission. The sections of the Act with which these applications were concerned and the disposition of such applications are shown in the following table:

[table omitted]

Some of the more significant matters in which applications were considered are summarized below:

On November 9, 1964, the Commission issued a notice and order for hearing with respect to an application of American & Foreign Power Company Inc. ("Foreign Power") for an order pursuant to (i) Section 3 (b) (2) of the Act declaring that Foreign Power is not an investment company or (ii) Section 6 (c) exempting Foreign Power from the provisions of the Act. The application was occasioned by Foreign Power's sales of or contracts to sell, between 1958 and 1964, its interests in public utility subsidiaries in Argentina, Mexico, Columbia, and Brazil to the governments or government agencies of those countries largely in exchange for notes of such governments or agencies. The proceeding on Foreign Power's application was consolidated with the proceeding on an application which had previously been filed by Electric Bond and Share Company ("Bond and Share"), the majority stockholder of Foreign Power, for an order pursuant to (i) Section 8 (f) of the Act declaring that Bond and Share had ceased to be an investment company as defined in Section 3 (a), or (ii) Section 3 (b) (2) of the Act declaring that Bond and Share is not an investment company.

Hearings were held during which Bond and Share amended its application to include a request, pursuant to Section 6 (c) of the Act, for an order exempting it from the provisions of the Act. On January 29, 1965, the Division of Corporate Regulation filed its proposed findings and conclusions and brief in support thereof recommending that the Commission deny the applications of Bond and Share and Foreign Power. On February 16, 1965, Foreign Power entered into an agreement providing for the sale of its interests in its public utility subsidiaries in Chile to an agency of the Chilean Government primarily in exchange for notes guaranteed by that Government. Following the reopening of the record of the proceedings to receive evidence with respect to that sale, reply briefs were filed by the applicants and by the Division of Corporate Regulation, and oral argument by the parties was heard by the Commission. At the close of the fiscal year the matter was pending.

On April 7, 1965, the Commission issued its opinion and order granting an application filed pursuant to Section 6 (c) of the Act by Variable Annuity Life Insurance Company of America ("VALIC"), for a limited exemption from the provisions of Sections 22 (d) and 27 (a) of the Act.

The Commission's order under Section 22 (d) permits VALIC to sell group variable annuities to those employers satisfying the provisions of Section 403 (b) of the Internal Revenue Code of 1954, as amended, ("Code") at the same sales load charged employees' pension and profit-sharing trusts which satisfy Section 401 of the Code and also charged tax exempt organizations enumerated under Sections 501 (c) (3) and (13) of the Code. The exemption also permits variation in the sales load charged to those employers enumerated in Section 403 (b) of the Code so as to increase the amount of purchase payments on behalf of any individual at any time after the first year in order that the same uniform sales load can be charged during the contract year in which the increase is made.

With respect to Section 27 (a), the Commission's order permits VALIC to charge, in the sale of its variable annuities to pension trusts, a sales load of up to 12.08 percent in each of the first 6 contract years, 5.5 percent in each of the next 6 contract years, and 2 percent each year for the remainder of the accumulation period. Under the order, the total cumulative deductions for sales load will be less at any point over the life of such contracts than the maximum cumulative deductions permitted by Section 27 (a), namely, 50 percent the first year and uniform rate thereafter.

On June 2, 1965, the Commission granted an application filed under Section 6 (c) of the Investment Company Act by Investors Diversified Services, Inc. ("IDS"), and its wholly-owned subsidiary, Investors Accumulation Plan, Inc. ("Plan Company"). Plan Company proposed to offer periodic payment plan certificates for accumulation of shares of Investors Stock Fund, Inc., a registered open-end diversified management investment company. IDS acts as investment adviser and underwriter for Investors Stock Fund, Inc., and will act as underwriter for the securities offered by the Plan Company. The Commission's order permits the deduction of sales loads on periodic payment plan certificates at the rate of 20 percent of payments during the 1st year, 18 percent during the 2nd and 3rd years, 7 percent during the 4th year and 4.2 percent thereafter. Over the course of the plan the sales load would be 8 percent of aggregate payments. The total cumulative deductions for sales load will be less at any point of time over the life of such contracts than the maximum cumulative deductions permitted by Section 27 (a).

During the fiscal year, Amoskeag Company ("Amoskeag"), a registered closed-end, nondiversified investment company organized as a trust, submitted to the Commission a plan of reorganization and requested, pursuant to Section 25 (b) of the Act, that the Commission render an advisory report in respect to the fairness of the plan and its effect upon the two classes of security holders of Amoskeag. The plan called for the transfer of the assets of the trust to a newly created corporation, in exchange for all of the debentures and common stock to be issued by the new corporation; the transfer of the debentures of the new corporation or cash to the preferred shareholders of the trust; the transfer of the common stock of the new corporation to the common shareholders of the trust; and the liquidation of the trust. It was proposed for the following stated reasons: (1) the new corporation would have perpetual existence in contrast to the limited term of the trust; (2) the trust form of organization deprived management and counsel of the relative legal certainty and flexibility of operation available to corporations; (3) dividends on preferred shares were not deductible by the trust for Federal income tax purposes (in the opinion of counsel, interest paid on the proposed debentures would be deductible); and (4) holders of preferred shares would have the election of receiving in cash the full liquidation preference of \$100 per share plus accrued dividends for their holdings, which would be in excess of the over-the-counter market bid quotations for the shares ranging from 82 to 95 during the 5 years 1960 to 1964, inclusive.

In its advisory report issued May 20, 1965, the Commission concluded that, on the basis of a comparison of the rights and financial attributes of the preferred and common shares

of the trust with those of the debentures and common stock of the new corporation, the terms of the plan were within such limits of fairness as would justify its submission to the security holders of Amoskeag for their consideration. The Commission pointed out, however, that it had no statutory power to approve or disapprove the plan, and that in no sense was the report to be deemed a recommendation, endorsement or approval of the plan.

REVISION OF RULES, REGULATIONS AND FORMS

During the fiscal year Rules 3c-3 and 17g-1 were amended and Rule 12d-1 was adopted. The amendments and adoption, respectively, of these rules were noted, and their provisions discussed, in the 30th Annual Report of the Commission. The proposed amendment of Rule 20a-2 relating to certain financial and other information to be disclosed in proxy statements of registered investment companies was also discussed in the 30th Annual Report where it was noted that the amendment was pending. The proposal was withdrawn during the past fiscal year.

Adoption of Rule 2a-4

During the fiscal year the Commission adopted Rule 2a-4, which defines the term "current net asset value" as used in the Act with reference to redeemable securities issued by a registered investment company. Under the rule, portfolio securities for which market quotations are readily available are to be valued at current market value, and other securities and assets are to be valued at fair value as determined in good faith by the board of directors of the registered company. The rule also provides that changes in holdings of portfolio securities or in the number of outstanding shares of the registered company shall be reflected no later than the first calculation on the first business day following the trade date or date of change. Under the rule, expenses, including any investment advisory fees, are to be included to the date of calculation; dividends receivable are to be included to date of calculation either at ex-dividend dates or record dates, as appropriate; and interest income and other income are to be included to date of calculation. The rule also provides for interim determinations of current net asset value between calculations made as of the close of the New York Stock Exchange on the preceding business day and the current business day so as to reflect any change.

PART IX

ADMINISTRATION OF THE INVESTMENT ADVISERS ACT OF 1940

The Investment Advisers Act of 1940 established a pattern of regulation of investment advisers similar to that contained in the Securities Exchange Act with respect to the conduct of broker-dealers. With certain specific exceptions, the Act requires persons

engaged for compensation in the business of advising others with respect to securities to register with the Commission and to conform to statutory standards designed to protect the public interest. The Act prohibits fraudulent conduct, and authorizes the Commission to define, and prescribe means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices. Pursuant to such authority, Rule 206 (4)-1 proscribes, among other things, the use of testimonials, circumscribes permissible references to past recommendations and the use of graphs and charts, and prohibits the use of false or misleading statements. Under Rule 206 (4)-2, an investment adviser who has custody or possession of the funds or securities of clients must segregate them, maintain them in the manner provided in the rule and comply with certain other conditions.

The Act prohibits an investment adviser from basing his compensation upon a share of the capital gains or appreciation of his client's funds, and prohibits the assignment of investment advisory contracts without the client's consent. Advisers are also required to make, keep and preserve books and records in accordance with the Commission's rules and the Commission is empowered to conduct inspections of such books and records.

Investment advisers who violate any of the provisions of the Act or of the rules thereunder are subject to appropriate administrative, civil or criminal sanctions. The Act provides, in Section 203 (d), that the Commission shall deny, revoke, or suspend for not more than 12 months, the registration of an investment adviser if it finds that such action is in the public interest and that the investment adviser or any partner, officer, director or controlling or controlled person of the investment adviser is subject to a specified disqualification. These disqualifications include wilful misstatements in an application or report filed with the Commission, the existence of a conviction or injunction based on or related to specified types of misconduct, wilful violation of any provision of the Securities Act, Securities Exchange Act or Investment Advisers Act or any rule or regulation thereunder, and aiding and abetting any other person's violation of such provisions, rules or regulations. In addition, the Commission may seek injunctions to restrain violations of the Act and may recommend criminal prosecution by the Department of Justice for fraudulent misconduct or wilful violation of the Act or the Commission's rules thereunder.

