34th ANNUAL REPORT
of the
SECURITIES AND EXCHANGE COMMISSION

For the Fiscal Year Ended June 30th

SECURITIES AND EXCHANGE COMMISSION
Headquarters Office
500 North Capitol Street
Washington, D.C. 20549

COMMISSIONERS

MANUEL F. COHEN, Chairman
HUGH F. OWENS
HAMER H. BUDGE
FRANCIS M. WHEAT
RICHARD B. SMITH

ORVAL L. DuBOIS, Secretary

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.,
January 3, 1969

SIR : On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Thirty-Fourth Annual Report of the Commission covering the fiscal year July 1, 1967 to June 30, 1968, in accordance with the provisions of Section 23 (b) of the Securities Exchange Act of 1934, as amended; Section 23 of the Public Utility Holding Company Act of 1935; Section 46 (a) of the Investment Company Act of 1940; Section 216 of the Investment Advisers Act of 1940; Section 3 of the Act of June 29, 1949, amending the Bretton Woods Agreement Act; Section 11 (b) of the Inter-American Development Bank Act; and Section 11 (b) of the Asian Development Bank Act.
Respectfully,

MANUEL F. COHEN,
Chairman.

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

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Commissioners

MANUEL F. COHEN of Maryland, Chairman -- Term expires June 5, 1973
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, 1971
RICHARD B. SMITH of New York -- Term expires June 5, 1972

Secretary: ORVAL L. DuBOIS
Executive Assistant to the Chairman: MEYER EISENBERG

Principal Staff Officers

CHARLES E. SHREVE, Director, Division of Corporation Finance.
ROBERT H. BAGLEY, Associate Director.
ALAN B. LEVENSON, Executive Assistant Director.

SOLOMON FREEDMAN, Director, Division of Corporate Regulation.
AARON LEVY, Associate Director.
ALAN S. MOSTOFF, Associate Director.

IRVING M. POLLACK. Director, Division of Trading and Markets.
EUGENE H. ROTBERG, Associate Director.
STANLEY SPORKIN, Associate Director.

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

ANDREW BARR, Chief Accountant.
LINDSEY J. MILLARD, Associate Chief Accountant.

LOUGHLIN F. McHUGH, Chief Economist, Office of Policy Research.

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

WILLIAM E. BECKER, Chief Management Analyst.

FRANK J. DONATY, Comptroller.

ERNEST L. DESSECKER, Records and Service Officer.

HARRY POLLACK, Director of Personnel.

RALPH L. BELL, EDP Manager.

REGIONAL AND BRANCH OFFICES

Regional Offices and Regional Administrators

Region 1. New York, New Jersey. -- Mahlon M. Frankhauser, 26 Federal Plaza, New York, New York 10007

Region 2. Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine. -- James E. Dowd, Suite 2203. John F. Kennedy Federal Building, Government Center, Boston, Mass. 02203

Region 3. Tennessee, Virgin Island, 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, N.B., Atlanta, Georgia 30309

Region 4. Illinois, Indiana, Iowa, Kansas City (Kansas), Kentucky, Michigan, Minnesota, Missouri, Ohio, Wisconsin. -- Thomas B. Hart, Room 1708, U.S. Courthouse and Federal Office Building, 219 South Dearborn Street, Chicago, Illinois 60604

Region 5. Oklahoma, Arkansas, Texas, that part of Louisiana lying west of the Atchafalaya River, and Kansas (except Kansas City). -- Gerald E. Boltz, 503 U.S. Court House, 10th & Lamar Streets, Forth Worth, Texas 76102

Region 6. Wyoming, Colorado, New Mexico, Nebraska, North Dakota, South Dakota, Utah. -- Donald J. Stocking, 7224 Federal Building, 1961 Stout Street, Denver, Colorado 80202

Region 7. California, Nevada, Arizona, Hawaii, Guam. -- Arthur E. Pennekamp, 450 Golden Gate Avenue, Box 36042, San Francisco, California 94102

Region 8. Washington, Oregon, Idaho, Montana, Alaska. -- James E. Newton, 900 Hoge Building, Seattle, Washington 98104

Region 9. Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia. -- Alexander J. Brown, Jr., 500 North Capitol Street, Washington, D.C. 20549

Branch Offices

Cleveland, Ohio 44199. -- Room 779, Federal Office Building, 1240 E. 9th Street.

Detroit, Michigan 48226. -- 230 Federal Building. Houston, Texas 77002. -- Room 2606, Federal Office Annex, Courts Building, 515 Rusk Ave.

Los Angeles, California 90028. -- Room 1403, U.S. Courthouse, 312 North Spring Street.

Miami, Florida 33130. -- Room 1504, Federal Office Building, 51 S.W., First Ave.

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

Salt Lake City, Utah 84111. -- Room 6004, 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 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 re-appointed for the terms expiring June 5, 1968 and June 5, 1973. He was designated Chairman of the Commission on August 20, 1964.

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 3 1/2 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 U.S. 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, and was reappointed for the term expiring June 5, 1971.

Richard B. Smith

Commissioner Smith was born in Lancaster, Pennsylvania, on July 9, 1928, and attended public schools there. He received a B.A. degree from Yale University in 1949, where he held a scholarship, and an LL.B. degree in 1953 from the University of Pennsylvania, where he was an editor of the Law Review. Upon graduation he became associated with the New York City law firm of Reavis & McGrath (then Hodges, Reavis, McGrath, Pantaleoni & Downey). He remained with that firm from 1953, except for a period with the legal department of W.R. Grace & Co. in 1956-57, until his appointment to the Commission, having become a partner of the firm in 1963. During this period he was engaged in the general practice of law, specializing in corporate finance and securities work. Commissioner Smith was active in bar association work, having served as a member, secretary and then Chairman (1963-66) of the Committee on Aeronautics of The Association of the Bar of the City of New York and during 1962-64 as a member of the Committee on State Legislation of the New York State Bar Association. He is also a member of the American Bar Association. In 1961-62 he acted as counsel to a Commission of Inquiry into labor questions in the thoroughbred racing industry, appointed by the Governor of the State of New York. He was president of the University of Pennsylvania Law Alumni Association of New York City during 1965-67 and serves as a member of the Board of Managers of the Alumni Society of the University of Pennsylvania Law School. He took office as a member of the Commission on May 1, 1967, for the term expiring June 5, 1967, and was reappointed to a 5-year term ending June 5, 1972.

FOREWORD

The Securities and Exchange Commission is a relatively small agency which occupies a central role in a vital, delicate, and rapidly changing aspect of the national economy -- the financing of American industry and the provision of necessary safeguards to the millions of investors who, directly or indirectly, entrust their savings to the securities markets.

Our securities markets are growing and changing at an unprecedented rate. There are now more than 24 million direct stockholders; a substantial portion of the share volume in the trading markets is the result of transactions by large financial institutions which manage the pooled savings of mutual fund holders, pension fund beneficiaries and life insurance policy holders. These indirect investors are estimated to number in excess of one hundred million. This growth of institutional investment has created some strain on the securities markets and raises important policy questions which require resolution.

The combination of broad individual participation and increasing institutional activity has brought about unprecedented volumes of trading. The average daily dollar value of securities traded on all markets is over $825 million and the average daily exchange volume of trading is over 22 million shares. Thus the markets and the regulators -- Federal, State, and self regulators -- are confronted not only with the problems of adjusting to what has sometimes been described as the "institutionalization of the markets"; they are also and at the same time confronted with, and almost overwhelmed by, the sheer volume of activity.

There are a number of aspects of institutionalization that deserve comment.

First, institutionalization of investment, in our present economy, contemplates that public savings will flow, in an accelerated fashion, into pooled and professionally managed accounts with emphasis on equity rather than debt holdings. Investment decisions, under such circumstances, tend to become more homogenous, largely because they reflect the decisions of a relatively few sophisticated managers. Such a development would require sophisticated and new market techniques to absorb potential investment imbalances in the equity markets.

Second, increased participation by institutions in the trading markets, both in absolute and relative terms, affects the allocation of public savings as between the securities markets and other channels of investment such as mortgages, other traditional forms of saving and land, and in view of the increasing institutional interest in stocks, as between the bond and equity markets.

Third, institutionalization contemplates that financial managers will compete with the classic securities brokers in merchandising a financial product with potential for capital appreciation. Banks, insurance companies and other companies have already begun to form financial conglomerates for the purpose of offering traditional and novel vehicles for public participation in the equity markets. The distributing and merchandising processes of enterprises with business techniques developed outside the traditional securities brokerage business, can be expected to lead to new merchandising methods in the distribution of new equity oriented products to the public.

Fourth, institutional investors are staffed by professional investment managers. They avidly seek out and analyze all available information with respect to companies in which they may have or contemplate an investment interest. More intelligent investment decisions may result, but it also becomes more difficult, particularly in view of the financial power of these institutions, for the individual investor to gain equivalent access to relevant information for his investment decisions.

Fifth, in the past, the significant institutional investors -- mutual funds, bank trust departments, pension funds and others -- tended to be, on the whole, conservative, investing for the long term. The last few years, however, have seen the emergence of what has sometimes been called the "cult of performance" in which attention has been focused on those who showed the greatest gains in the previous year or even the previous 6 months, with the result that more and more of these institutions, and particularly certain mutual funds, have actively and avowedly become short-term traders who act not only with speed but in volume, again throwing a strain on the mechanisms of the market.

Sixth, institutionalization of markets reflects a growing concentration of economic and financial power.

The growth of institutional and individual participation in the equities markets referred to is a reflection of an affluent society which has seen tremendous economic growth. It is also a result of an inflationary tendency in the postwar years. These have led the public to seek greater participation in that growth and some protection from inflation directly or indirectly through investment in equities rather than concentrating on fixed-income securities and other forms of savings. In sum, the stock markets, both on the exchanges and in over-the-counter markets, have become a more important part of the national economy than they ever have been before.

The Commission has made and is continuing to make major efforts to cope with the increased responsibilities these developments have thrown upon it.

Commencing in 1961 and ending in 1963, the Commission, pursuant to Congressional direction, made what is known as the "Special Study of the Securities Markets," the most exhaustive analysis of all phases of these markets since the Congressional investigations of the Thirties which led to the enactment of the securities laws. The explosive growth of mutual funds received attention in The Wharton School Study of Mutual Funds, initiated by the Commission in 1958 and completed in 1962, and in the Commission's own report of the Public Policy Implications of Investment Company Growth, sent to Congress in 1966.

Many of the Special Study's recommendations have been implemented, most notably through the Securities Acts Amendments of 1964, which extended the significant investor protections of the Securities Exchange Act to major segments of the over-the-counter market and provided procedures, both for upgrading training methods and requirements and raising standards of those engaged in the securities business. It also provided a more effective disciplinary scheme.

The Commission is presently engaged in the first thorough inquiry it has made into the rules, policies, practices and procedures of the exchanges respecting the commission rate structure. This inquiry is bringing together the knowledge and experience of many individuals and firms and will add substantially to the foundation provided by prior studies made by the Commission and by industry. Automation is on the threshold of revolutionizing the system of quotations for unlisted securities.

The Commission's work has also been aided by the use of a computer which makes possible the assembly and analysis of more comprehensive data than was possible before. It will also provide far more data concerning the operations of investment companies. Within the relatively near future much more will be known about the economics of the securities business. This information will be of great value not only for the Commission and other regulatory and self-regulatory authorities, but also for those actively engaged in the industry itself.

In many areas we have not passed beyond mere identification of some of the changes in the markets, which both cause and result from the developments mentioned. The Commission expects that the "institutional study," concerning which more will be said later in this report, will provide the vehicle for development of the relevant facts and the identification of trends and possible problem areas. Upon its completion, the Commission would submit a report to the Congress.

In summary, recent years have witnessed dramatic and significant changes of the securities markets which will put additional strains on the Commission and self-regulatory organizations in their efforts to fulfill the three principal mandates of the Congress: full and fair disclosure, maintenance of fair and orderly securities markets, and the detection and prevention of fraud. With respect to the latter mandate the securities markets have always been a fertile field for the unscrupulous. Constant vigilance and vigorous enforcement is necessary to rid the markets of those whose activities cast discredit upon all, and provide a form of competition which is unfair to the great majority who wish to conduct their business on the highest possible plane.

Despite these developments and emerging problems, the regulatory scheme in the United States is considered to be one of the most effective in the world. It is being studied and drawn upon in many foreign countries, most notably and most recently in Canada and in France. There remains, however, room for improvement. The Commission has directed studies of certain areas of its operations to determine whether improvements can be achieved. Thus, the disclosure requirements under the Securities Exchange Act of 1934 are under intense study to determine the extent to which they can be made simpler, more effective and more economical to administer. The task grows more difficult as technology advances, patterns of corporate growth and financing become increasingly more complex and the number of publicly held businesses increases. These developments make more urgent the Commission's need for sufficient manpower and other resources to fulfill adequately its responsibilities under the statutes entrusted to its administration.

PART I
IMPORTANT RECENT DEVELOPMENTS

Structure and Level of Commission Rates

The setting of commission rates for exchange transactions is perhaps the most important area in which exchanges have been permitted to establish rules of practice governing their membership. Under Section 19 (b) of the Exchange Act, the Commission is responsible, however, for determining the reasonableness of commission rates set by the exchanges, and it may after notice and opportunity for hearing order an adjustment of such rates. In May 1968, the Commission, after considerable study and discussion with various elements of the industry, for the first time took the initiative with respect to the adjustment of commission rates. In simultaneous actions, it directed the New York Stock Exchange to adopt an interim rate structure incorporating a volume discount or, in the alternative, to eliminate fixed rates of commission for large transactions, and initiated public hearings to consider fully what long-term changes are required in the rate structure and related matters.

Since formation of the New York Stock Exchange in 1792, the commission rate schedule has been adjusted on several occasions, most recently in 1959. Each change had been on the initiative of the Exchange and primarily involved an increase in the level of rates. These increases were justified by the Exchange on the ground that increased costs were not sufficiently offset by increases in trading volume. Since the New York Stock Exchange commission schedule has served as the model for all other exchanges, each increase or adjustment in level and structure of the New York Stock Exchange's rates brought with it a concurrent adjustment in the rates of the other exchanges.

It should be recalled that until the past several years, the exchanges were essentially markets for the relatively small transactions of thousands of individual investors and for smaller institutional transactions. As indicated in the Foreword, the mix of transactions on the exchange markets has been changing so that now a substantial percentage of trading is that of institutions effecting large transactions.

Until the recent interim changes, rates of commission were computed exclusively on the amount of money involved in each round-lot transaction, a round lot usually being 100 shares. There was no discount based on the size or volume of a transaction or on the amount of business clone by an institutional or other investor over a period of time. Accordingly, the commission for a 10,000-share transaction was 100 times that for a 100-share transaction. [Footnote: Historically there have been three different methods employed in computing commission rates for exchange transactions. From 1792 to 1919, the base was a flat rate on par value; from 1919 to 1947 it was a sliding scale per share charge on share value; and since 1947 it has been a sliding scale based on round lot value.]

Beginning in July 1968, the Commission conducted an extensive public investigatory hearing to determine whether any changes should be made in the rules, policies, practices and procedures of registered national securities exchanges respecting commission rate schedules and related matters. The hearing has been evidentiary in nature and constitutes a broad-range factual inquiry into such matters as: (1) commission rate levels for nonmembers and for members (including intra-member rates); (2) the services for which commission rates pay and the costs allocated thereto; (3) give-ups and reciprocal practices among different categories of members and nonmembers; (4) membership for financial institutions on exchanges; (5) economic access to exchange markets by nonmember broker-dealers; (6) competition among exchanges and other markets; and (7) access of exchange members to the third market. Interested persons were invited to come forward with evidentiary facts for inclusion in the record and, in the discretion of the hearing officer, to testify in the proceeding.

Pending the development of long-term solutions to the various problems under consideration in the public hearings, the Commission in September 1968 accepted a proposal of the New York Stock Exchange providing for an interim reduction in minimum commissions on larger trades. Also under this proposal, the customer-directed "give-up" would be prohibited and minimum intra-member rates reduced. Estimates furnished the Commission indicate that these interim changes will result in a total reduction of commission charges of $150 million a year, or approximately 7 percent of last year's total charges. On a daily basis, the reduced rate will result in savings of at least $600,000 of commissions each trading day. [Footnote: In 1966, the New York Stock Exchange (and subsequently the other exchanges), at the request of the Commission, had modified the so-called odd-lot differential applicable to purchases or sales of less than a round lot (generally 100 shares). The modification involved an increase in the "break point" at which a higher differential becomes payable. As a result of this change, estimated savings of more than $6 million were provided to investors in calendar year 1967 with respect to transactions executed on the New York Stock Exchange.] The American Stock Exchange approved similar interim changes, and the regional exchanges are expected to make comparable rate adjustments.

Study of Institutional Investors

As noted previously, in recent years there has been accelerated activity in all phases of the securities markets, the most noticeable aspects of which are the surge in volume of securities traded and the number of public investors, and the pervasive participation of institutional investors in the securities markets. The average daily volume of securities traded on the New York Stock Exchange has increased, for example, from less than 5 million shares in 1963 to over 12 million shares through mid-1968. The value of stock traded on all registered securities exchanges has increased from about $64 billion in 1963 to $162 billion in 1967. It is estimated that the number of individual stockholders in United States industry has grown from 17 million in 1962 to approximately 24 million at the present time, despite the fact that during this period individuals were net sellers (and institutions net buyers) of corporate securities.

Millions of investors now participate in equity securities holdings through their interests in investment companies, pension funds, and other institutions. From 1957 to 1967, the total value of stock held by the major financial institutions rose from $29 1/2 billion to more than $131 1/2 billion. [Footnote: These figures do not cover personal trust funds, common trust funds, foundations and college endowment funds as to which complete statistics are not available.] All indications are that the accelerated flow of savings into equity-oriented institutions will continue. Recent projections of private pension fund assets, for example, point to a doubling in this segment alone within the next 10 years.

In addition to the sharp growth of institutional shareholdings, there has been a dramatic increase in trading by institutions in the securities markets. Turnover rates of investment companies and pension funds -- perhaps the two most important institutional groups -- are much higher than they were only 10 years ago. Investment companies turned over on the average almost 40 percent of their stock portfolios in 1967 compared with only a 14 percent rate in 1957. The average turnover rate of private noninsured pension funds rose from less than 4 percent to over 11 percent in the same period. Transactions by institutions have been estimated to account for approximately 50 percent of present nonmember volume on the NYSE.

The combination of rapid growth and increased trading by institutions has placed strains on the traditional market mechanisms which were developed primarily to serve relatively small transactions by individual investors.

Another recent development is the increasingly active role which institutional investors are assuming in relation to their portfolio companies. Historically most institutions, especially mutual funds, even where they were the largest single shareholders, chose not to exercise their power over the management of portfolio companies. If they became disenchanted with management they were likely to liquidate their holdings rather than seek to effect changes. Recently, however, the Commission has noted instances where institutions have taken a more active part in the management of portfolio companies and have played an active role in acquisitions, proxy fights, etc.

In view of the recent developments, a better understanding is urgently needed both of the impact of institutional investors on the securities markets and portfolio companies and of the ability of the securities markets to adapt to institutional needs. Under a resolution of Congress signed into law on July 29, 1968, the Commission has been authorized to undertake a comprehensive study of these matters. In November 1968, the Commission announced the designation of Professor Donald E. Farrar to direct the study.

Mutual Fund Legislation

The 33rd Annual Report outlined the background and substance of the amendments to the Investment Company Act of 1940 which the Commission had proposed in May 1967. These proposals and the studies which preceded them were made pursuant to Section 14 (b) of that Act which authorizes the Commission, if it believes that "any substantial further increase in the size of investment companies creates any problem involving the protection of investors or the public interest," to make a study and investigation and to report the results and its recommendations to the Congress. The Commission's legislative proposals were designed principally to reduce sales loads imposed on the acquisition of fund shares where these loads are excessive, to eliminate the so-called "front-end load," and to provide a means to test the fairness of management fees. They also dealt, however, with a number of other areas as to which the Commission believed legislative action was required.

The Commission's proposals represented 10 years of effort by and on behalf of the Commission. In December 1966, the Commission had submitted its report, entitled "Public Policy Implications of Investment Company Growth," to the Congress. Two other reports which analyzed various problems associated with the investment company industry and its growth -- the Wharton Report, commenced in 1958 and submitted to Congress in August 1962, and the Report of the Special Study of Securities Markets, published in 1963-1964 -- had preceded the Commission's Report.

Hearings were conducted before the Senate Committee on Banking and Currency during July and August 1967, and before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives during October 1967 and March 1968. The Senate Committee reported a bill on July 1, 1968, which was passed by the Senate on July 26, 1968. However, on September 10, 1968, the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce voted not to give further consideration to the bill.

In proposing mutual fund legislation, the Commission recognized that most of the specific abuses aimed at in the Investment Company Act of 1940 have been substantially eliminated; however, the dramatic growth of the industry and accompanying changes have created new situations which were not anticipated in 1940. While many of the changes proposed by the Commission were accepted or even welcomed by the industry, the industry took exception to the principal recommendations of the Commission. The Senate Bill modified those recommendations as follows:

In the area of sales charges, the Commission proposed that a 5 percent ceiling be placed on the charge for mutual fund sales subject to a power in the Commission to approve appropriate higher ceilings. The bill as passed by the Senate gave authority to the National Association of Securities Dealers, Inc., a self-regulatory organization of brokers and dealers, to fix reasonable sales charges, subject to Commission oversight.

The Commission had recommended the abolition of the front-end load in contractual plans, under which as much as 50 percent of the payments made by the investor during the first year may be deducted for sales charges, so as to require that the sales load be spread equally over all payments during the life of the plan. The Senate, however, arrived at a formula whereby the load would not exceed 20 percent in any one year nor average more than 16 percent over the first 4 years.

Finally, the Commission had recommended that the Act provide expressly that compensation received by investment advisers shall be "reasonable" and that there be opportunity for judicial enforcement of this standard. The Commission was of the view that because of the fiduciary relationship existing between an investment company and its manager the compensation received by the manager should be reasonable and that the Federal courts would provide an appropriate forum in which the reasonableness of the management fee could be tested.

The bill as passed by the Senate provided that a determination by the directors with respect to compensation of or payments to certain affiliated persons was to be given "substantial weight" and shareholder approval was to be given such weight as was deemed appropriate in the circumstances. The Senate version also provided that any compensation or payments received by the investment adviser shall be presumed reasonable if approved or ratified by a majority of the outstanding voting securities of the company and a majority of the directors who are not interested persons of the company. The presumption could be rebutted by a preponderance of the evidence. The Senate bill also included a provision permitting a shareholders' suit to enforce the standard of reasonableness in the Federal courts if the Commission refused or failed to bring such suit within 6 months after request by a shareholder.

The Commission believes that its legislative proposals were responsive to the problems which it had found to exist, and it is hoped that legislation along the lines of those proposals will in the near future receive favorable consideration by the Congress.

The Texas Gulf Sulphur and Merrill Lynch Decisions

Shortly after the end of the fiscal year, a landmark decision relating to the issues of insiders' securities transactions based on undisclosed inside information and of corporate publicity was handed down by the Court of Appeals for the Second Circuit, sitting en banc, in S.E.C. v. Texas Gulf Sulphur Co. The Commission had filed its complaint in this case in 1965, charging violations of Section 10 (b) of the Securities Exchange Act of 1934 and Rule 10b-5 under that Act through stock purchases by insiders and through misleading corporate publicity. Briefly, it was alleged that certain insiders had purchased shares of Texas Gulf stock or calls thereon on the basis of material inside information concerning the results of exploratory drilling for base metals . by Texas Gulf near Timmins, Ontario; had passed this information to others and advised them to purchase Texas Gulf stock or calls; and had accepted stock options from Texas Gulf without disclosing material information to the board of directors. It was also alleged that the company issued a deceptive press release. Previous annual reports have discussed the institution of this action and the opinion of the district court dismissing the complaint against the corporation and 10 individual defendants but finding violations by 2 other individual defendants. On August 13, 1968, the court of appeals handed down its decision affirming unanimously the decision below insofar as it had been favorable to the Commission and reversing (7-2 on most issues) that decision in every major respect in which it had been unfavorable to the Commission.

The court unanimously held that a corporate insider in possession of important inside information about his corporation may not trade in the corporation's stock without disclosing that information, even though his transactions are not face-to-face but on a national securities exchange. This duty was unanimously held to apply to employees of the corporation, as well as to its top officers. The court also held unanimously that insiders may not pass such inside information to others for their use in securities transactions; the majority included recommendations on the basis of important inside information within this prohibition.

The court also held that there is a similar duty of disclosure to those responsible for the granting of stock options to company officials as additional compensation. If important information is not known to the directors of the company who grant the options but is known to the recipients, it must be disclosed to the directors. In this case the majority required such disclosure before acceptance of the options but suggested that disclosure before exercise of the options might be sufficient in some situations. The Commission had conceded on appeal that the duty of disclosure is limited to members of top management in this context, and the majority therefore did not decide whether any other corporate personnel were subject to a similar duty.

Since the duty of disclosure and the prohibition against tips apply only to material inside information, it was necessary for the court to define these two terms. In applying the traditional standard of materiality -- whether a reasonable investor would attach importance to the information in making his investment decision -- the majority held that the interests of all persons in the securities markets, speculative investors and conservative investors alike, must be considered. When the particular information consists of indications of a possible future event, the court called for a balancing of the indicated probability that the event would occur and its likely importance as measured against all of the corporation's activities. On this issue the majority held that a major factor, in determining the materiality of any particular information is the importance attached to it by those who knew about it, as indicated by the pattern of their own securities transactions.

Inside information is that which is not already available to the public. In determining what is necessary to make previously undisclosed information sufficiently available for insiders to trade, the court unanimously held that the mere giving of the information to reporters is not enough. Trading prior to the appearance of the information on the Dow Jones broad tape was held to be a violation. The majority stated that in some cases even this degree of disclosure might not be sufficient, although it suggested that further clarification by Commission rule would be appropriate.

The court held that a corporate press release likely to affect the market for its securities is subject to Section 10 (b) and Rule 10b-5, irrespective of the absence of any securities transactions by the corporation or its insiders and irrespective of the absence of any motive to affect the market for their benefit. Those provisions are violated if the release is materially deceptive in the light of the facts existing at the time of the release, unless the corporation had exercised due diligence in ascertaining the facts and had accurately stated what it knew. The majority held that in determining whether a corporate press release is deceptive the proper test is whether a reasonable investor exercising due care would have been misled by it.

The court remanded the case to the trial court for further findings with respect to the press release in question and for a determination of the remedies to which the Commission is entitled.

In a recent decision also dealing with the improper use of inside information, the Commission, pursuant to an offer of settlement, imposed sanctions on the broker-dealer firm of Merrill Lynch, Pierce, Fenner & Smith, Inc. and certain persons associated with it for violations of anti-fraud provisions of the securities laws or failure to exercise proper supervision to avoid such violations.

The violations involved the disclosure in June 1966 to certain of the firm's institutional and other large customers of nonpublic information reflecting a "significant deterioration" in the earnings of Douglas Aircraft Co., Inc., and the resulting sales or short sales by such customers of more than 190,000 shares of Douglas stock prior to public disclosure of the information and without any disclosure being made to the purchasers. While this adverse information was being disclosed to various large customers, the firm did not reveal it to other customers for whom it effected purchases of Douglas stock during the period in question. The respondents consented to the findings of violations and to the imposition of sanctions, but without admitting the allegations of the order for proceedings.

Citing the Commission's 1961 decision in Cady, Roberts de Co. and the Texas Gulf Sulphur decision, the Commission observed that the principles in those decisions "prohibited the disclosure [of the downturn in Douglas' earnings] by registrant to favored customers who might sell their holdings or sell short before appropriate public disclosure and thereby take advantage of the current market price before the expectable decline in such price upon public dissemination of the information. And, aggravating the inherent unfairness of the disclosure to certain customers was the fact that, at the same time, registrant was effecting purchases of the stock for other customers to whom the adverse information was not available."

According to the Commission's decision, "The information Douglas entrusted to registrant was of such importance that it could be expected to affect the judgment of investors whether to buy, sell, or hold Douglas stock. If generally known, such information could be expected to affect materially the market price of the stock. The advance disclosure of such information to a select group who could utilize it for their own benefit, and to the detriment of public investors to whom the information was not known, constituted an act, practice, or course of business which operated or would operate as a fraud or deceit upon such investors."

Upon the basis of these findings pursuant to the settlement offer, the Commission ordered that Merrill Lynch's New York Institutional Sales Office and its West Coast Underwriting Office be suspended for 21 and 15 days, respectively. Ten individual respondents were censured; in addition, one was dissociated from Merrill Lynch for 60 days and six others for 21 days.

In determining to accept the offer of settlement, the Commission considered the fact that none of the respondents had previously been the subject of disciplinary action as well as Merrill Lynch's undertaking to adopt, implement and ensure compliance with, revised procedures to provide more effective protection against disclosure of confidential information, including but not limited to the procedures set forth in a Statement of Policy which was incorporated in the offer of settlement. The Commission stated that as a matter of policy, it did not, "and indeed cannot, determine in advance that the Statement of Policy will prove adequate in all circumstances that may arise," and it stressed the need for "stringent measures" to avoid future violations. The decision observed that "obviously the prompt public dissemination of material information would be an effective preventive," and noted registrant's undertaking to use its best efforts to secure the public release of any material information given to its Underwriting Division.

The Takeover Bid Bill

On July 29, 1968, President Johnson signed the "Takeover Bid Bill," which is designed to close gaps in the full disclosure provisions of the securities laws.

In recent years, acquiring control of publicly held corporations through cash tender offers and purchases of blocks of securities, as opposed to proxy contests, has gained favor. When control is sought through the proxy contest, the Exchange Act and its proxy rules require disclosure to be made to shareholders concerning the identity of the participants in the contest, their associates, the shareholdings of these persons, and other relevant information. This information is subject to statutory sanctions and must also be filed with the Commission. Similarly, when control is sought through a stock-for-stock exchange, the offering must be registered under the Securities Act of 1933, and shareholders must be given a prospectus setting forth all material facts. Until July 1968, however, there were no comparable disclosure requirements which applied to a cash tender offer or stock acquisitions which may cause a change in control.

The takeover bid bill was designed to put cash tender offers and other block acquisitions on the same footing as proxy contests for control. It was not intended either to encourage or discourage such offers or acquisitions, nor was it intended to give an advantage either to management or the outside group.

The bill, which amended Sections 13 and 14 of the Exchange Act, grants the Commission rulemaking authority to require disclosure of pertinent information concerning stock acquisitions or proposed acquisitions in three contexts: (1) the making of a cash tender offer which, if successful, would result in the person or group making the offer owning more than 10 percent of any class of equity security registered pursuant to Section 12 of the Act or issued by a closed-end investment company registered under the Investment Company Act of 1940; (2) acquisitions by any person or group of any such class of equity security which would result in the ownership by such person or group of more than 10 percent of any such class of security; and (3) the purchase by a corporation of its outstanding equity securities. The bill also provides that if a majority of the directors are to be replaced in connection with an acquisition or tender offer, shareholders must be provided with information comparable to that required by the proxy rules in connection with an election of directors. The bill also authorizes the Commission to adopt rules with respect to solicitations or recommendations to accept or reject tender offers and provides for certain protections for persons who have tendered shares.

On July 30, 1968, the day after the bill became law, the Commission adopted temporary rules and regulations to make its provisions operative, and on August 30, 1968, certain amendments to these rules were adopted. These temporary rules represent an important step in the development of regulations to accomplish the full purpose of the legislation. On August 30, 1968, the Commission also published notice of the proposed adoption of a new rule 10b-13 and invited comments thereon. New section 14 (d) (7) of the Exchange Act provides, in substance, that where the terms of a tender offer are varied before its expiration by increasing the consideration offered to security-holders, all securities purchased pursuant to the tender offer must be purchased at the higher price, whether or not they were tendered before the increase was announced. Proposed Rule 10b-13 would extend this principle of affording equal treatment to all security-holders who sell their securities to a person making a tender offer during the period of such offer, whether or not the sales are made pursuant to the tender offer.

When the Senate Banking and Currency Committee was considering the legislation, it referred to an abuse which had occurred in connection with tender offers, known as "short tendering," but expressed the view that the Commission had adequate power to deal with the problem under the anti-fraud provisions of the Exchange Act. "Short tendering" grew out of the fact that in connection with a tender offer or a request or invitation for tenders of a particular security, it is customarily provided that the security need not be deposited if a bank or a member firm of a national securities exchange guarantees delivery. Abuses in this practice arose in situations in which tenders were to be accepted on a pro rata basis. It was learned that some brokers tendered a greater number of units than were owned by them or by the customers on whose behalf the tender was made, with the result that a disproportionately large number of their securities was accepted. To deal with this practice, the Commission in May 1968 adopted Rule 10b-4 which, in substance, prohibits a person from tendering any security for his own account unless he owns the security and from tendering or guaranteeing tender of a security on behalf of another person unless the security is in his possession or he has reason to believe that the other person owns the tendered security.

Expediting of Registration Statements

The Commission recently adopted new procedures in an effort to cope with the problems resulting from the enormous increase in the number of registration statements filed under the Securities Act of 1933. In the 1968 fiscal year, 2,473 registration statements were filed for processing by the Commission's Division of Corporation Finance, as compared to 1,543 in 1967. For the first quarter of fiscal 1969, 840 registration statements were filed as compared to 507 for the like period in 1968. There has also been a substantial increase in the number of registration statements filed by issuers which never before have been subjected to the registration process. Further, the number of definitive proxy statements filed with the Commission has increased from 2,661 in fiscal year 1964 to 5,244 in fiscal 1968. The backlog of registration statements to be processed by the staff of the Division of Corporation Finance has reached unprecedented proportions because of the enormous increase in the number of filings, accompanied at the same time by a reduction of personnel in the Division due to budgetary cuts.