Registration Statistics

At the close of the fiscal year 1,600 investment advisers were registered with the Commission. The following tabulation contains other statistics relating to registrations and applications for registration:

[table omitted]

Inspection Program

During fiscal 1965, 260 inspections of investment advisers were completed by the Commission's staff (as compared to 239 the preceding year). These inspections disclosed a total of 171 indicated violations of the Act and the rules and regulations promulgated thereunder, as reflected in the following table:

[table omitted]

Administrative Proceedings

Set forth below are statistics with respect to administrative proceedings under the Investment Advisers Act which were pending during fiscal year 1965:

[table omitted]

Among the decisions rendered during the fiscal year was one in which the Commission discussed at some length the obligations of investment advisers with respect to advertising material. In view of mitigating factors, the Commission, in Spear & Staff, Incorporated, accepted an offer of settlement consenting to findings that the registrant, aided and abetted by its president, wilfully violated the anti-fraud provisions of the Act and providing for an order directing registrant to refrain for 90 days from advertising for new subscribers to its publications and to undertake during that period to establish controls for the purpose of preventing future violations.

In its Findings and Opinion, the Commission analyzed registrant's advertising for its market letters, and found that such advertising was couched in enthusiastic and dramatic language, insistently implying that registrant possessed the ability to select stocks that were certain to appreciate in price substantially and rapidly and that "a certain road to riches was at hand for those who availed themselves of registrant's guidance." A frequently used advertisement inquired of prospective subscribers whether they desired to double their money in perhaps 12 or 24 months and urged that if they were so interested, they should learn about special situation investing from registrant. Another technique was to recount outstanding success stories and attribute the success of the selected individuals to investments in special situations, thereby furthering the impression that registrant was able to uncover for its subscribers opportunities for outstanding profits comparable to those which the described individuals had realized.

The Commission concluded that registrant's advertisements were deceptive and misleading in their over-all effect, particularly on unsophisticated investors, even though arguably no single statement was literally false. It stated that the advertisements obscured the numerous uncertainties and imponderables inherent in any attempt to forecast security prices. The Commission stated that in accepting respondents' offer of settlement, despite the seriousness with which it viewed the violation, it took into account that this was one of the first administrative proceedings in which it had dealt with the question of improper investment advisory advertising material, and various other mitigating factors. It

emphasized, however, that the relative leniency of the sanction imposed should not be misconstrued since in light of the admonitions of its opinion it would be disposed to deal more severely with any future instances of false and misleading advertising by investment advisers.

PART X OTHER ACTIVITIES OF THE COMMISSION CIVIL LITIGATION

The several statutes administered by the Commission authorize the Commission to seek injunctions against continuing or threatened violations of such statutes. Such violations may involve a wide range of illegal practices, including the purchase or sale of securities by fraud, and the sale of securities without compliance with the registration requirements of the Securities Act. The Commission also participates in various other types of proceedings, including appearances as amicus curiae in litigation between private parties where it is important that its views regarding the interpretation of the statutory provisions involved be furnished to the court, corporate reorganization proceedings under Chapter X of the Bankruptcy Act, and various types of civil appellate proceedings.

Tables 11 and 12 in the appendix to this report contain statistics with respect to the various types of civil proceedings in which the Commission participated prior to and during the fiscal year. A summary of injunction proceedings instituted by the Commission since 1934 may be found in Table 15. This section describes a few of the more noteworthy cases which were pending during the fiscal year, not including, however, cases arising under the Public Utility Holding Company Act or Chapter X of the Bankruptcy Act; such cases are discussed in the sections of this report dealing with those statutes.

During the year, the Commission was involved in significant litigation, both as a party and in an amicus curiae capacity, based upon Rule 10b-5 under the Securities Exchange Act of 1934. In *Securities and Exchange Commission v. Texas Gulf Sulphur Co.* an action instituted in April 1965, the Commission alleges that the rule was violated when certain officials of the defendant company purchased shares of its stock, as well as calls on such stock, between November 12, 1963 and April 16, 1964, without disclosing to the sellers material facts of which the officials were aware concerning the company's mining activities near Timmins, Ontario, Canada. The complaint alleges that on November 12, 1963, the company had completed a drill hole which has been characterized as the "most impressive ... in modern times." It is alleged that additional violations of the rule occurred when certain Texas Gulf officials advised other persons to engage in similar purchases, when certain of them received stock options from the company without disclosing the material facts about the ore strike to the board of directors and when the company itself, on April 13, 1964, issued a false and misleading press release concerning its activities in Timmins 3 days prior to its issuance of a second release which for the first time confirmed the existence of a rich copper and zinc ore body in the Timmins area. In

addition to injunctive relief against a repetition of the allegedly unlawful activities, the Commission seeks an order directing rescission of the allegedly unlawful purchases of stock and calls by the defendants, directing cancellation of the stock options in question and directing those defendants who advised others to purchase to make restitution to the sellers.

In a subsequent action, *Securities and Exchange Commission v. Golconda Mining Co. and Harry F. Magnuson*, it is alleged that Golconda and Magnuson, a substantial stockholder and controlling person of Golconda, violated the rule by purchasing stock of Hecla Mining Co. and selling stock of Lucky Friday Silver-Lead Mines Co., without disclosing to the respective sellers and purchasers a proposed merger between the two companies, known to Magnuson by virtue of his position as a director of each, at an exchange ratio different from the ratio of the market prices of the two stocks prevailing during the period of the alleged purchases and sales. The Commission seeks both an injunction against future violations and an order directing the defendants to make restitution to each person from whom they purchased Hecla stock and to whom they sold Lucky Friday stock during the period covered by the complaint.

During the fiscal year the Commission also agreed to a settlement of the case of *Securities and Exchange Commission v. Aldred Investment Trust, et al.*, which was instituted under Rule 10b-5 in 1961. In this case the Commission alleged that Richard L. Rosenthal, president and majority stockholder of Aldred Investment Trust, an investment company having less than 100 shareholders, had purchased through Birnbaum & Co., a registered broker-dealer, minority shares of Aldred stock at \$16 per share without disclosing to the sellers the identity of the purchaser, the purchaser's relationship to Aldred, the details of Aldred's investment portfolio or the fact that the net asset value of the stock had risen from \$27 to \$90 per share during the period in which the purchases took place. Birnbaum & Co. consented to the entry of a permanent injunction against future violations and the action was dismissed as against Rosenthal, after he offered rescission of their transactions to each of the persons from whom he purchased, and as against Aldred, after it had been recapitalized to eliminate all minority holdings.

Two private suits under the rule in which the Commission participated *amicus curiae* were *O'Neill v. Maytag, et al* and *List v. Fashion Park, Inc., et al*. In *O'Neill* the plaintiff, suing derivatively on behalf of National Airlines, Inc., alleged that National was defrauded within the meaning of the rule when its controlling directors caused it to acquire a large block of its own stock at an excessive price for the purpose of removing the threat to the directors' control represented by such stock. The district court dismissed plaintiff's complaint and the court of appeals affirmed, holding that while plaintiff did allege a breach of fiduciary duty by the directors, he did not allege a violation of Rule 10b-5 because the complaint failed to allege facts amounting to "deception" on the part of the defendants. The court pointed out, however, that "deception" might not be required under the rule where the fiduciary duty allegedly breached is one that was created "with particular reference to the purchase or sale of securities," as in the case of a broker-dealer

or investment adviser. The Commission's brief, urging reversal, had argued that it was clear from a reading of the entire complaint that plaintiff was claiming, although implicitly, that the directors did not fully disclose the conflicting interest which motivated the securities transactions to those entitled to such disclosure.

In the List case, a director of Fashion Park, Inc. and his broker had purchased from the plaintiff 5,100 shares of Fashion Park stock at \$18.50 per share without disclosing to him (1) that one of the purchasers was a director or (2) that the board of directors had 1 week earlier resolved to seek to sell or merge the company. The court of appeals affirmed the district court's dismissal of the complaint following trial, holding that although a securities purchaser may violate Rule 10b-5 while maintaining complete silence, the district court was not clearly in error in concluding that the plaintiff would have sold his stock even if he had known that a director was the purchaser, i.e., there was no "reliance" upon this nondisclosure, or in concluding that the corporate resolution was too remote to have influenced the conduct of a reasonable investor, i.e., the adoption of the resolution was not a "material" fact. While the Commission did not participate in this case at the trial or appellate levels, the Solicitor General, subsequent to the close of the fiscal year, submitted to the Supreme Court, at the Court's invitation, a memorandum amicus curiae expressing the Commission's views upon the question of whether the plaintiff's pending petition for a writ of certiorari should be granted. The position taken in this memorandum is that the court of appeals correctly determined that the rule may be violated by maintaining complete silence, but that the court's test of reliance is confusing and inappropriate in cases of complete nondisclosure and that the court erred in failing to evaluate the combined and cumulative impact of the two elements of nondisclosure. It is urged, however, that review by the Supreme Court is not warranted in view of the fact that the case involves primarily factual determinations and the petition does not appear to raise the questions which trouble the Commission.

The Commission's action against James J. Ling, Royce B. McKinley, and Joseph F. McKinney, former officers or directors, and Paul E. Broderick, the present treasurer of Electro-Science Investors, Inc., a registered investment company, was concluded on August 3, 1965, when the court entered final judgment based on stipulation and consent of all the parties.

The complaint alleged, among other things, that Ling, with the assistance of other defendants, took personal advantage of a corporate opportunity of the company to purchase and resell a large block of common stock of Tamar Electronics Industry, Inc., in which the company also had an interest, thus violating Section 17 of the 1940 Act, and that he realized substantial personal benefits from the transaction which rightfully belonged to the company. The complaint sought an accounting for and return of such profits of the company and an injunction pursuant to Section 36 of that Act preventing any of the defendants from serving as officers or directors of a registered investment company.

All defendants filed undertakings not to serve as officers or directors of any registered investment company (except that Mr. Broderick may continue as treasurer of the company). The court also approved a monetary settlement under which defendant Ling is to pay \$225,000 to the company in compromise of any claim the company may have against him.