Accordingly, in November 1968 the Commission adopted an expedited review procedure that is designed to reduce the backlog without sacrificing the statutory standards of disclosure. Under this procedure, a Division officer makes a cursory review of every registration statement as it is filed. Based on this review he determines (1) that the statement is so deficient that it does not warrant further review; (2) that only a cursory review will be made and that, upon receipt of certain supplemental information, the staff will recommend clearance; or (3) that the filing should be subject to the regular review process.

With respect to categories (1) and (2), counsel for the company is advised that the statutory burden of full disclosure is on the issuer, its affiliates, the underwriter and experts, that as a matter of law this burden cannot be shifted to the staff, and that the current work load is such that the staff cannot undertake additional review and comment.

Disclosure Study

Throughout its history, the Commission has reviewed its practices, procedures, and forms in the disclosure field in an effort to improve disclosures and, at the same time, eliminate unnecessary requirements where possible.

In late 1967 the Commission decided to supplement its usual review of special problems in the disclosure field with a broad internal study of the disclosure process. Among the factors which seemed to make such a study appropriate were the following:

(1) the need for an overall review of the actual workings of the disclosure provisions of the Securities Act of 1933;

(2) the substantial expansion in the number of issuers subject to the continuing disclosure requirements of the Securities Exchange Act of 1934 as a result of the Securities Acts Amendments of 1964. Because of this expanded coverage, the potential effectiveness of the Exchange Act as a disclosure tool is far greater than it used to be;

(3) the dramatic increase in the number of investors, many of them new to the securities markets;

(4) the marked trend toward a professionalization of security analysis; and

(5) technological developments which make it possible to put the information in the Commission's files into the hands of the financial community more cheaply and more expeditiously than was previously the case.

Since the end of 1967, a group drawn from the Commission's operating divisions and directed by Commissioner Francis M. Wheat has been delving into almost every aspect of disclosure under the Federal securities statutes. The Study Group has met and worked closely with many in the financial community, in industry, in the legal and accounting professions, and in academic life who are interested in, knowledgeable about, or affected by the disclosure provisions of the securities laws.

After the Study Group completes its examination of the field, it will report to the full Commission. The Commission will then evaluate the report and take such administrative action as it considers advisable. The Commission and the members of the Study Group hope that the work of the group and of those outside the Commission who have collaborated with it will in due time make for noteworthy improvements in the disclosure process, in investor protection, and in the efficiency of the capital markets.

Additional Financial Disclosure by Diversified Companies

The increase in business acquisitions and mergers in recent years has caused the Commission to consider the need for more detailed reporting on the disparate operations of registrants which are broadly diversified and to study the problems involved in any extension of the requirements in this area of financial reporting. Staff surveys have indicated that there has been an increase in voluntary disclosures by diversified companies in recent annual reports to stockholders. During the 1968 fiscal year important studies by professional organizations and by individuals on the topic of financial reporting by diversified companies were completed. The Commission had authorized the Chief Accountant to serve on an Advisory Committee, representing various sectors of the accounting, financial and industrial communities, in connection with the comprehensive study and survey conducted under the sponsorship of the Financial Executives Institute.

The studies and surveys indicated that an extension of the Commission's requirements was feasible. As a result, the staff undertook to develop amendments of the rules to elicit additional information from all companies affected which will be meaningful to investors but not unduly burdensome to the registrants. In September 1968, a proposal to revise the disclosure requirements under three Securities Act registration forms was issued for public comment.

Under the proposed revisions registrants would be required to state, for each of the 5 fiscal years preceding the filing of a registration statement, the approximate amount or percentage of sales or operating revenues and contribution to net income attributable to each class of related or similar products or services, which contributed 10 percent or more to total sales and operating revenues, or to income before income taxes and extraordinary items of income or expense, during either of the last 2 fiscal years. If the contribution to net income cannot practicably be stated, the contribution most closely approaching net income or loss is to be indicated. The approximate amount of assets employed in each such segment of the business is to be reported, to the extent practicable. Comparable data on revenues and earnings received from foreign sources, other than Canada, and from government procurement or any single customer are also to be reported.

Broker-Dealer Financial Reports

The Commission's staff and industry representatives have had extensive discussions during the past 2 years as to the best way to obtain improved financial information concerning the securities industry and, at the same time, avoid unnecessary burdens on broker-dealers. On the basis of these discussions and after careful review of comments received on a proposed rule, the Commission on June 28, 1968, adopted Rule 17a-10 under the Securities Exchange Act, which requires exchange members and broker-dealers to file annual income and expense reports with the Commission or with a registered self-regulatory organization which will transmit the reports to the Commission. The rule will become effective on January 1, 1969, and the first reports, which will be due in 1970, will cover the calendar year 1969.

The form accompanying the rule contains three major parts, each requiring income and expense data and information on the firm's capital funds and financial condition. Broker-dealers are required to complete only that part of the form which is appropriate to the size and type of their business. Part I is a summary form; Part II requires more complete information; and Part III requires detailed information. Many broker-dealers, including firms whose gross securities income was less than $20,000 during the calendar year, will not have to complete any part-of the form but will file only the introductory page of the form, showing their gross securities income and certain non-financial information about their business.

A major purpose of requiring the information is to provide comprehensive financial data on a continuing basis so that current information will be available to the Commission and to the self-regulatory agencies to assist them in meeting their respective responsibilities. It is anticipated that the Commission and the self-regulatory agencies will publish this information from time to time on an aggregate basis. As discussed above, the securities markets and the securities industry are presently experiencing a period of rapid change. The interests of the industry as well as the public interest require that governmental regulation and industry self-regulation adjust to the pace of such change and be aware of the effects of this change on the various types of firms engaged in the securities business. It is also necessary that the securities industry remain healthy and profitable and continue to assist the growth of our national economy. To meet these needs, continuing and informed analysis of the operations of the markets and of persons and organizations serving the markets is required. In the past, occasional useful studies have been authorized, but of necessity these studies have been limited and prone to obsolescence. The present informational needs of the Commission and the self-regulatory agencies demand a continuing flow of reliable and current data concerning the operations of and changes in the industry.

Automation of Over-the-Counter Quotations

In 1966 the Board of Governors of the National Association of Securities Dealers, Inc. (NASD) appointed a special Automation Committee to investigate the feasibility of automated quotations in the over-the-counter market. During the 1968 fiscal year, an independent management consulting firm, under the direction of the Automation Committee, conducted a study of the economic feasibility of such a system. The findings of the consultant and detailed specifications concerning a proposed NASD automated quotations system known as "NASDAQ" were submitted to several private firms. Following consideration of cost, design, and operation proposals received from these firms, the Automation Committee selected the firm which, in its opinion, could best supply and operate the physical equipment for the system under the direction and supervision of the NASD.

NASDAQ involves the use of electronic data processing equipment in combination with communications facilities in a three-level system designed to meet the quotations needs of registered representatives, customers, order desks, and professional traders in the over-the-counter markets. Level I would provide a current representative interdealer bid and ask price for any security registered in the system for the information of registered representatives and customers of retail firms. Level II would be designed for use by firm trading departments and would supply upon request a list of marketmakers, together with their respective current bid and ask prices for each security registered in the system. Level III will also be for use by trading departments, but will differ from Level II chiefly by providing input facilities allowing authorized marketmakers to enter, change or update bid and ask prices. It is contemplated that NASDAQ will be operational in 1970.

"Back Office" Problems

During fiscal year 1968, the volume of transactions in the securities markets increased to a rate virtually double that which had been anticipated by the securities industry. This unforeseen level of volume has placed tremendous strains on the back offices of broker-dealers and related clearance and transfer facilities. The result in many cases has been delays and errors in the execution and settlement of transactions. The existence of substantial numbers of transactions which remain unsettled over considerable periods of time presents financial risks to brokerage firms and their customers.

The Commission has stressed the responsibility of individual firms and the self-regulatory agencies to deal with these problems and has encouraged them to take all necessary measures. Various steps have been taken. Among other things, trading hours on the securities markets have been curtailed to give back office staffs more time to process backlogs. Numerous rule changes have been adopted by the exchanges and the NASD. In addition, the self-regulatory agencies have been examining broker-dealer firms both to identify individual problems and to evaluate industry-wide conditions and have placed restrictions on the activities of a number of firms.

The Commission has also taken direct action in the enforcement and regulatory areas. The Commission staff has inspected over 300 broker-dealer firms in order to ascertain the current status of their books and records and back office operations. Where violations have been found, appropriate enforcement action has been taken including the institution of proceedings and the imposition of restrictions.

The Commission has also issued statements cautioning brokers and dealers that they must comply with applicable requirements regarding maintenance of current books and records, financial responsibility and prompt delivery of securities and settlement of transactions. In this connection the Commission stated that a dealer who sells a security to a customer or a broker who buys a security for a customer violates the anti-fraud provisions of the securities laws if he has reason to believe that he will not be able to deliver the security to the customer promptly. The Commission also warned broker-dealers that it is a violation of applicable anti-fraud provisions for a broker-dealer to accept or execute any order for the purchase or sale of a security or to induce or attempt to induce such purchase or sale, if he does not have the personnel and facilities to enable him to promptly execute and consummate all of his securities transactions. It cautioned broker-dealers with back office problems to limit their activities so as to eliminate these problems.

The Commission presently has two proposed rule changes under consideration. The first would amend the Commission's net capital rule by imposing a graduated percentage deduction from market value of securities in the "failed to deliver" accounts of broker-dealers. This would provide an additional margin of safety for this category of receivables. The second change would make it unlawful for an issuer with publicly traded securities to fail to provide appropriate facilities for the prompt transfer of certificates.

The measures taken to date to cope with back office problems have been essentially of an emergency and short-term character. Long-term measures to improve the capacity of the industry to handle the increasing volume of transactions are being formulated by the self-regulatory agencies and the industry with the encouragement of the Commission.

PART II
FULL DISCLOSURE OF INFORMATION ABOUT THE ISSUERS OF SECURITIES

One basic purpose of the Federal securities laws administered by the Commission, in particular the Securities Act of 1933 and the Securities Exchange Act of 1934, is to provide disclosure of financial and other information about publicly held companies and those companies seeking to raise capital through the public offering of their securities, so as to enable public investors to evaluate the securities of these companies on an informed and realistic basis. To this end, the Securities Act requires a company proposing to offer its securities to the public to file a registration statement with the Commission disclosing prescribed categories of financial and other information and further requires that in the offer and sale of the securities investors be furnished a prospectus containing the most significant information set forth in the registration statement. The Securities Exchange Act, which deals in large part with trading in securities already outstanding, requires companies whose securities are listed on a national securities exchange and other companies in whose securities, traded over-the-counter, there is a substantial public interest to register those securities with the Commission and to file annual and other periodic reports which are designed to keep the information in the Exchange Act registration statement current. That Act also requires disclosure of material information to holders of registered securities whose proxies are solicited for the election of directors or the approval of corporate action, and requires "insiders" of companies whose equity securities are registered to report their holdings of and transactions in all equity securities of the company with which they are affiliated.

The scope of disclosure was further extended by the recently enacted "take-over-bid" legislation which, as implemented by Commission rules, affords disclosure to investors in connection with purchases of substantial blocks of stock of publicly held corporations either through cash tender offers or private or open market purchases and in connection with repurchases by corporations of their own stock.

A. DISCLOSURE IN CONNECTION WITH PUBLIC OFFERINGS

Disclosure under the Securities Act with respect to securities to be offered for public sale, either by an issuing company or a person in a control relationship to such company, is obtained through a two-step process: (1) by requiring the issuer to file with the Commission a registration statement containing certain required financial and other information; and (2) by requiring that a prospectus which is a part of the registration statement and contains the more significant data set forth in that statement, be furnished to investors so as to enable them to evaluate the securities and make an informed investment decision.

The registration statement is available for public inspection as soon as it is filed. Although the securities may be offered for sale upon filing of the statement under prescribed limitations, actual sales may not be made until the statement has become effective. The Commission has no authority to pass on the merits of the securities to be offered or the fairness of the terms of distribution. In fact, the Act makes it unlawful to represent to investors that the Commission has approved or otherwise passed on the merits of registered securities.

Type of Information Included in Registration Statement

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. 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 reducing 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 with the issuer; pending legal proceedings; and the purposes to which the proceeds of the offering are to be applied, and must include financial statements certified by an independent accountant. The registration statement of a foreign government must contain information concerning the purposes for which the proceeds of the offering are to be used, the natural and industrial resources of the issuer, its revenues, obligations and expenses, the underwriting and distribution of the securities being registered, and other material matters, but need not contain certified financial statements.

Adoption of Short Form for Registration of Securities of Certain Issuers

Effective December 31, 1967, the Commission adopted a new short form for registration, designated Form S-7. The form is for the registration of securities to be offered for cash by issuers which meet the following requirements, among others: they must have a class of securities either listed on an exchange or registered under Section 12 (g) of the Exchange Act, must have complied with the reporting and proxy requirements of that Act for at least 5 years and must have long records of earnings and stability of management and business. The form represents a closer integration of the requirements of the Securities Act and the Securities Exchange Act. During the fiscal year, 81 registration statements were filed on Form S-7.

Form S-7 is in the nature of an experiment. The Commission will carefully watch and review its operation in conjunction with the reporting and proxy requirements to determine whether the omission of information in the prospectus, particularly with respect to the identity, remuneration and other perquisites received by management and their interest in transactions with the issuer, carries out the statutory objectives of providing investors with sufficient information to enable them to make an informed judgment about the securities offered. Should experience indicate that such action is necessary or desirable, the Commission may amend or rescind Form S-7, or change the conditions for its use so as to limit or expand the types of issuers to which the form is available.

The Commission also amended paragraph (a) of Rule 174 under the Securities Act so that securities registered on Form S-7 will be exempt from the prospectus delivery requirements of the Act. Under this amendment a dealer is not required to deliver a prospectus to his customer if he is no longer acting as an underwriter of the offering or is not engaged in a transaction involving his participation in the offering.

Proposed Guides for Preparation and Filing of Registration Statements

In 1964, the Commission published certain guides for the preparation and filing of registration statements under the Securities Act.

During the 1968 fiscal year the Commission issued a release containing the existing guides, suggested modifications of those guides and proposed additional guides, and requested interested parties to comment thereon prior to publication of the guides in definitive form.

The published guides and those proposed for publication represent policies and practices presently followed by the Commission's Division of Corporation Finance. They are not rules of the Commission and were not published as bearing the Commission's official approval, although some may later be incorporated in rules or forms after appropriate publication and opportunity for comment. The guides do not purport to furnish complete criteria for the preparation of registration statements.

The staff is in the process of preparing guides describing the practices and policies followed by the Commission's Division of Corporate Regulation in the examination and processing of registration statements filed by management investment companies on Form N8B-1 under the Investment Company Act. It is expected that these guides will be published for comment in the near future and that they will be the first in a series of guides which will ultimately include Forms S-4, S-5 and S-6 under the 1933 Act.

Amendments to Rules Relating to Disclosure Detrimental to National Defense

During the fiscal year, the Commission adopted certain amendments to Rule 171 under the Securities Act, Rule 0-6 under the Securities Exchange Act and Rule 105 under the Public Utility Holding Company Act of 1935 relating to the disclosure of documents or information detrimental to the national defense or foreign policy. The amendments bring those rules into harmony with the recently adopted Public Information Act and specify the procedure to be followed by registrants with respect to classified material.

Adoption of Rules Relating to Industrial Revenue Bonds

During the fiscal year, the Commission invited public comments on a proposed Rule 131 under the Securities Act and a proposed Rule 3b-5 under the Securities Exchange Act relating to industrial revenue bonds, and shortly after the close of the fiscal year, the rules were adopted.

Industrial revenue bonds generally are instruments issued in the name of a government or its instrumentality to finance the acquisition of a revenue producing facility which is leased to a private company. Usually the facility has been specially constructed for that company.

Principal and interest on the bonds are payable from the proceeds of the lease, and the bonds are not backed by the taxing power and general credit of the governmental body in whose name they are issued. Thus, the typical industrial revenue bond financing plan represents a financing by a private company. Accordingly, investors should be given information concerning the business, prior experience, fiscal responsibilities and earnings of the company that has leased the facility, as well as the terms and conditions of the lease arrangement, in order to assess the worth of such investment. The municipality or other governmental unit usually has no significant obligation under the bond, except to the extent of applying lease payments received from the private company to the payment of principal and interest. The investor cannot look to the municipality for interest payments or repayment of the principal; he can look only to the possibility of success or failure of the private company. In these circumstances, the investor is offered an interest in an obligation of the private company which is a "security" within the meaning of the securities acts and should have the benefit of the disclosures required by the Securities Act and the Securities Exchange Act when applicable.

Accordingly, the new rules identify the interest in the obligation of the private company as a separate security issued by such company and, absent an exemption, such securities are subject to the registration and prospectus delivery requirements of the Securities Act and the various provisions of the Exchange Act. The rules do not operate to terminate the exemption for governmental and municipal bonds provided in the securities acts but only relate to that part of the obligation of the bonds as to which the real obligor is a business enterprise. The rules specifically exclude bonds issued in connection with a public project or facility owned and operated by or on behalf of and under the control of a governmental unit.

The new rules apply to industrial revenue bonds sold after December 31, 1968.

Joint Release Relating to Real Estate Syndications

During the fiscal year, the Commission and the securities authorities of Maryland, Virginia and the District of Columbia issued a joint release for the guidance of the industry and the bar respecting statutory requirements with respect to real estate syndications. This action was responsive to the fact that newspaper advertisements by various persons, corporations, partnerships, trusts and unincorporated organizations had offered for sale interests in real estate syndications, usually in the form of limited partnership interests or interests in joint or profit sharing ventures, which had not been registered with the appropriate regulatory bodies. Such offers and subsequent sales had been prevalent especially in the District of Columbia, Maryland and Virginia. These transactions raised important questions under the registration requirements and anti-fraud provisions of the Federal securities laws and the laws of these States and of the District of Columbia. The release emphasized that the interests in question were securities under Federal law and under the laws of these three jurisdictions and it outlined the requirements of the relevant statutory provisions.

Amendment of Rule Relating to Contents of Prospectus Used After Nine Months

Rule 427 under the Securities Act permits the omission from any prospectus used more than 9 months after the effective date of the registration statement of any information previously required to be contained in the prospectus insofar as later information covering the same subjects, as of a date not more than 16 months prior to the use of the prospectus, is contained therein. Where securities have been registered on Form S-1 but at the time of filing a prospectus as a part of a post-effective amendment the registrant would be entitled to register the securities on another form, such as Form S-8 or S-9, the Commission has permitted the prospectus to be prepared in accordance with the requirements of such other form. In order to make this practice generally known to all registrants and to make it applicable to forms, other than Forms S-8 and S-9, which may be adopted from time to time, Rule 427 was amended during the fiscal year to incorporate such practice.

Adoption of Rule Relating to Registration by Certain Successor Issuers

During the fiscal year the Commission adopted Rule 414 under the Securities Act relating to registration of securities by certain successor issuers. The new rule provides a means whereby an offering of registered securities by a predecessor company may be continued by its successor without repeating the full process of registration where the purpose of the succession is merely to change the state of incorporation of the registrant. The rule provides that the registration statement of the predecessor shall be deemed to be the registration statement of the successor where certain conditions are met, including the filing of an amendment to the registration statement by the successor expressly adopting the statement as its own for all purposes of the Act and the Securities Exchange Act.

Amendment of "No-Sale" Rule

Rule 133 under the Securities Act provides that, solely for the purpose of the registration requirements of Section 5 of the Act, the submission to stockholders of a corporation, under certain circumstances, of a proposed merger, consolidation, reclassification of securities or transfer of assets does not constitute an offer to such stockholders of the securities to be issued to them in the transaction. Where a transaction involves the transfer of assets to a corporation in consideration of its own securities, the rule provides that the consideration may consist of any kind of securities, whether equity or debt securities. However, where the assets are to be transferred to a subsidiary of the issuer of the securities involved in the transaction, the consideration previously could consist only of voting stock of such issuer. The rule was amended during the year so that it will apply in cases where the assets are to be transferred to a subsidiary of the issuer in consideration of any securities of the issuer.

Staff Examination of Registration Statements

Registration statements are examined by the Commission's staff for compliance with the standards of adequate and accurate disclosure. This examination is primarily the responsibility of the Division of Corporation Finance. Statements filed by investment companies registered under the Investment Company Act of 1940 are examined by the Division of Corporate Regulation. If it appears that a statement does not conform in material respects with the applicable requirements, the issuing company is usually notified by a letter of comment and is afforded an opportunity to file correcting or clarifying amendments. The Commission also has the power, after notice and opportunity for hearing, to issue a "stop-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, a letter of comment is not sent and the Commission either conducts an investigation to determine whether "stop-order" proceedings should be instituted or immediately institutes such proceedings. The exercise of the "stop-order" power during fiscal year 1968 is discussed on page 30. As to the new procedures adopted in November 1968 to expedite the processing of registration statements, see pages 11-12.

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 can 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, 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 the original filing to the effective date with respect to the 2,131 registration statements that became effective during the 1968 fiscal year 14 was 44, compared with 36 days for 1.460 registration statements in fiscal year 1967 and 38 days for 1,280 registration statements in fiscal year 1966.

The following table shows by months during the 1968 fiscal year the number of registration statements which became effective, and the number of calendar days elapsed during the registration process for the median registration statement.

[table omitted]

Statistics Regarding Registration Statements Filed

During fiscal year 1968 the number of registration statements filed as well as the dollar amounts of the offerings involved soared to record levels. A total of 2,906 registration statements was filed for offerings aggregating $54.0 billion. Compared with 1967 figures of 1,836 statements totalling $36.2 billion, this represented an increase of 58.3 percent in the number of statements filed and 49.2 percent in the dollar amount involved.

Of the 2,906 registration statements filed in the 1968 fiscal year, 893, or 30.7 percent, were filed by companies that had not previously filed registration statements under the Securities Act. Comparable figures for the 1967 and 1966 fiscal years were 440, or 24 percent, and 422, or 24.8 percent, respectively.

From the effective date of the Securities Act to June 30, 1968, a cumulative total of 31,861 registration statements has been filed under the Act by 13,398 different issuers covering proposed offerings of securities aggregating over $399.1 billion.

Particulars regarding the disposition of all registration statements filed under the Act to June 30, 1968, are summarized in the following table:

[table omitted]

As reflected in the above table, 148 registration statements were withdrawn during the 1968 fiscal year. The reasons assigned by the various registrants for requesting withdrawal were as follows:

[table omitted]

Statistics Regarding Securities Registered

During the fiscal year 1968, a total of 2,417 registrations of securities in the amount of $54.1 billion became effective under the Securities Act of 1933.15 The number of statements and the dollar amount of registrations were the largest on record and reflected the general expansion in the economy during the period and the increased need for funds by business.

The figures for 1968 include 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 1968, 69 percent was for the account of the issuer for cash sale, 25 percent for the account of the issuer for other than cash sale, and 6 percent for the account of others.

The following table compares the volume of securities registered for the account of the issuer and for the account of others for the past 3 fiscal years:

[table omitted]

The amount of securities offered for cash for the account of the issuer, approximately $37 billion, represented an increase of $9 billion or 34 percent over the previous year. Registration of new common stock issues aggregated $22.1 billion, an increase of $7 billion over the previous year, $4.4 billion of which reflects an increase of registrations of investment company issues which aggregated $13.8 billion during fiscal 1968. Registration of new bonds, notes and debentures increased by $1.7 billion over the previous year and amounted to $14 billion. Preferred stock issues aggregated $1.1 billion, twice the amount for the previous fiscal year, and the largest amount on record.

Corporate issues intended for immediate cash sale totaled $16.4 billion, an increase of $2.9 billion over the previous year. Manufacturing companies registered the highest volume of new issues of the corporate group, $6.4 billion, approximately $900 million more than in the previous year. Issues of electric, gas and water companies were next highest in volume, totaling $4.9 billion, $1.4 billion above the amount for this group in 1967. Among the other industry groups, communication amounted to $1.7 billion, financial and real estate to $1.0 billion, while extractive, transportation, and other miscellaneous issues amounted to $2.4 billion. Registration of foreign government issues scheduled for immediate sale totaled $1.2 billion as compared to $680 million in the preceding year.

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

[table omitted]

Of the funds raised from the cash sale of corporate securities for the account of issuers in 1968, 66 percent ($10.6 billion) was designated for plant and equipment expenditures and 23 percent ($3.7 billion) for working capital. The balance was to be used for retirement of securities and far other purposes including purchase of securities and repayment of long-term bank loans. Appendix Table 2, Part 4, contains a classification of uses of proceeds by principal industry groups.

Registration of issues to be offered over an extended period amounted to $19.7 billion, an increase of approximately $6 billion over the amount for 1967, and the largest amount on record. These issues are classified below:

[table omitted]

Stop Order Proceedings

Section 8 (d) of the Securities Act of 1933 gives the Commission the power, after notice and opportunity for hearing, to issue a stop order "suspending" the effectiveness of a registration statement which includes 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 effect of a stop order, which may be issued even after the sale of securities has begun, is to bar distribution of the securities so long as the order remains in effect. Although losses which may have been suffered by investors before issuance of the order are not restored to them by a stop order, the Commission's decision and the evidence on which it is based may serve to put them on notice of their rights and aid in their own recovery suits. As provided by the Act, a stop order is lifted when the registration statement has been amended to correct the deficiencies.

As of the beginning of the fiscal year, four stop-order proceedings were pending. During the year these proceedings were terminated, two of them through the issuance of stop order's and two by permitting withdrawal of the registration statement, subject to certain conditions, pursuant to offers of settlement accepted by the Commission. One of the stop orders was later lifted upon the filing of an amendment to the registration statement. During the fiscal year one new stop order proceeding was instituted.

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 shows the number of such examinations and investigations which were in progress 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 be exempted by the Commission in the exercise of this power.

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 U.S. 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 small business investment company under the Small Business Investment Act. Acting pursuant to this authority, the Commission has adopted Regulation E, which is described below. Exemption from registration under Section 3 (b) or 3 (c) of the Act does not carry 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 1968 fiscal year, 515 notifications were filed under Regulation A, covering proposed offerings of $112,318,744, compared with 383 notifications covering proposed offerings of $74,761,963 in the 1967 fiscal year.

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

[table omitted]

Reports of Sales. -- Regulation A provides that 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, the issuer or other person for whose account the securities are offered must file a report of sales containing specified information. A final report must be filed upon completion or termination of the offering.

During the fiscal year 1968, 724 reports of sales were filed reporting aggregate sales of $40,366,326.

Suspension of Exemption. -- The Commission may suspend an exemption under Regulation A 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 1968 fiscal year, temporary suspension orders were issued in five cases, which, added to the four cases pending at the beginning of the fiscal year, resulted in a total of nine cases for disposition. Of these, the temporary suspension order was vacated in one case and became permanent in six cases: in three by lapse of time, in two by withdrawal of the request for hearing, and in one on the basis of an offer of settlement. Two cases were pending at the end of the fiscal year.

Exempt Offerings Under Regulation B

During the fiscal year ended June 30, 1968, 453 offering sheets and 451 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 1967 and 1966 fiscal years, 353 and 235 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 1966-68. 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 laws 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 registered under the Investment Company Act of 1940 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.

The regulation, which is substantially similar to the general exemption provided by Regulation A, requires the filing of a notification with the Commission and, except in the case of offerings not in excess of $50,000, the filing and use of an offering circular containing certain specified information.

No notifications were filed under Regulation E during the 1968 fiscal 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 1968 fiscal year, 20 notifications were filed under Regulation F, covering assessments of $835,274. These notifications were filed in three of the nine regional offices of the Commission: Denver, San Francisco and Seattle. Underwriters were not employed in any of the Regulation F assessments. No Regulation F exemptions were suspended during the fiscal year.

Proposed Exemption for Securities of District; of Columbia Local Development Companies

The Commission has taken under consideration proposed Rule 237 under the Securities Act which if adopted would exempt securities issued by local development companies incorporated by and doing business in the District of Columbia from the registration requirements of the Act. The proposed rule defines the term "local development company" as a D.C. corporation with the authority to promote and assist the growth and development of small business concerns within the District. The purpose of the proposed rule is to allow local development companies interested in urban renewal projects in the District to offer securities in a manner which will encourage community participation in such projects. The exemption would be limited to offerings not exceeding $300,000, and would be available only for securities of those companies which have received a loan commitment under Section 502 of the Small Business Investment Act of 1958. The exemption would not apply to securities offered pursuant to an underwriting agreement, under a contract in which a discount or commission is offered as compensation, or for which an employee of the local development company is paid compensation in addition to his regular salary. An offering circular containing specified information must be used in the offering and must be filed with the Commission prior to its use. The proceeds of the sale of the securities must be kept in escrow until the Small Business Administration approves the disbursal of funds under its loan commitment. The proposed rule would not exempt any person who offers or sells the securities of a local development company from the anti-fraud provisions of the Act.

B. CONTINUING DISCLOSURE REQUIREMENTS

Registration of Securities on Exchanges

Unless a security is registered on a national securities exchange under the Securities Exchange Act of 1934 or is exempt from 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 (b) 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. Financial statements certified by an independent-accountant 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.

Statistics regarding securities traded on exchanges may be found in Part III of this report, as well as in certain of the appendix tables.

Registration of Over-the-Counter Securities

Section 12 (g) of the Exchange Act requires a company with total assets exceeding one million dollars and a class of equity securities held of record by 500 or more persons to register those securities with the Commission, unless one of the exemptions set forth in that section is available. [Footnote: Section 12 (g) contains various exemptive provisions with respect to certain types of securities. Of particular significance are the provisions relating to securities issued by insurance companies and securities of foreign issuers.] Upon registration, the periodic reporting, proxy solicitation and insider reporting and trading provisions contained in Sections 13,14 and 16 of the Act become applicable. During the fiscal year, 422 registration statements were filed under Section 12 (g). This makes a total, from the enactment of Section 12 (g) in 1964, through June 30, 1968, of 3,168 registration statements filed. Eight of these statements were withdrawn before they had become effective upon determination that they were not required to be filed under the Act. A total of 95 registrations have been terminated pursuant to Section 12 (g) (4) because the number of shareholders was reduced to less than 300. An additional 195 issuers which had registered securities have gone out of existence as a result of mergers, consolidations and the like, with the result that for practical purposes these registrations must also be considered to have been terminated.

Of the 422 registration statements filed under Section 12 (g) in fiscal year 1968, 235 were filed by issuers already subject to the reporting requirements of Sections 13 or 15 (d) of the Act. The latter figure includes 20 registration statements filed by issuers with another security registered on a national securities exchange, and 215 filed by issuers subject to the reporting requirements of Section 15 (d) because they had registered securities under the Securities Act. These latter companies, however, had not been subject to the proxy solicitation and insider reporting and trading provisions of Sections 14 and 16 of the Exchange Act. The remaining 187 issuers which filed registration statements had not been subject to any of the disclosure or insider trading provisions and became subject to them through registration.

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 a complete or partial exemption from the provisions of Sections 12 (g), 13, 14, 15 (d), or 16 if the Commission finds that because 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, the exemption is not inconsistent with the public interest or the protection of investors.

During the fiscal year, 9 applications for complete or partial exemptions were filed and 12 applications filed during prior years were still pending. Of these 21 applications, 1 was granted, 2 were withdrawn, the proceeding with respect to 1 was concluded by acceptance of a settlement agreement by the Commission and 17 were pending at the end of the year. The one exemption was granted because the applicant had merged into an issuer registered under Section 12 of the Act. The settlement agreement provided for the filing of a registration statement within a specified period, thereby subjecting the applicant to the reporting, proxy and stockholder information and insider trading provisions of the Act. Under the agreement the applicant, which owns a major league baseball club, would not be required to file semi-annual reports of earnings unless the Commission so directs.

In a decision announced shortly after the end of the fiscal year, the Commission denied an application by The National Dollar Stores, Ltd. for a conditional exemption from registration, but granted exemptions from the reporting requirements and from certain requirements as to the financial statements to be filed with a registration statement. National operates a chain of department stores. Its assets in January 1967 exceeded $12 million and its 10,000 shares of outstanding common stock, sold initially in 1928 and 1929 to members of the Chinese community in the San Francisco area, were held by 599 shareholders, mostly in small amounts except for a 50 percent interest owned by the founder's family. The shares have been traded infrequently and such transactions as have taken place have not involved brokers. Under a practice in effect for many years, stockholders wishing to sell shares have contacted the company which has found a buyer, generally among company employees.

The Commission concluded that, while an exemption from the registration requirements would not be appropriate, in view of the limited trading interest in the stock it would not be inconsistent with the public interest or the protection of investors to exempt National from the periodic reporting requirements, subject to certain conditions. Under this disposition, the company will be required to comply with the requirements as to proxy solicitations and its insiders will be subject to the insider reporting and trading provisions of the Act. The conditions specified include requirements that National deliver its most recent proxy statement and annual report to any prospective purchaser of its stock when it acts as intermediary and that it inform the Commission annually of all sales of its stock and advise it promptly of any material change in the facts recited in the Commission's opinion. The Commission expressly reserved jurisdiction to reconsider the exemption in the event of such a change or of a change in its rules relating to disclosures by Section 12 (g) companies.