In *Hoover v. Allen*, a derivative action by shareholders of American-Hawaiian Steamship Co., plaintiffs alleged that Daniel K. Ludwig, the principal shareholder of the company, had made false and misleading statements which were designed to depress the value of American-Hawaiian's stock and to induce other stockholders to sell their stock to the company, in order to enable Ludwig to obtain complete control of the company. Plaintiffs further alleged that Ludwig, after gaining such control, had committed acts of corporate waste. The complaint alleged violations of Sections 14 (a) (proxy provisions) and 18 (a) (false reports) of the 1934 Act and Sections 7 (a) (2) and (4) (registration provisions), 20 (a) (proxy provisions), 34 (b) (reporting provisions) and 36 (gross abuse of trust) of the 1940 Act.

The court dismissed all claims (except those involving Section 36) on the ground that the company suffered no injury directly connected with the purchase or sale of securities, noting that the company in fact benefited from its purchases since they were made at an allegedly depressed price. The court found that the acts of waste complained of were not so connected with the alleged fraud that they were cognizable under Section 10 (b) and that no injury was so connected with allegedly misleading proxy material as to state a cause of action under the proxy provisions of either Act.

The Commission's participation as *amicus curiae*, which was at the request of the court, was limited to the issues (1) whether a dormant nonoperating water carrier which held an ICC certificate was excluded from regulation under the 1940 Act under Section 3 (c) (9) thereof as a company "subject to regulation under the Interstate Commerce Act . . ." and (2) whether substantive violations of the 1940 Act were chargeable to a nonregistered company which should have been registered, under sections of the Act which in terms apply to a "registered investment company."

The court held that the Section 3 (c) (9) exemption was unavailable to water carriers, whether active or dormant. Further, by refusing to dismiss the Section 36 claims, the court also recognized that an action may be brought for substantive violations of the 1940 Act occurring during a period when an entity was illegally unregistered.

The Commission's action under the Investment Company Act against Continental Growth Fund, Inc., a registered investment company, and certain of its officers and directors, seeking to enjoin the individual defendants from continuing to act as officers and directors on the ground that they had been guilty of gross misconduct and gross abuse of trust, was terminated during the fiscal year with the settlement of the action against J.

Dudley Devine, the only remaining defendant, on the basis of a stipulation which recites that Mr. Devine has entered into an undertaking with the Commission.

In August 1963, on the Commission's application, the court had appointed a receiver for the fund's assets and in November 1963, it had entered an order permanently enjoining Richard G. Jacobs, a promoter of the fund and its former president, from further violations of the Investment Company Act. On June 24, 1964, the action was settled and discontinued by order of the court as against the other defendants on the basis of a stipulation which recited, among other things, that certain of the defendants and others had paid to the fund's receiver \$220,300 in settlement of losses resulting from the activities charged in the Commission's complaint, and had entered into undertakings similar to the above undertaking by defendant Devine.

In *Securities and Exchange Commission v. United Benefit Life Insurance Company* the Commission sought to enjoin the defendant company from offering and selling, in violation of the registration provisions of the Securities Act, a contract described by the company as an Annual Premium Flexible Fund Retirement Annuity. The Commission contended that the contract, representing a participation in a fund of securities, was a security within the meaning of that Act and also that the fund of securities constituted an investment company required to be registered under the Investment Company Act. At the close of the presentation of the Commission's evidence the district court dismissed the complaint, holding that the contract was an exempt "insurance product" and not a security. An appeal has been taken by the Commission to the Court of Appeals for the District of Columbia Circuit where the matter is now pending.

In a number of cases in which petitions for review were filed during or shortly prior to the fiscal year, various courts of appeals have affirmed Commission orders revoking the registrations of broker-dealers and in their decisions have expressed holdings of considerable significance. In *Boruski v. S.E.C.* the court, in rejecting the contention that the Commission's regulations requiring certified reports of financial condition were unreasonable, remarked that "it is difficult to see how the Commission could carry on its task of protection of the public investor without financial information such as it sought here." In response to Boruski's further contention that the Commission should have appointed counsel to represent him in the administrative proceeding, the court stated: "We know of no requirement that counsel be appointed in these administrative proceedings. The orders, although serious in their effect, are not criminal judgments."

In a companion case, *Financial Counsellors, Inc. v. S.E.C.*, the revocation of the broker-dealer registration of Financial Counsellors, Inc. was based upon its failure to disclose in its registration application that Boruski controlled it. The Act expressly requires disclosure of the identity of any person controlling the applicant and the court concluded that "the registration requirement provisions are of vital importance to the statutory scheme of securities regulations" and that revocation was "fully warranted."

A similar holding was made in the case of *Capital Funds, Inc. v. S.E.C.*, decided shortly after the end of the fiscal year, where the court ruled that a misstatement in an application for broker-dealer registration as to the identity of the owners of the business is not a "minor" point. The decision also held that the offer or sale of any part of an issue of securities to a nonresident is sufficient to deprive the entire issue of the benefit of the intrastate exemption from registration; that an industrial loan company, though organized under a Banking Statute and subject to supervision by a State Banking Commissioner, is not a banking institution within the meaning of the Securities Act; that the failure of the Commission to take action as to an earlier violation does not mean that it passed upon or approved any transaction; and that the Commission and its agents may not "waive" violations of Federal law, nor may estoppel be raised against the Commission.

In *Gearhart & Otis, Inc. v. S.E.C.*, the court held that objections which were not raised before the Commission could not be raised upon review, even though the objections in question could only have been raised by a petition for rehearing. However, the court added, with respect to one of the objections, that a Commissioner could participate in a decision even though he was appointed and took office subsequent to oral argument before the Commission.

In *Tager v. S.E.C.* the court refused to modify the sanctions imposed by the Commission, stating that courts should not "substitute their untutored views as to what sanctions will best accord with the regulatory powers of the Commission." In disposing of the petitioner's argument that his manipulation caused little harm to investors, the court observed: "The injury inflicted on the public, the market price inflation accomplished through the rigging, and the amount of profit realized by the broker are not immutable guides to an appropriate sanction as these factors are largely dependent upon market conditions and chance."

In this case as well as in the *Gearhart* and *Capital Funds* cases the courts reaffirmed their consistent holdings that willfulness, within the meaning of Section 15 (b) of the Securities Exchange Act, means merely that a person intentionally commits the act which constitutes the violation and does not mean that he must know he is breaking the law.

In *Nassau Securities Service v. S.E.C.*, the court sustained Commission action affirming a fine imposed by the National Association of Securities Dealers on the petitioner. The court rejected an attack on the make-up of the Association's tribunals because of their possible lack of disinterestedness, pointing out that disciplinary action taken by the Association is subject to full review of the Commission. The court also ruled that while it was "puzzled by the imposition of a \$1,000 forfeiture, the maximum fine in the NASD arsenal of remedies, for a breach of contract involving a sum less than one-third as large," it could not say that the Commission exceeded its discretion in upholding the Association's assessment.

In *Blau v. Max Factor & Co.*,⁶ the Court of Appeals for the Ninth Circuit held that an exchange of Max Factor common stock for Class A stock did not constitute a "purchase" of the Class A stock within the meaning of Section 16 (b) of the Exchange Act. The common stock was exchangeable for Class A at any time, and the only difference between the two classes was that the board of directors had the power to declare lesser dividends on the common than on the Class A. In holding that there was no purchase, the court distinguished *Park & Tilford, Inc. v. Schulte* where a conversion of convertible preferred into common was held to be a purchase. The court noted that unlike the Max Factor exchange, the preferred and common exchanged in *Park & Tilford* involved significantly different investment risks.

The plaintiff had challenged the validity of Rule 16b-9, under which the transactions involved were exempt from the operation of Section 16 (b), including its retroactive application to the facts of this case, and the Commission had filed an amicus curiae brief urging that the rule be upheld. In view of its conclusion that there was no purchase, the court found it unnecessary to determine the validity of the rule.

In accordance with a request from the Court of Appeals for the Third Circuit, the Commission participated amicus curiae in a reargument en banc in *Heli-Coil Corporation v. Webster*. This is an appeal from a district court decision holding appellant, a director of Heli-Coil Corporation, liable under Section 16 (b) for profits allegedly realized by him from short term dealings in the convertible debentures and common stock of the company. The Commission took the position that the court below correctly held that a voluntary conversion of debentures into common stock constituted a sale of the debentures and a purchase of the common stock within the meaning of Section 16 (b), that the stock acquired upon conversion was not exempt from Section 16 (b) as a security "acquired in good faith in connection with a debt previously contracted" and that a conversion was not exempt from Section 16 (b) as an arbitrage transaction. The Commission urged, however, that since under the circumstances of this case no profit was realized by appellant from the disposition of the debentures upon conversion, the judgment against him should have been limited to the profits realized from the sale of the common stock within 6 months of the conversion.

In *Western Auto Supply Co. v. Gamble-Skogmo, Inc.* the court, as urged by the Commission in an amicus curiae brief filed during the fiscal year, held (1) that the issuer's cause of action under Section 16 (b), as a matter of Federal law, survived a subsequent merger by the issuer with another corporation and assignment by the latter of its interest in the issuer to a third corporation; and (2) that shares of stock are fungible so that the purchase of a particular block cannot be matched against a transfer of most of that block to the purchaser's employee pension trust at the purchase price and thus make it unavailable for matching against a subsequent sale of other shares at a higher price within 6 months of the purchase of that block.

Particularly in view of the number of new companies that will be required to file reports with the Commission, increased enforcement of the filing requirements is being emphasized. In *Securities and Exchange Commission v. S & P National Corporation*, et al. a mandatory injunction was obtained directing the corporation and two named officers to file specified reports within 15 days of the date of the decree. The court further enjoined the defendants from failing to file or cause to be filed future reports which would become due. When the defendants failed to comply with the terms of the mandatory injunction the Commission filed a Petition for Adjudication of Civil Contempt. Pursuant thereto and with defendants' consent, an order was entered providing that the corporation and the officers "shall be in civil contempt of court" unless the required certified financial statements were filed by a specified day.

In *Securities and Exchange Commission v. Higashi*, the United States District Court for the District of Hawaii held, in a subpoena enforcement action, that the sequestration provisions of Rule 7 (b) of the Commission's Rules Relating to Investigations could not be applied to prevent a director of a corporation which was the subject of the Commission's investigation from being represented by the same counsel as that for the corporation. The Commission has appealed to the United States Court of Appeals for the Ninth Circuit, where the case is now pending.

CRIMINAL PROCEEDINGS

The statutes administered by the Commission provide that the Commission may transmit evidence of violations of any provisions of these statutes to the Attorney General, who in turn may institute criminal proceedings. Where facts ascertained as a result of an investigation by a regional office of the Commission or at times its headquarters office appear to warrant criminal prosecution, a detailed report is prepared. After careful review by the General Counsel's Office, the recommendations of the regional office and the General Counsel's Office are considered by the Commission, and if the Commission believes criminal prosecution is appropriate the case is referred to the Attorney General and to the appropriate U.S. attorney. Commission employees familiar with the case generally assist the U.S. attorney in the presentation of the facts to the grand jury, the preparation of legal memoranda for use in the trial, the conduct of the trial, and the preparation of briefs on appeal.

During the past fiscal year 52 cases were referred to the Department of Justice for prosecution. As a result of these and prior referrals, 34 indictments were returned against 208 defendants. The year also saw 106 convictions in 35 cases and the affirmance of 9 cases. Appeals were still pending in 12 other criminal cases at the close of the year. Of 9 defendants involved in 6 criminal contempt cases handled during the year, 1 was convicted, and 5 cases involving 8 defendants are still pending. From 1934, when the Commission was established, until June 30, 1965, 3,616 defendants have been indicted in

the U.S. district courts in 845 cases developed by the Commission and 1,880 convictions have been obtained.

As in prior years, the majority of the criminal cases prosecuted involved the offer and sale of securities by fraudulent representations, and other fraudulent practices. It is obviously not feasible to describe individually each of the many criminal matters pending during the fiscal year; only a few of the more noteworthy ones can be singled out for discussion.

The substantial sentences imposed in two criminal prosecutions involving violations of the registration provisions of the Securities Act of 1933 are significant. On September 17, 1964, Joseph Abrams, who had been found guilty by a jury of violating those provisions by offering and selling the unregistered stock of Automatic Washer Company, was sentenced to a prison term of 5 years. On February 16, 1965, Sidney Albert, who had been convicted of the same charges, was sentenced to 3 years in prison. Abrams and Albert have appealed; these appeals are presently pending in the Court of Appeals for the Second Circuit. Their convictions and the substantial sentences imposed on them should serve as a warning to unscrupulous promoters that they can not evade the registration requirements of the Securities Act by spurious reliance on exemptions from those requirements, and thereby deprive the investing public of full disclosure concerning the affairs of the issuer and its management.

The conviction of John C. Doyle of delivering unregistered securities of Canadian Javelin, Inc. to the public after sale is also significant. Doyle and three other defendants had been indicted in July 1962, for violating and conspiring to violate the registration and anti-fraud provisions of the Securities Act in connection with the offer and sale of Canadian Javelin. The indictment was initially sealed because two defendants were outside the United States and it was feared that disclosure of the indictment would prevent their return. In August 1962, Doyle represented to the Department of Justice that he had a commitment from an agent of the Commission that he would not be prosecuted. The Department of Justice rejected the claim and the indictment was made public in August 1963.

Thereafter all the defendants moved to dismiss the indictment, claiming that the prosecution was barred by the 5-year statute of limitations and that they had been denied the right to a speedy trial because of the delay in making the indictment public. The district court dismissed the indictment as to the three other defendants because of unnecessary post-indictment delay, but denied Doyle's motion because "the continued sealing was materially contributed to and caused by [Doyle's] own efforts."

On February 3, 1965, in the midst of a hearing, Doyle abandoned his commitment claim and pleaded guilty to a violation of the registration provisions of the Securities Act. He was later sentenced to 3 years imprisonment, with execution suspended as to 33 months, and was fined \$5,000. In imposing sentence the district court referred to a massive

distribution of unregistered stock and said: "It is not a question of 50 shares of stock alone the court has considered. The lack of registration is the important and paramount factor."

Doyle appealed his sentence to the Court of Appeals for the Second Circuit which affirmed the judgment and sentence saying: "Although Doyle's trial counsel chose to call the failure to register a technical violation, counsel can hardly be unaware of the close connection between a wilful failure to register securities and their fraudulent sale. . . ." The court emphasized that the prison sentence "must be conceded to be modest compared with the 5 year maximum allowed by 15 U.S.C. § 77x." The court of appeals further ordered its mandate to issue in 5 days because "sentence has already been too long delayed." On July 12, 1965, Justice Harlan denied Doyle's application for bail pending his petition for certiorari. On July 15, 1965, Doyle fled to Canada to avoid serving the prison sentence.

In April 1965, Paul R. Casavina and Horace J. Parisi were convicted in the United States District Court for New Jersey of violating Sections 5 and 17 of the Securities Act and the Mail Fraud Statute. Casavina was sentenced to 8 years imprisonment and Parisi received a suspended sentence and was placed on probation for 2 years. Evidence adduced during the trial showed that in excess of 600,000 shares of stock of Casavan Industries, Inc., a corporation controlled by Casavina, were sold by or through him by means of false and fraudulent representations. To justify the issuance of stock to Casavina and also to increase Casavan's purported assets from \$100,000 to approximately \$5 million, Casavina caused the corporation to acquire assets of little or no value from a number of other corporations. In this manner over 1.5 million shares of Casavan stock were issued, Casavina receiving more than 1 million of these shares, for which he paid no consideration.

During the fiscal year, 17 convictions were affirmed by appellate courts in 9 cases. In *United States v. McDaniel* the conviction of Paul E. McDaniel was affirmed by the Court of Appeals for the Fifth Circuit. McDaniel was convicted in 1963 for violating and conspiring to violate the registration and anti-fraud provisions of the Securities Act in connection with the offer and sale of the stock of Ambrosia Minerals, Inc. Together with George A. Mellon (presently a fugitive), he had arranged to have the stock of Ambrosia listed on the San Francisco Mining Exchange and had caused large blocks to be issued in the names of nominees. McDaniel and Mellon had manipulated the price of the stock on the exchange so that it rose from \$1 to over \$6 per share and had then proceeded to distribute approximately \$1 million worth of stock in the over-the-counter market during 1956 and 1957. They had not only issued false and misleading information to the public and filed false and misleading materials with the exchange and the Commission, but had also caused Ambrosia to pay two dividends in late 1956 and early 1957, although it never had any earnings. McDaniel was sentenced to serve 18 months in prison and to pay a fine of \$14,100.

On appeal McDaniel contended that he was not shown to have used the mails and that the mails were not used until after the sales had been made. In passing on this contention the court said:

"It may not have been clearly shown that appellant knew that the confirmations and stock certificates were to be mailed but the mailings were such an integral part of the transactions that the use of the mails for the delivery should have been foreseen and contemplated. The evil at which the Securities Act is directed is the fraud in the sale of securities. . . In other words, a scheme to defraud in relation to a sale of securities and the use of the mails in consummation thereof is the gist of the crime. The use of the mails need not be central to the scheme to defraud."

The court further stated that:

"[i]t matters not whether McDaniel himself did the mailing; the use of the mails by his broker must have been fully contemplated by him and attributed to him."

On October 27, 1964, the Court of Appeals for the Seventh Circuit affirmed the convictions of Walter E. Herr and William Gillentine for violating the Securities Act and the Mail Fraud Statute. The defendants made fraudulent sales of "inactive" distributorships to some 72 investors from March 1960, through February 1961. American Sales Training Research Association, Inc., of which the defendants were the promoters, was allegedly in the business of selling sales training material such as phonograph records, projectors and film. The defendants represented to investors that they could become "inactive" distributors by purchasing sales training material which, in turn, would be disposed of by a sales force maintained by the corporation. After a deduction for expenses, the "inactive" distributors were to receive the remaining profits, which the defendants represented to be as high as 6 percent a month.

On appeal the defendants contended that the distributorships were not "securities" within the meaning of the 1933 Act, and that only sales of merchandise were involved. In rejecting this contention, the court said:

"we construe it to be an investment contract. . . . [T]he facts here show that it was not the intention of either the defendants or the investors that the latter, themselves, were to actually resell the merchandise. . . . They [the investors] were led to believe that they could expect profits solely from the efforts of others."

Shortly after the close of the fiscal year the Court of Appeals for the Second Circuit affirmed the convictions of Roy B. Kelly and Cecil V. Hagen for violating and conspiring to violate the anti-fraud and registration provisions of the Securities Act and the Mail Fraud Statute in connection with the offer and sale to the public of Gulf Coast Leaseholds, Inc. stock, as well as conspiring to commit fraud upon the Commission in its function of protecting the investing public. Kelly and Hagen had each been sentenced to

3 years in prison. The court, however, reversed the conviction of Milton J. Shuck. At the outset of its opinion the court noted:

"It is a sad commentary upon the morals of our stock market places in general, and the over-the-counter market in particular, that at this late date in the history of federal securities regulation we are called upon once again to 'memorialize the rapacity of the perpetrators and gullibility, and perhaps also the cupidity of the victims'."

In a lengthy statement of facts the court noted that the Commission's insistence on full and accurate disclosure prevented Gulf Coast Leaseholds from obtaining a listing on the American Stock Exchange after the Board' of Governors of that Exchange had approved the listing and certified such action to the Commission. Noting the impact on the market of the false information about the company disseminated by the conspirators, the court said:

"But not even this stream of false information could budge the SEC into approving Gulf Coast's application for listing on the American Stock Exchange."

The court also complimented the prosecution team, which included Commission personnel, for its handling of the case.