Periodic Reports

Section 13 of the Exchange Act requires issuers of securities registered pursuant to Section 12 (b) or 12 (g) to file periodic reports keeping current the information contained in the application for registration or registration statement. These periodic reports include annual, semi-annual, and current reports. The principal annual report form is Form 10-K, which is designed to give current information regarding the matters covered in the original filing. 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 of immediate interest to investors has 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 securities. Section 15 (d) of the Exchange Act, generally speaking, requires issuers which have registered securities under the Securities Act of 1933 and which have no securities registered under Section 12 to file the reports described above.

The following table shows the number of reports filed during the fiscal year pursuant to Sections 13 and 15 (d) of the Exchange Act. As of June 30, 1968, there were 2,634 issuers having securities listed on a national securities exchange and registered under Section 12 (b) of the Act, 2,814 issuers having securities registered under Section 12 (g), and 1,285 additional issuers which were subject to the reporting requirements of Section 15 (d) of the Act.

[table omitted]

Proxy Solicitations

Scope and Nature of Proxy Regulation. -- Regulation 14A under the Exchange Act, implementing Section 14 (a) of that Act, governs the manner in which proxies or other authorizations may be solicited from the holders of securities registered under Section 12 of that Act, whether for the election of directors, approval of other corporate action, or some other purpose. [Footnote: This regulation also applies to security holders of registered public-utility holding companies, their subsidiaries and registered investment companies.] It requires that in any such solicitation, whether by the management or minority groups, disclosure must be made of all material facts concerning the matters on which such holders are asked to vote, and they must be afforded an opportunity to vote "yes" or "no" on each matter. The regulation also provides, among other things, that where 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 certain limitations, require the management to include in its proxy material any appropriate proposal which he wants 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 apply 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.

Under Section 14 (c) of the Act, issuers of securities registered under Section 12 must, in accordance with rules and regulations prescribed by the Commission, transmit information comparable to proxy material to security holders from whom proxies are not solicited with respect to a stockholders' meeting. Regulation 14C implements this provision by setting forth the requirements for "information statements."

Adoption of Amendments to Proxy and Information Rules

During the 1967 fiscal year, the Commission invited public comments with respect to proposed amendments to its proxy rules (Regulation 14A) under Section 14 (a) of the Exchange Act and its information statement rules (Regulation 14C) under Section 14 (c). Certain of the proposed amendments were adopted during that year, but at the request of persons who desired further time to study the proposals, the Commission extended the period within which comments could be submitted. Following receipt and consideration of a number of helpful comments, a series of other amendments were adopted during fiscal year 1968.

The principal changes include the following: Rule 14a-8, which provides that any security holder may, subject to certain prescribed limitations, require management to include in its proxy material any appropriate proposal which he desires to submit to a vote of security holders, was amended with respect to the minimum period preceding the proxy solicitation within which a security holder must submit his proposal to management to require its inclusion in the proxy material. The rule was further amended to permit the omission from such material of the proponent's name and address. Schedule 14A, which specifies the information that must be set forth in proxy material, was amended so as to require, among other things, more complete disclosure concerning options to purchase securities from the issuer or its subsidiaries held by officers and directors and disclosure of transactions between certain employee plans provided by the issuer, or its parents or subsidiaries, and certain insiders, and to clarify the situations where information concerning the interest of certain insiders in transactions with the issuer or a subsidiary may be omitted because it is not material. [Footnote: The amendments to Schedule 14A are also applicable to Schedule 14C of Regulation 14C. In addition, to maintain consistency between Regulations 14A and 140, the latter was amended to conform with the amendments to the proxy rules.]

Schedule 14B, which specifies the information to be filed in connection with election contests, was amended to require more complete disclosure by each participant in the contest of his transactions in the issuer's securities during the preceding 2 years.

The remaining changes were intended to clarify the existing rules and the items and instructions of Schedules 14A and 14C or to codify existing administrative practice.

Statistics Relating to Proxy and Information Statements

During the 1968 fiscal year, 5,244 proxy statements in definitive form were filed, 5,224 by management and 20 by nonmanagement groups or individual stockholders. In addition, 110 information statements were filed. The proxy and information statements related to 4,705 companies, some 519 of which had a second solicitation during the year, generally for a special meeting not involving the election of directors.

There were 4,473 solicitations of proxies for the election of directors, 751 for special meetings not involving the election of directors, and 23 for assents and authorizations.

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 1968 fiscal year, 162 proposals submitted by 34 stockholders were included in the proxy statements of 115 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, preemptive rights, 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, and limitations on charitable contributions.

A total of 92 additional proposals submitted by 34 stockholders was omitted from the proxy statements of 38 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 Non-Soliciting Companies. -- Of the 2,634 issuers that had securities listed and registered on national securities exchanges as of June 30, 1968, 2,424 had voting securities so listed and registered. During fiscal year 1968, 2,208, or 91 percent, of the latter group solicited proxies under the Commission's proxy rules for the election of directors.

Proxy Contests. -- During the 1968 fiscal year, 27 companies were involved in proxy contests involving the election of directors. In 21 contests control of the board was at stake while the other 6 involved representation on the board. Pursuant to the requirements of Rule 14a-11, 536 persons, both management and nonmanagement, filed detailed statements as participants.

Management retained control in 11 of the 21 contests for control of the board of directors, 4 were settled by negotiation, nonmanagement persons won 1 and 5 were pending as of June 30, 1968. Of the six cases where representation on the board of directors was involved, management retained all places on the board in two contests, opposition candidates won places on the board in three cases and one was pending as of June 30, 1968.

Insiders' Security Holdings and Transactions

Section 16 of the Securities 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 provide other stockholders and investors generally with information as to insiders' securities transactions and holdings, and to prevent the unfair use of confidential information by insiders to profit from short-term trading in a company's securities.

Ownership Reports. -- Section 16 (a) of the Exchange Act requires every person who beneficially owns, directly or indirectly, more than 10 percent of any class of equity security which is registered under Section 12 (b) for exchange listing or under Section 12 (g) for over-the-counter trading, or who is a director or an officer of the issuer of any such security, to file statements with the Commission disclosing the amount of all equity securities of the issuer of which he is the beneficial owner and changes in such ownership. Copies of such statements must also be filed with exchanges on which securities are listed. 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 Public Utility Holding Company Act and Section 30 (f) of the Investment Company Act.

During the fiscal year, 93,823 ownership reports (14,893 initial statements of ownership on Form 3 and 78,930 statements of changes in ownership on Form 4) were filed with the Commission. This is an increase of 8,540 over the 85,283 reports (13,494 initial statements and 71,789 statements of changes) filed during the 1967 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 to more than 24,000 subscribers.

Amendment of Rule Relating to Determination of 10 percent Ownership. -- Rule 16a-2 under the Exchange Act deals with the determination of when a person is the beneficial owner of more than 10 percent of a class of equity securities for purposes of the ownership reporting requirements of Section 16 (a). During the fiscal year, the Commission amended the rule to provide that a person shall be deemed to be the beneficial owner of securities which he has the right to acquire through the exercise of presently exercisable options, warrants or rights or through the conversion of presently convertible securities. Securities subject to such options, warrants, rights or conversion privileges held by such person are deemed outstanding for the purpose of computing the percentage of the class owned by him but are not deemed outstanding for the purpose of computing the percentage of the class owned by any other person.

The amended rule does not purport to determine whether transactions in options, warrants, rights or convertible securities may give rise to liabilities under Section 16 (b) of the Act. That question is one for determination by the courts independently of Rule 16a-2.

Recovery of Short-Swing Trading Profits. -- In order to prevent insiders from making unfair use of information which they may have 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 listed above) from certain purchases and sales, or sales and purchases, of securities of the company within any period of less than 6 months. The Commission at times participates as amicus curiae in actions to recover such profits when it deems it important to present its views regarding the interpretation of the statutory provisions or of the exemptive rules adopted by the Commission thereunder.

Changes in Rules Exempting Transactions From Short-Swing Trading Provisions. -- The Commission is authorized to exempt from the operation of Section 16 (b) of the Exchange Act any transaction not comprehended within the purpose of that Section. Rule 16b-7 exempts from the operation of Section 16 (b) certain acquisitions and dispositions of securities pursuant to mergers or consolidations. During the fiscal year Rule 16b-7 was amended to make explicit its intended scope. The rule provides that the exemption shall not be available to a person if he has made certain short-term purchases and sales other than those involved in the merger or consolidation. The amendments specify that the exemption is not defeated by short-term transactions which are exempted under any other rule adopted under Section 16 (b) and that as to transactions not so exempted, the exemption provided by Rule 16b-7 will be unavailable only to the extent of such transactions.

The Commission also adopted Rule 16b-11 which exempts from the operation of Section 16 (b) the sale of certain short-term subscription rights distributed for no consideration by an issuer to a class of its security holders pro rata in the course of an offering to such security holders of additional securities of such issuer.

Investigations With Respect to Reporting and Proxy Provisions

Section 21 (a) of the Exchange 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. The following investigations were undertaken pursuant to Section 21 (a) 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]

Proceedings to Obtain Compliance With Exchange Act Registration or Reporting Requirements

Section 15 (c) (4) of the Exchange Act, which was a part of the 1964 amendments of that Act, empowers the Commission to find, after notice and opportunity for hearing, that any person subject to the provisions of Section 12, 13, or 15 (d) of the Act or the rules thereunder has failed to comply with these requirements in any material respect. It authorizes the Commission to publish its findings and issue an order requiring compliance on such terms and conditions and within such time as it may specify. Section 15 (c) (4) thus provides an administrative forum, comparable to that provided by Section 19 (a) (2) for proceedings to delist an exchange-traded security, for the resolution of accounting and other technical questions arising from the disclosure provisions of the Exchange Act and a means for apprising investors of materially false or misleading filings.

In the most notable proceeding to date under Section 15 (c) (4), involving Crescent Corporation and Pakco Companies, Inc., whose securities were registered under Sections 12 (b) and 12 (g) of the Exchange Act, respectively, the Commission found "repeated and flagrant violations" of the reporting requirements. In its conclusions, the Commission stated:

"The reports filed with us by Crescent and Pakco were marked by numerous, serious and substantial deficiencies which . . . reflected a studied pattern of corporate indirection, camouflage and concealment, particularly relating to transactions in which Colasurdo [the controlling person of the two companies] had a material interest. . . . Colasurdo and his associates, as corporate directors, officers and insiders, occupied positions of trust with fiduciary obligations to the corporations and their security holders. They not only did not discharge their fiduciary obligations but concealed their conflicts of interest from other stockholders by the use of shell corporate entities and devious arrangements and nondisclosures and misstatements in reports filed with us. . . .

"Adequate reporting to stockholders is a matter of vital importance and is a subject of major concern to this Commission. This case points up the significance of the reporting requirements. A company such as Crescent, whose securities are listed on the New York Stock Exchange, not only has a statutory obligation to file certain reports with us and the Exchange, but also has voluntarily assumed certain commitments to the Exchange to keep the Exchange and the public informed of material events. Of particular significance to public stockholders are changes in control and membership in the board of directors and transactions in which persons in a position to exercise control or direction of corporate affairs have an interest. Where, as here, a majority of directors resigns within 11 days of a transfer of controlling blocks of stock, it is most important to the public stockholders that they obtain at the least prompt information with respect to the changes that have taken place. Indeed, to be fully effective, detailed information as to such changes should be given to stockholders before they are actually consummated, so that stockholders will be aware that a material alteration in the managerial structure of their company is about to take place and they will be alerted to the possible impact of the changes on their investment interests and be in a better position to take steps to protect those interests. Such disclosure would among other things make more difficult the concealment of transactions for the benefit of a controlling-person of the type that occurred in the present case." [Footnote: Prior to issuance of its opinion, the Commission had accepted offers of settlement submitted by the two companies providing for discontinuance of the proceedings on the basis of the filing of corrective reports, the mailing of corrective current report material to their stockholders and an undertaking to mail copies of the Commission's opinion to such stockholders if deemed appropriate by the Commission. Securities Exchange Act Release No. 8144 (August 14, 1967). In its opinion, the Commission concluded that copies thereof should be sent to the stockholders.]

Summary Suspension of Trading

Section 19 (a) (4) of the Exchange Act authorizes the Commission summarily to suspend trading in a security listed on a national securities exchange for up to 10 days if in its opinion the public interest so requires. As a counterpart to this provision, Congress in 1964 enacted Section 15 (c) (5) of the Exchange Act which authorizes the Commission summarily to suspend over-the-counter trading in any nonexempt security for up to 10 days if it believes that such action is required in the public interest and for the protection of investors.

During the 1968 fiscal year, the Commission temporarily suspended trading in 39 securities, compared to 22 in fiscal 1967 and 16 in fiscal 1966. In 7 instances exchange-listed securities were involved and the Commission acted under both Section 19 (a) (4) and Section 15 (c) (5). In each of these cases, the exchange on which the securities were listed had previously suspended trading.

In most instances the Commission ordered suspension of trading because adequate information concerning the company was not available or the Commission learned of information not generally known to the securities community and investors which indicated the existence of substantial questions concerning the financial condition or business operations of the companies involved or concerning the purchase or sale of the securities of such companies. For example, suspensions were ordered pending clarification and adequate public dissemination of information concerning: undisclosed transactions in the stock of the company by its officers, directors and controlling persons; matters disclosed in preliminary proxy material filed with the Commission which, under Commission rules, would not become public until examined by the Commission's staff and thereafter distributed by the company to its shareholders; and the possibility of irregularities in an offering which, among other things, raised questions as to whether a claimed intrastate exemption from the registration provisions of the Securities Act was in fact available. In other instances, no current information was available and there were substantial increases in the market price of stocks which appeared to have no reasonable basis. In two instances actions taken by state authorities formed the basis for Commission action.

In five cases, the Commission instituted enforcement action subsequent to the trading suspensions where violations of law were uncovered. For example, in a case involving Fastline, Inc., the Commission suspended over-the-counter trading in the company's common stock as a result of information obtained in a staff investigation indicating a lack of current, accurate information about Fastline's financial status or operations. It appeared from the investigation that Fastline had no offices, tangible assets, business operations, employees or any income whatsoever, and that the only officer of the company was a "provisional president." Although it appeared that Fastline had 1,207,324 shares outstanding, no books and records or accurate current stock transfer records could be found. Upon complaint filed by the Commission in the U.S. District Court for the Southern District of Florida, Fastline and certain individuals were enjoined from further offers and sales of Fastline's common stock in violation of the registration provisions of the Securities Act of 1933. The suspension of trading was then terminated by the Commission.

In another case, involving North American Research and Development Corporation, the Commission suspended trading in the company's common stock when it appeared that there was a complete lack of financial and other information with respect to the company, and that control persons and insiders had failed to disclose their trading in the stock. Subsequently, the Commission filed a complaint in the U.S. District Court for the Southern District of New York seeking to enjoin 43 defendants, including 6 broker-dealers, an investment adviser, and other corporations and individuals in addition to North American and its control persons and insiders, from further violations of the registration and anti-fraud provisions of the securities laws. Upon issuance of an order of preliminary injunction against the company and 13 other defendants, the Commission terminated the trading suspension. The appeals of some of the defendants are presently pending. The Commission has instituted administrative enforcement action against other defendants involved in the case.

C. ACCOUNTING AND AUDITING MATTERS

The several Acts administered by the Commission reflect a recognition by Congress that dependable financial statements of a company are indispensable to an informed investment decision regarding its securities. The value of such statements is directly dependent on the soundness of the judgment exercised in applying accounting principles and practices in their preparation, and on the adequacy and reliability of the work done by public accountants who certify the statements. A major objective of the Commission has been to improve accounting and auditing standards and to assist in the establishment and maintenance of high standards of professional conduct by certifying accountants. The primary responsibility for this program rests with the Chief Accountant of the Commission.

Pursuant to the Commission's broad rulemaking power regarding the preparation and presentation of financial information, it has adopted a basic accounting regulation (Regulation S-X) which, together with opinions on accounting principles published as "Accounting Series Releases," governs the form and content of financial statements filed under the statutes administered by the Commission. The Commission has also formulated rules with respect to accounting for and auditing of brokers and dealers and has prescribed uniform systems of accounts for companies subject to the Public Utility Holding Company Act of 1935. The accounting rules and the opinions of the Commission and its decisions in particular cases have contributed to clarification and wider acceptance of the accounting principles and practices and auditing standards developed by the profession and generally followed in the preparation of financial statements.

In the large area of financial reporting not covered by its rules, the Commission's principal means of protecting investors from inadequate or improper financial reporting is by requiring a 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 requirement of the opinion of an independent accountant is designed to secure for the benefit of public investors the detached objectivity of a knowledgeable person not connected with the management.

In order to keep abreast of changes and new developments in financial and economic conditions and in recognition of the need for a continuous exchange of views and information between the Commission's staff and outside accountants regarding appropriate accounting and auditing policies, procedures and practices for the protection of investors, the staff maintains continuing contact with individual accountants, other government agencies, and various professional organizations. These include 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.

The Work of the Accounting Principles Board

In furtherance of the policy of cooperation between professional organizations and the Commission, the Accounting Principles Board of the American Institute of Certified Public Accountants met with the Commission during the year to discuss its program for the improvement of accounting standards and practices through the issuance of accounting opinions. The Board sponsors research studies of problem areas in accounting to provide background information and factual data which may be used in the formulation of its opinions. Drafts of these studies and opinions are referred to the Commission's accounting staff for review and comment prior to publication. A major opinion issued during the year, entitled "Accounting for Income Taxes," provides for a more uniform application of tax allocation than has prevailed in the past. The Board also issued a statement on "Disclosure of Supplemental Financial Information By Diversified

Companies" in which such companies were urged to disclose this type of information voluntarily.

The Board has indicated that many major problem areas in accounting are under study with a view to the issuance of opinions in the future. Among these are convertible debt and warrants, earnings per share, intercorporate investments, materiality, research and development costs, price-level changes, goodwill and business combinations, equity accounting, regulated industries, extractive industries, and diversified companies.

Relations With the Accounting Profession and the Public

As part of the Commission's effort to maintain a continuing exchange of views with the accounting profession, the Chairman, other Commissioners, the Chief Accountant and other members of the accounting staff accept speaking engagements and participate in panel discussions at professional society meetings. In this way the Commission can indicate problem areas in accounting as to which it believes the profession can aid in developing solutions. As an example, the Chairman has spoken extensively on the need for more detailed reporting by diversified companies and for a study of the problems involved. He has also urged companies to effect improvements on a voluntary basis. More recently he has urged the profession to restudy the accounting principles applicable to business acquisitions or combinations in order to prevent abuses arising from inadequate restrictions on the choice between the alternatives of purchase or pooling-of-interests accounting to be accorded such transactions. The Chief Accountant also accepts engagements to explain the work of the Commission at colleges and universities throughout the country.

Because of its many foreign registrants and the vast and increasing foreign operations of American companies, the Commission has an interest in the improvement of accounting and auditing principles and procedures on an international basis. To promote such improvement the Chief Accountant corresponds with foreign accountants, interviews many who visit this country, and, on occasion, participates in international accounting conferences. In September 1967, he presented a report before the Ninth International Congress of Accountants in Paris, France, on the topic "The International Harmonization of Accounting Principles." En route to this conference he participated in an International Congress on Accounting Education in London, England. In October 1967 he participated in a panel discussion on the "conglomerate" problem at the 36th International Conference of the Financial Executives Institute in Montreal, Canada.

Other Current Developments

The Chief Accountant's Office is currently engaged in revising the accounting rules in Regulation S-X, the first general revision since 1950, in order to make changes, additions or eliminations that have become necessary as a result of changing conditions over the years. The revisions will be published for public comment in accordance with established procedures.

During the fiscal year the Chief Accountant's Office considered a question pertaining to the independence of accountants under Rule 2-01 (b) of Regulation S-X which has occurred frequently in recent years as a result of the increasing international and multi-country operations of United States corporations. The question arises in a situation where a parent company requires auditing services for divisions or subsidiaries in countries where its independent accountants do not practice and another accounting firm may be engaged to examine the financial statements for such operations, which would be deemed to be a nonmaterial segment of the international business. Heretofore Rule 2-01 (b) has been construed to preclude all the partners of such other accounting firm or of its affiliates from owning any securities of the parent company or the subsidiary under audit if that accounting firm is to be considered independent as to the parent company or such subsidiary. In an interpretative release issued after the end of the fiscal year, the Commission stated that, insofar as ownership of securities by partners is concerned, the accounting firm performing the audit of the subsidiary in these circumstances would be held to be not independent only if securities of the parent company or the subsidiary are owned by any of the partners of that accounting firm or of its affiliated firms who are located in the office which makes the examination or who are otherwise engaged in such examination.

The adoption by the Commission on October 3, 1967, of a revision of Form X-17A-5 (the annual report of financial condition required to be filed by brokers and dealers) reflects recognition of changing conditions and practices in the securities industry and emphasizes the importance of the independent accountant's review of both the financial statement and the effectiveness of the accounting system and procedures for safeguarding securities.

Rule 17a-10 under the Exchange Act, which was adopted on June 28, 1968, requires that broker-dealers file comprehensive annual financial reports reflecting their financial condition as of the end of the year and the results of operations for the period. The background find nature of this new rule are discussed elsewhere in this report.

The Chief Accountant and his staff cooperated with the Commission's Division of Trading and Markets in the preparation of a proposal for a rule prohibiting an issuer whose stock is publicly offered or traded from misrepresenting the results of its operations by distributing stock dividends or their equivalent to shareholders unless the issuer has earned surplus sufficient to cover the fair value of the shares distributed. The rule would not affect traditional stock splits involving the distribution of at least an additional share for each share outstanding.

Pro rata stock distributions to stockholders hi amounts which are relatively small in relation to the number of shares outstanding are a means of conveying the impression that a distribution is being made out of the earned surplus of the company without the drain on current assets that would result from the distribution of a cash dividend. Instances have recently come to the attention of the Commission in which such distributions were utilized by companies having little or no earned surplus, thus creating a misleading impression concerning the results of operations of the company.

The proposed rule would prohibit any pro rata stock distribution to stockholders which is designated as a stock dividend or is made in amounts of less than 25 percent of the number of shares of the same class outstanding prior to the distribution, unless the issuer has earned surplus in an amount at least equal to the fair value of the shares so distributed and has transferred such amount from earned surplus to permanent capitalization. In the case of a pro rata distribution in amounts ranging between 25 percent and 100 percent of the number of shares outstanding, the requirement with respect to the existence and transfer of the requisite amount of earned surplus would be applicable if the distribution is part of a recurring program.

These provisions would in substance codify long-standing views of the American Institute of Certified Public Accountants, as well as the standards of the New York and American Stock Exchanges.

The proposed rule provides that the Commission may exempt any activity otherwise prohibited by the rule, if it finds that the proposed activity would not constitute a manipulative or deceptive device or contrivance within the purposes of the rule. It is contemplated that this exemptive provision will be narrowly construed and will be applied by the Commission only in cases involving-unusual circumstances.

Resignation of Accountants From Practice Before the Commission

On the basis of information furnished to the Commission during the fiscal year, the Commission had reason to believe that in connection with the preparation and submission of broker-dealers' financial statements pursuant to Rule 17a-5 under the Exchange Act two accountants may have failed to adhere to generally accepted auditing standards and the Commission's minimum audit requirements and that one of them was in fact not independent.

The accountants tendered their resignations in which they agreed not to appear or practice before the Commission in the future. The Commission determined that in view of the resignations no proceedings pursuant to Rule 2 (e) of the Commission's Rules of Practice were necessary and entered orders accepting the resignations.

D. CIVIL LITIGATION INVOLVING DISCLOSURE MATTERS

Summarized below are two significant civil court cases pending during the fiscal year which relate to disclosure matters. In one of these cases the Commission participated as amicus curiae; the other case, in which the Commission did not participate, is included because of its significant impact upon the effectiveness of the statutory disclosure provisions administered by the Commission. Civil court cases which relate to other phases of the Commission's work, and in which the Commission participated either as a party or as amicus curiae during the fiscal year, are discussed in Parts IV-VII of this report.

Escott v. BarChris Construction Corp. was an action brought under Section 11 of the Securities Act of 1933 by purchasers of Bar-Chris securities who alleged that the company's registration statement with respect to the securities was false and misleading. The defendants, in addition to the corporation, included the company's directors and officers who had signed the registration statement, the underwriters and the auditors.

Each of the defendants, except the corporation itself, asserted as an affirmative defense his due diligence in attempting to ascertain the truth about the company. All of these defenses were rejected on various grounds. With respect to two principal officers and directors of the company, the court found that their limited education and lack of financial expertise did not excuse their signing of a false registration statement. The court found that one "outside" director, who had only recently joined the board and had no actual knowledge of the company's affairs, had a duty to make further inquiry before he signed a registration statement since a prudent man would not perform such an important act on the basis of sketchy information. The court criticized the work of one director who was also counsel to the issuer and did a "scissors and paste-pot job" in preparing the registration statement; the court stated that "as the director most directly concerned with writing the registration statement and assuring its accuracy, more was required of him in the way of reasonable investigation than could fairly be expected of a director who had no connection with this work," and added that an attorney is required to check statements of his client which are easily verifiable. Similar negligence was found on the part of the managing underwriter and its counsel, who made some inquiry but relied in large part on statements by the issuer. The other members of the underwriting group who made no independent inquiry but relied on the manager were also found liable. Finally, the court found that the accountants failed to meet their obligation to make a reasonable investigation and did not even comply with their own auditing standards.

In Sunray DX Oil Co. v. Helmerich & Payne, Inc., decided shortly after the close of the fiscal year, the Court of Appeals for the Tenth Circuit agreed with the position taken by the Commission as amicus curiae that it is improper to set forth in proxy soliciting material numerical estimates of unproved oil reserves. The court quoted with approval the view expressed by the Commission that

"It is altogether probable that investors unfamiliar with the technical aspects of the oil and gas business . . . would ignore or misconstrue the technical but extremely significant difference between 'proved' and 'probable' oil reserves . . . and would attribute to any numerical estimates of probable reserves a degree of certainty which is not warranted."

E. CRIMINAL PROSECUTIONS INVOLVING DISCLOSURE VIOLATIONS

During the year convictions were obtained or indictments returned in several cases referred by the Commission to the Department of Justice for criminal prosecution which involved noncompliance with the Securities Act registration provisions, or the responsibility of accountants who audit the financial statements of public corporations. Information of a general nature regarding the Commission's criminal reference activities and summaries of other significant cases may be found in Part IV of this report.

In a significant case litigated during the fiscal year, a well-known financier, Louis Wolfson, and his business associate, Elkin B. Gerbert, were convicted of conspiracy to violate and substantive violations of the registration provisions of Section 5 of the Securities Act. The indictment alleged that the defendants conspired to sell and sold to the public without registration a substantial block of stock owned by the defendants and members of the Wolfson family in Continental Enterprises, Inc., a company controlled by Wolfson which had accumulated a deficit of some $900,000 in its 8 years of existence. Wolfson was sentenced to 1 year imprisonment and fined $100,000, Gerbert to 6 months imprisonment and fined $50,000. The convictions have been appealed to the Court of Appeals for the Second Circuit.

Wolfson and Gerbert were again convicted during the year in an unrelated case involving a Commission investigation into purchases and sales of stock of Merritt, Chapman & Scott Corporation. In this case, Wolfson (chairman of the board of directors and chief executive officer of Merritt, Chapman), Gerbert (a director of the corporation), Marshall G. Staub (president of Merritt, Chapman) and Joseph Kosow (a Boston financier) were convicted on charges, among others, of conspiring to obstruct justice in the investigation of Merritt, Chapman. Wolfson and Gerbert were also found guilty of committing perjury during the investigation, and Wolfson and Staub were convicted of issuing and filing with the Commission false annual reports for Merritt, Chapman. A fifth defendant in the case, Alexander Rittmaster, who had been a close financial consultant to Wolfson for many years, pleaded guilty to the conspiracy count and testified as a key government witness at the trial. In essence, the case involved the execution and concealment from public shareholders of a scheme whereby Kosow had entered into a clandestine agreement to buy up a substantial block of Merritt, Chapman shares in nominee names in the open market, from 1961 to 1964, with the assurance that the corporation would thereafter repurchase the shares at a substantial profit to him.

Another significant development during the fiscal year was the conviction of Lowell M. Birrell, who had been a fugitive from justice in Brazil for several years until he returned to this country to face trial in one of several pending cases in which indictments were outstanding against him. Birrell was found guilty in the Southern District of New York on charges of conspiring to sell unregistered stock of American Leduc Petroleum, Ltd., a defunct oil corporation, and to defraud the purchasers of these securities as well as on substantive charges of violating Section 5 of the Securities Act.

Several criminal prosecutions during the past fiscal year involved the question of the criminal responsibility of certified public accountants who audit the financial statements of public corporations. For instance, two partners and an audit manager of a large firm of certified public accountants were convicted of conspiring to prepare and disseminate a false and misleading annual report to stockholders of Continental Vending Machine Corporation and to file a false 10-K report for that company with the Commission and the American Stock Exchange, for the year ended September 30, 1962, and of mail fraud by participating in a scheme to prepare a false and misleading annual report to stockholders. The convictions are being appealed. The president and chairman of the board of Continental Vending had been indicted on similar charges, but he pleaded guilty prior to trial and testified as a government witness. The case centered around a scheme whereby substantial sums were transferred over a period of years from Continental Vending to another company also controlled by the president and board chairman and thence to the latter. At September 30, 1962, approximately $3.5 million had not been repaid to Continental. The accountants certified the financial statements as of that date which did not disclose the nature of the transfer of these funds or the fact that they could not be repaid.

Another certified public accountant was named in an indictment which is presently awaiting trial, in which it is charged that the president of VTR, Incorporated, a company whose stock is listed on the American Stock Exchange, his brother (a former director of VTR and presently a director of three Florida financial institutions) and their brother-in-law (a former employee of VTR and presently president of one of the Florida financial institutions) had misappropriated approximately $1 million from VTR and had concealed the misappropriations by making sham repayments to VTR at the end of each year through check kites perpetrated through two financial institutions controlled by the defendants. The ostensible repayments were immediately withdrawn from VTR in early January of each year. The misappropriations and sham repayments were not disclosed in VTR's financial statements, certified by the defendant accountant, and filed with the Commission and the American Stock Exchange as part of VTR's annual reports and proxy materials.

F. EXEMPTION FOR SECURITIES OF INTERNATIONAL BANKS

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. Pursuant to this authority, the Commission has 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 following summary of the Bank's activities reflects information obtained from the Bank.

The Bank reported a net income of $169.1 million for the fiscal year ending June 30, 1968, before providing for a loss of $23.2 million arising from currency devaluation during the year. This compared with net earnings of $170 million in the fiscal year 1967.

The Executive Directors have allocated $75 million from the year's net income as a grant to the Bank's affiliate, the International Development Association. The remaining portion of the year's earnings, $94.1 million, will be transferred to the Bank's Supplemental Reserve. After allowance for devaluation losses, this Reserve will amount to $963 million. Total reserves, including the Special Reserve, will amount to $1,254 million.

During the year, the Bank made 44 loans in 31 countries totaling $847 million, compared with a total of $877 million last year (which included a $100 million line of credit to the International Finance Corporation). The loans were made in Argentina (2 loans), Brazil (2), Ceylon, Republic of China (3), Colombia (3), Costa Rica, El Salvador, Ethiopia, Gabon, Greece, Guatemala, Honduras, India, Iran (2), Israel, Ivory Coast, Korea, Malagasy Republic, Malaysia, Mexico (3), Nicaragua (2), Pakistan, Papua and New Guinea, Peru, Singapore (2), Spain, Sudan, Tanzania, Thailand (2), Tunisia and Yugoslavia (2). This brought the total number of loans to 552 (including IFC) in 85 countries and territories and raised the gross total of commitments to $11,518 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 $7,576 million.

During the year the Bank sold or agreed to sell $107 million principal amounts of loans, compared with sales of $69 million last year. On June 30, the total of such sales was $2,143 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 $3,289.6 million, reflecting a net increase of $214.3 million in the past year. During the year the funded debt was increased through the public sale of Can$15 million (US$13.9 million) of Canadian dollar bonds, $300 million of US dollar bonds of which $159.4 million were sold under delayed delivery arrangements, SwF75 million (US$17.5 million) of Swiss franc bonds, DM120 million (US$30 million) of Deutsche mark bonds, f40 million (US$11 million) of Netherlands guilder bonds, and SKr75 million (US$14.5 million) of Swedish kronor bonds, the private placements of bonds and notes of $290.4 million, DM183.5 million (US$45.9 million) and SwF50 million (US$11.6 million), and the issuance of $158.7 million of bonds under delayed delivery arrangements. The debt was decreased through the retirement of bonds and notes of $406.4 million, DM159.5 million (US$39.9 million) and SwF50 million (US$11.6 million), by purchase and sinking fund transactions amounting to $55.9 million, and by $6 million as a result of the revaluation of outstanding pounds sterling stock.

During the year The Gambia became a member of the Bank and the following four countries increased their subscriptions to the Bank's capital: Korea, Peru, Philippines and Viet-Nam. Thus on June 30, 1968, there were 107 member countries and the subscribed capital of the Bank amounted to $22,941.9 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 or guaranteed by the Bank similar to that provided for securities of the International Bank for Reconstruction and Development. Acting pursuant to this authority, the Commission adopted Regulation IA, which requires the Bank to file with the Commission substantially the same 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. The following summary of the Bank's activities reflects information submitted by the Bank to the Commission.

During the year ended June 30, 1968, the Bank made 17 loans totaling the equivalent of $113,450,000 from its ordinary capital resources, bringing the net total of loan commitments outstanding, after cancellations, to 157, aggregating $923,999,000. During the year, the Bank sold or agreed to sell $8,913,059 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, Mexico, Paraguay, Peru, Uruguay and Venezuela. One regional loan was extended.