COMPLAINTS AND INVESTIGATIONS

Each of the Acts administered by the Commission specifically authorizes investigations to determine whether violations of the Federal securities laws have occurred.

The nine regional offices of the Commission, with the assistance of their respective branch offices, are chiefly responsible for the conduct of investigations. In addition, the Office of Enforcement of the Division of Trading and Markets of the Commission's headquarters office conducts investigations dealing with matters of particular interest or urgency, either independently or assisting the regional offices. The Office of Enforcement also exercises general supervision over and coordinates the investigative activities of the regional offices and recommends appropriate action to the Commission.

There are available to the Commission several sources of information concerning possible violations of the provisions of the Federal securities laws. The primary source of information is complaints by members of the general public concerning the activities of certain persons in securities transactions. The Division of Trading and Markets and the regional offices give careful consideration to such complaints and, if it appears that violations of the Federal securities laws may have occurred, an investigation is commenced. Other sources of information which are of assistance to the Commission in carrying out its enforcement responsibilities are the national securities exchanges, the

National Association of Securities Dealers, Inc., brokerage firms, state and Canadian securities authorities, better business bureaus, and various law enforcement agencies.

It is the Commission's general policy to conduct its investigations on a confidential basis. Such a policy is necessary to effective law enforcement and to protect persons against whom unfounded or unconfirmed charges might be made. The Commission investigates many complaints where no violation is ultimately found to have occurred. To conduct such investigations publicly would ordinarily result in hardship or embarrassment to many interested persons and might affect the market for the securities in question, resulting in injury to investors with no countervailing public benefits. Moreover, members of the public would tend to be reluctant to furnish information concerning violations if they thought their personal affairs would be made public. Another advantage of confidential investigations is that persons suspected of violations are not made aware that their activities are under surveillance, since such awareness might result in frustration or obstruction of the investigation. Accordingly, the Commission does not generally divulge the result of a non-public investigation unless it is made a matter of public record in proceedings brought before the Commission or in the courts.

When it appears that a serious violation of the Federal securities laws has occurred or is occurring, a "case" is opened and a full investigation is conducted. Under certain circumstances it becomes necessary for the Commission to issue a formal order of investigation which appoints members of its staff as officers to issue subpoenas, to take testimony under oath and to require the production of documents. Usually this procedure is resorted to only when the subjects of the investigation and others involved are uncooperative and it becomes necessary to invoke the subpoena power to complete the investigation.

During the fiscal year ended June 30, 1965, the following formal orders were issued by the Commission upon recommendation of the staff divisions indicated:

Division of Trading and Markets --146

Division of Corporation Finance -- 26

Division of Corporate Regulation --14

When an investigation has reached the stage at which enforcement action appears appropriate, the Commission may proceed in one of several ways, although the use of one procedure may not necessarily preclude the use of another. The Commission may: (1) refer the case to the Department of Justice or appropriate local enforcement authorities for criminal prosecution, (2) institute through its own staff, in the appropriate U.S. district court, civil proceedings for injunctive relief to halt further violations of law, and, (3) institute administrative proceedings if the case is one where it has the power to do so.

The following table reflects in summarized form the investigative activities of the Commission during fiscal 1965:

[table omitted]

ENFORCEMENT PROBLEMS WITH RESPECT TO FOREIGN SECURITIES

The unlawful offer and sale of Canadian securities in the United States remained at a fairly low level in fiscal 1965. The cooperation of Canadian officials and segments of the Canadian securities industry with the Commission has been very good. The Commission assisted the Ontario Royal Commission on Windfall Oils and Mines Limited in its exhaustive investigation into the wild gyrations of Windfall shares on the Toronto Stock Exchange.

The most serious foreign securities problem confronting the Commission continues to be the increase in fraudulent promotions from countries other than Canada, particularly the Bahamas. In dealing with many of these promotions, the Commission is experiencing considerable success with the new, simplified procedures for obtaining foreign postal fraud orders, with the continuing cooperation of the Post Office Department. In addition to obtaining injunctive relief against a Bahamian bank, the Commission issued a public warning release in June of 1965, concerning the public offering of unregistered time deposit certificates and other securities by various organizations holding bank charters in the Bahamas. Although the named organizations designate themselves as "banks", they do not carry on normal banking operations. In its warning release, the Commission pointed out that these so-called "banks" should not be confused with the recognized banks and financial institutions conducting business in the Bahamas.

During the fiscal year, the Commission continued to maintain its Canadian Restricted List, consisting of Canadian companies whose securities the Commission had reason to believe were being, or recently had been, distributed in the United States in violation of the registration requirements of the Securities Act of 1933. Seven supplements to the list were issued. In line with the trend of the past few years, it was necessary to add only 4 names to the list during the year, compared with 2 in fiscal 1964, 7 in fiscal 1963, 9 in fiscal 1962, 47 in fiscal 1961 and 82 in fiscal 1960. A total of 36 names was deleted following compliance with established procedures. As of June 30, 1965, 107 companies were on the list, the smallest number since the list was established in 1951.

Following the end of the fiscal year, the Commission announced the issuance of a revised list, to be known as the "Foreign Restricted List," replacing the Canadian Restricted List. The new list will include the names not only of Canadian issuers but also those of other countries whose securities may be the subject of unlawful distributions in this country. As before, the current list and supplements thereto will be issued to and published by the press, and copies will be mailed to all registered broker-dealers and be made available to

the public. As a practical matter, most United States broker-dealers refuse to execute transactions in securities on the restricted list.

As of September 23, 1965, the list contained the names of 56 Canadian companies (representing the addition of 1 company and the deletion of 52 others) and 13 Bahamian organizations, as follows:

FOREIGN RESTRICTED LIST

Canadian issuers

Abbican Mines, Ltd.

Alaska Highway Beryllium Venture

Anuwon Uranium Mines, Ltd

Associated Livestock Growers of Ontario

Autofab, Ltd.

Bayonne Mine, Ltd.

Bonwitha Mining Co., Ltd

Canol Metal Mines, Ltd.

Canford Explorations, Ltd.

Consolidated Exploration & Mining Co., Ltd.

Consolidated Woodgreen Mines, Ltd.

Crusade Petroleum Corp., Ltd.

Dayjon Explorers, Ltd.

Devonshire Mining Co., Ltd.

Fairmont Prospecting Syndicate

The Fort Hope Grubstake

Guardian Explorations, Ltd.

Haitian Copper Mining Corp., Ltd.

International Claim Brokers, Ltd.

Ironco Mining & Smelting Co., Ltd.

Jack Haynes Syndicate

Jaylac Mines, Ltd.

Keele Industrial Developments, Ltd.

Kenilworth Mines, Ltd.

Kennament Development Corp., Ltd.

Ladysmith Explorations, Ltd.

Leader Mining Corp., Ltd.

Mack Lake Mining Corp., Ltd.

Maple Leaf Investing Corp., Ltd.

March Minerals, Ltd.

Merrican International Mines, Ltd.

Mid-National Developments, Ltd.

Milldale Minerals, Ltd.

Natto Mining Co., Ltd.

New Mallen Red Lake Mines, Ltd.

St. Stephen Nickel Mines, Ltd.

Norart Minerals Limited

Sastex Oil & Gas, Ltd.

Norbank Explorations, Ltd.

Sinclair Prospecting Syndicate

North West Pacific Developments, Ltd.

Success Mines, Ltd.

Nu-Gord Mines, Ltd.

Sudbay Beryllium Mines, Ltd.

Nu-World Uranium Mines, Ltd.

Trans-Oceanic Hotels Corp., Ltd.

Old Smoky Oil & Gas, Ltd.

Turbenn Minerals, Ltd.

Outlook Explorations, Ltd.

Tyndall Explorations, Ltd.

Paracansa Coffee Growers, Ltd.

Vimy Explorations, Ltd.

St. Lawrence Industrial Development Corp.

Ste. Sophie Development Corp.

Western Allenbee Oil & Gas Co., Ltd.

Wingdam & Lightning Creek Mining Co., Ltd.

Bahamian issuers

British Colonial Bank of Commerce (Bahamas) Ltd.

Investment Bankers of Bahamas, Ltd.

The Bank of World Commerce, Ltd.

Lords Bank and Trust Company, Ltd.

Bankers International Investment Corporation

New Zealand Bank and Trust Company (Bahamas) Ltd.
now known as Marlboro Bank and Trust Company

Transworld Investment Bank, Ltd.

Commons Bank and Trust Company, Ltd.

Jomur Trust Company, Ltd.

Essex Bank and Trust Company, Ltd.

Whitechapel Bank, Ltd.

Investments and Trust Company, Ltd.

Parliament Bank and Trust, Ltd.

SECTION OF SECURITIES VIOLATIONS

A Section of Securities Violations is maintained by the Commission as a part of its enforcement program to provide a further means of detecting and preventing fraud in securities transactions. The Section maintains files which provide a clearinghouse for other enforcement agencies for information concerning persons who have been charged with or found in violation of various Federal and state securities statutes. Considerable information is also available concerning violators resident in the Provinces of Canada. The specialized information in these files is kept current through the cooperation of various governmental and non-governmental agencies. At the end of the fiscal year, the files contained information, concerning 71,488 persons and firms. Included in the data processed by the Section during the year was information received from several states, Canada and Puerto Rico respecting 134 criminal actions, 55 injunctive actions, 238 cease and desist type orders and 68 other administrative orders, such as denials, suspensions and revocations.

Altogether during the fiscal year, the Section received and disposed of 4,206 "securities violations" letters and dispatched 835 communications to cooperating agencies. It added to the Commission's files information respecting 6,853 persons or firms, including information on 2,632 persons or firms not previously identified, and deleted the names of 2,884 persons or firms as to whom information was believed to be obsolete.