During the year the Bank also made 35 loans totaling the equivalent of $291,285,000 from its Fund for Special Operations, bringing the gross total of loan commitments outstanding to 177, aggregating $1,045,551,000. The Bank made no loans during the year from the Social Progress Trust Fund, which it administers under an Agreement with the

United States, leaving the gross total of loan commitments outstanding from that Fund at 117, aggregating $500,987,000.

On June 30, 1968, the outstanding funded debt of the ordinary capital resources of the Bank was the equivalent of $507,429,000, reflecting a net increase in the past year of the equivalent of $64,535,000. During the year the funded debt was increased through a public bond issue in Belgium in the amount of BF300,000,000 (US$6 million), a public offering in the United States of $60 million of bonds, the private placement in Latin America of an issue of $43 million of short-term dollar bonds, and the drawing under a loan agreement with the Export-Import Bank of Japan of the equivalent of $6,735,000 in Japanese yen. The funded debt was decreased through the retirement of $45 million of short-term dollar bonds, adjustment by $1,200,000 in US$ equivalent of English Sterling Stock through Pound Sterling devaluation and US$5 million through Sinking Fund purchases.

The subscribed ordinary capital of the Bank on June 30, 1968, was the equivalent of $1,778,830,000 of which $1,395,180,000 represented callable capital.

Asian Development Bank

The Asian Development Bank Act adopted in March 1966 authorizes United States participation in the Asian Development Bank and provides an exemption for certain securities which may be issued or guaranteed by the Bank similar to the exemption accorded the International Bank for Reconstruction and Development and the Inter-American Development Bank. Acting pursuant to this authority the Commission, during the fiscal year, adopted Regulation AD 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 and the Inter-American Development Bank. 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.

As of June 30, 1968, the Bank had 32 members which had subscribed to $970 million of capital stock, $615 million by 19 regional members and $855 million by 13 non-regional members, including $200 million by the United States. One-half of each member's subscription is paid-in capital, and the other half is callable capital to provide backing for future borrowings by the Bank. As of June 30, 1968, the Bank had not made any offering of bonds.

The Bank made its first loan from ordinary capital in January 1968, the equivalent of $5 million to the Industrial Finance Corporation of Thailand to finance foreign exchange components of the Corporation's loans in the private sector. The Bank loaned $2 million equivalent to Ceylon in July 1968 for tea factory modernization; $6.8 million equivalent to Korea in September 1968 for the Seoul-Inchon Expressway Project; and $7.2 million equivalent to Malaysia in September 1968 for the Penang Water Supply Project. During the year ending June 30, 1968, the Bank extended technical assistance to Indonesia in the field of food production and distribution, to the Korean Agriculture and Fishery Development Corporation, to the Philippines in the field of water management, and to Viet-Nam in the field of development finance.

G. TRUST INDENTURE ACT OF 1939

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

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

The Act was passed after studies by the Commission had revealed the frequency with which trust indentures failed to provide minimum protections for security holders and absolved so-called trustees from minimum obligations in the discharge of their trusts. It requires that the indenture trustee be free of conflicting interests which might interfere with the faithful exercise of its duties in behalf of the purchasers of the securities. It requires also that the trustee be a corporation with minimum combined capital and surplus; imposes high standards of conduct and responsibility on the trustee; precludes preferential collection of certain claims owing to the trustee by the issuer in the event of default; provides for the issuer's supplying evidence to the trustee of compliance with indenture terms and conditions such as those relating to the release or substitution of mortgaged property, issuance of new securities or satisfaction of the indenture; and provides for reports and notices by the trustee to security holders. Other provisions of the Act prohibit impairment of the security holders' right to sue individually for principal and interest except under certain circumstances, and require the maintenance of a list of security holders which may be used by them to communicate with each other regarding their rights.

[table omitted]

PART III
REGULATION OF SECURITIES MARKETS

In addition to the disclosure provisions discussed in Part II of this report, the Securities Exchange Act of 1934 gives the Commission important responsibilities over the securities markets and persons engaged in the securities business. Among other things, it requires securities exchanges to register with the Commission, vests them with important self-regulatory responsibilities subject to Commission supervision, and authorizes the Commission to change or supplement the rules of the exchanges where required in the public interest. The Act requires the registration and regulation of brokers and dealers doing business in the over-the-counter markets, provides for the registration of associations of brokers or dealers and supervised self-regulation by such associations, and contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets.

Developments and actions during the 1968 fiscal year in these areas, as well as statistical information concerning the securities markets, are discussed in this and the next part of the report. Certain developments of particular significance, however, including those relating to the structure and level of commission rates on the exchanges, are discussed in Part I.

REGULATION OF EXCHANGES

Registration and Exemption of Exchanges

The Securities Exchange Act requires an exchange to be registered with the Commission as a national securities exchange unless the Commission exempts it from registration because of the limited volume of transactions effected. As of June 30, 1968, the following 13 stock exchanges were registered:

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
Spokane Stock Exchange

During fiscal year 1968, an order of the Commission terminating the registration of the San Francisco Mining Exchange became effective.

The following three exchanges have been exempted from registration :

International Stock Exchange [Formerly Colorado Springs Stock Exchange.]
Richmond Stock Exchange
Honolulu Stock Exchange

Review of Exchange Rules and Procedures

Rule 17a-8 under the Exchange Act provides that each national securities exchange must file with the Commission a report of any proposed amendment to or other change in its rules and practices not less than 3 weeks (or such shorter period as the Commission may authorize) before taking any action to effectuate the change. These proposals are submitted for review and comment to the Commission's Branch of Regulation and Inspections of the Division of Trading and Markets. The Division also reviews, on a continuing basis, the existing rules, regulations, procedures, forms and practices of all national securities exchanges in order to ascertain the effectiveness of the application and enforcement by the exchanges of their own rules; to determine the adequacy of the rules of the exchanges, and of related statutory provisions and rules administered by the Commission, in light of changing market conditions; and to anticipate and define problem areas so that members of the Commission's staff can meet with representatives of the exchanges to work out salutary procedures within the framework of cooperative regulation.

Revisions in Exchange Member Trading Rules

In December 1967, the New York Stock Exchange upon the recommendation of the Commission adopted new provisions in its Floor Trading Plan in order to clarify certain aspects of on-floor and off-floor trading, and to further restrict registered traders. Two of these measures are designed to prevent an off-floor member from taking advantage of any news which he may receive prior-to its dissemination to the public. They deal with the manner in which members trading from off the floor must transmit their orders to the floor, and provide for a two-minute waiting period before off-floor members may trade in a stock in which a block transaction has occurred. The New York Stock Exchange Revised Rules also provide that a member who is not a registered trader and who initiates off-floor orders after having been on the floor that day must file a report of all such off-floor transactions. The floor trading rules were amended further to restrict congregating by registered traders when they are liquidating positions. The rule formerly applied only when registered traders were establishing or increasing positions.

Acting on recommendations of the Commission, the American Stock Exchange, in February 1968, published a "Commentary" to its existing rule on excessive dealing to restrict off-floor trading by members for their own account. This "Commentary" stated that "The Exchange expects that all trading by members and member organizations will have a constructive effect on the market by adding to its orderliness and liquidity." In addition, it outlined in specific terms what types of off-floor activity would be viewed as excessive.

In January 1968, the American Stock Exchange Floor Trading Plan was amended to correct an oversight in the original plan which had exempted registered traders and other members from the floor trading rules in any transactions made by them to assist in difficult market situations upon the request or approval of a floor official. This exemption was revised to apply only to members who are not registered traders, which was the intent when the Commission approved the original Floor Trading Plan.

Revisions in Listing and Delisting Standards

The various exchanges have rules and practices, generally referred to as listing and delisting standards, governing admissions to and removals from their lists. During the past year both the New York and American Stock Exchanges adopted more stringent standards. The New York Stock Exchange raised its minimum standards for listing as follows: net tangible assets from $10 million to $14 million; net income before Federal income tax in the latest year from $2 million to $2.5 million; number of stockholders of round lots from 1,700 to 1,800; number of shares publicly held from 700,000 to 800,000; and market value of publicly held shares from $12 million to $14 million. The criteria for continued listing were raised as follows: total number of stockholders from 800 to 1,000; number of stockholders of round lots from 700 to 900; number of shares publicly held from 300,000 to 400,000; market value of publicly held shares from $2.5 million to $4.0 million; net tangible assets from $5 million to $7 million; and average net earnings for the last 3 years from $400,000 to $600,000.

The American Stock Exchange raised its listing criteria as follows: net tangible assets from $1 million to $3 million; earnings from $150,000 for the last year ($100,000 average for last 3 years) to $300,000 ($5013,000 before taxes), plus a reasonable prospect of sustaining this level of earnings; number of shares publicly held from 250,000 to 300,000; market value of shares publicly held from $1,250,000 to $2 million; total number of stockholders from 750 to 900; and total number of stockholders of round lots from 500 to 600.

The delisting standards of the American Stock Exchange were also raised. One new standard provides that a company which has sustained losses in each of the 2 most recent years must have net tangible assets of at least $1 million and a company which has sustained losses in three of the 4 most recent years must have net tangible assets of $3 million. The previous requirement was that a company must have earnings in at least one of the last 3 years. In addition, the number of shares which must be publicly held was raised from 100,000 to 150,000; market value of shares publicly held from $500,000 to $750,000; total number of shareholders from 300 to 450; and number of round lot shareholders from 200 to 300. Under a new provision, the Exchange will consider removing from its list a stock which has been selling for a substantial period of time at a low price (generally below $5 per share) if the issuer does not effect a reverse split of such shares within a reasonable time after being notified by the Exchange that it deems such action appropriate.

Delisting of Securities From Exchanges

Under Section 12 (d) of the Securities Exchange Act and the Commission's Rule 12d2-2 thereunder, securities may be withdrawn or stricken from listing and registration, upon application by an issuer or an exchange, in accordance with the rules of the exchange and upon such terms as the Commission may impose for the protection of investors. During the fiscal year ended June 30, 1968, the Commission granted applications by exchanges and issuers to remove 56 stock issues, representing 53 issuers, and 4 bond issues from listing and registration. Since three stocks were each delisted by two exchanges, the total of stock removals was 59, as follows:

[table omitted]

The three applications by issuers which were granted during the year resulted in the removal of one security each from the American, Detroit and Pacific Coast Stock Exchanges.

The applications by exchanges are generally based upon one or more of the following grounds: the number of shares of the issue in public hands or the number of shareholders is insufficient; the market value of outstanding shares or the trading volume on the exchange is too low; the issuer has failed to meet the exchange's requirements as to earnings or financial condition; the issuer has failed to file required reports with the exchange; or the issuer has ceased operations or is in the process of liquidation.

In fiscal year 1968, the Commission issued several decisions granting delisting applications by exchanges which were opposed by the issuers of the securities. A particularly significant decision was rendered in the case of American Electronics, Inc. This case involved a delisting policy of the American Stock Exchange that securities will be considered for delisting where the issuer's financial condition and/or operating results do not appear to warrant continued listing, and a specific criterion adopted in furtherance of that general policy that delisting will be considered if the issuer has not operated at a net profit in at least one of the last 3 fiscal years. American Electronics had sustained losses in 6 of its last 7 years but had a small net profit in one of the 3 years immediately prior to the delisting application. It contended that the more specific delisting "criteria" rather than the more general "policies" should govern, and that a contrary position would permit the Exchange to act arbitrarily and would raise antitrust questions.

The Commission rejected these arguments. It held that the exchange may proceed on the basis of its stated policy to consider delisting where an issuer's financial condition and/or operating results do not warrant continued listing, and is not precluded from doing so because of its adoption of more specific criteria in furtherance of the stated policy. The Commission also stated:

"We cannot agree with the issuer's claim that rejection of its position would permit the Exchange to delist in a discriminatory and unfair manner and would render the Exchange's rules deficient under the Act and its actions Questionable under the antitrust laws. Such a rejection does not imply that the Exchange has an unfettered discretion. The delisting policies and procedures of an exchange must be reasonably designed to carry out the purposes of the Act and fairly administered, and particular delisting actions must be reasonably within the framework of the published policies. Indeed, exchange delisting programs meeting these standards are, in our opinion, 'necessary to make the Securities Exchange Act work.' The right of review of delisting applications by us and, on appeal, by the courts affords an adequate safeguard against any arbitrary or otherwise improper action. We believe the Exchange has complied with the applicable standards in this case."

The Commission further held that the issuer's stated expectations of profitable operation in the current year and projected improvement of its capital and working capital positions did not warrant postponement of delisting and it denied the issuer's requests for rehearing by the exchange or a hearing by the Commission.

Inspections of Exchanges

Pursuant to the regulatory scheme of the Exchange Act, the Commission actively oversees the discharge by the national securities exchanges of their self-regulatory responsibilities. As part of the program, the Branch of Regulation and Inspections in the Division of Trading and Markets conducts regular inspections of various phases of exchange activity. During the past fiscal year, the Branch conducted inspections of the New York, Midwest, Boston, Philadelphia-Baltimore-Washington, Pittsburgh and National Stock Exchanges. This inspection program provides a means of ensuring exchange compliance with regulatory responsibilities and enables the Commission to recommend improvements and refinements designed to increase the effectiveness of self-regulation.

In cases where it appears that revisions in internal policies are desirable in order to improve an exchange's performance, the Commission's staff communicates its views to the particular exchange and discusses the matters with exchange personnel to arrive at appropriate solutions.

STATISTICS RELATING TO SECURITIES TRADED ON EXCHANGES

Number of Issuers and Securities

As of June 30, 1968, 4,831 stock and bond issues, representing 2,773 issuers, were admitted to trading on securities exchanges in the United States. Of these, 4,628 securities issues (3,094 stock issues and 1,534 bond issues), representing 2,634 issuers, were listed and registered on national securities exchanges, the balance consisting primarily of securities admitted to unlisted trading privileges and securities listed on exempted exchanges. The listed and registered issues included 1,747 stock issues and 1,369 bond issues, representing 1,486 issuers, listed and registered on the New York Stock Exchange. Thus, with reference to listed and registered securities, 56.4 percent of the issuers, 56.5 percent of the stock issues and 89.2 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.

During the 1968 fiscal year, 241 issuers listed and registered securities on a national securities exchange for the first time, while the registration of all securities of 213 issuers was terminated. A total of 650 applications for registration of securities on exchanges was filed.

Market Value of Securities Available for Trading

As of December 31, 1967, the market value of stocks and bonds admitted to trading on U.S. stock exchanges was approximately $780 billion. The tables below show various components of this figure.

With reference to the tables, it should be noted that issues traded on either the New York or American Stock Exchange are not traded on the other of those exchanges. Many of these issues are also traded on the so-called regional exchanges. The figures below for "other exchanges," however, show only the number of issues traded solely on the regional exchanges. The figures in the tables exclude issues suspended from trading and a few inactively traded issues for which quotations were not available.

[table omitted]

The number and market value as of December 31, 1967 of preferred and common stocks separately were as follows:

[table omitted]

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 totals as of December 31 annually since 1936. Aggregates for stocks exclusively on the remaining exchanges have been compiled as of December 31 annually by the Commission since 1948. It should be noted that changes in aggregate market value 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.

Volume of Securities Traded

The total volume of securities traded on all exchanges in calendar year 1967 was 4.6 billion shares, including stocks, warrants and rights, and $5.4 billion principal amount of bonds. The 1967 total dollar volume of all issues traded was $168.3 billion. Trading in stocks increased 4.0 percent in share volume and 31 percent in dollar volume over 1966. Volume continued to increase substantially in the first 6 months of 1968.

The figures below show the volume and value of securities traded on all stock exchanges (registered and exempted) during the calendar year 1967, and the first 6 months of 1968. Tables 6 and 7 in the appendix of this Annual Report contain more comprehensive statistics on volume, by exchanges.

[table omitted]

Foreign Stocks on Exchanges

The estimated market value on December 31, 1967 of all shares and certificates representing foreign stocks on U.S. stock exchanges was $20.9 billion, of which $17 billion represented Canadian and $3.6 billion represented other foreign stocks.

[table omitted]

Consistent with the trend of recent years, the total number of foreign stocks on the exchanges declined during calendar year 1967 from 130 to 128. Trading in foreign stocks on the American Stock Exchange fell from 17.1 percent of aggregate share volume in 1966 to 11.59 percent in 1967. Similarly, on the New York Stock Exchange, trading in foreign stocks declined from 3.6 percent in 1966 to 2.6 percent in 1967.

Comparative Exchange Statistics

During fiscal year 1968, there was a moderate increase in the total number of stocks listed on exchanges. Consistent with the trend of recent years, the number of stocks listed on the New York and American Stock Exchanges increased, while the number of stocks listed exclusively on the other exchanges declined slightly.

[table omitted]

The aggregate value of shares listed on the New York Stock Exchange relative to the total share values on all exchanges eased during 1967, marking the first relative decline since 1961. The percentage of the total share value accounted for by American Stock

Exchange stocks, on the other hand, rose for the first time since 1961 as prices of stocks on that exchange experienced a relatively larger gain during the year than did New York Stock Exchange listed issues. The percentage for stocks traded exclusively on other exchanges continued to decline.

[table omitted]

The figures below show the annual volume of shares traded, including rights and warrants, on all exchanges during selected years since 1940. In 1967, both share and dollar volume continued their steady climb of the preceding four years and reached new peaks. Trading was particularly active on the American Stock Exchange with share and dollar volume on that Exchange increasing 75 and 60 percent, respectively, over the previous year. Volume on all exchanges continued at record rates during the first 6 months of 1968.

[table omitted]

The ratio of share volume on the New York Stock Exchange to the total on all exchanges showed a sharp drop in 1967, while the American Stock Exchange ratio rose to 28 percent, from 23 percent in 1966. The American Stock Exchange percentage of share and dollar volume has risen steadily since 1963, while the percentage of the New York Stock Exchange has decreased. The regional exchange percentage of both share and dollar volume declined slightly in 1967. In the first 6 months of 1968, the New York Stock Exchange share volume ratio declined slightly further but its dollar volume ratio experienced a steeper decline, as the American Stock Exchange dollar volume ratio increased to 18 percent from 14 percent in 1967. Stocks, rights and warrants are included in the following presentation. Annual data in more detail are shown in Appendix Table 7 in this Annual Report.

[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. There were 143 secondary distributions in 1967 compared to 126 the preceding year. Nevertheless, the dollar value of the shares sold in this manner declined 24 percent to $1,154.5 million. During the first 6 months of 1968, there were 74 secondary distributions with a total value of $712.4 million.

Special Offering Plans were adopted by many of the exchanges in 1942, and Exchange Distribution Plans in 1953, in an effort to keep as much trading as possible on their floors. Since 1962 there have been no special offerings. Exchange distributions continued to decline from the record of 72 in 1963 to 51 in 1967. However, the value of the 1967 exchange distributions was $125.4 million compared to $107.5 million in 1963.

[table omitted]

Unlisted Trading Privileges on Exchanges

The number of stocks with unlisted trading privileges which are not also listed and registered on other exchanges further declined during the fiscal year, from 103 to 97. The American Stock Exchange accounted for the entire decline except for one stock on the Honolulu Stock Exchange. During the calendar year 1967, the reported volume of trading on the exchanges in stocks with only unlisted trading privileges increased to about 38,065,577 shares, or about 0.85 percent of the total share volume on all exchanges, from about 23,985,000 shares, or about 0.75 percent of share volume during calendar year 1966.

About 96 percent of the 1967 volume was on the American Stock Exchange, while three other exchanges contributed the remaining 4 percent. The share volume in these stocks on the American Stock Exchange represented 2.8 percent of the total share volume on that exchange.

Unlisted trading privileges on exchanges in stocks listed and registered on other exchanges numbered 1,892 as of June 30, 1968. The volume of trading in these stocks for the calendar year 1967 was reported at about 148,841,743 shares. About 86.4 percent of this volume was on regional exchanges in stocks listed on the New York or American Stock Exchanges. The remaining 13.6 percent was in stocks listed on regional exchanges with the primary market on the American Stock Exchange which had the unlisted trading. While the 148,841,743 shares amounted to only 9.8 percent of the total share volume on all exchanges, they constituted major portions of the share volume of most regional exchanges, as reflected in the following approximate percentages: Cincinnati 75.7 percent; Boston 92.5 percent; Detroit 73.4 percent; Philadelphia-Baltimore-Washington 81.6 percent; Pittsburgh 65.7 percent; Midwest 28.9 percent; and Pacific Coast 27.7 percent.

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, 1968, as follows:

[table omitted]

OVER-THE-COUNTER TRADING IN COMMON STOCKS TRADED ON NATIONAL SECURITIES EXCHANGES

In accordance with Rule 17a-9, since January 1965 brokers and dealers who make markets in common stocks traded on national securities exchanges (sometimes referred to as the "third market") have been reporting their trading over the counter and on exchanges in the common stocks in which they make markets. They also report certain off-board trading in other common stocks traded on exchanges. Broker-dealers who are not market makers report their large third market transactions. The reporting system is designed to reflect all sales to persons other than broker-dealers, i.e., to individuals and institutions. Since the beginning of 1967, reports have been required only for common stocks listed on the New York Stock Exchange. About 98 percent of over-the-counter volume in listed common stocks is in New York Stock Exchange issues.

During the calendar year 1967, total over-the-counter sales of common stocks listed on the New York Stock Exchange amounted to 85.1 million shares valued at $4,152 million. This latter figure was the equivalent of 3.3 percent of the dollar volume on the New York Stock Exchange in common and preferred stocks. Third market volume in 1967 increased about 45 percent over the preceding year, an increase which was proportionately larger than the increase in Exchange volume.

In the first half of 1968, third market volume continued to increase at a greater rate than Exchange volume. As a result, over-the-counter dollar volume in New York Stock Exchange common stocks rose to 3.7 percent of the dollar volume in common and preferred issues on the Exchange.

[table omitted]

STATISTICAL STUDIES

The regular statistical activities of the Commission and its participation in the overall Government statistical program under the direction of the Office of Statistical Standards, Bureau of the Budget, were continued during fiscal year 1968 in the Commission's Office of Policy Research. 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' saving, stock transactions of financial institutions, 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 1935-68 are given in Appendix Table 1 and detailed statistics for the fiscal year 1968 appear in Appendix Table 2.

New Securities Offerings

Monthly and quarterly data are compiled covering all new corporate and noncorporate 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 issued offered for the 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' Saving

The Commission compiles quarterly estimates of the volume and composition of individuals' saving 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 saving 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 Noninsured Pension Funds

An annual survey is published of private pension funds 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. Quarterly data on assets of these funds are published in the Statistical Bulletin.

Stock Transactions of Financial Institutions

A statistical series containing data on stock trading of four principal types of financial institutions is published quarterly. Information on purchases and sales of common stock by private noninsured pension funds and nonlife insurance companies has been collected on a quarterly basis by the Commission since 1964; these data are combined with similar statistics prepared for mutual funds by the Investment Company Institute and for life insurance companies by the Institute of Life Insurance.

Financial Position of Corporations

The series on the working capital position of all U.S. corporations, excluding banks, insurance companies, investment 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 U.S. 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 U.S. 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 list 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 and American Stock Exchanges for account of members and nonmembers, odd-lot stock transactions on the New York and American Stock Exchanges, odd-lot transactions in 100 selected stocks on the New York Stock Exchange and block distributions of exchange stocks. Since January 1965, the Commission has been compiling statistics on volume of over-the-counter trading in common stocks listed on national securities exchanges (the so-called "third market") based on reports filed under Rule 17a-9 of the Securities Exchange Act.

Data on round-lot and odd-lot trading on the New York and American Stock 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.

Cost of Flotation of Security Issues

In calendar year 1967 the Commission began a study of the cost of flotation of registered equity issues offered by issuing corporations as well as selling shareholders for the years 1963-65.

Costs of flotation measure the initial costs of marketing securities, i.e., the costs entailed in transmitting funds from the investor to the issuing corporation. These costs are measured as the difference between the price paid by the investor (gross proceeds) and the net amount available to the issuer. They include compensation paid to underwriters, securities dealers, finders or agents, fees for lawyers and accountants, printing and engraving costs, Federal and State fees and other expenses connected with the issuance of securities. The current study covers initial costs of notation only and does not attempt to measure or compare the net cost of raising capital. Consequently, insofar as possible, costs not pertinent to the initial flotation, such as advertising charges for redemption notices or trustees' charges for continuing services, are excluded from the study. Moreover, this study only attempts to cover cash compensation; noncash compensation such as options -- an important cost in the distribution of some smaller, more speculative securities -- is omitted because of problems of valuation.

Costs of flotation studies have been prepared by the Commission at various times with the last study covering the years 1951, 1953 and 1955. The current study, however, will be broader in coverage and more comprehensive in its analysis. For example, the study will cover all types of securities which represent ownership interests in a business or which are convertible into or represent a call on such securities. Costs will be analyzed for each type of equity securities to show differences or similarities between limited partnership interests and common stock as well as for preferred stocks and convertible bonds. Moreover, the study will cover issues offered through securities dealers -- either as an offering to the general public or to stockholders -- as well as those sold directly by the issuer. Also, the current study incorporates into the analyses factors influencing costs not covered in past studies. Among these factors are the market place for outstanding securities of the issuer and the offering price of the issues in the case of common stocks.

PART IV
CONTROL OF IMPROPER PRACTICES IN SECURITIES MARKETS

REGULATION OF BROKER-DEALERS AND INVESTMENT ADVISERS

Registration, Financial Responsibility, Record Maintenance and Financial Reporting Requirements

Registration. -- Subject to limited exemptions, the .Securities Exchange Act of 1934 requires all brokers and dealers who use the mails or instrumentalities of interstate commerce in the conduct of an over-the-counter securities business to register with the Commission. Similarly, the Investment Advisers Act of 1940, which establishes a pattern of regulation comparable to that established by the Exchange Act with respect to brokers and dealers, requires the registration of investment advisers, with certain exceptions.

As of June 30, 1968, 4,397 broker-dealers and 2,007 investment advisers were registered. Both these figures reflect substantial increases during the year. The increase of 275 in investment adviser registrations is particularly striking.

The following tabulation reflects various data with respect to registrations of brokers and dealers and investment advisers during the 1968 fiscal year:

[table omitted]

During the fiscal year, the Commission amended both Form BD (broker-dealer application for registration) and Form ADV (investment adviser application for registration) and Rules 15b3-1 under the Exchange Act and 204H under the Advisers Act, effective September 1, 1968. The amendments were designed, among other things, to provide additional information to assist the Commission in performing its regulatory functions. In this connection, the revised forms will elicit detailed information concerning the direct or indirect control by the applicant or registrant of any other organization engaged in the securities or investment advisory business, the nature of any other business conducted by it and financing to be provided by persons other than the named principals. The additional information required will assist not only the Commission and State regulatory authorities, but also members of the public who examine the forms. Additionally, the amendments were designed to achieve substantial uniformity between Forms BD and ADV and the forms used by many of the State" regulatory authorities for registration of brokers and dealers and investment advisers. State regulatory bodies of 32 States have either adopted or are considering the adoption of forms which would result in the acceptance of applications and amendments on revised Forms BD and ADV as meeting State requirements if supplemented by any additional information required by State law or regulation. A third purpose of the amendments was to modernize procedures to conform with technological advances in the maintenance of records and retrieval of information. Broker-dealers and investment advisers who are already registered will have to file a complete revised form, no later than December 31, 1968.

The Commission also amended Rule 203-2 under the Investment Advisers Act. and adopted a new form, Form ADV-W, to be used by investment advisers seeking to withdraw from registration with the Commission. Form ADV-W requires specified information concerning, among other things, the arrangements made with respect to winding up the affairs of the business, including arrangements made for paying or delivering any funds or securities owed to clients and refunds on uncompleted investment advisory contracts. The information furnished will enable the Commission to determine whether the business is being terminated in compliance with applicable requirements and whether an investigation or administrative proceedings are necessary. The amended rule provides for a 60-day waiting period between the filing of Form ADV-W and the effective date of the registrant's withdrawal, unless acceleration is granted or proceedings are instituted by the Commission. The 30-day period previously provided by the rule was too short to permit the necessary determinations to be made.

The Commission participated during the fiscal year as amicus curiae in Eastside Church of Christ v. National Plan, Inc., a case dealing with the broker-dealer registration requirements of the Securities Exchange Act. The decision of the Court of Appeals for the Fifth Circuit in this case was generally in accord with the views expressed in the Commission's amicus brief. The court held that a company which was engaged in the business of directing bond sales programs for churches, and which purchased many church bonds for its own account as a part of its regular business and sold some of them, was both a broker and a dealer within the meaning of the Act. The court further held that transactions in which this company purchased bonds from certain churches in violation of the statutory provision which prohibits an unregistered broker-dealer from effecting securities transactions could be voided by the selling churches. In rejecting the company's contention that the churches must establish that any harm which they suffered was caused by the company's failure to register, the court stated that "it is sufficient to show merely that the prohibited transactions occurred and that [the sellers] were in" the "class of persons whose interest the Act was designed to protect." The court added:

"The requirement that brokers and dealers register is of the utmost importance in effecting the purposes of the Act. It is through the registration requirement that some discipline may be exercised over those who may engage in the securities business and by which necessary standards may be established with respect to training, experience, and records."

The court held that the churches could recover from the company with respect to transactions in which the company purchased bonds from a certain individual who was acting as the churches' agent in effecting the transactions. Recovery was not permitted, however, with respect to bonds which that individual purchased outright from the churches and then resold to the company. In denying recovery in the latter situation, the court stated: "This is on the theory that the church would be a stranger to the transaction."

Capital Requirements with Respect to Broker-Dealers. -- Rule 15c3-1 under the Exchange Act, commonly known as the net capital rule, imposes minimum net capital requirements on brokers and dealers. In addition, it 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 fiscal year, the Commission amended the net capital rule with regard to the prescribed deduction to be made from the market value of convertible debt securities in the computation of the "net capital" of a broker or dealer subject to the rule.

In the Report of the Special Study of the Securities Markets, it was pointed out with respect to convertible debt securities that, when "the price of the underlying stock is below the conversion price, it is probable that there is a greater tendency for the bonds to sell as debt securities," and, conversely, that when the market value of the securities exceeds their face value, they tend to be treated in the market as stock. It is also common knowledge that, at certain market levels, convertible debt securities attain a hybrid quality and are treated in the market as part stock and part debt.

Despite these characteristics, prior to the recent amendment the deduction of 30 percent of market value, which is applied to common stock in computing net capital, was also applied to convertible debt securities. By contrast, the deductions applicable to straight debt securities are computed on a sliding scale from 5 percent to 30 percent of market value, the applicable percentage depending on the difference between face value and market value when the market price is between 70 and 100. If the market price is 70 or below, the deduction is a straight 30 percent.

Under the amendment, a convertible debt security which is not in default and which has a fixed maturity date and rate of interest is given the same deduction as a straight debt security when its market value is below 90 percent of face value. If the market price is between 90 and 115, the convertible debt security is treated as a hybrid security to which a 30 percent deduction is applied with the proviso that the value of the security for net capital computation purposes shall in no event be less than 80 percent of the face value. At a market price of 115 and above, the percentage deduction for such a security becomes a straight 30 percent, the same deduction as applies under the rule to common stock.

Financial Reports of Broker-Dealers. -- Rule 17a-5 under the Exchange Act requires registered broker-dealers to file annual reports of financial condition with the Commission. These 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. During the fiscal year 4,039 reports were filed with the Commission.

These reports enable the Commission and the public to determine the financial position of broker-dealers. They provide one means by which the staff of the Commission can determine whether a broker-dealer is in compliance with the net capital rule. Failure to file required reports may result in the institution of administrative proceedings to determine whether the public interest requires remedial action against the registrant.

During the fiscal year, the Commission adopted a general revision of Form X-17A-5, the annual report of financial condition. The revisions of the form and related audit requirements reflect changing conditions and practices in the securities industry and are based on the experience gained from examination of reports filed with the Commission over the years. Among other things, the audit requirements were expanded to require the independent accountant to comment on any material inadequacies in the broker-dealer's accounting system, internal account control or procedures for the safekeeping of securities and to report any corrective action taken or proposed. Rule 17a-5 was amended to provide that the accountant's comments, if bound separately, would be deemed confidential.

The adoption of new Rule 17a-10, providing for annual broker-dealer reports of income and expenses, is discussed in a prior section of this report.

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

During the fiscal year, the Commission continued to be active in its regulatory activities with respect to "nonmember" brokers and dealers (i.e., those who are not members of the National Association of Securities Dealers, Inc. (NASD)) which are designed to provide regulation comparable to that imposed by the NASD on its membership. This regulatory program is known as the SECO program. During the year the number of nonmember broker-dealers increased from 462 to 495, although the number of associated persons decreased from about 22,000 to about 20,000.

The following table categorizes the nonmember broker-dealers by type of business and region:

[table omitted]

One of the requirements applicable to nonmember broker-dealers is that each associated person engaged in specified securities activities pass a general securities examination prescribed by the Commission or an examination deemed by the Commission to be a satisfactory alternative. Such alternative examinations include, thus far, those given by certain of the national securities exchanges, the NASD, the NAIC (in connection with variable annuities), and many States. During the fiscal year, 1,644 associated persons qualified by passing the Commission's examination, and approximately 4,356 others qualified by passing an alternative examination.

During the year, the Commission amended Rule 15b9-1 and adopted Rule 15b9-2 to provide a permanent fee structure for nonmember broker-dealers. Prior to its amendment Rule 15b9-1 covered both initial and annual fees. Now, 15b9-1 deals with initial fees while

8 Securities Exchange Act Release No. 8308 (May 8, 1968).

15b9-2 deals with animal fees which include a base fee applicable to all broker-dealers, a fee for associated persons and a fee for each office maintained by the broker-dealer. For purposes of simplification, the new rules prescribe the fee structure and the actual fees will be set each year in the applicable forms required to be filed.

Under the inspection program for nonmember broker-dealers 98 inspections were conducted during the year. In addition to matters normally covered in broker-dealer inspections, these inspections were designed to determine compliance with SECO rules and to obtain information which will prove helpful in the further development of the SECO program.

During the fiscal year, continuing efforts were made to cooperate with State authorities in coordinating regulatory activities involving nonmember broker-dealers. Certain State examinations were reviewed and determined to be satisfactory alternatives to the Commission's general securities examination. Other cooperative efforts included the initial preparation of a new form which would combine Form SECO-2 and a uniform State form for applications of associated persons. The new form is expected to be recommended for adoption in the next fiscal year.

Also during the year, the Commission improved the processing and utilization of applications by associated persons with the adoption of a system for placing the information contained in Forms SECO-2 on the Commission's computer.

On July 27, 1967, Rules 15b10-1 through 151)10-7 under Section 15 (b) (10) were adopted by the Commission, effective October 2, 1967.9 The new rules, discussed in detail in the previous annual report, established standards of general business conduct, suitability of recommendations and supervision of associated persons, regulate discretionary accounts and impose record keeping requirements. At the present time, the Commission's staff is engaged in drafting additional rules under Section 15 (b) (10) concerning advertising and sales literature of nonmember broker-dealers.

During the fiscal year the Commission issued its first decision concerning a violation of the rules covering nonmember broker-dealers. The case, Associated Securities, Inc., resulted in the revocation of the registration of the broker-dealer. In addition to violations of the anti-fraud provisions of the Securities Act and the Exchange Act, the Commission found that the registrant, aided and abetted by its officers, had willfully violated Sections 15 (b) (8) and 15 (b) (9) of the Exchange Act and Rules 15b8-l, 15b8-2 and 15b9-1 thereunder by permitting associated persons to engage in securities activities when Forms SECO-2 had not been filed with respect to them and the required filing fees had not been paid, and by filing a false and misleading Form SECO-4-67 which understated the number of persons associated with the registrant and the fees to be paid with respect to them.

Detection of Improper Practices

Public Complaints. -- The Commission has various sources of information concerning possible violations of the Federal securities laws. A primary source is complaints by members of the general public concerning the activities of certain persons in securities transactions. During fiscal 1968 the Commission received some 3,400 complaints from investors and others relating to broker-dealers and investment advisers. The Commission's staff gives careful consideration to such complaints and, if violations are indicated, an investigation may be commenced. Other outside sources of information include the stock exchanges, the National Association of Securities Dealers, Inc., brokerage firms, State and Canadian securities authorities, better business bureaus, and various law enforcement agencies.

Inspections. -- The program of surprise inspections of broker-dealers and investment advisers by the Commission's staff is another important device for the detection of improper practices. During fiscal 1968, 514 broker-dealer inspections and 165 investment adviser inspections were carried out. These inspections produced indications of various types of infractions, as shown below:

[table omitted]

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. This Section maintains files which contain information concerning persons who have been charged with, or found in violation of, various Federal and State securities statutes, as well as considerable information concerning Canadian violators. These files play a valuable role in the Commission's enforcement program and provide a clearinghouse for other enforcement agencies. The information in the files is kept current through the cooperation of various governmental and nongovernmental agencies.

During the fiscal year, the Section received 3,366 "securities violations" letters either providing or requesting information and dispatched 1,899 communications to cooperating agencies. Among other matters, information was received from several States and Canada respecting 106 criminal actions, 39 injunctive actions, 142 actions in the nature of cease and desist orders and 140 other administrative orders, such as denials, suspensions and revocations of registrations of issuers, broker-dealers and salesmen. Information with respect to 4,574 persons or firms was added to the files, including information regarding 1,847 persons and firms not previously identified. As of the end of the 1968 fiscal year, the files contained information concerning 77,323 persons and firms.

Use of Computer for Name Searches. -- The use of the Commission's computer for "name searches" in the enforcement program has resulted in a substantial increase in the amount of information available and the speed with which it can be obtained. The names of suspected securities law violators are checked against the more than 1 million entries presently stored in the computer. Upon request, the Commission also performs "name searches" on prospective securities salesmen and others whose names are submitted by the exchanges, the NASD and the State securities commissions. If the subject checked has been named in formal filings with the Commission, has been a party to a proceeding, or has been involved in an investigation, such information, together with pertinent dates, relationships and cross references, is available immediately on a printout. Formerly a time-consuming manual search of indices and files was required.

Investigations

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

The nine regional offices of the Commission are chiefly responsible for the conduct of investigations. In addition, the Office of Enforcement of the Division of Trading and Markets at the Commission's headquarters office conducts investigations dealing with matters of particular interest or urgency, either independently or with the assistance of 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.

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 involved, 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 results of a nonpublic 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 full investigation is conducted. Under certain circumstances it becomes necessary for the Commission to issue a formal order of investigation which designates members of its staff as officers to issue subpoenas, take testimony under oath and require the production of documents. During the fiscal year ended June 30, 1968, the Commission issued 166 such formal orders.

The following table reflects in summarized form the investigative activities of the Commission during fiscal 1968:

[table omitted]

Imposition of Sanctions

Where 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 with respect to the same conduct. The Commission may: (1) institute administrative proceedings, (2) institute civil proceedings in the appropriate U.S. district court to enjoin further violations of law, or (3) refer the case to the Department of Justice or appropriate local enforcement authorities for criminal prosecution.

Administrative Proceedings. -- Under the Securities Exchange Act, as amended in 1964, the Commission has available to it a wide range of administrative sanctions which it may impose against brokers and dealers and persons associated with them. The Commission may deny a broker-dealer's application for registration. With respect to a broker-dealer already registered, it may impose sanctions ranging from censure through suspension of registration to revocation of registration. It may also suspend or terminate a broker-dealer's membership in a stock exchange or registered securities association. Associated persons of broker-dealers may be censured, or suspended or barred from association with any broker-dealer. Under the Investment Advisers Act, the Commission may impose comparable sanctions against investment advisers, but has no authority to take direct disciplinary action against persons associated with investment advisers.

The Commission may impose a sanction only if, after notice and opportunity for hearing, it finds that (1) the respondents committed willful violations of the securities acts or are subject to certain disqualifications, such as convictions or injunctions relating to specified types of misconduct, and (2) a particular sanction is in the public interest.

Set forth below are statistics regarding administrative proceedings pending during fiscal 1968 with respect to brokers and dealers and investment advisers.

[table omitted]

In addition, action was taken against 81 individuals associated with the firms included above or. with firms previously sanctioned which disqualified such individuals from engaging in the securities business without the subsequent approval of the Commission or for a specified period of time.

[table omitted]

Formal administrative proceedings under the statutes administered by the Commission generally culminate in the issuance of an opinion and order. Where hearings are held, the hearing officer who presides normally makes an initial decision following the hearings, unless such decision is waived by the parties. Under an amended procedure which went into effect in April 1968, the initial decision includes an appropriate order. 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 the final decision of the Commission.

In those instances where it prepares its own decision upon review or waiver of an initial decision, 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."

A few of the more significant decisions of the Commission in administrative proceedings with respect to broker-dealers and investment advisers are summarized in the following paragraphs:

In Walston & Co., Inc., involving the sale by the respondent broker-dealer of tax-exempt bonds of a special assessment district, the Commission found, on the basis of offers of settlement accompanied by a stipulation of facts, that the respondent failed to disclose to customers that the district was formed for the benefit of a promoter of a speculative real estate development and consisted of one tract of undeveloped land owned by the promoter, that the promoter had no prior experience in selling real estate and had no financial ability to service the bonds, and that the service of the bonds depended entirely on the sale of lots, In finding that the firm and the manager of a division of its municipal bond department had willfully violated the anti-fraud provisions of the securities laws, the Commission stated that " [i]t is incumbent on firms participating in an offering and on dealers recommending municipal bonds to their customers as 'good municipal bonds' to make diligent inquiry, investigation and disclosure as to material facts relating to the issuer of the securities and bearing upon the ability of the issuer to service such bonds," In view of the facts, among others, that the firm had been active in efforts to salvage the rights of bondholders, repurchased bonds from customers and instituted procedures to provide greater control over the handling of bond offerings, the Commission accepted offers of settlement providing for censure of the firm and the manager, suspension of the activities of the firm's municipal bond department for 30 days, and suspension of the manager from association with a broker or dealer for 6 months.

The Commission reemphasized the importance of a broker's fiduciary obligation to secure the best price for its customers in Thomson & McKinnon, a decision involving "interpositioning," i.e., the interposing of a second broker-dealer between the customer and the best available market. On the basis of facts stipulated in connection with an offer of settlement, the Commission found that the firm engaged in a systematic practice over a prolonged period of interposing several other broker-dealers between itself and the market makers in certain over-the-counter securities. The firm engaged in this practice primarily to reciprocate for listed business referred to it by the interposed broker-dealers and to reward them for furnishing certain services. The Commission also found that the firm and the partner in charge of the over-the-counter stock department failed to exercise reasonable supervision to prevent the violations. In view of certain mitigating factors, including the fact that the NASD had sanctioned the respondents for part of the same misconduct and that improved internal procedures had been adopted, the Commission accepted the offer of settlement and ordered the suspension of the firm's over-the-counter stock department for 7 days and suspended the partner from association with any broker-dealer for 85 days.

In Richard Bruce & Co., Inc., the Commission found, among other things, that the firm had authorized, if not encouraged, the solicitation of orders for a speculative stock on the basis of unconfirmed and extravagant reports or rumors, and had instructed sales personnel to transmit such reports to persons who in the salesmen's judgment could afford to lose money or would not complain if they did, in a situation where losses were or could reasonably be anticipated. The Commission stated:

"Since broker-dealers and their associated persons hold themselves out as professionals in the securities business, a report disseminated by them in connection with recommending a security, notwithstanding the fact that customers are advised that the report is unconfirmed, gains in authority and credibility. Under these circumstances, the use of such reports as part of a sales pitch was contrary to the basic obligation of a broker-dealer to deal fairly with the investing public."

As in the past, a number of cases decided during the year dealt with campaigns by broker-dealers to sell highly speculative securities by means of a concerted high pressure sales effort including the use of false and misleading representations and predictions, and without regard to the financial needs and objectives of their customers. Among these cases were Century Securities Company and Billings Associates, Inc. In each case the Commission revoked the broker-dealer registrations of the firms and barred various individuals who, as principals or salesmen, participated in the fraudulent schemes, from being associated with a broker or dealer.

Among court decisions affirming Commission orders in broker-dealer and investment adviser proceedings were the following:

In Hansen v. S.E.C., the Court of Appeals for the District of Columbia Circuit held that in a proceeding to determine whether an application for registration as a securities broker should be denied, the Commission did not commit error in admitting into evidence the record of a prior administrative proceeding involving the same transactions. In the prior proceeding Hansen had declined an opportunity to participate as a party; and in the later proceeding he was given an opportunity to, and did, cross-examine the witnesses whose testimony was contained in the record of the prior proceeding.

In De Mammos v. S.E.C., the Court of Appeals for the Second Circuit affirmed from the bench an order of the Commission barring a securities salesman from association with any broker or dealer. One of the issues argued in the court of appeals was whether the proper standard of proof in an administrative broker-dealer proceeding is the preponderance of the evidence, as the Commission had held, rather than the more rigorous standards used in criminal and certain types of civil cases. Although the court issued no opinion, its affirmance of the Commission's order necessarily decided this issue in favor of the preponderance standard applied by the Commission.

In Lawrence v. S.E.C., decided shortly after the close of the fiscal year, the Court of Appeals for the First Circuit, in affirming a Commission order based upon a finding of violation of the anti-fraud provisions of the Securities Act and the Securities Exchange Act, held that the use of interstate facilities to clear a check used as payment in a fraudulent transaction was sufficient to establish Federal jurisdiction even though all meetings and negotiations regarding that transaction took place within a single State. The court also ruled that a written commitment to deliver securities in the future is itself a security within the meaning of both Acts.

In Marketlines, Inc. v. S.E.C., the Court of Appeals for the Second Circuit affirmed an order of the Commission revoking Marketlines' registration as an investment adviser. The Commission's order had been based in part upon Marketlines' publication and distribution of false and misleading advertisements of its market letters. The court stated that "the Commission could properly conclude that the entire content and tone of the advertisements was designed to whet the appetite of the unsophisticated." In rejecting Marketlines' contention that the Commission had erred in evaluating the advertisements in terms of their impact on unsophisticated investors, the court stated that "the Commission's duty to protect the gullible is apparent" and that "it is not improper to judge advertisements by their impact on the segment of the public at which they are aimed."

Civil Proceedings. -- Each of the several statutes administered by the Commission authorizes the Commission to seek injunctions in the Federal district courts against continuing or threatened violations of those statutes or the Commission's rules thereunder. Injunctive actions frequently are directed against broker-dealers and persons associated with them, and in such cases the complaint may allege noncompliance with various regulatory provisions such as the net capital and books and records requirements, as well as violations which may be committed by any person such as securities sales or purchases in violation of the anti-fraud or registration provisions of the securities acts.

Criminal Prosecution. -- 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 an investigation by the Commission's staff indicates that criminal prosecution is warranted, a detailed report is prepared. After careful review the Office of Criminal Reference and Special Proceedings and the General Counsel's Office, the report and the General Counsel's recommendations are considered by the Commission, and if the Commission believes criminal proceedings are warranted 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 40 cases were referred to the Department of Justice for prosecution. As a result of these and prior referrals, 42 indictments were returned against 123 defendants, including 24 broker-dealers and broker-dealer principals and 15 broker-dealer employees. Convictions were obtained against 84 defendants in 34 cases, including 6 broker-dealers and broker-dealer principals and 15 broker-dealer employees. Convictions were affirmed in 5 cases, and appeals were still pending in 9 other criminal cases at the close of the period.

Among the many important criminal prosecutions initiated during the year were the following: an indictment of four persons for violating the short sale provisions of Section 10 (a) and Rule 10a-1 of the Exchange Act in connection with alleged illegal short sales of Georgia-Pacific Corporation stock over the New York Stock Exchange; an indictment of a registered representative and two back-office employees in Texas branch offices of a New York Stock Exchange member firm, charging the misappropriation of customers' funds and securities and the unauthorized execution of securities and commodities transactions for the purpose of obtaining funds to finance their personal speculative securities and commodities trading accounts; an indictment of a broker-dealer charging, for what is believed the second time in the history of the Federal securities laws, criminal violations of Regulation T of the Federal Reserve Board, relating to the extension and maintenance of credit by brokers and dealers; and an indictment of a Florida attorney for willfully evading compliance with a Commission investigatory subpoena.

In United States v. Light, the Court of Appeals for the Second Circuit affirmed the convictions of several defendants of conspiracy to violate the anti-fraud provisions of the Securities Act of 1933 and the mail fraud and wire fraud statutes in the sale of securities of two companies through two brokers. One ground of appeal was that the trial court erred in denying the defense motion to suppress certain books and records of a broker which had been voluntarily turned over to the Commission during a civil injunction proceeding and were later delivered by the Commission's staff to the U.S. Attorney. In rejecting the contention that use of the books and records in the criminal proceeding was illegal because there was no consent to their delivery to the prosecution, the court noted that the documents seized were "public records" required by law to be kept and made available to the Commission and stated that

"* * * once records have been voluntarily turned over to a government agent, the government is not guilty of fraud or deceit in failing to apprise the subject of a change in the character of the investigation, for he is made aware of the risks attendant upon a voluntary disclosure by the warning inherent in the request."

The court further observed that even assuming, arguendo, that the Commission violated its agreement to return the documents and not make them available to anyone else, the Fourth Amendment would not bar their admission into evidence in the absence of a showing that they were originally obtained through fraud and deceit.

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

Section 15A of the Exchange Act provides for registration with the Commission of national securities associations and establishes standards and requirements for such associations. The National Association of Securities Dealers, Inc. (NASD) is the only association registered under the Act. The Act contemplates that such associations will serve as a medium for. self-regulation by over-the-counter brokers and dealers, subject to general supervision by the Commission. 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. The Commission is authorized to review disciplinary actions taken by them, to disapprove changes in their rules, and to alter or supplement their rules relating to specified matters.

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 nonmember broker or dealer except on the same terms and conditions as the member affords the general public. The NASD has adopted such rules. As a result, membership is necessary to profitable participation in underwritings since members may grant price concessions, discounts and similar allowances only to other members.

During the fiscal year, the NASD's membership increased by 111 to a total of 3,770 members by the end of the year. This increase was the net result of 344 admissions to and 233 terminations of membership. At the same time, the number of branch offices increased by 662 to a total of 5,945 as a result of the opening of 1,169 new offices and the closing of 507 others. During the year the number of registered representatives and principals, categories which together include all partners, officers, traders, salesmen and other' persons employed by or affiliated with member firms in capacities which involve doing business directly with the public, increased by 18,358 to an all-time high of 108,883 as of June 30, 1968. This increase, which was the net result of 26,268 initial registrations, 13,466 re-registrations and 21,376 terminations of registrations, was attributable in part to an increase in the number of insurance companies entering the securities business for the purpose of offering shares of mutual funds and/or interests in variable annuities to the investing public, and in part to the increase in activity in the securities markets generally.

During this period the NASD administered 64,457 qualification examinations of which approximately 38,880 were for NASD qualification and the balance for other agencies, including major exchanges, the Commission 30 and various States.

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 the violator is an individual associated with a member, his registration as a representative may be suspended or revoked, he may be suspended or barred from being associated with any member, and he may be fined and/or censured. Under Section 15A (b) (4) of the Exchange Act and the NASD's bylaws, 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; he is barred or suspended from association with a broker or dealer or with 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 upon a broker-dealer 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 NASD reported to the Commission its final disposition of disciplinary complaints against 80 member firms and 82 individuals associated with them. With respect to 15 members and 12 associated persons, complaints were dismissed because the alleged violations had not been established. [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, according to the NASD, the member could not have known of or prevented the impropriety. The Securities Acts Amendments of 1964 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 fiscal year there were 16 cases in which the sole respondents were individuals associated with members.] In the remaining cases, violations were found and penalties were imposed on 65 members and 70 registered representatives or other individuals. The maximum penalty of expulsion from membership was imposed against 9 members, and 5 members were suspended from membership for periods ranging from 5 days to 1 year. In many of these cases, substantial fines were also imposed. In another 47 cases, members were fined amounts ranging from $100 to $5,000. In 4 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 associated individuals found in violation of NASD rules. The registrations of 27 registered representatives were revoked, and 9 representatives had their registrations suspended for periods ranging from 5 days to 1 year. Fines in various amounts were also imposed against many revoked or suspended representatives. In addition, 33 other representatives were censured and/or fined amounts ranging from $250 to $4,000. One individual was barred from association with any NASD member.

Commission Review of NASD Disciplinary Action. -- Section 15A (g) of the Exchange Act 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 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 committed the acts found by the NASD and thereby violated the rules specified in the determination, and that such conduct was inconsistent with just and equitable principles of trade, the Commission must sustain the NASD's action unless it finds that the penalties imposed are excessive or oppressive, in which case it must cancel or reduce them.

At the start of the fiscal year, seven NASD disciplinary decisions were pending before the Commission on review. During the year six additional cases were brought up for review. Six cases were disposed of by the Commission. In two of these, the Commission sustained in full the disciplinary action taken by the NASD. It dismissed the review proceedings in one case as moot, and permitted the withdrawal of one application for review. With respect to the two remaining cases, in one the Commission denied the application for review as being untimely filed, and in the remaining case the NASD and the applicants filed a stipulation discontinuing the review proceedings. Seven cases were pending as of the end of the year.

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 NASD 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, three applications for approval of admission to or continuance in membership were pending. During the year, 10 additional applications were filed, 8 applications were approved, and 5 were pending at the year's end.

Disciplinary Action by Exchanges

Although the Exchange Act does not provide for Commission review of disciplinary action taken by exchanges, each national securities exchange reports to the Commission actions taken against members and member firms and their associated persons for violation of any rule of the exchange or of the Exchange Act or any rule or regulation thereunder. During the fiscal year, eight exchanges reported approximately 100 separate actions, including impositions of fines in 33 cases ranging from $50 to $10,000, with total fines aggregating $44,800; the suspension from membership of 11 individuals; and the censure of 3 member firms. These exchanges also reported the imposition of various sanctions against 63 registered representatives and employees of member firms. In addition, the American Stock Exchange reported a large number of informal staff actions of a cautionary nature.

MISREPRESENTATIONS IN THE SALE OR PURCHASE OF SECURITIES

Among the improper practices which constantly concern the Commission and its staff and which are the subject of frequent enforcement action is the use of false or misleading representations in connection with the sale or purchase of securities. The comments in the preceding section regarding detection methods, investigations and sanctions are in general equally applicable to this type of conduct. The Commission also frequently participates as amicus curiae in litigation between private parties under the anti-fraud provisions of the securities laws, where it considers it important to present its views regarding the interpretation of those provisions. For the most part, this participation is in the appellate courts.

During the course of the fiscal year, the Commission participated either as a party or as amicus curiae in a number of cases involving important issues under the anti-fraud provisions.

In the Supreme Court's first decision involving the scope of the term "security" as defined in the Securities Exchange Act of 1934, the Court in Tcherepnin v. Knight reversed the decision of the court of appeals 34 and held, in accordance with the views expressed by the Commission as amicus curiae, that withdrawable capital shares issued by a State-chartered savings and loan association are securities and, consequently, that the district court had jurisdiction of an action brought by holders of such shares based upon alleged violations of the anti-fraud provisions in Section 10 (b) of the Act and Rule 10b-5 thereunder. While recognizing that the legal form of withdrawable shares is determined under State law, Federal law was held to "govern whether shares having such legal form constitute securities under the Securities Exchange Act." The Court applied to its interpretation of the Securities Exchange Act principles long established in cases decided under the Securities Act and found the legislative history of the Securities Act pertinent as well. Both statutes were said to reflect an "expansive concept of security" which "embodies a flexible rather than a static principle." As under the Securities Act, the Court held that "instruments may be included within any of .. [the Securities Exchange Act's] definitions, as a matter of law, if on their face they answer to the name or description." Thus, the withdrawable capital shares were found to have the "essential attributes of investment contracts" and were alternatively held to be "stock," "transferable share [s]" and "certificate [s] of interest or participation in any profit sharing agreement." The Court expressly rejected the view of the court of appeals that the words "an instrument commonly known as a 'security' " are a limitation on the other descriptive terms contained in the statutory definition of security. It also observed that the characteristics of savings and loan shares -- such as their issuance in unlimited amounts, their nonnegotiable character and their lack of preemptive rights, as well as the lack of a shareholder's right to inspect the corporate books and records -- "serve only to distinguish among different types of securities. They do not, standing alone, govern whether a particular instrument is a security under the Federal securities laws." Also rejected was the suggestion that fluctuation in value and trading in securities markets are essential attributes of securities under the Securities Exchange Act.

In another case involving the definition of security, Continental Marketing Corp. v. S.E.C. the Court of Appeals for the Tenth Circuit held that the combined activities of the various defendants in selling live beaver in conjunction with contracts for the care, management, replacement and resale of the beaver constituted an investment contract within the meaning of the Securities Act and the Securities Exchange Act, even though the performance of the service contracts was to be carried out by persons other than the person initially selling the beaver. The defendants in this case had, at one time, carried put through a single business entity their various selling and service activities, which were designed to build a "domestic beaver industry." Subsequently, however, they had fragmented their activities and placed them under numerous separate business entities so that some were devoted exclusively to the selling activities while others provided the various management services, including the ranching of the beaver. The various entities acted together in conducting the overall business, and only by acting together could the business continue.

The court of appeals, rejecting the defense contention that an investment contract can be found only where the management services are performed by the seller or by parties actually owned or controlled by the seller, stated:

"The more critical factor is the nature of the investor's participation in the enterprise. If it is one of providing capital with the hopes of a favorable return then it begins to take on the appearance of an investment contract. .."

The court noted, in this regard, that in this case the "economic inducement" held out to the prospective investor was "the faith or hope in the success of .. the domestic beaver industry .. as a whole, and not the value of the animals alone."

Last year's annual report discussed the amicus curiae brief filed by the Commission in Pappas v. Moss, a case in which a claim was asserted under Section 10 (b) of the Exchange Act and Rule 10b-5. This case involved the sale of authorized but unissued shares of common stock of a corporation to certain outsiders and to the defendant directors. These shares were issued at an allegedly inadequate price. All of the directors, who approved the transaction with themselves, were fully aware of the facts; and shareholder approval was not required under State law. Nevertheless, shareholder approval was sought so that the stock could be listed on the American Stock Exchange, and allegedly false statements were made to the shareholders in the process. The defendant directors owned a majority of the shares of the corporation and voted them in favor of the transaction.

The Court of Appeals for the Third Circuit, in accordance with the views of the Commission, held that the corporation may have been the victim of a violation of Rule 10b-5 even though all of the directors knew the true facts. In rejecting the defendants' argument that there could be no deception and consequently no violation of Rule 10b-5 because of the directors' knowledge, the court stated that if deception is required,

"it is fairly found by viewing this fraud as though the 'independent' stockholders were standing in the place of the defrauded corporate entity at the time the original resolution authorizing the stock sales was passed. . . . Certainly the deception of the independent stockholders is no less real because, 'formalistically,' the corporate entity was the victim of the fraud. The same is true of the fact that the fraud may go unredressed because those in a position to sue lack actual knowledge of the fraud."

In Heit v. Weitzen and two related cases 3S the Commission filed a brief, amicus curiae, in the Court of Appeals for the Second Circuit taking the position that the language "in connection with the purchase or sale of any security" in Section 10 (b) of the Exchange Act and Rule 10b-5 is broad enough to be applicable to statements made by a corporation whose securities are publicly held whenever those statements are likely to affect the market for those securities, irrespective of whether the corporation or those responsible for the dissemination of the statement engage in securities transactions and irrespective of the absence of any motive to affect the market. After the close of the fiscal year a panel of that court decided this issue in accordance with the Commission's position and the previous decision of the court, sitting en bane, in S.E.C. v. Texas Gulf Sulphur Co. The court also agreed with the Commission that, if such a public statement by a corporation violates Rule 10b-5, a private right of action for damages may be implied on behalf of injured investors; and it quoted from the Commission's brief to the effect that this latter holding raised important questions of policy as to the extent of the monetary liabilities that could result, but that such questions could best be decided after the trial of the case in the context of a complete record rather than on a motion for summary judgment.

The Commission also participated as amicus curiae in several other cases involving questions with respect to private remedies under the Federal securities laws. One of these cases was Jordan Building Corp. v. Doyle, O'Connor & Co., decided by the Court of Appeals for the Seventh Circuit after the close of the fiscal year. The court held, in accordance with the views of the Commission, that an implied private right of action in favor of a defrauded purchaser exists under Section 10 (b) of the Exchange Act and Rule 10b-5, even though the conduct complained of may also have given rise to an action based upon the express remedy available to purchasers under Section 12 (2) of the Securities Act. The court similarly adopted the Commission's position that an action can be maintained against a broker-dealer under Section 10 (b) and Rule 10b-5, even though the conduct complained of may also have violated Section 15 (c) (1) of the Exchange Act and Rule 15c1-2, which expressly apply to broker-dealers.

The Commission, as amicus curiae in Hohmann v. Packard Instrument Co., decided shortly after the close of the fiscal year, and in Dolgow v. Anderson advocated a broad remedial construction of the class-action provisions of Federal Rule of Civil Procedure 23, as amended effective July 1, 1966, to permit private actions arising under the Federal securities laws to be maintained on behalf of classes of investors to the fullest possible extent. In both cases the Commission noted that the practicality of private litigation under these statutes -- and its consequent effectiveness as an important supplement to the Commission's enforcement efforts -- often depends upon the ability of a litigant with a small individual claim to seek and obtain relief on behalf of a class of similarly-situated persons. The decision in each case was consistent with the views expressed by the Commission.

The final case in this group relating to private remedies, Paul H. Aschkar & Co. v. Kamen & Co., involved the question of the liability of a broker-dealer firm to persons injured by violations of the anti-fraud provisions of the Federal securities laws committed by employees of the firm acting within the scope of their employment. Following the decision of the Court of Appeals far the Ninth Circuit in this case, construing the "controlling-persons" provisions in Section 15 of the Securities Act and Section 20 (a) of the Exchange Act as precluding a broker-dealer firm's liability for the frauds of its employees unless the principals of the firm are personally at fault, a petition for a writ of certiorari was filed in the Supreme Court. The Commission submitted a memorandum at the invitation of the Court, urging that the writ be granted; and after it was granted, the Commission filed a brief, amicus curiae, urging reversal of the court of appeals' decision.

The Commission took the position that the "controlling-persons" provisions were not designed to deal with customary employer-employee relationships and hence that those provisions, including the requirements as to personal fault, do not govern or restrict the civil liability of a broker-dealer firm for violations of the anti-fraud provisions committed by employees of the firm acting within the scope of their employment. The Commission further urged that such civil liability should not be governed by State law either; that instead it should be determined as a matter of uniform Federal law in accordance with the underlying statutory purposes; and that the objectives of the securities laws would best be advanced by holding broker-dealer firms liable in damages as a matter of course to persons defrauded by the firms' employees acting within the scope of their employment. Following the close of the fiscal year, the parties stipulated to a settlement of the case, and the writ of certiorari was dismissed.

In S.E.C. v. National Securities, Inc., the Court of Appeals for the Ninth Circuit held that the McCarran-Ferguson Act precluded the application of the anti-fraud provisions of the Exchange Act to false and misleading statements made in soliciting stockholder consents to a merger of insurance companies approved by a state insurance commissioner. A petition by the Commission for a writ of certiorari was granted by the Supreme Court on April 22, 1968. It is the Commission's position that the McCarran-Ferguson Act, the purpose of which was to re-establish the power of the States to regulate and tax the "business of insurance," did not diminish or impair the established applicability of the Federal securities laws to transactions in insurance company securities. The Commission contends that such transactions are not part of the "business of insurance."

In W. J. Abbott & Co. v. S.E.C., the court held that a commodity broker regulated under the Commodity Exchange Act by the Department of Agriculture must make its books and records, relating to managed accounts in commodities and commodities futures, available for inspection by the Commission pursuant to a subpoena duces tecum issued in a Commission investigation into possible violations of the Federal securities laws. The court concluded that the Commodity Exchange Act and the regulations providing for inspection of the books and records of commodity brokers by the Department of Agriculture do "not exclude any other agency, in this instance the S.E.C., from exercising investigative powers granted to it by Congress in areas and activities specifically designated to such other agency by statutory authority." Accordingly, a motion to quash the Commission's subpoena was denied and an application by the Commission for enforcement of the subpoena was granted. On petition for reconsideration the court also held that the Commission need not produce evidence of possible violations before it is entitled to enforcement of an investigative subpoena.

S.E.C. v. Garcia, another case dealing with investigative subpoenas, involved a somewhat unusual situation. At the hearing in the district court in this subpoena enforcement proceeding, the various respondents denied that they had possession of the subpoenaed corporate records or knowledge of their whereabouts, or they gave no information as to their whereabouts. The respondents were the corporation whose records were being sought, present and former officials of the company, partners of the accounting firm which had certified the company's financial statements and counsel to the company. Notwithstanding the denials, the court ordered all of the respondents to produce the requested documents by a certain date or appear before the court thereafter at a designated time to testify as to why they had failed to produce them. After the entry of this order, one of the respondents disclosed that subpoenaed documents had 'been burned and buried on the property of another respondent. A search warrant was then obtained from a United States commissioner, and the burned and charred remains of certain of the documents were unearthed. Thereafter the court heard testimony concerning the documents and directed that the record in the proceeding be referred to the United States attorney to consider whether there was evidence of criminal violations.

MANIPULATION

The Exchange Act and Commission rules under the Act prohibit various kinds of manipulative activities. In order to enable the Commission to meet its responsibilities for the surveillance of the securities markets, the market surveillance staff has devised a number of procedures to identify possible manipulative activities. A program has been adopted with respect to surveillance over listed securities, in which the staff's activities are closely coordinated with the stock watching operations of the New York and American Stock Exchanges. Within this framework, the 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 other sources, determines matters of interest, possible violations of applicable law, and the appropriate action to be taken.

In addition, the market surveillance staff maintains a continuous ticker tape watch of transactions on the New York and American Stock Exchanges and the sales and quotations sheets of regional exchanges 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.

If any of these sources reveals possible violations, the market surveillance staff conducts a preliminary inquiry into the matter. These inquiries, some of which are conducted with the cooperation of the exchange concerned, generally begin with the identification of the brokerage firms which were active in the security. The staff may communicate with partners, officers or registered representatives of the firms, with customers, or with officials of the company in question to determine the reasons for the activity or price change in the securities involved and whether violations may have occurred.

The Commission has also developed an automated over-the-counter surveillance program to provide more efficient and comprehensive surveillance. The automated equipment is programmed to identify, among other things, unlisted securities whose price movement or dealer interest varies beyond specified limits in a pre-established time period. When a security is so identified, the automated system prints out current and historic market information concerning it. This data, combined with other available information, is collated and analyzed to select those securities whose activity indicates the need for further inquiry or referral to the Commission's enforcement staff.

In addition to the Commission's market surveillance activities, the other detection methods previously discussed are also useful tools in the detection of manipulation. Prior comments of a general nature regarding investigations and the nature of sanctions available are equally pertinent to manipulations.