APPLICATIONS FOR NONDISCLOSURE OF INFORMATION

The Commission is authorized under the various Acts administered by it to grant requests for nondisclosure of certain types of information which would otherwise be disclosed to the public in applications, reports or other documents filed pursuant to these statutes. Thus, under paragraph (30) of Schedule A of the Securities Act of 1933, disclosure of any portion of a material contract is not required if the Commission determines that such disclosure would impair the value of the contract and is not necessary for the protection of investors. Under Section 24 (a) of the Securities Exchange Act of 1934, trade secrets or processes need not be disclosed in any material filed with the Commission. Under Section 24 (b) of that Act, written objection to public disclosure of information contained in any material filed with the Commission may be made to the Commission which is then authorized to make public disclosure of such information only if in its judgment such disclosure is in the public interest. Similar provisions are contained in Section 22 of the Public Utility Holding Company Act of 1935 and in Section 45 of the Investment Company Act of 1940. These statutory provisions have been implemented by rules specifying the procedure to be followed by applicants for a determination that public disclosure is not necessary in a particular case.

The number of applications granted, denied or otherwise acted upon during the year are set forth in the following table:

[table omitted]

ACTIVITIES OF THE COMMISSION IN ACCOUNTING AND AUDITING

The several Acts administered by the Commission recognize the importance of dependable informative financial statements which disclose the financial status and earnings history of a corporation or other commercial entity. These statements, whether filed in compliance with the requirements under those statutes or included in other material available to stockholders or prospective investors, are indispensable to investors as a basis for investment decisions. The Congress, cognizant of the fact that such statements lend themselves readily to misleading inferences or even deception, whether or not intended, included express provisions in the various Acts with respect to financial information required to be disclosed. Thus, for example, the Securities Act requires the inclusion in the prospectus of balance sheets and profit and loss statements "in such form as the Commission shall prescribe" and authorizes the Commission to prescribe the "items or details to be shown in the balance sheet and earnings statement, and the methods to be followed in the preparation of accounts" Similar authority is contained in the Securities Exchange Act, and even more comprehensive power is embodied in the Investment Company Act and the Public Utility Holding Company Act.

Pursuant to the broad rulemaking power thus conferred with respect to the preparation and presentation of financial statements, the Commission has prescribed uniform systems of accounts for companies subject to the Holding Company Act; has adopted rules under the Securities Exchange Act governing accounting for and auditing of securities brokers and dealers; and has promulgated rules contained in a single comprehensive regulation, identified as Regulation S-X, which governs the form and content of financial statements filed in compliance with the several Acts. This regulation is supplemented by the Commission's Accounting Series Releases, of which 101 have so far been issued. These releases were inaugurated in 1937 and were designed as a program for making public from time to time opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions. The rules and regulations thus established, except for the uniform systems of accounts which are regulatory reports, prescribe accounting principles to be followed only in certain limited areas. In the large area of financial reporting not covered by such rules, the Commission's principal means of protecting investors from inadequate financial reporting, fraudulent practices and overreaching by management is by requiring a certificate of an independent public accountant, based on an audit performed in accordance with generally accepted auditing standards, which expresses an opinion as to whether the financial statements are presented fairly in conformity with accounting principles and practices which are recognized as sound and which have attained general acceptance.

The Securities Act provides that the financial statements required to be made available to the public through filing with the Commission shall be certified by "an independent public or certified accountant." The other three statutes permit the Commission to require that such statements be accompanied by a certificate of an independent public accountant, and the Commission's rules require, with minor exceptions, that they be so certified. The value of certification by qualified accountants has been conceded for many years, but the requirement as to independence, long recognized and adhered to by some individual accountants, was for the first time authoritatively and explicitly introduced into law in 1933. Under the Commission's rules, an accountant who is qualified to practice in his own state is qualified to practice before the Commission unless he has entered into disqualifying relationships with a particular client, such as becoming a promoter, underwriter, voting trustee, director, officer, employee, or stockholder; has demonstrated incompetence or subservience to management; or has engaged in unethical or improper professional conduct.

The Commission endeavors to encourage and foster the independence of the accountant in his relationships with his client so that he may better be able to perform the service to the public contemplated by the Congress in the various Acts administered by the Commission. Because of his special status and responsibility, the accountant has a unique opportunity to be a leader in raising standards of investor protection. The financial statements provide the key information both in the distribution and trading of securities. The work of the accountant in their preparation and publication is vital. Independent accountants lend authority to management's representations by their opinions as experts,

and they operate as a check on management in assuring that the financial data are fairly presented in accordance with generally accepted accounting principles.

The Commission is vigilant in its efforts to assure itself that the audits which it requires are performed by independent accountants; that the information contained in the financial reports represents full and fair disclosure; and that appropriate auditing and accounting practices and standards have been followed in their preparation. In addition, it recognizes that changes and new developments in financial and economic conditions affect the operations and financial status of the several thousand commercial and industrial companies required to file statements with the Commission and that accounting and auditing procedures cannot remain static and continue to serve well a dynamic economy. The Commission's accounting staff, therefore, studies the changes and new developments for the purpose of establishing and maintaining appropriate accounting and auditing policies, procedures and practices for the protection of investors. The primary responsibility for this program rests with the Chief Accountant of the Commission, who has general supervision with respect to accounting and auditing policies and their application.

Progress in these activities requires continuing contact and consultation between the staff and accountants both individually and through such representative groups as, among others, the American Accounting-Association, the American Institute of Certified Public Accountants, the American Petroleum Institute, the Financial Analysts Federation, the Financial Executives Institute, and the National Association of Railroad and Utilities Commissioners, as well as many Government agencies. Recognizing the importance of cooperation in the formulation of accounting principles and practices, adequate disclosure and auditing procedures which will best serve the interests of investors, the American Institute of Certified Public Accountants, the Financial Analysts Federation, and the Financial Executives Institute appoint committees which maintain liaison with the Commission's staff.

The Commission on its part authorized its Chief Accountant to continue to serve during the year as a member of an advisory committee to the Accounting Principles Board of the American Institute of Certified Public Accountants. This committee served as adviser to the Institute's Director of Research while he was engaged in making an inventory of generally accepted accounting principles and practices recognized by the accounting profession and currently in use. The results of this work, which will be useful to laymen as well as to accountants, can be found in an accounting research study published by the Institute entitled "Inventory of Generally Accepted Accounting Principles for Business Enterprises," by Paul Grady.

In addition to this formal participation the Chief Accountant's Office has furnished suggestions to the Institute's Director of Research and to the Accounting Principles Board who are now revising and bringing up to date prior pronouncements made by the Institute's Committee on Accounting Procedure and preparing for publication opinions of

the Accounting Principles Board. These opinions are based on studies made by the research staff of the Institute and by other persons selected to make the required studies.

The many daily decisions to be made which require the attention of members of the Chief Accountant's staff include questions raised by the operating divisions of the Commission, the regional offices, and the Commission itself. As a result of this day-to-day activity and the need to keep abreast of current accounting problems, the Chief Accountant's staff continually reexamines accounting and auditing principles and practices. From time to time members of the staff are called upon to assist in field investigations, to participate in hearings and to review Commission opinions insofar as they pertain to accounting matters.

Profiling and other conferences with officials of corporations, practicing accountants and others are also an important part of the work of the staff. Resolution of questions and problems in this manner saves registrants and their representatives both time and expense. The 1964 amendments to the securities acts bring into contact with the Commission many heretofore "unregulated" companies. In many cases, the independent accountant has been a primary bridge between the issuer and the Commission. Registrants falling into this category and the accountants who will certify the financial statements for them have been assisted by members of the Commission and its staff who have lectured and participated in institutes and symposiums sponsored by various groups in different parts of the country, where the provisions of the 1964 amendments were explained.

Many specific accounting and auditing problems are found in the examination of financial statements required to be filed with the Commission. Where examination reveals that the rules and regulations of the Commission have not been complied with or that applicable generally accepted accounting principles have not been adhered to, the examining division usually notifies the registrant by an informal letter of comment. These letters of comment and the correspondence or conferences that follow continue to be a most convenient and satisfactory method of effecting corrections and improvements in financial statements, both to registrants and to the Commission's staff. Where particularly difficult or novel questions arise which cannot be settled by the accounting staff of the divisions and by the Chief Accountant, they are referred to the Commission for consideration and decision.

The staff of the Chief Accountant's Office and the staff of the Office of Policy Research conferred several times during fiscal 1965 with representatives of the New York Stock Exchange and its accounting consultants, Price Waterhouse & Co., for the purpose of implementing the recommendation set forth in the Special Study with respect to obtaining the necessary information for a clearer understanding of the Stock Exchange's commission rate structure and level and the odd-lot differentials. As a result of these conferences the income and expense report developed by the Exchange for the annual reporting of member firms doing a public commission business was modified and

expanded, thus becoming a more useful source of information for additional studies which will be made by the Commission and the Exchange. A financial reporting form comparable to the Exchange's income and expense report was developed for use by the major New York Stock Exchange odd-lot member firms when filing their annual reports.

The proposed revision of Form X-17A-5, the annual report of financial condition required to be filed by certain brokers and dealers pursuant to Section 17 of the Securities Exchange Act of 1934, mentioned in last year's annual report of the Commission, is progressing through the required rulemaking process. This form and the related minimum audit requirements are being revised to meet changing conditions and practices in the securities industry.

The Chief Accountant and his staff cooperated with the staff of the Federal Reserve System and the Federal Deposit Insurance Corporation in the preparation of rules and regulations under the Securities Acts Amendments of 1964 which now govern the reports banks are required to file with the Federal Reserve Board and the Federal Deposit Insurance Corporation.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Section 15 of the Bretton Woods Agreements Act, as amended, exempts from registration under both the Securities Act of 1933 and the Securities Exchange Act of 1934 securities issued, or guaranteed as to both principal and interest, by the International Bank for Reconstruction and Development. The Bank is required to file with the Commission such annual and other reports with respect to such securities as the Commission determines to be appropriate in view of the special character of the Bank and its operations, and necessary in the public interest or for the protection of investors. The Commission has, pursuant to the above authority, adopted rules requiring the Bank to file quarterly reports and also to file copies of each annual report of the Bank to its board of governors. The Bank is also required to file reports with the Commission in advance of any distribution in the United States of its primary obligations. The Commission, acting in consultation with the National Advisory Council on International Monetary and Financial Problems, is authorized to suspend the exemption at any time as to any or all securities issued or guaranteed by the Bank during the period of such suspension.