Among Commission decisions during the year dealing with manipulative activities, the following are of particular interest:

In Atlantic Equities Company the registrations of several broker-dealers were revoked, the application for registration of another was denied and 15 individuals were found to be causes of the sanctions against their respective firms. Despite staff warnings to the underwriter of a Regulation A offering that a possible "hot issue" was involved and that the market might be manipulated, the underwriter and the other respondents engaged in a scheme which insured that the offering would be a "hot issue," involving the withholding of blocks of stock and their subsequent distribution at artificially inflated prices through misrepresentations.

In Charles E. Salik, the Commission found, on the basis of a stipulation of facts entered into in connection with an offer of settlement, that the portfolio manager for a registered investment adviser to a mutual fund, in anticipation of selling certain of the fund's portfolio securities, purchased the same securities for the fund in the open market immediately prior to the close of business. The following day, these and the portfolio securities were sold at prices reflecting the inflationary effect of the purchases. The Commission held that the purchases constituted a manipulation and a fraud on those persons who purchased at prices affected by the immediately preceding purchases. The president of the investment adviser who, like the portfolio manager, was a member of the fund's investment committee, was found to have failed to exercise reasonable supervision to prevent the violations. On the basis of the offers of settlement, the Commission barred both individuals from association with any broker-dealer, investment adviser or investment company, subject to certain exceptions and conditions.

In a criminal case growing out of the financial collapse of the Westec Corporation, a conglomerate enterprise, four indictments were returned against the two principal officers of Westec and several of their relatives and business associates. The cases involved charges that from 1963 until late 1966, when Westec was forced into bankruptcy, the defendants manipulated the price of Westec stock on the American Stock Exchange through massive open-market purchases, the dissemination of false and misleading statements and rumors, and the filing and publication of false financial statements. It was charged that as part of the scheme control was secretly obtained over a large block of Westec stock, most of which was later sold by the two principal officers in unregistered distributions in order to finance acquisitions by Westec.

One of the principal officers pleaded guilty to charges of conspiracy to violate the registration and anti-fraud provisions of the Securities Act, and the anti-manipulative and annual report filing provisions of the Exchange Act, and then testified as a key government witness against the other, who was convicted of conspiracy to file false financial statements with the Commission and the American Stock Exchange, and of 12 counts of mail fraud. Another defendant pleaded guilty to violations of the anti-manipulative provisions of the Exchange Act.

IMPROPER USE OF INSIDE INFORMATION

Corporate insiders by virtue of their position may have knowledge of material facts which are unavailable to the general public and may be able to use such knowledge to their advantage in transactions in the company's securities. Section 16 of the Securities Exchange Act was designed to curb the misuse of inside formation. As previously noted, that Section requires insiders to report their security holdings and transactions and provides for the recovery by or on behalf of the issuer of short-swing trading profits realized by insiders. The Commission is not a party in suits under Section 16, but frequently participates as amicus curiae in those instances where significant interpretive issues are involved.

In Blau v. Rayette-Faberge, Inc., the Court of Appeals for the Second Circuit held that counsel fees may be awarded to a stockholder's attorney solely for discovering and informing a corporation of a claim for the recovery of short-swing profits under Section 16 (b) of the Exchange Act which the corporation then successfully pursues at the stockholder's request. The court stated, however, that a fee should not be awarded solely for such discovery and information unless "the corporation has done nothing for a substantial period of time after the suspect transactions and its inaction is likely to continue." The court specifically noted that its decision was in accord with the position previously urged by the Commission as amicus curiae in Gils on v. Chock Full O'Nuts Corp.

The short-swing recovery provisions of Section 16 (b) operate without regard to whether the insider in fact made use of inside information in the transactions involved,, Under the anti-fraud provisions of the securities laws, however, those who actually make improper use of inside information in the purchase or sale of securities may be liable for damages or subject to injunctive action, either at the instance of injured private litigants or the Commission itself, or subject to disciplinary action in administrative proceedings instituted by the Commission. Two important recent decisions under the anti-fraud provisions dealing with improper use of inside information were those of the Court of Appeals for the Second Circuit, sitting en bane, in S.E.C. v. Texas Gulf Sulphur Co. and of the Commission in the Merrill Lynch case. Those decisions are summarized in Part I of this report.

ENFORCEMENT PROBLEMS WITH RESPECT TO FOREIGN SECURITIES

The unlawful offer and sale of Canadian securities in the United States increased significantly during 1968. It would appear that this increase is due at least in part to the intensified interest of unsophisticated investors in highly speculative securities. The Commission has worked with the securities commissions of the Canadian provinces, the Royal Canadian Mounted Police and such quasi-official bodies as the Toronto and Montreal Stock Exchanges and the Broker-Dealers' Association of Ontario in efforts to curb these violations.

The Commission has provided assistance to the Canadian Government, when requested, in connection with steps being taken to create a Federal securities agency in Canada. It has also continued to work closely with the Ontario Royal Commission on Atlantic Acceptance Corporation Limited in its investigation into the circumstances surrounding the collapse, in June 1965, of Atlantic Acceptance, a large Canadian finance company.

Offers and sales to American residents of unregistered securities in the form of certificates of deposit issued by Bahamian banks have practically ceased, largely as a result of vigorous enforcement action by the Commission, and the enactment in late 1965 of Bahamian legislation regulating the banking business in the Bahamas. There has been a considerable increase, however, in the offer and sale to American residents of unregistered securities of various Panamanian companies. The Commission has been working with the Department of State and other State and Federal agencies in an attempt to halt these activities. The Commission is also continuing to assist the Internal Revenue Service in investigations of evasions of the Interest Equalization Tax on purchases by Americans of foreign securities from foreign sellers.

There have been increasing problems involving violation of the Investment Advisers Act of 1940 by foreign investment advisers. To date, the Commission has instituted one formal enforcement action in this area; in this case it obtained an injunction against an unregistered Canadian investment adviser. Further investigations are in progress with a view to determining other appropriate enforcement action.

Since September 30, 1967, the names of six Canadian and one Bahamian companies have been deleted from the Commission's Foreign Restricted List in accordance with established procedures, while the names of nine Canadian companies were added to the list. The current list and supplements to it are issued to and published by the press, and copies are mailed to all registered broker-dealers.

As of August 1, 1968, there were 33 companies on the list, including 3 Bahamian, 1 British Honduran, 22 Canadian and 7 Panamanian companies, as follows:

Bahamian

American International Mining

Compressed Air Corporation Limited

Durman, Ltd., formerly known as Bankers International Investment Corporation

British Honduran

Caribbean Empire Company, Ltd.

Canadian

Allegheny Mining and Exploration Company, Ltd.

Amalgamated Rare Earth Mines, Ltd.

Antoine Silver Mines, Ltd.

Briar Court Mines, Ltd.

Claw Lake Molybdenum Mines, Ltd.

Crest Ventures, Limited

Ethel Copper Mines, Limited

Ironco Mining & Smelting Company, Ltd.

Keele Industrial Developments, Ltd.

Kenilworth Mines, Ltd.

Kokanee Moly Mines, Ltd.

Lynbar Mining Corp., Ltd.

Norart Minerals Limited

Obseo Corporation, Ltd.

Pacific Northwest Developments, Ltd.

Paracanusa Coffee Growers, Ltd.

Pascar Oils, Ltd.

Pyrotex Mining and Exploration Company, Limited

St. Lawrence Industrial Development Corporation

Trihope Resources Limited

Victoria Algoma Mineral Company, Ltd.

Wee Gee Uranium Mines, Ltd.

Panamanian

British Overseas Mutual Fund Corporation

Cerro Azul Coffee Plantation

Darien Exploration Company, S.A.

De Veers Consolidated Mining Corporation, S.A.

Euroforeign Banking Corporation, Ltd.

Panamerican Bank & Trust Company

Victoria Oriente, Inc.

PART V
REGULATION OF INVESTMENT COMPANIES

In broad terms, an investment company is any arrangement by which a group of persons invests funds in an entity that is itself engaged in investing in securities. Investment companies are an important vehicle for public participation in the securities markets. They enable small, as well as large investors to participate in a professionally managed and diversified portfolio of securities.

The Investment Company Act of 1940 sets forth the Commission's responsibilities in protecting persons who invest in investment companies. It provides a comprehensive framework of regulation which, among other things, prohibits changes in the nature of an investment company's business or its investment policies without shareholder approval, protects against loss or outright stealing or abuse of trust and provides specific controls to eliminate or to mitigate inequitable capital structures. The Act also requires that an investment company disclose its financial condition and investment policies; requires management contracts to be submitted to shareholders for approval; prohibits underwriters, investment bankers, or brokers from constituting more than a minority of the investment company's board of directors; regulates the means of custody of its assets; and provides specific controls designed to protect against investment companies entering into unfair transactions with their affiliates.

In addition to the requirements of the Investment Company Act, an investment company must comply with the Securities Act of 1933 when it makes an offering of its securities and it is subject to the applicable provisions of the Securities Exchange Act of 1934, including those relating to proxy and tender offer solicitations and insider trading and reporting rules.

COMPANIES REGISTERED UNDER THE ACT

As of June 30, 1968, there were 967 investment companies registered under the Act. Of this total 862 were "active" companies whose assets had an aggregate market value of approximately $69.7 billion. Compared with corresponding totals at June 30, 1967, these figures represent an over-all increase of approximately $11.5 billion, or almost 20 percent, in the market value of assets and an increase of 119, or almost 15 percent, in the number of active registered companies. The increase in assets was the largest recorded by investment companies in any single fiscal year since the passage of the Act and exceeds the total increase in investment company assets during the 15 years after its enactment. This increase is due partly to appreciation in assets of previously registered companies and partly to the large increase in the number of registered companies. The impact of this unprecedented growth on the securities market is discussed earlier in this report.

The following table shows the numbers and categories of active registered companies and the approximate market value of the assets in each category as of June 30, 1968.

[table omitted]

The approximately $6.2 billion of assets of the "active" registered unit investment trusts includes approximately $5 billion of assets of unit investment trusts which invest in securities of other registered investment companies, substantially all of them mutual funds.

A total of 167 companies registered under the Investment Company Act during the fiscal year, a greater number than registered in any year since the adoption of the Act. The following table shows the various categories of companies registered during the fiscal year and those which terminated their registration.

[table omitted]

As the table shows, 17, or approximately 10 percent, of the newly registered companies were variable annuity separate accounts of insurance companies. Including these companies, there were 26 active variable annuity separate accounts registered at June 30, 1968, consisting of 4 unit investment trusts and 22 management open-end investment companies. A significant part of the Commission's regulatory effort with respect to variable annuities has been the dove-tailing of the requirements of the Investment Company Act with the patterns and. procedures which have grown up in the insurance industry.

In the 33rd Annual Report of the Commission we discussed the capital leveraged investment companies in which half of the capital is supplied by income shareholders and half by capital shareholders. At present there are 9 active capital leveraged companies in operation, including 1 open-end company. As of June 30, 1968, they had total assets of over $450 million. The shares of seven of these companies are traded on the New York Stock Exchange or the American Stock Exchange and at June 28, 1968, their capital shares were selling at discounts ranging from 17.8 percent to 26.6 percent of net asset value.

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]

INVESTMENT COMPANY FILINGS REVIEWED

As previously noted, investment companies offering their shares for sale to the public must register them under the Securities Act of 1933. The registration statements filed by such companies are reviewed for compliance with that Act as well as the Investment Company Act. Periodic and other reports must also be filed. Proxy soliciting material filed by investment companies is reviewed for compliance with the Commission's proxy rules. The following table sets forth the nature and volume of filings processed during the past fiscal year:

[table omitted]

Revision of Annual and Quarterly Report Forms

During fiscal year 1968, the Commission adopted a revised annual report, Form N-1R, and a revised quarterly report, captioned Form N-1Q, for management investment companies. These forms are effective for fiscal years and for calendar quarters, respectively, ending on and after December 31, 1967.

The revision of Form N-1B prescribes attachments to the annual reports to be used by registrants to supply data to the Commission in a form readily adaptable for electronic data processing purposes. The attachments will enable the Commission to retrieve and analyze pertinent financial data more efficiently by use of its computers. The processing will also enable the Commission to screen on a continuing basis the information furnished in the annual reports to ascertain the areas and the companies in which problems exist.

The revised Form N-1Q includes a new item which requires management investment companies to report on a calendar quarterly basis the number of shares (or other unit) or principal amount of securities acquired for, or divested from, their portfolios during the reporting quarter. These reports provide the public and the Commission with valuable information about securities transactions of management investment companies, and they will materially aid the Commission and others in conducting studies of these transactions and their impact in the market place.

CONTROL OF IMPROPER PRACTICES

Inspection and Investigation Program

During the fiscal year, the Commission's staff conducted 102 investment company inspections pursuant to Section 31 (b) of the Investment Company Act. Many of these inspections disclosed violations not only of the Investment Company Act but also of other statutes administered by the Commission. While many of the violations uncovered during these examinations appear to have resulted from a lack of familiarity with the Investment Company Act and were soon corrected when brought to management's attention, a number of the violations were serious in nature. These included improper pricing practices, inadequate disclosure concerning the activities of the investment company and failure to observe established procedures for safekeeping company assets or to maintain adequate fidelity bond coverage for persons dealing with company assets. Inspections also uncovered a number of instances in which self-dealing transactions had been effected by affiliated persons in violation of Section 17 of the Act.

The tremendous influx of money into the mutual fund industry and the proliferation of new funds have resulted in serious accounting and bookkeeping problems. In some cases funds have priced shares inaccurately because their books were not in condition to enable them to compute accurately their net asset value. A sudden avalanche of money into a fund may cause a breakdown of the bookkeeping system and result in small investors either paying too much when they buy shares or receiving too little when they redeem shares. In a recent inspection the staff found that a new fund was so flooded with orders that its books and records had become chaotic. As a result, no one was able to determine the fund's assets, much less their value. The fund therefore suspended sales and hired a large staff of auditors to reconstruct its accounts from inception.

Largely as an outgrowth of information obtained during inspections, 8 private investigations were commenced during the fiscal year to develop facts concerning what appeared to be serious violations of the statutes administered by the Commission.

Civil and Administrative Proceedings

During the 1968 fiscal year, the Commission instituted three civil actions and one administrative proceeding involving investment companies. Two of the civil actions involved charges that companies were operating as investment companies without having registered under the Investment Company Act. Other proceedings previously instituted were concluded or progressed toward conclusion.

Status Cases. -- In S.E.C. v. Fifth Avenue Coach Lines, Inc., the Commission, alleging violations of the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 and of certain provisions of the Investment Company Act, charged that Fifth Avenue had operated illegally as an unregistered investment company and that certain affiliated persons had misappropriated almost $5 million of the company's assets. The Commission sought an injunction against further violations of the Federal securities laws, the appointment of a trustee or receiver for the company, and certain other equitable relief.

Shortly after the close of the fiscal year, following a 6-week trial, the court found that Fifth Avenue had operated as an unregistered investment company since June 30, 1967, and should have registered as such. It enjoined three of the individual defendants, Victor Muscat, Edward Krock and Roy M. Cohn, from committing violations of the securities laws, and appointed a trustee-receiver to conduct the company's affairs, register Fifth Avenue as an investment company, prosecute suits for monetary damages against certain individuals and investigate and ascertain whether other actions can be maintained. In so doing, the court found that the defendants Muscat, Krock and Cohn had "conspired to use Fifth for their own purposes," that they had evidenced a "marked propensity" to engage in "the sort of self-dealing and dealing with affiliated companies which the . . . [Investment Company Act] was designed to prevent" and that, while most of the transactions charged did not involve fraud in the purchase or sale of securities, they involved "overreaching" and "flagrant violations of fiduciary duty." The opinion makes clear that the substantive provisions of the Investment Company Act, which by their terms only apply in the case of a "registered" investment company, can be violated by an affiliated person of an unregistered investment company which should have been registered.

Similarly, in S.E.C. v. Insurance Investors Trust Co., the company was preliminarily enjoined from operating as an unregistered investment company and was placed in temporary receivership.

The 32nd Annual Report discussed earlier stages of the litigation in S.E.C. v. S & P National Corporation, an injunctive action in which the Commission alleged that S & P and its wholly-owned subsidiaries were doing business as unregistered investment companies in violation of the Investment Company Act and that reports filed by S & P pursuant to the Securities Exchange Act of 1934 were false and misleading. During the current fiscal year the defendants consented to the entry of final judgments enjoining future violations and appointing a permanent trustee-receiver of the companies to succeed a temporary trustee-receiver whose appointment had earlier been affirmed by the court of appeals. These judgments were part of a Plan of Settlement and Reorganization approved by the court which also provided that the insider interests in S & P would be subordinated to the interests of outside public stockholders. In that connection the Plan contained provisions for an offer which had been made by S & P to its public stockholders to purchase their S & P shares at prices above the market prices of the shares in recent years. The trustee-receiver was discharged, and after return of the companies to the control of their directors a Plan of Complete Liquidation and Dissolution was adopted by the companies and with modifications was approved by the court.

Transactions Involving Affiliated Persons. -- In S.E.C. v. Talley Industries, Inc., following administrative proceedings in which the Commission had determined that purchases of the stock of General Time Corporation ("General Time") by American Investors Fund, Inc. ("Fund"), a registered open-end investment company, and Talley Industries, Inc. ("Talley"), an "affiliated person" of the Fund, constituted a "joint arrangement" which violated Section 17 (d) of the Investment Company Act and Rule 17d-1 thereunder, the Commission instituted suit in the District Court for the Southern District of New York to prevent Talley and the Fund from benefiting from their unlawful stock purchases and to enjoin them and the Fund's investment adviser from further violations.

Talley had begun buying stock of General Time in December 1967 with a view towards a merger of General Time with Talley. Three days after its first purchase, the president of Talley asked the president of the Fund if he would consider purchasing General Time stock for the Fund's investment portfolio. Within a few days, the Fund began, through Talley's principal broker, to buy General Time stock and, over a period of 1 1/2 months, accumulated almost 10 percent of General Time's outstanding shares. There was evidence that Talley curtailed its acquisitions of General Time stock until the Fund had concluded its purchases. Ultimately Talley acquired approximately 12 percent of General Time's outstanding stock.

The district court dismissed the Commission's complaint on the ground that Talley and the Fund were not joint participants in a transaction because each had acquired its stock in separate purchases and had no interest in the shares held by the other. Shortly after the end of the fiscal year the Court of Appeals for the Second Circuit, noting the need for a liberal construction of Section 17 (d), reversed and remanded the case to the district court. It held that when a registered investment company and an affiliated person engage in a plan to achieve together a substantial stock position in another company they can have effected a "transaction in which such registered company . . . is a joint or a joint and several participant" with the affiliate even though there is no legally binding agreement between them. The court also held that the Commission, in seeking to implement Section 17 (d) by the general requirement of advance application for approval found in Rule 17d-l, had not exceeded the authority granted to it by Congress.

The court of appeals noted that, although the case was not before it on a petition to review the Commission's order and therefore the provision of Section 43 (a) of the Act making the Commission's findings conclusive if supported by substantial evidence was not applicable by its terms, the principle of that rule "applies none the less." The court found that there was substantial evidence here to support those findings.

On remand, the district court issued a final judgment of permanent injunction enjoining Talley and the Fund from effecting any transactions with respect to the securities of General Time which would violate Section 17 (d) and Rule 17d-1 without having first obtained an appropriate order from the Commission. The judgment, however, among other things, permitted Talley and the Fund to vote their General Time shares (so long as they did not consult with regard thereto) and contained provisions enjoining Talley from disposing of General Time shares except on certain conditions designed to provide protection for the Fund. The judgment also provided that, if Talley should decide to dispose of General Time shares in a manner other than particularized in the judgment, prior approval of the Commission and thereafter of the court would have to be obtained. General Time appealed from this judgment; and the Court of Appeals for the Second Circuit held that General Time had no standing to do so, ruling that the section and rule were not intended to protect a portfolio company of an investment company. General Time has petitioned the Supreme Court for a writ of certiorari.

The 33rd Annual Report discussed the district court's holding in the case of S.E.C. v. Sterling Precision Corporation. On appeal by the Commission, the district court's grant of summary judgment in favor of Sterling was affirmed on the ground that an issuer's redemption of securities owned by a registered investment company is not a "purchase" within the meaning of the prohibition against transactions with affiliated persons contained in Section 17 (a) (2) of the Investment Company Act. Although it has been decided not to ask the Supreme Court to review this decision, the Commission has announced that it still believes such transactions may be subject to Section 17 (a) under appropriate circumstances and that it may raise the issue again if such action appears necessary.

Compensation of Management. -- An administrative action involving Insurance Securities Incorporated ("ISI"), investment adviser to Insurance Securities Trust Fund ("Trust Fund"), was settled during the year. For several years ISI had been billing the Trust Fund for the performance of what it called "brokerage services." The Commission's staff took the position that many of these services should have been performed under the advisory contract between ISI and the Trust Fund and were covered by the compensation paid ISI as adviser. The Commission accepted an offer of settlement providing that ISI would only charge the Trust Fund actual costs of acting as broker. The settlement was retroactive to July 1, 1967, and also provided that ISI would be billed no more than $350,000 per year for 1968, 1969 and 1970. For the year ended June 30, 1967, ISI had billed the fund over $1.3 million and had made a profit of over $1 million.

While the Commission's formal investigation of ISI was in progress but before the administrative proceeding described above had actually been instituted, a representative and derivative shareholders' suit was filed attacking the same "brokerage services" and also charging that the management fees and sales loads charged were illegal and excessive. The district court requested the Commission's views on the fairness of a settlement that had been submitted to it by the parties subsequent to the termination of the administrative proceeding. Shortly after the close of the fiscal year the court accepted the Commissions views and disapproved the settlement of this private action on the ground that it did not confer any significant benefit not already obtained by the Commission in the administrative proceeding. Appeals have been taken from this decision.

Meaning of "Fundamental" Policy. -- In Green v. Brown, which involved certain requirements of the Investment Company Act relating to investment policies, the Commission filed a brief as amicus curiae in the Court of Appeals for the Second Circuit. Section 13 (a) (3) of the Act prohibits an investment company, in the absence of shareholder authorization, from deviating from any "fundamental" investment policy recited in its registration statement filed under the Act. In this case an investment company had recited in its registration statement that it would not invest more than 20 percent of its combined capital and surplus in the securities of any one issuer and that this 20 percent policy could not be changed without shareholder approval. The plaintiff, a shareholder of the company, asserted that in two instances the company's directors violated Section 13 (a) (3) by causing the company, without prior shareholder approval, to make investments which were in excess of the 20 percent limitation. After the institution of suit, the company's shareholders ratified the challenged investments.

The district, court held that Section 13 (a) (3) had not been violated because the company's registration statement had not used the word "fundamental" in describing the 20 percent policy. The court also stated that the ratification by the shareholders was a valid defense to the suit.

The Commission, disagreeing with the decision of the district court, urged on appeal that when an investment company declares in its registration statement filed under the Act that a particular investment policy may not be changed without shareholder approval, that policy is a "fundamental" policy within the meaning of Section 13 (a) (3). The Commission also urged that the challenged investments, both of which consisted of loans, violated Section 21 (a) of the Act which prohibits a management investment company from making loans that are not permitted by the investment policies recited in the company's registration statement (Section 21 (a) had not been considered by the district court). In addition, the Commission took the position that shareholder ratification cannot immunize investment company directors from liability resulting from their prior violations of the Act. Shortly after the close of the fiscal year the court of appeals, without deciding any of these questions, remanded the case to the district court for further consideration in light of, among other things, the issues raised by the Commission. In so doing, the court stated that the district court had construed the Act "in a way that is at least questionable, without the benefit of the Commission's views," and that certain considerations urged by the Commission were "weighty."

APPLICATIONS FOR COMMISSION ACTION

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 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 above sections.

During the fiscal year, 257 applications were filed under these and other sections of the Act, and 261 applications were disposed of. As of the end of the year, 151 applications were pending. The following table presents a breakdown, by sections involved, of the number of applications filed and disposed of during the year and the number pending at the beginning and close of the year.

[table omitted]

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

Transactions Involving Affiliated Persons. -- An exemption from Section 17 (a) was requested by Berkshire Industries, Inc. to permit the merger into it of its 91 percent owned subsidiary, American-Hawaiian Steamship Company, a registered investment company. The merger plan as originally submitted provided that the public stockholders of American-Hawaiian would receive $275 cash in exchange for each share of American-Hawaiian. Extensive testimony was taken over a 5-month period as to the value of American-Hawaiian's assets and stock to determine principally whether the price of $275 was reasonable and fair. The merger plan was amended twice during the progress of the hearings to increase the price per share to be paid to the minority stockholders to $375 and then to $575.

American-Hawaiian's principal asset consists of an 11,600 acre tract in Southern California being developed into a planned community or new city to be known as Westlake which is projected to have over 70,000 residents. American-Hawaiian's assets also include a 1/2 interest in two large New York City office buildings, a manufacturing subsidiary and portfolio securities.

One of the crucial issues at the hearings involved the proper appraisal techniques to be used in valuing Westlake. The appraisals of four qualified real estate experts ranged from approximately 43 million dollars to a maximum of 130 million dollars. The parties waived an initial decision by the hearing examiner and briefs were submitted to the Commission.

A merger of two of the largest closed-end investment companies, Electric Bond and Share Company and American and Foreign Power Company Inc., discussed in last year's annual report, was approved by the Commission during the 1968 fiscal year. The Commission found the terms to be reasonable and fair and not to involve overreaching on the part of any person concerned. Among the matters dealt with in the Commission's opinion were the reliability of the market price of a security as an indicator of the investment value of that security when there have been substantial yearly purchases and sales of that security by an affiliated person; the impact on the market price of a security of a dividend that is a return of capital to shareholders of that security; the treatment of recurring capital gains as an income stream:; factors affecting the quality of earnings and assets; the valuation of operating companies; the valuation of the dollar obligations of several Latin American countries; and the issuance of certificates of contingent interest.

Offer of Exchange. -- Sections 11 (a) and (c) of the Act require prior Commission approval, irrespective of the basis of exchange, when an offer of exchange of a security issued by an open-end company is made for a security issued by a registered unit investment trust. In an opinion issued after the close of the fiscal year, the Commission denied approval to a proposed exchange offer under the principal terms of which certificate holders of a "fixed trust" could have redeemed their interests and had the proceeds applied to the acquisition of shares of an affiliated open-end management investment company ("fund") at net asset value without payment of a sales load. The portfolio of the fixed trust was limited by the terms of the trust indenture to the shares of 28 named companies without management discretion to vary its composition, while the portfolio of the fund was flexible.

A trust certificate holder who accepted the proposed offer would have incurred redemption charges and possible capital gains taxes, and his fund interest, unlike his interest in the trust, would have been subject to an annual advisory fee of approximately % of 1 percent of its value. The fund and the sponsor of the trust argued that the proposed exchange would nevertheless be beneficial because the fund's portfolio management could be obtained without payment of another sales load and because of asserted disadvantages of continued investment in the trust, arising out of the various "archaic, uneconomic and wasteful" provisions contained in the trust indenture which, they claimed, together with the trust's assertedly inferior investment performance made it unattractive to many of its investors.

The Commission, denying the application, cited testimony by the fund's president that, although the trust had performed "relatively poorly" in the last few years, investors in it had made money and were basically pleased, and noted that, despite the fact that the trust indenture contained provisions permitting its amendment, no attempt had been made to eliminate archaic features except as part of efforts to convert the trust into a management company.

The Commission concluded that the submission of the proposed offer to certificate holders of the trust would be inequitable since it would require them to choose between retaining their interests in the trust as presently constituted, without modifications of the trust indenture which applicants themselves had recognized to be desirable, or transferring to a new investment vehicle with attendant costs and continuing management fees. It indicated that if appropriate efforts were first made to achieve curative changes and all or some of them were effected, a trust investor then offered an exchange into fund shares would be able to make an evaluation different from that entailed in the present offer under which he would likely be influenced by the presence of the archaic features of the trust. It therefore denied approval of the offer but stated that such denial would not preclude the submission to it of a new proposal which would overcome the deficiencies it had found.

"Scholarship" Plans. -- Issuers of "Scholarship" plans registered under the Investment Company Act requested exemptions to permit such plans to be offered to investors. After the end of the fiscal year, the Commission granted certain exemptions to The Trust Fund Sponsored by The Scholarship Club, Inc. In general, under the plan each investor becomes a member of the Scholarship Club, agrees to open a savings account in his own name in a Federally insured bank or savings and loan association and to pay into it either a lump sum or monthly deposits, and designates a child under 9 years old as the beneficiary of his plan. The investor further agrees that all earnings accruing to the account will vest in and be transferred to the fund sponsored by the Scholarship Club to be invested by it and ultimately distributed for the benefit of the student beneficiaries designated by investors. The account's principal may be withdrawn by the investor at any time; but such withdrawal will terminate his plan and result in forfeiture by him of earnings on the account theretofore transferred to the fund as well as the elimination of the investor's designated beneficiary from any participation in the assets of the fund. Amounts forfeited by investors are to be added to the distributions to be applied against the 2nd, 3rd and 4th year college expenses of those beneficiaries who meet the plan's qualifications. The staff opposed the application for exemptions.

The exemption order issued by the Commission permits the fund to operate with investors having one vote per plan owned and electing a majority of the directors; permits the issuance of periodic payment plans which will not be fully redeemable; permits a deduction of amounts of sales load to be made over a 3-year period although amounts deducted in the 3rd year differ proportionally from amounts deducted in the first 2 years; and permits sales notwithstanding that by the nature of the plans their net asset value may not be specifically determined. In granting these exemptions, the Commission stated that it was not undertaking to determine whether the plan's proposed operation is a good way for parents to provide for the college education of their children and it also made clear that it considered full, adequate and informative disclosure in the plan's prospectus and sales literature to be a critical requirement.

Merger of Two Exchange Funds into a Mutual Fund. -- Two "exchange funds," one of which was the first such fund to register under the Investment Company Act, were permitted to be merged into an existing open-end fund whose shares are continuously offered to the public. "Exchange funds" are open-end investment companies which obtain their initial portfolio of securities in a tax-free exchange in which investors transfer securities, usually with a substantial unrealized appreciation, for shares of stock of the fund.

Upon completion of their initial public offerings the cost-to-market value of the portfolios of both exchange funds involved in this merger was less than 15 percent. The Commission was concerned that any subsequent investors who paid cash to acquire the shares of either fund might be subjected to a large indirect tax liability. Thus it required, as it did with all subsequently formed exchange funds, that they not offer any of their shares to the public after the initial deposit of portfolio securities without prior Commission approval.

A merger into a fund which continuously offers its shares to the public falls within this prohibition. Therefore, the funds filed applications for (1) exemptions pursuant to Section 6 (c) to permit the mutual fund to continue to sell its shares to the public and (2) for orders pursuant to Sections 17 (b) and (d) and Rule 17d-1 to permit the merger since the transaction involved affiliated persons. At the time of the merger both exchange funds had eliminated most of the appreciated securities from their portfolios through gradual turnover of securities and thus all three companies had about the same amount of unrealized appreciation. The Commission, finding that none of the investment companies would be treated less advantageously than any other and that the transaction was fair and reasonable and involved no overreaching on the part of any person concerned, approved the merger.

Restructuring of Certain SBIC's. -- Under Section 12 (e) of the Investment Company Act, a registered investment company may utilize up to 5 percent of the value of its assets to purchase or otherwise acquire any securities issued by another investment company engaged in the business, among others, of financing promotional enterprises or purchasing securities of issuers for which no ready market is in existence provided that certain other conditions are met.

In order to provide a framework in which investment companies can retain and operate a portion of their assets under the Small Business Administration program and at the same time free the major portion of their assets to enable them to take advantage of investment opportunities not contemplated under that program, the Commission granted conditional exemptions so as to permit the restructuring of two publicly owned small business investment companies. The companies, with the concurrence of the Small Business Administration, created wholly owned subsidiaries to which they transferred their SBA licenses and certain of their assets. The exemptions permit the parent to invest in its SBIC subsidiary if the aggregate value of its existing investment plus the cost of any additional investment does not exceed 25 percent of the value of the parent's total assets on a corporate basis. The parent remains a registered closed-end investment company and will be free to invest the major portion of its assets in investments of a type ineligible under the Small Business Investment Company Act. Its subsidiary SBIC which will also be registered as a closed-end investment company will invest in assets of a type eligible under the SBIC Act and will retain the preferred tax treatment available to SBIC's and the ability to borrow from the SBA.

Bank Commingled Accounts. -- The 32nd Annual Report discussed the Commission's order granting certain exemptions with respect to the Commingled Investment Account to be operated by the First National City Bank of New York as a collective investment fund under regulations of the Comptroller of the Currency. The National Association of Securities Dealers, Inc. ("NASD") filed a petition to review this order in the Court of Appeals for the District of Columbia Circuit. In November 1967, following oral argument, a panel of the court dismissed the petition on the ground that the NASD had no standing to seek review of the Commission's order. A petition for rehearing by the court en bane was granted, but the court subsequently vacated both the order granting rehearing and the judgment and opinions of November 1967 "in order to permit reconsideration by the assigned division." The case is awaiting decision. In another proceeding involving the same Commingled Account, Investment Company Institute v. Camp, in which the Commission has not participated, the District Court for the District of Columbia has held that the Banking Act of 1933 precludes banks from commingling managing agency accounts. First National City Bank is appealing that decision.

Control Determinations. -- The 32nd Annual Report discussed the Commission's opinion and order denying an application filed pursuant to Section 2 (a) (9) of the Investment Company Act by a stockholder of four investment companies for which Investors Diversified Services, Inc. ("IDS") serves as investment adviser and principal underwriter. The application had sought a Commission determination that certain persons were in control of IDS and of a company which controlled IDS. On petition for review of the Commission's order, the Court of Appeals for the Second Circuit held that it had jurisdiction, pursuant to the judicial review provisions of the Act, to review a Commission determination under Section 2 (a) (9) with respect to control. Finding that the Commission's decision was supported by substantial evidence, the court affirmed the Commission's order.

CHANGES IN RULES RELATING TO STATUS OF VARIOUS INVESTMENT COMPANIES

Amendment of Rule 3c-2 To Permit Greater Participation by Investment Companies in the Securities of Unregistered Small Business Investment Companies

After the close of the fiscal year the Commission adopted an amendment to Rule 3c-2 to permit registered investment companies to own more than 10 percent of any unregistered SBIC without requiring the SBIC to register under the Act. Section 3 (c) (1) excludes from the definition of an investment company an issuer with less than 100 beneficial owners of securities if certain other criteria are satisfied. However, under that Section the stockholders of a company which owns more than 10 percent of the issuer's securities would be included as beneficial owners of the issuer's securities. Rule 3c-2 previously permitted companies with more than 100 shareholders, other than registered investment companies, to invest up to 5 percent of their assets in unregistered SBIC's without requiring the registration of the SBIC's. The amendment extends the exclusion provided by Rule 3c-2 to ownership of more than 10 percent of an SBIC's securities by a registered investment company if, and so long as, the value of all securities of SBIC's owned by the registered investment company does not exceed 5 percent of the value of its assets.

New Rule 6c-1 To Clarify Status of Foreign Subsidiaries

Rule 6c-1 adopted by the Commission provides an exemption from the Investment Company Act for certain "finance" subsidiaries of United States corporations organized primarily for the purpose of financing the foreign operations of their parent companies through the sale of debt securities to foreign investors. The finance subsidiaries were designed, consistent with the requirements of the programs instituted by the President in February 1965 and January 1968, to raise capital abroad for the foreign operations of United States corporations in a manner which would not adversely affect the balance of payments position of the United States.

In order to clarify the status of a finance subsidiary under the Investment Company Act, it was necessary in the past for the company and its parent to file a request for exemption from the Act in each case. The result was that 50 such companies had filed applications and received exemptive orders from the Commission. The adoption of Rule 6c-1 provides an automatic exemption for companies which meet the qualifications of the rule. So long as the terms of any underwriting agreement prohibit offers and sales to members of the public who are United States nationals or residents, transactions among United States underwriters and dealers participating in an initial distribution will not disqualify a subsidiary.

OTHER DEVELOPMENTS

New Investment Companies With Unusual Investment Policies

During the fiscal year two "venture capital companies" registered under the Investment Company Act. These closed-end companies intend to focus their investments in the securities of unseasoned or newly organized corporations in technological and scientific fields. In this manner they expect to offer an additional source of financing for companies offering innovative products and services and also to provide the public with an opportunity to participate in these investments. The venture capital companies hope to perform relatively independently from the securities markets in general. A third company, which registered as an open-end company, will invest between 10 to 15 percent of its assets in industries of developing countries that are related directly to world food and population problems. Typical of such investments would be securities of firms processing food, manufacturing fertilizer, farm machinery and irrigation equipment, and firms engaged in land development. The balance of the company's portfolio will be invested in securities of domestic companies and will not be so limited.

Funds with Multiple Advisers

During the fiscal year two open-end funds with multiple advisers filed registration statements under the Act. At year's end, only one such fund was offering its shares to the public; the registration statement of the other had not yet become effective. The assets of the fund are allocated by the principal manager among a number of independent portfolio managers, each of whom manages a segment. New money received from the continuous offering of the fund's shares will be allocated, on the basis of respective investment performances, among those portfolio managers who have outperformed the Dow-Jones Industrial Average during the preceding four quarters. The fund manager may, subject to the approval of the fund's board of directors, replace a portfolio manager whose performance is unsatisfactory.

The fees payable to each portfolio manager will range from 1/8 to 1/2 of 1 percent of the average value of the net assets of that portion of the fund managed by such manager. Such fee rates are lower than the present fee rates of other funds which are managed exclusively by the portfolio managers. However, the total management fee rate of the multiple adviser fund may be higher than the customary rates paid by more conventional funds because of the overriding management fee, ranging from 1/4 to 3/8 of 1 percent of the average net asset value of the fund, which the fund pays its principal manager.

PART VI
REGULATION OF PUBLIC-UTILITY HOLDING COMPANIES

Under 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 nonutility companies which are subsidiary companies of registered holding companies. There are three principal areas of regulation under the Act. The first includes those provisions of the Act which require the physical integration of public-utility companies and functionally related properties of holding-company systems and the simplification of intercorporate relationships and financial structures of such systems. 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 area of regulation includes the exemptive provisions of the Act, provisions relating to the status under the Act of persons and companies, and provisions regulating the right of persons affiliated with a public-utility company to become affiliated with a second such company through the acquisition of securities.

COMPOSITION OF REGISTERED HOLDING-COMPANY SYSTEMS

At the close of the 1968 fiscal year, there were 25 holding companies registered under the Act. Of these, 21 are included in the 17 "active" registered holding-company systems, 4 of the 21 being subholding utility operating companies in these systems. [Footnote: The four subholding companies are Louisiana Power & Light Company, a public-utility subsidiary of Middle South Utilities, Inc.; The Potomac Edison Company and Monongahela Power Company, public-utility subsidiaries of Allegheny Power System, Inc.; and Southwestern Electric Power Company, a public utility subsidiary of Central and South West Corporation.] The remaining 4 registered holding companies, which are relatively small, are not considered part of "active" systems. [Footnote: These holding companies are British American Utilities Corporation; Kinzua Oil & Gas Corporation and its subholding company, Northwestern Pennsylvania Gas Corporation; and American Gas Company and Standard Gas & Electric Company, which are in the process of dissolution.] In the 17 active systems, there are 89 electric and/or gas utility subsidiaries, 47 nonutility subsidiaries, and 15 inactive companies, or a total, including the parent holding companies and the subholding companies, of 172 system companies. The following-table shows the number of active holding companies and the number of subsidiaries (classified as utility, nonutility, and inactive) in each of the active systems as of June 30, 1968, and the aggregate assets of these systems, less valuation reserves, as of December 31, 1967.

[table omitted]

SECTION 11 MATTERS IN REGISTERED HOLDING-COMPANY SYSTEMS

In S.E.C. v. New England Electric System ("NEES"), the Supreme Court reversed the previously reported decision of the Court of Appeals for the First Circuit and directed affirmance of the Commission's order requiring NEES to divest itself of its gas properties and, thus, to limit its operations to a single integrated utility system as required by Section 11 (b). The Commission had rejected NEES' assertion that the gas properties could not be independently operated "without the loss of substantial economies" 6 and that it was therefore entitled to retain the additional system under Clause (A) of Section 11 (b) (1), but the court of appeals had found the Commission's analysis deficient.

In finding adequate basis in the record to support the Commission's conclusions, the Supreme Court noted that the Commission had "weighed NEES' estimated $1,100,000 losses in relative rather than absolute terms, calculating the losses as a percentage of NEES' 1958 revenues, expenses, and income," and had then compared the estimated loss ratios to those which had been shown in prior divestment cases. The Court held: "It was well within the range of the Commission's administrative discretion to use the loss ratios, as it did, 'as a guide in adjudicating the pending case.' . . . The Commission in its expert judgment may so employ evaluative factors it considers relevant."

Similarly, the Court upheld both the Commission's consideration of data concerning the operations of other gas companies in the same geographic area and its determination, in light of such data, that NEES had failed in its attempt "to sustain its burden of showing that the separated gas system would wither into critical health. . . ." The Court stated: "It cannot be a basis for finding error that the Commission found the attempt [by NEES] unpersuasive, given the gas system's size, and the prognosis of efficiencies comparable to those achieved by the independents."

The court also found support for the Commission's findings "that the projected $1,100,000 loss of economies did not in fact take into account any offsetting benefits" which might be expected to result from competition between gas and electric companies serving the same areas now under common holding-company management.

As reported previously, on November 3, 1966, Pennzoil Company, a registered holding company, and United Gas Corporation, its gas utility subsidiary, jointly filed a plan with the Commission pursuant to Section 11 (e) of the Act, which superseded an earlier plan. The plan provided for the consolidation of Pennzoil and United to form a single corporation through an exchange of common stock of Pennzoil and United for securities of the consolidated company. The proceedings on the plan were consolidated with proceedings instituted by the Commission under Sections 11 (b) (1) and 11 (b) (2). On February 7, 1968, the Commission issued its Findings and Opinion disapproving the plan. It held that the proposed exchange was not fair to the common stockholders of United and the plan did not satisfy the requirements of Section 11 (b) (1). Pursuant to Section 11 (b) (1), the Commission ordered Pennzoil to dispose of United's retail gas distribution facilities, holding that "the elimination of Pennzoil as a holding company upon effectuation of the plan would merely alter the form of common control and ownership under these circumstances. Neither in law nor as a matter of statutory discretion can we regard such modal rearrangements as a permissible technique for avoiding the provisions of Section 11 (b) (1)."

Pennzoil and United amended the Section 11 (e) plan, agreeing to the disposition of the gas distribution properties by the consolidated company and revising the terms of the exchange with respect to the common stock of United, and, as thus amended, the plan was approved, subject to a reservation of jurisdiction with respect to certain matters.

The consolidation of Pennzoil and United became effective on April 1, 1968, and the Commission issued an order under Section 5 (d) of the Act terminating the registration of Pennzoil as a holding company and reserving jurisdiction in respect of the disposition of the gas distribution properties and the refinancing of the $214,975,000 of Pennzoil debt, maturing in June and July 1968, which the consolidated company assumed. [Footnote: On June 11, 1968, the Commission issued an order authorizing Pennzoil United, Inc. to issue and sell certain debentures and notes to banks aggregating $280 million which was applied, in part, to the payment in full of the $214,975,000 principal amount of indebtedness and jurisdiction in this respect was released.]

In Northeast Utilities, the Commission, on August 7, 1967, approved a Section 11 (e) plan proposing the elimination of the publicly-held minority interests in The Connecticut Light and Power Company and The Hartford Electric Light Company, two subsidiary companies of Northeast Utilities. The Commission presently has under consideration another Section 11 (e) plan filed by Northeast Utilities proposing the elimination of the publicly-held minority interest in Holyoke Water Power Company, also a subsidiary company of Northeast.

In American Gas Company, the Commission approved Part II of the plan of liquidation and dissolution pursuant to Section 11 (e) of the Act. The Commission found, among other things, in accordance with established precedents, that no redemption premium was payable for prepayment of American's bonds and that payment of principal and accrued interest thereon was fair and equitable. Upon consummation of Part II, the Commission entered an order terminating the registration of American as a holding company.

After the acquisition of more than 97 percent of the common stock of Michigan Gas and Electric Company ("MGE") by American Electric Power Company', as permitted by the Commission's order dated July 24, 1967," American and MGE filed a Section 11 (e) plan for the elimination of the outstanding minority interest held by the public in the MGE stock through the payment therefor of $115 for each seven shares held, the same price approved as reasonable in the Commission's earlier order. After the end of the fiscal year, the Commission issued an order approving the plan.

PROCEEDINGS WITH RESPECT TO ACQUISITIONS, SALES AND OTHER MATTERS

As previously reported, Vermont Yankee Nuclear Power Corporation and 7 of its 10 sponsor-companies filed an application relating to the initial financing by Vermont Yankee of its proposed nuclear-powered electric generating plant through the issuance of common stock to the sponsor-companies. As also noted, a substantially identical proposal was filed by Maine Yankee Atomic Power Company and 9 of its 11 sponsor-companies. Applications for intervention and requests for hearing by various municipalities and cooperatives were filed in these proceedings. By separate Findings, Opinion and Order, the Commission approved the applications and denied the requests for hearing and for the imposition of certain conditions. Applicants for intervention in these proceedings filed petitions for review, now pending, in the U.S. Court of Appeals for the District of Columbia Circuit. [Footnote: On May 1, 1968, the Commission issued a Memorandum Opinion and Order (Holding Company Act Release No. 16053) authorizing the issue and sale of an additional $10 million of Vermont Yankee common stock and the acquisition thereof by its sponsor-companies. As in the prior case, applications for intervention and requests for hearing were filed, and the Commission denied such requests on the basis of its prior opinions. A petition to review filed by the applicants for intervention is pending in the U.S. Court of Appeals for the District of Columbia Circuit (Municipal Electric Association of Massachusetts v. S.E.C., No. 22078). On May 6, 1968, the Commission authorized the issue and sale of 90-day promissory notes of Vermont Yankee to banks (Holding Company Act Release No. 16056) and on the same day authorized the issue and sale of 12-month promissory notes of Maine Yankee to a bank (Holding Company Act Release No. 16507), and denied in each case applications for intervention and requests for hearings. Petitions to review both of these orders have been filed by the applicants for intervention in the U.S. Court of Appeals for the District of Columbia Circuit and are presently pending (Municipal Electric Association of Massachusetts v. S.E.C., Nos. 22079 and 22080).]

The proceedings with respect to Peoples Gas and Light Company ("Peoples") involved a proposal by Peoples, an exempt holding company, to organize a new company, Peoples Gas Company, which, pursuit to an invitation for tenders, would acquire the outstanding common stock of Peoples on a share-for-share basis. The Commission noted that generally the Act "does not favor the superimposing of a holding company upon an existing and functioning holding-company system" but approved the proposed acquisition "only because of the unusual and exceptional circumstances" therein indicated. The approval contained the condition that, promptly after the consummation of the exchange, steps be taken to have the only gas utility subsidiary company of Peoples merged into Peoples Gas or become its direct subsidiary company. The Commission also granted Peoples Gas an exemption under Section 3 (a) (1) of the Act but required that it register as a holding company in order to retire any unexchanged minority stock of Peoples and thus comply with Section 11 (b) (2) of the Act.

In Brockton Taunton Gas Company v. S.E.C., the Court of Appeals for the First Circuit affirmed the previously reported 2i order of the Commission granting an application by Eastern Gas and Fuel Associates for permission to exercise an option to acquire 4.2 percent of the outstanding common stock of Brockton Taunton Gas Company and also to acquire additional shares by means of a cash tender offer. At the time Eastern filed its application with the Commission it owned 4.9 percent of Brockton's common stock. Under Section 9 (a) (2) of the Holding Company Act, prior Commission approval was required before Eastern could acquire directly or indirectly 5 percent or more of Brockton's voting securities. The option held by Eastern was to purchase Brockton shares then owned by the so-called "Brocktaun Trust." It had been alleged that the trust was merely a "straw trust" created as an accommodation for Eastern and that Eastern had thereby acquired more than 5 percent of Brockton's stock in violation of Section 9. The Commission, in its findings and opinion, assumed but did not find that the Brocktaun trust arrangement constituted a violation of Section 9 (a) (2). The Commission concluded that the acquisition would serve the public interest and tend towards the economical and efficient development of an integrated public-utility system. The court held that the

Commission was entitled to give its approval in the public interest despite the assumed violations.

Illinois Power Company, both an electric utility company and gas utility company and also an exempt holding company, filed an application regarding a proposed offer to exchange 0.65 share of its common stock for each outstanding share of common stock of Central Illinois Public Service Company, a nonassociate electric utility company and gas utility company and also an exempt holding company. A hearing on the proposal was ordered by the Commission and was in process at the close of the fiscal year. Certain preferred stockholders have intervened in the proceeding.

American Electric Power Company, Inc., a registered holding company, filed an application relating to a proposed offer by American to exchange, through an invitation for tenders, shares of common stock to be issued by it for the outstanding shares of common stock of Columbus and Southern Ohio Electric Company, a nonassociate electric utility company. A hearing on American's application was in progress at the end of the fiscal year.

Shortly after the end of the fiscal year, there was filed, and the Commission noticed for hearing, a proposal by two registered holding companies, New England Electric System and Eastern Utilities Associates, and a nonaffiliated electric utility company, Boston Edison Company, to form a new holding-company system to be named Eastern Electric Energy System which would register as a holding company. Boston Edison Company and the present subsidiary companies of New England Electric System and Eastern Utilities Associates would be public-utility subsidiary companies of the system while the two latter companies would, in effect, be merged into the new holding company.

During the year, a hearing was held on an application filed by Kaneb Pipe Line Company, a products pipeline carrier, pursuant to Section 2 (a) (7) of the Act, requesting the Commission to declare it not to be a holding company notwithstanding its ownership of 19.48 percent of the voting securities of Kansas-Nebraska Natural Gas Company, Inc., a natural gas public-utility company. The management of Kansas-Nebraska appeared in opposition and contended that the security ownership and activities of Kaneb required, among other things, a finding that Kaneb exercised such a controlling influence over Kansas-Nebraska as to require Kaneb's registration under the Act. Oral argument was held shortly after the end of the fiscal year, and the matter awaits Commission determination.

Effective July 15, 1988, the Commission adopted a new rule under the Act (Rule 51)2S which makes clear what advance steps a person may take in making acquisitions which require prior Commission approval pursuant to Section 9 (a) of the Act, Where acquisitions are proposed to be made subject to later Commission approval, the new rule, in general, permits only such preliminaries as will not substantially affect the public interest or the interest of investors or consumers in the event the Commission should later find that a proposed transaction does not conform to the applicable statutory standards. The rule also takes into account the possibility that an application for approval of an acquisition, particularly a contested one, may take a substantial period of time for disposition and contemplates the possible issuance of certificates of deposit.

The rule provides certain procedures, including a hearing on application, under which certificates of deposit may be authorized by the Commission prior to approval of the proposed acquisition.

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

During the fiscal year 1968, 13 active registered holding-company systems issued and sold for cash 44 issues of long-term debt and capital stock, aggregating $926 million, pursuant to authorizations granted by the Commission under Sections 6 and 7 of the Act. All of these issues were sold for the purpose of raising new capital.

The following table shows the amounts and types of securities issued and sold by registered holding companies and their subsidiaries during fiscal 1968:

[table omitted]

The table does not include securities issued and sold by subsidiaries to their parent holding companies, short-term notes sold to banks, portfolio sales by any of the system companies, or securities issued for stock or assets of nonaffiliated companies. Transactions of this nature also require authorization by the Commission except, 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 then outstanding. The table also does not include the issuance and sale of $65 million principal amount of debentures by Pennzoil United, Inc. which ceased to be a registered holding company on April 1, 1968, subject to reservations of jurisdiction over certain financing and other matters.

Competitive Bidding

All of the 44 issues of securities sold for cash in fiscal 1968, as shown in the preceding table, and the Pennzoil United debenture issue were offered for competitive bidding pursuant to the requirement of Rule 50 under the Act.

During the period from May 7, 1941, the effective date of Rule 50, to June 30, 1968, a total of 1,014 issues of securities with an aggregate value of $15,921 million were sold at competitive bidding under the rule. These totals compare with 238 issues of securities with an aggregate value of $2,636 million which have been sold pursuant to orders granting exceptions under paragraph (a) (5). Of the total amount of securities sold pursuant to such orders, 133 issues with a total value of $2,153 million were sold by the issuers and the balance of 105 issues aggregating $483 million were portfolio sales. Of the 133 issues sold by the issuers, 71 were in amounts of from $1 to $5 million each, 3 debt issues were in excess of $100 million each, 2 stock issues totaling $36 million were issued in fiscal 1966 to holders of convertible debentures and employee stock options, and the remaining 57 issues were in amounts ranging between $5 million and $100 million.

POLICY AS TO REFUNDABILITY OF DEBT ISSUES

In accordance with its long-standing policy under the Act, the Commission has continued to require that all debt securities and preferred stocks 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. Exceptions from this policy have been permitted only where clearly warranted by the circumstances of a particular case. One such exception during fiscal 1968 was the issue and sale by Pennzoil United, Inc. of $65 million principal amount of its present debentures due 1988 at competitive bidding on June 18, 1968. These debentures carry a 5-year restriction against refunding at a lower interest cost.

The 33rd Annual Report, pages 126-27, contains a summary of the results of an examination by the Commission's staff of all electric and gas utility bond issues (including debentures) sold at competitive bidding between May 14, 1957, and June 30, 1967, by companies subject to the Act as well as those not subject. This study was extended to include fiscal year 1968. During this period, 762 electric and gas utility debt issues, aggregating $19,047.4 million principal amount, were offered at competitive bidding. These included 507 refundable issues totaling $10,380 million, and 255 nonrefundable issues totaling $8,667.4 million. The latter issues were all nonrefundable for 5 years except two. Of the two exceptions, one was nonrefundable for 7 years and the other for 10 years. The refundable issues thus represented 66.5 percent of the total number of issues and 54.5 percent of principal amount.

During fiscal year 1968, 96 debt issues were offered, aggregating $3,042 million principal amount. They consisted of 36 refundable issues totaling $882.5 million and 60 nonrefundable issues totaling $2,159.5 million. The number of refundable issues thus represented 37.5 percent of the number of issues and 29 percent of principal amount.

The weighted average number of bids for fiscal 1968 was 4.42 on the refundable issues and 4.12 on the nonrefundable issues, while the median number of bids was 4.5 on the refundables and 4 on the non-refundables. With respect to the success of the marketing of the debt issues, an issue was considered to have been successfully marketed if at least 95 percent of the issue was sold at the syndicate price prior to termination of the syndicate.

On this basis, during fiscal 1968, 44 percent of the refundable issues were successful, as against 58 percent of the nonrefundable issues. In terms of principal amount for fiscal 1968, 44.5 percent of the refundable issues were successful as compared to 53.9 percent of the nonrefundable issues. Extension of the comparison to include the aggregate principal amount 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 during fiscal year 1968, 76 percent of the combined principal amount of all the refundable issues were sold at syndicate price, as compared with 80 percent of the nonrefundable issues.

PART VII
PARTICIPATION IN CORPORATE REORGANIZATIONS

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. When 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.

For purposes of carrying out its functions under Chapter X, the Commission has divided the country into five geographic areas. The New York, Chicago, San Francisco and Seattle regional offices of the Commission each have responsibility for one of these areas. Each of these offices has lawyers, accountants and financial analysts who are engaged actively in Chapter X cases in which the Commission has field 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 for the fifth area.

SUMMARY OF ACTIVITIES

In the fiscal year 1968, the Commission continued to maintain a high level of activity under Chapter X. It entered its appearance in 22 new proceedings involving companies with aggregate stated assets of approximately $140 million and aggregate indebtedness of approximately $120 million. These proceedings involved the rehabilitation of corporations engaged in various businesses, including, among others, hotel management, real estate development, gas and oil development, residential construction, commercial and real estate financing, heavy industrial machining, and a race track.

Including the new proceedings, the Commission was a party in a total of 109 reorganization proceedings during the year. The stated assets of the companies involved in these proceedings totalled approximately $860 million and their indebtedness totalled approximately $730 million. The proceedings were scattered among district courts in 35 states and the District of Columbia as follows: 11 each in California and New York; 8 in Florida; 7 in Arizona; 6 in New Jersey; 5 each in Pennsylvania and Washington; 4 each in Indiana, Michigan, and Texas; 3 each in Illinois, Louisiana, Minnesota and North Carolina; 2 each in Alabama, Colorado, District of Columbia, Hawaii. Kansas, Montana, Nevada, Ohio, South Dakota, and West Virginia; and 1 each in Arkansas, Connecticut, Delaware, Indiana, Kentucky Maryland, Massachusetts, Missouri. Oklahoma, North Dakota, Tennessee, and Utah.

During the year, 17 proceedings were closed. As of the end of the fiscal year the Commission was a party in 92 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 safe guards to which all parties are entitled. The Commission also attempt; to secure judicial uniformity in the construction of Chapter X and the procedures thereunder.

In American National Trust and Republic National Trust, which were consolidated for administration purposes, a receiver was appointed pending approval or dismissal of involuntary Chapter X petitions filed by creditors. The order of appointment granted the receiver, in effect, the full powers and duties of a Chapter X trustee, including the power to investigate the acts and conduct of prior management. The Commission sought to have the authority of the receiver narrowed to include only duties normally vested in a temporary receiver. The question became moot upon approval of the Chapter X petitions and appointment of the receiver as the Chapter X trustee.

In Wac, Inc., the Commission objected to the retention in office of the Chapter X trustee, who had been the supervising partner in charge of an audit of the debtor's books shortly before the filing of the Chapter X petition. The accounting firm was a creditor of the estate since its bill was unpaid, and accordingly the Commission considered the partner disqualified as trustee under Section 158 (1). In addition, since Chapter X requires an independent investigation of the debtor, the Commission felt that the trustee may have compromised his independence by reason of the pre-Chapter X audit of the debtor and hence was not "disinterested" under Section 158 (4). The issues became moot when the trustee resigned.

In Commonwealth Financial Corp., the Commission moved to vacate the order appointing co-counsel for the Chapter X trustees on the ground that he was not "disinterested" under Section 158 (4). The co-counsel was an attorney who had represented a major creditor of the debtor in other matters, and his father was Chairman of the Board of Directors of that creditor and Chairman of a creditors' committee. The motion of the Commission was denied, but within a few days co-counsel resigned and the judge accepted his resignation.

In Federal Shopping Way, Inc., the involuntary Chapter X petition alleged, as an act of bankruptcy, the prior appointment of a receiver in a civil suit filed by the Commission against the debtor involving alleged fraud in the sale of securities under the Securities Act of 1933. The Commission supported the position that this allegation satisfied Section 131 (2) .6 The matter was pending at the close of the fiscal year.

In Parkwood, Inc., the court held, as urged by the Commission, that the Chapter X petitions had been filed in good faith in that it was not unreasonable to expect that a plan of reorganization could be effected. The court noted that the announced position of creditors holding first deeds of trust that they would not acquiesce in a plan of reorganization which did not make them current on all obligations thus secured had no bearing on the question of good faith. The court pointed out that the alternatives to reorganization -- foreclosure or forced sale -- might substantially diminish an indicated equity in excess of $4 million above the claims of the holders of the first deeds of trust.

In Gladstone Mountain Mining Company, a dormant mining company with book assets of $3,200 and total liabilities of $1,000 consisting of accounting and legal fees filed a voluntary petition under Chapter X. The company sought to increase its capital stock from 1.5 million to 5 million shares so that it could use the additional stock to acquire speculative assets. The company's stock is listed on the Spokane Stock Exchange and it has several hundred shareholders, but it had had no income from operations for the past several years. The Commission moved to dismiss the petition for lack of "good faith" under Section 146 (3) because it appeared that the proceeding was instituted principally to capitalize a new speculation rather than to rehabilitate < going-concern enterprise.

In Tower Credit Corporation, as previously reported, the Com mission supported, on appeal, the order of the district judge approving the Chapter X petition as having been filed in "good faith" under Section 146 (4), urging that the Chapter X proceeding would better subserve the interests of creditors and stockholders than would the pending State court receivership. The Commission pointed out the many advantages of the Chapter X proceeding over a State court receivership, such as the trustee's investigation into past management' abuses; the greater ability of the Federal reorganization court to deal exclusively with the assets of a multi-state business operation; the reorganization standards to measure the feasibility of a reorganization plan and its fairness to affected persons; and the requirement that the judge be satisfied as to the qualifications of the persons who are t constitute the new management of the reorganized company. After the close of the fiscal year, the appeal was dismissed pursuant to a stipulation of the parties.

In re Bankers Trusty the Commission supported, on appeal, the district court's denial of a motion made by a creditor and trust certificate holder to dismiss the Chapter X petition as to one of the five trusts being reorganized in a consolidated proceeding on the ground, among others, that venue was improper in the Federal court in Indiana. The district judge had determined that, while the venue requirements of Sections 128 and 129 of Chapter X had in fact not been met, he nevertheless had discretion under Section 32 of the Bankruptcy Act (authorizing the judge to transfer the proceeding if venue is improper) to retain jurisdiction. On appeal, the Commission urged that the district court (1) had no power to dismiss the Chapter X petition for improper venue and (2) acted within its discretion and properly refused to transfer the Chapter X proceeding to another district court. After the close of the fiscal year, the court of appeals agreed with the Commission that, notwithstanding the district court's determination that venue was improper, the district court lacked authority to dismiss the proceeding and did not abuse its discretion in refusing to transfer the proceeding.

In Vinco Corp. the court denied a motion to vacate the order which 3 years previously had approved the involuntary Chapter X petition. The motion to vacate was based primarily on the ground that the debtor had not been served with the subpoena and copy of the involuntary petition. In denying the motion, the court pointed out that the debtor's attorney and the board chairman's personal attorney each had been served with a copy of the petition, that the debtor had been represented by an attorney at the hearing to consider its approval, and that the debtor had participated in the Chapter X proceeding and filed a proposed plan of reorganization. On appeal by the debtor to the Court of Appeals for the

Sixth Circuit, the Commission urged that the motion to vacate was barred under Section 149 of Chapter X, which provides that once the order approving a Chapter X petition has become final it "shall be a conclusive determination of the jurisdiction of the court."

In Tower Credit Corporation, the referee in bankruptcy did not permit Commission counsel to participate in cross-examination in a hearing on the petition of the Chapter X trustee seeking to require certain holders of large blocks of Tower stock to return their stock to the estate. The district judge denied the Commission's motion for an order directing the referee to permit the Commission to participate fully in the hearing. The court of appeals granted the Commission's petition for a writ of mandamus, 19 directing the district judge (1) to set aside his order denying the motion and (2) to enter an order directing the referee that in any continued or adjourned session of the hearings, the Commission must be allowed to propound questions to witnesses on cross-examination and to offer evidence. The court of appeals noted that, under Section 208 of Chapter X, the Commission is "a party in interest, with the right to be heard on all matters arising in such proceeding" and that a limitation such as the district court sought to impose would hamper the Commission severely in its tasks as advisor to the court and protector of the public interest.

In General United Corporation, Inc., the Commission, as reported previously, moved to classify stockholders into position as creditors because they had been defrauded in violation of Section 10 (b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The district judge confirmed the holding of the referee in bankruptcy that the Commission lacked standing to bring such a motion on behalf of the stockholders, although the court's order acknowledged that a charge of fraud seemed justified by the record, and that a class action would be appropriate. The court interpreted Section 208 of Chapter X which defines the Commission's status as "a party in interest" in the proceeding, as limiting the Commission to the role of an amicus curiae The Commission has filed a petition for a writ of mandamus with the court of appeals, urging that the Commission has the requisite standing to file the motion and that the ruling of the court seriously impair; the role of the Commission as a party to the Chapter X proceeding ii the interest of public security holders.

In Los Angeles Land and Investments, Ltd., the court, in it opinion classifying creditors pursuant to Section 197, found, as urged by the Commission, that each person who had purchased from the debtor an undivided interest in land, sold in violation of the real estate laws of Hawaii and California and of the Securities Act of 193t should be classified as a general unsecured creditor to the extent o the payments made plus interest for the purpose of participating i ' a plan of reorganization.

In Riker Delaware Corporation, the Court of Appeals for the Third Circuit held that the power to enter a "turnover order" under Section 25T of Chapter X could be exercised only by the judge and not by the referee. The referee, at the request of the trustee, had issued an order requiring the secured creditor in possession of the properties tinder his mortgage to turn over the properties to the trustee. The court of appeals ordered, as urged by the Commission, that the matter should be remanded to the district judge and that the turnover order, as previously modified by the court of appeals, should stay in effect pending the judge's consideration.

In Yale Express System, Inc., as previously reported, the court of appeals had remanded the case to the district court to determine whether, under equitable principles, a creditor secured by a substantial number of truck trailers and bodies was entitled to reclamation, or, in the alternative, to rental payments for the use of the trucks and trailers during reorganization. On remand, the district court held that reorganization of the debtor was a "reasonable possibility" and that the secured creditor should not be permitted to reclaim its trailers or receive rental payments because this would make successful reorganization impossible. The Commission concurred with the court's ruling and supported its position in a second appeal taken by the secured creditor.

In affirming the district court, the court of appeals held that, in view of the reasonable possibility of a successful reorganization and "the fundamental purpose of reorganization proceedings to enable the debtor to continue operations as well as to protect the rights of creditors . . .," the lower court had not abused its discretion in denying claims for reclamation. Moreover, since equal treatment would have to be afforded all secured creditors, the granting of rental payments could "nullify the reorganization as effectively as granting the petition for reclamation." In response to the secured creditor's contention that equitable considerations compelled a favorable ruling in its behalf because the vehicles in which it claimed a security interest were depreciating, the court noted that ". . . . to such extent as Fruehauf has been damaged by the use of its property pending the reorganization, it is entitled to equitable consideration in the reorganization plan." The court of appeals further noted that the trustee had offered to fix the value of the security interest claimed by the secured creditor so that its position in any reorganization would be unaffected by possible depreciation.

In Webb & Knapp, Inc., as previously reported, the Chapter trustee instituted an action against the indenture trustee, based on the latter's alleged misconduct or gross negligence, to recover on behalf of the debenture holders the entire principal amount of debentures outstanding ($4,298,000). This action, which was supported by the Commission, was dismissed by the district court on motion of the indenture trustee." The district court ruled that the claims involved were personal to the debenture holders and that the Chapter X trustee had no standing to assert the claims on their behalf. The trustee and the Commission had argued before the district court, among other things, that where public creditors are widely dispersed and may be without effective representation, the Chapter X trustee should be permitted to represent their interest, consistent with the aims of the Bankruptcy Act. The Chapter X trustee has appealed the dismissal of his action.