The Bank reported a net income of \$136.9 million for the fiscal year ending June 30, 1965. This compared with net income of \$97.5 million in the fiscal year 1964. The difference between the two figures results mainly from the fact that since July 1, 1964, the Bank has discontinued treating a portion of loan receipts as commission to be credited to the Special Reserve and, with a few minor exceptions, all income from loans is considered as regular income.

On July 29, 1965, the Executive Directors allocated \$61.9 million from the year's net income to the Supplemental Reserve against losses on loans and guarantees, increasing it to \$667.5 million. This increased the Bank's total reserves, including the Special Reserve, to \$956.5 million. The Executive Directors recommended to the Board of Governors that the remaining \$75 million of the year's net income be transferred to the Bank's affiliate, the International Development Association.

During the year, the Bank made 38 loans totaling \$1,023.3 million, compared with a total of \$809.9 million last year. The loans were made in Brazil (2 loans), Chile, the Republic of China (2 loans), Finland (2 loans), Gabon, Honduras, India (3 loans), Iran (2 loans), Italy, Jamaica, Japan (3 loans), Malaysia, Mexico, Morocco, Nigeria, Paraguay, Peru (2 loans), Philippines (2 loans), Portugal, Rhodesia and Zambia, Sierra Leone, Spain, Thailand (2 loans), Uruguay, Venezuela (2 loans) and Yugoslavia. This brought the total number of loans to 424 in 77 countries and territories and raised the gross total of commitments to \$8,954.6 million. By June 30, as a result of cancellations, exchange adjustments, repayments and sales of loans, the portion of loans signed still retained by the Bank had been reduced to \$5,966.8 million.

During the year the Bank sold or agreed to sell \$106.2 million principal amounts of loans, compared with sales of \$173.3 million last year. On June 30, the total of such sales was \$1,884.7 million, of which all except \$69 million had been made without the Bank's guarantee.

On June 30, the outstanding funded debt of the Bank was \$2.724 million, reflecting a net increase of \$232.2 million in the past year. During the year the funded debt was increased through the private placement of bonds and notes totaling \$198 million and DM 400 million (equivalent US\$100 million) and the public sale of bonds as follows: Can\$25 million (US\$23.1 million), DM 250 million (US\$62.5 million), Sw F 60 million (US\$14 million), and US\$200 million, of which \$17.9 million were sold under delayed delivery arrangements. The debt was decreased through the retirement of bonds and notes totaling US\$248 million, Sw F 33 million (US\$7.8 million), DM 200 million (US\$50 million), Can\$11.5 million (US\$10.6 million), and by net sinking and purchase fund transactions amounting to \$31.1 million.

During the year eight countries increased their capital subscriptions to the Bank: the Dominican Republic by \$5.3 million, the United Arab Republic by \$35.5 million, Honduras by \$2 million, Costa Rica by \$2.7 million, Italy by \$306 million, Malaysia by \$83.3 million, Panama by \$8.6 million and Sudan by \$40 million. Thus on June 30, 1965, the subscribed capital of the Bank amounted to \$21,669.4 million.

INTER-AMERICAN DEVELOPMENT BANK

The Inter-American Development Bank Act, which authorizes the United States to participate in the Inter-American Development Bank, provides an exemption for certain securities which may be issued by the Bank similar to that provided for securities of the International Bank for Reconstruction and Development. Acting pursuant to this authority, the Commission adopted Regulation IA, which requires the Bank to file with the Commission substantially the same information, documents and reports as are required from the International Bank for Reconstruction and Development. The Bank is also required to file a report with the Commission prior to the sale of any of its primary obligations to the public in the United States.

During the year ended June 30, 1965, the Bank made 26 loans totaling the equivalent of \$182,806,242 from its ordinary capital resources, bringing the gross total of loan commitments outstanding at June 30, to 115, aggregating \$583,695,165. During the year, the Bank sold or agreed to sell \$4,702,476 in participations in the aforesaid loans, all of such participations being without the guarantee of the Bank. The loans from the Bank's ordinary capital resources were made in Argentina, Brazil, Chile, Colombia, El Salvador, Nicaragua, Peru, Uruguay, and Venezuela.

During the year the Bank also made 17 loans totaling the equivalent of \$65,832,689 from its Fund for Special Operations, bringing the gross total of loan commitments outstanding at June 30, to 56, aggregating \$192,354,268. In addition, the Bank made 31 loans aggregating \$99,587,000 from the Social Progress Trust Fund, which it administers under an Agreement with the United States, bringing the gross total of loan commitments outstanding at June 30, to 112, aggregating \$482,433,534.

On June 30, 1965, the outstanding funded debt of the ordinary capital resources of the Bank was the equivalent of \$285,093,548, reflecting an increase during the year of the equivalent of \$135,900,000. This increase consisted of two public bond issues, including a \$100 million U.S. dollar issue and a German mark issue in the amount of DM 60 million (\$15 million); the private placement of an issue in the United Kingdom in the amount of £ 3 million (\$8.4 million), and the borrowing of \$12.5 million from an agency of the Government of Spain.

The subscribed ordinary capital of the Bank on June 30, 1965, was the equivalent of \$1,284,985,000, of which \$903,405,000 represented callable capital.

STATISTICS AND SPECIAL STUDIES

The work and personnel of the Office of Statistical Studies were transferred during the past fiscal year, in part to the Office of Policy Research and in part to the Office of Regulation, Division of Trading and Markets. The regular statistical activities of the Commission and the overall Government statistical program under the direction of the Office of Statistical Standards, Bureau of the Budget, have been continued in these

Offices. The statistical series described below are published in the Commission's monthly Statistical Bulletin. In addition, current figures and analyses of the data are published quarterly on new securities offerings, individuals' savings, financial position of corporations, and plant and equipment expenditures.

Issues registered under the Securities Act of 1933

Monthly statistics are compiled on the number and volume of registered securities, classified by industry of issuer, type of security, and use of proceeds. Summary statistics for the years 1935-65 are given in Appendix Table 1 and detailed statistics for the fiscal year 1965 appear in Appendix Table 2.

New Securities Offerings

Monthly and quarterly data are compiled covering all new corporate and non-corporate issues offered for cash sale in the United States. The series includes not only issues publicly offered but also issues privately placed, as well as other issues exempt from registration under the Securities Act such as intrastate offerings and offerings of railroad securities. The offerings series includes only securities actually offered for cash sale, and only issues offered for account of issuers.

Estimates of the net cash flow through securities transactions are prepared quarterly and are derived by deducting from the amount of estimated gross proceeds received by corporations through the sale of securities the amount of estimated gross payments by corporations to investors for securities retired. Data on gross issues, retirements and net change in securities outstanding are presented for all corporations and for the principal industry groups.

Individuals' Savings

The Commission compiles quarterly estimates of the volume and composition of individuals' savings in the United States. The series represents net increases in individuals' financial assets less net increases in debt. The study shows the aggregate amount of savings and the form in which they occurred, such as investment in securities, expansion of bank deposits, increases in insurance and pension reserves, etc. A reconciliation of the Commission's estimates with the personal savings estimates of the Department of Commerce, derived in connection with its national income series, is published annually by the Department of Commerce as well as in the Securities and Exchange Commission Statistical Bulletin.

Private Pension Funds

An annual survey is published of private pension plans other than those administered by insurance companies, showing the flow of money into these funds, the types of assets in

which the funds are invested and the principal items of income and expenditures. Data on stock transactions of pension funds and property and casualty insurance companies are also collected quarterly and it is anticipated that these will be published in the near future.

Financial Position of Corporations

The series on the working capital position of all United States corporations, excluding banks, insurance companies and savings and loan associations, shows the principal components of current assets and liabilities, and also contains an abbreviated analysis of the sources and uses of corporate funds.

The Commission, jointly with the Federal Trade Commission, compiles a quarterly financial report of all United States manufacturing-concerns. This report gives complete balance sheet data and an abbreviated income account, data being classified by industry and size of company.

Plant and Equipment Expenditures

The Commission, together with the Department of Commerce, conducts quarterly and annual surveys of actual and anticipated plant and equipment expenditures of all United States business, exclusive of agriculture. After the close of each quarter, data are released on actual capital expenditures of that quarter and anticipated expenditures for the next two quarters. In addition, a survey is made at the beginning of each year of the plans for business expansion during that year.

Directory of Registered Companies

The Commission annually publishes a listing of companies required to file annual reports under the Securities Exchange Act of 1934. In addition to an alphabetical listing, there is a listing of companies by industry group classified according to The Standard Industrial Classification Manual.

Stock Market Data

The Commission regularly compiles statistics on the market value and volume of sales on registered and exempted securities exchanges, round-lot stock transactions on the New York exchanges for account of members and non-members, odd-lot stock transactions on the New York exchanges and block distributions of exchange stocks. Publication of odd-lot transactions in 75 selected stocks on the New York Stock Exchange was begun in the fall of 1964. Since January 1965, the Commission has also been compiling statistics on volume of over-the-counter trading in common stocks listed on national securities exchanges based on reports filed under Rule 17a-9 of the Securities Exchange Act dealing with the "third market."

Data on round-lot and odd-lot trading on the New York exchanges are released weekly. The other stock market data mentioned above, as well as these weekly series, are published regularly in the Commission's Statistical Bulletin.