In Westec Corporation, Chemetron Corporation filed a claim in the reorganization proceeding seeking rescission of its sale to the debtor prior to the Chapter X proceeding of Pan Geo Atlas Corporation and requested leave to file suit against the debtor and others in connection with this transaction. Shortly thereafter, the trustee filed objections to Chemetron's claims and to its motion for leave to file suit and counterclaimed against Chemetron for $10 million. Both Chemetron's claim and the trustee's counterclaim are based on fraud. Chemetron objected to the jurisdiction of the bankruptcy court to hear the counterclaim and its claim in the same summary proceeding. The Commission urged that the reorganization court had summary jurisdiction to hear both a creditor's claim and the trustee's counterclaim upon which affirmative relief could be granted where, as in the instant case, the counterclaim arose out of the same transaction as the creditor's claim. Thereafter, the trustee and Chemetron proposed a compromise of the claim and counterclaim, conditioned upon the approval of a proposed plan of reorganization. The Commission recommended to the court that the compromise be considered only at the time of the hearing on a plan of reorganization. The court adopted the Commission's view, and, after the close of the fiscal year, a proposed plan was filed and hearings were conducted by the court.

In F. L. Jacobs Co., previously reported, after the plan was consummated the trustees filed a petition in the reorganization court to restrain the New York Stock Exchange and the Commission from delisting the debtor's common stock and to order the restoration of trading of the stock on the Exchange. The court agreed with the Commission that the court had no jurisdiction to enjoin an administrative proceeding for delisting and that the Commission had exclusive jurisdiction over such matters, subject to statutory review by the court of appeals.

The Exchange had suspended trading in the debtor's stock in 1958, and in 1959 had filed an application with the Commission, pursuant to Section 12 (d) of the Securities Exchange Act of 1934, to strike the debtor's common stock from listing and registration, but action thereon was deferred during the reorganization proceedings. After a plan of reorganization was consummated and after the debtor's unsuccessful efforts to enjoin the administrative proceeding, the Exchange pressed its delisting application, referring to the debtor's failure to meet de-listing criteria as to assets and earnings for several years during the reorganization proceeding and noting that the debtor did not meet, by a substantial amount, certain original listing standards. Under the Exchange delisting standards, a company which falls below those standards may be required to bring itself up to the stricter original listing standards as a condition to continued listing. In opposition, the debtor noted that it was not presently below the delisting standards and pointed to the success of the reorganization and to the fact that it had been operating at a profit for some years and was expanding. The Commission held that under the circumstances here involved, including the fact that the Jacobs stock would have been delisted in 1959 absent intercession of the Chapter X proceeding, "it seems clearly appropriate for the Exchange to require Jacobs to satisfy original listing standards as a condition to the resumption of trading."

TRUSTEE'S INVESTIGATION

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

In Westec Corporation, the trustee conducted an extensive investigation into the affairs of the debtor, in which the Commission's staff participated. Shortly after the close of the fiscal year, the trustee instituted suit against 93 individuals and firms, including 18 brokerage houses and the debtor's accounting firm, charging fraud and mismanagement leading to the company's financial collapse.

In Commonwealth Financial Corporation, the former president of the debtor moved for a protective order staying any attempts by the trustees to take his deposition in the course of the trustees' Section 167 investigation. He alleged that the Commission apparently had beer conducting a separate and independent investigation of the affairs of the debtor including his activities.

The court denied the motion, finding that the Commission was authorized to participate in the trustees' investigation and ruling that the former president was free to assert his Fifth Amendment right against self-incrimination at any time and that this constitutional safeguard was sufficient protection.

After the close of the fiscal year, the former president appealed to the court of appeals. The court denied his motion for a stay pending the appeal and ordered the trustees' motion to quash the appeal continues until the argument of the appeal on the merits.

REPORTS ON PLANS OF REORGANIZATION

Generally, the Commission files a formal advisory report only in case involving a substantial public investor interest and presenting significant problems. When no such formal report is filed, the Commission may state its view briefly by letter, or authorize its counsel to make an oral or written presentation to amplify the Commission's views. During this fiscal year the Commission did not publish any formal advisory reports; its views on 10 plans involved in 5 proceedings were transmitted to the court by written memoranda or presented orally at the hearings on approval of the plans.

In TMT Trailer Ferry, Inc., the Supreme Court reversed 51 the decision of the court of appeals, which had affirmed an order of the district court confirming a plan of reorganization for the debtor. The district court had excluded stockholders from participation in the reorganized company because of its finding that the debtor was insolvent. The Supreme Court held, as urged by the Commission and the stockholders' protective committee, that the going-concern value of TMT had been improperly established in that the district court had referred solely to the operating experience of TMT while under trusteeship and failed to consider the foreseeable prospects of the company once it was out of the reorganization proceeding. The court also ruled that the district court erred in allowing almost in full two substantial disputed claims aggregating about $2 million, on. the basis of alleged compromises, without hearings on the merits of the claims and the objections to them. The court did not reach other contentions of the Commission and committee: (1) that a Chapter X trustee, as a matter of law, could not succeed himself as president of the reorganized company; and (2) that stockholders who had purchased stock sold to them in violation of the Federal securities laws had claims against the debtor as to which they could participate as creditors in a plan of reorganization, regardless of the insolvency of the debtor.

In Yale Express System, Inc., a plan for the reorganization of Republic Carloading & Distributing Company, a major subsidiary of Yale, proposed, in effect, the complete separation of Republic and six of its subsidiaries from the Yale system and the surrender of Yale's 96.8 percent stock ownership in Republic in return for the cancellation of approximately $16 million of senior and prior debt owed by Yale to certain institutional creditors and $3 million owed by Yale to Republic. The Commission took the position, with which the court agreed, that, among other things, the plan provided adequate consideration for Yale's relinquishment of its interest in Republic and that implementation of the plan would leave the balance of Yale's creditors, including its subordinated public debenture holders, in a substantially better posture than that possible under any consolidated plan of reorganization.

In Canandaigua Enterprises Corporation,* reported previously, the Commission filed four separate memoranda on six different proposed plans of reorganization, and on an amendment of one of the plans, finding fair and equitable only the two plans which provided for the auction sale of the debtor's assets at a minimum upset price of $4 million, and the distribution to creditors of all proceeds and cash on hand according to their respective priorities. It was estimated that these plans would provide at least a 50 percent payment of the unsecured claims, including those of public debenture holders. The plans were also found to be feasible, with the reservation that the court should be satisfied of a firm offer to purchase the assets and the ability of the offeror to perform. The court has ruled on five of the plans and in its decision has, in effect, adopted the recommendations of the Commission. However, only the trustee's plan was approved because "no advantage to the unsecured creditors would result from the approval of two practically identical plans."

The three other plans of reorganization were not approved by the court, which referred to "the reasons set forth" in the Commission's memoranda. The Commission had objected to one plan because it provided for the participation of stockholders despite the debtor', clear insolvency and because of the excessive debt structure it proposed. Another plan providing for a fixed distribution to unsecured creditors of 48 percent of their claims was found to be unfair because it precluded creditors from benefiting from a possible reduction in tin debtor's recorded claims or a sale of the assets at a price in 'excess o: the opening bid. A third plan, which offered unsecured creditors 49 percent stock interest in the company or a cash alternative of 50 percent of their claims, was found to be unfair because of the in adequate contribution of the plan proponent for the 51 percent stock interest and control in the reorganized company, and valuable con cession rights. As to the sixth plan and the amended plan which the court has not yet reviewed, the Commission found them to be unfair because each plan contains alternatives which are unfair, when measured by the parallel provisions in the other. One of the two plan offers the unsecured creditors the largest stock interest of any proposed plan (59 percent) as an alternative to cash, and the other plan offers the largest cash distribution of any proposed plan (75 percent) as an alternative to stock. The trustee's motion for authority to sell the assets of the debtor apart from any plan of reorganization was opposed by the Commission and denied by the Court. One of the unsuccessful plan proponents has appealed the court's order rejecting its plan.

In Arizona Lutheran Hospital, involving a nonprofit organization, the court approved and confirmed, as urged by the Commission, the trustee's plan of reorganization which provided for the distribution of the proceeds of a previous sale of all the assets to Lutheran Hospital & Homes Society of America, Inc. Under the plan, in accordance with the terms of the sale, the first mortgage bonds, held by about 1,000 persons, received cash payment in full for the outstanding principal balance of $2.7 million and accrued interest of $900,000. Unsecured creditors received nonnegotiable notes issued by the purchaser of the assets representing the full amount of the principal of their claims, to be paid over a 4,/2 year period without interest. The Commission noted that the court had found that the value of the assets securing the bonds was less than the principal due on the bonds, and that the bondholders nevertheless were to be paid in full, including interest, while unsecured creditors would not receive interest on their claims. The Commission pointed out, however, that a suit had been instituted against the purchaser of the assets and others alleging violations of Federal securities laws in the sale of the bonds to the public investors; that dismissal of the suit was one of the conditions of the sale and the plan; and that the payment to the bondholders reflected in part settlement of the suit.

In Polycast Corporation, the plan of reorganization for the continuation of the debtor's business, which the court confirmed, provided that all general unsecured creditors, including the public debenture holders, would have the option of receiving for each $100 of claim either $3 in cash or 10 shares of the new common stock. The debtor's public stockholders would not participate in the plan, since the court found the debtor to be insolvent. The plan proponents would receive over 80 percent of the new common stock in return for a contribution of cash and assets necessary for the operation of a new manufacturing process. The Commission advised the court, and the court agreed, that the plan was fair and equitable and feasible.

In Commonwealth Investment Corp, the court, as recommended by the Commission, approved a plan which provided for the sale of the debtor's assets and the disposition of the proceeds to the debtor's creditors and stockholders. Under the plan the stockholders were to receive about $150,000 from the sale after the satisfaction of creditor claims, plus whatever was recovered from pending causes of action on behalf of the estate. The plan provided for the subordination of about 300,000 shares of common stock held by former officers and directors.

In Atlas Sewing Centers, Inc., as reported previously, the district court in 1965 had declared a plan of reorganization to have been substantially consummated. However, the new securities and cash required to be issued were never issued and in 1967 the court found that the plan proponent had not fulfilled his obligation to provide additional funds. The district court appointed a receiver and entered an order adjudging the debtor a bankrupt. In March 1968, the trustee was surcharged $56,666.67, the total of the fees he had been granted by the court during the course of the Chapter X proceeding, because he had acted in "deliberate defiance" of orders of the Court of Appeals for the Fifth Circuit and had given "unfaithful service" to the district court. The trustee's appeal to the Court of Appeals for the Fifth Circuit from the surcharge order was pending at the close of the fiscal year.

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 124 applications for compensation totaling about $3 million were reviewed.

In Arlington Discount Co., reported previously, the Commission filed a motion under Section 328 of Chapter XI, which was granted, whereupon the debtor amended its petition to comply with the requirements of Chapter X. Subsequently, the attorneys for the debtor-in-possession in the Chapter XI proceeding requested a final allowance of $40,000 for services rendered for the approximately 6-month period during which the proceeding had been in Chapter XI. The Commission recommended an allowance of $15,000, pointing out that a great deal of the time spent by the attorneys had been unproductive and of no benefit to the estate because the debtor, on the advice of the applicants, had filed a petition under Chapter XI rather than under Chapter X. The court allowed $7,500, stating, among other things, that the use of Chapter XI by the attorneys was "in complete disregard of the standards laid down by the Supreme Court" in

Securities and Exchange Commission v. American Trailer Rentals Co., 379 U.S. 594 (1965). The attorneys have appealed to the Court of Appeals for the Sixth Circuit 65 and the matter was pending at the close of the fiscal year.

In Coast Investors, Inc., as previously reported, counsel for a committee appealed from an order of the district court which awarded him $10,000 as compensation for services. Counsel sought an allowance of $18,000, which amount the Commission recommended. On appeal the Commission argued that the district court erred in holding that a different standard for allowances applies when the Chapter X reorganization plan provides, as in this case, for an orderly liquidation. While the court of appeals agreed that the same fee standards apply to all Chapter X proceedings, it held that in the instant case the lower court's reference to the orderly liquidation over a period of years under the plan was merely factual, and noted also that failure to achieve a successful reorganization should not diminish the compensation for useful services since Congress desired to encourage bona fide efforts to reorganize debtor corporations as going concerns.

In Food Town, Inc., the proceeding had been referred generally to the referee in bankruptcy who had held numerous hearings as referee and as special master over a period of years. The referee requested a fee for-his services pursuant to Section 241 of Chapter X. The Commission pointed out that the referee's salary is fixed by statute and any allowances for his services are paid to the Treasury of the United States for the Referees' Salary and Expense Funds; that these funds are not allocated to any specific referee and thus referees have no interest in the charges for their official services; and that the annual salary of the referee may serve as a guide for determining under Section 241 the compensation to be allowed for the referee's services in Chapter X. The Commission rejected a suggestion that the allowances for the referee's services should reflect overhead costs of his office. The court, as recommended by the Commission, awarded the amount requested by the referee, without commenting on the issues raised by the Commission.

In Westec Corporation, a practicing attorney who had been designated by the court as special master to conduct and preside over examinations to be taken on behalf of the trustee requested an interim allowance based on a rate of $350 a day for his time spent so presiding and in other matters such as conferences with attorneys. The Commission, noting that the applicant was acting as a quasi-judicial officer, expressed the view that compensation provided for other judicial officers was an appropriate reference. Noting that a United States district judge receives a salary of $35,000 per annum, or a daily rate of $150 to $175, it recommended an allowance for the special master at the rate of $200 per day. The Commission took the position that the allowance should reflect the fact that the special master must pay his office overhead but also the relatively limited scope of his responsibilities. The court awarded the special master the fees requested by him.

In Hydrocarbon Chemicals, Inc., appeals were taken from the orders of the district court, previously reported, (1) denying compensation to the debtor's principal attorney because he traded in the debtor's stock during the Chapter XI proceeding which preceded the Chapter X proceeding, and (2) denying compensation to two attorneys retained by the principal attorney on the basis that their retention had not been authorized as provided by General Order 44 of the Bankruptcy Act (requiring prior court authorization for the services of an attorney to be performed for a trustee, receiver, or debtor-in-possession). The principal attorney, who served in both the Chapter XI and Chapter X proceedings, was denied any compensation because he had sold short stock of the debtor 2 days before the filing of the Chapter XI petition and had covered his short sale by the purchase of the debtor's stock immediately after filing that petition. As urged by the Commission, the court of appeals affirmed the denial of compensation, noting that Section 249 of Chapter X was applicable to securities transactions where, pursuant to Section 328 of Chapter XI, a Chapter XI proceeding has been superseded by a Chapter X proceeding. The court further held that General Order No. 44 did not bar an award of compensation to the two attorneys retained by the principal attorney, who sought compensation for services rendered during the Chapter XI phase of the proceeding. Since a receiver had been appointed during the Chapter XI proceeding, the debtor had not been in possession and General Order No. 44 did not apply to attorneys for the debtor unless the services performed by the debtor's attorneys in the Chapter XI proceeding had been of a character reserved to a receiver in a Chapter XI proceeding. In accordance with the Commission's suggestion, the questions of whether the services could have been performed only by counsel for the Chapter XI receiver and the amount of compensation, if any, to be awarded, were remanded to the district court for its consideration. The court also agreed with the Commission that the disqualification from compensation of the principal attorney did not also bar the attorneys he had retained. After the close of the fiscal year, the court of appeals granted the petition of the Chapter X trustee for rehearing on this point and ordered reargument en banc.

In Tale Express System, Inc., the collateral trustee under a trust agreement between the debtor and certain of its institutional creditors entered into prior to the inception of the reorganization proceeding sought compensation of $15,000 for its own services as trustee and reimbursement of $23,250 for payment of fees to its counsel. The district court, agreeing with the Commission, held that the reasonableness of the fees must be based on reorganization standards, as distinguished from ordinary commercial standards, although the terms of the trust agreement would be a factor in evaluating reasonableness. The court awarded the trustee $8,593, as recommended by the Commission. The Commission had recommended an allowance of $17,500 for the trustee's counsel, and the court awarded $19,900.

In Parkwood, Inc., the Commission submitted a memorandum in connection with an application by the holder of a first deed of trust on one of the debtor's real estate properties for reimbursement of fees and expenses paid and to be paid to its counsel. The deed of trust and note provided that the debtor would pay reasonable counsel fees if suit were brought or if any litigation occurred. The Commission urged that, assuming the validity under applicable State law of the deed of trust and note and of the provision relating to attorneys' fees, a Federal standard must be applied in. determining the reasonableness of the fees to be awarded by the reorganization court and that the standards of reasonableness which would be applied by the State courts were not controlling. In the same case the Commission took the position with regard to applications for interim allowances that such interim allowances should not be based on a fixed percentage of what the applicants regard as full compensation. The Commission pointed out that, since interim allowances are payments on account of a possible future allowance and do not purport in any way to reflect or measure the value of the services rendered, the court does not adopt an assumed or hypothetical final allowance and then award a percentage of such allowance. For the court to do so would create the erroneous impression that implied approval had been given to the full amount claimed. The referee in bankruptcy, sitting as special master, agreed with the Commission and the judge adopted his recommendations as to awards. In the same proceeding the Commission recommended an award of interim reimbursement of reasonable expenses incurred by a committee representing holders of second deeds of trust on various properties of the debtor. The Commission pointed out that interim allowances for compensation and expenses are not usually recognized for persons other than the trustee and his counsel. However, formation of committees to represent numerous and usually scattered equity holders is to be encouraged in reorganization proceedings. Since committees should be encouraged to take an active role in the proceeding and be effective instruments for communication between the security holders they represent, an award of interim reimbursement of reasonable expenses seemed warranted. The committee did not apply for interim fees.

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 Manufacturers' Credit Corporation, the debtors, consisting of the parent and 25 affiliated and subsidiary companies, were engaged primarily in the business of operating bus lines in New Jersey and vicinity. Over a period of many years certain of the debtors had sold to the public their unsecured promissory notes carrying interest at rates between 9 percent and 15 percent per annum, totalling approximately $58 million, without registration of these securities with this Commission or the Interstate Commerce Commission. Approximately 5,000 public investors held these notes at the time of the filing of the Chapter XI proceeding. The Court of Appeals for the Third Circuit, affirming the order of the district court, which had granted the Commission's Section 328 motion, agreed with the-Commission that the proposed plan of arrangement under Chapter XI which would have turned the companies over to the creditors (including the public noteholders) was not sufficient to protect the public investors, but that the full safeguards of Chapter X were required. In reaching this conclusion the court considered the need to make a substantial adjustment of widely-held public debt, the necessity for a thorough investigation of possible management improprieties by an independent trustee, and the fact that there could exist causes of action under Federal securities laws on behalf of the public investors which could better be prosecuted by a trustee than by the individuals involved.

In Kendall Industries, the Commission supported the motion of creditors pursuant to Section 328 and urged that the financial condition of the debtor required more than a simple composition of its unsecured debts and that, particularly, a large amount of secured debt would have to be modified, necessitating the broader scope of Chapter X. The court granted the motion and the debtor amended its petition to comply with the requirements of Chapter X.

PART VIII
SUPPORTING ACTIVITIES PUBLIC INFORMATION SERVICES

Dissemination of Information

As the discussion in prior sections of this Report indicates, most large corporations in which there is a substantial public investor interest have filed registration statements or registration applications under the Securities Act or the Securities Exchange Act with the Commission and are required to file annual and other periodic reports. Widespread public dissemination of the financial and other data included in these documents is essential if public investors generally are to benefit by the disclosure requirements of the securities laws. This is accomplished in part by distribution of the prospectus or offering-circular in connection with new offerings. Much of the data is also reprinted and receives general circulation through the medium of securities manuals and other financial publications, thus becoming available to broker-dealer and investment adviser firms, trust departments and other financial institutions and, through them, to public investors generally.

Various activities of the Commission also facilitate public dissemination of information filed as well as other information. Among these is the issuance of a daily "News Digest" which contains (1) a resume of each proposal for the public offering of securities for which a Securities Act registration statement is filed; (2) a list of issuers of securities traded over-the-counter which have filed registration statements under the Securities Exchange Act; (3) a list of companies which have filed interim reports disclosing significant corporate developments; (4) a summary of all notices of filings of applications and declarations, and of all orders, decisions, rules and rule proposals issued by the

Commission; (5) announcements of the Commission's participation in corporate reorganization proceedings under Chapter X of the Bankruptcy Act and of the filing of advisory reports of the Commission on the fairness and feasibility of reorganization plans; (6) a brief report regarding actions of courts in litigation resulting from the Commission's law enforcement program; and (7) a brief reference to each statistical report issued by the Commission. During the year, the News Digest included summary reports on the 2,616 registration statements filed with the Commission (not including investment company offering proposals filed as amendments to previously filed statements), 1,128 notices of filings, orders, decisions, rules and rule proposals issued by the Commission, 289 developments in litigation under its enforcement program, 19 releases on corporate reorganization proceedings, and 78 statistical releases.

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 25956 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.

These informational activities are supplemented by public discussions from time to time of legal, accounting and other problems arising in the administration of the Federal securities laws. During the year, members of the Commission and numerous staff officers made speeches before various professional, business and other groups interested in the Federal securities laws and their administration and participated in panel discussions of like nature. Participation in these discussions not only serves to keep attorneys, accountants, corporate executives and others abreast of developments in the administration of those laws, but it also is of considerable value to the Commission in learning about the problems experienced by those who seek to comply with those laws. In order to facilitate such compliance the Commission also issues from time to time general interpretive releases and policy statements explaining the operation of particular provisions of the Federal securities laws and outlining policies and practices of the Commission.

During fiscal year 1968, the Commission published in booklet form a compilation of releases, Commission opinions and other material dealing with matters frequently arising under the Investment Company Act, and a compilation of releases dealing with matters arising under the Securities Exchange Act and the Investment Advisers Act. A previous compilation booklet, containing releases relating to Securities Act matters, had been published in fiscal year 1965.

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).0 (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.

Stock Transactions of Financial Institutions. 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.

Private Noninsured Pension Funds (assets available quarterly in the Statistical Bulletin).

Directory of Companies Filing Annual Reports.

Other Publications:

Decisions and Reports of the Commission (Volume 41 only).

Securities and Exchange Commission -- The Work of the Securities and Exchange Commission.

Commission Report on Public Policy Implications of Investment Company Growth.

Availability of Information for Public Inspection

The many thousands of registration statements, applications, declarations, and annual and periodic reports filed with the Commission each year are available for public inspection at the Commission's public reference room in its principal offices in Washington, D.C. Also available at that location are some additional documents contained in Commission files and indexes of Commission decisions.

The categories of materials which are available for public examination are specified in the Commission's rule concerning records and information, 17 CFR 200.80, as revised to implement the provisions of the Public Information Amendment to Section 3 of the Administrative Procedure Act which became effective July 4, 1967. The rule also establishes a procedure to be followed in requesting records or copies thereof, provides a method of administrative appeal from the denial of access to any record, and provides for the imposition of fees when more than one-half man-hour of work is performed by members of the Commission's staff to locate and make available records requested. The fee rate which has been established is $2.50 for each one-half man-hour or fraction thereof after the first one-half man-hour.

The Commission has special public reference facilities in the New York and Chicago Regional Offices, and some facilities for public use in other regional and branch offices. Each regional office has available for public examination copies of prospectuses used in recent offerings of securities registered under the Securities Act; registration statements and recent annual reports filed pursuant to the Securities Exchange Act by companies having their principal office in the region; broker-dealer and investment adviser applications originating in the region; letters of notification under Regulation A filed in the region; and indexes of Commission decisions. Additional material is available in the New York, Chicago and San Francisco regional offices.

Members of the public may make arrangements through the public reference room at the Commission's principal offices to purchase copies of material in the Commission's public files. Under the existing contract with a commercial copying company, the cost of facsimile copies made from documents supplied by the Commission is 9 cents per page for pages not exceeding 8 1/2 x 14" in size, with a $2 minimum charge. In a significant step forward during the fiscal year, the Commission entered into a contract with a private company pursuant to which a microfilm and "microfiche" service will be available at reasonable cost to persons or firms who have or can obtain viewing facilities. The microfiche service will provide up to 60 images of pages on a 4" x 6" film, referred to as a "fiche." Initially, annual microfiche subscriptions will be offered in a variety of packages covering all public reports filed on Forms 10-K, 9-K, and 8-K under the Securities Exchange Act of 1934 and Form N-1Q, under the Investment Company Act of 1940, with subscriptions retroactive to include reports filed since January 1, 1968. The packages offered will include various groupings of these reports, including reports based on selected industry classifications. Arrangements also may be made to subscribe to reports of companies of one's own selection, but at a somewhat higher cost than for standard subscription packages. It is believed that the subscription system can be extended to additional groups of filings in the future. The company also will supply at reasonable prices copies in microfiche or microfilm form of any other public records of the Commission desired by a member of the public. Readers will be installed in major public reference areas in the Commission's headquarters and regional offices, and sets of reports will be available for examination there.

Visitors to the public reference rooms of the Commission's Washing ton, D.C., New York and Chicago offices also may make immediately reproductions of material in those offices on coin-operated copying machines at a cost of 25 cents per 8 1/2" x 14" page. The charge for an attestation with the Commission seal is $2. Detailed information concerning copying services available and prices for the various types of service and copies may be obtained from the Public Reference Section of the Commission.

Each year, many thousands of requests for copies of and information from the public files of the Commission are received by the Public Reference Section in Washington, D.C. During the 1968 fiscal year, 8,715 persons examined material on file in Washington and several thousand others examined files in the New York, Chicago, and other regional offices. More than 16,833 searches were made for information requested by individuals and approximately 2,470 letters were written with respect to information requested.

ELECTRONIC DATA PROCESSING

Extension of Application of Automation Techniques

Reference has already been made in previous sections of this report to certain uses of the Commission's computer. During the 1968 fiscal year the Commission expanded its use of automation for the analysis of data related to the economics and practices of the securities industry. In one new application, the computer is now being used for the analysis of data contained in the quarterly reports of management investment companies on Form N-1Q. These reports provide the Commission with information about portfolio transactions and holdings for the same periods for all such companies and facilitate market impact and other studies. The computer is also used for the collection and monthly updating of price and volume data for listed securities. This data is processed in conjunction with Form N-1Q, data in connection with market impact studies.

In March 1968, the Commission revised Form N-1R, the annual report of management investment companies, to require such companies to furnish much of the" data in a manner readily adaptable to computer processing. A system has been designed to use the computer for retrieval and analyses of data for industry studies. It also will be used to screen on a continuing basis the information furnished in the reports in order to identify companies or groups of companies in which problems exist.

A system is under development for the processing of data contained in the revised broker-dealer and investment adviser application forms. Much of the examination of information contained in the new forms will be done by the computer, and the EDP files also will be used for comprehensive studies of the securities industry.

EDP applications planned for the future include systems for (a) analyses of data contained in Forms X-17A-10, the new income and expense reports of registered broker-dealers, and (b) processing of reports of security holdings and transactions of corporate insiders.

Increase in EDP Capability

In fiscal 1968 the Commission increased its EDP capability by making certain changes incident to the purchase of its IBM System 360 computer configuration. A Model 40 control processing unit and an 1100 line per minute printer were substituted for the Model 30 unit and the 600 line per minute printer, respectively, which previously had been under lease.

The EDP staff also developed a series of general purpose statistical/ economic analyses computer programs that offer a high degree of flexibility for varied analyses of large bodies of data related to the economics of the securities industry and industry practices. In addition, the staff began a study looking toward improved methods and equipment for conversion of data into machinable form.

Assistance to State Administrators and Others

As a further means of coordinating its regulatory activities with those of the States and the self-regulatory institutions, during the past year the Commission developed procedures for supplying certain information from its computer files. Under these procedures the Commission, upon request, furnishes State authorities or self-regulatory institutions with data from the Commission's integrated regulatory and enforcement information system or the over-the-counter market surveillance system. In addition, selected data from the Commission's computer files has been furnished to the Department of Justice in response to a number of requests from that Department.

Sharing of EDP Facilities

During the past year the Commission continued its sharing arrangement with the Naval Ship Engineering Center, Department of the Navy. Under this arrangement the Commission provides about 2,000 hours of computer time per year at a significant saving to the Government as compared with the prevailing rates of outside sources. In January 1968, the Commission entered into a supplemental agreement with the Center to keypunch and verify more than 1 million cards per year. The rate charged by the Commission for this project also is considerably lower than the prevailing outside rate. The Commission has also provided small amounts of computer time to other Federal agencies.

EDP Training

During the year the Commission continued its training programs geared to the specific needs of its computer specialists. The program is designed to enable the Commission's EDP staff to utilize more advanced hardware and software in the development and implementation of new and revised computer systems.

PERSONNEL AND FINANCIAL MANAGEMENT

Organizational Changes

During fiscal year 1968, certain organizational changes were effected in accordance with the Commission's policy of continuing review of all its operations to assure maximum utilization of manpower and the most efficient and economical operations possible.

In August 1967, the Branch of Information Processing, formerly located in the Office of Records and Service, was established as a separate Office of Data Processing. With the growing impact of EDP on the Commission's activities, it is desirable that the head of the Office of Data Processing should be in a position to deal directly with users and prospective users throughout the Commission, and, within the framework of overall Commission policy, be free to make operating and policy decisions concerning EDP activities.

In October 1967, an additional Associate Regional Administrator position was established in the New York Regional Office. This position was designated as Associate Regional Administrator for Enforcement, and the previously established position was designated as Associate Regional Administrator for Regulation. This change was designed to provide for maximum attention to policy formulation and implementation in each of these programs.

In November 1967, a fifth Branch of Investment Company Regulation was established in the Division of Corporate Regulation. This change was designed to enable the Division better to cope with the significant increase in workload in the regulation of investment companies.

Personnel Program

Highlights of the Commission's personnel program in fiscal 1968 included (1) the adoption of a formal Equal Employment Opportunity Action Plan; (2) the expansion of college recruitment efforts to fill entrance level positions; (3) the continuation of training activities for employees; and (4) the addition of an important fringe benefit in the form of a Dependent Life Insurance Plan.

Recognizing a need to translate stated policy into affirmative action, the Commission, in July 1967, adopted a comprehensive Action Plan under the Equal Employment Opportunity Program. The plan specifically and realistically outlines short and long-range objectives under the program and specific action to be taken to carry out a program of equal opportunity for employment and career development. In this connection, the Chairman appointed an Equal Employment Opportunity Officer, reporting directly to him, to serve as consultant and principal staff adviser to the Commission in carrying out the over-all Equal Employment Opportunity Program.

In furtherance of the objectives of the Action Plan and the Civil Service Commission's Program for the Maximum Utilization of Skills and Training (MUST), the Director of Personnel launched a special program to interview personally and individually all employees in the Headquarters Office serving in nonprofessional jobs in the lower grade levels. The primary purpose of these interviews is to determine whether the skills of these employees are being fully utilized and to counsel them about career development opportunities in general. As a consequence of these sessions, some jobs were redesigned and promotions made based on increased duties and responsibilities.

During the fall and spring recruitment season of 1967-1968, the Commission undertook a nationwide coordinated program for on-campus visitations to selected law schools and colleges with schools of business administration, for the recruitment of attorneys and financial analysts. More schools than ever before were visited, with very gratifying results. The Commission's effectiveness in attracting high-quality graduates was enhanced this year because recruiters were authorized to make advance commitments to honors graduates. Most of the visits were made by members of the Commission's professional staff who had attended or were graduates of the school visited.

Visits to predominantly Negro colleges and universities received strong emphasis as the Commission stepped up its efforts to recruit qualified minority group graduates. Additionally, as part of its equal opportunity program, letters were written to all Spanish-surnamed college graduates with majors in accounting, finance and economics from schools throughout the country. They were informed of the Commission's needs and urged to visit its nearest office for further information regarding employment opportunities.

Additional emphasis was also placed on the recruitment of women candidates by taking such positive steps as contacting law and business schools to obtain the names of women students and sending personal letters to them about specific job opportunities. Further, with the help of the Commission's present women employees who belong to bar associations, or other professional organizations, detailed information was sent to these organizations about career opportunities for women in the SEC, and applications were solicited from interested members.

Since the fall of 1967, the Commission has officially sponsored a stenographic course, after hours, in the Headquarters Office. Upon completion of the course, the participants, who are predominantly members of minority groups, hopefully will qualify in the necessary civil service examination and become eligible for reassignment and possible grade promotion. This training course, which also will help to alleviate the problem of locating qualified stenographers and secretaries, is available to any SEC employee interested in enrolling.

In July 1967, all married employees of the Commission were offered enrollment in a voluntary Family Protection Plan sponsored by the SEC Recreation and Welfare Association. The program, providing complete protection for spouse and children, was designed to supplement insurance coverage already available to Government employees. This plan is offered as an employee service at no cost to the Commission since employees pay the total premium and deal directly with the insurance company or its agent on a private transaction basis.

As part of its Thirteenth Annual Service and Merit Awards Ceremony held in November 1967, the Commission gave "Distinguished Service Awards" to Messrs. Andrew Barr, Chief Accountant; Franklin E. Kennamer, Assistant General Counsel of the San Francisco Regional Office; Irving M. Pollack, Director of the Division of Trading and Markets; and Donald J. Stocking, Administrator of the Denver Regional Office. Sixteen employees were given 30-year pins for SEC service. Within-grade salary increases in recognition of high quality performance were granted to 82 employees. In addition, cash awards totaling $11,705 were presented to 85 employees for superior performance or special service.

The Commission this year approved the adoption of a Public Service Award. This award is made to recognize those employees who make a significant contribution toward improving the quality of communications or services to the public. The first recipient of this award was the Public Reference Section of the Office of Records and Service.

Personnel Strength; Financial Management

The following comparative table shows the personnel strength of the Commission as of June 30, 1967 and 1968:

[table omitted]

The Commission is required by law to collect fees for (1) registration of securities issued; (2) qualification of trust indentures; (3) registration of exchanges; (4) brokers and dealers who are registered with the Commission but who are not members of a registered securities association (the National Association of Securities Dealers (NASD) is the only such organization); and (5) certification of documents filed with the Commission.

[table omitted]