OPINIONS OF THE COMMISSION

Formal administrative proceedings under the statutes administered by the Commission generally culminate in the issuance of an opinion and order. Under a procedure adopted during the 1964 fiscal year, applicable to proceedings initiated on or after August 1, 1964, a hearing officer makes an initial decision following a hearing at which he has presided, unless such decision is waived by the parties. If Commission review is not sought, and if the case is not called up for review on the Commission's own initiative, the initial decision becomes final and an order pursuant to it is issued by the Commission.

In those instances where it prepares its own decision, upon review or waiver of an initial decision or where the record has been stipulated by the parties, the Commission, or the individual Commissioner to whom a case may be assigned for the preparation of an opinion, is generally assisted by the Office of Opinions and Review. This Office is directly responsible to the Commission and is completely independent of the operating divisions of the Commission, consistent with the principle of separation of functions embodied in the Administrative Procedure Act. Where the parties to a proceeding waive their right to such separation, the operating division which participated in the proceeding may assist in the drafting of the Commission's decision.

The Commission's opinions are publicly released and are distributed to the press and to persons on the Commission's mailing list. In addition, they are printed and published periodically by the Government Printing Office in bound volumes entitled "Securities and Exchange Commission Decisions and Reports."

DISSEMINATION OF INFORMATION

As the discussion in prior sections of this Report has shown, most large corporations in which there is a substantial investor interest now have registration applications or statements on file with the Commission and are required to file annual and other periodic reports with it. Much of the vital financial and other information included in these documents receives widespread dissemination through the medium of securities manuals and other financial publications and thus becomes available to public investors, broker-dealer and investment adviser firms, trust departments and other financial institutions.

Various activities of the Commission serve to facilitate public dissemination of corporate and other information. Among these is the publication of a daily "News Digest" which contains a resume of each proposal for the public offering of securities for which a

registration statement is filed. The News Digest also lists new registrations by companies as well as filings of interim reports reflecting significant corporate developments. In addition, it includes an informative discussion of all important orders of the Commission and of each decision issued or rule adopted by the Commission, as well as a brief report on court actions which are part of the Commission's law enforcement program. Thus, over 1,200 registration statements, 875 orders, decisions and rules, and 288 court enforcement actions were reported in the News Digest during the year.

The News Digest is made immediately available to the press, and it is also reprinted and distributed by the Government Printing Office, on a subscription basis, to some 2,500 investors, securities firms, practicing lawyers and others. In addition, the Commission maintains mailing lists for the distribution of the full text of its orders, decisions, rules and rule proposals.

During the year, individual members of the Commission and numerous staff officers addressed various professional, business and other groups and participated in panel discussions of the laws administered by the Commission, the rules and regulations thereunder, and the policies, procedures and practices of the Commission. These speeches and discussions are helpful in promoting a better understanding of the functions and activities of the Commission and thus facilitating compliance with the laws and rules. In addition, they stimulate public discussion of ways and means of improving the administrative process.

Information Available for Public Inspection

The many thousands of registration statements, applications, declarations and annual and other periodic reports filed with the Commission each year are available for public inspection at the Commission's principal office in Washington, D.C. In addition, copies of recent reports filed by companies having securities listed on exchanges other than the New York Stock Exchange and the American Stock Exchange, and copies of current reports of many non-listed companies which have registered securities for public offering under the Securities Act, may be examined in the Commission's New York Regional Office. Recent reports filed by companies whose securities are listed on the New York and American Stock Exchanges may be examined in the Commission's Chicago Regional Office. Moreover, there are available for examination in all regional offices copies of prospectuses relating to recent public offerings of securities registered under the Securities Act; and all regional offices have copies of broker-dealer annual financial reports and Regulation A letters of notification filed in their respective regions.

Reports of companies whose securities are listed on the various exchanges may be seen at the respective exchange offices. In addition, the registration statements filed pursuant to the new Section 12 (g) of the Securities Exchange Act of 1934 are available for public inspection in the principal office in Washington, D.C., the New York, Chicago and San

Francisco Regional Offices, and the regional office nearest the home address of the registrant.

In order to facilitate wider dissemination of financial and other information contained in corporate reports filed with the Commission under the Federal securities laws (an objective strongly urged by the Special Study Report), the Commission has arranged to take standing orders, on an experimental basis, for photocopies of annual reports filed on Form 10-K. This service may be extended later to other reports, depending upon public reception and the experience gained in supplying copies of annual reports.

Under the existing contract with a printing company for the reproduction of material in the Commission's public files in response to requests of members of the public, photocopies may be obtained at a cost of 7.6 cents per page for pages not exceeding 8 1/2" x 14" in size. The detailed per page prices are given in Release No. 34-7640, which may be obtained from the Publications Unit of the Commission. The charge for each certification of any document by the Commission is \$2.

In order to make corporate reports more readily available for examination by interested members of the public, the Commission has also made arrangements for the Form 10-K annual reports and Form 10 registration statements to be placed on open shelves in the public area of its Public Reference Room in Washington, D.C., thus making these reports available for immediate inspection. There are presently four coin-operated photocopiers in the Public Reference Room to enable visitors to make immediate reproductions of reports at a cost of 25 cents per page. (The New York Regional Office has a similar machine.)

Each year many thousands of requests for photocopies of and information from the public files of the Commission are received in the Public Reference Room in Washington, D.C. During the year 5,472 persons examined material on file in the Washington, D.C. office, and several thousand others examined files in the New York and Chicago regional offices. More than 15,900 searches were made for individuals requesting information and approximately 2,134 letters were written with respect to information required.

PUBLICATIONS

In addition to the daily News Digest, and releases concerning Commission action under the Acts administered by it and litigation involving securities violations, the Commission issues a number of other publications, including the following:

Weekly:

Weekly Trading Data on New York Exchanges: Round-lot and odd-lot transactions effected on the New York and American Stock Exchanges (information is also included in the Statistical Bulletin).

Monthly:

Statistical Bulletin.

Official Summary of Securities Transactions and Holdings of Officers, Directors and Principal Stockholders.

Quarterly:

Financial Report, U.S. Manufacturing Corporations (jointly with the Federal Trade Commission). (Statistical Series Release summarizing this report is available from the Publications Unit.)

Plant and Equipment Expenditures of U.S. Corporations (jointly with the Department of Commerce).

New Securities Offerings.

Volume and Composition of Individuals' Saving.

Working Capital of U.S. Corporations.

Annually:

Annual Report of the Commission.

Securities Traded on Exchanges under the Securities Exchange Act of 1934.

List of Companies Registered under the Investment Company Act of 1940.

Classification, Assets and Location of Registered Investment Companies under the Investment Company Act of 1940.

Corporate Pension Funds.

Directory of Companies Filing Annual Reports.

Other Publications:

Decisions and Reports of the Commission.

Judicial Decisions.

A Study of Mutual Funds (by The Wharton School).

Report of Special Study of Securities Markets.

Accounting Series Releases -- Compilation of 1-89.

Securities and Exchange Commission-Its Functions and Activities.

ORGANIZATION

During the fiscal year certain organizational changes were effected in accordance with the Commission's policy of continuing review of its organization and functional alignments:

Reference has already been made to the reallocation of certain functions relating to investment companies from the Division of Corporation Finance to the Division of Corporate Regulation. The change was designed to concentrate responsibility in the latter division for administration of the securities laws as they apply to investment companies, and to enable the Division of Corporation Finance better to assume and discharge its increased responsibilities under the Securities Acts Amendments of 1964. In related action, two new branches and an Assistant Director were added to the Division of Corporate Regulation to assist in handling the increased duties resulting from the assumption of its additional functions and from the increased responsibilities in recent years in administering the regulatory provisions of the Investment Company Act.

In addition, several new branches were created in the Division of Trading and Markets, and certain statistical activities were transferred from that Division to the Office of Policy Research.

PERSONNEL AND FINANCIAL MANAGEMENT

An important development in the Commission's personnel management program in fiscal 1965 was the adoption of a Management Intern Program under a formal training agreement approved by the Civil Service Commission. The main objective of this program is to recruit and train persons of proven ability and high potential for top level supervisory and administrative positions.

Candidates are selected from lists of eligibles established by the Civil Service Commission as a result of the written and oral Management Intern Examination. The

academic training and backgrounds of persons chosen vary according to the long-range needs of the Commission and include law, finance and other disciplines in addition to public administration.

The first intern under this new program was appointed on April 12, 1965. Following 12 to 15 months of specialized management training, he will be assigned to one of the operating divisions of the Commission.

During fiscal 1965, within-grade salary increases in recognition of high quality performance were granted to 92 employees. These awards are authorized by Section 702 of the Classification Act of 1949, as amended by the Salary Reform Act of 1962. Also during fiscal 1965, cash awards totaling \$960 were made to 18 employees for adopted suggestions, and cash awards for superior performance amounting to \$4,000 were presented to 24 employees.

The Commission is required by law to collect fees for registration of securities issued, qualification of trust indentures, registration of exchanges, and sale of copies of documents filed with the Commission.⁴⁵

The following table shows the Commission's appropriation, total fees collected, percentage of fees collected to total appropriation, and the net cost to the taxpayers of Commission operations for the fiscal years 1963, 1964 and 1965.

[table omitted]

NEW BUILDING AND ELECTRONIC DATA-PROCESSING EQUIPMENT

In the Commission's budget for fiscal 1966 the Congress appropriated funds for relocation of offices in Washington, D.C. Shortly after the end of the 1965 fiscal year, the General Services Administration signed a lease for a new eight story office building on North Capitol Street, a location near Union Station and easily accessible to the public. This building will house all of the Commission's Washington activities, including the Washington Regional Office.

After the relocation of offices, a computer system and related equipment will be installed in the new building. This electronic data-processing equipment will initially be used for record keeping and agency administrative functions. Later, it will also be employed in the Commission's regulatory work, including economic studies and surveillance of the markets.